Growing Complaints against Highly Paid Executives Compel the Senate Finance Committee to Approve Limit on Executive Compensation Plans

In-House News:

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By Kenneth Davis

The Senate Finance Committee recently approved legislation that will place a $1-million annual limit on the amount a highly paid executive can place tax-free into a deferred compensation plan and make it more difficult for individuals to protect their compensation from creditors in bankruptcies.

Senate Finance Committee Spokeswoman Carol Guthrie said the provision, which was introduced by Senate Finance Committee Chairman Max Baucus (D-MT), was approved unanimously as part of a larger package of legislation (*The Deal*).

In response to the Enron and WorldCom scandals, the new law restricts the flexibility executives have in controlling distributions from deferred compensation plans and restricts nonqualified deferred compensations, said Senate Finance Committee Ranking Member Chuck Grassley.

The actions of the committee are, in part, a response to growing complaints that executives are receiving unusually high pay that in many cases is not aligned with performance. Pay packages like the $210-million severance package given to former Home Depot CEO Robert Nardelli have put a spotlight on these issues in Congress (*The Deal*).

The provision could raise the taxes on hundreds of executives by millions of dollars over the next 10 years. Many executives take advantage of their abilities to place compensation tax-free into deferred compensation plans. Such plans allow executives to put their income, sometimes several million dollars per year, into special accounts without immediately paying taxes. The money earns interest, which isn't taxed right away. After retirement, the executive withdraws the money and pays taxes on it, but because of the earlier tax deferrals, the account may have grown millions of dollars larger than an ordinary savings account.

The limit on the executive perk is linked, in a complex way, to a proposal to raise the minimum wage to $7.25 per hour from $5.15 per hour. Limiting the perquisite enjoyed by highly paid executives would raise $806 million over 10 years by Congressional estimates. The money would be used to help cover tax breaks for small businesses hurt by a proposed increase in the minimum wage. Raising the minimum wage, which has fallen (in inflation-adjusted dollars) to its lowest level in more than 50 years, is a top priority among Democrats.

"Congress needs to raise the minimum wage now, and this package of tax incentives will help a minimum wage increase pass the Senate and be signed into law," said Baucus.

The measure symbolizes an effort on Capitol Hill to find a new political center in a Congress that Democrats control by a narrow margin. Democrats criticized the federal budget deficit during the campaign and have pledged not to increase it. To pay for the small-business tax breaks, they came up with a plan to revoke tax provisions that they regard as corporate loopholes and tax shelters. The measure taken to limit executive compensation plans is one of a dozen other provisions aimed at limiting corporate and executive tax loopholes.

In addition to limiting deferred compensation for executives, the committee is expected to target several controversial corporate tax shelters, as well as Americans who renounce their citizenship for tax reasons. But the deferred compensation provision appears likely to generate alarm among business leaders.

Limiting deferred compensation would be "earthshaking" for American executives, said Patrick McGurn, Executive Vice President of Institutional Shareholder Services in Rockville, MD, in a *Free Internet Press* article.

"A lot of executives are deferring the lion's share of their compensation these days," McGurn added. "And the typical executive at a Fortune 100 company makes well over $1 million. So there is a huge amount of compensation that would go into deferral accounts that could not be deferred if the tax code were changed."

Some business lobbyists reacted to the proposal with great skepticism.

"There are lots of technical problems with this," said Lynn D. Dudley, Vice President of the American Benefits Council and an advocate of employer-sponsored benefits. "It makes sense to me to have this discussion. Congress is sensitive to this issue, and we want to work with them. But more needs to be done to vet the practical implications of this," (*Free Internet Press*).

Other lobbyists were surprised at the measure and said they had not even known it was being discussed.

"I didn't know it was coming," said Dan Danner, Executive Vice President of the National Federation of Independent Business, a small-business lobby. "It's not something that we proposed or had anything to do with," (*Free Internet Press*).

On the Net

United States Committee on Finance
www.senate.gov/~finance/index.html

American Benefits Council
www.americanbenefitscouncil.org

National Federation of Independent Business
www.nfib.com/page/home