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Testimony Before the Senate Finance Committee
Hearing on Nonqualified Deferred Compensation Arrangements

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I. Introduction

Chairman Baucas, Senator Grassley, and Members of the Committee, I am Kathryn J. Kennedy[1], a professor of law at The John Marshall Law School and the director of the school's graduate programs in taxation and employee benefits law. I am also a pension actuary with 25 years of experience in the employee benefits field. As director of the school's graduate programs in tax law and employee benefits law, I oversee a program dedicated exclusively to the study of employee benefits law, the *only* one of its kind in the nation. Presently, the curriculum offers 18 different employee benefits courses – ranging from executive compensation to health and welfare law to qualified retirement plans to employee stock ownership plans.

II Purpose of my Testimony

My purpose in giving this testimony is two-fold: to dispel the myth that nonqualified deferred compensation plans (NQDC plans) are providing some massive tax loop-hole for executives of privately-held corporations *and* to highlight legitimate concerns that Congress may wish to address in the NQDC area. My remarks are limited to privately-held corporations' NQDC plans, which are funded by neither employer stock nor split-dollar life insurance.

The best way to understand the tax effect of **nonqualified** deferred compensation plans is to understand what they are not – **qualified** deferred compensation plans (qualified under IRC §401(a)). Generally for compensation deferred for or by an employee, the employer's deduction must "match" the employee's inclusion of such amounts as taxable income in the same tax year.[2] By using a **qualified** retirement plan, the employer is permitted to *accelerate* this deduction to the earlier time when the contribution is made, while the employee defers taxation on the contribution and the tax-exempt earnings until actual distribution is made (which could be 20 to 30 years in the future).[3] Thus, Congress provides a substantial tax subsidy for deferrals made under **qualified** retirement plans, both for the employer and the covered employees.

Rank and file employees' deferred compensation is protected under qualified plans since they have exclusive rights to the plan assets and such rights may not be subject to forfeiture (except in the context of the qualified plan's vesting schedule). ERISA's funding and fiduciary rules assure that assets will be maintained for these plans and prudently invested by the plan fiduciary. There are legitimate policy reasons for providing such a subsidy for qualified plans. Savings for retirement is promoted, and employees are able to retire with sufficient retirement income. Also, it is possible that the improved general welfare actually strengthens the tax base while reducing pressures on the governmental safety net.

In contrast, when compensation is deferred under a NQDC plan, it may appear that the IRS is losing tax revenue because the employee is not presently taxed on such deferral. However, since the deferral is **nonqualified**, monies remain with the employer (until future distribution) and are taxed *presently* at the corporate tax rates. Any employer earnings on such deferrals are also taxed as earned.[4] In contrast with a qualified retirement plan where the plan assets must be held in a separate IRC §501(a) trust for the exclusive benefit of the participants, any assets used to informally fund a NQDC plan remain part of the employer's general assets.

The employee's taxation of such deferrals, if *properly* structured under a NQDC, is deferred until actual receipt of the payments. During this time span, the deferrals must remain subject to risk, thereby subjecting the employee to some type of potential loss or forfeiture until the payment is actually made.[5] To do otherwise will subject the employee to immediate taxation under the doctrine of constructive receipt, although actual receipt of the monies is delayed.

Thus, there is no massive tax loophole afforded by NQDC arrangements. The IRS is receiving tax presently at the corporate level on these deferrals and their earnings; taxation of the deferrals at the employee level is delayed as such deferrals are subject to risk until the time of actual payment. Indeed, the future taxability of the employee is offset by future deductibility to the corporation – approximately a "wash." The IRS receives its tax now, not later.

Why then do we have NQDC plans? There are legitimate reasons why such plans are so popular:

- For the executive, such plans provide for the gap at retirement between the level that can be provided under the qualified retirement plan and the replacement income level that is desired. Continued use of dollar limitations on deferrals under qualified plans (through compensation limits and maximum benefit/contribution limits)[6] created pressure to supplement the executive's retirement benefit. EGTRRA '01 increased those dollar limitations, but not significantly. These nonqualified arrangements also provide flexibility by permitting the executive to alter the timing of the receipt of such compensation thereby allowing the corporation continued use the employee's compensation during the period of deferral.

- For the corporation, a NQDC plan permits the actual *amount* of the executive's compensation to be dependent on future performance; acts as a retention device to keep executives by "handcuffing" them to the employer; serves as a recruitment device to hire mid-career executives who otherwise will lose benefits under their existing employer plans; and permits early retirement for current executives if desired. Qualified plans cannot achieve these objectives as vesting schedules are mandated by the Code, early retirement window benefits must be nondiscriminatory, and the level of plan compensation cannot be dependent upon future performance criteria.[7]

- There exists a slight tax arbitrage between the top corporate rate of 38% and the top individual rate of 38.6% (for 2002, but reducing to 35% by 2006). So the tax code has embodied a modest incentive to have income taxed sooner if at the corporate rate, or later if at the individual rate, but this will change as individual rates decrease in the future.

In order for the executive to delay taxation of deferrals under NQDC plans, certain tax rules must be satisfied.[8] These rules are set forth in the Internal Revenue Code and have been interpreted by the IRS and the courts. The Service's application of some of these rules, especially in regards to subsequent elections to alter the mode of distribution (*e.g.,* lump sum or installment), has been regarded as unduly restrictive,[9] whereas the courts provide greater latitude in providing for the alteration of the mode of payment.[10] As a result of the courts' hammering against the IRS' rulings, current guidance from the Service has been lacking, which certainly provides an environment for abuse.

III. Tax Rules Regarding Delayed Taxation of Income for Executives

The simplest nonqualified deferred compensation arrangement exists where the executive has an unfunded and unsecured promise by the employer to pay compensation at some future date in time. It is unfunded in the sense that no assets are set aside for the executive, and unsecured such that upon the employer's bankruptcy or insolvency, the creditors' claims come before the payment of the executive compensation. The actual date of the deferred payment to the executive under the NQDC plan can be negotiated (*for example*, termination of employment, death, disability, or retirement). Such arrangement avoids any immediate tax to the executive. It should be noted that there is a special timing rule applicable to NQDC plans for FICA tax purposes, which may treat the deferral differently for FICA purposes than for income tax purposes.[11]

Withdrawals: When – If the executive and the employer wish to permit withdrawal rights for the executive under the NQDC plan such that the executive can accelerate the payment of the deferrals to an earlier date, the Service requires that the withdrawal right be restricted or conditioned upon the occurrence of certain events.[12] The executive's unfettered right to withdraw deferred benefits would result in constructive receipt, thereby taxing him/her as if the payments were actually made, even though he/she chooses not to actually take the money.[13]

The Service has expressly approved of the following triggering events with no immediate adverse tax consequences for the executive: attainment of a certain age; becoming partially or totally incapacitated; completion of a certain period of service; termination of employment; reduction in hours worked from full-time to part-time;[14] change of control of the employer;[15] decrease of employer's net worth below $10 million;[16] or employer's liquidation.[17] Under the NQDC plan, if a triggering event occurs and payment is required by the employer to the executive, the executive owes income tax only at the time of actual receipt of the payments.

Withdrawals: How Much – An alternative to the use of triggering events is to permit withdrawal rights for the executive under the NQDC plan, but impose a substantial burden upon the exercise of such withdrawal rights. Again the Service has approved of the use of such penalties, including "haircut" provisions and suspension from future participation.[18] Thus if the executive exercises his/her withdrawal rights, there is taxation only at the time of exercise, and the executive either forfeits a percentage of his/her total deferred benefits and/or is suspended from future plan participation for some period of time. The Service has approved of haircut penalties as low as 5%, 6% and 10%,[19] and suspension periods of six months to a year.[20]

While the potential for abuse exists for executives to exercise these provisions while the employer is in financial trouble, withdrawn payments are subject to the terms of the Fraudulent Conveyance Act.[21] Thus any payments made by the employer to an insider (*e.g*., executive) within the previous 12 months of bankruptcy may be rescinded by the bankruptcy courts. **Certainly Congress can question whether such penalties and suspension periods are too generous to the executive and decide to impose more restrictive provisions. Also Congress may decide to extend the reach of the bankruptcy statutes to a longer look-back period.**

Not Yet Withdrawn: Securing the Assets – As the above rules do not protect the executive from the employer's later "change of heart," executives have sought ways of "securing" or informally funding the employer's promise to pay these deferred payments. The first private letter ruling in which the Service affirmed the use of such security involved a rabbi whose congregation desired to establish a trust to fund his deferred compensation.[22] The Service approved of the use of a trust (coined the "rabbi trust"), whereby employer assets could be set aside or segregated for the express purpose of satisfying its obligations under the NQDC plan, securing for the rabbi that the monies would be there when promised. The assets in the rabbi trust had to be available to the employer's creditors in the event of bankruptcy or insolvency; unless so conditioned, the rabbi would have a secured promise to pay from the employer resulting in immediate taxation for the rabbi.[23] For tax purposes, the rabbi trust is an employer grantor trust under IRC §671 whereby income, losses, and deductions flow back to the employer.[24] The use of such a security device also does not result in "funding" for ERISA purposes, thereby subjecting the underlying plan to its participation, vesting, funding and fiduciary rules.[25]

Rabbi trusts are the most common funding vehicle used by employers today to secure the availability of monies when due.[26] There is no requirement as to a minimum level of assets that must be maintained in the rabbi trust. The assets are not provided the same tax benefits as assets under qualified retirement plans (which accumulate tax-free until distribution). Instead the assets under the rabbi trust are taxed to the employer as they are earned at the corporate tax rates (unless invested in tax-exempt vehicles).[27] Benefits are then paid to the executives when due and taxed when actually received under the NQDC plan (unless used for the benefit of the employer's creditors in the event of bankruptcy or insolvency), resulting in a corresponding deduction for the employer. Rabbi trusts have become so popular that the Service has issued model rabbi trust language, which sets forth mandated, alternative and optional provisions.[28] The Service did not provide sample language in its model rabbi trust for the use of haircut provisions. As the Service has announced its intention not to issue any future private letter rulings on trust provisions that deviate from the model language, it is not clear whether the Service is retreating from its prior position regarding the use of haircut clauses.[29]

Employers using rabbi trusts may not necessarily wish to fund the trust at its inception, preferring instead to use such assets for business purposes. To alleviate the executives' concerns, the trust may then *require* the "funding" with assets upon the occurrence of a triggering event (*e.g.,* change of control).[30] Such trusts are commonly known as "springing trusts" as the trust becomes "funded" once the triggering event occurs. The Service has explicitly approved in its model rabbi trust document the use of a "change of control" triggering event for funding purposes.[31] Other triggering events that are commonly used in funding rabbi trusts include the "potential change in control" (*i.e.*, announcement of a take-over bid) or "change of heart" (*i.e.*, employer's refusal to pay benefits under the plan in bad faith or without cause). Because the Service has approved the funding of the rabbi trust as its inception, subsequent funding of the trust triggered by certain events should present no constructive receipt issues for the executive. Some rabbi trusts are expanding the list of triggering events to include such things as the employer's liquidation, decline in its credit-worthiness, or inability to meet its debts when due. **Congress could explicitly provide that the events relating to the employer's financial health are triggering events that will result in constructive receipt for executives.**

There have been a variety of non-cash methods used by employers to provide some security for executives under the rabbi trust prior to the triggering event which would require full funding. Such methods may prove costly and cumbersome, and may raise corporate law and securities issues. These methods include use of a letter of credit;[32] use of employer stock;[33] and use of a warrant to issue employer stock.[34] Corporate-owned life insurance may also be an underlying asset of the NQDC plan; however, discussion of the use of such an asset is beyond the scope of my testimony.

Not Yet Withdrawn: Retrieving the Assets – One potentially serious problem is the establishment of the rabbi trusts offshore (*i.e.*, outside the jurisdiction of the U.S. courts) or their establishment by a foreign employer, in order to keep them from the employer's creditors.[35] This added layer of protection obviously creates more difficulty and cost for the employer's creditors in collecting such assets in the event of bankruptcy or insolvency. The Service has indicated that it will not issue advance rulings on rabbi trusts established by foreign employers or in foreign countries.[36] **If perceived as an abuse of the rabbi trust security device, Congress could clearly require that the assets of a rabbi trust have a trust situs and be located within the jurisdiction of the United States.**

In lieu of using a rabbi trust, executives have relied upon third party guarantors to make the promised payments in the event the employer becomes bankrupt or insolvent. Executives have used surety bonds,[37] letters of credit,[38] indemnity insurance,[39] shadow trusts, agency agreements, escrow arrangements,[40] and grantor trusts known as secular trusts.[41] Use of insurance-type guarantees is generally temporary in nature, as these policies are short in duration and limited in coverage; they may also be available only for larger and financially sound employers. Use of escrows or agency agreements permit the employer to revoke the agreement upon the occurrence of certain triggering events (*e.g.*, change of control) in order to provide greater control for the employer over the direction of the assets. The Service has ruled that such agency-type arrangements do not subject the executive to any immediate tax. Such arrangements generally afford *less* protection to the executive than the traditional rabbi trust. Despite the variety of these third party guarantees, the use of the rabbi trust continues to be the most popular security device.

Not Yet Withdrawn, But Taxed to Employee – At the other end of the spectrum, the employer and the executive may agree to formally fund the NQDC plan by means of a grantor trust known as a "secular trust," which can protect the executive even against the risk of employer bankruptcy or insolvency.[42] An irrevocable trust is established which provides the executive with exclusive rights to receive future benefits. Employer contributions to the trust are deductible when made, as the executive (as owner of the trust) is taxed immediately on such amounts and any interest/earnings as earned.[43] Due to the immediate taxation of interest/earnings to the executive, it may be desirable to use life insurance as a funding asset as its cash accumulation may be tax-sheltered.

The attractiveness of a secular trust is better understood when corporate tax rates exceed individual income tax rates, as the tax saved by the employer's deduction for contributions made to the secular trust exceeds the income tax paid by the executive. If the executive's pay is grossed-up for the additional tax, there is no downside for the executive. So long as the maximum individual income tax rates (ranging from 15% to 38.6%)[44] have exceeded the maximum corporate tax rates (ranging from 15% to 38%)[45], the secular trust has been less appealing from a tax vantage point. The Service has issued favorable rulings regarding secular trusts, but has yet to issue a model secular trust document.[46] While the DOL has ruled on the use of a rabbi trust for NQDC plans, it has yet to rule as to whether the use of a secular trust would cause the underlying NQDC plan to be "funded" for ERISA purposes. **Thus, use of secular trusts may cause some problems under ERISA, but those issues are outside the scope of today's discussion.**

Hybrids – There are a few hybrid funding vehicles that attempt to combine elements of both the rabbi trust and the secular trust. One such vehicle is known as the **rabbicular trust**.℠ Upon its inception, it is a rabbi trust with no resulting tax consequences to the executive. But upon the triggering of certain events, the rabbi trust is terminated and the assets are distributed into individual secular trusts (which are then protected from the employer's general creditors).[47] Obviously at the occurrence of the triggering event, the executive becomes taxable on the amounts distributed from the rabbi trust and contributed to the secular trust. If the triggering event is simply a change in control, there should be no adverse consequence to the executive under the rabbi trust as the IRS' model Rabbi Trust document permits such triggering event to fund the rabbi trust and make it irrevocable. In addition, the normal deferred compensation rules do not constructively tax the executive simply because the executive obtains the right to withdraw monies from the NQDC upon a change of control. However, if the triggering event is tied to the employer's financial health or its bankruptcy or insolvency, the Service is likely to view the executive to be in constructive receipt of the deferrals as he/she is no longer subject to any risk of loss. In addition, the bankruptcy look-back provisions may recapture the assets transferred to the secular trust.

Another vehicle, known as the **vesting trust** or the **non-sectarian trust**, is similar to the secular trust arrangement, but is established on a separate basis. The trust then is taxable as a separate entity. The vesting trust is structured to pay benefits to the executives *only if* certain triggering events occur; if the events do not occur, the monies revert back to the employer and the executive is paid directly by the employer out of its general assets. While the Service has not formally ruled on such an arrangement, it may regard it as a funded arrangement, thereby taxable under the Code.[48]

A vehicle known as a **secured trust**[49] has been described as a trust that protects NQDC plans in the event of an employer's insolvency. This trust is structured so as to provide benefits to the executive *only if* the employer goes bankrupt or has a change of control, and thus is *not* subject to the claims of the employer's creditors. If the executive terminates employment *prior* to these triggering event, his/her benefits are forfeited under the trust and the monies revert back to the employer. The employer is regarded as a contingent beneficiary under the secured trust, as it *may* receive the monies in the event of the executive's termination of employment.

If the employer goes bankrupt before the executive terminates employment, the secured trust pays the benefits to the executive as it is not subject to the claims of the creditors. And if the employer is financially healthy at the time of the executive's termination, it simply pays the executive its deferred compensation out of its general assets and the assets of the secured trust revert back to the employer. The executive is certainly at risk that the employer may have a "change of heart" at the time of termination as he/she will be then relying on the employer's general assets for payment. The argument is made that the executive has no constructive receipt in the secured trust as he/she is subject to a substantial risk of forfeiture (*i.e.*, receiving payment *only if* the employer goes bankrupt or has a change in control).

The final vehicle discussed is known as a **heavenly trust**.[50] This refers to a use of two trusts – a rabbi trust where assets are set aside for NQDC benefits but subject to the claims of creditors and a secured trust that is established solely to pay benefits in the event of the employer's insolvency or bankruptcy and is not subject to the claims of creditors. The argument is made that the rabbi trust results in no constructive receipt to the executive as it is subject to the claims of creditors, and that the secured trust results in no constructive receipt as benefits are subject to a "substantial risk of forfeiture" due to the unlikelihood of the employer going bankrupt or insolvent. The Service is likely to view the combined use of the trusts as resulting in constructive receipt as they eliminate any risk of loss or forfeiture for the executive.

The Service has yet to rule on either a secured trust or a heavenly trust; employers relying on such trust would certainly be advised to seek an opinion letter from counsel. The secured trust used alone (without a tandem rabbi trust) subjects the executive to the risk that the employer could have a "change of heart." The heavenly trust appears to insulate the executive from any risk. **Congress could certainly legislate that the use of such hybrid arrangements will result in constructive receipt for the executive. However, the use of the rabbicular trust℠ is clearly permissible under the IRS model rabbi trust document if the change of control is the triggering event. Thus Congress may wish to limit its changes to triggering events that relate to the employer's financial condition (*e.g.,* bankruptcy or insolvency).**

IV Conclusion

I thank you for the opportunity to discuss this topic with you. While the popular press has sensationalized executive compensation plans, drawing attention to the large fortunes of deferred compensation amassed for and by executives, the fault does not lie with the application of the federal tax code. The federal code taxes the employer *immediately* on such deferrals, deferring the corporate-level deduction until the actual time of payment to the employee, and requires that these deferrals be subject to significant risk of loss/forfeiture in order to avoid immediate taxation for the executive.

In closing, I would like to propose possible solutions to certained perceived problems. If Congress believes that nonqualified deferrals should be subject to even **greater risks of forfeitures**, certainly such restrictions may be added to the Code and regulated by the Service. However, such added restrictions might appear excessive, given that the IRS receives taxes in NQDC plans currently. If Congress' real concern goes to the **magnitude** of the deferred compensation package for an individual executive, the Service already has the power to deny the employer's later deductions at the time of payout, to the extent they are judged unreasonable and excessive.[51]

If Congress' real concern goes to the **timing** of such payments (*e.g.*, in contemplation of bankruptcy), then this important issue is covered not by the tax code but by the bankruptcy statutes.

If Congress believes that **offshore assets** are too far away for creditors' reach, certainly Congress may legislate a retrieval and instruct the Service to issue rulings to that effect.

But if Congress' real motivation is to regulate the dollar limits and type of compensation that may be paid to executives, both in absolute and relative terms, I certainly question whether the tax code is the most expedient vehicle to accomplish such result.[52] Congress' attempts in 1984 to regulate the amount of "excess parachute payments" (*i.e*., non-performance related payments that become payable to an executive solely upon a change of control) by denying employer's deductions and assessing excise taxes on executives have not been entirely successful.[53] Employers design their parachute agreements to make sense from a business perspective, even if part of the deduction is foregone. And if necessary, executives may be given a tax gross-up allowance by the employer to offset the resulting excise and income tax consequences for the excessive parachute payments.[54] Thus, such arrangements may cost more in terms of taxes, but if they make sense from a business perspective, the practice will not be eliminated.

Finally if Congress decides to legislate in this area, it may consider whether adding *new* layers of complexity at the individual and corporate level to reduce the level of NQDC plans is counter-intuitive at a time when Congress is trying to simplify the tax code.

Footnotes

[1] The author would like to acknowledge the efforts of the JMLS employee benefit graduate students Christopher Condeluci, Joseph Yonadi, and Daniel Zimbler in their fine research and analytical skills in drafting this testimony.

[2] IRC §404(a)(5) (known as the "matching rule" whereby the employer's deduction must match the employee's inclusion of such amounts as taxable income for the same tax year).

[3] IRC §404(a)(1)-(3).

[4] *See Albertson's, Inc. v. Commissioner*, 42 F.3d 537 (9th Cir. 1994), *rev'g* 38 F.3d 1046 (9th Cir. 1993) (see *also* 95 T.C. 415 (1990)) where the Ninth Circuit reversed its earlier decision and agreed with the Tax Court's conclusion that a current deduction for an employer for the interest/earnings component of a nonqualified deferred compensation plan would be contrary to the intent of IRC §404(a)(5). Thus, such interest and earnings would be subject to the matching rule of IRC §404(a)(5).

[5] *See* IRS Regs. § 1.451-2(a) which provide "[i]ncome although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions."

[6] *See* IRC §§401(a)(17) and 415 which impose compensation ceilings and maximum benefit/contribution ceilings for qualified defined benefit and defined contribution plans.

[7] *See* IRC §411(a) which sets forth the appropriate vesting schedules that may be used in a qualified plan and IRC §414(s) which provide definitions of "compensation" for qualified plan purposes that do not include nonqualified deferred compensation.

[8] These tax rules are the constructive receipt doctrine (*see supra* note 5); the economic benefit doctrine (*see* GCM 35196 (Jan. 16, 1973); and §83 requirements regarding property transferred to an individual in connection with the performance of services (*see* IRS Regs. §1.83-3(e)).

[9] In 1978, the Service attempted to reverse its prior constructive receipt rules by stating that forfeitures provisions would no longer protect deferrals from constructive receipt. Congress reacted by passing §132 of the Revenue Act of 1978, which provided that the tax treatment of private deferred compensation plans would be determined in accordance with principles set forth in regulations, rulings and caselaw which were in effect February 1, 1978.

[10] *See Veit v. Commissioner* (referred to as *Veit I*), 8 T.C. 809 (1947), acq. 1947-2 C.B.4, where the Tax Court permitted the taxpayer's deferral election even though most of the services had been performed as the amount due was not definitely determinable; *Veit v. Commissioner* (referred to as *Veit II*), 8 T.C. 919 (1949), where the taxpayer's election was permitted to change payment schemes even though the amounts were determinable; and *Martin v. Commissioner*, 96 T.C.814 (1991), appeal dism'd (10th Cir. 2/18/92), affirming the taxpayer's change in payment schemes shortly before termination of employment.

[11] The Social Security Amendments of l983 created a special timing rule for NQDC benefits, subjecting them to taxation at the later of (1) the time of the performance of services or (2) when such benefits are no longer subject to a substantial risk of forfeiture. Thus, for NQDC benefits that are not subject to any substantial risk of forfeiture, benefits are taxable when the services are performed. For many executives, this will result in Medicare Tax of 1.45% on all such amounts (as there is no maximum taxable wage base used on the medical portion of the FICA tax rate). However, if the NQDC benefits are subject to a substantial risk of forfeiture, the FICA payments are delayed until the risk lapses; if the lapse occurs at the executive's retirement, this will subject the entire amount of the NQDC

benefits subject to FICA taxes.

[12] *See supra* note 5.

[13] *See* Nonqualified Plans Discussed by IRS Official, RIA Executive Compensation & Taxation Coordinator (Jan., 1996), page 6 (IRS official indicates that the mere existence of certain triggering provisions may cause the executive to have immediate taxation).

[14] *See* Rev. Rul. 60-31, 1960-1 C.B. 174, modified by Rev. Rul. 64-279, 1964-2 C.B.121, and Rev. Rul. 70-435, 1970-2 C.B. 100.

[15] *See* PLR 9508014 (Nov. 22, 1994) ("the Plan provides that benefits will be paid upon ... the voluntary termination of the plan by a corporate successor"); PLR 9204012 (Oct. 23, 1991); PLR 8746052 (Aug. 19, 1987) (amounts were paid after an involuntary termination following a change of control); PLR 8418095 (Jan. 31, 1984) (deferrals become immediately payable upon a change of control).

[16] PLR 9508014 (Nov. 22, 1994) ("the plan automatically terminates if the Company's net worth falls below $10,000,000).

[17] PLR 8435031 (May 24, 1984) ("In the event that the employer is liquidated, pursuant to a transaction whereby no successor corporation assumes the assets and liabilities of the Employer, the entire value of the [deferral] is to be paid to the Employee ... in one lump sum").

[18] *See* Rev. Rul. 55-423, 1955-1 C.B. 41 and Rev. Rul. 80-157, 1980 -1 C.B. 186.

[19] *See, e.g.,* PLR 8557052, 8123097 (March 12, 1981), 8107013 (1981). For further discussion of haircut provisions, see Jennifer Roof, *Haircut plans: A viable means for executive compensation planning?*, JOURNAL OF DEFERRED COMPENSATION (Summer 2000).

[20] *See* Rev. Rul. 55-423, 1955-1 C.B. 41 (which approved a six-month suspension) and Rev. Rul. 77-34, 1977 - 1 C.B. 276 (which approved a 12-month suspension).

[21] The Uniform Fraudulent Conveyance Act, 7A U.L.A. (2000) was drafted by the national conference and then adopted by states in various amended forms; some states repealed the use of this Act in favor of the Uniform Fraudulent Transfer Act, 7A U.L.A. (2000).

[22] *See* PLR 8113107 (Dec. 31, 1980).

[23] *Id.*

[24] *See* PLR 9230012 (April 24, 1992) (holding that the rabbi trust was a grantor trust under IRC §671 since the trust income could be used to discharge the legal obligations of the employer without the consent of an adverse party).

[25] *See* ERISA §§201(2), 301(a)(3), and 401(a)(1). *See also* DOL letter to Richard H. Manfreda, Chief, Individual Income Tax Branch, IRS (Dec. 13, 1985).

[26] *See* the results of the Clark Bardes Consulting – Compensation Resource Group's 2000 Executive Benefit Survey (indicating that 83% of their respondents with NQDC plans used some security device, the rabbi trust being the most common), available at http://www.crgworld.com/transcripts/chat_01718.html (4/13/02).

[27] *See* IRC §§671-677.

[28] *See* Rev. Proc. 92-64, 1992-2 C.B. 422.

[29] *Id.* §3 (stating that "rulings will not be issued on unfounded deferred compensation arrangements that use a trust other than the model trust, except in rare and unusual circumstances.")

[30] *Id.* §1(b).

[31] *Id.* §5.02, Section I, Alternatives (f).

[32] *See* PLR 9443006 (April 29, 1994) (employer's purchase of a letter of credit secured by its general assets to assure the payment of vacation pay was property under IRC §83 for the employees who were the beneficiaries under the letter of credit).

[33] *See* PLR 9235006 (Dec. 4, 1991) (which was the first favorable ruling regarding the use of employer stock in a rabbi trust); Rev. Proc. 92-64, 1992-2 C.B. 422 (which allowed rabbi assets to be invested in "securities (including stock or rights to acquire stock) or obligations issued by the company"); Notice 2000-56, 200-2 C.B. 393 (providing guidance when a parent corporation contributes stock to the rabbi trust for its subsidiary's employees).

[34] *See* James Hutchinson and Michael Stevens, *Securing the Rabbi Trust Promise: Issuing a Warrant to Purchase Employer Stock*, JOURNAL OF DEFERRED COMPENSATION (Spring 2000).

[35] *See* Gerald Nowotny, *Securing Nonqualified Deferred Compensation and Executive Benefits Using Offshore Rabbi Trusts*, WG&L/RIA JOURNAL OF ASSET PROTECTION (July/August 1997) and Henry Ordower, *A Theorem for Compensation Deferral: Doubling Your Blessings By Taking Your Rabbi Abroad,* 47 Tax. Law. 301 TAX LAWYER (Winter 1994).

[36] AALU Washington Report Bulletin 93-102 (Dec. 7, 1993) reported that the Service would no longer rule on rabbi trusts established in foreign countries or by foreign employers.

[37] *See* PLR 8406012 (Nov. 3, 1983) (employee's purchase of a surety bond with an independent insurer to pay the unfunded and unsecured nonqualified deferrals in the event of the employer's default was valid and did not confer economic benefit on the employee). In 1986, the IRS suspended rulings on surety bonds; hence, they have little practical importance today.

[38] *See supra* note 32.

[39] *See* PLR 9344038 (Aug. 2, 1993) (employee's purchase of indemnification insurance with an independent insurer to pay the nonqualified deferrals in the event the employer was unable to do so did not result in any economic benefit to the employee).

[40] These arrangements provide retain the investment control over the assets with the employer even though a third party holds the assets for the benefit of the executives; upon the occurrence of a triggering event, the assets must be paid to the executives. Such arrangements provide some security protection for the executives but are less secure than a rabbi trust; thus they are not commonly used.

[41] *See supra* note 28, at 425, §3.

[42] *See* PLR 8841023 (July 9, 1988); PLR 8843021 (July 29, 1988).

[43] *Id.*

[44] *See* IRC §1(b), as amended by EGTRRA 2001 (maximum marginal individual rate of 39.6% is reduced to 38.6% for 2002-03, 37.6% for 2004-05, 35% for 2006-10).

[45] See IRC §§11 and 1201.

[46] *See* PLR 8843021 (July 29, 1988), PLR 8841023 (July 9, 1988), PLR 9031031 (May 8, 1990).

[47] The term "Rabbicular Trust" is a servicemark of Michael G. Goldstein, J.D., LL.M., St. Louis, Missouri, 1994. *See* Michael Goldstein, Michael Swirnoff, and William Drennan, *Taxation and Funding of Nonqualified Deferred Compensation: A Complete Guide to Design and Implementation*., ABA Real Property, Probate and Trust Law Section, ABA (1998).

[48] *See* AALU Washington Report Bulletin No. 93-102 (Dec. 7, 1993).

[49] This trust is proprietary to Compensation Resource Group, Inc., available at http://www.clarkbardes.com/crg (4/13/02).

[50] *See* Henry Smith, Barry Downey, and Michael Connors, *Nonqualified Deferred Compensation Answer Book*, Aspen Publishers (3d. 1996).

[51] *See LabelGraphics, Inc. v. Commissioner*, 221 F.3d 1091 (9th Cir. 2000) (affirming a denial of deduction for petitioner president's excessive compensation as not being a reasonable business expense).

[52] *See* Susan Stabile, *Is There a Role for Tax Law in Policing Executive Compensation?*, 72 ST. JOHN'S LAW REVIEW 81 (1998) (discussing the viability of using the tax code as a means of regulating executive compensation).

[53] *See* IRC §§280G (which denies a deduction for the employer who makes an excessive parachute payment) and 4999 (which imposes a 20% excise penalty on the executive for receipt of the excessive parachute payment).

[54] *See Deferred Compensation Arrangements*, 385-3rd TAX MANAGEMENT PORTFOLIO, The Bureau of National Affairs.