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September 20, 2016 (rev'd September 26, 2016)

Submitted via hand delivery on September 20, 2016

DEPARTMENT OF THE TREASURY
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224
Attn: Gregory Burns and Regina Johnson

Re: CC:PA:LPD:PR (REG-123854-12) - Application of Section 409A to Nonqualified
Deferred Compensation Plans

Dear Mr. Burns and Ms. Johnson:

Please accept my submission of this comment letter to the Internal Revenue Service in respect of its June 2016 proposed regulations to clarify or modify certain provisions of the final regulations under section 409A of the Internal Revenue Code.

Specifically, this comment letter recommends that the IRS consider issuance of additional guidance to clarify whether nonqualified deferred compensation amounts payable in a future year may be accelerated and/or waived currently, in order to satisfy repayment obligations in respect of other, unrelated compensation that is subject to clawback pursuant to an excess incentive compensation recovery policy adopted in accordance with and pursuant to applicable Federal law and the listing rules of a national securities exchange and association, without adverse tax consequences under section 409A to the taxpayer to whom the clawback obligation applies.

I. EXECUTIVE SUMMARY

On June 22, 2016, the Treasury Department and the IRS proposed certain clarifications and modifications to the final regulations and the proposed income inclusion regulations under section 409A.¹ These proposed regulations address a variety of distinct provisions under section 409A, each with emphasis on a narrow and specific application of the regulations.

Two of the discrete modifications proposed by the IRS would expand the scope of existing relief under the existing regulations under section 409A in order to facilitate compliance with, or avoid

¹ Dept. Treas., Internal Revenue Service, "Application of Section 409A to Nonqualified Deferred Compensation" (81 FR 40569) (June 22, 2016), at 40570-40571.

violation of, applicable law. First, the proposed regulations would expand the exception to the general prohibition on acceleration of payment of nonqualified deferred compensation for compliance with a *bona fide* foreign ethics or conflicts of interest law, to permit acceleration of all types of nonqualified deferred compensation (and not merely certain types of foreign earned income as set forth in the existing regulations).² Second, the proposed regulations would extend to short-term deferral payments the exception to the general rule prohibiting changes in the time and form of payment of deferred compensation where making the payment on the payment date designated in the applicable plan would violate Federal securities laws or other applicable law, provided that payment is made as soon as reasonably practicable following the date on which the service recipient anticipates that no violation would occur.³

However, neither of these modifications would clarify whether taxpayers could relinquish rights to future payment of deferred compensation in order to satisfy clawback requirements imposed on unrelated compensation to the extent required under Federal securities law or stock exchange listing standards, nor address whether compensation recovery requirements imposed by the SEC and/or applicable stock exchanges fit within the scope of the ethics or conflicts laws exception. This is particularly noteworthy in anticipation of requirements that public companies develop and implement excess incentive-based compensation recovery policies under The Dodd Frank Act.

II. CLAWBACK POLICY REQUIREMENTS UNDER SECTION 954 OF THE DODD-FRANK ACT

Among the many provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) that directly impact compensation, Section 954 generally directs the SEC to issue rules requiring the national securities exchanges and associations to prohibit the listing of any security of an issuer that has not developed and implemented policies to recover certain excess incentive-based compensation upon an accounting restatement required as a result of a material failure to comply with applicable financial reporting requirements, to the extent that such compensation was based on the erroneous data.⁴

² Proposed Treas. Reg. 1-409A-3(j)(4)(iii)(B).

³ Proposed Treas. Reg. 1-409A-1(b)(4)(ii). If adopted, payments that would otherwise be made after the end of the applicable 2-½ month period may still qualify as short-term deferral payments if the service recipient reasonably anticipates that making the payment during the applicable 2-½-month period would violate Federal securities laws or other applicable law, provided that payment is made as soon as reasonably practicable following the date on which the service recipient anticipates that no violation would occur.

⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 954, 124 Stat. 1376, 1514 (2010).

Proposed rulemaking released by the SEC in July 2015 generally would apply Section 954 of the Dodd-Frank Act broadly to nearly all public company issuers, and would restrict the use of issuers' discretion in their application of those principles and rules.⁵

The proposed SEC rulemaking would give issuers flexibility in how to accomplish recovery, accepting that the appropriate means of recovering compensation may vary depending on the issuer and the type of compensation subject to clawback.⁶ However, the SEC cautioned that notwithstanding this flexibility, recovery should occur reasonably promptly, and undue delay to recover compensation would constitute noncompliance with the mandated clawback policy in violation of Rule 10D-1.⁷

III. OFFSET OF DEFERRED COMPENSATION UNDER SECTION 409A

The Dodd Frank clawback requirements raise potential issues under section 409A, since section 409A generally treats an offset or reduction of a future obligation to pay deferred compensation as an impermissible acceleration of the payment of such deferred compensation in violation of the rules (other than certain *de minimis* offsets),⁸ and would immediate income recognition and an additional 20% tax on impermissible payments on the service provider.⁹ Thus, an executive officer for whom clawback obligations were triggered, and who had legally binding rights to payment of unrelated nonqualified deferred compensation in the future, generally could not use his or her deferred compensation entitlements in order to repay amounts of excess incentive compensation before such amounts would otherwise be paid without adverse tax consequences under section 409A.

This is particularly concerning for two reasons: First, an issuer may be faced with a difficult choice of whether to impermissibly accelerate deferred compensation (with penalty to the executive officer) or risk a potential Rule 10D-1 violation for failure to recover excesses pay promptly. Second, to the extent that the deferred compensation was payable in shares of company stock (such as a stock-settled restricted stock unit with a deferred settlement), or measured in whole or in part by the value of the stock (such as a phantom stock award payable in cash in the future), such a delay requires both the former executive officer and the company (i.e.,

⁵ Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 33-9861, Exchange Act Release No. 34-75342 (proposed July 1, 2015) (to be codified at 17 C.F.R. pts. 229, 240, 249 & 274) (2015).

⁶ See Securities and Exchange Commission *supra* note 4, at 75.

⁷ *Id.*

⁸ Treas. Regs. § 1.409A-3(j)(1); Treas. Regs. § 1.409A-3(j)(4)(xiii).

⁹ I.R.C. § 409A(a).

the shareholders) to assume the risk that a decline in share price would jeopardize the likelihood of full recovery of the excess incentive compensation.

Existing section 409A regulations would permit a *delay* in the time and form of payment of deferred compensation where the making of the payment on the specified payment event would violate Federal securities laws or other applicable laws, but would not appear to permit an *acceleration* of deferred compensation to comply with Federal securities laws or stock exchange listing standards.¹⁰

Further, the section 409A regulations currently include an exception to the general prohibition on acceleration of deferred compensation for “compliance with ethics laws or conflicts of interest laws,” but it is not clear whether the Dodd-Frank clawback requirements would fit within the scope of this exception.¹¹

As noted above, the June 2016 proposed regulations would expand the existing exceptions to the general rules under section 409A against modifications to the time of payment for ethics/conflict of interest rules and for Federal securities or other applicable laws. Thus, further expansion of these exceptions would be not inconsistent with the narrow and specific focus of the proposed rules.

IV. REQUEST FOR RELIEF

Enforcement of clawback policies could be facilitated through IRS guidance or relief to permit deferred compensation to be used to satisfy current repayment obligations to comply with Federal securities laws or stock exchange listing standards without adverse tax consequences under section 409A. Permitting a service provider to settle a clawback obligation by agreeing to give up deferred compensation having a value, as of the date of settlement, equal to the excess incentive compensation, would bring closure to the company and the executive officer as to their recoupment obligations and reduce the risk of non-payment in the future due to loss of value.

Accordingly, I respectfully submit that the proposed regulations under section 409A addressing violation of Federal securities laws or other applicable laws, as well as those addressing compliance with ethics laws or conflicts of interest laws, could be further clarified and expanded to permit the acceleration of nonqualified deferred compensation to comply with Federal securities laws or stock exchange listing standards, and/or to clarify clawback policies adopted to comply with Federal securities laws or stock exchange listing standards constitute “ethics laws or conflicts of interest laws” for purposes of the applicable exception to the general prohibition on acceleration of deferred compensation of section 409A.

¹⁰ Treas. Regs. § 1.409A-2(b)(7)(ii).

¹¹ Treas. Regs. § 1.409A-3(j)(4)(iii)(B).

I urge the IRS to consider the merits and policy implications with such relief, perhaps in coordination with Securities and Exchange Commission staff. Although the IRS and/or SEC may have little sympathy for executive officers who receive “excess” pay that was not actually earned based on performance, the ability to settle compensation clawback policies promptly, without additional tax penalty, would seem to have little downside.

Of course, decisions on the requested relief could wait until additional guidance and/or rulemaking from the SEC and the exchanges becomes available or later when the applicable clawback rules effective. I recognize that any such relief raises several policy questions, including, among others:

- Whether availability of any such relief would depend upon the taxpayer to whom the clawback obligation applies not being alleged to have engaged in misconduct or otherwise have personal involvement in the restatement triggering the clawback;
- Whether relief would be available only to the extent clearly required by the Dodd Frank Act, the SEC rules and/or the exchange listing rules, or if nonqualified deferred compensation could be applied to satisfy repayment obligations under the terms of corporate clawback policies that are broader than those mandated under the statutory, regulatory and/or exchange requirements;
- Whether any such relief would apply only to vested nonqualified deferred compensation, or if relief could apply to unvested amounts; and
- Whether any such relief would be available only to the extent the executive officer’s base compensation, savings and other assets were insufficient to satisfy the repayment obligations (and if so, what thresholds would warrant relief, and under what circumstances).

Thank you for the opportunity to comment on the proposed rules. I am available to meet and discuss these matters with the IRS and its staff, and to respond to any questions.

Sincerely,

Joshua M. Miller