July 31, 2006

The Honorable William M. Thomas  The Honorable Charles B. Rangel
Chairman     Ranking Member
House Committee on Ways and Means  House Committee on Ways and Means
1102 Longworth House Office Bldg.  1106 Longworth House Office Bldg.
Washington, DC 20515         Washington, DC 20515

The Honorable Charles E. Grassley  The Honorable Max S. Baucus
Chairman     Ranking Member
Senate Committee on Finance  Senate Committee on Finance
219 Dirksen Senate Office Bldg.  219 Dirksen Senate Office Bldg.
Washington, DC  20515   Washington, DC  20515

Re:    I.R.C. Section 409A

Gentlemen:

We are writing on behalf of the American Bar Association Section of Taxation to urge reconsideration of section 409A of the Internal Revenue Code. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Section 409A of the Code, enacted by the American Jobs Creation Act of 2004, creates a detailed regulatory system governing most nonqualified deferred compensation. Although generally effective on January 1, 2005, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) have administratively postponed much of the section 409A compliance burdens at least until January 1, 2007. This provides an opportunity for your Committees to review the potential impact of the new law before it becomes fully effective.

Although section 409A is generally viewed as a reaction to a limited number of perceived abuses, the statute subjects a vast array of compensation arrangements to federal regulation and imposes penalties for failure to comply that can greatly exceed the economic consequence of the noncompliant event. Section 409A applies to small businesses as well as large public companies, to rank-and-file employees as well as senior executives, to nonprofits and governmental entities, and to U.S. employees working abroad as well as foreign employees working in the United States. Compliance with the new law will require countless plans, agreements and arrangements to be amended and, in many cases, renegotiated, in order to avoid penalties.

The need for legislation was largely generated by the moratorium imposed by Congress in 1978 on the further issuance of relevant administrative guidance by the IRS and Treasury. Indeed, during the pendency of the legislation, Treasury recommended repeal of the 1978 moratorium rather than enactment of new tax laws. We submit that Treasury’s position was correct at that time and remains correct today. The problems that have surfaced since 1978 could adequately have been addressed by the publication of timely administrative guidance. This would have allowed ample opportunity for regulations to be proposed that addressed the key problem areas; for an appropriate period to comment on that guidance; for further refinements in the administrative approach; and for the gradual implementation of those rules that were found necessary to curb abuse. Instead, Congress has created a
federal regulatory system that is largely unnecessary, will impose enormous administrative burdens on taxpayers, their advisors, employers and others, as well as on the IRS and Treasury, and is not a measured response to the underlying problems.

We want to emphasize that the IRS’ and Treasury’s efforts to produce guidance under section 409A have been exemplary. Preliminary guidance was issued promptly at the end of 2004 and extensive proposed regulations were published in September 2005. Nevertheless, this guidance also underscores the enormous scope and complexity of section 409A, and makes clear that the process of adapting to the new law will take many years. Moreover, despite their extraordinary efforts, the IRS and Treasury have yet to publish guidance on a number of critical subjects, including the section 409A penalty regime, the application to partnerships, and the reporting and withholding requirements.

We therefore urge you to utilize the current transition period and, if necessary, consider postponing the effective date of section 409A, in order to hold comprehensive hearings and otherwise gather information about the potential impact of the new law, including the estimated costs of compliance. We believe that if a thorough review were undertaken, you would have an opportunity to appreciate more fully the reasons for narrowing the scope of section 409A or even repealing the statute entirely.

Such reconsideration is not without precedent with respect to compensation legislation. Section 89, enacted in 1986, mandated that companies provide all employees with equivalent benefits, such as health coverage. Proposed interpretive regulations would have required extensive administrative costs to maintain such plans. This led to the cancellation or reduction of many plans. Congress eventually acknowledged that the legislation was ill-conceived and repealed section 89 in 1989.

We have submitted voluminous comments in response to the guidance already published under section 409A, and have otherwise sought ways to assist the IRS and Treasury in the daunting, virtually unparalleled task of implementing that section. We would welcome the opportunity to participate in a general review of section 409A.

Thank you for your consideration.

Dennis B. Drapkin  
Chair, Section of Taxation

Susan P. Serota  
Chair-Elect, Section of Taxation

cc: Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy), Treasury Department  
Donald L. Korb, Chief Counsel, Internal Revenue Service  
Robert Winters, Republican Chief Tax Counsel, House Ways and Means Committee  
John Buckley, Democratic Chief Tax Counsel, House Ways and Means Committee  
Mark Prater, Chief Tax Counsel, Senate Finance Committee  
Russell Sullivan, Democratic Staff Director, Senate Finance Committee  
Thomas Barthold, Acting Chief of Staff, Joint Committee on Taxation