FINAL TRANSCRIPT

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**ACC - The Jobs Creation Act of 2004 - Deferred Compensation Changes

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PRESENTATION

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

For those of you that are online welcome. I am Eileen Groves, Chairman of the ERISA Subcommittee of the ACCs Labor and Employment Committee. We welcome you to this Web cast "The Jobs Creation Act of 2004 - Deferred Compensation Changes." Congress passed the JCA in October and established a new section of the Tax Code, 409A, which for the first time set out explicit rules in regard to deferred compensation arrangements. These new rules will be applicable or effective for any deferments after 12/31/04.

Under the statute, the IRS is to issue rules or guidance within 60 days or by December 21st. Since this act is so pressing(ph) and changing, the Labor and Employment Committee thought it was important that we alert you so that you can at least start to look at your plans with a sense of what is coming down the road. We are expecting momentarily or within the next week or two for these rules and guidances to be issued by the IRS, but we wanted you to be prepared because we recognize this is a tight timeframe because they're coming out just before the holidays.

Our panelists today are Michael Jacobster and Bruce Schwartz of the White Plains Office of Jackson & Lewis. Both of these gentlemen have been working in the tax and employment benefits area for over 20 years representing clients on deferred compensation, tax issues, administrative hearings, et cetera. Both of the gentlemen have post-law degrees in tax from New York University.

I welcome Bruce and Michael and thank them for a little -- their willingness to be prognosticators. And some of the things that they may say, as they acknowledge, may be underwater in about two weeks because they may not have guessed right. But everything is up to conjecture. I think, Michael, you're starting first?

Michael Jacobster - *Jackson and Lewis - Attorney*

Yes. The outline of how this discussion is going to go is this. I'm going to first give about a couple of minutes on what the present law is because you can't understand what the act does unless you understand something about present law. I will also speak about what are the consequences of failure to comply with new Section 409A of the Code. Bruce Schwartz will then talk about affected arrangements. He'll talk about the election and distribution rules and then I will chime in on effective dates and what to do because there's a fairly complicated effective date provision here.

Now as far as background goes the IRS has for close to 60 years been trying to control deferred compensation. Back in the late 1940s in the Veeck (ph) decisions which involved deferrals and election through received distribution of commission amounts - yes commission amounts - the IRS tried to take the view that those elections had to be made very close to the time the services were performed or the sales made.

In the Veeck cases which I think are fairly extreme - they're tax court cases from the late 1940s - Howard Beet(ph), a salesman for a company sold some sort of machinery -- kept deferring commission and deferring the receipt of commissions and he and the company kept revising their contracts. For example, he'd be paid out in 1943 and then the beginning of '43 would roll around and they'd defer to '45. All of this is because of the high war profits taxes. And the Tax Court said you know, you had no real right to the money at the time the deferrals were entered into. The parties are free to organize their business affairs as they see fit and because he didn't forfeit the right to anything the election stands. It's no current inclusion and the elections are still good.

Now the IRS again in 1978 issued a proposed regulation that effectively did away with all deferred compensation. It said if you have the option to defer compensation it's going to be treated taxable to time you otherwise would have gotten it notwithstanding the election or option to defer. In the Revenue Act of 1978 Congress in Section 132 said nonsense to that. We're going to put a freeze on it and we're going to only apply the law as it existed the date prior to the issuance of the proposed regulation.

Now there are several concepts in deferred compensation which were very important up until now. Well they still are important. The first is constructive receipt. An individual receives income - a cash basis taxpayer like you and me and all other mere mortals - if the individual (a) actually receives it; or (b) constructively receive it. Now individually constructively receives income if the individual has the right to draw down upon it without restriction at anytime. That is sort of come and get it type of concept.

You cannot turn your back on income. Someone is passing a check to you across the table. You have constructively received it even if you laid your hands and say no. An amount is not constructively received if it is subject to substantial restrictions or limitations. That was the basis for the famous "haircut" in a lot of deferred compensation plans. I can take it now but I'll be hit by 10%. That was generally considered by practitioners to be a substantial restriction of limitations.

Likewise, in the area of stock appreciation rights, the IRS ruled in a revenue ruling that there was no constructive receipt because the loss of the valuable right to receive due to appreciation was considered a substantial limitation. We don't know how these concepts are finally going to be affected by this statute.

Here's another concept. The concept was the economic benefit adoption. What the economic benefit adoption said if something is set aside for you in very - set aside irrevocably for you, you're taxed whether or not you actually get your fingers on it. For example, if amounts were set aside in trust for an individual the individual would be -- and the trust is not subject to any restrictions such as rabbi trust and we can get into that in a moment -- then you would receive it under the economic benefit doctrine.

The economic benefit doctrine is somewhat codified in Section 83 of the Code which deals with compensatory transfers of property to -- for services. And under that section there's a transfer of property an individual's taxed if the property is not subject to a substantial risk of forfeiture. Property -- The transfer of property includes putting money in trust - not putting money I'm sorry -- putting real or personal property in trust. Money is not covered by Section 83. So that is the background on which we are working.

Rabbi trusts are simply a variation on this doctrine. Under a rabbi trust a grantor trust which is considered for tax purposes the property of the grantor -- in the case the employer or corporation -- is set up. The trust is subject to the claims of general creditors and that was considered sufficient to prevent a transfer to the employee. These rules also affect the structure of certain rabbi trusts.

Now if you go to page 3 or slide 3, the basic rule of this new Section 409A is that deferred compensation will be currently included in income when the income is fully earned and is not subject to a substantial risk of forfeiture -- vesting or you have to be around on a certain date unless the arrangement meets the new rules.

If you go to slide 5 the downside of all this is that deferrals that do not meet the new rules are subject to inclusion in gross income when they become non-forfeitable. And this rule of taxation, this Rule of Inclusion applies retroactively back to the first time of the deferral. So it could be years before - in the case of a forfeitable benefit it could be years before you're hit. In addition to subject inclusion and income there's a 20% penalty and interest at the underpayment rate plus 1%.

Earnings, whether they're actual earnings of so-called notional amounts, are treated the same as deferrals. And throughout the statute you'll notice that earnings rise and fall with the underlying deferrals and are treated the same. There is one Rule of Mitigation. The Rule of Mitigation is that as the statute puts it, and puts it fairly nicely, the penalty -- the bad tax effect only applies with respect to all compensation deferred under the plan for participants with respect to whom the failure relates.

Why I think that's important is that not only an operational problem that only affects the particular individual and not the plan as whole but because the language says with respect to whom the failure relates I believe - no one has commented on this directly -- that even if there is a plan document failure - the plan document doesn't conform to the act only the individuals to whom that failure relates - that is again a wrongful distribution that's not in accordance with the act - should be hit. Again, I don't know if IRS guidance will conform that but that appears to be how the statute works.

If you don't mind going back to Section 4 and Bruce will continue the discussion the act basically doesn't deal with all aspects of the constructive receipt issue. What it deals with is the timing of the initial deferral election both for elective, non-elective and performance based compensation. It limits the distribution events. It limits the ability to change elections and to further defer distribution, timing or the form of distribution. It eliminates virtually all accelerations although people are talking about a minor acceleration for things beyond the control of the participant like divorce decrees where money is meted and stuff like that. It eliminates certain methods of pouring monies into rabbi trust financial health triggers. It eliminates transfers abroad to overseas rabbi trusts - offshore rabbi trusts -- which have again become very popular.

At this point one of the issues is what arrangements are affected and that's real unclear. And Bruce will take up on that.

Bruce Schwartz - *Jackson and Lewis - Attorney*

Hi. The sections on this -- the slides are numbers 6 through 8. The list in those slides and I'll go through those are really a compilation based on a little bit in the statute and a big reliance on what's in the legislative history and then the rest is speculation as to what the IRS is going to define as deferred compensation. To give you an idea of the range that the IRS has to work with all the statutes said is that and it refers to any non-qualified deferred compensation plan. It defines that as "any plan and that includes any arrangement and any contract with a single individual that provides for the deferral of compensation." That is the full definition.

There are a couple of exclusions. One for tax qualified retirement plans as we're all used -- 401k plans, defined benefit plans, cash balance plans and the like. Also excludes bona fide and vacation leave, sick leave, compensatory time, disability pay or death benefit plans. That is the only guidance in the statute itself and considering that the statute then goes on to specifically give the IRS complete authority to write whatever regulation it wants you understand how important this guidance from the IRS is going to be.

Going through the list of the arrangements affected. The first one, elective salary or bonus deferral plans and arrangements. The statute is really written from the classic elective deferral in the sense that I want to defer 10% of my salary or defer payment of 50% of my bonus. All the terms of the statute make sense in that context. Once we go out of that area everything else really awaits further explanation to the IRS as to what they want us to do.

We get into other types of plans non-elective deferred compensation plans where we're just making a promise to pay somebody a certain number of dollars at a certain event down the road or a passage of time or upon termination of employment-

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Excuse me. Jacqueline are you on the line?

Jacqueline Windley - *Association for Corporate Counsel - Committees Manager*

Yes I am.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

I've gotten three emails about people asking about the slides.

Jacqueline Windley - *Association for Corporate Counsel - Committees Manager*

Asking about the slides?

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Right and how can they get to see the slides.

Jacqueline Windley - *Association for Corporate Counsel - Committees Manager*

The slides should be available on the site.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

On the ACC site to the Web cast and then what half way down the page?

Jacqueline Windley - *Association for Corporate Counsel - Committees Manager*

Yes. If you could forward those emails to me I'll respond.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

I have been. Sorry Bruce.

Bruce Schwartz - *Jackson and Lewis - Attorney*

Okay. To go through the rest of the list and this is the most important part frankly of these rules is to figure out ultimately what arrangements are going to be covered and which arrangements are not and the list on page 6 goes through more including supplemental executive retirement plans, excess benefits plans, plans which would top off the tax qualified plan because of the statutory limits. Anybody who does a 401k mirror or wrap plan which the IRS used to specifically permit and we don't know what the IRS is going to do with that under these new rules. It applies to deferred compensation plans for directors. Also for deferred compensation arrangements with independent contractors or consultants. It's not limited to employees.

We are not clear for example what the IRS will do with severance pay plans, in particular plans which may offer an employee a choice of taking a lump sum or taking installments. The other issue with severance pay plans, what if we negotiate severance package. We had nothing in place prior. We don't know whether that's going to be covered under 409A. I could tell you what as logical matter it shouldn't be but the IRS authority is so broad that they could sweep that into these rules.

We know that Congress also indicated that stock appreciation rates can be covered under these rules notwithstanding the fact that 20 years - actually 24 years ago the IRS said we have no problems with stock appreciation rights. You'd run into the same exact issue with phantom stock arrangements or any equity appreciation-type plan potentially can be subject to these rules.

On page 7 we list rules which we know are not affected by this and that comes out of primarily what's in the legislative history and the assumption that the IRS will adopt rules which follow the legislative history of - the list there includes obviously tax qualified retirement plans; vacation leave; sick leave, compensatory time, disability pay, death benefit plans, incentive stock option plans under Section 422 of the Internal Revenue Code; employee stock purchase plans under the Section 423; non-qualified stock options, but only if the strike price is based on the fair market value at the time of grant. We've known for years the IRS has been trying to go after discounted stock options. The problem was they never had a tax theory under which to go after. This statute now gives them the opportunity to regulate those.

We also -- we know that restricted stock as long as there's not deferral after they become vested - if they're taxed at that point that's fine. And another one which frankly is incomprehensible to me annual bonuses which are paid within two and a half months of the year. The question of why the two and a half months rule is relevant to anything doesn't make any sense to me because I'm assuming a standard bonus arrangement where there is a set payment date, for example, after the company's financials have been finalized and then whatever factors are used to determine the bonus payout. And if there's no discretion in that event it's hard to understand why that type of arrangement would be subject to 409A, but potentially it is.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Bruce for a second if I can interrupt again. I've gotten an email from Jacqueline who tells me that when you log on to the Web cast you connect to the Web cast and you logon with your name and email address et cetera you'll open up onto the screen and the slides should be available on that screen. She is also contacting the provider to see if there's a problem but if you logon and get to the next screen the link to the slide should be right there. Bruce if you could continue on. I apologize and anyone who has an email question or want to tell me you're having problems let me know. I'm forwarding them on to Jacqueline as we're going along.

Bruce Schwartz - *Jackson and Lewis - Attorney*

In going through this list and what is the most difficult part about this law is once you get to the rules on traditional, and we'll go through those in a moment, on the deferral election and distribution for the basic salary deferral or a bonus deferral election the rules are very straightforward. They take away a certain amount of flexibility but they still allow people to defer within certain hardwired options.

What is going to be the important thing and I think why it's important to, at this point, start inventorying all arrangements you have and remember that includes also individual employment agreements is because how - these are not traditionally - it seems to be an abusive situation with non-elective or also when you get into stock appreciation rights or phantom stock arrangements. And if we have to go through all those it's going to be a tremendous amount of work and rethinking about how those types of arrangements and plans are structured. So at this point it becomes very important just to inventory what you have, not just on a planned basis but on an individual basis.

On page 9 and to get a little more detail as to how the statute imposes new requirements on everybody. The initial deferral election. For years the IRS has always taken the position that you must make your deferral election before you begin to perform services that relates to those -- that particular compensation. In the cast of just salary deferral the IRS position always was then you had to make the election prior to the beginning of the calendar year in which you began to perform those services. Up until this statute, the IRS didn't win that type of argument in court.

The more difficult one is the IRS position on bonuses which they have now won in this statute. In order to defer a bonus the general rule is now you must make your bonus deferral election before the period - the bonus earning period begins. So if you have an annual bonus for 2005 which is based on 2005 performance under this statute you would have to make your election before the end of 2004. Now that particular year is going to be mitigated, we hope, by the IRS transition rules, but going forward for example for 2005, 2006 you'll have to be aware of that.

There is one potential option with the IRS. Once again we need further guidance from the IRS on bonuses. What they do permit is if a bonus is -- meets whatever definition of performance based compensation and if you're publicly traded that is going to be or at least what Congress has directed the IRS to define performance based compensation the same way we do for purposes of Section 162M of the Code which is the limitation on deduction in excess of $1 million of employee compensation.

Those are basically objective criteria which need to be adopted within the first 90 days of the bonus earning period. The legislative history just directs the IRS to use those rules as a guide in defining performance based compensation. If you fit within whatever criteria the IRS is going to tell us, then you can make a deferral election up until six months before the end of the bonus earning period. So if -- for example, if we use the 2005 bonus and it does meet whatever criteria are going to be for performance based compensation you can make an election up through June 30 of 2005 to defer the payment of that bonus.

The same thing would run if you have a long term incentive plan, let's say, a three year performance cycle you could go two years and six months into the performance cycle before you hit the deadline for making the deferral election. The problem is at this point we just don't know how they're going to define performance based compensation, but we do know - we're assuming it's going to be pretty close to whatever 162M is going to be and the criteria there. That's defined in section - on slide 10 and carry over into slide 11.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Bruce?

Bruce Schwartz - *Jackson and Lewis - Attorney*

Yes.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Two questions I received relevant to this point. One was what if you are participating in a deferred plan that doesn't vest for, let's say, five years but the deferrals have occurred prior to 1/1/05. Are they covered by the old law or the new law?

Bruce Schwartz - *Jackson and Lewis - Attorney*

Mike is going to discuss that in the transition issue. It is - the IRS is very - at least what we've heard at this point it's very unclear what the IRS is going to grandfather or how they're going to define arrangements which are currently running and what exactly you have to do to grandfather those. So the old rules continue to apply. There's language in the transition rules that refer to earned invested. There's a whole big debate as to what the IRS thinks that those terms mean. So we don't really know. We will hopefully know next week, but right now I don't know if you have an existing arrangement if it's not yet vested how the IRS is going to interpret the grandfather. We hope that they will bless every arrangement which is already - any performance period which is already currently running. We don't know that specifically at this point though.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Okay thank you.

Bruce Schwartz - *Jackson and Lewis - Attorney*

Slide 12, one of the other new requirements is about distribution election. At the time you make the deferral election you also must elect the time and form of payment. Now it's also possible by the way you can have a plan which doesn't give the employee a choice then there's no issue. It raises more interesting questions in the case of a non-elective plan when you make the distribution election.

In particular, if you have a defined benefit SERP arrangement -- a Supplemental Executive Retirement Plan -- which for example ties into your regular defined benefit pension plan it's really - nobody knows how that or when that election is suppose to be made. An the statute itself and in legislative history the Congress spent all of one sentence on defined benefit deferred compensation arrangements and they have left it entirely up to the IRS to tell us how the rules are supposed to work. They don't deal with - actually all the sentence reads is "the secretary may issue regulations regarding elections with respect to payments under non-elective supplemental retirement plan." That is our complete guidance as of today.

Page 13 are where we get into the permissible distribution, the other major feature of these rules. A plan must provide - doesn't have to provide all these events -- but it cannot provide for a provide for a distribution event other than one of these listed events. And they are and I'll go into these in a little more detail, separation from service or you can have a fixed schedule - essentially installment paying out; payout at a specific time disability; death; change in control or unforeseeable emergencies which is the old hardship concepts.

Slide 14, separation from service is more of a term of art than what it seems on its face. The legislative history makes clear - that doesn't mean necessarily just termination of employment. Congress wants that to mean it's a controlled group concept. So if somebody is transferred from, say, a company participating in a deferred compensation plan to a non-participating subsidiary that is not considered to be a separation from service. You're still working for the control group. That transfer cannot be a distribution event.

If any of you remember the old same desk rule which applied to 401k plans that's where this language comes from. The other thing about that is if you have an officer who has a consulting arrangement with the company and does in fact consult after they leave officer status they have not separated from service. The rule is not termination from employment. It's separation from service. You have to cease performing all services whether as an employee or as a consultant with the company.

Also there's a little rule. This is essentially an Enron-angled rule. Key employees even after separation from service must wait six months to get a distribution. Key employees -- they borrowed the definition from tax qualified plans dealing with top heavy plans which of course makes no sense for a publicly traded corporation because no publicly traded corporation has ever looked at the statutory definition of who is or who is not a key employee under those rules because it's statistically impossible except in very limited cases to be one. But the shorthand of that definition is you're basically talking about up to a maximum of 50 corporate officers who are making at least 100, for this year, $135,000. That's an inflation adjusted number. I would assume in virtually all cases a $135,000 mark is irrelevant.

Page 15 -- slide 15. Permissible distribution of fixed schedule or specified time. Those are essentially installment payments when we're talking about a fixed schedule. The important issue the IRS makes when they talk about the occurrence of an event when they say specified time - for example time is what is acceptable, either a specific date or you reach a particular age that's fine.

That's considered a specified time. But an event and the example in the legislative history is an event such as I have a child who enrolls in college I want a distribution event - distribution from the plan at that point and the legislative history says that is not an acceptable distribution event anymore.

Page 16 and 17. The new rules have a very specific definition for disability. It puts you into the practice of having to define subjectively disability or the alternate definition on slide 17 essentially looks to if they begin to receive payments under the long term - under a long term disability plan. Well this creates all sorts of interesting problems because this is all driven from the tax side, but there's potentially an ERISA issue because in most part anything with significant deferred compensation, I'm thinking more of plans which would defer until termination of employment, we now get into - even though a top hat plan is exempt from most of the ERISA provisions, you are subject to ERISA enforcement and also the ERISA claims appeals procedures. And if you're making a decision about a distribution based on disability you have all sorts of special distribution rules un -- needlessly complicating the whole world on this but we don't know what the IRS - whether the IRS will give a more favorable definition to us to use with more objective criteria so we can avoid that question.

Slide 18. A distribution based on change of control. This assumes that the person has not terminated employment or separated from service but rather a change of control occurs and we're just going to cash everybody out. That's a permissible event but we need the IRS to define what a change in control is. The legislative history says that the IRS can, not required to, but can adopt a definition of change in control that mimics the definition in the golden parachute excise tax rules under Section 280G of the code. Once again, we await the IRS.

Slides 19 and 20 deals with distributions for unforeseeable emergencies, the old hardship distribution. Most plans have these. I think all that happens here is we now have a very specific definition of -- or a more limited definition of hardship. This tracks the definition, which the IRS has approved for years under its old ruling posture, and also if you deal with tax exempt under Section 457 it mimics that provision. Also the requirements for a hardship, in proving hardship are sort of similar to the rules for hardship distribution under a 401(k) plan. So it means that in the past, frankly, hardship distributions tended to look a little rubberstamped. You are going to have to do a little more papering of the file and get a little more information, which is arguably a little more intrusive than we ever have had to do with this provision in the past.

The next slide, section 20 -- slide 21, which was really what the IRS was after for years, acceleration of payment. The statute flat-out prohibits any acceleration of payment except as provided by IRS regulation. They were absolutely aiming at what Mike mentioned earlier, haircut provisions. They also were aiming at, and this is some court cases that they lost, the ability to change your form of distribution from, example, from installment to a lump sum or from an annuity type payment to a lump sum. That no longer will be any good.

The -- Congress did direct the IRS to adopt some exceptions where there are situations beyond the control of the participant. We would assume that they'll probably include, for example, death, the acceleration to a beneficiary, a distribution because of other securities law or some other law for a conflict of interest situation or a court approved settlement such as a divorce, things of that nature.

On slide 22 there's one interesting thing which also which you normally would not consider to be an acceleration. We certainly didn't in the past. Typically in plans we would put in that if the amount of the benefit did not exceed a certain dollar amount, oftentimes, a lot of times we'll use a $50,000 amount, rather than providing lump -- installment payments, we'd provide them in a lump sum. Congress said that the IRS can provide that. The example they gave, however, is the absurdly low number of $10,000. We don't know whether the IRS is just going to parrot that amount or is going to allow a larger amount where if the account balance or whatever the lump sum present value is, say, the old $50,000 level, that we can then still mandatorily redistribute. We don't know that.

As another aside, by the way, this acceleration provision raises the question of what happens if you terminate the arrangement and you want to distribute because you terminate the plan or terminate the agreement. That raises the interesting question is that an acceleration and arguably it might be. Once again, we need to hear from the IRS as to what they want us to do.

The final slide, and what I'm going to assess are slides 23 and 24. And this is aimed at, at the very beginning of the discussion Mike referenced the Veeck case, which basically allowed someone to change their mind on both the timing and the form of payment almost up until the date that payment -- that the check was going to be cut for payment. Congress has instead adopted a rather specific and concrete rule. They do allow you to change your payment and they do allow you to change the timing, but you must make that election now in accordance with these rules, which means at least 12 months in advance of where the payment is first scheduled to begin. And two, you must defer it for at least an additional five years, which is a tremendous penalty in which if you want to change your mind on the election that you would have first made when you made your initial deferral election in the first place.

Those are the changes and, unfortunately, a lot of this remains to be dictated by what the IRS is going to define in the regulations for what were very common deferral practices. We can argue how much of these are really an abuse. A lot of this stuff comes out of a joint committee, a taxation report on the Enron compensation practices. Personally, I think Congress more than overshot the mark, but they have now given a pretty big hammer to an agency which has lost every case in this area for 60 years and unfortunately, I suspect they will take the opportunity to win back all the territory they've ever lost on this. Mike is going to pick up from here.

Michael Jacobster - *Jackson and Lewis - Attorney*

This statute contains a fairly prolix(ph) effective date provision. The primary effective date is that it applies to amounts deferred in taxable years beginning after December 31st, 2004. Since we are all -- since we're probably all cash basis taxpayers and we probably elected a calendar year way back when we had our first job in high school, that is January 1st, 2005.

As the -- consistent with the theme of the statute, earnings on amounts deferred before the effective date are treated parallel -- in a parallel manner to the deferrals to which they relate. That is, if the deferrals are grandfathered, so are the earnings if a deferral -- if the deferrals are not grandfathered, then the earnings are not.

An amount is considered deferred before January 1st, 2005, and by the way, we're on slide 27, if the amount is earned and vested before such date. Now, the question is what does earned and vested mean? And that is just what the legislative history says, that's almost a direct read from it. In common parlance, earned and vested means that by -- before January 1st, 2005 the individual's perform the services and has all rights to receive the income subject to it being handed to him.

At a roundtable discussion a couple of weeks ago among some guys at Treasury on the outside, it seemed that people are talking almost about an accrual type concept in that if the amount was earned -- if the performance period would have passed, if there was a right to receive it but it had not been ascertained as of that date, then there was some chance this would be earned and vested. I don't know what is going to come out. This is certainly going to be an issue for the IRS guidance.

How this statute applies with respect to fiscal year arrangements and in certain fiscal year situations, I cannot tell you. On the other hand, since these arrangements hit taxpayers who are mostly individuals and virtually every individual I know is a cash basis calendar year taxpayer for the simple reason that under current law you elect your status and fiscal year with your first income tax return and so we've all elected that, as I said, since our first job in high school or earlier, I think that's a very narrow issue, don't you, Bruce? A very narrow issue.

Bruce Schwartz - *Jackson and Lewis - Attorney*

What the question will be with fiscal year bonus plans, how the election time period will run. There is a line in the legislative history which just asked the Congress -- sorry, ask the IRS to deal with it. And that's about the scope of the help we get.

Michael Jacobster - *Jackson and Lewis - Attorney*

Now, there's an exception to the January 1st, 2005 rule. If a plan -- in a plan in existence in 2004 it's materially modified after October 3rd, 2004, it is treated as though it were a post-December 31st, 2004 deferral. The basic rule here appears that the addition of anything, of any right or features material modification, but you can certainly take away and eliminate and that will not be a modification. So getting rid of the haircuts is not a modification. I think that's right in the legislative history.

Accelerated vesting, in case you're thinking of that, is specifically in the legislative history as a material modification. The legislative history gives the very helpful example that a change in the plan administrator would not be a material modification. There are going to be grandfathering, therefore, of pre-January 1st, 2005 deferrals. If you operate under the terms of a deferred compensation arrangement that complies with current law, that is law in existence today, that is not materially modified after October 3rd, 2004 with respect to amounts deferred before January 1st, 2005, such amounts would not -- would not be subject to the new rules.

The question has come up, could you please talk about the effect of the statute on a discounted stock option plan that may be issued in December 21st, 2004?

If the option -- you know, I don't know whether it is -- if it is issued under a currently existing plan, that might be a material modification unless the plan provides for the issue of discounted stock options. If it is issued today and is fully vested, it should be subject to current rules. The question is whether you're going to have discounted stock -- but I've very rarely seen as a structural matter discounted stock options that are not subject to some vesting requirement. And you might have in today's atmosphere of corporate governance something to explain to your shareholders if you're a public company.

Treasury, by December 31st, so really you have a real division, a real kind of Berlin Wall. Option old, old, old amounts deferred, amounts deferred before December 31st, 2004 and -- under which the plan is not modified, will not be subject to the new rules. They will almost exist in stasis. Earnings on those amounts will be subject to the old rules to the current -- today's rules and anything that is modified after October 3rd, 2004 or is an amount deferred after October -- after January -- after December 31st, 2004 will be subject to the new rules. I believe I can say that an election today to defer -- an election today to defer bonus income that is to be earned next year is a post-2001 amount deferred -- I'm sorry, post-January 1st, 2005 deferral.

By December 31st the secretary is supposed to be issuing guidance to provide a limited period of time during which old pre-December 31st, 2004 plans may have by(ph) violating these rules be amended to provide their participants may cancel their deferral elections and terminate their participation in the plan and if they cancel deferral election they can also elect the amounts to be includable income to the participants when earned or if later when not subject to a substantial risk of forfeiture and generally to provide a timeframe to conform with the provisions with respect to amounts deferred as of next year.

What to do? Let me see if there's anything else I should -- oh, yes, rabbi trusts. If you go to paragraph 26 -- I'm sorry, slide 26, the new rules really don't change the game for rabbi trusts to any great extent. The new rules do, however, change to practices. First, if property is transferred to a rabbi trust based upon a factor dealing with the financial health of the employee, to be defined by the Treasury, that will result in immediate taxation and I believe the same penalty and interest structure as for deferrals. Secondly, transferring money for rabbi trusts offshore or taking a rabbi trust offshore will also result in immediate taxation. Those are anti-abuse provisions basically.

Bruce Schwartz - *Jackson and Lewis - Attorney*

(inaudible - microphone inaccessible) Enron.

Michael Jacobster - *Jackson and Lewis - Attorney*

Yes, Enron, right. As I said, transition guidance is expected out by 12/21. The basic thing that most counsel have to do is to identify current plans and arrangements. And not only current plans and arrangements that you're pretty sure are going to be hit by this legislation, but with those that might be. Now remember, it is not only what we call plans like the deferred compensation plans, Big D (ph), Big P -- Big C, Big P, but there are buried in individual employment agreements with a lot of executives mini-deferral arrangements. These too are affected. Side agreements, anything that can result in the deferral income to a later year, an election as to how and when it's going to be received is going to be affected by this.

And it is the individual arrangements, I think, that are going to be difficult to ferret out because they are embodied in separate agreements. So you'll have to review a number of your executive employment agreements to see whether they are affected. These plans have to be reviewed for features that are potentially nonconforming.

Now I've been asked the question a lot, this question, we have had a deferred compensation plan or a SERF or whatever you want to call it, whatever type of deferred compensation arrangement, going now for 10 years, eight years, five years, 20 years. What should we do? And I've recommended to clients that if you have a plan that has significant deferrals and a significant hypothetical or notional earnings inherent in the deferrals, along with -- relating to the deferrals, significant features like haircuts, choices between annuity forms, you can wait virtually to the day of retirement to figure out what to do, I would freeze those arrangements as of today. I'd freeze them because that is the only way I believe you have some certainty that old law, that is today's law, will apply to them. And I would start up mirror arrangements that conform to the new -- to the new -- to the new rules.

I would avoid anything that might look like a material modification to existing grandfathered plans. Freezing, it's not certain, but informally Treasury seems to believe that freezing will be okay. Cutbacks are generally okay. If fact, in the ERIC, I believe the -- on the Web site for ERIC there are a series of 27-page questions and recommendations. One of the things ERIC would like clarification on is whether conforming a plan to these new rules is a material modification and that's how things have gotten.

You're going to need participant communications. You're going to need participant communications because you want to get bonus and other deferral elections that you know about for years subsequent to 2004 year potentially now. Those elections may have to be modified later depending on what the IRS guidance appears to say. You're going to have to look at the arrangements. A lot of these arrangements say that the company may amend or terminate the arrangement, but nothing that is accrued to the past can be touched. So there's a complete lockup of distribution forms, elections, haircuts. You may have to go out to each individual participant and get permission as a contractual matter to change it.

You may also want to go to your Board of Directors. Why? The Board of Directors is normally the entity that can modify these arrangements because everyone felt that's the body that should do it. You may want to get a delegation from the Board for certain offices to be able to amend the plan and to enter into such arrangements that are needed to conform to this Act in case you have to act quickly.

After the Treasury issues guidance, you're going to again have to go through the process of reviewing what plans and arrangements are covered, see how you want to restructure or which elections you want to offer revocations of and amend plans. We have about five minutes. Do you want to start taking questions?

QUESTIONS AND ANSWERS

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

If we have time. I've had a number of questions emailed to me and I've forwarded them on to Michael and Bruce. If we don't get to your question, we will try to get answers to them and post them -- send them back to you and/or we will post all of the questions asked on the web page. I have gotten an email from Jacquelyn saying that they are going to post the slide presentation in a PDF format on the Web cast page after this cast. And I apologize to those that had problems, but I think everyone who had a problem has received the slides by email.

But going to some of these questions, there was one question, may have been answered, may not have been answered in your presentation. But what if you have deferred arrangement which allows for a lump sum or an annuity payment. And you, let's say, when you signed on, picked a lump sum payment and now you want to change it to an annuity. Would that be subject to this additional five-year rule?

Michael Jacobster - *Jackson and Lewis - Attorney*

Under the legislative history, if you do it today and the plan permits it, the legislative history says that the exercise of a right under a current plan is not considered a material modification.

Bruce Schwartz - *Jackson and Lewis - Attorney*

Correct.

Michael Jacobster - *Jackson and Lewis - Attorney*

So I believe if you want to do it today, it's not entirely clear, but if all you are doing is exercising a current right under the terms of the plan, I'll read the legislative history, the exercise or reduction of an existing benefit right or feature is not a material modification. It could be done today if the plan language explicitly permits it.

Bruce Schwartz - *Jackson and Lewis - Attorney*

Or two or three years from now.

Michael Jacobster - *Jackson and Lewis - Attorney*

I'm not sure.

Bruce Schwartz - *Jackson and Lewis - Attorney*

The question which arises is the scope of the grandfather. You can read the legislative history to say that if you have the option today, that that option should be available to you with respect to anything earned prior to December 31st.

Michael Jacobster - *Jackson and Lewis - Attorney*

But it has to be earned and (inaudible - cross talk)

Bruce Schwartz - *Jackson and Lewis - Attorney*

Earned and vested prior to that date, that that change in distribution form continues into the future. That also gets in the question of why you may want to freeze on December 31st existing plans to make clear the distinction between the old rules and old choices and options you provide and the new rules to make a clear break point easier just in case. We assume that -- I mean that's the logical construct of the grandfather rule, but -- and the legislative history, but it frankly depends on how the IRS is going to define these types of changes.

Michael Jacobster - *Jackson and Lewis - Attorney*

Now, I was addressing the issue of continuing deferrals under the plan post-2005. Let's say a guy has currently elected annuity payments and will want to go to a lump sum at retirement. You have to do that unless --

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Bruce Schwartz - *Jackson and Lewis - Attorney*

If you have a defined benefit plan, you're going -- you have to work with your actuary to figure out the amount earned and accrued as of December 31st and essentially bifurcate the benefit in order to even have any shot at preserving the grandfather.

Michael Jacobster - *Jackson and Lewis - Attorney*

Or you're going to have to freeze and start up again. What other question, Eileen?

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

There was another question here. It says the Job Act does not specifically state that a plan termination is a distributable event, but it seems reasonable to consider it as such.

Bruce Schwartz - *Jackson and Lewis - Attorney*

I disagree with that. A plan termination, unlike like a tax qualified plan, there's no -- it's really just a contractual promise to pay. I would -- it arguably could fit under the definition of an acceleration of payment. It is possible -- I'm speculating here what the IRS might do -- and you see this, for example, in termination of 401(k) plans, that as long as a new plan is not created within a certain timeframe, if I remember it's two years for 401(k) plan purposes, it's possible the IRS might apply the same concept here. However, absent that type of guidance from the IRS, our position would be that a termination of the plan is not a special event. If it does not fall in that list, and the list is exclusive, it says only upon these events, that a plan termination arguably falls in the acceleration provision, which is strictly prohibited, and that you can't do that unless the IRS tells us otherwise.

Michael Jacobster - *Jackson and Lewis - Attorney*

Plan termination is one of the issues that ERIC has asked the Treasury to address, by the way, in this area. And conceptually, this is not like a qualified plan, termination is not -- all that happens here that is -- all that happens in a non-qualified deferred compensation plan is that deferrals will stop if the plan is terminated and everything else earned up to date stays in place and the contractual right to payment exists. So termination is not a really clear concept with this type of arrangement.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

And, Michael, you have referred several times to the web link for ERIC. Do you -- can you give that to our listeners?

Bruce Schwartz - *Jackson and Lewis - Attorney*

I believe it is www.eric, which is short for the ERISA Industry Committee, so it's eric.org. They have a topics page and there is a subsection there for non-qualified deferred compensation on issues that they have written to Treasury about and sometimes the Department of Labor discussions are quite comprehensive. You can argue whether they raise points that frankly shouldn't be raised sometimes -- sometimes to ask the question is to get the answer you don't want to hear. But they do have some useful analysis and that's where we're referring to, if you navigate through that site you will find what we're talking about. All of which may be -- or a lot of which may be rendered moot in a week or two.

Michael Jacobster - *Jackson and Lewis - Attorney*

And I use that site because it's one of the primary lobbying groups in this area and they're fairly influential. Any other questions?

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Well, there are loads of other questions and it's hard for me to choose from, unless you have a favorite one. I think our best bet might be to just promise that we'll try to get answers but that Jackson & Lewis is not lending legal advice when they're answering these questions.

Michael Jacobster - *Jackson and Lewis - Attorney*

Yes, we are not.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Take that disclaimer?

Michael Jacobster - *Jackson and Lewis - Attorney*

We're speculating, in fact. Anything we say at this point is pure speculation and we're not giving individual circumstances in giving -- in describing our views on a particular question.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

I should say that a week or two ago I listened in on a Web cast and there was a representative from the IRS there and they did indicate or this individual did indicate that the IRS was appreciative that these new rules were coming in so very late in the year, so short to the effective date, and that they -- can't say lenient, but understanding phase-in process.

Bruce Schwartz - *Jackson and Lewis - Attorney*

As a matter of personal opinion, I think the IRS is going to be pretty generous in the transition period in allowing people to square things up with whatever the new rules are. On the other hand, I also think the new rules are going to be pretty harsh and broad sweeping. So the IRS will give us time on the one hand, but I think they're going to make us jump through a lot of hoops on the other.

Michael Jacobster - *Jackson and Lewis - Attorney*

And you have to remember that for the IRS, this is a great triumph. It caps 60 years of losing every case in this area.

Eileen Groves - *Association for Corporate Counsel - Chairman of ERISA Subcommittee*

Thank you very much, Michael and Bruce, and to our listeners. The Labor and Employment Committee thought it was very important for you to at least be briefed upon this because we may not be able to get the changes done by 1/1/05, but at least we have time to start going through our file cabinets and going through our plans to find out what we have so we are not caught short six, eight months down the line and say, "Oh, I didn't see that", or "I didn't know that was affected." Now is the time to do our housecleaning, so to speak.

And hopefully within the next week or two we will get some guidance and it's very possible and probable that we may be back to you earlier in -- early in 2005 to try to explain to you what the rules say and maybe take some of these questions that were asked and answer them under the new rules versus looking through our crystal ball today.

So thank you very much Jackson & Lewis. Jackson & Lewis is the sponsor of the Labor and Employment Committee and for ACC and we appreciate their support all through the year. And we thank Bruce and Michael for their work on this topic.

I would alert the listeners that the Labor and Employment Committee is planning a Web cast in January on class actions and the moderator will be C.S. McKinney (ph). So please wait on the email from ACCA telling you about the class action Web cast in January of '05. To all my listeners and to Michael and Bruce, happy holidays.
