

Statement for the Record

Of the

AMERICAN **BANKERS** ASSOCIATION

For the Hearing Held Before the

Committee on Ways and Means

United States House of Representatives

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Mr. Chairman and members of the Committee, this statement is being submitted for the record by the American Bankers Association (“ABA”). ABA, on behalf of the more than two million men and women who work in the nation’s banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

The ABA appreciates the opportunity to submit this statement for the record regarding the Small Business and Work Opportunity Act of 2007, H.R. 2. We are troubled by three revenue raising provisions (Sections 206, 214, and 201) that have been included in the bill by the Senate, and are particularly concerned that they tax businesses retroactively.

Retroactive tax policy is bad tax policy. America’s business community must be able to depend on the certainty of the law in order to make informed business decisions. Enacting

retroactive tax policy completely changes the economics of those past decisions and could result in excessive and arbitrary costs. Moreover, it adds to the risk and uncertainty of any business decision and could force businesses to delay or shun decisions for fear that later changes in the law will render such decisions illegal or financially burdensome, or both. Hence, retroactive changes to tax law should be avoided. The ABA, therefore, urges this Committee to remove these sections from the bill.

In this statement, the ABA wishes to express our concerns regarding the three revenue raising provisions embodied in H.R. 2:

- **Congress should not impose an arbitrary limit on income that can be deferred under non-qualified deferred compensation plans, particularly since recent changes in law affecting these plans have yet to be implemented and the consequences of those previous changes are unknown. (Sec. 206)**

- **Expanding the definition of “covered employees” would *retroactively* tax deferred compensation amounts even though decisions about these amounts have been made under existing law for many years. (Sec. 214)**

- **Changing the effective date for SILO transactions will result in a retroactive tax increase on banks. (Sec. 201)**

Each of these concerns will be addressed below.

I. Limitation of Deferrals for Non-Qualified Deferred Compensation is Inappropriate

The bill seeks to limit the aggregate amount of executive compensation that can be deferred under Internal Revenue Code Section 409A. Under that section, deductibility of deferred compensation is limited to \$1 million or the average annual compensation over five years, whichever is lesser. Furthermore, this provision is made applicable to deferred compensation plans for all employees, not simply to deferred compensation for senior executives.

However, many employers offer deferred compensation plans to middle management and other non-executive employees as a way to create incentives, reward hard work, and retain valuable employees. If the provision in question is enacted, it will create an arbitrary limit on deferred compensation plans, which in turn would reduce the overall compensation of the employee. Moreover, many employees find these plans provide additional resources for retirement. Thus, arbitrary restrictions would put a greater strain on the ability to save for retirement for these individuals. Additionally, deferred compensation plans that are already in existence will become subject to this provision. This has the potential of punishing employees and employers for compensation agreements reached long before this provision was considered.

It should also be noted that Congress recently changed the rules for non-qualified deferred compensation arrangements when it enacted the Pension Protection Act of 2006. The Department of the Treasury (“Treasury”) was directed to promulgate regulations implementing these changes, but it has not yet finalized its rules. We believe that it is inappropriate for Congress to make further changes to the law concerning deferred compensation arrangements, when the impact of previous changes in this law are still unknown. Prior to any further changes to the law governing non-qualified deferred compensation plans, employers and Congress should be afforded time to study the rules promulgated by Treasury (once finalized) in order to understand and evaluate their impact.

II. Expanding the Definition of “Covered Employees” Will Result in Retroactive Taxation

As passed by the Senate, H.R. 2 expands the definition of “covered employees” in an effort to limit the amount of executive compensation that publicly-held companies can deduct from their taxes. Under existing law, both the CEO of a publicly-held company, and the four officers with the highest compensation levels, are considered “covered employees.” Any compensation that “covered employees” receive that is in excess of \$1 million is not tax deductible by the company.

H.R. 2 expands the definition of “covered employee” to include any employee that was a “covered employee” for any preceding taxable year beginning after December 31, 2006. The language of the provision indicates that it is applicable only to executives that are subject to reporting after 2006. However, this does *not* mean that the tax burden is limited to compensation after 2006. ***In fact, the provision captures the full amount of deferred compensation from all prior years for “covered employees” that the employer is contractually obligated to fulfill.*** This represents a significant problem for deferred compensation plans designed to accommodate executives that are currently considered “covered employees.”

As an example, consider the case of senior executives of a bank who have been covered employees for several years and have received deferred compensation in the form of company stock. Over time, the price of the stock received has appreciated and the value of their account has grown substantially. Under the deferred compensation plan created many years earlier, the bank expected that it would be able to pay the deferred amounts upon retirement or termination of the executives. Since the executives would no longer be considered “covered employees,” the bank would then be able to deduct this expense.

However, the provision in H.R. 2 will result in the bank losing its ability to deduct those previously deferred amounts. This in turn will increase the bank's tax liability by millions of dollars, resulting in a retroactive tax increase.

A retroactive tax increase of this nature will punish businesses for legitimate decisions that were based on the certainty of existing tax law. It will also create great uncertainty and risk with respect to future issues of compensation. Businesses should be able to continue to rely on the certainty of the law and any restrictions imposed should apply prospectively only.

III. Changing the Effective Date for SILO Transactions Results in Retroactive Taxation

The proposed changes to the effective date for leasing provisions under the American Jobs Creation Act ("AJCA") of 2004 are also of concern. With the passage of the AJCA, Congress enacted limitations on the deductibility of losses from future sale-in/lease-out ("SILO") transactions. Effective March 14, 2004, deductions from property leased to a tax-exempt entity were limited to the taxpayer's gross income generated from the lease for that tax year. Significantly, Congress made clear at the time that this change to the tax law would be applied only on a prospective basis.

Prior to the passage of the AJCA, several issues impacting the effective date of the new provisions were debated. These included: (1) the fact that most transactions had been based on long-standing tax law; (2) that several transactions were in mid-stream and a loss of tax benefits would have negatively impacted them financially; and (3) that the effective date for any such change in the law should be prospective. As a result of these considerations, the final version of AJCA included appropriate grandfathering for transactions entered into before March 12, 2004.

Now, three years later, the Senate is attempting to change the effective date. If enacted, the net effect will be a retroactive tax increase on banks, punishing them for entering into transactions that were, in some cases, crafted many years ago.

We would like to thank the committee for holding this hearing and giving us the opportunity to comment. Additionally, we look forward to working with you on these and other issues during the 110th Congress. For further details on ABA's positions on these important issues, please contact either Larry Seyfried by phone (202) 663-5322, or e-mail larrys@aba.com, or Lisa Bleier at (202) 663-5479 or by e-mail at lbleier@aba.com.