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Deferred Compensation under the Tax Reform Act of 1969

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EXECUTIVE compensation covers a broad range of benefits, including current cash payments, stock bonuses and options in their various forms, qualified pension plans, life insurance and even such fringe benefits as use of company provided automobiles and aircraft. A significant portion of the compensation picture encompasses contracts and plans which defer the receipt of income until a taxable period later than the period to which the services giving rise to the compensation are related. Although only one of many compensation devices, deferred compensation is of considerable importance to American industry as a form of executive pay. A recent study of executive remuneration of the Fortune "Top 100" industrial companies showed that fifty-nine of the companies offered their executives some form of deferred compensation contract or plan.

The Tax Reform Act of 1969 has occasioned the reevaluation of a number of existing tax planning devices, including deferred compensation plans. The present analysis will concentrate on the status of certain commonly used deferred compensation arrangements in light of changes made by the Tax Reform Act. The tax status of the recipient will be emphasized with only passing examination given to the employer's deductions.

I. Deferred Compensation and Its Objectives

The main reason for the existence of deferred compensation is found in Section 1 of the Internal Revenue Code which establishes (absent the Tax Reform Act changes) rates ranging as high as seventy per cent on taxable income. Given high tax rates, there is an incentive for tax planners and their corporate clients to develop means of reducing the impact of the tax. Thus, the basic idea of deferred compensation is, first, to have compensa-
tion taxed at a lower rate than it would be if received currently. This objective can be accomplished by either deferral until retirement or, where the compensation is uneven, because of a bonus, for example, deferral to a later year to get an income averaging effect.  

Since it achieves its first goal by postponing the tax, deferred compensation sometimes also seeks, as a second objective, to provide a tax sheltered growth of the funds available for eventual distribution. If the funds allocated for compensation can be set aside for investment without being diminished by tax payments, the greater investment leverage can significantly increase the total dollars available for ultimate distribution. The dual objectives of deferred compensation are, therefore, tax sheltered investment growth and taxation of income at lower rates. Deferred compensation seeks to protect against present tax at high rates in favor of later taxation at lower rates.

The types of deferred compensation plans are extremely varied and individualized and may or may not include both of the basic benefits. They may take the form of individual contracts or a general plan covering a group of executives. It is also common for companies to have different plans for different groups of employees. The arrangement is often tied to the employee’s continued service with the company or to an agreement not to compete if he does leave the company. Further, deferred compensation plans may have incentive elements related to company earnings, dividends, stock performance or a combination of factors. Phantom stock, a method of deferred compensation which credits an employee’s deferred account with amounts equivalent to shares of company stock which, hopefully, grow prior to the time of payment and sometimes accumulate dividends as well, is a frequently used deferred compensation device.

Many of the basic provisions of deferred arrangements, however, are part of the effort to assure the deferral of tax. To see the evolution of the arrangements and the basic requirements for reaching the desired tax planning goal requires some history.

II. The Basic Rules—Revenue Ruling 60-31 and Friends

There are two problems for the tax attorney in formulating a successful

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3 IRC §§ 1301-1305, the income averaging provisions, effective for 1964 and later years only somewhat reduced the importance of this latter deferral.

4 The third desired effect is, of course, to produce capital gain treatment on some or all of the final payment. This is the basic idea of the stock related forms of compensation (e.g., restricted stock, options, etc.). Qualified pension plans also have some of this element.
deferred compensation arrangement. They are constructive receipt and economic benefit. The problems arise simply from the fact that the compensation is earned now but paid later.

The general rule for inclusion in income is that

\[
\text{[t]he amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer.} \ldots^5
\]

However, the Regulations incorporate the constructive receipt doctrine:

Income although not actually reduced to a taxpayer’s possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer’s control of its receipt is subject to substantial limitations or restrictions.\ldots^6

The regulation cites examples of constructive receipt but they are not in terms helpful in the deferred compensation area. Thus, the problem of what are “substantial limitations or restrictions” is raised by the regulation but not answered.

In several early cases the taxpayers achieved considerable success in overcoming constructive receipt arguments made by the Internal Revenue Service. The two *Veit* cases\(^7\) illustrate this success. The first case involved an employment contract which Veit had with his employer, pursuant to which he received a salary plus ten per cent of the net profits of the corporation for the two years covered by the contract. The compensation was to be paid in the year following the second year of the profit determination, and, in order for Veit to be entitled to the additional compensation, he was required to remain with the company for the entire two-year period of the contract. During the second year, the taxpayer and the company entered into a second agreement pursuant to which the compensation due under the bonus arrangement was deferred one year more. Then, before the time at which his rights matured under the amended contract, Veit and the corporation entered into an agreement to defer the payments over a five-

\(^5\) IRC § 451(a).


\(^7\) *Howard Veit*, 8 T.C. 809 (1947); *Howard Veit*, 8 T.C.M. 919 (1949).
year period. In the first case the Commissioner argued that the taxpayer had constructively received the amounts to which the employment contract related as of the year in which the first deferral was made. The Tax Court refused to find constructive receipt because the taxpayer and the corporation had entered into an “arm’s length business transaction” prior to the time the taxpayer’s right to receive the payments had matured.\(^8\)

In the second Veit case, the court concentrated on the second deferral agreement which called for payment of the compensation in installments over a period of five years. Again, the court refused to find constructive receipt. It observed that “there was never a time when the [amount] was unqualifiedly subject to . . . demand or withdrawal.”\(^9\) Thus, in the view of the Tax Court, so long as the agreement to defer was made prior to the time the rights to receive payment under an employment contract matured, the doctrine of constructive receipt would not apply. The Internal Revenue Service acquiesced in the first case.\(^10\)

These cases indicated one helpful rule—the deferral can be made after the compensation is earned so long as it is made before the right to receive arose and providing that it is not a subterfuge.\(^11\)

In 1960 the Service issued its first substantive statement in the area, Revenue Ruling 60-31\(^12\) which sets the basic pattern within which deferred compensation operates. Because it is the chief pronouncement of the Service and because subsequent development of deferred compensation followed its outline, it deserves special attention here. The ruling described five factual situations involving deferred arrangements and, citing Section 1.451-1(a) and Section 1.446-1(c)(1)(e) of the Regulations, determined that “the question for resolution is whether in each of the situations described the income in question was constructively received in a taxable year prior to the taxable year of actual receipt.”\(^13\)

The ruling, in discussing constructive receipt, used the following language to set its standards:

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8 8 T.C., supra note 7, at 818.
9 8 T.C.M., supra note 7, at 919, 922.
11 Interestingly, the court was untroubled by the fact that the corporation, on the accrual basis, could sustain a deduction in an earlier year than the cash basis recipient reported income. Howard Veit, supra note 7, at 922. But see IRC § 404(a)(5), which now provides to the contrary.
13 Id. at 177.
In short, the question is factual under the substantial limitations test of the regulation. Having outlined the law in such general terms, the ruling considered each of the five situations.

In the first illustration, the taxpayer and a corporation had executed a five-year employment contract under which the taxpayer received a stated salary, plus additional annual compensation in a fixed amount. The additional compensation was credited to a bookkeeping reserve to be paid in equal annual installments over a five-year period beginning with the termination of the taxpayer's employment. The ruling specifically stated that the corporation was under a mere contractual obligation to make the payments when due and no trust was intended. The contract also provided that, if the taxpayer failed or refused to perform his duties, the corporation's obligation was relieved as to additional contributions to the reserve. The contract contained no provision for forfeiture by the employee, and, on his death, the remaining balance would be distributed to his estate. The ruling held that under this arrangement the additional compensation would be taxable only as actually received.

The second factual situation involved a more general plan to make future payments of additional compensation for current services to a number of key employees designated by the company's board of directors. The amount of additional compensation depended on a percentage of annual net earnings in excess of a prescribed figure. The amount so allocated was set up in a separate account for each participant and distributions from the account were made when the employee reached sixty years of age or was no longer employed by the company. Distributions were made over a period of years and the employer's obligation was contingent upon the employee's refraining from competitive activities and remaining available for consultation. In the event of death, distribution would be made to the employee's estate. Again, it was specifically provided that the corporation

\[14\] Id. at 177-78.
had a mere contractual obligation to make the payments and no trust was intended. As with the first situation, the ruling held that the deferred compensation would be includable only when actually received. The ruling took pains to emphasize that neither arrangement constituted a trust, and both were accordingly distinguishable from cases involving trust arrangements and to the situation to which Section 1.402 (b)(1)(a)(1) refers.15 Aside from this reference to trust characteristics, the ruling did not discuss the Service's reasoning concerning the first two cases nor did it disclose what facts the Service considered relevant in deciding that constructive receipt did not occur in them.

The third case involved an agreement between an author and a publisher. The taxpayer granted to the publisher the rights to his book, and, pursuant to the agreement, the publisher agreed to pay specified royalties based on receipts from the sale of the work. At the same time, a second agreement was entered into providing that in consideration of the first contract the publisher would not pay the taxpayer more than a specified sum in any one calendar year. Any amounts in excess of that sum would be carried over into succeeding years. Again, the ruling on deferral was favorable, noting that the supplemental agreement was made before the royalties were earned. Thus, the royalties were held includable in income only as actually received.

The two remaining cases involved in the ruling related to bonus arrangements. In the fourth situation the taxpayer was a football player who entered into a two-year contract for a specified salary. In addition, it was agreed that he would be paid a bonus in a specified amount. The ruling stated that the taxpayer could have demanded and received payment of the bonus at the time of signing the contract. Instead, however, the taxpayer arranged that the bonus should be paid to an escrow agent designated by him subject to the company's approval. The escrow account was in the taxpayer's name, payments were made subject only to the escrow agreement, and, in the event of death, the amount was to be paid to the taxpayer's estate. The ruling held that the bonus payment was taxable in the year paid to the escrow agent. It distinguished this case from an earlier ruling16 which had held a baseball player's bonus taxable when received on the grounds that payment to the escrow agent gave the taxpayer economic control over the amount. The ruling cited E. T. Sproull v. Com-

missioner, which relied not on constructive receipt but on the economic benefit theory to tax an amount contributed to a trust for the benefit of a taxpayer.

The fifth case described in the ruling involved a boxer who entered into an agreement with a boxing club under which he was to receive a percentage of the gross receipts from a fight. At the same time, a separate agreement was executed providing for payment of the taxpayer’s share over a four-year period. In this case the Service found that the agreement constituted a joint venture. Thus, the taxpayer was not an employee of the club, and, consequently, the ruling held that his share of the gross receipts belonged to him all along. Having all the benefits of his share, the boxer was taxable immediately.

The principles of this ruling are very difficult to adapt to factual situations other than those described in it, particularly since the ruling emphasized that constructive receipt and the realization of economic benefit are basically factual determinations. The ruling did, however, lay down some guidelines. For example, it indicated that amounts credited to deferred compensation accounts should remain assets of the employer rather than being set aside in separate accounts or trusts. Establishing an escrow account is similarly undesirable. On the other hand, an absence of forfeiture provisions in the deferred compensation contract is not fatal. Particularly in the last instance the ruling eliminated the need for provisions which had commonly been included in deferred compensation contracts prior to its issuance.

Disappointingly, Revenue Ruling 60-31 announced a no-ruling policy which left uncertainty in the area and was not changed until 1964.

Revenue Ruling 60-31 remained the basic statement of the Internal Revenue Service position until fairly recently when a series of additional rulings broadened the scope of the deferred compensation rules. Because the need to assure tax deferral leads to caution in drafting plans and contracts within the bounds of Service policy, the law of deferred compensation finds its basic voice in such rulings rather than in litigation. Examination of the rulings thus is necessary for an understanding of the permissible in deferred compensation.

Precision in describing what characteristics of a deferred compensation

17 16 T.C. 244 (1951), aff’d, 194 F.2d 541 (6th Cir. 1952).
18 But see Ray S. Robinson, 44 T.C. 20 (1965); Rev. Rul. 70-435, 1970-34 Int. Rev. Bull., at 12, which have revised this holding.
arrangement would be acceptable was not particularly advanced, however, by Revenue Ruling 67-449.20 There the deferred compensation plan involved supplemental compensation awards payable over a four-year period. The rights of the employee to each installment would accrue only if “during the entire period from the making of the award until December 31 of the year preceding that in which such installment is payable, he has earned out such installment.” To earn the installment the employee must continue in the employ of the company, or, if his employment is terminated, he must refrain from engaging in competition or entering the service of a competing company and must make himself available to consult with the company. The employee had a further election to defer the payment of each installment until after termination of employment, providing that he met the same conditions until the time at which payment was to be made. This latter election had to be made not later than December 15 of the year preceding the year in which each installment would otherwise be payable. With regard to this arrangement, the ruling held:

... in view of the substantial forfeiture provisions set out in this non-qualified deferred compensation plan, compensation deferred thereunder will be taxable only in the taxable year in which it is actually received unless otherwise made available to the employee at an earlier date.21

The deferral in this ruling is not surprising in view of the standards of Revenue Ruling 60-31. What is surprising, in view of the statement in the former ruling that such provisions would not be required, is the apparent reliance on the forfeiture provisions in the plan as a requirement for deferral. It has been suggested that the Service did not intend to change the standards promulgated in Revenue Ruling 60-31.22 It is, however, very difficult to reconcile this view with the ruling’s statements of reliance on forfeiture provisions.23 What was becoming clear is the extent to which an employee may be allowed to go in making a series of elections as to his time of receipt of deferred compensation awards provided such elections are made prior to the year in which his rights mature.

The Service has also indicated that some types of funding to protect deferred compensation awards of an employee will be permitted, notwith-

21 Id. at 174.
standing the language of Revenue Ruling 60-31 in connection with the absence of trusts for the benefit of the employee and the unfavorable result in the escrow situation. In Revenue Ruling 68-99, the taxpayer and the employer executed an employment contract under which the taxpayer at retirement would receive a specified monthly payment for life. The employer, after the employment contract had been entered into, made a contract with an insurance company for life insurance on the employee in order to insure that funds would be available to pay the pension. All rights under the insurance policy were retained by the employer and the proceeds were payable only to the employer. The ruling held that the contract did not result in the recognition of income by the employee since the insurance contract did not produce a present economic benefit and that income would be incurred only as payments under it were actually made to the taxpayer. Unlike the football player's escrow account in Revenue Ruling 60-31, the control over the policy was retained by the employer. As a result, the economic benefit doctrine did not produce taxable income. This ruling accordingly opened the use of insurance as a protective funding medium for deferred compensation so long as the employee did not obtain control of the policy.

Two rulings in 1969 were concerned with more typical deferred compensation arrangements. Revenue Ruling 69-649 discussed a situation where the employer awarded an annual incentive bonus to certain key employees and normally paid such awards in cash. During 1967, however, the employer approved a supplementary retirement plan under which part or all of an incentive award could be paid in the future, the deferral being made at the sole discretion of the committee determining the amount of the award. The employee was not given an election as to whether the award would be deferred or not, that determination residing entirely in the committee. The facts further stated that the corporation's obligation was merely contractual without any funding, although no further services were required to receive the award. The ruling held that any deferred bonus award would not be includable in income in the year earned, but would be included only in the taxable year actually received. This ruling indicates that the Service will not require any additional services between the time the award is earned and the time it is paid in order for deferral to take place. This would seem to indicate that the forfeiture provisions and the additional

24 1968-1 CUM. BULL. 193.
employment requirements referred to in Revenue Ruling 67-449 would not be required for favorable ruling.

Revenue Ruling 69-650 similarly involved a general employment contract made available to a group of employees earning a specified amount of compensation. Pursuant to the contract, each executive could elect to defer receipt of a portion of his scheduled salary. Election was made before the beginning of the year to which the salary related and, pursuant to it, the employee could elect to defer either five or ten per cent of his salary. Where an election was made, the corporation established a deferred compensation account for each employee, but the ruling specifically stated that the amounts deferred were to be satisfied from general corporate funds subject to the claims of the creditors. Again, the facts of the ruling did not state any continuing obligation on the part of the employee to be available for consultation or similar services. Distribution was to be made in installments following termination of regular employment. In this case, the ruling held that the deferred portion of the employee's salary was not includable in income in the year earned, but its inclusion was deferred until the year in which it was actually received or made available to him. Thus, the deferred portion need not be a special amount but may constitute a portion of an employee's regular salary, provided the election is made before the year in which the salary is earned. Again, the Service will probably not require the performance of any continuing services, provided that the arrangement is not funded.

The pattern of rulings following Revenue Ruling 60-31 establishes a very broad scope for deferred compensation arrangements. The rulings give substantial latitude to corporations and employees in making the elections, and they do not, at least in the case of nonfunded plans, require continuing services or forfeiture provisions.

Restricted stock, while not strictly deferred compensation within the limited scope of this analysis, applies comparable rules, and the development of restricted stock as a compensation device was significant in terms of motivating Congress to make changes in the Tax Reform Act. The basic restricted stock rules are set out in Revenue Ruling 68-86. The ruling poses the case of an agreement between a corporation and its employee under which the employee received a base salary plus an annual bonus. The employee could elect prior to the beginning of each year to have all or part of the bonus awarded to him in restricted stock. The shares of such stock

26 Id. at 107.
were stamped with a legend stating that they could not be sold, assigned, transferred, discounted or pledged as collateral without the prior written consent of the salary committee of the employer's board of directors. These restrictions continued during the term of employment and lapsed a specific number of years after the termination of employment. The corporation's salary committee could, in its judgment, approve a release from the restrictions in the case of hardship. The ruling determined that these restrictions had a significant effect on the value of the stock. Thus, pursuant to the rules of Section 1.421-6(d)(2) of the Regulations, compensation would be realized by the employee when the restrictions lapse or when the stock is sold, whichever happens first.

Accordingly, the election by the employee . . . to have all or part of any bonus awarded him for that year paid to him in stock of his employer corporation that is subject to restrictions which have a significant effect on its value, will result in the realization of compensation by the employee at the time the restrictions on the stock lapse, or the stock is sold in an arm's length transaction, whichever event occurs earlier.28

The restricted stock ruling opened an active new area in the deferred compensation field.29 As will be noted, however, this area of deferred compensation was quickly foreclosed, or at least limited, by the Tax Reform Act.30 It would also appear from the ruling, however, that a provision permitting an employee to receive compensation otherwise deferred pursuant to a hardship provision in the plan will not prevent the plan from resulting in deferral of income. The Service may be reluctant to rule in this area in the absence of specific statements of the conditions in which hardship will be found.

III. The Tax Reform Act

One of the most significant things about the Tax Reform Act in the deferred compensation area is what it did not do. The proposed provision on deferred compensation contained in the House version of the Act31

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28 Id. at 185. The ruling also determined that the amount of the compensation would be the lesser of fair market value determined without regard to the restrictions at the time of acquisition of the stock or the fair market value of the stock at the time the restrictions lapsed or the consideration was received on its sale.

29 See generally Childs, Restricted Stock, 46 Taxes 753 (Dec. 1968).

30 Indeed, the Treasury by proposing amendments to the Regulations sought to close it even before the Act was passed.

was omitted by the Senate. The proposed section would have continued the deferral of tax on deferred compensation arrangements but when the deferred compensation was received a minimum tax would have applied to deferred compensation in excess of $10,000 received in any taxable year. The minimum tax would have been computed by attributing the deferred income to the years in which it was considered earned and calculating tax at the rates attributable to that year. Deferred compensation would have been considered earned ratably over the employee’s entire period of service unless, under regulations to be promulgated, the payment was found properly attributable to only a portion of the period. In the alternative, the deferred compensation would have been taxed by calculating an average increase in tax for the recipient’s highest three taxable years during the last ten years of his earning period. Transitional rules made the proposed section inapplicable to deferred compensation attributable to a taxable year beginning before January 1, 1970, and also to any deferred compensation attributable to a taxable year beginning before January 1, 1974, if paid or made available pursuant to a binding contract existing on July 11, 1969.  

In discussing the reasons for the proposed change, the committee report noted that, pursuant to Revenue Ruling 60-31 and its fellows, tax deferral was easily available in the case of unfunded arrangements. In the case of funded arrangements the report observed that an employee would be taxed currently on the contribution to the fund if his rights were nonforfeitable even though receipt was postponed. Looking at these two rules, the report stated that

> [i]t is anomalous that the tax treatment of deferred compensation should depend on whether the amount to be deferred is placed in a trust or whether it is merely accumulated as a reserve on the books of the employer corporation. An employee who receives additional compensation in the form of a promise to pay him that compensation in the future made by a large, financially sound, corporation, is probably as likely to receive the compensation as an employee whose deferred compensation is placed in trust.  

The arguments for and against this proposal were summarized by the Joint Committee on Internal Revenue Taxation and the Senate Finance

33 Id. at 90.
Committee in a document explaining the House proposals for the Senate Finance Committee. In favor of the minimum tax, it noted the argument that an employee receiving deferred compensation has really received a valuable contractual right and the proposal represented a reasonable compromise between immediate taxation and complete deferral of tax on this right. It was also argued that the distinction in the treatment of funded and unfunded compensation was not sound. Further, the income shifting possibilities were regarded as undesirable. Finally, the fifty per cent maximum tax on earned income proposed elsewhere in the bill was suggested as a factor reducing the impact of restricting deferral.

In favor of preserving the existing treatment, it was argued that deferred compensation arrangements provide a useful compensation tool for smaller and medium-sized companies and that deferred compensation benefits were valuable tax incentives. In addition, the taxation of income at tax rates applicable to years other than the year in which the income was received was regarded as undesirable. Finally, the difficulty of administering the proposal was cited.

The Senate omitted the House's proposed section on deferred compensation. The omission of this section from the Tax Reform Act was sustained in conference.

In short, the House enacted a middle-ground proposal for taxing deferred compensation plans. Tax would have been deferred but would have been imposed when the compensation was received at the rates which would have applied if it had been taxed when earned. In supporting the omission of the proposed section before the Senate Finance Committee, Assistant Secretary of the Treasury for Tax Policy Cohen indicated that the Treasury believed that the deferred compensation area required additional study with a view towards determining a better solution to the problems in the area than the proposed provision.

The most important thing that the Tax Reform Act did do to deferred compensation was to enact Section 1348 of the Code establishing a fifty

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per cent maximum rate on earned income. For the highest-paid executives, the advantages of deferred compensation may be substantially limited by the availability of the new fifty per cent tax. The new fifty per cent tax rate ceiling, compared to the prior top rate of seventy per cent, is of fairly limited application, however, because on a joint return the fifty per cent rate is reached only for taxable income in excess of $52,000. Considering deductions and personal exemptions, substantial savings on current income produced by the reduction of the maximum rate on earned income will not be significant for very many individuals. For the more modestly paid, the advantage of deferring compensation into years after retirement will continue to be significant.  

The maximum tax section has another effect on deferred compensation resulting from the fact that the maximum rate applies only to earned income as it is defined in the section. Earned income expressly does not include "any deferred compensation within the meaning of Section 404." Since the latter section includes any compensation paid or accrued on account of any employee under a plan deferring the receipt of such compensation, most types of deferred compensation will be excluded from the earned income provisions when received. On the face of the provision, therefore, an executive whose income is high enough at the time deferred compensation is received would have a detriment from deferring compensation into a later year since the deferred compensation could be taxed at rates higher than fifty per cent, compared to taxation at a maximum of fifty per cent if received in the year earned.

There is an important exception to this, however, since "deferred compensation does not include any amount received before the end of the taxable year following the first taxable year of the recipient in which his right to receive such amount is not subject to a substantial risk of forfeiture. . . ." Thus, deferred compensation received by the end of the year after the year in which there is no longer a risk of forfeiture is still subject to the fifty per cent maximum tax.

Substantial risk of forfeiture is a term added to the tax law by the new provisions on restricted stock. A substantial risk of forfeiture exists under

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39 IRC § 1348(b)(1).
40 IRC § 404(a).
41 IRC § 1348(b)(1).
42 IRC § 83(c)(1).
that section if a person's rights to property are conditioned upon future performance of substantial services. Until regulations are issued, it will not be clear what the parameters of this provision are but, as has previously been noted, deferred compensation frequently does not involve any requirement for additional services in years after that in which the deferred compensation is earned. 43 In order, therefore, to make available a distribution of deferred compensation qualified for the fifty per cent maximum tax, the deferred compensation arrangement would have to be tailored to require performances up to the year or years in which payment is available. On the other hand, by definition, a deferral for not more than one year past the year in which earned would not be excluded from the fifty per cent maximum tax rules.

Another change made by the Tax Reform Act which affects the deferred compensation area is the new limitation on the use of restricted stock. Under newly enacted Section 83, the excess of the fair market value of restricted property (determined without regard to the restrictions) in excess of the amount paid for the property is included in income in the first taxable year in which the rights of the taxpayer are transferable or are not subject to substantial risk of forfeiture. The recipient may, however, elect to include the taxable amount in income in the year received. 44 This provision substantially limits the application of Revenue Ruling 68-86 45 and the provisions of Section 1.421-6 of the Regulations, by requiring that restricted stock be subject to a substantial risk of forfeiture in order for the deferral to occur. 46 The problems as to what constitutes a substantial risk of forfeiture have been noted above. Under Section 83, however, restricted stock is significantly limited, making other forms of deferred compensation more interesting.

In addition to these basic changes in the deferred compensation area, several other provisions of the Tax Reform Act must now be considered in making basic decisions as to the use of deferred compensation plans. For example, the increase in capital gains rates, 47 the inclusion of capital gains items as preference items subject to the minimum tax on preferences, 48 and

44 IRC § 83(b).
45 See note 28 supra.
46 For general discussion of this provision, see Bachelder, supra note 40, at 669 et seq. See also Summary of H.R. 13270, Tax Reform Act of 1969, 91st Cong., 1st Sess. 44 et seq. (Comm. Print 1969).
47 IRC § 1201.
48 IRC §§ 56-58.
the liberalized income averaging provisions, all need to be considered in determining the desirability of a deferred compensation arrangement for each individual.

IV. The Current Status of Deferred Compensation

Generally, while the Tax Reform Act has made a number of changes in the general area of deferred compensation which must be reckoned with in formulating new deferred compensation plans and in living with existing plans, it has not destroyed the utility of deferred compensation for most executives. The highest paid executives will want to reconsider the value of a deferral which, when received, will not qualify for the fifty per cent maximum tax on earned income unless subjected to a substantial risk of forfeiture during the interim and taken within two years after the time that restriction lapses. Where, however, earnings after retirement for an executive are not expected to approach the level at which the marginal tax rate is fifty per cent or more, deferral of compensation to that period can still be very valuable. In both cases the opportunities for delaying the imposition of the tax are still favorable in terms of increased investment leverage during the interim period.

The efforts of the House Ways and Means Committee to restrict the availability of deferred compensation at the time of the Tax Reform Act are disturbing, particularly when they are considered with the Treasury Department's promise to review the area of deferred compensation and develop specific proposals. Deferred compensation today must thus be considered in terms of possible changes in its status. One likely avenue of change would be a rule comparable to the new Section 83 which would apply to deferred compensation arrangements. Deferred compensation plans would be required to include a substantial risk of forfeiture, however that term is ultimately defined in the Regulations or by the courts. This could restrict one of the most attractive features of deferred compensation plans but would by no means end its attractiveness as an executive compensation device. Treasury or Congress may well have other ideas for limiting deferred compensation. Adoption of new deferred compensation plans and continuance of old plans must, therefore, be made with the expectation of watching changes in the legislative area very closely. Until such changes are made, however, deferred compensation remains a very useful device for executive pay.

40 IRC § 1302.