

### Johnson Amendment # 3

#### SEC. 671. TREATMENT OF NONQUALIFIED DEFERRED COMPENSATION PLANS.

(a) **IN GENERAL.**—Subpart A of part I of subchapter D of chapter 1 is amended by adding at the end the following new section:

#### SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED COMPENSATION UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS.

(a) **RULES RELATING TO CONSTRUCTIVE RECEIPT.**—

(1) **IN GENERAL.**—

(A) **GROSS INCOME INCLUSION.**—In the case of a nonqualified deferred compensation plan, all compensation deferred under the plan for a participant for all taxable years (to the extent not subject to a substantial risk of forfeiture and not previously included in gross income) shall be includible in a participant's gross income for the taxable year unless at all times during the taxable year ~~the plan~~ all compensation deferred with respect to such participant meets the requirements of paragraphs (2), (3), and (4) ~~and is operated in accordance with such requirements.~~

(B) **INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO PREVIOUSLY DEFERRED COMPENSATION.**—

(i) **IN GENERAL.**—If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under clause (ii).

(ii) **INTEREST.**—For purposes of clause (i), the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the under-payments that would have

occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

(2) DISTRIBUTIONS.—

(A) IN GENERAL.—The requirements of this paragraph are met if the plan provides that compensation deferred under the plan may not be distributed earlier than—

- (i) separation from service as determined by the Secretary (except as provided in subparagraph (B)(i)),
- (ii) the date the participant becomes disabled (within the meaning of subparagraph (C)),
- (iii) death,
- (iv) a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation,
- (v) to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or
- (vi) the occurrence of an unforeseeable emergency.

(B) SPECIAL RULES.—

(i) SPECIFIED EMPLOYEES.—In the case of specified employees, the requirement of subparagraph (A)(i) is met only if distributions may not be made earlier than 6 months after the date of separation from service. For purposes of the preceding sentence, a specified employee is a key employee (as defined in section 416(i)) of a corporation the stock in which is publicly traded on an established securities market or otherwise.

(ii) UNFORESEEABLE EMERGENCY.—For purposes of subparagraph (A)(vi)—

(I) IN GENERAL.—The term ‘unforeseeable emergency’ means 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 section 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.

(II) LIMITATION ON DISTRIBUTIONS.—The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant’s assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(C) DISABLED.—For purposes of subparagraph (A)(ii), a participant shall be considered disabled if the participant—

(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 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, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant's employer.

(3) ACCELERATION OF BENEFITS.—The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

(4) ELECTIONS.—

(A) IN GENERAL.—The requirements of this paragraph are met if the requirements of subparagraphs (B) and (C) are met.

(B) INITIAL DEFERRAL DECISION.—The requirements of this subparagraph are met if the plan provides that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made not later than ~~the close of the preceding taxable year~~six months before and in the calendar year preceding the date that such compensation would be paid if such election were not made or at such ~~other~~later time as provided in regulations. In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.

(C) CHANGES IN TIME AND FORM OF DISTRIBUTION.—The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment—

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case an election related to a payment not described in clause (ii), (iii), or (vi) of paragraph (2)(A), the plan requires that the first payment with respect to

which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph.

**(5) SPECIAL RULE FOR CERTAIN NONELECTIVE ARRANGEMENTS.—**

*Paragraphs (a)(3) and (4) shall not be violated solely because participants may elect the form of distribution in a nonelective deferred compensation arrangement at the same time and with the same commencement date as payment elections made under a qualified employer plan sponsored by the participant's employer, provided that such nonelective deferred compensation arrangement provides benefits under an accrual formula that is substantially the same as the qualified employer plan sponsored by the employer, except that compensation in excess of Code section 401(a)(17) is taken into account and benefits in excess of the limitations under Code section 415 are accrued.*

**(b) RULES RELATING TO FUNDING.—**

(1) OFFSHORE PROPERTY IN A TRUST.—In the case of assets set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of paying deferred compensation under a nonqualified deferred compensation plan, for purposes of section 83 such assets shall be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors—

(A) at the time set aside if such assets are located outside of the United States, or

(B) at the time transferred if such assets are subsequently transferred outside of the United States.

(2) EMPLOYER'S FINANCIAL HEALTH.—In the case of compensation deferred under a nonqualified deferred compensation

plan, there is a transfer of property within the meaning of section 83 with respect to such compensation as of the earlier of—

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted.

(3) **INCOME INCLUSION FOR OFFSHORE TRUSTS AND EMPLOYER'S FINANCIAL HEALTH.**—For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1) or (2), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

(4) **INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO TRANSFERRED PROPERTY.**—

(A) **IN GENERAL.**—If amounts are required to be included in gross income by reason of paragraph (1) or (2) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under subparagraph (B).

(B) **INTEREST.**—The interest determined under this subparagraph for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the amounts so required to be included in gross income by paragraph (1) or (2) been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

(c) **NO INFERENCE ON EARLIER INCOME INCLUSION OR REQUIREMENT OF LATER INCLUSION.**—Nothing in this section shall be construed to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this section. Any amount included in gross income under this section shall not be required to be included in gross income under any other

provision of this chapter or any other rule of law later than the time provided in this section.

(d) OTHER DEFINITIONS AND SPECIAL RULES.— For purposes of this section—

(1) NONQUALIFIED DEFERRED COMPENSATION PLAN.— The term ‘nonqualified deferred compensation plan’ means any plan that provides for the deferral of compensation, other than—

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(C) an option described in section 83(e)(3) to purchase stock in a corporation (or a member of a controlled group) for which the individual performs services and that is exercisable at no less than the fair market value of such stock on the date of grant and, as specified by the Secretary in regulations, rights to receive cash or stock that are economically substantially similar to such an option.

(2) QUALIFIED EMPLOYER PLAN.—The term ‘qualified employer plan’ means—

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5), and

(B) any eligible deferred compensation plan (within the meaning of section 457(b)) of an employer described in section 457(e)(1)(A).

(3) PLAN INCLUDES ARRANGEMENTS, ETC.— The term ‘plan’ includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) SUBSTANTIAL RISK OF FORFEITURE.—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person’s rights to such compensation are conditioned upon the future performance of substantial services by any individual.

(5) **TREATMENT OF EARNINGS.**—References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(e) **REGULATIONS.**—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) providing for the determination of amounts of deferral in the case of a nonqualified deferred compensation plan which is a defined benefit plan,

(2) relating to changes in the ownership and control of a corporation or assets of a corporation for purposes of subsection (a)(2)(A)(v),

(3) exempting arrangements from the application of subsection (b) if such arrangements will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors,

(4) defining financial health for purposes of subsection (b)(2), and

(5) disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section.”.

**(b) W-2 FORMS.**—

(1) **IN GENERAL.**—Subsection (a) of section 6051 (relating to receipts for employees) is amended by striking “and” at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting “, and”, and by inserting after paragraph (12) the following new paragraph:

“(13) the total amount of deferrals under a nonqualified deferred compensation plan (within the meaning of section 409A(d)).”.

(2) **THRESHOLD.**—Subsection (a) of section 6051 is amended by adding at the end the following:

“In the case of the amounts required to be shown by paragraph (13), the Secretary (by regulation) may establish a minimum amount of



deferrals below which paragraph (13) does not apply and may provide that paragraph (13) does not apply with respect to amounts of deferrals which are not reasonably ascertainable.”.

**(c) CONFORMING AND CLERICAL AMENDMENTS.—**

(1) Section 414(b) is amended by inserting “409A,” after “408(p),”.

(2) Section 414(c) is amended by inserting “409A,” after “408(p),”.

(3) The table of sections for such subpart A of part I of subchapter D of chapter 1 is amended by adding at the end the following new item:

**(d) EFFECTIVE DATE.—**

(1) IN GENERAL.—The amendments made by this section shall apply to amounts deferred after ~~June 3,~~ December 31, 2004.

(2) ~~CERTAIN AMOUNTS DEFERRED IN 2004 UNDER CERTAIN IRREVOCABLE ELECTIONS AND BINDING ARRANGEMENTS~~ AND PRIOR YEARS.—The amendments made by this section shall ~~not~~ apply to amounts deferred ~~after June 3, 2004, and before January 1,~~ prior to January 1, 2005, only if there is a material modification of the terms governing the deferral of such compensation after June 3, 2004. The amendments made by this section adding 409A(a)(4)(B), which governs the timing of deferral elections, shall not apply to compensation for which the period of service began prior to December 31, 2004, and that would be paid on or before December 31, 2005, pursuant to but for an irrevocable election or binding arrangement made before June 4, 2004. to defer.

(3) EARNINGS ATTRIBUTABLE TO AMOUNT PREVIOUSLY DEFERRED.—The amendments made by this section shall apply to earnings on deferred compensation only to the extent that such amendments apply to such compensation.

**(e) GUIDANCE RELATING TO CHANGE OF OWNERSHIP OR CONTROL.—**Not later than 90 days after the date of the enactment of this Act, the Secretary of the Treasury shall issue guidance on what constitutes a

change in ownership or effective control for purposes of section 409A of the Internal Revenue Code of 1986, as added by this section.

**(f) GUIDANCE RELATING TO TERMINATION OF CERTAIN EXISTING ARRANGEMENTS.**—Not later than 90 days after the date of the enactment of this Act, the Secretary of the Treasury shall issue guidance providing a limited period during which an individual participating in a non-qualified deferred compensation plan adopted before June 4, 2004, may, without violating the requirements of paragraphs (2), (3), and (4) of section 409A(a)(2) of the Internal Revenue Code of 1986 (as added by this section), 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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#### **NONQUALIFIED DEFERRED COMPENSATION (“NQDC”) DESCRIPTION OF JOHNSON AMENDMENT**

The amendment makes technical changes to the proposed legislation on NQDC. The amendments are consistent with eliminating abusive arrangements and provide bright-line rules on a going forward basis for NQDC. These modifications are needed to ensure that employers can satisfy the new rules on a timely basis; that participants in non-abusive arrangements are not improperly penalized; and that employers may continue to offer appropriate NQDC and equity arrangements that will assist employees in saving for their retirement and satisfy retention goals.

Specifically, the following changes are included in the amendments:

- Clarifies that the legislation is prospective and applies only to amounts deferred after December 31, 2004. Amounts deferred (including earnings) under prior law are not subject to the new rules and continue to be governed by current law provided that there is no material modification of the existing plan.
- Provides that employee elections to defer compensation may be made in a prior calendar year and six months in advance of payment. This rule ensures that the employee is not in constructive receipt at the time of the deferral election and provides a bright-line that is appropriate for both annual and multi-year bonus arrangements.
- Provides transition relief for NQDC deferred after December 31, 2004 (but before January 1, 2006) where the election to defer does not satisfy the six-month rule for elections.

- Allows employees covered by certain supplemental nonelective pensions to make elections as to the form of their retirement payments at retirement. This exception is limited to plans that substantially mirror a qualified plan to ensure that the exception is not inappropriately expanded.
- Clarifies that NQDC does not include employee stock options issued with a fair market value exercise price and stock appreciation rights (“SARs”) that are based upon the fair market value of the stock on the date of grant (regardless of whether they are settled in cash or shares). SARs based on the fair market value price of the stock are economically equivalent to options. SARs are not “disguised” NQDC. Like options, they are designed to provide an equity interest over a multi-year period.
- Clarifies that the tax penalties for failure to satisfy the new rules apply only to the participant whose NQDC is noncompliant.