INTERNAL REVENUE SERVICE

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Nov 26 2002

Dear [redacted]:

This responds to your October 12, 2002, inquiry addressed to Commissioner Rossotti on the use of nonqualified deferred compensation plans by top executives. Your letter was referred to our office for reply. You state that although you can defer no more than $25,000 to $30,000 per year in tax sheltered pension and profit sharing vehicles, top executives are deferring much larger sums of compensation. You enclosed an October 11, 2002, article from the Wall Street Journal entitled "Well-hidden Perk Means Big Money for Top Executives" describing deferred compensation plans of top executives.

We are glad to provide you with the following general information regarding executive compensation arrangements. Deferred compensation arrangements are either qualified or nonqualified. Qualified plans are governed by the rules of the Employee Retirement Income Security Act of 1974 (ERISA). ERISA specifically excludes from most of its requirements plans that are unfunded and maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, i.e. nonqualified plans. Thus, nonqualified deferred compensation plans do not have to meet the participation, vesting, and fiduciary requirements that apply to qualified plans, including the requirement that plan assets be held in a trust for the exclusive benefit of plan participants.

Qualified plans receive tax favored treatment if the applicable requirements of the Internal Revenue Code are met. Among these requirements is that there is an annual limit on the amount that may be contributed on behalf of a participant. From the information you have provided, the retirement plan in which you participate appears to be a qualified plan. As you may be aware, the contribution limit for 2002 was $40,000 and it may be helpful for you to know that the Service recently announced that the limit for 2003 remains unchanged at $40,000. We have enclosed a copy of News Release IR-2002-111 for your information.

Generally, in nonqualified arrangements, participants only receive a contractual promise to pay the agreed upon benefits from their employer and the plans are unfunded. A plan is considered unfunded as long as plan assets, if any, are available to the

employer’s general creditors in the event of the employer’s bankruptcy or insolvency and plan participants have no greater rights to plan assets than any other of the employer’s general creditors. Because nonqualified plans are not subject to the restrictions of ERISA and the Code, there are no limits on contributions to these plans. Thus, because nonqualified deferred compensation plans are not subject to most of the provisions of ERISA, they need not comply with the contribution limitations that are applicable to qualified plans. However, participants’ benefits under nonqualified plans are not funded or secured and participants must rely on an employer’s solvency in order to receive their benefits.

We hope you will find the above information helpful. If you need further assistance, please do not hesitate to contact at .

Sincerely yours,

Catherine Livingston Fernandez
Chief, Executive Compensation Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)