

May 27, 2004

MEMORANDUM TO CLIENTS

Re: Legislative Update: Pensions and Nonqualified Deferred Compensation

Significant changes to the rules that apply to nonqualified deferred compensation arrangements have been pending in Congress as part of Enron-related pension legislation and international and corporate tax reform legislation. There has been some activity in recent weeks, so this area is still very much in play. In addition, the Senate Finance Committee has now filed its report and introduced statutory language on its version of Enron-related pension legislation. Here is an update on these recent developments.

A. Senate Finance Committee Enron Pension Reform Bill

Last fall, the Senate Finance Committee approved its version of Enron-related pension reform legislation (the National Employee Savings and Trust Equity Guarantee Act of 2004 ("NESTEG")), including significant changes to the nonqualified deferred compensation rules and an amendment that would have dramatically curbed the use of corporate owned life insurance (COLI). In February, the Senate Finance Committee approved a revised version of the COLI amendment in the NESTEG bill and moved the effective date for many of the pension and nonqualified deferred compensation amendments in the bill to years beginning after December 31, 2004.

On May 14, the Finance Committee finally filed its committee report on NESTEG and it was formally introduced as legislation (S. 2424). In general, the provisions in the introduced bill and Committee report track the Joint Committee on Taxation's descriptions of the provisions before the Committee last fall and in February. Despite the recent filing of the Committee report and introduction of the bill, it remains unlikely that the Senate will pass the NESTEG legislation in the relatively few legislative days remaining this year.

An update of our summary and comparison of key pension and COLI amendments in the Finance Committee NESTEG bill and the Enron-related legislation (H.R. 1000) approved by the House last year will be available shortly.

B. International and Corporate Tax Reform Bill

In March, the Senate added the nonqualified deferred compensation amendments to the international and corporate tax reform bill (S. 1637, the Jumpstart Our Business

Strength ("JOBS") Act of 2004) on the Senate floor. Senate consideration of the legislation had been slowed by partisan disputes on whether and to what extent Senate Democrats would be permitted to offer certain non-germane amendments to the bill. In early May, Senate leaders reached a compromise regarding these amendments, and the Senate overwhelmingly passed S. 1637 by a vote of 92-5 on May 11.

The nonqualified deferred compensation amendments in the Senate-passed international and corporate tax reform bill generally mirror those in the NESTEG bill – but do not include the COLI amendments or repeal of the longstanding limitation on Treasury's ability to issue guidance in the deferred compensation area (sec. 132 of the Revenue Act of 1978). The proposed amendments generally would be effective for amounts deferred in taxable years beginning after December 31, 2004. Treasury would be directed to provide participants with a limited period of time after the date of enactment to terminate participation in the plan or cancel an outstanding deferral election with regard to amounts earned after December 31, 2004.

The version of international and corporate tax reform legislation (H.R. 2896) approved by the House Ways and Means Committee last fall also contains a package of amendments to the nonqualified deferred compensation rules. Progress on the House version of the legislation has been stalled for months, in part because of differences between House Democrats and some Republicans on the distribution of tax reforms between international domestic business operations. Since the Senate passed its version of the legislation, Ways and Means Chairman Bill Thomas (R-CA) has been working with Republican Ways and Means members on a revised version of the legislation, and it now appears that the House may be able to pass the legislation before Congress breaks for its July 4th recess.

A side-by-side comparing the nonqualified deferred compensation changes in the versions of international and corporate tax reform legislation passed by the Senate and approved by the Ways and Means Committee is attached. This reflects comments on issues clarified in the recently released Senate report.

It remains to be seen whether international and corporate tax reform legislation including the nonqualified deferred compensation amendments will be enacted this year. Possible obstacles to final action on the legislation include attempts by Senate Democrats to block the legislation from going to conference and likely disputes between the House and Senate over the extent to which the legislation must be "paid for" with revenue-raising provisions. Nevertheless, the Senate's approval of the legislation, and the recent efforts to reach a compromise in the House, increase the chances that far-reaching changes in the nonqualified deferred compensation area will be enacted this year.