



The
ERISA
Industry
Committee

January 22, 2007

Dear Senator:

I am writing on behalf of The ERISA Industry Committee ("ERIC") to express ERIC's strong opposition to the Senate Finance Committee's proposed amendments to the tax code (1) to impose taxes, penalties, and interest charges on employees who become entitled to receive deferred compensation in excess of limits that are extremely restrictive, highly inappropriate, and completely unpredictable and (2) to deny publicly-held companies the right to deduct compensation that they pay to their former officers.

The widespread and harmful impact of these amendments cannot be overstated. If the amendments are enacted, they will undermine, if not destroy, traditional, non-abusive retirement-income, severance, and other deferred compensation arrangements covering thousands of employees. The amendments are not targeted at abusive arrangements and will needlessly harm thousands of mid-level employees -- many of whom earn in the neighborhood of \$125,000 a year, far less than their employers' top executives.

The Finance Committee approved the amendments without holding hearings that would have given the members of the Committee the opportunity to identify and correct the amendments' serious defects. We understand that the amendments could be presented to the Senate this week for consideration in connection with the minimum wage legislation. ERIC urges you to oppose the amendments.

The summary prepared by the staff of the Joint Committee on Taxation makes it evident that --

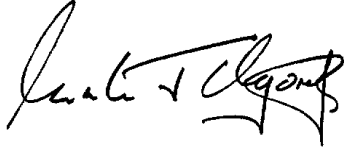
- **The proposed limit on deferred compensation will apply to employees at all salary levels, not just to senior officers or executives.** This is not merely a theoretical possibility; it is *certain* to happen, as we explain in the following paragraphs.
- **For the vast majority of employees, the proposed limit on deferred compensation is far lower than \$1 million.** This is so for many reasons, including the following:
 - First, the limit is *initially* equal to the *lesser of* (a) the employee's average compensation over the past 5 years or (2) \$1 million. For the vast majority of employees, the relevant limit will be the 5-year average compensation limit -- far less than \$1 million.
 - Second, the amendment treats any interest or earnings credited on post-2006 deferrals as *additional* deferred compensation -- effectively reducing the limit on the amount that an employee can defer currently.
 - Third, the amendment does not apply only to amounts that an employee voluntarily elects to defer. It applies to the aggregate of all of the deferred benefits an employee is entitled to receive under a wide variety of plans that are treated as deferred compensation plans for tax purposes. For example, the amendment will apply to benefit restoration plans -- plans whose only function is to make up to an employee what the employee has lost because of the Internal Revenue Code limits on tax-qualified plans. The amendments

will also apply to numerous severance plans, early retirement window plans, and incentive plans.

- **The amendments' treatment of interest and earnings as additional deferrals will have pernicious and unpredictable effects.** For example, the amendments' treatment of interest and earnings will --
 - Prevent an employee from deferring *any amount* in a year in which a deferred compensation plan credits the employee with interest or earnings that, by themselves, equal or exceed the limit on deferrals that would otherwise apply. In these circumstances, the interest and earnings credits will cause the deferral limit for the employee to be *zero*.
 - Penalize an employee for reasons beyond the employee's control. Under the amendments, an employee can exceed the applicable limit on deferrals in a year merely because of favorable earnings experience in that year (for example, where an employee is credited with phantom units of employer stock and the employer's stock price greatly appreciates in a single year).
 - Impose the lowest limits on an employer's longest-service employees. Because of their long service, these employees are likely to have accumulated the greatest amounts of deferred compensation, and will therefore be entitled to the greatest amounts of interest or earnings on their deferred compensation. As we have explained, the greater interest or earnings credits will result in lower limits on current-year deferral for the long-service employees.
 - Make it impossible for employees to engage in reliable advance planning to avoid exceeding the amendments' deferral limits. Where the earnings that are credited on deferred compensation are tied to a variable index, the earnings cannot be known until the last day of the year.
 - Discourage phased retirement. Because phased retirement will cause an employee's 5-year average compensation to decline, phased retirement will increase the risk that an employee will exceed the limit on deferrals in a year because of favorable earnings experience in that year.
- **Congress should give the recently enacted provisions governing the tax treatment of deferred compensation -- set forth in Section 409A of the Internal Revenue Code -- a chance to work before making major changes in those provisions.** Congress adopted an entirely new set of rules for deferred compensation in 2004, and the Treasury is only now about to issue the regulations needed to implement the 2004 provisions. The existing rules should not be changed or supplemented before the existing rules have been fully implemented and given a chance to work.
- **The Committee's proposed amendments would inappropriately expand the limit that Section 162(m) now imposes on the deductibility of compensation that a publicly-held company pays to certain *current* employees by applying that limit to the compensation that the company pays to *former employees* who were covered by the deduction limit in any preceding year after December 31, 2006.** The limit imposed by Section 162(m) does not apply to former employees. If the amendment applies the Section 162(m) limit to

payments made after 2006 to former employees who were covered by Section 162(m) at any time after 2006, the limit would apply to payments that employers and employees **deliberately deferred** in order to assure the deductibility of those payments. It would be unseemly for Congress to adopt legislation that punishes employers for doing precisely what Section 162(m) and the regulations encouraged them to do in the past: to defer payments exceeding the Section 162(m) limit until the employee was no longer a covered employee. Congress should not penalize employers for doing what Congress and the Treasury told them they could do.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark J. Ugoretz". The signature is fluid and cursive, with a large initial "M" and a distinct "Ugoretz" ending.

Mark J. Ugoretz
President