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Section 3801 – Increases Taxes on Savings and Fundamentally Alters Compensation Plans in America

Topline: H.R. 1 – Section 3801 - would virtually eliminate the NQDC market, with broad impacts on a number of common compensation arrangements across our economy.

- **It amounts to a $16.2 billion tax increase on employee savings.**
- **It would result in virtually all compensation being paid annually limiting the ability for shareholders to align long-term compensation with shareholder objectives (performance based compensation).**
    - Both bank regulators (particularly after the financial crisis) and shareholders have been encouraging these types of compensation arrangements for years.
- **The change would force employees' existing balances to be taxed by 2025 interrupting millions of employee's personal financial plans.**

- **This change will require companies to restructure long established compensation arrangements.**

- **Deferred compensation (SERP, Voluntary Deferral, Stock) is used by companies large and small across our entire economy to benefit employees at all levels.**
    - Recent data indicates that 69% of NQDC participants have less than $100,000 in their plan, with 67% of all participants expected to make annual contributions of less than $25,000.

- **Millions of U.S. employees may experience (1) lower pay due to reduced equity and performance-based incentive opportunities; (2) reduced retirement benefits; and (3) higher taxes.**

If we want to make American companies competitive, Congress must not eliminate the ability for companies to create compensation arrangements that allow them to *recruit and retain.*

Impact on NQDC and Other Common Compensation Arrangements

The bill changes the definition of substantial risk of forfeiture, reducing it to being conditioned on a single event: "the future performance of substantial services by any person."

The change to the definition of substantial risk of forfeiture would mean that all compensation would be included in income upon vesting. This would virtually eliminate the marketplace for NQDC, as employees would be taxed upon their deferred compensation once they are vested, even though payment may occur many years in the future and be contingent on various conditions.

Impact on NQDC and Other Common Compensation Arrangements (continued)

Further, the changes will have negative outcomes in other common compensation arrangements. For example, elective salary deferrals are fully vested at the time they are deferred, so under this bill salary deferrals would be immediately taxed (ending the practice). As another example, employer contributions would be taxed when they vest—meaning the bill could be very detrimental to companies and banks that use NQDC plans. In fact, initial research from our members indicates that most of the NQDC plans administered for community banks would be impacted.

Would Effectively Eliminate Many Common Compensation Practices

The following widespread and long-standing forms of compensation would effectively be eliminated or dramatically curtailed by §409B as proposed:

- Stock options, potentially including tax-qualified IRC §422 Incentive Stock Options
- Employee stock purchase plans (ESPPs), potentially including tax-qualified IRC §423 ESPPs
- Multi-year performance bonus plans that provide employees with share in the growth and financial success of the employer
- Compensation holdback policies designed to reduce excessive risk-taking practices
- Stock-based awards designed to provide income protection at death, disability, or retirement and align to shareholder interests through retirement
- Severance arrangements intended to give income security to terminated employees for periods longer than 3 months
- Retirement plans which provide retirement security at companies when 401(k) plans are not available or contributions limits are severely constrained
- Other forms of retirement programs intended to make up for IRC limitations or provide long-term retention and incentives

Many of these practices are especially common among small and private businesses, where the potential for growth and innovation is high but cash-flow and liquidity are constrained. These practices are also broad-based and allow employees outside of executive management to share in the upside of a growing company and save for retirement.