MEMO

Date: March 29, 2013

From: Jonathan D. Weir, JD*

To: WFR Clients & Business Partners

Subject: American Taxpayer Relief Act of 2012 and Nonqualified Deferred Compensation Plans

The information provided below is to you to help you understand how the **American Taxpayer Relief Act of 2012** (ATRA 2012) impacts your highly compensated employees (HCEs) and the related topic of Nonqualified Deferred Compensation (NQDC) plans.

The Key items to note that are effective as of January 1, 2013

- At AGI of over $450,000 (joint) and single taxpayers over $400,000, there is a new tax bracket of 39.6% and other existing brackets are now permanent
- Capital Gains have been increased to 20% from 15% at the above thresholds
- At AGI of over $300,000, there is a phase out of personal exemptions and itemized deductions
- AMT thresholds will be indexed to inflation and are now permanent
- At AGI over $250,000 (joint), there is a new 3.8% tax on net investment income, which includes any dividends and capital gains
- At AGI of over $250,000 (joint), there is a new 0.9% Medicare tax on covered wages

Impact on NQDC Plans

There is no direct impact from the ATRA 2012 on NQDC Plans. The deferral limits for HCE participants into such deferred compensation plans were not enacted as Congress had considered. <u>Under ATRA 2012 however, the higher marginal tax rates above make pre-tax deferrals more even more attractive to HCEs for the following reasons:</u>

- Pre-tax deferrals reduce a participant's taxable income at their highest marginal rate and offer the potential to reduce or eliminate the impact of the tax changes to participants who are close to certain income thresholds
- No current tax is paid by plan participants on contributions to or earnings in the deferred compensation accounts
- Investment gains or losses not currently taxed and are compounded on a tax-deferred basis
- Tax rates being made *permanent* has reduced the uncertainty over the future taxation of NQDC plan participant distribution

- Participants can potentially reduce their tax burden by spreading out distributions through their retirement and coordinating their retirement income with qualified plan distributions, social security and other income
- Under the new legislation, after-tax investments held by higher income individuals face increased ordinary income and capital gains. Further, there are limited controls over when realized gains are triggered with after-tax investments. Thus, it is almost certain there will be taxes in the current year on dividends, interest and capital gains. In a NQDCP the participant has control over this taxation timing subject to deferred compensation legislation 409A. Participants have greater flexibility when to elect distributions and incur the income and taxation than with traditional after-tax investments.

ATRA 2012 has served to heighten the significance of Nonqualifed Deferred Compensation Plans for employers and executives alike. Attracting, retaining, rewarding and retiring key employees continues to be of paramount importance for employers, as is finding programs for employees to fill the retirement gap that was only made wider by the Great Recession.

Please contact us for more information on improving the NQDC plan you already have or finding one that is suitable for your company. **Weir Financial Resources - 716.845.3343 - jweir@weirresources.com**