WILLKIE FARR & GALLAGHER

CLIENT MEMORANDUM

PROPOSED LEGISLATION WOULD AFFECT TAXATION OF DEFERRED COMPENSATION BENEFITS FOR EXECUTIVE OFFICERS, DIRECTORS AND 10% SHAREHOLDERS

Legislation has been introduced in the House of Representatives (H.R. 5095, the "American Competitiveness and Corporate Accountability Act of 2002") that would significantly change the taxation of benefits provided to executive officers, directors and 10% shareholders under nonqualified deferred compensation plans maintained by many corporations. The bill is one of several legislative measures proposed in response to the Enron bankruptcy and other recent corporate scandals. The prospects for passage of the bill are unclear at this time, but bipartisan support appears to be present in Congress.

If enacted, the bill would require that benefits for affected participants under a nonqualified deferred compensation plan that are "funded," such as through a "rabbi" trust, be taxed on the date the benefits are no longer subject to a "substantial risk of forfeiture" (i.e., when the benefits vest). Because most executive deferred compensation plans provide for immediate vesting, plans that fund benefits through rabbi trusts could no longer be used to defer compensation for affected participants (i.e., the benefits would be taxed immediately). The bill would not affect the tax consequences under deferred compensation plans where the corporation sets aside assets not held in trust, so long they remain general assets of the corporation and are at all times available to satisfy the claims of the corporation's general creditors.

The bill would also limit the events upon which a nonqualified deferred compensation plan could distribute benefits. As proposed, plan benefits would become taxable when vested, unless the plan allows for distributions to be made only on the date of the participant's separation from service, death or another specific date. Plans that provide for acceleration of distributions upon certain events, such as upon a change of control, disability or hardship, would result in taxation of plan benefits when they vest.

Not all plan participants would be affected by the proposed legislation. As drafted, the bill would apply only to individuals who are subject to section 16(a) of the Securities Exchange Act of 1934, or who would be subject to that section if the corporation were a public corporation. In general, this would include directors, 10% shareholders and certain executive officers (i.e., the chief executive officer, chief financial officer, controller, any vice president in charge of a principal business unit, division or function, and any other person who performs a similar policy-making function).

As currently drafted, the bill would be effective with respect to compensation deferred after July 10, 2002. Although a later effective date may apply if the bill is ultimately enacted, corporations may want to consider the consequences the proposed legislation could have for an existing deferral program or one that is about to be adopted. For example, corporations should consider not using a rabbi trust to fund amounts deferred by affected participants after the

proposed effective date. Such amounts could instead be held as a general asset of the employer until the final outcome of the bill has been determined. Corporations taking such actions should review the terms of the relevant plan to determine whether plan amendments are necessary.

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If you have any questions regarding the proposed legislation, please call Frank A. Daniele at (212) 728-8216 or Peter J. Allman at (212) 728-8101.

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