

**NONQUALIFIED DEFERRED COMPENSATION LEGISLATIVE PROPOSALS\***

FEATURE	LEGISLATIVE PROPOSALS	COMMENTS
<b>Types of Arrangements Affected</b>	<p>The proposals apply broadly to deferred compensation arrangements, including both elective and non-elective arrangements and individual arrangements.</p> <p>Exceptions are provided for:</p> <ul style="list-style-type: none"> <li>• tax-qualified plans</li> <li>• tax-deferred annuities</li> <li>• SEPs</li> <li>• SIMPLE plans</li> <li>• governmental 457(b) plans</li> <li>• vacation leave</li> <li>• sick leave</li> <li>• compensatory time</li> <li>• disability pay</li> <li>• death benefit plans</li> <li>• under the Senate bill only, non-elective deferred compensation plans for non-employees described in Section 457(e)(12), if in existence on May 1, 2004.</li> </ul>	<p>Common types of deferral arrangements covered by the proposals include:</p> <ul style="list-style-type: none"> <li>• elective salary deferral arrangements</li> <li>• elective annual and long-term bonus deferral arrangements</li> <li>• SERPs</li> <li>• Excess or mirror plans</li> <li>• severance arrangements (including, <i>e.g.</i>, individual employment agreements providing for special termination payments)</li> <li>• phantom stock and restricted stock unit awards</li> <li>• stock appreciation rights</li> <li>• tax-exempt (non-governmental) employer 457(b) plans</li> <li>• 457(f) plans</li> <li>• directors deferred compensation or incentive plans</li> <li>• deferred compensation plans for sales representatives and other independent contractors.</li> </ul> <p>Although the proposals do not provide an explicit exception for stock options or restricted stock, it seems unlikely at this point that the proposals would be interpreted to override the property taxation regime under Section 83 for stock options, except perhaps in the case of discount options.</p>

\* The proposals regarding nonqualified deferred compensation described in this chart are included in the House and Senate versions of the legislation to repeal the U.S export tax regime. The two bills are S. 1637, the Jumpstart Our Business Strength (JOBS) Act, which was passed by the Senate on May 11, 2004, and H.R. 4520, the American Jobs Creation Act of 2004, which was passed by the House on June 17, 2004. The deferred compensation proposals in the House and Senate bills are in most respects similar or identical, although there are some significant differences in a few areas which are indicated in this chart. Differences in the bills will need to be reconciled in conference before any legislation is enacted; therefore, assuming this legislation proceeds, certain of the proposals discussed in this chart may be changed or eliminated in the final version. Also, if the legislation is enacted, subsequent Treasury regulations interpreting the new rules would likely materially affect their impact.

*Note: This chart has been prepared for the information of clients and friends of Miller & Chevalier Chartered. It does not provide legal advice and it is not intended to create a lawyer-client relationship. Readers should not act upon the information in this chart without seeking professional counsel. This chart was prepared by Fred Oliphant and Jeanette Dayan.*

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<b>Participants Affected</b>	<p>Generally, all deferred compensation plan participants are subject to the new rules.</p> <p>Certain distribution rules are stricter in the case of top executives (see “Distributions”).</p>	<p>In certain earlier versions of the deferred compensation legislation, the new rules applied only to certain participants, <i>e.g.</i>, those qualifying as officers, directors or 10% owners under Section 16 of the Securities Exchange Act, or who would qualify if employed by a public company. The scope of the current proposals generally is not limited in this way.</p>
<p><b>Deferral Elections</b></p> <ul style="list-style-type: none"> <li>• <b>Initial Elections</b></li> <li>• <b>Subsequent Elections</b></li> </ul>	<p>Initial deferral elections must be made before the tax year in which the services giving rise to the compensation are performed, or as otherwise provided by Treasury regulations. A 30-day grace period applies to new participants.</p> <ul style="list-style-type: none"> <li>• The House Ways and Means Committee Report on H.R. 4520 states, for example, that it is expected that Treasury will issue regulations allowing elections to defer long-term bonuses (<i>i.e.</i>, bonuses earned over a multi-year period) to be made after the performance period begins, but no later than 12 months before the earliest date on which the bonus is initially payable.</li> </ul> <p>A plan can allow participants to make subsequent elections to delay payment or to change the form of payment (only one subsequent election is permitted under the Senate bill; there is no limit on the number of elections under the House bill), provided that:</p> <ul style="list-style-type: none"> <li>• the second election may not be given effect for 12 months,</li> <li>• the second election is made at least 12 months before the originally scheduled payout date (if a specified date), and</li> <li>• payments are deferred for an additional period of at least 5 years.</li> </ul> <p>Presumably, the requirement that a second election not be given effect for 12 months would require a participant who has previously elected deferred compensation to be payable on separation from service to make the second election at least 12 months prior to actual separation.</p> <p>Acceleration of payments is generally prohibited, except in the limited circumstances described below (see below</p>	<p>The proposals regarding initial and subsequent elections could require significant changes to many types of deferral arrangements for new deferrals. For example:</p> <ul style="list-style-type: none"> <li>• <b>Salary Deferral Arrangements</b> <ul style="list-style-type: none"> <li>○ Although most salary deferral arrangements should already satisfy the proposals regarding the timing of initial deferral elections, any provisions regarding second elections might need to be changed for new deferrals under the new rules.</li> </ul> </li> <li>• <b>Bonus Deferral Arrangements</b> <ul style="list-style-type: none"> <li>○ Annual bonuses are often determined and paid 2 to 3 months following the end of the performance year and many employers currently allow deferral elections with respect to such bonuses to be made during the performance year. Under these proposals, however, elections to defer annual bonuses generally would have to be made before the beginning of the performance year. Note that this could pose a particular problem for 2004 annual bonuses, to the extent subject to the new rules, because it may already be too late for participants to make deferral elections on these bonuses unless a transition rule can be used (see below under “Effective Date and Transition Rules”). Provisions regarding second elections also might need to be changed.</li> <li>○ It is not clear what timing restrictions would apply to elections to defer long-term bonuses, but changes to many of these types of arrangements would also likely be necessary. Long-term bonuses with performance periods ending in 2004 could also raise transition issues, particularly if vesting or payment occurs after the effective date of the new rules.</li> </ul> </li> <li>• <b>457(b) Plans</b> <ul style="list-style-type: none"> <li>○ Presumably tax-exempt employers would no longer be able to follow the more flexible election rules for salary reduction plans under Section 457(b) (allowing deferral elections to be made before the month in which the compensation is earned), and would have to follow the new rules on initial elections.</li> </ul> </li> </ul>

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<p><b>Deferral Elections Cont'd</b></p>	<p>under “Distributions”). Therefore, a participant could not, for example, change the form of payment from installments to a lump sum. It may be possible to make a change in the other direction subject to the additional 5-year deferral requirement, but the language in the House Report suggests that there may be limitations on making a change to a payment option that is a series of payments.</p> <p>Furthermore, although not entirely clear, language in the House Report suggests that any election by a participant as to the time or form of payment of deferred compensation would be subject to the timing restrictions on initial elections. This language creates some uncertainty for plans where the only election made by participants is a payout election, <i>e.g.</i>, a SERP or severance plan.</p>	<ul style="list-style-type: none"> <li>○ Section 457(b) permits tax-exempt employer plans to allow participant elections to accelerate or defer distributions under certain circumstances (<i>e.g.</i>, acceleration is permitted if the participant’s benefit is not greater than \$5,000 and certain other requirements are met). It appears that, given the new rules, this acceleration option would no longer be available and any election under a 457(b) plan to defer the commencement of distributions would be subject to the new restrictions on subsequent elections.</li> <li>● <b>SERPs/Excess Plans</b> <ul style="list-style-type: none"> <li>○ The new proposals in this area would affect those SERPs/excess plans that offer participants a choice regarding payments.</li> <li>○ In addition, the form and timing of payments under some of these plans are tied to the participant’s payment election under the related qualified plan. It appears that this type of payment mechanism also would be at risk under the new rules, and would likely have to be revised for new accruals.</li> <li>○ It would make the most sense for SERP payment elections to be subject to the new rules for second elections, and not the rules for initial elections, although the language in the House Report makes this unclear.</li> <li>○ The timing rules for initial deferral elections could cause significant problems for mirror 401(k) plans, and could even effectively limit the timing of participants’ deferral elections under the related 401(k) plan.</li> </ul> </li> <li>● <b>Severance Arrangements</b> <ul style="list-style-type: none"> <li>○ These election proposals would not affect severance arrangements that dictate the timing and form of payment (<i>e.g.</i>, lump sum, installments), but would affect arrangements that allow participant elections. It is unclear whether the rules regarding initial deferral elections or subsequent elections would apply in this context; in either case, the logistical problems could be significant. Treasury regulations may provide some guidance on these points.</li> </ul> </li> <li>● <b>Phantom Stock/Restricted Stock Units</b> <ul style="list-style-type: none"> <li>○ The new election rules would affect phantom stock and restricted stock unit awards that allow participants to elect the settlement date or form and conceivably could require that the election be made as far ahead as the close of the taxable year preceding the grant date. Any subsequent election would have to be made at least 12 months before the originally scheduled settlement date and result in an additional deferral of at least 5 years. Treasury regulations may provide some guidance on these points.</li> </ul> </li> </ul>

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<b>Deferral Elections Cont'd</b>		<ul style="list-style-type: none"> <li>• <b>Stock Appreciation Rights</b> <ul style="list-style-type: none"> <li>○ SARs operate in the same way as stock options, except that, on exercise, the spread between the exercise price and the current value of the underlying shares is paid to the participant in cash. Unless Treasury guidance indicates otherwise, it appears that a participant's election to exercise a SAR could also be subject to the new election rules - <i>e.g.</i>, the participant would have to designate the exercise date up-front - which, as a practical matter, would make these types of awards infeasible (including where a SAR is granted in tandem with a stock option).</li> </ul> </li> </ul>
<b>Distributions</b>	<p>Distributions generally must be limited to:</p> <ul style="list-style-type: none"> <li>• Separation from service <ul style="list-style-type: none"> <li>○ Separation from service distributions to key employees of public companies cannot be made until at least 6 months after the separation date. Key employees include: <ul style="list-style-type: none"> <li>▪ officers earning more than \$130,000 (adjusted for inflation and limited to 50 employees)</li> <li>▪ 5% owners</li> <li>▪ 1% owners earning more than \$150,000</li> </ul> </li> </ul> </li> <li>• Disability (as defined by the legislation)</li> <li>• Death</li> <li>• A specified time (or pursuant to a fixed schedule) specified under the plan at the time the compensation is deferred</li> <li>• A change in control of the corporation or a change in a substantial portion of the assets of the corporation, to the extent permitted by Treasury regulations <ul style="list-style-type: none"> <li>○ Treasury is directed to issue regulations defining a change in control for purposes of this provision within 90 days after enactment of the legislation.</li> <li>○ Under the Senate bill, change in control distributions to a Section 16 officer, director or 10% owner generally could not be made until at least one year after the change in control. A distribution to a Section 16 participant within one year after a change in control, unless due to death or disability, is treated as an excess parachute payment under Section 280G and subject to the 20% excise tax under Section 4999 (in addition</li> </ul> </li> </ul>	<p>Some changes that could be required with respect to new accruals by these proposed distribution rules include:</p> <ul style="list-style-type: none"> <li>• <b>Salary and Bonus Deferral Plans</b> <ul style="list-style-type: none"> <li>○ Many elective deferred compensation plans contain more flexible distribution rules that would have to be revised for new accruals. "Haircut" provisions, for example, would no longer be permitted, and hardship and change in control distributions would be subject to new Treasury regulations. Given the consequences of violating the new rules (see below under "Penalty Provisions"), employers might want to hold off on making hardship and change in control distributions involving new accruals until Treasury guidance is issued.</li> <li>○ A 6-month wait would apply to termination distributions to key employees of public companies. If the Senate version is adopted, any payment to a Section 16 participant might need to be delayed to avoid tax penalties in the event the scheduled payment date or separation from service would be before the one year anniversary of a change in control.</li> <li>○ Employers with plans offering payment on separation from service may need to consider whether payment may be made to a terminated executive who continues to render services in a consulting relationship.</li> </ul> </li> <li>• <b>SERPs/Excess Plans</b> <ul style="list-style-type: none"> <li>○ A SERP or excess plan could not provide that payments to a participant will commence at the same time payments commence under the related qualified plan because that would not be a permissible distribution event. A plan could, however, provide for distribution at a specified age, <i>e.g.</i>, age 65, or after retirement (or could allow a participant to make a payment election, subject to the</li> </ul> </li> </ul>

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<b>Distributions Cont'd</b>	<p>to any 20% tax the payment may be subject to under the general parachute rules). The bill text suggests that the 20% excise tax might apply even where earlier payment could be made under the new distribution rules because the participant has separated from service in connection with the change in control.</p> <ul style="list-style-type: none"> <li>• An unforeseeable financial emergency, <i>e.g.</i>, resulting from a sudden or unexpected illness or accident, loss of property due to casualty, or other similar extraordinary and unforeseeable circumstances due to events beyond the control of the participant.</li> </ul>	<p>new timing restrictions on initial and subsequent elections). Retirement distributions to key employees of public companies would be subject to a 6-month wait.</p> <ul style="list-style-type: none"> <li>○ Many of these plans also include change in control protections, such as accelerated vesting, benefit enhancements and accelerated payout. Any change in control distributions would be subject to new Treasury regulations. In addition, if the Senate version is adopted, any payment to a Section 16 participant might need to be delayed until the one-year anniversary of a change in control.</li> <li>• <b>Severance Arrangements</b> <ul style="list-style-type: none"> <li>○ Severance payments to key employees of public companies would be subject to a 6-month wait, and possibly a longer wait for Section 16 participants in the event of a change in control.</li> </ul> </li> <li>• <b>Phantom Stock/Restricted Stock Units/SARs</b> <ul style="list-style-type: none"> <li>○ Many of these types of stock-based awards contain protections providing for accelerated vesting and payout in the event of a change in control. Any payment provisions would be subject to new Treasury regulations, and possibly stricter rules for Section 16 participants.</li> </ul> </li> <li>• <b>457(f) Plans</b> <ul style="list-style-type: none"> <li>○ Some 457(f) plans provide for current distributions to cover taxes on vested benefits. These distributions would not be permitted under the new rules.</li> </ul> </li> <li>• <b>Plan Terminations</b> <ul style="list-style-type: none"> <li>○ Plan termination is not a permissible distribution event under the new rules. Employers therefore would need to consider the impact of the proposals on their ability to terminate plans in the future if this would entail immediate distributions.</li> </ul> </li> </ul>
<b>Investment Options</b>	<p>Under the Senate bill, if a participant has a choice of investment options for measuring earnings on deferred compensation, the options must be comparable to those offered under the employer's qualified defined contribution plan with the fewest options. Treasury is to provide other requirements where the employer does not offer a defined contribution plan with investment options. There is no limitation on deferred compensation plan investments under the House bill.</p>	<p>This proposal would affect many elective deferred compensation plans, <i>e.g.</i>, salary and bonus deferral plans and 457 plans, which often allow participants to select investments, and could result in a more limited range of choices. It may not be possible under this proposal for a plan to offer the choice of a guaranteed rate of return or a rate based on some internal rate of return which are not offered under the qualified defined contribution plan.</p>

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<p><b>Deferral of Stock Option and Restricted Stock Gains</b></p>	<p>The Senate bill prohibits the deferral of stock option and restricted stock gains by providing that any exchange of an option, restricted stock or any other property based on employer stock for deferred payments will result in current taxation to the employee. The House bill does not contain any restriction of this sort.</p>	<p>This proposal would affect any elective deferred compensation plan or equity plan that allows for additional deferrals of stock gains, and would require the elimination of that option. It is not clear whether this proposal would adversely affect a plan that offers participants deemed investment options that include employer stock.</p> <p>Even without this express prohibition, the rules regarding initial deferral elections under the House and Senate bills could make the deferral of stock option and restricted stock gains infeasible. The requirement that an initial deferral election must be made before the tax year in which the services giving rise to the compensation are performed would appear to require that deferral elections on these gains be made by the end of the tax year preceding the year in which the stock award is initially granted (unless Treasury guidance indicates otherwise). Such early elections would prohibit the deferral of gains on currently outstanding awards, and, as a general matter, would not appear practical or desirable from an employee standpoint.</p>
<p><b>Funding Arrangements</b></p> <ul style="list-style-type: none"> <li data-bbox="235 841 464 898">• <b>Offshore Rabbi Trusts</b></li> <li data-bbox="235 1149 464 1235">• <b>Financial Health Provisions</b></li> </ul>	<p>The proposals generally prohibit the use of foreign trusts to hold deferred amounts by providing that vested participants will be currently taxable if assets are held in a foreign trust. Treasury is authorized to provide exceptions to this rule and also to include arrangements other than trusts within its scope. The Senate bill provides an exception where substantially all of the services related to the deferrals are performed in the foreign jurisdiction where the trust is held.</p> <p>The proposals also would prohibit the use of financial health triggers in rabbi trusts by providing that vested participants will be currently taxable to the extent that assets will become restricted to the provision of benefits in connection with a change in the employer’s financial health. Treasury is authorized to provide exceptions to this rule and to define “financial health” for this purpose.</p>	<p>The proposals would affect deferred compensation plans that use rabbi trusts with prohibited provisions. Plans that use domestic rabbi trusts that do not contain financial health protections would not be affected.</p> <p>Companies with deferred compensation arrangements covering expatriates, inpatriates, and third country nationals (who may be U.S. residents) should review these arrangements to determine whether they may be viewed as impermissibly funded. To the extent that Treasury expands the scope of the provision to other arrangements, the provision could extend to plans currently thought to be unfunded.</p>



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<b>Tax/Penalty Provisions</b>	<p>If a deferred compensation plan violates any of the requirements with respect to deferral elections, distributions or investment options described above, all vested deferrals under the plan will be currently taxable.</p> <ul style="list-style-type: none"> <li>• Under the House bill, the tax imposed will be increased by interest at the IRS underpayment rate plus 1%, measured from the date of the deferral or, if later, vesting. This additional interest will also apply if a plan uses an impermissible funding arrangement.</li> <li>• Under the Senate bill, the tax imposed will be increased by interest at the IRS underpayment rate, measured from the date of the deferral or, if later, vesting, plus 10% of the taxable amount. These additional charges will also apply if a plan uses an impermissible funding arrangement.</li> </ul>	<p>It appears that a violation of the above requirements would result in current taxation and penalties for <u>all</u> vested plan participants, even if a violation occurs only with respect to a single participant. Thus, the scope of what is a “plan” will be important. Depending on how “plan” is interpreted, employers might want to consider breaking out deferral arrangements into separate plans, or even individual agreements, to protect participants. For example, an employer might want to consider establishing new deferred compensation plans beginning in 2005 (covering only compensation earned in 2005 and later), particularly if the employer is attempting to take transition measures or positions with respect to 2004 bonuses payable in 2005 that may be problematic under the new rules (see below under “Effective Date and Transition Rules”).</p> <p>More specifically, the amounts potentially subject to tax and penalties in the event of a violation could include:</p> <ul style="list-style-type: none"> <li>• In the case of elective salary or bonus deferral plans, SERPs, excess plans and covered 457 plans, all currently vested account balances and benefits under the plans. While 457(f) plan benefits may already be subject to current tax, inside build-up is not, so these plans also would be adversely affected. (Also see note above regarding current distributions to cover taxes on 457(f) plan benefits.)</li> <li>• In the case of a severance plan, all vested benefits that have not yet been paid; which, as a practical matter, would appear to affect only terminated employees receiving installment payments.</li> <li>• In the case of phantom stock, restricted stock units or SARs, all plan awards covered by the legislation that have vested but not yet been paid. (If an employer has an omnibus equity plan providing for various types of equity awards, it appears that all outstanding covered awards (e.g., phantom stock, RSUs) could be affected.</li> </ul>
<b>Reporting Requirements</b>	<p>Deferred amounts are required to be reported on a participant’s W-2 for the year deferred, even if not currently includible in income. Treasury may provide exceptions for small amounts and, under the House bill, amounts that are not reasonably ascertainable (i.e., SERP and excess plan benefits).</p>	<p>This proposal could impose new reporting requirements with respect to elective deferred compensation plans, SERPs and excess plans (subject to a possible “reasonably ascertainable” requirement that would likely be tied to the FICA tax rules), 457 plans, phantom stock, restricted stock units and SARs. It is not clear when, in other situations, nonvested or unearned amounts would need to be reported.</p>

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<p data-bbox="191 232 403 289"><b>Effective Date and Transition Rules</b></p> <p data-bbox="191 841 430 898"><b>Termination of Prior Elections</b></p>	<p data-bbox="489 232 1039 321">Under the Senate bill, the new rules would apply to amounts deferred in taxable years beginning after <b>December 31, 2004</b>.</p> <p data-bbox="489 354 1108 532">Under the House bill, the new rules would apply to amounts deferred after <b>June 3, 2004</b>. The House bill also includes a narrow transition rule exempting from the new rules amounts deferred after June 3, 2004 and before January 1, 2005 pursuant to an irrevocable election or binding arrangement made before June 4, 2004.</p> <p data-bbox="489 565 1108 808">Under both bills, the new rules would not apply to deferrals made before the designated effective date or any earnings on those deferrals credited before or after the effective date. The House Ways and Means Committee Report, however, indicates that the intent is that amounts originally deferred before the effective date that are further deferred under a subsequent election will be subject to the new rules.</p> <p data-bbox="489 841 1108 1052">Both the House and Senate bills direct Treasury to issue guidance, within 90 days after legislation is enacted, giving participants in a deferred compensation plan adopted before the effective date of the new rules a limited opportunity to cancel any outstanding deferral election with respect to amounts earned after the effective date, if the amounts are includible in income as earned.</p>	<p data-bbox="1140 232 1474 256"><b>2004 Bonus and Other Issues</b></p> <p data-bbox="1140 258 1900 347">The effective date provisions in both the House and Senate bills would pose particular problems for 2004 bonus deferrals, and could also raise issues for other types of plans:</p> <ul style="list-style-type: none"> <li data-bbox="1161 354 1923 686">• Annual bonuses earned in 2004 typically will not be paid until 2005, arguably making them subject to the new rules (under both the House and Senate effective date provisions), including the rules regarding the timing of initial deferral elections. Therefore, it may already be too late to allow employees to defer these bonuses, and any prior elections to defer these amounts could have adverse tax implications unless the plan fully complies with the new rules with respect to the amounts. Depending on which effective date provision is accepted, an employer could take the position that the new rules do not apply to 2004 bonuses, but the strength of this position is unclear.</li> <li data-bbox="1161 693 1923 930">• Long-term bonuses with performance periods that are already in progress could face the same issue. Although Treasury regulations could provide some relief for deferral elections on these awards, this relief might not protect long-term bonuses that have performance periods ending in 2004 and are payable in 2005 (given the statement in the House Ways and Means Committee Report that deferral elections on long-term bonuses would in any event have to be made at least 12 months before the bonus would otherwise be paid).</li> <li data-bbox="1161 937 1923 1084">• Under the Senate bill, the new rules would not impact deferrals under 457(b) plans until 2005. The effective date provisions in the House bill, however, could pull in 2004 deferrals under these plans in certain circumstances, <i>e.g.</i>, if participants are allowed to change their deferral elections during the year.</li> <li data-bbox="1161 1091 1923 1206">• Under the Senate bill, the new rules would not impact SERP and excess plans accruals until 2005. Arguably, the transition rule in the House bill would also exempt all 2004 accruals under these plans, although this is not clear.</li> <li data-bbox="1161 1213 1923 1482">• Phantom stock/restricted stock unit and SAR awards made before the June 4, 2004 or December 31, 2004 effective date should not be subject to the new rules, assuming that deferral occurs at the time an award is granted or amounts credited to a participant’s account and is not tied to vesting. With outstanding SARs, however, the fact that a holder may further defer SAR amounts by refraining from exercise could be problematic (given the language in the House Ways and Means Committee Report suggesting that further deferrals of amounts deferred before the effective date will cause the amounts to</li> </ul>



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<b>Effective Date and Transition Rules</b> <b>Cont'd</b>		<p>come within the new rules). The new rules would apply to awards of all of these types granted after the applicable effective date, which means that employers should take care about making new awards of these types at this time.</p> <p><b><u>Considerations for 2004 Bonuses</u></b></p> <p>Since the differences in the House and Senate bills must be reconciled in conference, it is not clear what the final effective date provisions will look like. Either the House or Senate approach could be adopted, or some variant. For example, the general House approach could be adopted with a later effective date and later cut-off date for irrevocable elections under the transition rule (<i>e.g.</i>, tied to the conference report date).</p> <p>Given the uncertainty in this area, some possible approaches that employers may wish to consider with respect to 2004 bonuses include:</p> <ul style="list-style-type: none"> <li>○ Do nothing and hope for a more generous transition rule than the current bills provide.</li> <li>○ Obtain deferral elections on 2004 bonuses now, to increase the chances that the elections will come within any eventual transition rule. Employers might want to consider including unwinds in any early elections in the event no legislation is enacted or the elections do not result in a tax-effective deferral. These types of contingencies, however, could cause the elections to fall outside any transition rule.</li> <li>○ An employer might also consider, possibly in combination with soliciting early deferral elections, making changes to its plans to ensure that amounts are vested as of December 31, 2004, also to bolster its plan's chances of coming within any eventual transition rule. However, the strength of the argument that amounts that are vested as of December 31, 2004 can be considered deferred by that date is unclear.</li> <li>○ An employer may wish to consider amending its bonus plan to have the 2004 performance period end early (<i>e.g.</i>, at the end of the third quarter), allowing for the 2004 bonuses to be determined and paid before the end of the year, provided that deferral elections can be made sufficiently in advance of payment to avoid constructive receipt under current law.</li> </ul>

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<p><b>Effective Date and Transition Rules</b> Cont'd</p>		<p><b>General Changes Going Forward</b> Aside from these transition issues, if legislation is enacted this year, employers will need to review their deferred compensation plans and make changes to comply with the new rules, likely with little lead time. In summary, some changes that might have to be made for future deferrals and awards include:</p> <ul style="list-style-type: none"> <li>• <b>Elective Deferral Arrangements</b> <ul style="list-style-type: none"> <li>○ Changes to bonus deferral provisions to provide for initial deferral elections before the start of the performance period (perhaps subject to a more liberal rule for long-term bonus deferrals). Elections to defer 2005 salary and bonuses (<i>i.e.</i>, bonuses earned in 2005 and payable in 2006) would have to be in place by the end of 2004.</li> <li>○ Changes to second election provisions.</li> <li>○ More restrictive distribution events, <i>e.g.</i>, elimination of haircut provisions and changes to hardship and change in control provisions.</li> <li>○ Limitations on investment choices.</li> <li>○ Elimination of stock option and restricted stock deferrals.</li> <li>○ Elimination of offshore rabbi trusts and financial health provisions in trusts.</li> </ul> </li> <li>• <b>SERPs/Excess Plans</b> <ul style="list-style-type: none"> <li>○ Changes to distribution provisions, <i>e.g.</i>, if benefit commencement is tied to qualified plan benefits or the plan provides for distribution to key employees upon termination of employment (without the 6 month wait).</li> <li>○ If participants are allowed to elect the timing and form of payments, possible new election and second election provisions.</li> <li>○ Elimination of offshore rabbi trusts and financial health provisions in trusts.</li> </ul> </li> <li>• <b>457(b) Plans</b> <ul style="list-style-type: none"> <li>○ Changes to deferral election provisions to require full-year elections before the start of each year. Elections to defer 2005 compensation would have to be in place by the end of 2004.</li> <li>○ Elimination of acceleration provisions for small benefits.</li> <li>○ Restrictions on subsequent elections to delay the commencement of benefits.</li> <li>○ Limitations on investment choices.</li> <li>○ Elimination of offshore rabbi trusts and financial health provisions in trusts.</li> </ul> </li> </ul>

FEATURE	LEGISLATIVE PROPOSALS	COMMENTS
<b>Effective Date and Transition Rules</b> <b>Cont'd</b>		<ul style="list-style-type: none"> <li>• <b>457(f) Plans</b> <ul style="list-style-type: none"> <li>○ In addition to the above, elimination of yearly distributions to cover current tax liabilities.</li> </ul> </li> <li>• <b>Severance Arrangements</b> <ul style="list-style-type: none"> <li>○ Changes to (or possible elimination of) election provisions, to the extent participants are allowed to elect the form of payment.</li> <li>○ Changes to distribution provisions, <i>e.g.</i>, requiring deferred distributions for public company key employees.</li> </ul> </li> <li>• <b>Phantom Stock/Restricted Stock Units/SARs</b> <ul style="list-style-type: none"> <li>○ Changes to election provisions for new awards, to the extent participants are allowed to elect to elect the time or form of payment.</li> <li>○ Changes to any change in control payment provisions.</li> <li>○ Possible elimination of SARs going forward.</li> </ul> </li> </ul>

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