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Fourth Quarter 2010

Matters of Interest
Executive and Director Benefits and COLI

Tax Bill Signed

President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 on December 17, 2010 (the "Tax Bill"). The Tax Bill, among other things, temporarily extends Bush-era tax cuts for two more years.

Specifically, the bill provides for:

- The temporary extension of the 10% (lowest) bracket. The temporary extension of the 25%, 28%, 33%, and 35% brackets.
- The temporary repeal of the Personal Exemption Phase-out ("PEP") and itemized deduction ("Pease") limitation. The proposal extends the repeal of PEP and Pease for an additional two years, through 2012.
- The temporary extension of the 15% (and lower) capital gains and dividend rates. Under current law, the capital gains and dividend rates for taxpayers below the 25% bracket is equal to zero percent. For those in the 25% bracket and above, the capital gains and dividend rates will remain 15% for an additional two years, through 2012.
- Two-year AMT patch. The Tax Bill increases the AMT exemption amounts for 2010 to $47,450 (individuals) and $72,450 (married filing jointly) and for 2011 to $48,450 (individuals) and $74,450 (married filing jointly). The Tax Bill is effective for taxable years beginning after December 31, 2009.
- Numerous other provisions are extended, including certain employment and investment incentives (including, in the latter category, "bonus" depreciation).

Highlights

- Tax Bill Signed (no changes for tax rates in 2011)
- 409A Failures—Relief Modified and Expanded
- Revenue Ruling 2010-27 (scope of unforeseeable emergencies further explained)
- Deferred compensation soon to be required at large financial institutions?
- Current interest rate information

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- Extension of unemployment insurance and employee payroll tax cut. The unemployment insurance proposal provides a one-year reauthorization of federal UI benefits, coupled with a payroll/self-employment tax holiday during 2011 of two percentage points. This means employees will pay only 4.2 percent on wages and self-employment individuals will pay only 10.4 percent on self-employment income up to the threshold.
- The Tax Bill also sets a new exemption amount for the estate, gift, and generation transfer taxes for two years of $5 million per person and $10 million per couple through 2012. The exemption amount is indexed for inflation in increments of $10,000 beginning in 2012. The bill imposes a top tax rate of 35 percent (reduced from the 45% applicable in 2009).
- The increased estate tax exemptions and 35% rate are effective January 1, 2010, in effect making them retroactive. However, the Tax Bill provides for an election to choose no estate tax and a modified carryover basis for estates of decedents dying on or after January 1, 2010 and before January 1, 2011.
- The increased gift tax exemption takes effect on January 1, 2011.

409A Failures—Previous Relief Modified and Expanded

On November 30, the IRS expanded the corrections program for nonqualified deferral plans that fail IRC Section 409A with the release of Notice 2010-80. The notice modifies prior notices as follows:

Notice 2010-6 modifications, effective for tax years beginning on or after January 1, 2009:

- Extends the correction program to certain plans linked to another qualified or nonqualified plan so long as the linkage has no effect on time and form of payment, and to stock rights intended to comply with 409A rules.
- Provides additional correction method and transition relief for plans where the participant can accelerate or delay payment by tying payment commencement to a participant-controlled, employment-related event, such as when an employment agreement or noncompete is signed.
- For plan document corrections made before January 1, 2011, plan sponsors are no longer required to report corrections to participants and participants are no longer required to report those corrections with their federal income tax filings. However, plan sponsors are still required to report corrections on their own tax return.

Notice 2008-113 modifications, effective for tax years beginning on or after January 1, 2010:

- For 409A operational failures corrected within the same tax year as the failure occurred, the participant reporting requirement is removed. The employer, however, must still report on its tax return that it is relying upon Notice 2008-113 to make a correction.

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The IRS issued the expanded corrections program in anticipation of the plan document and operational failure corrections deadline at the end of this year. In the Notice, the IRS says they are continuing to analyze comments on correction guidance and expect to issue additional corrections guidance in the future.

Revenue Ruling 2010-27—Unforeseeable Emergencies

The IRS issued Revenue Ruling 2010-27 in November to provide guidance, in the form of three examples, on what constitutes an unforeseeable emergency under Code Sections 409A, 457(b) and 457(d)(1)(A).

The determination of whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution under section 457(d)(1)(A) is based on the relevant facts and circumstances. A distribution on account of an unforeseeable emergency may not be made to the extent the emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship), or by cessation of deferrals under the plan.

In addition, a distribution due to an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need. However, the distribution may include any amount necessary to pay federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution. A plan is not required to provide for distributions in the event of an unforeseeable emergency, and if it does, it is not required to include all of the events for which such distributions are permitted under the applicable guidance.

In all of the examples below it is assumed that all other requirements have been met. For example, it is assumed that the Participants below have no other assets to meet the described expense other than the assets they have in the deferred compensation plan.

Example 1

A Participant requests an unforeseeable emergency distribution to pay for the cost of having the Participant's principal residence repaired after significant water damage from a water leak that was discovered in the basement. The Participant provides written estimates of the repair costs.

The ruling finds that to the extent the costs are not covered by insurance this is an unforeseeable emergency under the applicable Code provisions because it is "an extraordinary and unforeseeable circumstance that arises as a result of events beyond the control of the participant and is substantially similar to the need to pay for damage to a home as a result of a natural disaster."

Example 2

A Participant requests an unforeseeable emergency distribution to pay for funeral expenses for the Participant's adult son, who is not a dependent of the Participant.

Regulations provide specifically that funeral expenses of a participant's spouse or dependent would be considered emergency expenditures. The ruling finds that, in addition to the examples

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given in the regulation, the funeral expenses of a nondependent adult son can also be paid for with a distribution based on the unforeseeable emergency provision.

This ruling might be considered surprising because the regulations specify that funeral expenses of a spouse or a dependent qualify. The failure to list nondependents could have been read to exclude nondependents from the scope of the rule.

Example 3

A Participant requests an unforeseeable emergency distribution to pay accumulated credit card debt, not due to extraordinary and unforeseeable circumstances arising from events beyond the control of the Participant.

In this case, the ruling finds that because the situation does not fit within any of the regulation's enumerated examples and does not arise out of any events beyond the control of the Participant, it does not constitute a situation justifying a distribution due to an unforeseeable emergency.

The examples seem to indicate that if there is event that occurs beyond the control of the Participant, the IRS is going to be lenient in finding a justification of an unforeseeable emergency distribution (assuming all other requirements are met). This should give Plan administrative committees some comfort that the IRS is not interested in reading the regulations in a hyper-technical manner.

Technical Note

The ruling is directed specifically at the requirements to find an unforeseeable emergency under Code Sections 457(b) and 457(d), and their implementing regulation 1.457-6(c). However, the ruling finds that the definition of unforeseeable emergency under Regulation 1.409A-3(i)(3) is substantially similar to the definition under Reg. 1.457-6(c) and accordingly finds that the principles and rulings under the revenue ruling will apply to amounts deferred under a nonqualified deferred compensation plan subject to Section 409A that may be paid upon an unforeseeable emergency.

Deferred Compensation to be Required at Large Financial Firms?

The Wall Street Journal reports that the Federal Reserve, Securities and Exchange Commission and other federal banking agencies are considering requiring large financial firms to award half or more of executives' pay in the form of stock or other deferred compensation. The discussions are a result of a provision in the Dodd-Frank financial overhaul law enacted last summer. The provision instructs regulators to prohibit and compensation arrangement that "encourages inappropriate risks" at financial firms with more than $1 billion in assets. (http://online.wsj.com/article/SB10001424052748703886904576032050259562540.html?mod=WSJ_hps_sections_business—subscription required).

European Union regulators approved restrictions on incentives for excessive risk-taking in December, imposing limits both on cash payouts and the size of bankers' bonuses. The rules will allow bankers to receive about 25 percent of their bonuses in cash and require the rest to be deferred or held in shares for a minimum of three years.

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The United Kingdom's Financial Services Authority followed suit in mid-December and will require that a firm must not award, pay or provide a variable compensation component unless a substantial portion of it, which is at least 40%, is deferred over a period which is not less than three to five years. In addition, at least 60% of variable compensation of a particularly high amount (over £500,000) must be deferred. The U.K. rules breaks firms into four different tiers with differing rules applying to the different tiers. The two lower tiers (including for example, any U.K. bank with less than £50 million in capital resources) may not be required to defer variable compensation at all.

In light of the recent actions in Europe and England, it would not be surprising to see deferral of some portion of incentive compensation be required by U.S regulators at larger U.S. banks and, perhaps even, at other large financial firms.

Rate Information

Moody's Long-Term Corporate Bond Yields

	11/30/2010	HIGH—PAST 12 MONTHS	LOW—PAST 12 MONTHS	NOVEMBER AVERAGE	OCTOBER AVERAGE
Average—all risk ratings	5.29%	5.86%	5.05%	5.37%	5.15%

U.S. Consumer Price Index

		PERCENT CHANGE FROM	
	NOVEMBER 2010 INDEX LEVEL	OCTOBER 2010	NOVEMBER 2009
All items	218.803	—	1.1
Core	222.077	—	0.8

Prime Rates (U.S. Effective Date: December 16, 2008)

			52-WEEK	
	LATEST	WEEK AGO	HIGH	LOW
U.S.	3.25	3.25	3.25	3.25

London Interbank Offered Rate, or Libor (December 21, 2010)

			52-WEEK	
	LATEST	WEEK AGO	HIGH	LOW
One month	0.26063	0.26063	0.35406	0.22813
Three month	0.30281	0.30188	0.53925	0.24875
Six month	0.45719	0.45619	0.76113	0.38250
One year	0.78325	0.78375	1.22413	0.75525

Source for CPI, prime rate, and LIBOR: http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html (accessed December 22, 2010).

The information incorporated into this presentation has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy.

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