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REPORT
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SMALL BUSINESS AND WORK OPPORTUNITY ACT OF 2007

JANUARY 22, 2007.—Ordered to be printed

Mr. BAUCUS, from the Committee on Finance,
submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 349]

The Committee on Finance, having considered an original bill, S. 349, to amend the Internal Revenue Code of 1986 to provide additional tax incentives to employers and employees of small businesses, and for other purposes, reports favorably thereon and recommends that the bill do pass.

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EFFECTIVE DATE

The provision generally is effective for information provided on or after the date of enactment. The provision authorizing the Tax Court to adopt rules to preserve the anonymity, privacy, or confidentiality of any person that may be identified in the appeal of an award determination is effective as if included in section 406 of the Act.

N. Expand Denial of Deduction for Certain Excessive Employee Remuneration

(Sec. 214 of the bill and sec. 162(m) of the Code)

PRESENT LAW

Under present law, compensation in excess of $1 million paid by a publicly-held corporation to the corporation's "covered employees" generally is not deductible.[105] Covered employees are the chief executive officer as of the close of the taxable year and the four other most highly compensated officers of the company as reported in the company's proxy statement.

Subject to certain exceptions, the deduction limitation applies to all otherwise deductible compensation of a covered employee for a taxable year, regardless of the form in which the compensation is paid, whether the compensation is for services as a covered employee, and regardless of when the compensation was earned. The deduction limitation applies when the deduction would otherwise be taken.

Performance-based compensation is not subject to the deduction limitation and is not taken into account in determining whether other compensation exceeds $1 million. In general, performance-based compensation is compensation payable solely on account of the attainment of one or more performance goals and with respect to which certain requirements are satisfied, including a shareholder approval requirement.[106]

REASONS FOR CHANGE

The Securities and Exchange Commission recently modified the group of executives for whom compensation is required to be disclosed under the Securities Exchange Act of 1934. Given these modifications, the Committee believes that it is appropriate to delink the definition of covered employee from the Securities laws. The Committee also believes that the denial of the deduction for certain excess employee remuneration should apply to any individual who serves as the Chief Executive Officer during the year, regardless of whether that position is retained on the last day of the taxable year. Under present law, the deduction limitations for certain excess employee remuneration can be avoided by delaying payment of compensation to a year in the future in which the individual is no longer a covered employee. The Committee believes

[105] Sec. 162(m).

[106] In addition, the following types of compensation are not subject to the deduction limitation and are not taken into account in determining whether other compensation exceeds $1 million: (1) compensation payable on a commission basis; (2) payments to a tax-qualified retirement plan (including salary reduction contributions); and (3) amounts that are excludable from the individual's gross income (such as employer-provided health benefits). Sec. 162(m)(4).

that it is appropriate to continue to treat individuals as covered employees if they had been covered employees in a preceding taxable year.

EXPLANATION OF PROVISION

The provision modifies the definition of covered employee. Under the provision, covered employees include any individual who was the Chief Executive Officer of the company (or individual acting in such a capacity) at any time during the taxable year. In addition, covered employees include the four officers with the highest compensation for the year (other than the Chief Executive Officer). Under the provision, covered employees also include individuals who previously were covered employees for any preceding taxable year beginning after December 31, 2006, with respect to the corporation or any predecessor. In the case of an individual who is a covered employee after December 31, 2006, covered employees also include beneficiaries of such employees with respect to any remuneration for services performed by such employee as a covered employee (whether or not such services are performed during the taxable year in which the remuneration is paid). For example, under the provision, if the Chief Executive Officer retires in November, compensation received in the year of retirement, or paid under a deferral agreement in a succeeding year, is subject to the deduction limitations for a covered employee.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2006.

II. BUDGET EFFECTS OF THE BILL

A. COMMITTEE ESTIMATES

In compliance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following statement is made concerning the estimated budget effects of the revenue provisions of the "Small Business and Work Opportunity Act of 2007" as reported.

to the agency administering section 212(a)(10)(E) whether such taxpayer is in compliance with the new tax rules, and to identify the items of any noncompliance. Recordkeeping requirements, safeguards, and civil and criminal penalties for unauthorized disclosure or inspection apply to return information disclosed under this provision.

EFFECTIVE DATE

The provision generally is effective for U.S. citizens who relinquish citizenship or long-term residents who terminate their residency on or after the date of enactment. The due date for tentative tax, however, may not occur before the 90th day after the date of enactment. The portion of the provision relating to income taxes on gifts and inheritances is effective for gifts and inheritances received from former citizens or former long-term residents (or their estates) on or after the date of enactment, whose relinquishment of citizenship or residency termination occurs after such date. The portion of the provision relating to immigration and disclosure with respect to former citizens is effective with respect to individuals who relinquish citizenship on or after the date of enactment.

F. LIMIT AMOUNTS OF ANNUAL DEFERRALS UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS

(Sec. 206 of the bill and sec. 409A of the Code)

PRESENT LAW

Amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied.[78] The requirements include rules relating to distributions, acceleration of benefits and funding. For example, distributions from a nonqualified deferred compensation plan may be allowed only upon certain times and events. Rules also apply for the timing of elections. In general, elections to defer compensation for a taxable year must be made not later than the close of the preceding taxable year. Section 409A does not include rules limiting the amount that may be deferred under a nonqualified deferred compensation plan.

A nonqualified deferred compensation plan generally includes any plan that provides for the deferral of compensation other than a qualified employer plan or any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan means a qualified retirement plan, tax-deferred annuity, simplified employee pension, and SIMPLE. A qualified governmental excess benefit arrangement (sec. 415(m)) and an eligible deferred compensation plan (sec. 457(b)) is a qualified employer plan.

If the requirements of section 409A are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income

[78] Code sec. 409A.

when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.

Under present law, Treasury is authorized to prescribe regulations as are necessary or appropriate to carry out the purposes of the provision.

REASONS FOR CHANGE

The Committee is concerned with the large amount of executive compensation that is deferred in order to avoid the payment of income taxes. Rank and file employees generally do not have the opportunity to defer taxation on otherwise includible income in excess of the qualified plan limits. However, it is common for nonqualified deferred compensation arrangements to allow executives to choose the amount of income inclusion they wish to defer.[79] The Committee is concerned that the ability to defer unlimited amounts of compensation gives executives more control over the timing of income inclusion than rank and file employees. The Committee believes that the amount of compensation that can be deferred to avoid the payment of tax should be limited.

EXPLANATION OF PROVISION

The provision adds an additional requirement to the rules governing the income inclusion of amounts deferred under a nonqualified deferred compensation plan. Under the provision, the annual aggregate amounts deferred under a nonqualified deferred compensation plan by an individual may not exceed the applicable dollar amount for the taxable year. The applicable dollar amount is the lesser of (1) $1 million or (2) the average annual compensation payable during the base period to the participant by the employer maintaining the nonqualified deferred compensation plan (or a predecessor or related entity) and which was includible in the participant's gross income for taxable years in the base period. Earnings (whether actual or notional) attributable to nonqualified deferred compensation are treated as additional deferred compensation and are subject to the provision. Thus, such amounts are taken into account in determining whether the limit on the amount deferred is exceeded.

If the requirement is not satisfied, the present-law sanctions for failure to satisfy section 409A apply. Thus, if the requirement is not satisfied, all amounts deferred under the nonqualified deferred compensation plan for all taxable years are currently includible in gross income to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. If the requirements of the provision are not satisfied, as under present law, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a sub-

[79] See, e.g., Ellen E. Schultz and Theo Francis, As Workers' Pensions Wither, Those for Executives Flourish, Wall St. J., June 23, 2006, at A1, and Deferring Compensation Also Creates A Company Debt to Executives, June 23, 2006, at A8. Theo Francis, 'Phantom' Accounts for CEOs Draw Scrutiny, Wall St. J., June 13, 2005, at B1.

stantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.[80]

Earnings (whether actual or notional) in a subsequent taxable year on amounts included in income under the provision are includible in income in such subsequent taxable year to the extent such earnings are not subject to a substantial risk of forfeiture and not previously included in gross income. The present-law sanctions under 409A (interest at the underpayment rate plus one percentage point and a 20-percent additional tax) also apply.

The base period is the five-taxable-year period ending with the taxable year preceding the taxable year for which the limitation is being determined (the "computation year"). If, before the beginning of the computation year, an election is made to defer compensation for services performed in the computation year, the base period is the five-taxable-year period ending with the taxable year preceding the taxable year in which the election is made. For example, suppose an executive elects in 2008 to defer a portion of compensation to be earned in 2009. The base period for the 2009 computation year would be 2003 to 2007. In the case that the individual does not perform services for the employer for the entire five-year period, the base period is the portion of such period during which the individual performs services for the employer (or a predecessor employer). It is intended that the Secretary of the Treasury issue guidance similar to that under section 280G regarding the base period determination in cases in which the individual does not perform services for the employer for the entire five-year period.

As under section 409A generally, except as provided by the Secretary, aggregation rules similar to the rules under section 414(b) and (c) apply. In addition, all nonqualified deferred compensation plans maintained by all employers treated as a single employer under these aggregation rules are treated as one plan.

The provision applies to all amounts deferred under nonqualified deferred compensation plans (as defined under section 409A), including plans of both private and publicly-held corporations.

As under section 409A generally, this limitation is not intended to prevent the inclusion of amounts in gross income under any provision or rule of law earlier than the time provided in the provision. The provision does not affect the rules regarding the timing of an employer's deduction for nonqualified deferred compensation.

The regulatory authority of the Secretary of the Treasury to prescribe regulations as are necessary to carry out the purposes of section 409A generally applies to the provision. Under such existing regulatory authority, it is expected that the Secretary of the Treasury will issue guidance relating to defined benefit arrangements, including the application of the annual limitation and determination of the amounts deferred.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2006, with respect to amounts deferred after such date (and earnings on such amounts). Amounts deferred (and earnings on amounts deferred) in taxable years beginning before January 1,

[80] These consequences apply under the provision to amounts deferred after the effective date of the provision.

2007, are not subject to the provision. Taxable years beginning on or before December 31, 2006, are taken into account in determining the average annual compensation of a participant during any base period.

The provision directs the Secretary of the Treasury, within 60 days after enactment, to issue guidance providing a limited time period during which a nonqualified deferred compensation plan adopted before December 31, 2006, may, without violating the requirements of section 409A, be amended to provide that a participant may, no later than December 31, 2007, cancel or modify an outstanding deferral election with regard to all or a portion of amounts deferred after December 31, 2006, to the extent necessary to meet the requirements of the provision. Amounts subject to the cancellation or modification are currently includible in income to the participant to the extent not subject to a substantial risk of forfeiture and not previously included in income. Such guidance must also allow nonqualified deferred compensation plans adopted before December 31, 2006, to be amended to conform to the requirements of the provision with regard to amounts deferred after December 31, 2006.

G. Increase in Criminal Monetary Penalty Limitation for the Underpayment or Overpayment of Tax Due to Fraud

(Sec. 207 of the bill and secs. 7201, 7203, and 7206 of the Code)

PRESENT LAW

Attempt to evade or defeat tax

In general, section 7201 imposes a criminal penalty on persons who willfully attempt to evade or defeat any tax imposed by the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than five years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Willful failure to file return, supply information, or pay tax

In general, section 7203 imposes a criminal penalty on persons required to make estimated tax payments, pay taxes, keep records, or supply information under the Code and who willfully fail to do so. Upon conviction, the Code provides that the penalty is up to $25,000 or imprisonment of not more than one year (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $100,000.

Fraud and false statements

In general, section 7206 imposes a criminal penalty on persons who make fraudulent or false statements under the Code. Upon conviction, the Code provides that the penalty is up to $100,000 or imprisonment of not more than three years (or both). In the case of a corporation, the Code increases the monetary penalty to a maximum of $500,000.

Uniform sentencing guidelines

Under the uniform sentencing guidelines established by 18 U.S.C. 3571, a defendant found guilty of a criminal offense is sub-