

# ***AALU's Washington Report***

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AALU Bulletin No: 04-87

June 18, 2004

Subject: **House Approves New Deferred Compensation Rules**

Major References: [\*House Ways and Means Committee Report on the American Jobs Creation Act of 2004 \(H. Rept. 108-548\) \(as issued June 16, 2004\) -- Nonqualified Deferred Compensation Plans Portion \(pages 274 through 281\)\*](#)

Prior AALU Washington Reports: 04-85; 04-82; 04-77; 04-64

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*The full House, by a vote of 251-178, approved the American Jobs Creation Act of 2004 ("AJCA") (H.R. 4520), which includes new nonqualified deferred compensation rules similar to those included in the Jumpstart our Business Strength Act ("JOBS") (S. 1637) that was approved by the full Senate on May 11, 2004 (see our Bulletins Nos. 04-85; 04-82; 04-77 and 04-64). In addition, the House Ways and Means Committee, which approved the AJCA late on June 14, 2004, released its report on the legislation on June 16, 2004, and the report includes some potentially favorable language regarding the timing of bonus deferral elections under the new deferred compensation rules.*

## **Background**

The AJCA and JOBS bills are primarily focused on the repeal of the U.S. export tax regime in response to a 2002 World Trade Organization Ruling. Until that repeal is accomplished, certain U.S. tax exports will be subject to escalating sanctions from the European Union. The bills would replace the current system with corporate tax relief for domestic manufacturers, U.S.-based multinationals, and a wide range of other businesses.

The proposed new deferred compensation rules are generally unrelated to the rest of the provisions in the two bills, but are expected to remain in the legislation as the two bills are reconciled in conference because the deferred compensation rules have been scored as generating almost \$900 million in revenue over a 10-year period, which is needed to partially offset the cost of the other provisions in the bills.

## **Next Steps**

Now that the House and Senate have approved their respective versions of the two bills, the differences will have to be reconciled in conference. Although there are significant differences in the international and corporate provisions of the bills, the differences in their deferred compensation provisions are minor for the most part (see our Bulletin No. 04-82).

Because of the economic and political consequences of the international provisions, the proponents of the legislation want to proceed to conference as soon as possible, with some indicating that a conference may begin as early as next week (June 21, 2004). However, the opponents of the legislation would like to delay the conference as long as possible and have threatened to exploit a procedural hurdle to that end. Although the Senate has passed its version of the legislation (the JOBS bill), under the Constitution all tax legislation must originate in the House. As a result, the Senate must consider the AJCA (i.e., the House-passed version) and then can substitute its version, the JOBS bill. As part of this process, Congressional opponents can propose amendments to the JOBS bill and otherwise delay a second passage by the full House. That, in turn, would delay a conference.

In addition, even when a conference is finally convened, it is expected to be long and contentious because of the significant differences in the portions of the bills not dealing with deferred compensation.

## **House Ways and Means Committee Report**

As part of the House's consideration of the AJCA, the House Ways and Means Committee issued a report describing the legislation ("Committee Report"). The Committee Report include some potentially favorable language with respect to the timing of bonus deferral elections.

The new rules generally require that all deferral elections be made before the end of the calendar year preceding the calendar year in which the services are performed. Under many existing bonus deferral arrangements, the bonus for a particular year (e.g., 2004) is not paid until some point in the next calendar year (2005 in the example). In many cases, executives are not required to defer bonuses until some point before the end of the bonus year (2004 in the example), which is arguably before the bonus has been earned. However, under the new rules, the bonus election would have to be made before the beginning of the bonus year (2003 in the example). This requirement is even more onerous with respect to multi-year bonus plans. For example, some plans may pay a bonus for an executive's performance over a 3-year period (e.g., for 2002, 2003, and 2004, with the bonus actually payable in 2005). Under the new rules, a bonus deferral election would have been required to be made in 2001, the calendar year before the services began.

The new rules expressly grant the Treasury the authority to provide exceptions to the general rule that deferral elections must be made before the services are performed. In this regard, the Committee Report states:

"For example, it is expected that Treasury regulations will provide that, in appropriate circumstances, elections to defer incentive bonuses earned over a period of several years may be made after the beginning of the service period, as long as such elections may in no event be made later than 12 months before the earliest date on which such incentive bonus is initially payable. The Secretary may consider other factors in determining the appropriate election period, such as when the amount of the bonus payment is determinable. It is expected that Treasury regulations will not permit any election to defer any bonus or other compensation if the timing of such election would be inconsistent with the purposes of the provision."

Although this language expressly addresses multi-year bonus arrangements, and indicates that the Treasury should provide some relief, it also could be the basis for additional relief with respect to single year bonus arrangements. For example, the Treasury could allow deferral elections at some point during the year in which the services are performed if the compensation is scheduled to be paid in the next calendar year (e.g., at least six months before the scheduled payment date if it is in the next calendar year).

With the exception of the effective date provisions, AALU supports the version of the new deferred compensation rules contained in the AJCA (see our Bulletin No. 04-82). As the legislation continues to wind its way through Congress, AALU will work for passage of the AJCA version adjusted to obtain effective date relief and other modifications (e.g., further relief with respect to the timing rules for bonus deferrals).

Any AALU member who wishes to obtain a copy of the [Nonqualified Deferred Compensation Plans portion of the Committee Report](#) may do so through the following means: (1) use hyperlink above next to "major reference," (2) log onto the AALU website at [www.aalu.org](http://www.aalu.org), enter the Members Portal with your social security number and select Current Washington Report for linkage to source material; (we are no longer using the Fax-on-Demand system) or (3) write to AALU, Attention [DeLane Jones](#), 2901 Telestar Court, Falls Church, Virginia 22042-1205, and include a reference to this Washington Report No. 04-87.



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## D. Nonqualified Deferred Compensation Plans

### 1. Treatment of nonqualified deferred compensation plans (sec. 671 of the bill and new sec. 409A and sec. 6051 of the Code)

#### Present Law

##### In general

The determination of when amounts deferred under a nonqualified deferred compensation arrangement are includible in the gross income of the individual earning the compensation depends on the facts and circumstances of the arrangement. A variety of tax principles and Code provisions may be relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine,<sup>448</sup> the provisions of section 83 relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts (sec. 402(b)) and nonqualified annuities (sec. 403(c)).

In general, the time for income inclusion of nonqualified deferred compensation depends on whether the arrangement is unfunded or funded. If the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received. If the arrangement is funded, then income is includible for the year in which the individual's rights are transferable or not subject to a substantial risk of forfeiture.

Nonqualified deferred compensation is generally subject to social security and Medicare taxes when the compensation is earned (i.e., when services are performed), unless the nonqualified deferred compensation is subject to a substantial risk of forfeiture. If nonqualified deferred compensation is subject to a substantial risk of forfeiture, it is subject to social security and Medicare tax when the risk of forfeiture is removed (i.e., when the right to the nonqualified deferred compensation vests). Amounts deferred under a nonaccount balance plan that are not reasonably ascertainable are not required to be taken into account as wages subject to social security and Medicare taxes until the first date that such amounts are reasonably ascertainable. Social security and Medicare tax treatment is not affected by whether the arrangement is funded or unfunded, which is relevant in determining when amounts are includible in income (and subject to income tax withholding).

In general, an arrangement is considered funded if there has been a transfer of property under section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of section 83.<sup>449</sup> Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial

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<sup>448</sup> See, e.g., *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952); Rev. Rul. 60-31, 1960-1 C.B. 174.

<sup>449</sup> Treas. Reg. sec. 1.83-3(e). This definition in part reflects previous IRS rulings on nonqualified deferred compensation.

interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor, for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under section 83. On the other hand, deferred amounts are generally not includible in income if nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the arrangement is unfunded, then the compensation is generally includible in income when it is actually or constructively received under section 451.<sup>450</sup> Income is constructively received when it is credited to an individual's account, set apart, or otherwise made available so that it may be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

### **Rabbi trusts**

Arrangements have developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion. A "rabbi trust" is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy.

As discussed above, for purposes of section 83, property includes a beneficial interest in assets set aside from the claims of creditors, such as in a trust or fund, but does not include an unfunded and unsecured promise to pay money in the future. In the case of a rabbi trust, terms providing that the assets are subject to the claims of creditors of the employer in the case of insolvency or bankruptcy have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.<sup>451</sup> As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

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<sup>450</sup> Treas. Reg. secs. 1.451-1 and 1.451-2.

<sup>451</sup> This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence the popular name "rabbi trust." Priv. Ltr. Rul. 8113107 (Dec. 31, 1980).

The IRS has issued guidance setting forth model rabbi trust provisions.<sup>452</sup> Revenue Procedure 92-64 provides a safe harbor for taxpayers who adopt and maintain grantor trusts in connection with unfunded deferred compensation arrangements. The model trust language requires that the trust provide that all assets of the trust are subject to the claims of the general creditors of the company in the event of the company's insolvency or bankruptcy.

Since the concept of rabbi trusts was developed, arrangements have developed which attempt to protect the assets from creditors despite the terms of the trust. Arrangements also have developed which attempt to allow deferred amounts to be available to individuals, while still purporting to meet the safe harbor requirements set forth by the IRS.

### **Reasons for Change**

The Committee is aware of the popular use of deferred compensation arrangements by executives to defer current taxation of substantial amounts of income. The Committee believes that many nonqualified deferred compensation arrangements have developed which allow improper deferral of income. Executives often use arrangements that allow deferral of income, but also provide security of future payment and control over amounts deferred. For example, nonqualified deferred compensation arrangements often contain provisions that allow participants to receive distributions upon request, subject to forfeiture of a minimal amount (i.e., a "haircut" provision).

The Committee is aware that since the concept of a rabbi trust was developed, techniques have been used that attempt to protect the assets from creditors despite the terms of the trust. For example, the trust or fund may be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

While the general tax principles governing deferred compensation are well established, the determination whether a particular arrangement effectively allows deferral of income is generally made on a facts and circumstances basis. There is limited specific guidance with respect to common deferral arrangements. The Committee believes that it is appropriate to provide specific rules regarding whether deferral of income inclusion should be permitted.

The Committee believes that certain arrangements that allow participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion. The Committee also believes that certain arrangements, such as offshore trusts, which effectively protect assets from creditors, should be treated as funded and not result in deferral of income inclusion.<sup>453</sup>

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<sup>452</sup> Rev. Proc. 92-64, 1992-2 C.B. 422, modified in part by Notice 2000-56, 2000-2 C.B. 393.

<sup>453</sup> The staff of the Joint Committee on Taxation made recommendations similar to the new provision in the report on their investigation of Enron Corporation, which detailed how executives deferred millions of dollars in Federal income taxes through nonqualified deferred compensation arrangements. See Joint Committee on Taxation, *Report of Investigation of Enron*

### **Explanation of Provision**

Under the provision, all amounts deferred under a nonqualified deferred compensation plan<sup>454</sup> for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture<sup>455</sup> and not previously included in gross income, unless certain requirements are satisfied. If the requirements of the provision are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. Actual or notional earnings on amounts deferred are also subject to the provision.

Under the provision, distributions from a nonqualified deferred compensation plan may be allowed only upon separation from service (as determined by the Secretary), death, a specified time (or pursuant to a fixed schedule), change in control in a corporation (to the extent provided by the Secretary), occurrence of an unforeseeable emergency, or if the participant becomes disabled. A nonqualified deferred compensation plan may not allow distributions other than upon the permissible distribution events and may not permit acceleration of a distribution, except as provided in regulations by the Secretary.

In the case of a specified employee, distributions upon separation from service may not be made earlier than six months after the date of the separation from service. Specified employees are key employees<sup>456</sup> of publicly-traded corporations.

Amounts payable at a specified time or pursuant to a fixed schedule must be specified under the plan at the time of deferral. Amounts payable upon the occurrence of an event are not treated as amounts payable at a specified time. For example, amounts payable when an individual attains age 65 are payable at a specified time, while amounts payable when an individual's child begins college are payable upon the occurrence of an event.

Distributions upon a change in the ownership or effective control of a corporation, or in the ownership of a substantial portion of the assets of a corporation, may only be made to the extent provided by the Secretary. It is intended that the Secretary use a similar, but more

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*Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations (JCS-3-03), February 2003.*

<sup>454</sup> A plan includes an agreement or arrangement, including an agreement or arrangement that includes one person.

<sup>455</sup> As under section 83, the rights of a person to compensation are subject to a substantial risk of forfeiture if the person's rights to such compensation are conditioned upon the performance of substantial services by any individual.

<sup>456</sup> Key employees are defined in section 416(i) and generally include officers having annual compensation greater than \$130,000 (adjusted for inflation and limited to 50 employees), five percent owners, and one percent owners having annual compensation from the employer greater than \$150,000.

restrictive, definition of change in control as is used for purposes of the golden parachute provisions of section 280G consistent with the purposes of the provision. The provision requires the Secretary to issue guidance defining change of control within 90 days after the date of enactment.

An unforeseeable emergency is defined as a severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant, the participant's spouse, or a dependent (as defined in 152(a)) of the participant; loss of the participant's property due to casualty; or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant. The amount of the distribution must be limited to the amount needed to satisfy the emergency plus taxes reasonably anticipated as a result of the distribution. Distributions may not be allowed to the extent that the hardship may be relieved through reimbursement or compensation by insurance or otherwise, or by liquidation of the participant's assets (to the extent such liquidation would not itself cause a severe financial hardship).

A participant is considered disabled if he or she (i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months; or (ii) is, by reason on any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three months under an accident and health plan covering employees of the participant's employer.

As previously discussed, except as provided in regulations by the Secretary, no accelerations of distributions may be allowed. For example, changes in the form of a distribution from an annuity to a lump sum are not permitted. The provision provides the Secretary authority to provide, through regulations, limited exceptions to the general rule that no accelerations can be permitted. It is intended that exceptions be provided only in limited cases where the accelerated distribution is required for reasons beyond the control of the participant. For example, it is anticipated that an exception could be provided in order to comply with Federal conflict of interest requirements or court-approved settlements.

The provision requires that the plan must provide that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. For example, it is expected that Treasury regulations provide that, in appropriate circumstances, elections to defer incentive bonuses earned over a period of several years may be made after the beginning of the service period, as long as such elections may in no event be made later than 12 months before the earliest date on which such incentive bonus is initially payable. The Secretary may consider other factors in determining the appropriate election period, such as when the amount of the bonus payment is determinable. It is expected that Treasury regulations will not permit any election to defer any bonus or other compensation if the timing of such election would be inconsistent with the purposes of the provision. Under the provision, in the first year that an employee becomes eligible for

participation in a nonqualified deferred compensation plan, the election may be made within 30 days after the date that the employee is initially eligible.

The time and form of distributions must be specified at the time of initial deferral. A plan could specify the time and form of payments that are to be made as a result of a distribution event (e.g., a plan could specify that payments upon separation of service will be paid in lump sum within 30 days of separation from service) or could allow participants to elect the time and form of payment at the time of the initial deferral election. If a plan allows participants to elect the time and form of payment, such election is subject to the rules regarding initial deferral elections under the provision.

Under the provision, a plan may allow changes in the time and form of distributions subject to certain requirements. A nonqualified deferred compensation plan may allow a subsequent election to delay the timing or form of distributions only if: (1) the plan requires that such election cannot be effective for at least 12 months after the date on which the election is made; (2) except in the case of elections relating to distributions on account of death, disability or unforeseeable emergency, the plan requires that the additional deferral with respect to which such election is made is for a period of not less than five years from the date such payment would otherwise have been made; and (3) the plan requires that an election related to a distribution to be made upon a specified time may not be made less than 12 months prior to the date of the first scheduled payment. It is expected that in limited cases, the Secretary shall issue guidance, consistent with the purposes of the provision, regarding to what extent elections to change a stream of payments are permissible.

If impermissible distributions or elections are made, or if the nonqualified deferred compensation plan allows impermissible distributions or elections, all amounts deferred under the plan (including amounts deferred in prior years) are currently includible in income to the extent not subject to a substantial risk of forfeiture and not previously included in income. In addition, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture.

Under the provision, in the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying nonqualified deferred compensation, such assets are treated as property transferred in connection with the performance of services under section 83 (whether or not such assets are available to satisfy the claims of general creditors) at the time set aside if such assets are located outside of the United States or at the time transferred if such assets are subsequently transferred outside of the United States. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property. Interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the amounts been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture. It is expected that the Secretary shall provide rules for identifying the deferrals to which assets set aside are attributable, for situations in which assets equal to less than the full amount of deferrals are set aside. The Secretary has authority to exempt arrangements from the provision if the arrangements do not result in an improper deferral of U.S. tax and will not result in assets being effectively beyond the reach of creditors.

Under the provision, a transfer of property in connection with the performance of services under section 83 also occurs with respect to compensation deferred under a nonqualified deferred compensation plan if the plan provides that upon a change in the employer's financial health, assets will be restricted to the payment of nonqualified deferred compensation. The transfer of property occurs as of the earlier of when the assets are so restricted or when the plan provides that assets will be restricted. It is intended that the transfer of property occurs to the extent that assets are restricted or will be restricted with respect to such compensation. For example, in the case of a plan that provides that upon a change in the employer's financial health, a trust will become funded to the extent of all deferrals, all amounts deferred under the plan are treated as property transferred under section 83. If a plan provides that deferrals of certain individuals will be funded upon a change in financial health, the transfer of property would occur with respect to compensation deferred by such individuals. Any subsequent increases in the value of, or any earnings with respect to, such assets are treated as additional transfers of property. Interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the amounts been includible in income for the taxable year in which first deferred or, if later, the first taxable year not subject to a substantial risk of forfeiture.

A nonqualified deferred compensation plan is any plan that provides for the deferral of compensation other than a qualified employer plan or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and SIMPLE.<sup>457</sup> A governmental eligible deferred compensation plan (sec. 457) is also a qualified employer plan under the provision.<sup>458</sup> Plans subject to section 457, other than governmental eligible deferred compensation plans, are subject to both the requirements of section 457 and the provision. For example, in addition to the requirements of the provision, an eligible deferred compensation plan of a tax-exempt employer would still be required to meet the applicable dollar limits under section 457.

Interest imposed under the provision is treated as interest on an underpayment of tax. Income (whether actual or notional) attributable to nonqualified deferred compensation is treated as additional deferred compensation and is subject to the provision. The provision is not intended to prevent the inclusion of amounts in gross income under any provision or rule of law earlier than the time provided in the provision. Any amount included in gross income under the provision shall not be required to be included in gross income under any provision of law later than the time provided in the provision. The provision does not affect the rules regarding the timing of an employer's deduction for nonqualified deferred compensation.

The provision requires annual reporting to the Internal Revenue Service of amounts deferred. Such amounts are required to be reported on an individual's Form W-2 for the year deferred even if the amount is not currently includible in income for that taxable year. Under the provision, the Secretary is authorized, through regulations, to establish a minimum amount of

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<sup>457</sup> A qualified employer plan also includes a section 501(c)(18) trust.

<sup>458</sup> A governmental deferred compensation plan that is not an eligible deferred compensation plan is not a qualified employer plan.

deferrals below which the reporting requirement does not apply. The Secretary may also provide that the reporting requirement does not apply with respect to amounts of deferrals that are not reasonably ascertainable. It is intended that the exception for amounts not reasonable ascertainable only apply to nonaccount balance plans and that amounts be required to be reported when they first become reasonably ascertainable.<sup>459</sup>

The provision provides the Secretary authority to prescribe regulations as are necessary to carry out the purposes of provision, including regulations: (1) providing for the determination of amounts of deferral in the case of defined benefit plans; (2) relating to changes in the ownership and control of a corporation or assets of a corporation; (3) exempting from the provisions providing for transfers of property arrangements that will not result in an improper deferral of U.S. tax and will not result in assets being effectively beyond the reach of creditors; (4) defining financial health; and (5) disregarding a substantial risk of forfeiture.

It is intended that substantial risk of forfeitures may not be used to manipulate the timing of income inclusion. It is intended that substantial risks of forfeiture should be disregarded in cases in which they are illusory or are used inconsistent with the purposes of the provision. For example, if an executive is effectively able to control the acceleration of the lapse of a substantial risk of forfeiture, such risk of forfeiture should be disregarded and income inclusion should not be postponed on account of such restriction.

#### **Effective Date**

The provision is effective for amounts deferred after June 3, 2004. The provision does not apply to amounts deferred after June 3, 2004, and before January 1, 2005, pursuant to an irrevocable election or binding arrangement made before June 4, 2004. Earnings on amounts deferred before the effective date are subject to the provision to the extent that such amounts deferred are subject to the provision.

It is intended that amounts further deferred under a subsequent election with respect to amounts originally deferred before June 4, 2004, are subject to the requirements of the provision.

No later than 90 days after the date of enactment, the Secretary shall issue guidance providing a limited period of time during which an individual participating in a nonqualified deferred compensation plan adopted before June 4, 2004, may, without violating the requirements of the provision, terminate participation or cancel an outstanding deferral election with regard to amounts earned after June 3, 2004, if such amounts are includible in income as earned.

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<sup>459</sup> It is intended that the exception be similar to that under Treas. Reg. sec. 31.3121(v)(2)-1(e)(4).