



# PRIVATE PENSIONS

## IRS and DOL Should Strengthen Oversight of Executive Retirement Plans

Accessible Version

January 2020

# GAO Highlights

Highlights of [GAO-20-70](#), a report to congressional requesters

## Why GAO Did This Study

Some types of employers offer executive retirement plans to help select employees save for retirement. There are no statutory limits on the amount of compensation that executives can defer or benefits they can receive under these plans. However, employees in these plans do not receive the full statutory protections afforded to most other private sector employer-sponsored retirement plans, such as those related to vesting and fiduciary responsibility, among other things. These plans can provide advantages but they also have disadvantages because plan benefits are subject to financial risk, such as in a company bankruptcy. GAO was asked to review these plans.

This report examines, among other objectives, (1) the prevalence, key advantages, and revenue effects of executive retirement plans and (2) how federal oversight protects benefits and prevents ineligible participation. GAO analyzed industry-compiled Securities and Exchange Commission plan data for 2013 to 2017 (the most recent data available at the time of our analysis); reviewed relevant federal laws, regulations, and guidance; and interviewed officials from IRS and DOL, among others.

## What GAO Recommends

GAO is making four recommendations, including that IRS improve its instructions for auditing companies that offer these plans, and that DOL consider modifying reporting by companies to better describe participants in these plans. IRS and DOL neither agreed nor disagreed with our recommendations.

View [GAO-20-70](#). For more information, contact Charles Jeszeck at (202) 512-7215 or [jeszeckc@gao.gov](mailto:jeszeckc@gao.gov)

January 2020

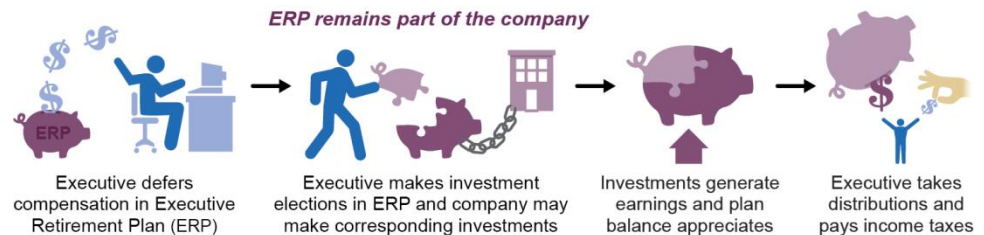
## PRIVATE PENSIONS

### IRS and DOL Should Strengthen Oversight of Executive Retirement Plans

## What GAO Found

Executive retirement plans allow select managers or highly compensated employees to save for retirement by deferring compensation and taxes. As of 2017, more than 400 of the large public companies in the Standard & Poor's 500 stock market index offered such plans to almost 2,300 of their top executives, totaling about \$13 billion in accumulated benefit promises. Top executives at large public companies generally accumulated more plan benefits than top executives at the smaller public companies in the Russell 3000 stock market index. Advantages of these plans include their ability to help executives increase retirement savings and potentially reduce tax liability, but the plans come with risks as well. To receive tax deferral, federal law requires the deferred compensation to remain part of a company's assets and subject to creditor claims until executives receive distributions (see figure). Department of Treasury officials and industry experts said executive retirement plans can be tax-advantaged and may have revenue effects for the federal government; however, the revenue effects are currently unknown.

#### Federal Income Tax Treatment of Deferred Compensation in Executive Retirement Plans



Source: GAO review of industry literature and federal tax requirements for executive retirement plans. | GAO-20-70

The Internal Revenue Service (IRS) oversees executive retirement plans for compliance with federal tax laws. For example, IRS must ensure that key executives are taxed on deferred compensation in certain cases where that compensation has been set aside, such as when a company that sponsors a qualified defined benefit retirement plan is in bankruptcy. However, IRS audit instructions lack sufficient information on what data to collect or questions to ask to help its auditors know if companies are complying with this requirement. As a result, IRS cannot ensure that companies are reporting this compensation as part of key executives' income for taxation. The Department of Labor (DOL) oversees these plans to ensure that only eligible employees participate in them since these plans are excluded from most of the federal substantive protections that cover retirement plans for rank-and-file employees. DOL requires companies to report the number of participants in the plan; however, the one-time single page filing does not collect information on the job title or salary of executives or the percentage of the company's workforce participating in these plans. Such key information could allow DOL to better identify plans that may be including ineligible employees. Without reviewing its reporting requirements to ensure adequate useful information, DOL may continue to lack insight into the make-up of these plans and will lack assurance that only select managers and highly compensated employees are participating.

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#### Abbreviations

CEO	Chief Executive Officer
CFO	Chief Financial Officer
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
EIN	Employer Identification Number
ERISA	Employee Retirement Income Security Act of 1974
ERP	Executive Retirement Plan
FICA	Federal Insurance Contributions Act
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
MDG	Main Data Group
NGR	New Generation Research, Inc.
PBGC	Pension Benefit Guaranty Corporation
PPA	Pension Protection Act of 2006
SEC	Securities and Exchange Commission
S&P	Standard & Poor's
Treasury	Department of the Treasury
USTP	United States Trustee Program

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January 28, 2020

The Honorable Ron Wyden  
Ranking Member  
Committee on Finance  
United States Senate

The Honorable Patty Murray  
Ranking Member  
Committee on Health, Education, Labor, and Pensions  
United States Senate

The Honorable Bernard Sanders  
Ranking Member  
Subcommittee on Primary Health and Retirement Security  
Committee on Health, Education, Labor, and Pensions  
United States Senate

Executive retirement plans<sup>1</sup> allow select managers or highly compensated employees to save for retirement by deferring the receipt of compensation and paying taxes on that compensation and earnings upon distribution in a future year.<sup>2</sup> Generally, there are no statutory limits on the amount of compensation that executives are allowed to defer or benefits they can receive through an executive retirement plan.<sup>3</sup> However, executives participating in these plans face financial risks because the tax-deferred compensation is considered an unfunded and unsecured company

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<sup>1</sup>This report focuses on unfunded retirement-related nonqualified deferred compensation plans sponsored by taxable private sector companies primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, commonly referred to as “top hat plans.” See 29 U.S.C. §§ 1051(2), 1081(a)(3), and 1101(a)(1). Unless otherwise clear from context, we refer to top hat plans sponsored by taxable private sector companies in this report as “executive retirement plans.” This report does not address other types of nonqualified deferred compensation plans, including an unfunded “excess benefit plan”, or executive retirement plans sponsored by governmental units or tax-exempt organizations. See 29 U.S.C. §§ 1002(36), and 1003(b)(5), and 26 U.S.C. § 457.

<sup>2</sup>Executive retirement plan benefits can be based generally on either: (1) an account balance tied to the performance of market investments or interest rates, or (2) a formula that accounts for factors such as an employee’s years of service or salary.

<sup>3</sup>Executives are subject to federal income taxes on plan distributions.

promise to pay and assets associated with the plan remain as assets of the company, subject to creditor claims in bankruptcy.<sup>4</sup> Therefore, benefits for executives are not guaranteed. Executive retirement plans can have costs for the companies that offer them and may have revenue effects for the federal government. Executive retirement plans are also exempt from most requirements under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Thus, employees included in the plan do not receive the full protections of ERISA.<sup>5</sup>

Given a lack of comprehensive federal agency data on executive retirement plans, it is difficult to know how costly or beneficial these plans are for executives and companies, and what the revenue effects of these plans are for the federal government. You asked us to review how these plans are used and what benefits these plans offer executives. This report examines (1) what is known about the prevalence, key advantages, and revenue effects of executive retirement plans; (2) potential outcomes for executive retirement plan benefits in company bankruptcy; and (3) how federal oversight protects benefits and prevents ineligible participation in executive retirement plans.

To better understand the prevalence, key advantages, and revenue effects of executive retirement plans, we analyzed data purchased from the Main Data Group (MDG), an executive compensation benchmarking company, which compiled data from Securities and Exchange Commission (SEC) disclosures on executive retirement plan benefits provided to top executives at public companies.<sup>6</sup> We analyzed 2013 to 2017 data, which were the most recent available at the time of our analysis. To assess the reliability of the data provided, we interviewed MDG officials regarding their data collection processes. We also independently compared executive retirement plan data from a random sample of SEC filings obtained from the SEC's public database for

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<sup>4</sup>According to industry experts, executives are subject to the risk that their company may not pay plan benefits, such as if their company goes bankrupt or reneges on the promise.

<sup>5</sup>ERISA establishes certain minimum standards and requirements for most private sector employer-sponsored retirement plans (e.g., 401(k) plans) related to participation, vesting, funding, and fiduciary responsibility, among other things. These minimum standards and requirements are intended to protect plan participants and beneficiaries from mismanagement and misuse of assets and to help ensure benefits under their plans, among other things.

<sup>6</sup>In the annual SEC proxy statement, a company must disclose information concerning the amount and type of compensation paid to its chief executive officer, chief financial officer, and the three other most highly compensated executive officers.



required disclosures with data for the same companies as reported by MDG. We found the data to be sufficiently reliable for our purposes of providing high level trend information on executive retirement plans. We reviewed relevant research on the cost of executive retirement plans on companies that offer them, key advantages to executives that participate in these plans, and the revenue effects of these plans to the federal government. We also interviewed a range of industry experts regarding the use of executive retirement plans; including attorneys, plan consultants, record keepers, third-party administrators, industry groups, investment advisors, and researchers. We selected executive retirement plan experts to interview based on a combination of published work, breadth and depth of experience, as well as peer referrals. We interviewed representatives from industry associations representing a diverse range of stakeholder groups, such as those that offer, provide services to, or conduct research on executive retirement plans.

To provide insight into the potential outcomes of executive retirement plan benefits during company bankruptcy, we conducted a non-generalizable review of a random sample of companies that provided an executive retirement plan and filed for bankruptcy during the period from October 17, 2005—the effective date for most of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Bankruptcy Act)—through November 30, 2017—the most recent at the time of our analysis. The 2005 Bankruptcy Act made significant changes to federal bankruptcy law, including provisions limiting certain forms of executive compensation in corporate bankruptcy. We reviewed 151 randomly selected corporate bankruptcy cases (30 Chapter 7 and 121 Chapter 11) from a total of 732 relevant bankruptcy cases (138 Chapter 7 and 594 Chapter 11). We based our analysis on data from 38 Chapter 11 cases, where we identified executive retirement plans in existence at or around the time of company bankruptcy, and we were able to identify in court filings estimated recovery percentages for how plan benefits were expected to be resolved through each case. Because the nature of bankruptcy proceedings depends on the facts and circumstances of each individual cause, the results of our analysis are not generalizable, but provide illustrative examples of potential outcomes from such cases.

To better understand how federal agency oversight protects participant benefits and prevents ineligible employees from participating in these plans, we reviewed court cases identified by Department of Labor (DOL) officials and industry experts related to employee eligibility in these plans and current DOL policy related to plan eligibility. We also reviewed relevant federal laws, regulations, guidance, and documents related to

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these plans. We interviewed officials from DOL, the Department of the Treasury (Treasury), the Internal Revenue Service (IRS), SEC, the Pension Benefit Guaranty Corporation (PBGC), and the United States Trustee Program (USTP) within the Department of Justice to determine the extent of federal oversight or involvement with executive retirement plans—including during company bankruptcy—as well as whether they have issued relevant guidance or regulations. We also asked industry experts for their perspectives on guidance and other information related to eligibility and other issues affecting executive retirement plans.

We conducted this performance audit from September 2016 to January 2020 in accordance with generally accepted government auditing standards. Those standards require that GAO plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for the report's findings and conclusions based on the report's audit objectives.

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## Background

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### Executive Retirement Plans

Companies that offer executive retirement plans typically do so to supplement benefits provided under qualified retirement plans or to provide retirement benefits in lieu of a qualified retirement plan.<sup>7</sup> In an executive retirement plan, a select group of managers or highly compensated employees defer the receipt of compensation earned in one year to be paid in a future year, generally at or after retirement. Executive retirement plans are not subject to certain statutory limits that apply to qualified retirement plans, such as limits on the annual amount of benefits received, the annual amount of contributions made to the plan, or the

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<sup>7</sup>A qualified retirement plan is an employer-sponsored plan that satisfies certain requirements set forth in the Internal Revenue Code of 1986, as amended. In order to be tax-qualified, private pension plans must satisfy a number of requirements, including minimum requirements on coverage and benefits. These minimum benefits and coverage requirements are intended to ensure that rank-and-file employees, and not merely a top group of highly paid employees such as owners and executives, participate in and receive benefits from the plan. Plan sponsors must provide coverage and benefits in a manner that generally does not discriminate against workers who are not among an employer's highly compensated employees, as defined in IRC section 414(q).

annual compensation level used to determine benefits and contributions.<sup>8</sup> Executive retirement plans can be structured as defined benefit plans or defined contribution plans but generally must defer compensation to a future year.<sup>9</sup> For executive retirement plans structured as a defined contribution plan, executives' benefits are based on a plan account balance.<sup>10</sup> During the deferral period, companies will typically allow executives to select from among a menu of market indices (e.g., of stock, or bond performance or of interest rates) or other investment options and base the plan account balance on the performance of those selections.<sup>11</sup> The company generally credits plan contributions and changes in the value of the plan account balance to executives, but does not have to make actual investments that correspond to executives' selections because companies are not obligated to designate funds for the plan before distributions are made.<sup>12</sup> For executive retirement plans structured

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<sup>8</sup>In contrast, qualified retirement plans are subject to dollar limits on benefits and contributions as set forth in the Internal Revenue Code.

<sup>9</sup>Employers choosing to offer retirement plans generally sponsor two broad types of plans: (1) defined contribution plans, in which individuals are generally able to accumulate retirement savings in an individual account based on employee and employer contributions and investment returns (gains and losses) earned on the account; and (2) defined benefit plans, which traditionally promise to provide a benefit for the life of the participant, based on a formula specified in the plan that typically takes into account factors such as an employee's salary, years of service, and age at retirement.

<sup>10</sup>The account balance of an executive retirement plan reflects the accumulated value of a plan at a point in time. However, any assets associated with the plan remain as assets of the company, subject to creditor claims in bankruptcy.

<sup>11</sup>In contrast, an executive may choose to not defer compensation and instead, invest through a taxable account outside the executive retirement plan. In this illustrative counterfactual scenario, the executive would pay income taxes on current compensation, invest the balance in the same (or comparable) investments and pay applicable taxes on investment earnings. The executive would be subject to applicable taxes on investment earnings (e.g., dividends, short- or long-term capital gains, etc.) as they are realized. In practice, the applicability of taxes on investment earnings could lead the executive to invest differently outside an executive retirement plan than the market indices or investment options chosen inside such a plan.

<sup>12</sup>An executive's investment elections in an executive retirement plan are notional (i.e., as opposed to actual investments). As discussed in more detail below, in order to achieve the desired tax-deferral, a company generally cannot set aside company assets to formally fund account balances under an executive retirement plan in a way that protects those account balances from the claims of the company's creditors, according to IRS. Companies may choose to invest company assets in a way that corresponds to the investment elections made by executives, but those assets remain company assets, rather than assets that participating executives can draw upon for their exclusive benefit, according to IRS.

as a defined benefit plan, executives are typically paid based on a formula that accounts for salary and years of employment. Distributions from all executive retirement plans are made from company assets. In the first objective of this report, we discuss and illustrate the defined contribution form of executive retirement plans, except as otherwise indicated.<sup>13</sup>

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## Employee Retirement Income Security Act of 1974

ERISA contains various provisions intended to protect the interests of plan participants and beneficiaries in workplace retirement plans.<sup>14</sup> These protections include requirements related to reporting and disclosure, participation, vesting, and benefit accrual, as well as plan funding.

Generally, most of the substantive protections of ERISA do not apply to executive retirement plans. Specifically, ERISA requirements pertaining to participation, vesting, funding, and fiduciary responsibilities do not apply to executive retirement plans. The policy underlying the executive retirement plan exemption from the substantive provisions of ERISA has been described by DOL as based on a recognition by Congress that “certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan.”<sup>15</sup>

Additionally, ERISA grants DOL the authority to prescribe alternative methods of compliance for the reporting and disclosure provisions under Part 1 of Title I for any plan or class of plans, which includes executive

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<sup>13</sup>Industry experts told us that most executive retirement plans are structured as defined contribution plans.

<sup>14</sup>Title I of ERISA generally provides requirements for private sector employers sponsoring retirement plans. Part 2 of Title I includes requirements regarding participation and vesting, which include provisions prescribing the maximum amount of time an employee must work before their benefits become non-forfeitable, meaning that their benefits generally cannot be taken away by the plan. Part 3 of Title I includes requirements regarding plan funding, which prescribe minimum funding standards for defined benefit plans. Part 4 of Title I includes provisions pertaining to fiduciary responsibility, including the requirement that plan fiduciaries discharge their duties in the sole interest of plan participants and beneficiaries. In addition, Title II of ERISA amended the Internal Revenue Code (IRC) to parallel many of the Title I requirements, among other things.

<sup>15</sup>See Department of Labor Advisory Opinion 90-14A Washington D.C.: May 8, 1990.

retirement plans.<sup>16</sup> Using this authority, DOL issued a regulation permitting administrators of executive retirement plans to submit a one-time single page filing statement to satisfy ERISA reporting requirements in 1975, according to DOL.<sup>17</sup> DOL's executive retirement plan filing statement includes:

- the name and address of the employer,
- the employer identification number (EIN) assigned by the IRS,
- a declaration that the employer maintains a plan or plans primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees, and
- a statement of the number of such plans and the number of employees in each plan.

In addition, plan administrators are required to provide plan documents to DOL upon request.<sup>18</sup>

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## The Internal Revenue Code and Tax Treatment of Executive Retirement Plans

The Internal Revenue Code (IRC) provides preferential tax treatment for workplace retirement plans that meet certain qualification requirements set out in the IRC.<sup>19</sup> The structure of tax incentives<sup>20</sup> and certain limits on

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<sup>16</sup>See 29 U.S.C. § 1030. While executive retirement plans are exempt by statute from Parts 2, 3, and 4 of Title I of ERISA, including the participation, vesting, funding, and fiduciary responsibility provisions, they are not exempt by statute from the reporting and disclosure provisions in Part 1 of ERISA or the administration and enforcement provisions of Part 5.

<sup>17</sup>See 29 C.F.R. § 2520.104-23. Plan administrators are required to file the statement within 120 days of establishing the plan. The alternative method of compliance is only available for executive retirement plans for which “benefits (i) are paid as needed solely from the general assets of the employer, (ii) are provided exclusively through insurance contracts or policies, the premiums for which are paid directly by the employer from its general assets, issued by an insurance company or similar organization which is qualified to do business in any State, or (iii) both”. See 29 C.F.R. § 2520.104-23(d).

<sup>18</sup>See 29 C.F.R. § 2520.104-23(b)(2).

<sup>19</sup>The preferential tax treatment afforded to qualified retirement plans allows plan participants to exclude contributions and investment earnings from their current taxable income and their employers to take an immediate tax deduction (within limits) for their contributions. The IRC is codified in Title 26 of the U.S. Code.

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qualified retirement plans<sup>21</sup> are intended to balance encouraging employers to establish and maintain voluntary, tax-qualified pension plans with ensuring lower-income employees receive an equitable share of the tax-subsidized benefits. Although executives may benefit from tax deferral under an executive retirement plan, these plans are not eligible for the same preferential tax treatment afforded to qualified retirement plans under the IRC. For the executive to be eligible for the tax deferral,

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<sup>20</sup>The IRC establishes requirements that private pension plans must satisfy to qualify for favorable tax treatment. Employers that sponsor these tax-qualified plans are entitled to a tax deduction (within limits) for the contributions they make under these plans. Employer contributions are not included in an employee's taxable income until distributed.

<sup>21</sup>Section 415 of the IRC provides for dollar limits on benefits and contributions under qualified retirement plans. For 2019, section 415(b)(1) limits annual benefits an employee can receive from a qualified defined benefit plan to the lesser of 100 percent of the employee's average compensation for his high 3 years or \$225,000, and section 415(c)(1) limits contributions that can be made to a defined contribution plan to the lesser of 100 percent of the employee's compensation or \$56,000, \$62,000 including catch-up contributions. Both benefit and contribution limits are subject to cost-of-living adjustments for later years. Contributions can be comprised of both employee and company contributions. Section 401(a)(17) of the IRC limits the annual compensation used as the basis for calculating an employee's benefit accruals or contributions to such plans. For 2019, section 401(a)(17) limits the maximum annual compensation that can be taken into account for these calculations to not exceed \$280,000 (subject to cost-of-living adjustments in later years) for each employee. In addition, for 2019, participants in qualified defined contributions plans can contribute up to \$19,000 per year (\$25,000 including catch-up contributions for employees age 50 and over). See 26 U.S.C. § 402(g)(1)(A)-(C) & (4).

executive retirement plans must be an “unfunded and unsecured” company promise to pay benefits in the future.<sup>22,23</sup> Generally, for an executive retirement plan to be considered unfunded and unsecured, the executive’s rights to receive plan distributions will be no greater than the rights of a general unsecured creditor in the event of company bankruptcy or insolvency.<sup>24</sup> Companies are not permitted to fund (i.e., set aside assets for the exclusive benefit of participants that are separate from company assets and beyond the reach of creditors) executive retirement plans while maintaining the benefits of tax-deferral for executives. However, companies are able to “informally fund” executive retirement plans by transferring amounts to a trust that remains part of the company’s general assets—often referred to as a “Rabbi Trust”—to help keep its promise to pay benefits.<sup>25</sup> Because executive retirement plans are unfunded, executives’ benefits in these plans can be subject to credit

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<sup>22</sup>See 26 U.S.C. § 83(a) and 26 C.F.R. § 1.83-3(e). In addition, ERISA requires executive retirement plans to be “unfunded” in order to be exempt from most substantive provisions of Title I. According to DOL officials, determining whether an executive retirement plan is considered “unfunded” for purposes of Title I of ERISA generally requires an evaluation of the individual facts and circumstances. DOL officials noted that an important factor is whether contributions or other assets have been set aside for the exclusive benefit of plan participants or in a way that make them plan assets under ERISA.

<sup>23</sup>Companies are not required to make actual investments that correspond to an executive’s investment election in an executive retirement plan. To pay for executive retirement plan benefits, companies can either (1) designate funds to informally fund plan benefits or (2) adopt a pay-as-you-go approach. When a company elects to informally fund its executive retirement plan, it designates funds and can make investments using those funds to pay for future benefits as they accrue to help ensure that there are sufficient assets to pay plan distributions when due, but those funds remain general assets subject to the claims of the company’s creditors. Under a pay-as-you-go approach, a company keeps track of its plan liabilities as they accrue and makes distributions to executives out of its general funds when due.

<sup>24</sup>In a corporate bankruptcy, general unsecured creditors are typically the last creditor class to be paid and only if there are remaining funds after all creditors with payment priority have been fully repaid.

<sup>25</sup>According to the IRS officials, assets in a Rabbi Trust cannot be set apart from the company’s general creditors for the exclusive benefit of executives. They noted that plan benefits can be paid from a Rabbi Trust provided that trust assets become part of the company’s general assets in the case of an insolvency or bankruptcy. Rabbi Trusts may protect participants in executive retirement plans against various risks—not including company bankruptcy or insolvency—that would cause the company to not pay promised benefits, such as the risk that the company reneges on its promise. The term “Rabbi Trust” comes from an IRS Private Letter Ruling that concluded that the funding of a trust for the benefit of an individual, who was a rabbi, would not constitute a taxable event because assets in the trust would be subject to the claims of creditors and not paid or made available under section 451 of the IRC. See I.R.S. Priv. Ltr. Rul. 81-13-107 (Dec. 31, 1980).

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risk of non-payment<sup>26</sup>, such as in the event of a company bankruptcy, according to IRS officials.<sup>27</sup>

The IRC provides rules regarding deferring compensation in executive retirement plans, including restrictions on the timing of distributions, restrictions on payment acceleration, and restrictions on the timing of deferral elections.<sup>28</sup> At the time of deferral, the amount of compensation deferred under the plan is generally excluded from executives' income for tax purposes and not tax deductible for the company (see fig. 1).<sup>29</sup> During the deferral period, because any assets associated with the executive retirement plan remain company assets (and subject to creditor claims),

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<sup>26</sup>According to industry experts and literature, there are at least four general types of risks that may cause a company not to pay promised executive retirement plan benefits: 1) the company reneges, known as a "change-of-heart" risk, 2) company ownership changes, such as through a merger or acquisition, leading the company to renege, known as a "change-in-control" risk, 3) company insolvency that generally results in an inability to pay; and 4) company bankruptcy.

<sup>27</sup>Bankruptcy is governed by a federal court procedure conducted under the U.S. Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. See generally Title 11 of the U.S. Code. Bankruptcy helps individuals and businesses eliminate or restructure debts they cannot repay and helps creditors receive some payment in an equitable manner. A business debtor may seek liquidation, primarily governed by Chapter 7 of the U.S. Bankruptcy Code, or reorganization, governed by Chapter 11. A business that successfully reorganizes under Chapter 11 may continue some or all of its operations, whereas a business that seeks liquidation generally ceases to operate after the liquidation. A company that fails to reorganize under Chapter 11 may liquidate with court approval through a Chapter 11 liquidation plan or convert to Chapter 7 liquidation, among other outcomes.

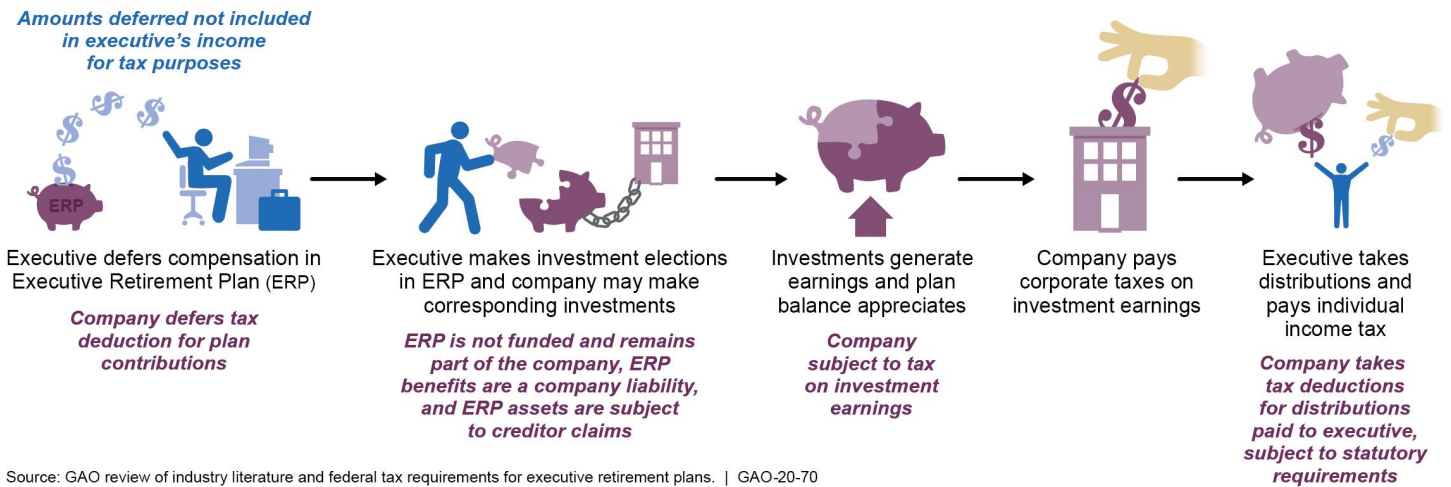
<sup>28</sup>See 26 U.S.C. § 409A. Section 409A was added to the IRC in 2004 and generally became effective for amounts deferred after December 31, 2004. See American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 885, 118 Stat. 1418, 1634-41 (codified as amended at 26 U.S.C. § 409A). According to a House Ways and Means Committee report from 2004, section 409A was added to the IRC because the committee believed, among other things, that many nonqualified deferred compensation arrangements (which include executive retirement plans) allowed improper deferral of income. The Committee report stated that certain arrangements that allow participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion for taxation and that it would be appropriate to provide specific rules regarding when deferral of income inclusion should be permitted. See H.R. Rep. No. 108-548 (2004).

<sup>29</sup>Federal Insurance Contributions Act (FICA) taxes (also referred to as payroll taxes) assessed on deferred compensation in an executive retirement plan are based on different timing rules than requirements for wages, generally. FICA taxes are assessed, up to applicable limits, generally at the later of when services are performed or when there is no substantial risk of forfeiture to deferred compensation (i.e., the deferred compensation is vested). Therefore, executives may have FICA taxes withheld prior to scheduled distributions under the plan.



the company is subject to applicable taxes on any investment earnings attributable to the assets. Executives are subject to federal income taxes on their executive retirement plan distributions when they are received. However, if an executive retirement plan fails to meet the applicable requirements at any time during a taxable year, all of the compensation deferred, including investment earnings associated with the deferred compensation, is included in each executive's gross income for the taxable year to the extent it is vested, along with an additional 20 percent tax on the compensation to be included in gross income plus additional income tax.<sup>30</sup> Companies must defer taking their tax deductions, up to statutory limits, for plan contributions they make until the executive is taxed on those benefits.

**Figure 1: Federal Income Tax Treatment of Deferred Compensation in Executive Retirement Plans**



Notes: This figure is a generalized illustration of the income tax treatment of compensation deferred in a retirement-related nonqualified deferred compensation plan, referred to in this figure as an "executive retirement plan." Companies are not required to make actual investments. Plan benefits from an executive retirement plan structured as a defined benefit are typically based on a formula rather than the value of an account balance. For all executive retirement plans, plan assets remain part of company assets from which benefits are paid when distributed.

<sup>30</sup>If an executive retirement plan fails to meet the applicable requirements at any time during a taxable year, all compensation deferred, including investment earnings associated with the deferred compensation, is included in each affected executive's gross income for the taxable year, to the extent it is not subject to a substantial risk of forfeiture, along with an additional 20 percent tax on the compensation to be included in gross income plus an additional income tax calculated based on underpayment interest due if amounts had not been deferred. See 26 U.S.C. § 409A(a). In this report, we generally refer to deferred compensation that is not subject to a substantial risk of forfeiture as being vested.

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## Additional Federal Regulatory Oversight

In addition to DOL's role under ERISA and IRS's role administering the IRC requirements related to executive retirement plans, other federal agencies may have roles related to executive retirement plans. For example, SEC requires public companies to provide an annual proxy statement that includes information on the amount and type of executive compensation—including benefits from executive retirement plans—paid to their Chief Executive Officer (CEO), Chief Financial Officer (CFO), and the next three most highly compensated executive officers.<sup>31</sup>

Other federal agencies that play a role with respect to qualified retirement plans, such as the PBGC, may monitor the status of executive retirement plans in certain circumstances, such as in bankruptcy proceedings involving a company with both an executive retirement plan and a qualified single-employer defined benefit plan (see table 1).

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<sup>31</sup>See 17 C.F.R. § 240.14a-101(b)(13). Generally, there is no similar reporting requirement for private companies.

**Table 1: Summary of Federal Oversight and Activities Involving Executive Retirement Plans**

Federal agency	Summary of oversight and activities
<b>Department of Labor (DOL) - Employee Benefits Security Administration (EBSA)</b>	Within DOL, EBSA oversees executive retirement plan compliance with applicable provisions of Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA); generally, those under Part 1, pertaining to plan reporting and disclosure, and Part 5, pertaining to administration and enforcement. EBSA issues related regulations and guidance, and has the authority to conduct oversight and enforcement of executive retirement plans under ERISA.
<b>Department of the Treasury - Internal Revenue Service (IRS)</b>	<p>Within the Department of the Treasury, IRS is primarily responsible for enforcing the Internal Revenue Code (IRC), including provisions applicable to executive retirement plans.</p> <p><u>Audits and enforcement.</u> IRS conducts audits of companies to review their financial information for compliance with tax laws and of qualified retirement plans to analyze their operational features. IRS uses the review process to assist with its enforcement activities and to focus resources on areas of high non-compliance. Executive retirement plans are reviewed in the scope of auditing the sponsoring company.</p> <p><u>Corrections programs for retirement plans.</u> IRS offers sponsors of qualified retirement plans a way to correct plan errors through its Employee Plans Compliance Resolution System. Companies that sponsor executive retirement plans and their employees can correct certain errors in these plans through procedures described in an IRS notice.</p>
<b>Department of the Treasury - Office of Tax Policy (Treasury)</b>	This office develops and implements tax policies and programs and reviews regulations and rulings to administer the IRC, among other things. Treasury and IRS coordinate with DOL to develop guidance for IRC requirements for executive retirement plans, according to Treasury officials.
<b>Pension Benefit Guaranty Corporation (PBGC)<sup>a</sup></b>	PBGC protects the retirement incomes of American workers in qualified private sector defined benefit pension plans by encouraging the continuation of these plans and by providing timely and uninterrupted payment of pension benefits. PBGC officials told us that PBGC generally does not have regulatory authority over executive retirement plans but the agency may monitor the status of these plans during bankruptcy proceedings as an interested party if a company offers a qualified single-employer defined benefit plan.
<b>U.S. Securities and Exchange Commission (SEC)</b>	SEC's mission is to protect investors; maintain fair, orderly, and efficient markets, and facilitate capital formation. The agency oversees compliance with public company disclosure requirements, including those related to benefits provided to top executives.
<b>Department of Justice – United States Trustee Program (USTP)</b>	USTP seeks to promote the efficiency and protect the integrity of the Federal bankruptcy system. To further the public interest in the just, speedy, and economical resolution of cases filed under the U.S. Bankruptcy Code, the USTP monitors the conduct of bankruptcy parties and private estate trustees, oversees related administrative functions, and acts to ensure compliance with applicable laws and procedures. As part of its supervisory function over the administration of bankruptcy cases, USTP monitors executive compensation practices of companies in bankruptcy, which can include executive retirement plans, according to USTP officials.

Source: GAO analysis of agency documents and interviews with agency officials. | GAO-20-70

<sup>a</sup>PBGC is listed on GAO's 2019 High Risk Series because the financial stability of its pension insurance programs faces many structural challenges that require congressional action. See GAO: *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas*, [GAO-19-157SP](#) (Washington D.C.: March 6, 2019).

## Most Large Public Companies Provide Their Top Executives with Executive Retirement

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## Plans but the Federal Revenue Effects of these Plans Are Unknown

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### Most Large Public Companies Provide Top Executives with Executive Retirement Plans

According to our analysis<sup>32</sup>, more than 400 of the 500 largest U.S. public companies provided executive retirement plans to almost 2,300 top executives, totaling about \$13 billion in accumulated plan benefits<sup>33</sup> in 2017 (see fig. 2).<sup>34</sup> Although DOL collects limited data on the prevalence of executive retirement plans, public companies subject to SEC reporting requirements for executive retirement plans must report the benefits provided to the Chief Executive Officer (CEO), Chief Financial Officer (CFO), and the next three most highly compensated executive officers.<sup>35,36</sup> Industry experts we interviewed said that most large

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<sup>32</sup>Companies that report to the SEC can structure nonqualified deferred compensation plans under a number of different types of arrangements, such as those not intended for retirement savings (which are outside the scope of this report). However, industry experts and agency officials from Treasury and IRS told us that companies structure most nonqualified deferred compensation plans as ERISA top hat plans offered to a select group of management or highly compensated employees, which we refer to in this report as executive retirement plans. The data we used for our analysis come from the Main Data Group, an executive compensation firm that sources data from SEC filings. See Appendix I for more details on our methodology. In this report, the terms “top executives” or “executives” when referencing our analysis of Main Data Group data refer to the top five executives of companies that are subject to SEC reporting requirements for executive retirement plan benefits during a reporting year.

<sup>33</sup>See Appendix I for details on how we determined accumulated plan benefits provided to top executives in our analysis of SEC disclosure data obtained from the Main Data Group.

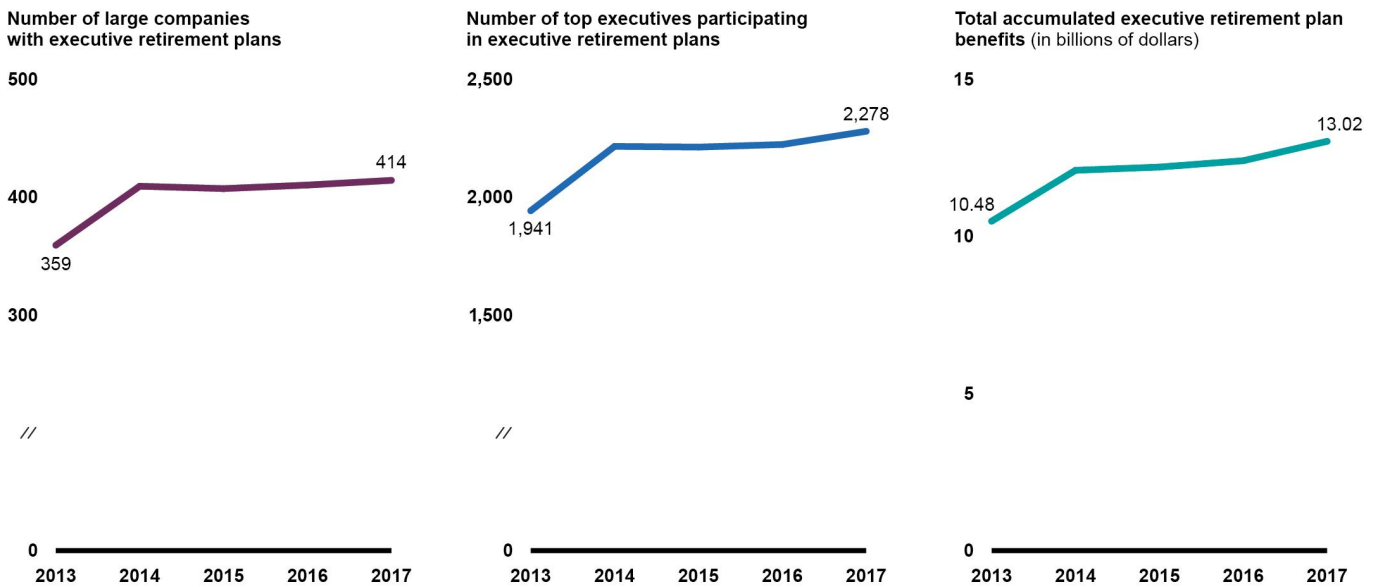
<sup>34</sup>These companies represent about 83 percent of SEC-filing companies listed on the Standard and Poor’s (S&P) 500 index that offered at least one active executive retirement plan for their executives for the SEC reporting year 2017. The S&P 500 index represents the largest 500 U.S. public companies by market capitalization. In this report, references to our analysis of Main Data Group data for “large companies” refer to plans provided to top executives in S&P 500 companies.

<sup>35</sup>Companies may report data for more than five executives to the extent more than five employees meet the disclosure requirement criteria during the reporting year, such as if a company changes CEO or CFO. Private companies are generally not subject to SEC reporting requirements for their executive retirement plans.

<sup>36</sup>Companies included in our analysis may provide executive retirement plan benefits beyond the top five executives, but we were unable to determine the prevalence of this because SEC disclosures do not require reporting beyond the top five executives.

companies offer executive retirement plans to help executives and highly compensated employees save more for retirement because most executives have reached the contribution and income limits imposed on savings in qualified retirement plans.<sup>37</sup>

**Figure 2: Large Public Companies, Top Five Executives, and Accumulated Plan Benefits for Executive Retirement Plans from 2013 to 2017**



Source: GAO analysis of data from the Main Data Group. | GAO-20-70

Note: The top five executives at “large” public companies refer to the Chief Executive Officer (CEO), Chief Financial Officer (CFO), and the next three most highly compensated executive officers employed among companies in the Standard & Poor’s (S&P) 500 index. Companies may report data for more than five executives to the extent more than five employees meet the disclosure requirement criteria during the reporting year, such as if a company changes CEO or CFO. The S&P 500 generally represents the largest 500 U.S. public companies by market capitalization. The values of accumulated executive retirement plan benefits shown here are not adjusted for inflation.

<sup>37</sup>As described earlier, the IRC provides for dollar limits on benefits and contributions under qualified retirement plans and limits the annual compensation used as the basis for calculating an employee’s benefit accruals or contributions to such plans. See 26 U.S.C. §§ 401(a)(17) and 415. Because companies typically offer executive retirement plans to provide retirement plan benefits in excess of qualified retirement plan limits, executives may receive benefits from both types of plans.

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## Executive Retirement Plan Benefits Are Concentrated Among a Subset of Top Executives

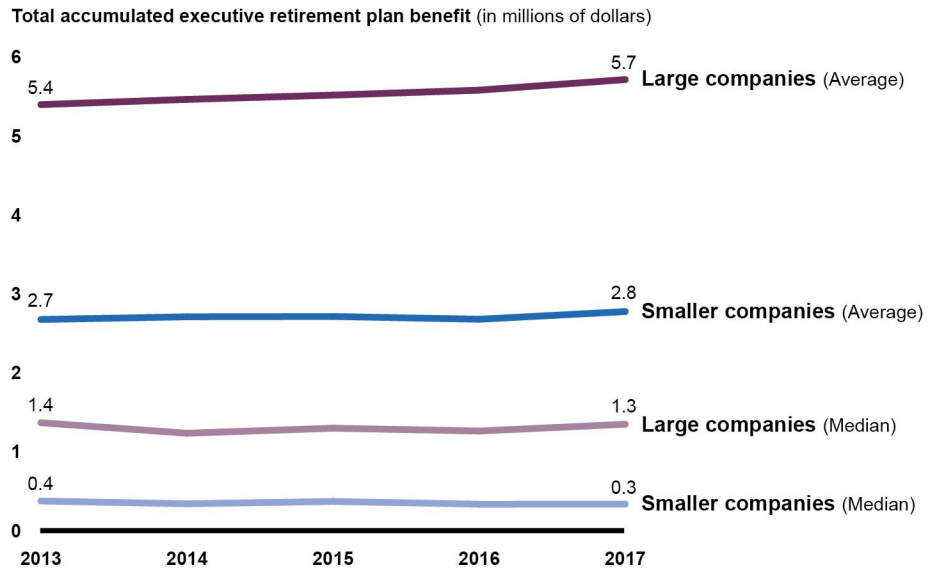
Top executives at large public companies generally accumulated more executive retirement plan benefits than top executives at smaller companies.<sup>38</sup> The most recent available data from 2017 show that the average accumulated plan benefit among the top five executives in large companies was about \$5.7 million, about twice as much as their counterparts in smaller companies, where the average was about \$2.8 million.<sup>39</sup> The average and median accumulated plan benefits generally remained consistent for large and smaller companies from 2013 to 2017 (see fig. 3).

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<sup>38</sup>In our analysis of data from the Main Data Group, the top executives at “large” public companies refer to those employed in S&P 500 companies and the top executives for “smaller” public companies are for those top executives employed in companies in the Russell 3000 index. The Russell 3000 generally represents the largest 3,000 U.S. public companies by market capitalization. Companies listed in the S&P 500 are generally also listed in the Russell 3000.

<sup>39</sup>As of 2017, the corresponding median was an accumulation of about \$1.3 million in total plan benefits for top five executives at large companies, more than four times the nearly \$300,000 median total accumulated by their counterparts in smaller companies. For this report, total executive retirement plan benefits include those structured as defined benefit plans and defined contribution plans, as reported to the SEC in required proxy statements. For more details on our analysis, see Appendix I.

**Figure 3: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives in Large and Smaller Public Companies from 2013 to 2017**



Source: GAO analysis of data from the Main Data Group. | GAO-20-70

Note: The top five executives at “large” public companies refer to the Chief Executive Officer, Chief Financial Officer, and the next three most highly compensated executive officers employed among companies in the Standard and Poor’s (S&P) 500 index. Top five executives at “smaller” public companies are for those same top five executives employed in companies in the Russell 3000 index. The S&P 500 and Russell 3000 generally represent the largest 500 and 3,000 U.S. public companies respectively by market capitalization. Companies listed in the S&P 500 are generally also listed in the Russell 3000. The values of accumulated executive retirement plan benefits shown here are not adjusted for inflation. Average and median benefits for top executives may not be evenly distributed across all companies in the dataset.

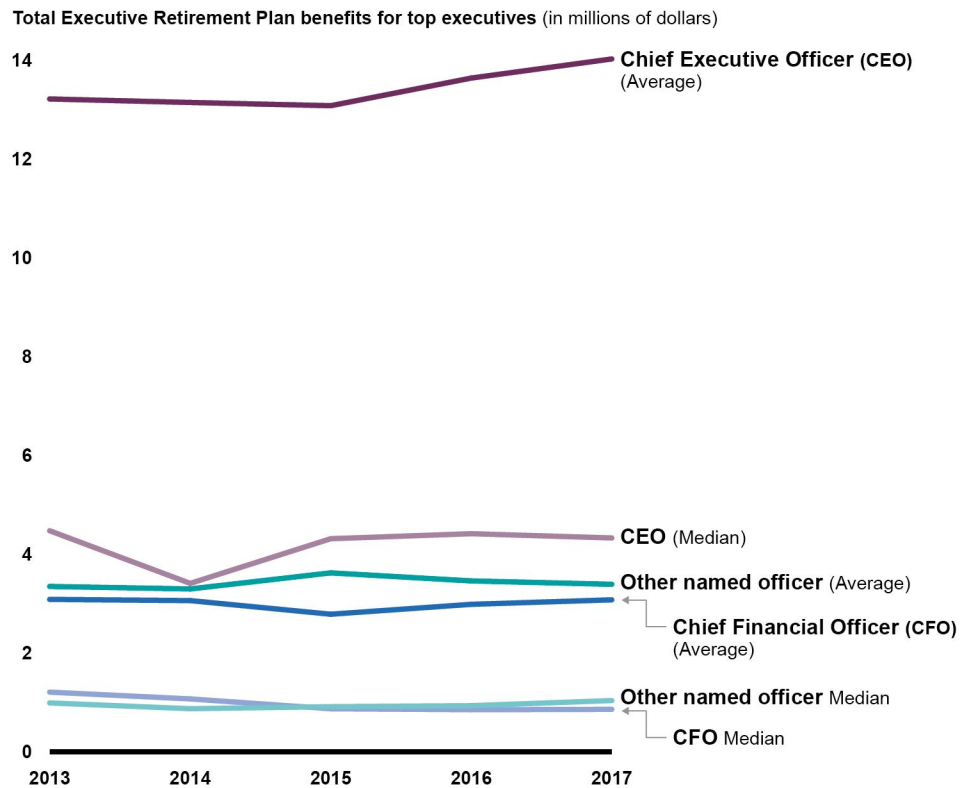
In addition, our analysis showed that, among the top five executives at large public companies, accumulated plan benefits are concentrated among a subset of these top executives based on their job title, company contributions, and plan type. The average accumulated plan benefit among top executives in large companies was consistently greater than the median accumulated plan benefit from 2013 to 2017 (see fig. 3). For example, as of 2017, the average accumulated plan benefit among top executives was more than four times the median, indicating that plan benefits for a smaller subset of executives is greater than a majority of other individual executives.

Total Accumulated Plan Benefits by Title

CEOs accumulated more executive retirement plan benefits than the next four highest compensated executives. As of 2017, the CEOs had accumulated, on average, about \$14 million in executive retirement plan

benefits. In contrast, CFOs had accumulated, on average, about \$3 million and the next three most highly compensated executive officers with other titles accumulated an average of about \$3.4 million in accumulated plan benefits.<sup>40</sup> Our analysis also showed that, for each of the three job title categories (CEO, CFO, and the next three most highly compensated executive officers), the average accumulated plan benefits were at least twice the median amount from 2013 to 2017 (see fig. 4).

**Figure 4: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Title for Large Public Companies from 2013 to 2017**



Source: GAO analysis of data from the Main Data Group. | GAO-20-70

Note: The top five executives at “large” public companies refer to the Chief Executive Officer, Chief Financial Officer, and the next three most highly compensated executive officers employed among companies in the Standard and Poor’s (S&P) 500 index. The S&P 500 generally represents the largest 500 U.S. public companies by market capitalization. The values of accumulated executive

<sup>40</sup>For the same year, CEOs had a median accumulated plan benefit of more than four times that of the CFO or other executive officer peers. Executives that held the titles of both CEO and CFO were categorized as a CEO for our analysis.



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retirement plan benefits shown here are not adjusted for inflation. Average and median benefits for top executives may not be evenly distributed across all companies in the dataset.

### Plans with Company Contributions

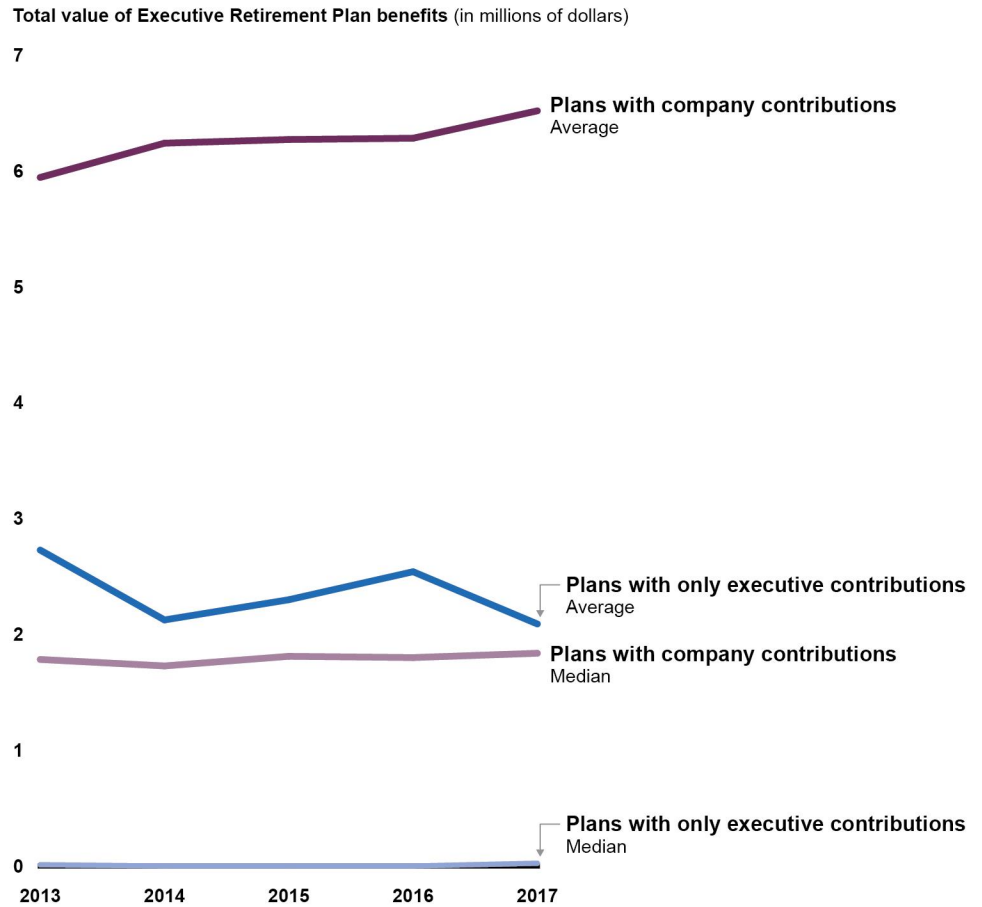
From 2013 to 2017, about 80 percent of large companies that offered an executive retirement plan made company contributions to the plan.<sup>41</sup> As of 2017, the average accumulated plan benefit for top executives among companies providing company contributions was more than \$6.5 million. This was more than twice the average of nearly \$2 million for executives in about 20 percent of the remaining companies that offered an executive retirement plan that did not include company contributions.<sup>42</sup> Our analysis showed that plan benefits are also concentrated among a subset of executives as the average amount of accumulated plan benefits for executives in plans that received company contributions were several times greater than the median from 2013 to 2017 (see fig. 5).

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<sup>41</sup>Company contributions include those provided to defined benefit and defined contribution plans. A company credits an executive retirement plan with its company contribution, but does not make an actual employer contribution until it distributes funds to the executive. Plans that do not include company contributions are made up of executives' contributions (i.e., their salary deferrals) only.

<sup>42</sup>For the same year, the median total accumulated plan benefit for the top five executives in plans that provided company contributions was \$1.8 million, many times more than the median of about \$24,000 accumulated by executives in plans without company contributions.

**Figure 5: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Source of Contributions for Large Public Companies from 2013 to 2017**



Source: GAO analysis of data from the Main Data Group. | GAO-20-70

Note: The top five executives at “large” public companies refer to the Chief Executive Officer, Chief Financial Officer, and the next three most highly compensated executive officers employed among companies in the Standard and Poor’s (S&P) 500 index. The S&P 500 generally represents the largest 500 U.S. public companies by market capitalization. The values of accumulated executive retirement plan benefits shown here are not adjusted for inflation. Average and median benefits for top executives may not be evenly distributed across all companies in the dataset.

Executives with Defined Benefit Plans

The top five executives with defined benefit executive retirement plans generally accumulated more plan benefits than those with defined

contribution executive retirement plans alone.<sup>43</sup> As of 2017, about 30 percent of large companies that sponsored an executive retirement plan offered a defined benefit plan, as compared with about 70 percent that only offered a defined contribution plan.<sup>44</sup> In 2017, the top five executives at large companies with a defined benefit plan had accumulated plan benefits of nearly \$9 million on average, more than twice the average of about \$4.4 million for top five executives with defined contribution executive retirement plans alone.<sup>45</sup> Our analysis showed that plan benefits are concentrated among a subset of executives as the average accumulated plan benefits for top five executives with a defined benefit plan was several times more than the median from 2013 to 2017 (see fig. 6). However, industry experts told us the number of companies offering defined benefit executive retirement plans has declined over time.

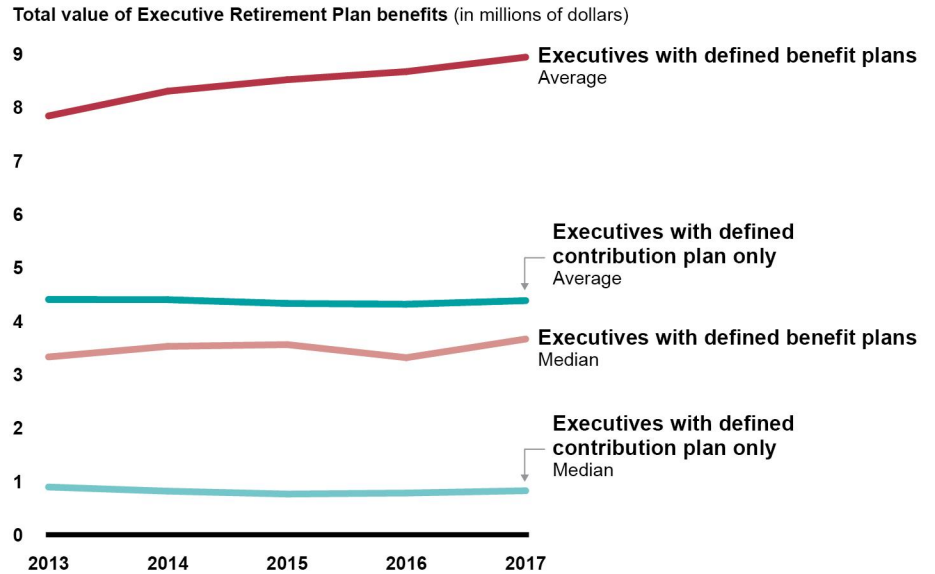
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<sup>43</sup>Top five executives with defined benefit executive retirement plans in this context include those with only a defined benefit plan as well as those who also have a defined contribution plan.

<sup>44</sup>Executives can receive benefits from multiple executive retirement plans, including both defined benefit and defined contribution plans.

<sup>45</sup>In 2017, the median accumulated plan benefits among large company top executives with defined benefit plans exceeded \$3.6 million, more than four times the median of about \$800,000 for top five executives with defined contribution plans alone.

**Figure 6: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Plan Type for Large Public Companies from 2013 to 2017**



Source: GAO analysis of data from the Main Data Group. | GAO-20-70

Note: The top five executives at “large” public companies refer to the Chief Executive Officer, Chief Financial Officer, and the next three most highly compensated executive officers employed among companies in the Standard and Poor’s (S&P) 500 index. The S&P 500 generally represents the largest 500 U.S. public companies by market capitalization. The values of accumulated executive retirement plan benefits shown here are not adjusted for inflation. Average and median benefits for top executives may not be evenly distributed across all companies in the dataset. Top five executives with defined benefit executive retirement plans include those with only a defined benefit plan as well as those who also have a defined contribution plan.

## Executive Retirement Plans Can Offer Executives Tax, Savings, and Financial Planning Advantages

Executive retirement plans can help executives reduce their potential tax liability, increase retirement savings, and provide financial planning

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advantages through: (1) tax substitution of investment earnings,<sup>46</sup> (2) additional company compensation for investment earnings, (3) additional company compensation for personal income taxes, and (4) allowable distributions during working years.

### Tax Substitution of Investment Earnings

Treasury officials and some industry experts told us that executives who participate in executive retirement plans may be able to reduce their potential federal tax liability on plan investment earnings and increase their savings because these plans substitute the executive's applicable

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<sup>46</sup>Executive retirement plans, to the extent they may be tax-advantaged, can provide tax advantages for executives, companies, or both. Tax incidence theory addresses the distribution of the burden of taxation or of the benefits of tax subsidies or expenditures. The actual burden of a tax does not always fall on the people or businesses that actually pay the tax to the government. The statutory incidence of a tax—the parties who are legally required to pay the tax—may not be the same as its economic incidence—the parties who actually bear the burden of the tax—because taxpayers who legally must pay the tax can sometimes shift the burden to others through changes in prices, wages, and returns on investments. The full application of tax incidence theory to executive retirement plans is beyond the scope of this report. GAO, *Understanding the Tax Reform Debate: Background, Criteria, and Questions*, [GAO-05-1009SP](#) (Washington, D.C.: September 2005).

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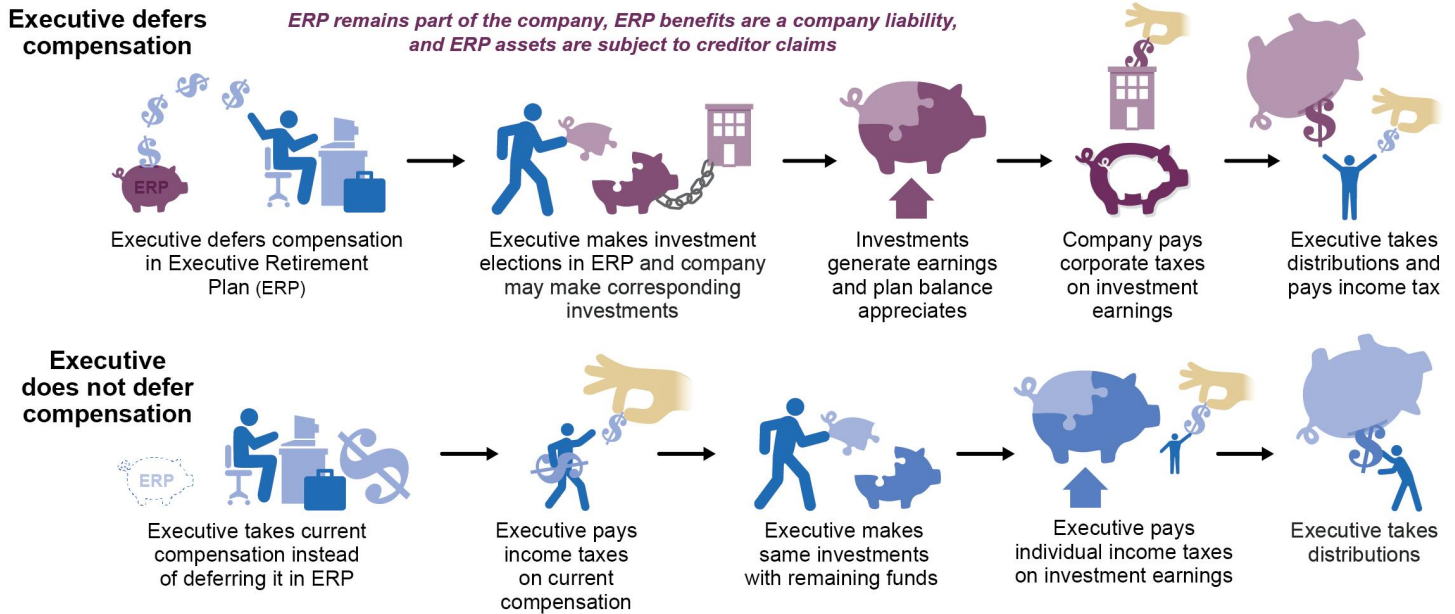
individual tax rate on investment earnings<sup>47</sup> with the company's corporate tax rate (see fig. 7).<sup>48</sup>

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<sup>47</sup>Businesses are generally organized as C corporations, S corporations, partnerships or sole proprietorships for federal tax purposes. Only C corporations owe corporate income tax; S corporations, partnerships, and sole proprietorships are generally treated as pass-through entities where the tax on income earned by the pass-through entity is paid by the owners at their applicable tax rate. For this report, the company examples are for a C corporation.

<sup>48</sup>Companies and individuals are subject to federal taxes on investment earnings, but different statutory rates may apply. Because any assets associated with an executive retirement plan remain part of company assets, the company pays taxes on investment earnings for assets associated with the plan until benefits are distributed to the executive. Upon distribution of the benefits to the executive, the company is entitled to a deduction of the distribution amount for federal income tax purposes and the executive reports the distribution amount as ordinary income for federal income tax purposes. Different federal tax rates can apply based on the type of investment, the length of the investment period, and whether the taxpayer is an individual or a corporation. For example, beginning on January 1, 2018, the highest individual tax rates on realized short-term capital gains is 37 percent and 20 percent for realized long-term capital gains. In contrast, the corporate tax rate on both short-term and long-term capital gains is 21 percent, beginning January 1, 2018. Prior to 2018, the highest income tax rate in effect was 35 percent for corporations and 39.6 percent for individuals in the highest tax bracket. Both before and as of 2018, the realized long-term capital gains rate applicable to most investments is lower for individuals in the highest income bracket as compared with the rates generally applicable to corporations. Capital gains are generally not taxed until the sale or other disposition of a capital asset.

**Figure 7: Comparison of Federal Tax Treatment of Deferred Compensation with Current Compensation**



Source: GAO review of industry literature and federal tax requirements for executive retirement plans and taxable investment accounts. | GAO-20-70

Notes: This figure is a generalized illustration comparing the federal income tax treatment of deferred compensation in an executive retirement plan with taking current compensation, making the simplifying assumption that the executive would make the same investment elections or decisions whether inside or outside the plan. In an executive retirement plan, companies are not required to make actual investments. Plan benefits from an executive retirement plan structured as a defined benefit are typically based on a formula rather than the value of an account balance. For executive retirement plans, plan assets remain part of the company's assets from which benefits are paid when distributed.

In an executive retirement plan, the company defers compensation for the executive, but investment earnings on associated assets during the deferral period are taxed to the company at the company's applicable corporate tax rate (see "Executive defers compensation" at top of fig. 7).<sup>49,50</sup> In contrast, the executive who chooses not to defer compensation

<sup>49</sup>An executive that participates in an executive retirement plan generally does not pay any taxes on amounts deferred and investment earnings under the plan until funds are distributed. During the deferral period, the company will typically base the value of the executive retirement plan account balance on the performance of market indices (e.g., stocks, or bond performance, or of interest rates) and allow the executive to select among them as notional investment of the deferred compensation. To be eligible for tax-deferral, an executive's investment elections in an executive retirement plan are notional (i.e., as opposed to actual investments) because the executive does not control actual investment of plan assets, which remain under company ownership. In turn, the company may, but is not required to, make complementary investments to help ensure there are funds available to pay future plan benefits to the executive when due.

and instead takes the current compensation (paying income taxes) and invests the balance will pay taxes on investment earnings at the individual tax rate (see “Executive does not defer compensation” at bottom of fig. 7).<sup>51</sup> The actual taxes paid under either scenario—deferring compensation or not—will depend on a number of factors, including the type of investments, if any, selected by the executive or the company, length of time invested, and applicable tax rates.<sup>52</sup> For example, an executive who does not defer compensation and invests outside of the plan might select investments that are expected to produce long-term capital gains, which are taxed at lower individual rates than short-term capital gains. This same executive, if deferring compensation through the plan, might elect to invest in short-term bonds or investment earnings based on a market interest rate, which are taxed at a lower corporate tax rate inside the plan than outside.<sup>53</sup> As another example, a company might invest deferred compensation in a tax-favored vehicle such as corporate-owned life insurance.

According to Treasury officials and some industry experts, by participating in an executive retirement plan, executives may be able to effectively reduce their potential federal income tax liability during the deferral period because investment earnings on associated plan assets are taxed at the company’s corporate rate that may be lower than the executive’s individual tax rate.<sup>54</sup> This tax substitution of investment earnings may

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<sup>50</sup>FICA taxes (also referred to as payroll taxes) assessed on deferred compensation in an executive retirement plan are based on different timing rules than requirements for wages, generally. FICA taxes are assessed, up to applicable limits, generally at the later of when services are performed or when there is no substantial risk of forfeiture to the deferred compensation (i.e., the deferred compensation is vested). Therefore, executives may have FICA taxes withheld prior to scheduled distributions under the plan.

<sup>51</sup>In this illustrative alternative scenario, the executive does not defer compensation and instead pays income taxes on current compensation, invests the balance in the same or comparable investments (using a taxable account) and pays applicable taxes on investment earnings as they are due.

<sup>52</sup>This report does not address investments, if any, made by companies for their executive retirement plans or investments available to executives to invest in outside of the plan.

<sup>53</sup>Beginning in January 1, 2018, the highest individual tax rates on realized short-term capital gains is 37 percent and 20 percent for realized long-term capital gains. In contrast, the corporate tax rate on both short-term and long-term capital gains is 21 percent, beginning January 1, 2018. Capital gains are generally not taxed until the sale or other disposition of a capital asset.

<sup>54</sup>See Daniel Halperin & Ethan Yale, *Deferred Compensation Revisited*, 114 Tax Notes 939 (2007) and Michael Doran, *The Puzzle of Nonqualified Retirement Pay*, 70 Tax L. Rev. 181, 194 (2017).



allow the plan account to grow over time at a higher rate of investment return than if an executive invested in the same or similar assets outside the plan.<sup>55</sup> Further, any such tax advantages may allow companies to reduce their total compensation costs.<sup>56</sup> Conversely, Treasury officials told us the IRC may effectively disadvantage executive retirement plans to the extent the tax on an executive's investment earnings outside the plan is lower than the tax the company would pay if invested through the plan. In this circumstance, the tax disadvantage may increase the cost of companies' total compensation. However, our analysis of tax rates suggests that the corporate tax rate may be lower than the individual tax rate on several forms of investment income. In this case, the company may be able to achieve a higher after-tax rate of return on investments than the executive can, depending on the type of investment and amount of time invested.<sup>57,58</sup> The lower the applicable corporate tax rate is relative

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<sup>55</sup>A higher after-tax investment rate of return is generally beneficial for executives in plans structured as a defined contribution plan because the amount of benefits reflects an account balance tied to investment performance. In contrast, a higher after-tax rate of return does not directly benefit an executive in plans structured as a defined benefit arrangement because the company generally pays the executive a specified amount (e.g., a multiple of salary and years of service) unrelated to the performance of investments.

<sup>56</sup>Executive retirement plans, to the extent they enjoy a tax advantage, can provide tax benefits for executives, companies, or both. Tax incidence theory addresses the distribution of the burden of taxation or of the benefits of tax subsidies or expenditures. The full application of tax incidence theory to executive retirement plans is beyond the scope of this report. See [GAO-05-1009SP](#).

<sup>57</sup>A lower tax rate on pre-tax investment earnings results in a higher after-tax investment rate of return. Different tax rates can apply depending on the type of investment. As of 2018, the federal income tax rate for most types of investment earnings is 21 percent for corporations. For individuals in the highest income tax bracket, the federal income tax rate is 37 percent. Prior to 2018, the highest income tax rate was in effect 35 percent for corporations and 39.6 percent for individuals in the highest tax bracket. Both before and as of 2018, the realized long-term capital gains rate applicable to most investments is lower for individuals in the highest income bracket as compared with the rates generally applicable to corporations. Certain higher-income individuals may be subject to an additional 3.8 percent Net Investment Income Tax. Specifically, the tax applies to the lesser of an individual's (1) net investment income for the taxable year, or (2) the amount by which the individual's modified adjusted gross income for the taxable year exceeds the statutory threshold amounts. The threshold is generally \$200,000 for single filers and \$250,000 for those married filing jointly. See U.S.C. § 1411.

<sup>58</sup>Two industry experts told us that a company's after-tax return on capital (i.e., a measure of its profitability on invested capital) would be an appropriate proxy for the plan's after-tax investment return, especially in cases where companies do not invest assets associated with the plan. These experts said that a company's after-tax return on capital can be compared with an executive's own after-tax investment return (outside the plan) to determine whether a tax advantage exists for the executive's participation in the plan.

to the applicable individual tax rate, the greater the tax benefit for the executive or the company.<sup>59</sup> Treasury officials and some industry experts told us that, in this scenario, the potential tax advantage resulting from tax substitution of investment earnings is effectively a federal subsidy because the federal government receives less in tax revenue.<sup>60</sup> And due to the effects of compounding, the tax advantage is also greater the longer the deferral period (and higher the investment return).

Treasury officials and experts whose published work we reviewed and interviewed told us the potential effective federal tax subsidy for executive retirement plan investment earnings can be greater when companies have effective tax rates that are lower than statutory tax rates.<sup>61,62</sup> This can occur, for example, when a company's losses from the current year or losses carried over from prior years offset all other company income, including any investment earnings associated with their executive retirement plan.<sup>63</sup> In these instances, the federal government could

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<sup>59</sup>Executive retirement plans, to the extent they are tax-advantaged, may also effectively allow a company to pay an executive a market rate of total compensation at a lower overall cost than in the absence of an executive retirement plan.

<sup>60</sup>In contrast, this tax advantage from tax substitution on investment earnings would be a tax disadvantage if the applicable corporate tax rate were to exceed the applicable individual tax rate. An analysis of tax advantages or disadvantages would have to consider the different investment elections or decisions that might be made by the executive outside the plan, the executive inside the plan, and the company with plan assets.

<sup>61</sup>A company's effective tax rate can be lower than its statutory tax rate. We previously reported that in each year from 2006 to 2012, at least two-thirds of all active corporations had no federal income tax liability. Larger corporations were more likely to owe tax. Among large corporations (generally those with at least \$10 million in assets) less than half—42.3 percent—paid no federal income tax in 2012. Of those large corporations whose financial statements reported a profit, 19.5 percent paid no federal income tax that year. GAO, *Corporate Income Tax: Most Large Profitable U.S. Corporations Paid Tax but Effective Tax Rates Differed Significantly from the Statutory Rate*, [GAO-16-363](#) (Washington, D.C.: Mar. 17, 2016).

<sup>62</sup>See Daniel Halperin & Ethan Yale, *Deferred Compensation Revisited*, 114 Tax Notes 939, 943 (2007) and Michael Doran, *The Puzzle of Nonqualified Retirement Pay*, 70 Tax L. Rev. 181, 198-99, (2017). For another perspective on the potential effect of lower effective corporate tax rates on the use of executive retirement plans, see David I. Walker, *The Practice and Tax Consequences of Nonqualified Deferred Compensation*, 75 Wash. & Lee L. Rev. 2065, 2122 (2018).

<sup>63</sup>A currently profitable company may pay no federal tax in a given year as a result of using tax deductions for losses carried forward from prior years and tax incentives.

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effectively subsidize the plan investment earnings because it receives no taxes on those earnings until funds are distributed.

### Additional Compensation for Investment Earnings

Companies also provide executives with additional executive retirement plan compensation that increases their overall savings by not passing along taxes paid on investment earnings during the deferral period, according to Treasury officials and some industry experts.<sup>64</sup> In this scenario, a company's assets associated with the executive retirement plan are reduced for taxes it pays on investment earnings, but the executive's corresponding plan account balance is unaffected by tax because the company provides the executive with additional plan compensation in the same amount as the taxes the company pays.<sup>65</sup> Unaffected by taxation on investment earnings, the account balance accumulates over time at a pre-tax investment rate of return, rather than at the company's potentially lower after-tax investment rate of return, until those funds are distributed to the executive. In this manner, this additional compensation provided by the company allows the account balance of an executive retirement plan to accumulate in the same way as in a qualified defined contribution retirement plan (e.g., a 401(k) plan).<sup>66</sup> The additional compensation can result in a substantial benefit for an executive, and due to the effects of compounding, the benefit is greater the longer the deferral period (and higher the investment return).

### Additional Compensation for Personal Income Taxes

Lastly, industry experts said some companies provide additional executive retirement compensation to pay for the personal income taxes that executives expect to pay when plan benefits are distributed. This practice is known as a tax "gross-up" because the company increases the amount of gross or pre-tax executive retirement plan benefits to pay for the executive's anticipated income taxes at distribution. As a result, the executive effectively receives the total amount of the initial pre-tax benefit

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<sup>64</sup>Our review of select industry literature showed that executive retirement plan account balances grow without any reduction for income taxes until benefits are distributed.

<sup>65</sup>The additional plan compensation, upon becoming vested, would be subject to payroll (i.e., FICA) taxes up to the statutory limits.

<sup>66</sup>The cost to the company of this additional benefit will vary with the company's applicable tax rate on investment returns.

at distribution.<sup>67,68</sup> For example, a company that wants an executive who is in the 37 percent income tax bracket to receive \$1,000 from the plan on an after-tax basis would provide an additional \$588 in plan compensation (for a total of \$1588) to cover the executive's anticipated taxes at distribution.<sup>69</sup>

Treasury officials said that while tax gross ups and other similar executive compensation practices provide an economic benefit to executives, these practices by companies to offset executives' tax burden is a corporate governance issue for shareholders to decide and that tax law does not address their appropriateness.<sup>70</sup> Some industry experts told us that it has become less common for public companies to offer tax gross-ups, mostly due to shareholder concerns about their appropriateness in light of required public disclosures.<sup>71</sup>

### Plan Distributions during Working Years

Executive retirement plans can also provide executives with financial planning benefits through allowable distributions during their working years. Treasury officials and industry experts said that while executive retirement plans are intended for retirement purposes, plans typically also allow executives to take distributions while still working. These distributions generally are allowed if they comply with applicable statutory

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<sup>67</sup>The company could also provide the executive with additional compensation outside the plan and achieve the same result.

<sup>68</sup>Industry experts said some companies provide tax gross-ups to pay for additional income taxes executives' expect to pay as a result of administrative errors made by the company in implementing the plan that violated provisions in IRC section 409A.

<sup>69</sup>The executive would receive about \$1588 in gross income and after paying about \$588 in personal income taxes (37 percent of \$1588), would be left with \$1,000 in after tax income.

<sup>70</sup>Additional compensation a company provides, whether it be for tax gross-ups or to pay for taxes on investment earnings, to an executive through an executive retirement plan would generally be includible in income when paid.

<sup>71</sup>The SEC began requiring public companies to file disclosures pertaining to executive retirement plan benefits, including tax gross-ups, provided to its top five executive officers (CEO, CFO, and the next three most highly compensated executive officers) beginning in 2006.

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requirements.<sup>72</sup> Industry experts told us that executives can align distributions during their working years with income needs, such as to pay for a child's college expense, or for specific goals, such as buying a home. Industry experts said that the ability to structure pre-retirement distributions can allow executives to smooth out their overall income over time to better coordinate use of other income sources during their working years and retirement, which they said can lead to overall tax savings.

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## Federal Revenue Effects of Executive Retirement Plans Are Unknown

Executive retirement plans can provide tax advantages that may have revenue effects for the federal government, but the extent of those effects currently is unknown. Treasury is responsible for providing economic analysis and revenue estimates of tax legislation for the executive branch, and Treasury officials said that the Congressional Joint Committee on Taxation prepares official revenue estimates of all tax legislation considered by the Congress. Treasury officials told us that while executive retirement plans do not receive the preferential tax treatment afforded to qualified retirement plans, these arrangements can result in tax advantages that may have revenue effects for the federal government. These officials explained that executive retirement plans are tax revenue neutral when corporate tax rates and individual tax rates (or taxes paid) are the same because the federal government would generally receive the same amount of taxes regardless of the executive's decision to defer compensation. Treasury officials also told us that executive retirement plans could have federal revenue effects to the

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<sup>72</sup>See 26 U.S.C. § 409A. Section 409A provides specific rules regarding the timing and form (e.g., installments, lump sum, etc.) of payments under an executive retirement plan. An executive or the plan must specify the time and form of payment for future benefits at the time the executive makes compensation deferral elections. The plan may allow for payment no earlier than: the scheduled or fixed date(s) specified in the initial election, separation from service, disability, death, change of control, or unforeseeable emergency. Once a plan has specified when the deferred compensation will be paid, the timing of the payment generally cannot be accelerated. Changes in the form or timing of payments must be made at least 12 months prior to the first payment and postpone the first payment a minimum of 5 years. An executive retirement plan that fails to meet applicable requirements under section 409A will subject all compensation deferred to be immediately included in gross income and taxable to the executive, to the extent it is not subject to a substantial risk of forfeiture, along with an additional 20 percent tax on the compensation to be included in gross income plus an additional income tax calculated based on underpayment interest due if amounts had not been deferred.

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extent corporate and individual tax rates (or taxes paid) diverge from each other.<sup>73</sup>

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## Bankruptcies Reviewed Resulted in Various Expected Outcomes for Executive Retirement Plan Benefits

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### Executive Retirement Plan Participants' Expected Benefit Losses and Recoveries Varied Across Company Bankruptcies Reviewed

Among the 38 Chapter 11 corporate bankruptcy cases we reviewed<sup>74</sup>, 30 cases showed that participants in executive retirement plans expected to receive general unsecured creditor status when settling their plan benefit

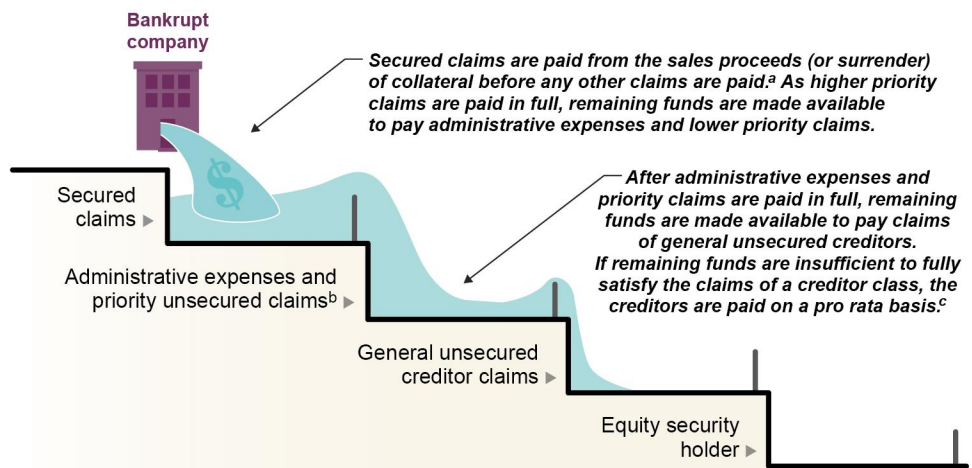
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<sup>73</sup>As of 2018, the federal income tax rate for most types of investment earnings is 21 percent for corporations. For individuals in the highest income tax bracket, the federal income tax rate is 37 percent. Prior to 2018, the highest income tax rate in effect was 35 percent for corporations and 39.6 percent for individuals in the highest tax bracket. Both before and as of 2018, the realized long-term capital gains rate applicable to most investments is lower for individuals in the highest income bracket as compared with the rates generally applicable to corporations.

<sup>74</sup>Our findings are based on evidence obtained from a review of selected case documents available in 38 Chapter 11 bankruptcy cases. We were unable to ascertain actual outcome information of the cases we reviewed; rather, we base our findings on estimated recovery information provided in appropriate court filings. For this report, we refer to companies that filed a Chapter 11 reorganization plan as a reorganization bankruptcy and those that filed a liquidation plan as a liquidation bankruptcy. Bankruptcy is governed by a federal court procedure conducted under rules and regulations of the U.S. Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. See generally Title 11 of the U.S. Code. Bankruptcy allows individuals and businesses to eliminate or restructure debts they cannot repay and helps creditors receive some payment in an equitable manner. A business debtor may seek liquidation, primarily governed by Chapter 7 of the U.S. Bankruptcy Code, or reorganization, governed by Chapter 11. A business that successfully reorganizes under Chapter 11 may continue some or all of its operations, whereas a business that seeks liquidation generally ceases to operate after the liquidation. A company that fails to reorganize under Chapter 11 may liquidate with court approval through a Chapter 11 liquidation plan or convert to a Chapter 7 liquidation, among other outcomes.

claims.<sup>75</sup> As a general unsecured creditor, executives in these plans are part of what is typically the last creditor class to be paid in bankruptcy, and only if funds remain after claims from all other creditors with payment priority have been paid in full (see fig. 8).<sup>76</sup>

**Figure 8: General Payment Order of Claims in Federal Bankruptcy**



Source: GAO review of the U.S. Bankruptcy Code and industry literature. | GAO-20-70

Note: This figure is intended to illustrate a general overview of the order of payment of creditor claims in a corporate bankruptcy. This figure is not intended to illustrate the full range of scenarios that may be involved in a bankruptcy, which would necessarily depend on the facts and circumstances of each bankruptcy.

<sup>a</sup>A claim is secured only to the extent of the collateral securing the claim. See 11 U.S.C. § 506(a).

<sup>75</sup>In the context of our review of corporate bankruptcy cases, the term executive retirement plan (commonly referred to as top hat plans) refers to unfunded plans offered to a select group of management and highly compensated employees. To determine the resolution of executive retirement plan benefits in bankruptcy, we reviewed case filings for evidence of specific treatment provided to employees with these claims. These claims are not limited to the top five executives as is the case for our analysis of data on the prevalence of these plans in the prior section. To the extent we did not find evidence of specific treatment for executive retirement plan benefits, we relied on estimated recovery information for the class of general unsecured creditors. See Appendix I for details on our methodology.

<sup>76</sup>Under the U.S. Bankruptcy Code, creditors are generally organized by classes based on claims and payment order. Approved claims in each class are generally paid in full before any junior class is paid anything, unless the plan as approved by the court provides otherwise. If there are insufficient funds to pay the entire class, creditors receive pro rata payment from remaining funds, based on the size of their claims relative to the amount of total claims for their class. Generally, the priority of payment for claim holders is in the following order: secured creditors, unsecured creditors entitled to priority, general unsecured creditors, and equity security holders. The U.S. Bankruptcy Code also provides priority for certain administrative expenses.

<sup>b</sup>See 11 U.S.C. §§ 503(b) and 507(a). The U.S. Bankruptcy Code provides first priority to administrative expenses, which generally include expenses incurred during the case that are actual and necessary to preserve the bankruptcy estate, such as administrative expenses of the bankruptcy trustee and reasonable attorney's fees. Expenses related to the maintenance of an ongoing business, such as existing unperformed contractual obligations—known as an “executory contract”—can also be considered an administrative claim to the extent a bankruptcy court approves the bankruptcy estate's “assumption” of the contract in which they are contained. See 11 U.S.C. §§ 365 and 502(g)(1). Following the first priority for administrative expenses, the U.S. Bankruptcy Code provides for a number of other priority unsecured claims, including claims that relate to certain tax and employee claims, among other things. For example, certain employee claims for wages and benefits earned within 180 days before the bankruptcy petition date also receive priority, but are limited to \$13,650 (adjusted for inflation) per employee. See 11 U.S.C. § 507(a)(4).

<sup>c</sup>Creditor claims within a particular class are paid on a “pro rata” basis if the bankruptcy estate does not have enough funds to fully pay creditors in a particular class. In this circumstance, creditors will receive pro rata payment from remaining funds, based on the size of their claims relative to the amount of total claims for the class. If no funds remain, as may be the case for general unsecured creditors, they may receive nothing. Equity security holders generally own a share of a company, and they may lose their stake in the company in bankruptcy if there are insufficient funds to pay all creditors.

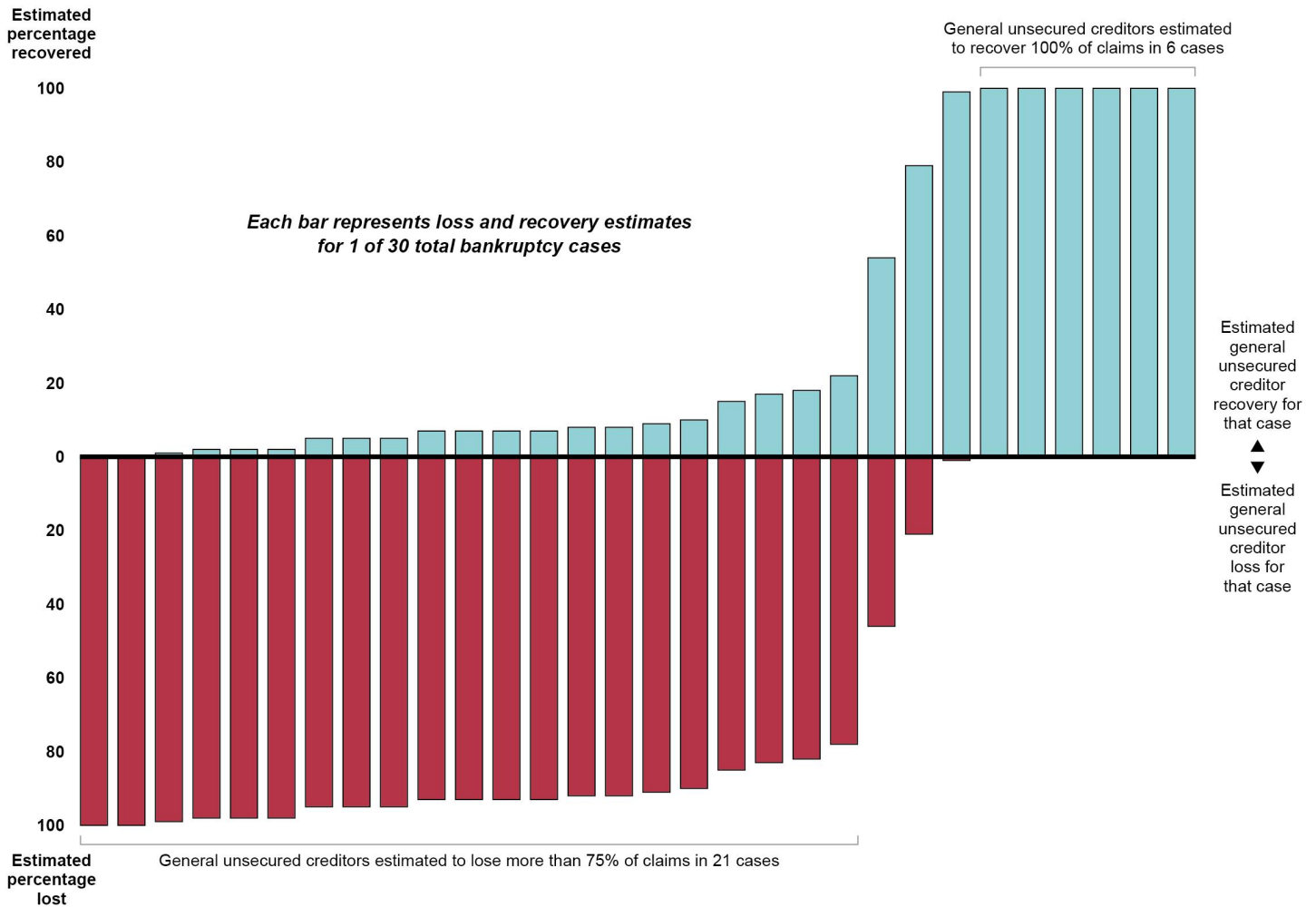
Our review of bankruptcy cases showed that executives' expected losses and recoveries varied among the 30 Chapter 11 cases we reviewed where all or some plan participants were expected to receive general unsecured creditor status for their plan benefit claims (see fig. 9).<sup>77</sup> In 21 of the 30 cases, plan participants were expected to sustain losses of more than 75 percent of their plan benefit claims, and in 17 of these 21 cases, participants were estimated to lose 90 percent or more. However, the remaining nine cases showed that participants were expected to recover more than half of their plan benefit claims with six of those cases expecting a full recovery and one case expecting a 99 percent recovery.

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<sup>77</sup>Recoveries are based on estimates (and not actual recoveries) provided in court-approved bankruptcy case filings. In 24 of 30 cases we reviewed, all executive retirement plan participants were expected to receive general unsecured creditor status for their plan benefits. In the remaining six cases, some plan participants were expected to receive general unsecured creditor status while others were not.



**Figure 9: Estimated Executive Retirement Plan Participant Benefit Claims Loss and Recovery as General Unsecured Creditors among Bankruptcy Cases Reviewed**



Source: GAO review and analysis of corporate bankruptcy case data. | GAO-20-70

Note: This figure shows estimates, based on the court-approved filings, of claims loss and recovery for the class of general unsecured creditors in the 30 of 38 cases we reviewed where there were participants in executive retirement plans who were expected to receive general unsecured creditor status for their plan benefit claims. In 24 of 30 cases, all executive retirement plan participants were expected to receive general unsecured creditor status for their plan benefits. In the remaining six cases, some plan participants were expected to receive general unsecured creditor status while others did not. Estimates rounded to the nearest percent.

Companies generally file for bankruptcy when they do not have sufficient assets to pay off their debts. Bankruptcy and industry experts said that executive retirement plan participants as general unsecured creditors may expect to sustain a significant or even a total loss of their deferred compensation in a company bankruptcy. However, bankruptcy and

industry experts noted that the level of losses or recoveries depends on the facts and circumstances of each case, including the type of bankruptcy the company filed.<sup>78</sup>

Our review of bankruptcy cases showed differences in expected benefit losses and recoveries based on whether the bankrupt company intended to continue to operate by filing a reorganization plan or sell all of its assets to pay creditors by filing a liquidation plan.<sup>79</sup> Among the 30 Chapter 11 bankruptcy cases where participants in executive retirement plans were expected to receive general unsecured creditor status, 14 filed a reorganization plan and 16 filed a liquidation plan.

### Reorganization

Among the bankruptcy cases we reviewed, executives were generally estimated to sustain less severe claims losses and recover more of their plan benefits if their company filed a reorganization plan to continue to operate and restructure its debts. In seven of 14 reorganization cases we reviewed, executive retirement plan participants were estimated to recover about 80 percent or more of their plan benefit claims, with participants in six of those cases expected to fully recover their benefits. In contrast, participants in the remaining seven of 14 cases were estimated to sustain benefit claims losses of about 20 percent or more, with participants in five cases expected to lose 90 percent or more. Industry experts told us plan participants are more likely to sustain fewer losses when their bankrupt company reorganizes because it has a plan to emerge from bankruptcy and pay its debts as it continues to operate. Bankruptcy and industry experts noted that in some reorganization cases, general unsecured creditors can receive full recoveries.

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<sup>78</sup>A full assessment of the risks of benefit losses to executives would also require assessing the risk of a company becoming bankrupt, which is beyond the scope of this report.

<sup>79</sup>One bankruptcy expert told us that most Chapter 11 cases filed do not result in a court-confirmed plan and that many cases are dismissed or liquidated. A recent study suggests that about 40 percent of Chapter 11 cases closed between fiscal years 2010 and 2016 resulted in a confirmed plan with remaining cases generally either dismissed or converted to liquidation. Flynn, Ed., "Bankruptcy by the Numbers: Dead-on-Arrival Cases (at Bankruptcy Court)" *ABI Journal*, January (2018): pp. 58-59.

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### Liquidation

Executives were generally estimated to sustain greater plan benefit claim losses if their company filed a liquidation plan. In 15 of 16 liquidation cases we reviewed, executive retirement plan participants were estimated to sustain losses of nearly 50 percent or more of their plan benefit claims. Participants in the remaining case were expected to nearly fully recover their benefits. Industry experts told us that whether a company has a viable post-bankruptcy future affects its ability to fulfill its debt obligations, including paying promised plan benefits to executive retirement plan participants. Bankruptcy experts said the severity of plan benefit claims losses for participants is generally greater when a bankrupt company liquidates because it signals the end of a company and is a last resort after it has exhausted all other options to restructure its debts and continue to operate.<sup>80</sup>

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### **Executive Retirement Plan Benefits Were Expected to be Maintained in Some Bankruptcies Reviewed Where Participants Were Not Expected to Receive General Unsecured Creditor Status**

Among the 38 Chapter 11 bankruptcy cases we reviewed, 11 involved the situation where all or some of the executive retirement plan participants were not expected to receive general unsecured creditor status for their benefit claims.<sup>81</sup> Although the circumstances varied among these 11 cases, the expected outcome was that some of these participants' plan

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<sup>80</sup>Bankruptcy experts told us nearly all companies that file for Chapter 11 bankruptcy intend to reorganize but those that find reorganization is not feasible will file a Chapter 11 liquidation plan instead of converting to a Chapter 7 bankruptcy.

<sup>81</sup>Three of the 11 cases we reviewed where benefits for some executive retirement plan participants were expected to be maintained were also included among the 30 cases where plan participants were expected to receive general unsecured creditor status for their benefits because these cases did not provide the same treatment for plan benefit claims to all participants.

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benefits which were accrued at or around the time the company filed for bankruptcy were expected to be preserved or paid.<sup>82</sup>

### Reorganization

Among the 11 cases we reviewed in which executive retirement plan benefits were expected to be maintained, eight occurred with a bankrupt company that filed a reorganization plan. In three of the eight cases, benefits for all plan participants were expected to be preserved; in five cases participants were divided into different groups where some were expected to have their benefits preserved and others were not.<sup>83</sup>

Bankruptcy and industry experts said that, paying plan benefit claims in a bankruptcy often depends on the financial health of the company and the value of the executive to the future of the company. These experts also said that not all executive retirement plan participants receive the same treatment for their claims. These experts added that a common scenario is to preserve in some manner the benefits for key executives who are retained, while giving executives who are not retained, or former executives no longer with the company, less favorable treatment as a general unsecured creditor. Industry experts also told us that some executive retirement plan participants' benefits may be preserved or the participants may be provided with more favorable treatment because they are key executives who need to be retained to help ensure their company successfully reorganizes and emerges from bankruptcy. These experts explained that key executives may not be willing to risk staying on without assurances that accrued plan benefits will be preserved or made up in some manner. Bankruptcy and industry experts said that because key high-level executives can be integral to the success of a company reorganization, its major creditors are more likely to agree to preserve

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<sup>82</sup>In one of the 11 cases, the executive retirement plan was dissolved and benefits were distributed prior to the filing date of the bankruptcy petition. For our analysis, we treated this case as if benefits were expected to be maintained. Although executives receive general unsecured creditor status for their plan benefits in order for their deferred compensation to be eligible for tax deferral, bankruptcy and industry experts said executives can receive better treatment for their benefits in company bankruptcy provided key creditors agree.

<sup>83</sup>We were unable to determine from our case reviews information about each participant (e.g., job titles, salaries, etc.) to ascertain whether the preservation of plan benefits were related to any category or type of employees.

plan benefits for them because it will likely result in increased overall recoveries and greater benefits for their stake in the company.<sup>84</sup>

Lastly, bankruptcy and industry experts said that in order for bankrupt companies to retain key executives, they typically need to provide assurances that, in addition to executive retirement plan benefits, executives will receive other forms of compensation. Bankruptcy and industry experts noted that because various forms of executive compensation may be interchangeable to the executive, informal agreements may be arranged so that executive retirement plan benefit losses that may occur as a general unsecured creditor are made-up through other forms of compensation. However, they told us these types of arrangements are not discernable from bankruptcy filings.

### Liquidation

In three of the 11 cases we reviewed in which executive retirement plan benefits were expected to be preserved, the companies filed a Chapter 11 liquidation plan. Court filings indicated executive retirement plan participants in two of the three cases received distributions shortly before the company filed bankruptcy. In one case, the bankruptcy estate<sup>85</sup> chose not to seek to recover those funds despite restrictions for early

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<sup>84</sup>Creditors vote by class to determine whether there is sufficient support to approve a Chapter 11 bankruptcy plan. Under the U.S. Bankruptcy Code, creditors that are adversely affected (generally known as “impaired”) by a proposed bankruptcy plan may vote in favor or against it (creditors that are not impaired are presumed to accept the plan). Impaired creditors that are not expected to receive any property under the plan are presumed to reject the plan. Impaired creditors vote on the plan based on separate classes, as defined in the plan, which organizes similarly situated creditors and equity security holders. The plan must generally treat every claimant in a given class the same as other members of the same class. A class of creditors has voted in favor of a proposed plan if creditors that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class have voted in favor of the plan. The plan is confirmed consensually only if all classes accept. Among other requirements for confirmation, each creditor under the plan must receive property worth at least as much as they would have received if the company had liquidated under Chapter 7 (this requirement is often referred to as the “best interests of creditors” test). A plan that does not receive unanimous acceptance by all impaired classes may still be confirmed if it does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. See 11 U.S.C. §§ 1123, 1126, and 1129.

<sup>85</sup>The bankruptcy estate refers to all legal or equitable interest of the company at the time it files for bankruptcy. The estate includes all property in which the company has an interest. In most Chapter 11 cases, the company remains in control of the bankruptcy estate during the bankruptcy proceeding, referred to as a debtor-in-possession.

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distributions before a bankruptcy in part because the costs to recover the monies outweighed the benefits.<sup>86</sup> Bankruptcy and industry experts said that while there are restrictions and penalties for early distributions before a bankruptcy, the costs and time associated with suing to recover monies can discourage bankruptcy estates from pursuing legal action.

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## Opportunities Exist to Strengthen Agency Oversight Efforts to Protect Benefits and Prevent Ineligible Employees from Participating in Executive Retirement Plans

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### IRS Provides Little Oversight of Companies with Executive Retirement Plans during a Restricted Period

IRS oversees executive retirement plans for compliance with the IRC during audits of companies who offer such plans. The Pension Protection Act of 2006 amended the IRC to provide that, during a restricted period, which includes bankruptcy, if a company that sponsors a qualified single-employer defined benefit plan sets aside or reserves assets in a trust for the purposes of paying nonqualified deferred compensation (which includes executive retirement plan compensation) to applicable covered employees (key executives), the key executives are required to include the amount of assets in their gross income for the taxable year.<sup>87</sup> A restricted period is defined as: (1) any period in which the plan sponsor is

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<sup>86</sup>For the second case, we were unable to determine what actions, if any, the bankruptcy estate took with regard to executive retirement plan distributions made shortly before the company filed for bankruptcy.

<sup>87</sup>See Pub. L. No. 109-280, § 116, 120 Stat. 780, 856-58 (codified as amended at 26 U.S.C. § 409A(b)(3)). The requirement is limited to assets that are set aside or reserved for the purpose of paying deferred compensation of “applicable covered employees” which generally includes “covered employees,” as described in IRC section 162(m)(3), and individuals subject to section 16(a) of the Securities Exchange Act of 1934, among others. Prior to 2018, section 162(m)(3) “covered employees” generally included the CEO (or individual acting in such capacity) and the four highest compensated officers for the taxable year (other than the CEO). Provisions in the December 2017 tax law, which became effective in 2018, amended the definition of “covered employee” by replacing CEO with “principle executive officer or principle financial officer” and revising the requirement to the “three” highest compensated officers for the taxable year (other than the CEO and CFO). See Pub. L. No. 115-97, § 13601(b), 131 Stat. 2054, 2156 (codified at 26 U.S.C. § 162(m)(3)).

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a debtor in bankruptcy; (2) any period when the qualified single-employer defined benefit plan of the company is in at-risk status; or (3) the 12-month period that begins 6 months before the date the qualified single-employer defined benefit plan is terminated if, as of the termination date, the plan's assets are not sufficient to cover benefit liabilities.<sup>88</sup> In general, a company's qualified single-employer defined benefit plan is in at-risk status if it is less than 80 percent funded.<sup>89</sup>

As part of its oversight effort, IRS officials said that its examiners can use IRS's Nonqualified Deferred Compensation Audit Techniques Guide (the guide) to audit these plans for compliance with the IRC, including the relevant provision, which was added by the Pension Protection Act of 2006.<sup>90</sup> The guide describes the requirements in section 409A of the IRC related to deferred compensation set aside during a restricted period.<sup>91</sup> While the guide is designed to provide guidance for IRS employees, the guide is publicly available and also useful for businesses and tax

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<sup>88</sup>See 26 U.S.C. § 409A(b)(3)(B).

<sup>89</sup>In general, a plan is in at-risk status for a plan year if—(i) the funding target attainment percentage for the preceding plan year (determined under section 430) is less than 80 percent, and (ii) the funding target attainment percentage for the preceding plan year (determined under section 430 by using the additional actuarial assumptions described in paragraph (1)(B) of IRC section 430(i) in computing the funding target) is less than 70 percent. See 26 U.S.C. § 430(i)(4).

<sup>90</sup>IRS audits only a small percentage of companies during the year. In 2018 (the most recent year of statistical data publicly available), IRS reported that it audited just over 8 percent of large corporations—those with assets in excess of \$10 million. By comparison, the rate was 0.6 percent for all other corporations and 0.6 percent for individual returns. Since IRS reviews executive retirement plans during company audits, it follows that most executive retirement plans do not come under IRS review during the year. Since most companies are not under IRS audit, IRS generally does not know to what extent, if any, taxpayers are complying with the relevant IRC provision.

<sup>91</sup>IRS officials said that examiners select issues for audit through a risk analysis process and are not required to select issues related to executive retirement plans if other issues pose a greater risk. The IRS uses risk analysis techniques to determine where to focus its limited resources based on facts and circumstances of the case with the goal being to focus on the highest compliance risk issues to ensure tax compliance, according to IRS. However, companies are required to report assets set aside for deferred compensation during a restricted period as income in the current year for executives. In its oversight role, IRS would obtain and evaluate information sufficient to understand the risks associated with companies failing to comply with this requirement.

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professionals who prepare returns.<sup>92</sup> However, the guide does not instruct examiners or other users on how to determine compliance with the relevant provision.<sup>93</sup> For example, the guide does not instruct examiners or other users to determine if the company has set aside assets—such as by making contributions of funds to a Rabbi Trust—to pay deferred compensation during bankruptcy. It also does not require examiners or other users to obtain data sufficient to determine whether there exists a restricted period with respect to the company’s qualified single-employer defined benefit plan. Lastly, it does not provide instructions regarding the type of data to collect or questions to ask to determine whether a company’s defined benefit plan is in a restricted period. When asked if additional instructions were available to examiners on auditing companies with these plans for compliance with the relevant provision, IRS officials pointed us to sections of the Internal Revenue Manual (IRM), IRS’s primary source of instructions to staff, and other internal training manuals.<sup>94</sup> However, we found no specific instructions in these sources related to the relevant IRC provision or its oversight.

IRS officials said examiners can also review SEC filings to determine whether there exists a restricted period with respect to a company’s

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<sup>92</sup>IRS officials also said that although IRS publishes audit guides to provide IRS examiners insight into specific issues and accounting methods unique to specific industries, the guides do not provide a legal precedent and should not be relied upon as such, nor is it mandatory that examiners follow instructions in the guide. Officials further said that guides are not designed to remove the discretion given to managers and examiners in the application of a variety of audit techniques or procedures appropriate to any given examination.

<sup>93</sup>The guide only suggests that examiners determine if the company maintains any qualified retirement plans as a way to determine compliance with this provision.

<sup>94</sup>Specifically, IRS officials directed us to IRM 4.23.5.16.1.1 (Section 409A), IRM 20.2.11.17 (IRC 409A, Inclusion in Gross Income of Deferred Compensation under Nonqualified Deferred Compensation Plans) on its website and provided us with the Small Business/Self-Employed Employment Tax Basic Phase II Training Participant Guide and the Advanced Employment Tax For Employment Tax Agents Participant Guide. We also asked if any documentation was available describing enforcement actions IRS has taken related to the provision. Officials said prior enforcement efforts focused on IRC section 409A in general and found no issues related to section 409A(b)(3); officials also acknowledged that there is no formal designation for this type of violation. As a result, the agency is unable to identify whether the issue has been examined in the past. Specifically, IRS officials said that there is no Uniform Issue List Code on section 409A(b)(3). According to IRS, the Uniform Issue List Code is a code that IRS formally assigns to a written determination that indexes the key legal issue(s) addressed in the document.



qualified single-employer defined benefit plan<sup>95</sup>. However, SEC filing requirements do not apply to many privately-held companies, limiting the usefulness of this information source for IRS audit examiners for this purpose. IRS officials also said that Form 5500, *Annual Return/Report of Employee Benefit Plan*, and the attached schedules are available on the DOL website and that examiners can download and review these data during their examinations.<sup>96</sup> For example, officials said information on the 5500 Form's Schedule SB, *Single-Employer Defined Benefit Plan Actuarial Information*, can be used to verify the income tax deduction for contributions to pension plans. Specifically, the schedule's Item 4 box, Part I Basic Information, will be marked if the plan is in at-risk status. The form, however, does not capture whether companies set aside assets for the purpose of paying deferred compensation or elicit information about a company's bankruptcy. Moreover, the IRM, the guide, and the IRS training manuals provide no instruction to examiners regarding how to review this information during audits of companies with executive retirement plans.

IRS also may be able to use non-confidential information that PBGC collects to monitor the financial condition of companies that sponsor single-employer defined benefit plans. In its capacity to provide plan termination insurance, PBGC monitors single-employer defined benefit plans—including companies' financial condition and plans' at-risk status—through a variety of reporting requirements and initiatives.<sup>97</sup> For example, because PBGC represents itself and the pension plan and participants as a creditor when companies (publicly and privately-held) sponsoring single-employer defined benefit plans file for bankruptcy, it is aware of such bankruptcy filings. PBGC also uses data that companies are

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<sup>95</sup>Public companies that have filed for federal bankruptcy will file Form 8-K with the SEC to inform the agency where the bankruptcy case is pending and which chapter of bankruptcy was filed, among other things. Form 8-K is used to notify the SEC of certain material corporate events on a more current basis than required annual or quarterly reports.

<sup>96</sup>The Form 5500, *Annual Return/Report of Employee Benefit Plan*, including all required schedules and attachments, is used to report information concerning employee benefit plans. Plan administrators of most private sector employee benefit plans subject to ERISA must file information about each benefit plan every year. For example, companies submit Schedule SB, *Single-Employer Defined Benefit Plan Actuarial Information*, with the Form 5500, which includes information on the plan's at-risk status and its funded status (in particular, the plan's funding target attainment percentage).

<sup>97</sup>Companies are also required annually to file premium calculations and payment with PBGC that provide information on a defined benefit plan's funded status.

required to report on Form 5500, describing the assets and liabilities of their single-employer defined benefit plans, to identify when a defined benefit plan is underfunded or in at-risk status.<sup>98</sup> IRS may be able to use the timely, non-confidential information PBGC possesses to help IRS identify whether companies with single-employer defined benefit plans are setting aside assets for the purpose of paying deferred compensation under an executive retirement plan during a restricted period.<sup>99</sup>

Federal standards for internal control require federal agencies to obtain and use quality information and to communicate this information to internal and external parties that can help the agency achieve its objectives and address related risks.<sup>100</sup> Without providing specific instruction to its examiners to collect and evaluate information that describes company actions relative to this requirement limiting tax deferral for key executives for amounts deferred under an executive retirement plan and set aside by the company during a restricted period, IRS cannot sufficiently determine if companies are including these amounts in the executives' gross income as required by the IRC provision.<sup>101</sup> Without taking steps to improve the sufficiency of its audit instructions to help strengthen its oversight, IRS cannot know if companies are reporting the correct amount of income for taxation for these key executives and if the correct amount of tax is being paid by the executives in these instances. IRS also may not be collecting additional

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<sup>98</sup>PBGC officials said that they did not know how many companies with single-employer defined benefit plans funded an executive retirement plan when in a restricted period. However, officials also said that the agency has no oversight role for executive retirement plans or responsibility for implementing specific provisions of the IRC prohibiting such funding.

<sup>99</sup>PBGC's "reportable events" regulation requires written notice to PBGC of certain events involving the plan or the company that may expose plan participants and PBGC's insurance program to risk, but provides that such information is confidential. See 29 C.F.R. pt. 4043. Further, under the agency's Early Warning Program, PBGC monitors corporate transactions and bankruptcy proceedings that may threaten funding or the continuation of ongoing plans. According to PBGC, in most cases, PBGC enters into a confidentiality agreement with the plan sponsor that would not permit PBGC to share sensitive business and financial information.

<sup>100</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 2014).

<sup>101</sup>The IRS uses risk analysis techniques to determine where to focus its limited resources based on facts and circumstances of the case, according to IRS. The goal is to focus on the highest compliance risk issues to ensure tax compliance. Other issues may pose more significant potential compliance risk than executive retirement plans, according to IRS.

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taxes and interest due from key executives who participate in executive retirement plans. Absent improved IRS oversight in this area, companies may be failing to report assets set aside to pay deferred compensation to key executives while in a restricted period as income for these employees. To the extent some companies are failing to report this income, they may continue to do so at the cost of foregone federal tax revenues while lacking an important incentive from IRS to cease this practice.<sup>102</sup>

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### Required DOL Reporting on Executive Retirement Plans Does Not Include Complete and Timely Data on Employee Participation

Another aspect of executive retirement plan oversight is ensuring that only eligible executives are allowed to participate since these plans are excluded from most of ERISA's substantive protections. DOL requires companies to report on their executive retirement plans, but the reporting lacks important information that could allow the agency to identify plans that may be including ineligible employees. Currently, under its alternative reporting method regulation, DOL regulations require the administrator of the executive retirement plan, typically the sponsoring company, to submit a one-time single page filing statement within 120 days of the executive retirement plan being established to satisfy ERISA reporting requirements (see fig. 10).<sup>103</sup> According to DOL officials, no other filings

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<sup>102</sup>GAO recently reported on the implications of corporate restructuring on pension benefits for employees and retirees. GAO Retirement Security: *Trends in Corporate Restructurings and Implications for Employee Pensions*, [GAO-19-447R](#) (Washington D.C.: July 12, 2019).

<sup>103</sup>See 29 C.F.R. § 2520.104-23. The administrator must also provide documents to DOL on request as required by 29 U.S.C. § 1014(a)(6), according to DOL officials. Officials also said that DOL also has a Delinquent Filer Voluntary Correction Program with provisions for administrators that miss the 120 day deadline. DOL officials told us that the 120 days requirement arises from the fact that ERISA requires other plan documents to be distributed within 120 days of establishing a new ERISA plan (i.e., within 120 days of the plan becoming subject to Part 1 of Title I of ERISA). Thus, the filing of the executive retirement plan filing statement should be before that date in order for the filing statement to be an "alternative method of compliance," according to DOL officials.

are required for executive retirement plans to comply with Part 1 of Title I of ERISA.<sup>104</sup>

Figure 10: Department of Labor’s Single Page Filing Statement for Executive Retirement Plans

The screenshot shows the Department of Labor's website for filing executive retirement plans. The page is titled "Employee Benefits Security Administration" and "Top Hat Plan Statements Online Filing System". It includes a navigation menu, a search bar, and a main content area with several sections: "Amended Filing Information", "Employer Information", "Declaration: Employer maintains the plan or plans primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.", "Plan Administrator Information", "Plan Information", and "Additional Information (optional, up to 5000 characters)".

Callouts from the screenshot point to the following sections:

- Employer Information:** EIN, Name, Address, City, State, Zip Code.
- Plan Administrator Information:** Name/Office, Address, City, State, Zip Code, Email, \* Telephone.
- Plan Information:** Input the total number of plans and click Submit. Number of Plans, Submit.
- Declaration:** Declaration: Employer maintains the plan or plans primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees. I agree .

Source: Department of Labor. | GAO-20-70

<sup>104</sup>DOL pointed us to its website for electronic filing of executive retirement plans that includes the following statement: “An existing [executive retirement] plan filing by an employer does not cover a new [executive retirement] plan that is subsequently adopted. A new filing, however, is not required when a[n executive retirement] plan is amended to include a separate class of participants. Whether a new arrangement is a separate plan or rather is part of an existing plan is determined under all of the facts and circumstances.”

The information provided in the filing statement does not describe the job title or salary of executives participating in the plan, the percentage of the company's workforce that is eligible to participate, or the actual percentage of employees who participate in the plan; nor does it compare the salaries of executives with rank-and-file workers.<sup>105</sup> Because DOL only requires companies to submit the filing statement once within 120 days of plan formation, the agency is not aware when participation in the plan changes over time or if plans are terminated.<sup>106</sup>

When asked if these additional data would be useful to the agency, one DOL official said that they could be used to increase oversight of executive retirement plans. For example, the official said if the filing statement included the percentage of the company's workforce that participated in such a plan, a high participation percentage could signal to DOL that the company might be permitting employees to participate in the plan who do not meet the "select group" requirements, and that such information could prompt a DOL audit. However, the DOL official said the agency would need to evaluate how the data would be used and the collection costs before determining the data's overall value. The preamble to DOL's regulation states that the agency chose to require limited reporting because these plans are for executives who generally have access to information concerning their rights and obligations under the

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<sup>105</sup>In this report, we refer to employees who are not members of a "select group of management or highly compensated employees" as rank-and-file employees. According to DOL Advisory Opinion 90-14A, DOL has viewed the policy underlying the executive retirement plan exemption from the substantive provisions of ERISA as based on a recognition by Congress that "certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan."

<sup>106</sup>DOL officials said other classes of plans that are exempt from Form 5500 filing also would not notify DOL when the plan is terminated or otherwise discontinued.

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plan and do not need ERISA protections.<sup>107</sup> Moreover, DOL officials said there is no statutory requirement specifically directing the agency to collect executive retirement plan data and no requirement for companies to file an amended filing statement to report substantive plan changes. However, ERISA authorized DOL to prescribe an alternative method of reporting and the agency chose to require a limited one-time single page filing statement for executive retirement plans.

DOL officials said the data currently collected can only be used for simple analysis or to facilitate the agency's ability to respond to requests from Congress, the media, or the public. This limited usefulness regarding eligibility is due to the age and limits of the original data submitted.<sup>108</sup> However, officials told us there currently is no plan to place executive

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<sup>107</sup>According to DOL officials, ERISA grants DOL the authority to prescribe alternative methods of compliance for the reporting and disclosure provisions under Part 1 of Title I for any plan or class of plans, which includes executive retirement plans. In promulgating regulations to provide an alternative reporting method for executive retirement plans, DOL noted that: (1) highly compensated or management employees generally have ready access to information concerning their rights and obligations and do not need the protections afforded them by Part I of Title I of ERISA; (2) the possibility of breaches of fiduciary responsibilities is decreased because the alternative method of compliance applies only to unfunded or totally insured pension plans so that reporting requirements geared to the enforcement of the fiduciary responsibility provisions of Title I, such as certain portions of the annual report, become less important; and (3) the imposition of the reporting and disclosure requirements of Part 1 of Title I of ERISA on these plans would entail wasteful expenses associated with the preparation, printing and distribution of unnecessary materials which might cause employers to eliminate such plans altogether or curtail benefits offered under such plans. See Coverage; Reporting and Disclosure Requirements, 40 Fed. Reg. 34,526, 34,530 (Aug. 15, 1975) (codified as amended at 29 C.F.R. § 2520.104-23).

<sup>108</sup>DOL's current filing statement includes a box to allow the filer to designate if the form is an amended filing. The instructions for the filing statement states an amended return is only required if there is a mistake on the original filing. The instructions also state that a new filing is not required if the plan is amended to add a new class of participants. Therefore, changes in the status of the plan, such as, if the plan is terminated by the company or no longer exists because the company has liquidated in bankruptcy, may not be reported to DOL. Our review of bankruptcy cases to determine the possible outcome of executive retirement plan benefits under company bankruptcy demonstrated the limitations of DOL's data. We used DOL data to develop a list of companies with executive retirement plans that also filed for bankruptcy. However, since the data may not be updated, we independently verified that companies had executive retirement plans at or around the time of the bankruptcy filing through a review of court documents. See Appendix I.

retirement plan reporting on DOL's regulatory project agenda.<sup>109</sup> Federal standards for internal control state that agencies should (a) use quality information to achieve its objectives; (b) obtain data from reliable sources in a timely manner based on identified information requirements; and (c) process the data into quality information—information that is appropriate, current, complete, accurate, accessible, and timely—to support its internal control system.<sup>110</sup> Without reviewing or clarifying its reporting requirements to allow the agency to collect more useful information on executive retirement plans, DOL will continue to lack insight into the composition of these plans and, as a result, may be missing opportunities to ensure that companies with executive retirement plans are meeting the eligibility requirements for the plan.

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## Experts Have Indicated Companies are Often Unclear on How to Establish Executive Retirement Plan Eligibility

Many industry experts we spoke to said that eligibility requirements for executive retirement plans are not clearly defined and that companies are unclear on how to establish eligibility. DOL has acknowledged that at least in one case a company may have denied ERISA protections to rank-and-file employees by allowing them to participate in executive retirement plans.<sup>111</sup> DOL officials also said the agency has issued guidance on the executive retirement plan provisions in ERISA. For example, DOL pointed us to Advisory Opinion 90-14A, which DOL officials said is the agency's most recent advisory opinion on provisions related to plan participant eligibility. The Advisory Opinion restates that executive retirement plans

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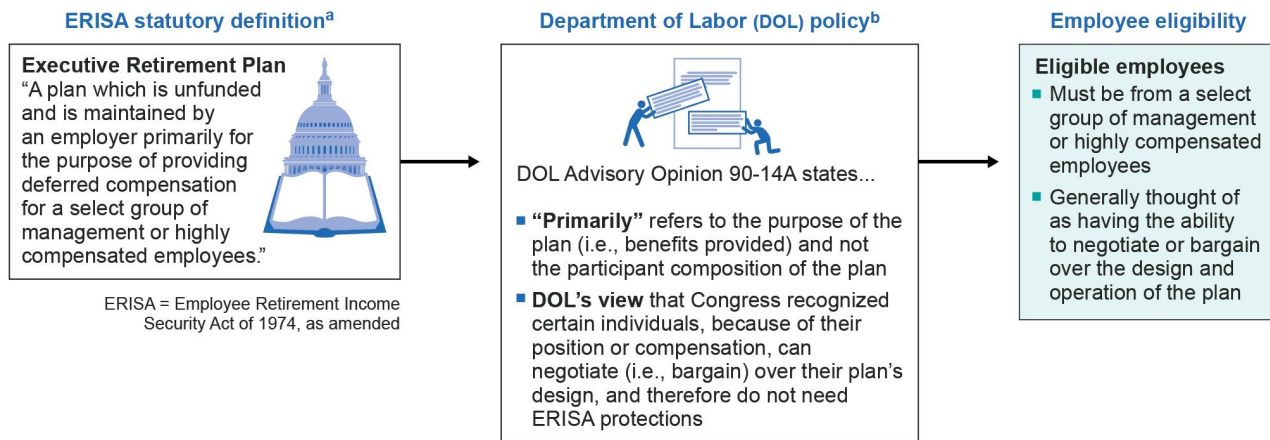
<sup>109</sup>The regulatory agenda is a listing of all the regulations DOL expects to have under active consideration for promulgation, proposal, or review during the next 6 to 12 months. On June 17, 2019, DOL issued final regulations requiring electronic submission of executive retirement plan filing statements. See Electronic Filing of Notices for Apprenticeship and Training Plans and Statements for Pension Plans for Certain Select Employees, 84 Fed. Reg. 27,952 (June 17, 2019). The regulations became effective on August 16, 2019.

<sup>110</sup>[GAO-14-704G](#).

<sup>111</sup>In a 2015 amicus brief DOL submitted in a case involving an executive retirement plan, DOL describes the case as concerning “circumstances under which rank-and-file workers will be denied ERISA's robust substantive protections for participation, funding, vesting, and fiduciary requirements” because their plan qualified for the exemption from substantive provisions of Title I of ERISA as an executive retirement plan. See Brief for the Secretary of Labor as Amicus Curiae Supporting Plaintiffs-Appellants, *Bond v. Marriott Int'l, Inc.*, 637 Fed. Appx. 726 (4th Cir. 2016) (Nos. 15-1160(L) & 15-1199) at n.5, accessed July 18, 2019, [https://www.dol.gov/sol/media/briefs/bond\\_2015-05-28.pdf](https://www.dol.gov/sol/media/briefs/bond_2015-05-28.pdf).

are excluded from most of ERISA’s substantive protections and describes DOL’s view that the term “*primarily*,” as used in the statute, refers to the purpose of the plan—the benefits provided—rather than the participant composition of the plan (see fig. 11).<sup>112</sup> The Advisory Opinion further states DOL’s view that executive retirement plans that include employees who are not from a select group of management or highly compensated would fail to constitute a “select group” under ERISA, which would subject the plan to all of the requirements of Title I.

**Figure 11: Eligibility to Participate in Executive Retirement Plans**



Source: GAO review of federal law and DOL Advisory Opinion 90-14A. | GAO-20-70

<sup>a</sup>See 29 U.S.C. §§ 1051(2), 1081(a)(3), and 1101(a)(1).

<sup>b</sup>DOL officials stated that DOL’s current policy for executive retirement plans is described in Advisory Opinion 90-14A. DOL answers inquiries from individuals and organizations in the form of advisory opinions, which generally apply the law to a specific set of facts.

Despite the information in the Advisory Opinion, several industry experts expressed the view that DOL’s current policy lacks specific information on the factors companies should consider when establishing eligibility for participation in these plans. Recent industry surveys we reviewed have suggested some companies may be extending employee eligibility to a relatively high percentage of their workforce—in some cases, more than 30 percent—and to relatively lower-paid or lower-ranked employees. For example, results from a recent survey of executive retirement plan

<sup>112</sup>Generally, most of the substantive protections of ERISA do not apply to plans that are unfunded and “maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.” These requirements include those related to participation, vesting, plan funding, and fiduciary responsibility.



sponsors suggested that just over 8 percent of respondents offer eligibility to between 20 to 30 percent of their workforce and just over 4 percent offer eligibility to more than 30 percent of their employees. Further, over 20 percent of respondents indicated that over 15 percent of their workforce was considered highly compensated employees and eligible to participate in an executive retirement plan.<sup>113</sup> Industry experts pointed to court cases that they identified as contributing to the confusion regarding executive retirement plan eligibility, including cases that have suggested a limit on the percentage of employees who may participate in an executive retirement plan and still constitute a select group.<sup>114</sup> Several industry experts suggested that DOL could help to address this issue in the future by providing a safe harbor that describes limits or thresholds companies could follow to establish eligibility. Two industry experts identified a range of possible information DOL could provide, such as a ceiling on the percentage of the company's workforce permitted to participate, job titles that could be eligible for participation, or a compensation threshold.<sup>115</sup> Industry experts also suggested more detailed information on factors to consider for eligibility, rather than a "one-size-fits-all" design, would help to ensure the information would be flexible enough for a variety of companies to apply.

We asked DOL officials about issuing clarifying information on the statutory requirements under ERISA for eligibility into these plans. DOL officials stated that the agency has the authority to do so but has no plans to issue guidance because it has not encountered eligibility problems

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<sup>113</sup>See Plan Sponsor Council of America: *2018 Non-Qualified Plan Survey* (Chicago, Ill.: 2018).

<sup>114</sup>For example, in one case identified by industry experts, the Court of Appeals for the Second Circuit suggested that an executive retirement plan that allowed 15.34 percent of its workforce to participate was "probably at or near the upper limit of the acceptable size for a 'select group.'" See *Demery v. Extebank Deferred Comp. Plan (B)*, 216 F.3d 283, 289 (2d Cir. 2000). An earlier case identified by industry experts from the Eastern District of North Carolina found an executive retirement plan that covered an average of 18.7 percent of employees during a certain period to be "too large to be considered 'select.'" See *Darden v. Nationwide Mut. Ins. Co.*, 717 F. Supp. 388, 396-97 (E.D.N.C. 1989).

<sup>115</sup>An employee benefits attorney identified a court decision that established a four-factor test made up of quantitative and qualitative factors to determine whether a plan qualifies as an executive retirement plan and suggested that more precise eligibility criteria might help practitioners and offer more certainty for employers. See *Bakri v. Venture Mfg. Co.*, 473 F.3d 677 (6th Cir. 2007). These factors include participation rate, compensation comparisons, descriptions of job duties, and plan language. See *id.* at 678.

during plan audits and enforcement actions.<sup>116</sup> Rather, DOL officials said that in light of resource constraints, other high priority guidance projects, and the absence of systematic abuses involving these plans, it does not believe it advisable to shift resources from other projects to undertake a guidance project in this area. DOL officials said the agency no longer renders decisions on the status of “select group” eligibility for executive retirement plans in advisory opinions or in response to external inquiries because such determinations involve factual questions that are not well suited to an advisory opinion or informal participant assistance process.

Federal standards for internal control require federal agencies to communicate quality information externally through reporting lines so that external parties can help the entity achieve its objectives and address related risks.<sup>117</sup> By exploring ways it may be able to help reduce the incidence of ineligible employees participating in executive retirement plans, DOL could help ensure ineligible rank-and-file employees are not participating in these plans and are receiving the applicable protections under ERISA.<sup>118</sup> One such way may be by providing information to companies on factors to consider when determining a “select group” to aid companies in establishing plan eligibility.

A related issue that companies can face is dealing with eligibility decisions that turn out to be in error. DOL officials told us they have not issued any guidance on how companies are to correct eligibility errors found in executive retirement plans. Officials referred us to a 2015 amicus brief DOL filed in a particular case that described the department’s views

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<sup>116</sup>DOL officials said that the agency finds few eligibility problems because it is not a commonly reviewed issue.

<sup>117</sup>[GAO-14-704G](#).

<sup>118</sup>In some instances, employees who participate in an executive retirement plan also receive benefits from a qualified retirement plan that receives ERISA protections for those benefits. These employees may or may not already be receiving benefits or contributions under their qualified plan up to the limits in sections 401 and 415 of the IRC. In addition, under section 402, for 2019, participants in qualified defined contributions plans can contribute up to \$19,000 per year (\$25,000 including catch-up contributions for employees age 50 and over under section 414(v)).

on how companies might consider addressing eligibility errors.<sup>119</sup> The amicus brief suggests that the company could modify the plan to exclude the ineligible rank-and-file employees and award them the full vesting and other protections under ERISA while maintaining the plan's status under ERISA as an executive retirement plan for those executives who do qualify.<sup>120</sup> However, the amicus brief states that DOL took no position on the form of equitable relief appropriate under ERISA to redress an employer's violation of vesting requirements by including rank-and-file employees in an executive retirement plan. The amicus brief also suggests that this approach would avoid providing a windfall gain to executives who properly could have been included in such a plan, because they possess sufficient bargaining power to protect their rights, and are not the intended beneficiaries of the substantive provisions under Parts 2, 3, and 4 of Title I of ERISA. When asked about this remedy, DOL officials said that funds from the executive retirement plan could be distributed to a qualified retirement plan for rank-and-file employees, with their benefits immediately fully vested and receiving ERISA protections.<sup>121</sup>

When we discussed the possible remedy described in the amicus brief with IRS officials, they said that while 409A regulations were being drafted, they were aware that applying strict distribution rules could have adverse tax consequences for rank-and-file employees participating in

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<sup>119</sup>DOL officials acknowledged that most companies would not know to look to a DOL amicus brief for information to address eligibility errors in executive retirement plans and that the agency does not use amicus briefs as a form of agency guidance. Officials also said that briefs represent legal positions articulated by DOL in individual cases that are often cited by courts in written decisions and that companies would likely work with capable ERISA attorneys and benefits consultants who would be familiar with positions in DOL amicus briefs.

<sup>120</sup>The brief suggests that in certain circumstances in which companies allowed ineligible rank-and-file employees to participate in an executive retirement plan, an appropriate remedy "may be" to provide relief only to those non-management, non-highly compensated employees who were improperly included in the plan. The circumstances referred to in the brief include instances where (1) the plan included very few such employees, (2) the employer included such employees inadvertently, and (3) the company had an objectively reasonable basis for believing that such employees qualified as management or highly compensated for purposes of 29 U.S.C. § 1051(2).

<sup>121</sup>In a defined contribution plan, vesting is a plan feature that determines when participants can keep the employer contributions to their accounts (and the investment returns based on those contributions) if they leave a job. Different criteria apply for vesting in a defined benefit plan.

executive retirement plans.<sup>122</sup> IRS officials said that removing these employees from these plans and awarding them full vesting of their benefits under Title I of ERISA could violate section 409A, raising concerns that the possible remedy noted in DOL's amicus brief may be inadequate for companies seeking a method to correct plan errors.<sup>123</sup> Officials also said that there are certain exceptions under section 409A when accelerated payments may be permitted<sup>124</sup>; however, IRS officials said there is no current exception permitting an accelerated payment to be made to a rank-and-file employee in order to correct a violation of Title I of ERISA.<sup>125</sup>

IRS officials said they are willing to work with DOL to promulgate new section 409A regulations to create an exception to the accelerated payment rule for plans that seek to remove ineligible rank-and-file employees from the plan and make distributions to an employee's qualified retirement plan in order to maintain the plan's ERISA

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<sup>122</sup>Under section 409A, an executive retirement plan generally may not permit the acceleration of the time or schedule of any payments under the plan, except as provided in Treasury regulations. See 26 U.S.C. § 409A(a)(3) and 26 C.F.R. § 1.409A-3(j)(1). Section 409A was enacted in October 2004 and was generally effective on January 1, 2005 for amounts deferred after December 31, 2004.

<sup>123</sup>If an executive retirement plan fails to meet the applicable requirements at any time during a taxable year, all compensation deferred, including investment earnings associated with the deferred compensation, is included in each affected executive's gross income for the taxable year, to the extent it is not subject to a substantial risk of forfeiture, along with an additional 20 percent tax on the compensation to be included in gross income plus an additional income tax calculated based on underpayment interest due if amounts had not been deferred. See 26 U.S.C. § 409A(a). In this report, we generally refer to deferred compensation that is not subject to a substantial risk of forfeiture as being vested.

<sup>124</sup>See 26 C.F.R. § 1.409A-3(j)(4).

<sup>125</sup>According to IRS officials, section 409A requires that amounts be distributed only upon the occurrence of certain payment events, one of which being a specified date for payment set forth in the plan at the time of deferral. If amounts are distributed to a rank-and-file employee before such payment date set forth in the plan, this would be an impermissible acceleration under section 409A, triggering a violation resulting in income inclusion and additional income taxes, according to IRS officials. Further, IRS officials said that if an employer tries to "correct" an executive retirement plan by removing a rank-and-file employee from the plan by distributing all deferred amounts to the employee or by vesting an amount and securing the amount through the use of a trust, such a distribution could result in a section 409A violation. Officials also said that if the rank-and-file employee was the only individual in the plan or the company was willing to terminate the plan as to all participants, the company would be permitted to terminate the entire plan and accelerate payments without triggering a section 409A violation.

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exemption.<sup>126</sup> However, IRS officials said that prescribing corrective action in these situations is under DOL's purview and that DOL first would need to further delineate the meaning of an executive retirement plan employee and then decide the proper approach for removing ineligible rank-and-file employees from a plan before any new regulations under section 409A could be considered.<sup>127</sup> As mentioned above, federal standards for internal control require federal agencies to externally communicate necessary quality information to achieve their objectives. Without additional information from DOL on what companies can do to reduce the incidence of ineligible rank-and-file employees participating in these plans, some ineligible employees may continue to participate in some instances, potentially subjecting them to unexpected tax consequences such as if they are removed from the plan and the payment of their deferred compensation is accelerated. Further, without knowing how to properly remove ineligible rank-and-file employees when they are found participating in executive retirement plans, companies may be uncertain on how to re-establish an executive retirement plan's exemption from the substantive provisions of Title I of ERISA for otherwise eligible participants.

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## Conclusions

Although executive retirement plans are an important retirement savings vehicle for corporate executives and other highly compensated

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<sup>126</sup>According to IRS officials, promulgating new regulations would be the way to allow for accelerated payments under an executive retirement plan to remedy eligibility errors that would otherwise constitute a violation of section 409A, potentially avoiding income inclusion and additional tax consequences for employees. Officials said that under current statute, IRS can only permit accelerated payments through regulations permitting such payments.

<sup>127</sup>We have also reported that some employers have designed ways to indirectly transfer some executive retirement plan benefits into their existing qualified defined benefit plans. In effect, plans accomplish this by increasing the benefits under the qualified plan, with an offsetting reduction in the benefits under the executive retirement plan, which extends to participating employees the security of qualified defined benefit plan funding. These arrangements, commonly referred to as Qualified Supplemental Executive Retirement Plans, can provide these employees with a higher qualified benefit amount as well as the increased benefit security provided by the backing of qualified plan assets. In a 2011 report, we noted that a Treasury official indicated that, while an employer cannot directly transfer nonqualified deferred compensation liability to a qualified plan, various steps can be taken that indirectly have that effect. See GAO, *Private Pensions: Little Information Available on Qualified Supplemental Executive Retirement Plans* [GAO-11-533R](#) (Washington D.C.: May 12, 2011).

employees, little is known about certain key aspects of these arrangements. While some federal regulatory data exist on plans provided to the top five executives of publicly owned companies, information about the design, participation, and benefits provided under plans offered by privately owned companies or offered to employees beyond top five executives are largely unknown, as is their net revenue effect on the federal government.

In addition, IRS has not taken steps nor collected adequate information to know if companies under audit with a qualified single-employer defined benefit plan are setting aside assets for the purpose of paying benefits deferred under executive retirement plans while the companies are in at-risk status—a practice the law intended to discourage. Through effective oversight, IRS can help ensure that it is collecting the appropriate amount of income taxes as a result of this potential practice.

Another important consideration with respect to executive retirement plans is their potential to permit ineligible rank-and-file employees to participate in the plan, thereby leaving such employees without the protections of ERISA. Little information is available at the federal level about who is included in executive retirement plans because companies provide minimal information to DOL only once when they implement such a plan. By revisiting its reporting requirements, DOL can help ensure that only executives who can bear the risks inherent in these plans are permitted to participate. DOL has other opportunities to diminish this risk by providing assistance to companies, such as additional information describing plan eligibility, which could help companies reduce the incidence of rank-and-file employees participating in these plans. In addition, DOL can provide direction that companies can follow to remove rank-and-file employees found participating in these plans to ensure their benefits are protected and coordinate with the IRS so that these employees do not incur unexpected tax consequences that could result from erroneous inclusion in an executive retirement plan.

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## Recommendations for Executive Action

We are making a total of four recommendations, including one to IRS and three to DOL.

The IRS Commissioner should develop specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide, or other IRS training material to aid examiners in

obtaining and evaluating information they can use to determine whether there exists a restricted period with respect to a company with a single-employer defined benefit plan and if a company with a single-employer defined benefit plan has, during a restricted period, set aside assets for the purpose of paying deferred compensation under an executive retirement plan. (Recommendation 1)

The Secretary of Labor should review and determine whether its reporting requirements for executive retirement plans should be modified to provide additional information DOL could use to oversee whether these plans are meeting eligibility requirements. (Recommendation 2)

The Secretary of Labor should explore actions the agency could take to help companies prevent the inclusion of rank-and-file employees in executive retirement plans and determine which, if any, actions should be implemented. (Recommendation 3)

The Secretary of Labor should provide specific instructions for companies to follow to correct eligibility errors that occur when rank-and-file employees are found to be participating in executive retirement plans, and should coordinate with other federal agencies on these instructions, as appropriate. (Recommendation 4)

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## Agency Comments and Our Evaluation

We provided a draft of this report to DOL, IRS, PBGC, SEC, Treasury, and the United States Trustee Program within the Department of Justice for review and comment. DOL, IRS, PBGC, SEC, and Treasury provided technical comments, which we have incorporated where appropriate. IRS and DOL also provided formal comments, which are reproduced in appendices II and III, respectively.

In response to our recommendation to develop specific instructions to aid IRS examiners in monitoring executive retirement plans for compliance with federal tax law, IRS stated that they would review and consider developing further specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide or other IRS training material to aid examiners. GAO continues to maintain that implementing this recommendation will help ensure that IRS is aware of when companies with at-risk single-employer defined benefit plans are reporting assets set aside to pay deferred compensation to key executives while in a restricted period as income for those employees.

DOL stated that it does not have plans to issue guidance or regulations regarding executive retirement plans, citing, among other considerations, existing resource constraints and priority regulatory and guidance projects in development, and that it would not be advisable to shift resources from other projects. GAO continues to maintain that DOL's one-time single page alternative reporting for executive retirement plans lacks important information sufficient to help the agency identify whether companies may be including ineligible employees in its plan and DOL's current data on executive retirement plans has limited usefulness due to the age and limits of the original data submitted. DOL also stated that the agency has not encountered evidence of systematic abuses involving executive retirement plans or that ERISA's claims procedure rules and judicial remedies are inadequate to protect participants' benefit rights. As we report, industry surveys indicate that some companies may be extending employee eligibility to high percentages of their workforce who are lower-paid and lower-ranked employees who may not be considered a part of a select group. Industry experts also told us that plan eligibility requirements for executive retirement plans are not clearly defined and that companies are unclear on how to establish eligibility, and they identified court cases that contribute to the confusion regarding plan eligibility. Additionally, the remedy DOL suggested in an amicus brief for companies to follow to correct eligibility errors in these plans could have unintended consequences for participants because, according to IRS officials, it could result in violations of federal tax law and additional tax for participants.

Without implementing our recommendations, DOL will continue to be unable to ensure that only executives who can bear the risks inherent in these plans are participating. We urge DOL to develop instructions to correct eligibility errors, in coordination with other federal agencies, as needed, in a way that does not adversely affect rank-and-file employees participating in these plans.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees; the Secretaries of the Departments of the Treasury, Labor, and Justice; the Commissioner of the Internal Revenue Service; the Chairman of the Securities and Exchange Commission; and the Director of the Pension Benefit Guaranty Corporation. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.



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If you or your staff have any questions about this report, please contact me at (202) 512-7215 or [jeszeck@gao.gov](mailto:jeszeck@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made contributions to this report are listed in appendix IV.



Charles A. Jeszeck  
Director  
Education, Workforce, and Income Security

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# Appendix I: Objective, Scope, and Methodology

This report examines (1) what is known about the prevalence, key advantages, and revenue effects of executive retirement plans; (2) the potential outcomes of executive retirement plan benefits in company bankruptcy; and (3) how federal agency oversight protects benefits and prevents ineligible participation in executive retirement plans.

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## Overall Methodology

To address these objectives, we reviewed relevant federal laws, regulations, guidance, and other agency documents related to executive retirement plans. We reviewed relevant research on executive retirement plans, which we identified with the help of a GAO librarian, through stakeholder interviews, by reviewing sources cited in documents we obtained, and through limited internet searches driven by stakeholder and documentary evidence. This research included published research on the costs of executive retirement plans on the companies that offer them and the revenue effects on the federal government. We interviewed a non-generalizable sample of executive retirement plan experts representing different roles in the industry, including plan consultants, plan providers (including record keepers and insurers), attorneys, investment advisors, actuaries, proxy advisors, and researchers. We also interviewed an array of bankruptcy experts—including those with experience in executive compensation—to understand bankruptcy procedure and the treatment of executive retirement plans in company bankruptcy. We selected executive retirement plan and bankruptcy experts to interview based on a combination of published work, breadth and depth of experience, as well as peer referrals. We interviewed representatives from industry associations representing a diverse range of stakeholder groups, such as those that offer, provide services to, or conduct research on executive retirement plans. As part of this effort, we contacted the American Institute of Certified Public Accountants to discuss their perspective on the use of executive retirement plans but they declined to meet with us. We also interviewed agency officials from the Department of Labor's (DOL) Employee Benefits Security Administration (EBSA), Department of the Treasury's Office of Tax Policy, the Internal Revenue Service (IRS), the Securities and Exchange Commission, the Pension Benefit Guaranty

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Corporation (PBGC), and the United States Trustee Program within the Department of Justice.

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## Prevalence of Executive Retirement Plans

To understand the prevalence of executive retirement plans, we analyzed data provided by the Main Data Group (MDG), an executive compensation benchmarking and corporate governance analytics firm. MDG compiled the data provided from required SEC disclosures from filing years 2013 to 2017 (the most recent data available at the time of our analysis) for executive retirement plan benefits provided to top executives in Standard & Poor's (S&P) 500 and Russell 3000 companies as reported in the annual 10-K, proxy statement, and other documents. Companies listed in the S&P 500 are generally also listed in the Russell 3,000. The SEC generally requires public companies to disclose executive compensation information—including executive retirement plan benefits—provided to the Chief Executive Officer, Chief Financial Officer, and the next three most highly compensated executive officers. These data are principally found in the annual proxy statement within the Summary Compensation Table, Pension Benefits Table, and Nonqualified Deferred Compensation Table. The data include executive retirement plan benefits offered as a defined benefit plan and defined contribution plan. For a given year, the total accumulated value of executive retirement plans structured as a defined benefit provided to top executives are based on the “present value of accumulated benefit” and “payments during the last fiscal year” as reported in the Pension Benefits Table. For defined contribution plans, the total accumulated values are based on the “aggregate balance at last fiscal year end” and the “aggregate withdrawals/distributions” for the reporting period as disclosed in the Nonqualified Deferred Compensation Table. To determine the average level of plan benefits for top executives, we summed the total accumulated plan benefits for all top executives in a given year and divided them by the total number of executives. For the median, we sorted the total accumulated plan benefits for all executives in a given year and determined the midpoint. To assess the reliability of the data provided, we interviewed MDG officials regarding their data collection processes. We also independently compared executive retirement plan data from a random sample of SEC filings obtained from Edgar (the SEC's public database for required disclosures) with data for the same companies as reported by MDG. We found the data to be sufficiently reliable for the purpose of describing the prevalence of executive

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retirement plans among companies subject to SEC's disclosure requirements.

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## Corporate Bankruptcy Case Reviews

To understand the expected outcomes for executive retirement plan benefits during company bankruptcy, we analyzed data collected from our non-generalizable review of a random sample of companies that offered an executive retirement plan and filed for bankruptcy during the period from October 17, 2005—the effective date for most of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Bankruptcy Act)—through November 30, 2017—the most recent at the time of our analysis. The 2005 Bankruptcy Act made significant changes to federal bankruptcy law, including provisions limiting executive compensation in corporate bankruptcy. Using the unique Employer Identification Number (EIN) the IRS assigns to companies, we matched corporate Chapter 7 and Chapter 11 bankruptcy cases with DOL's database of executive retirement plans to obtain lists of companies that filed for bankruptcy and offered at least one executive retirement plan.<sup>1</sup> We obtained lists of corporate bankruptcy filings from New Generation Research Inc.'s (NGR) online database.<sup>2</sup> NGR is a provider of data on corporate bankruptcies and companies in financial distress. We obtained from DOL its comprehensive list of executive retirement plans as filed with the agency from July 1982 to August 2017.<sup>3</sup> The NGR and DOL data are not exclusive to public or private companies. To assess the reliability of the NGR and DOL data, we corresponded with officials regarding their respective data collection processes and requirements. We found the data to be sufficiently reliable for our purposes. The results of our data matching produced 138 Chapter 7 cases and 594 Chapter 11 cases of companies that filed for bankruptcy and offered an executive retirement plan. We reviewed a random selection of 151 cases (30 Chapter 7 and 121 Chapter 11) from a total of 732 relevant bankruptcy cases.

To review bankruptcy court cases, we developed a standardized protocol to review each identified case and data collection instrument to input the

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<sup>1</sup>We did not determine the likelihood a company with an executive retirement plan would file for bankruptcy.

<sup>2</sup>New Generation Research Inc. operates the online database:  
<https://www.bankruptcydata.com>

<sup>3</sup>DOL's list of executive retirement plans is known as their "top hat" plan database.

data. The protocol included step-by-step instructions for reviewers to follow, including prescribed court documents to review and data to be collected. We obtained feedback on our case review protocol and data collection instrument from two outside bankruptcy experts—an attorney with expertise in the tax aspects of corporate bankruptcies and a bankruptcy law professor and former attorney who previously served as a federal bankruptcy judge—and incorporated their technical feedback on the documents. We also worked with a GAO methodologist to pretest our case review protocols and data collection instruments on a review of a select sample cases from the matched list to ensure our review process could collect reliable data between different reviewers.

To obtain bankruptcy case documents to review, we used court filings obtained from PACER exclusively and did not rely on other data sources. PACER is an electronic public access service provided by the Federal Judiciary that allows users to obtain case and docket information online from federal appellate, district, and bankruptcy courts. Case documents are available on PACER as they are filed or entered into the court's case system. Based on our case review protocol, we reviewed (where available), the court docket, case summary, bankruptcy petition, first day motions, management affidavit, schedule of assets and liabilities, statement of financial affairs, court-approved disclosure statement, court-approved plan (of reorganization or liquidation), and settlement agreements, among other documents with information relevant to executive retirement plans and their expected resolution in bankruptcy. We reviewed cases based on documents available in PACER between April and May 2018.

Our review of 151 cases (30 Chapter 7 and 121 Chapter 11) from the matched lists resulted in 38 Chapter 11 cases where we identified executive retirement plan benefits in existence at or around the time of company bankruptcy and were able to determine the expected resolution of those benefits for employees as a result of the bankruptcy proceeding.<sup>4</sup> As part of our review, we excluded cases if: (1) we were unable to confirm the presence of an executive retirement plan through review of court documents, (2) the case did not have a court-approved disclosure statement with estimated recovery percentages for various creditor

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<sup>4</sup>Executive retirement plan benefits identified in our case reviews are not limited to the top five executives as is the case for our analysis of SEC disclosure data on the prevalence of these plans.

classes in the case docket<sup>5</sup>, or (3) if the case was open (i.e., not terminated) and had a reorganization or liquidation plan confirmed on or after May 2016, about 2 years from the start of our review. For the foregoing reasons, we were unable to identify expected outcomes in any of the Chapter 7 cases reviewed. For Chapter 11 cases, we were unable to ascertain actual outcome information for any of the cases we reviewed, but based the expected outcome of the executive retirement plan benefits on estimates provided in the court-approved disclosure statement, bankruptcy plan (reorganization or liquidation), or settlement agreement, which may differ from actual recoveries. To determine the expected resolution of executive retirement plan benefits, we reviewed case filings for evidence of specific treatment provided to employees with these claims. To the extent we did not find evidence of specific treatment for executive retirement plan benefits, we relied on estimated recovery information for the class of general unsecured creditors.<sup>6</sup> Because the nature of bankruptcy proceedings depends on the facts and circumstances of each individual cause, the results of our analysis are not generalizable but provide illustrative examples of the potential outcomes of such cases.

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## Review of Selected Court Cases and Surveys on Plan Eligibility and Participation

We reviewed selected court cases related to employee eligibility in executive retirement plans as identified by DOL, industry experts, and other literature. We also reviewed executive retirement plan surveys produced by industry firms, including plan sponsor organizations, benefit consultancies, record keepers, and other plan providers. We also interviewed representatives from many of these organizations regarding the use of executive retirement plans and determined that their survey data generally accorded with these discussions. We found the data to be sufficiently reliable for our purposes.

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<sup>5</sup>Because DOL does not require companies to update their one-time single page executive retirement plan filings, such as if the plan is terminated or the company is liquidated, we independently verified the presence of a plan based on bankruptcy court filings.

<sup>6</sup>In an executive retirement plan, for an executive to be eligible for tax deferral, the plan must be an "unfunded and unsecured" company promise to pay benefits in the future. Generally, for an executive retirement plan to be considered unfunded and unsecured, the executive's rights to receive plan distributions will be no greater than the rights of an general unsecured creditor in the event of company bankruptcy or insolvency.

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# Appendix II: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

November 25, 2019

Charles A. Jeszeck  
Director, Education, Workforce and Income Security  
U.S. Government Accountability Office  
441 G Street N.W.  
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the draft report, *Private Pensions: IRS and DOL Should Strengthen Oversight of Executive Retirement Plans* (GAO-20-70). The focus of the report is to examine the prevalence, key advantages, and revenue effects of executive retirement plans, the potential outcomes for these plan benefits in company bankruptcies, and how federal oversight protects benefits and prevents ineligible participation. We appreciate Government Accountability Office's (GAO) acknowledgement of the role the Internal Revenue Service (IRS) serves in ensuring compliance with federal tax laws relating to executive retirement plans.

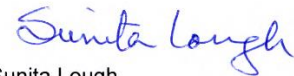
As noted in your report, several government agencies have a role with respect to executive retirement plans – including the IRS, Department of Labor (DOL), Securities and Exchange Commission, Pension Benefit Guaranty Corporation, and United States Trustee Program. The IRS' role is to ensure that these plans comply with the requirements under the Internal Revenue Code. Of the four recommendations in your report, one is directed to the IRS and the remaining three are directed to DOL. The four recommendations to the Agencies are designed to provide more information about the benefits and net revenue effect of these funds, ensure companies with a qualified single-employer defined benefit plan are not setting aside assets for paying deferred compensation while the companies were in a restricted period, and ensure the information available and reporting requirements by the DOL prevent ineligible rank-and-file employees from participating in executive retirement plans. With that as background, please find our response to the recommendation that is directed to the IRS.



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If you have any questions, please contact me, or a member of your staff may contact Scott Ballint, Director, Large Business and International Division, Enterprise Activities Practice Area, at (304) 238-8235.

Sincerely,



Sunita Lough  
Deputy Commissioner for  
Services and Enforcement

Enclosure

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**Comments on the GAO Recommendations directed to the IRS**

**Recommendation 1:**

The IRS Commissioner should develop specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide, or other IRS training material to aid examiners in obtaining and evaluating information they can use to determine whether there exists a restricted period with respect to a company with a single-employer defined benefit plan and if a company with a single-employer defined benefit plan has, during a restricted period, set aside assets for the purpose of paying deferred compensation under an executive retirement plan.

**Comment:**

The IRS will review and consider developing further specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide, or other IRS training material to aid examiners.

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# Appendix III: Comments from the Department of Labor

U.S. Department of Labor

Employee Benefits Security Administration  
Washington, D.C. 20210



NOV 01 2019

Charles A. Jeszeck  
Director, Education, Workforce and Income Security  
Government Accountability Office  
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the Government Accountability Office's draft report entitled "Private Pensions: IRS and DOL Should Strengthen Oversight of Executive Retirement Plans" (GAO-20-70). The draft report examines, among other things, (1) the prevalence, key advantages, and revenue effects of executive retirement plans and (2) how federal oversight protects benefits and prevents ineligible participation.

Much of the draft report deals with issues involving tax compliance questions within the jurisdiction of the Department of the Treasury and the Internal Revenue Service. Those entities would be the best source of information on these matters.

The draft report, however, contains three recommendations for the Secretary of the Department of Labor (Department):

1. The Department should review and determine whether its reporting requirements for executive retirement plans should be modified to provide additional information the DOL could use to oversee whether these plans are meeting eligibility requirements.
2. The Department should explore actions the agency could take to help companies prevent the inclusion of rank-and-file employees in executive retirement plans and determine which, if any, actions should be implemented.
3. The Department should provide specific instructions for companies to follow to correct eligibility errors that occur when rank-and-file employees are found to be participating in executive retirement plans, and should coordinate with other federal agencies on these instructions, as appropriate.

Sections 201(2), 301(a)(3), and 401(a)(1) of the Employee Retirement Income Security Act (ERISA) provide an exclusion from the requirements of Parts 2, 3 and 4 of Title I (pertaining to participation, vesting, funding and fiduciary responsibilities, respectively) for "a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" (commonly referred to as a "top-hat" plan). It is the longstanding view of the Department that in providing relief for "top-hat" plans from the broad remedial provisions of ERISA, Congress recognized that

certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan.

Currently the Department does not have plans to issue guidance or regulations in this area. In light of existing resource constraints at the Department, existing priority regulatory and guidance projects in development, and the absence of evidence of systematic abuses involving such plans or that ERISA's claims procedure rules and judicial remedies are inadequate to protect participants' benefit rights, the Department does not believe it would be advisable to shift resources from other projects to undertake guidance or regulations as described in the draft report.

However, the Department will, as priorities and resources permit, engage with interested stakeholders to discuss the issues presented in the report. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,

  
Preston Rutledge  
Assistant Secretary

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# Appendix IV: GAO Contact and Staff Acknowledgments

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## GAO Contact

Charles Jeszeck, (202) 512-7215 or [jeszeckc@gao.gov](mailto:jeszeckc@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, the following individuals made important contributions to this report: Tamara Cross (Assistant Director), David Lin (Analyst-in-Charge), Ted Burik, Dan Powers, and David Reed. Also contributing to this report were James Bennett, Joanna Berry, Colenn Berracasa, Sherwin Chapman, Nina Daoud, Sarah Gilliland, Laura Hoffrey, Angie Jacobs, Kirsten Lauber, Ted Leslie, Avani Locke, Sheila R. McCoy, James R. McTigue Jr., Jeffrey Miller, Ed Nannenhorn, Oliver Richard, Marylynn Sergent, Frank Todisco, Walter Vance, Kathleen Van Gelder, and Adam Wendel.

# Appendix V: Accessible Data

## Data Tables

### Accessible Data for Federal Income Tax Treatment of Deferred Compensation in Executive Retirement Plans

1. Executive defers compensation in Executive Retirement Plan (ERP)
2. Executive makes investment elections in ERP and company may make corresponding investments
  - a. (ERP remains part of the company)
3. Investments generate earnings and plan balance appreciates
4. Executive takes distributions and pays income taxes

Source: GAO review of industry literature and federal tax requirements for executive retirement plans. | GAO-20-70

### Accessible Data for Figure 1: Federal Income Tax Treatment of Deferred Compensation in Executive Retirement Plans

1. Executive defers compensation in Executive Retirement Plan (ERP)
  - a. Amounts deferred not included in executive's income for tax purposes
  - b. Company defers tax deduction for plan contributions
2. Executive makes investment elections in ERP and company may make corresponding investments
  - a. ERP is not funded and remains part of the company, ERP benefits are a company liability, and ERP assets are subject to creditor claims
3. Investments generate earnings and plan balance appreciates
  - a. Company subject to tax on investment earnings
4. Company pays corporate taxes on investment earnings
5. Executive takes distributions and pays individual income tax
  - a. Company takes tax deductions for distributions paid to executive, subject to statutory requirements
  - b.

Source: GAO review of industry literature and federal tax requirements for executive retirement plans. | GAO-20-70

### Accessible Data for Figure 2: Large Public Companies, Top Five Executives, and Accumulated Plan Benefits for Executive Retirement Plans from 2013 to 2017

Year	Number of large companies with executive retirement plans
2013	359
2014	409

Year	Number of large companies with executive retirement plans
2015	407
2016	410
2017	414

Year	Number of top executives participating in executive retirement plans
2013	1941
2014	2214
2015	2211
2016	2222
2017	2278

Year	Total accumulated executive retirement plan benefits (in billions of dollars)
2013	10.476
2014	12.094
2015	12.197
2016	12.399
2017	13.016

Source: GAO analysis of data from the Main Data Group. | GAO-20-70

**Accessible Data for Figure 3: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives in Large and Smaller Public Companies from 2013 to 2017**

Year	Large companies (Average)	Large companies (Median)	Smaller companies (Average)	Smaller companies (Median)
2013	5.397	1.367	2.675	0.375
2014	5.463	1.234	2.709	0.34
2015	5.517	1.298	2.713	0.37
2016	5.58	1.262	2.678	0.335
2017	5.714	1.348	2.775	0.336

Source: GAO analysis of data from the Main Data Group. | GAO-20-70



**Accessible Data for Figure 4: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Title for Large Public Companies from 2013 to 2017**

Year	Chief Executive Officer (CEO) [Average]	CEO [Median]	Chief Financial Officer (CFO) [Average]	CFO [Median]	Other named officer [Average]	Other named officer [Median]
2013	13.215	4.47331	3.084	1.20656	3.34608	0.987874
2014	13.1441	3.40826	3.05966	1.06949	3.29549	0.870918
2015	13.0785	4.31238	2.78394	0.870105	3.62077	0.912118
2016	13.638	4.41402	2.9842	0.850959	3.45806	0.932492
2017	14.0249	4.32784	3.07516	0.858169	3.38996	1.03576

Source: GAO analysis of data from the Main Data Group. | GAO-20-70

**Accessible Data for Figure 5: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Source of Contributions for Large Public Companies from 2013 to 2017**

Year	Plans with only executive contributions (Average)	Plans with only executive contributions (Median)	Plans with company contributions (Average)	Plans with company contributions (Median)
2013	2.72703	0.011134	5.94397	1.78281
2014	2.12409	0	6.23961	1.7272
2015	2.29861	0	6.27114	1.8101
2016	2.54039	0	6.28228	1.79917
2017	2.08956	0.023922	6.51875	1.83651

Source: GAO analysis of data from the Main Data Group. | GAO-20-70

**Accessible Data for Figure 6: Average and Median Accumulated Executive Retirement Plan Benefits for Top Five Executives by Plan Type for Large Public Companies from 2013 to 2017**

Year	Executives with defined benefit plans (Average)	Executives with defined benefit plans (Median)	Executives with defined contribution plan only (Average)	Executives with defined contribution plan only (Median)
2013	7.84453	3.33372	4.40954	0.898981
2014	8.30794	3.53192	4.40486	0.821831
2015	8.52194	3.56454	4.33481	0.767977

Year	Executives with defined benefit plans (Average)	Executives with defined benefit plans (Median)	Executives with defined contribution plan only (Average)	Executives with defined contribution plan only (Median)
2016	8.67391	3.32036	4.32016	0.786902
2017	8.94406	3.66877	4.38768	0.829766

Source: GAO analysis of data from the Main Data Group. | GAO-20-70

**Accessible Data for Figure 7: Comparison of Federal Tax Treatment of Deferred Compensation with Current Compensation**  
**Executive defers compensation**

*ERP remains part of the company, ERP benefits are a company liability, and ERP assets are subject to creditor claims*

1. Executive defers compensation in Executive Retirement Plan (ERP)
2. Executive makes investment elections in ERP and company may make corresponding investments
3. Investments generate earnings and plan balance appreciates
4. Company pays corporate taxes on investment earnings
5. Executive takes distributions and pays income tax

**Executive does not defer compensation**

1. Executive takes current compensation instead of deferring it in ERP
2. Executive pays income taxes on current compensation
3. Executive makes same investments with remaining funds
4. Executive pays individual income taxes on investment earnings
5. Executive takes distributions

Source: GAO review of industry literature and federal tax requirements for executive retirement plans and taxable investment accounts. | GAO-20-70

**Accessible Data for Figure 8: General Payment Order of Claims in Federal Bankruptcy**

Bankrupt company

Secured claims are paid from the sales proceeds (or surrender) of collateral before any other claims are paid.<sup>a</sup> As higher priority claims are paid in full, remaining funds are made available to pay administrative expenses and lower priority claims.

After administrative expenses and priority claims are paid in full, remaining funds are made available to pay claims of general unsecured creditors. If remaining funds are insufficient to fully satisfy the claims of a creditor class, the creditors are paid on a pro rata basis.<sup>c</sup>

1. Secured claims
2. Administrative expenses and priority unsecured claims<sup>b</sup>
3. General unsecured creditor claims
4. Equity security holder

Source: GAO review of the U.S. Bankruptcy Code and industry literature. | GAO-20-70

**Accessible Data for Figure 9: Estimated Executive Retirement Plan Participant Benefit Claims Loss and Recovery as General Unsecured Creditors among Bankruptcy Cases Reviewed**

General unsecured creditors estimated to lose more than 75% of claims in 21 cases

General unsecured creditors estimated to recover 100% of claims in 6 cases

Bankruptcy cases	Estimated general unsecured creditor loss for that case	Estimated general unsecured credit or recovery for that case
1	100	0
2	100	0
3	99	1
4	98	2
5	98	2
6	98	2
7	95	5
8	95	5
9	95	5
10	93	7
11	93	7
12	93	7
13	93	7
14	92	8
15	92	8
16	91	9
17	90	10
18	85	15
19	83	17
20	82	18
21	78	22
22	46	54
23	21	79
24	1	99
25	0	100
26	0	100
27	0	100
28	0	100
29	0	100

Bankruptcy cases	Estimated general unsecured creditor loss for that case	Estimated general unsecured credit or recovery for that case
30	0	100

Source: GAO review and analysis of corporate bankruptcy case data. | GAO-20-70

**Accessible Data for Figure 10: Department of Labor’s Single Page Filing Statement for Executive Retirement Plans**

Screen grab from <https://www.askebsa.dol.gov/efile/Home/tophat>

**Website asks for employer information**

- EIN, Name, Address, City, State, and ZIP code

**Website asks for plan administrator information**

- Name/Office, Address, City, State, ZIP code, Email, Telephone

**Plan information**

- Total number of plans

Form asks people to “agree” with the following declaration: Employer maintains the plan or plans primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.

Source: Department of Labor. | GAO-20-70

**Accessible Data for Figure 11: Eligibility to Participate in Executive Retirement Plans**

**ERISA statutory definition<sup>a</sup>**

Executive Retirement Plan

“A plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees.”

**Department of Labor (DOL) policy<sup>b</sup>**

DOL Advisory Opinion 90-14A states

- “Primarily” refers to the purpose of the plan (i.e., benefits provided) and not the participant composition of the plan
- DOL’s view that Congress recognized certain individuals, because of their position or compensation, can negotiate (i.e., bargain) over their plan’s design, and therefore do not need ERISA protections

**Employee eligibility**

To be eligible employees

- Must be from a select group of management or highly compensated employees
- Are generally thought of as having the ability to negotiate or bargain over the design and operation of the plan

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ERISA = Employee Retirement Income Security Act of 1974, as amended

Source: GAO review of federal law and DOL Advisory Opinion 90-14A. | GAO-20-70

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## Agency Comment Letters

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### Accessible Text for Appendix II Comments from the Internal Revenue Service

#### Page 1

November 25, 2019

Charles A. Jeszeck

Director, Education, Workforce and Income Security

U.S. Government Accountability Office

441 G Street N.W.

Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the draft report, *Private Pensions: IRS and DOL Should Strengthen Oversight of Executive Retirement Plans* (GAO-20-70). The focus of the report is to examine the prevalence, key advantages, and revenue effects of executive retirement plans, the potential outcomes for these plan benefits in company bankruptcies, and how federal oversight protects benefits and prevents ineligible participation. We appreciate Government Accountability Office's (GAO) acknowledgement of the role the Internal Revenue Service (IRS) serves in ensuring compliance with federal tax laws relating to executive retirement plans.

As noted in your report, several government agencies have a role with respect to executive retirement plans - including the IRS, Department of Labor (DOL), Securities and Exchange Commission, Pension Benefit Guaranty Corporation, and United States Trustee Program. The IRS' role is to ensure that these plans comply with the requirements under the Internal Revenue Code. Of the four recommendations in your report, one is directed to the IRS and the remaining three are directed to DOL. The

four recommendations to the Agencies are designed to provide more information about the benefits and net revenue effect of these funds, ensure companies with a qualified single-employer defined benefit plan are not setting aside assets for paying deferred compensation while the companies were in a restricted period, and ensure the information available and reporting requirements by the DOL prevent ineligible rank-and-file employees from participating in executive retirement plans. With that as background, please find our response to the recommendation that is directed to the IRS.

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If you have any questions, please contact me, or a member of your staff may contact Scott Ballint, Director, Large Business and International Division, Enterprise Activities Practice Area, at (304) 238-8235.

Sincerely,

Sunita Lough

Deputy Commissioner for Services and Enforcement

Enclosure

Page 3

Comments on the GAO Recommendations directed to the IRS

Recommendation 1:

The IRS Commissioner should develop specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide, or other IRS training material to aid examiners in obtaining and evaluating information they can use to determine whether there exists a restricted period with respect to a company with a single-employer defined benefit plan and if a company with a single-employer defined benefit plan has, during a restricted period, set aside assets for the purpose of paying deferred compensation under an executive retirement plan.

Comment:

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The IRS will review and consider developing further specific instructions within the Internal Revenue Manual, the Nonqualified Deferred Compensation Audit Techniques Guide, or other IRS training material to aid examiners.

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## Accessible Text for Appendix III Comments from the Department of Labor

### Page 1

NOV 01 2019

Charles A. Jeszeck

Director, Education, Workforce and Income Security

Government Accountability Office

Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the Government Accountability Office's draft report entitled "Private Pensions: IRS and DOL Should Strengthen Oversight of Executive Retirement Plans" (GAO-20-70). The draft report examines, among other things, (1) the prevalence, key advantages, and revenue effects of executive retirement plans and (2) how federal oversight protects benefits and prevents ineligible participation.

Much of the draft report deals with issues involving tax compliance questions within the jurisdiction of the Department of the Treasury and the Internal Revenue Service. Those entities would be the best source of information on these matters.

The draft report, however, contains three recommendations for the Secretary of the Department of Labor (Department):

1. The Department should review and determine whether its reporting requirements for executive retirement plans should be modified to provide additional information the DOL could

use to oversee whether these plans are meeting eligibility requirements.

2. The Department should explore actions the agency could take to help companies prevent the inclusion of rank-and-file employees in executive retirement plans and determine which, if any, actions should be implemented.
3. The Department should provide specific instructions for companies to follow to correct eligibility errors that occur when rank-and-file employees are found to be participating in executive retirement plans, and should coordinate with other federal agencies on these instructions, as appropriate.

Sections 201(2), 301(a)(3), and 401(a)(l) of the Employee Retirement Income Security Act (ERISA) provide an exclusion from the requirements of Parts 2, 3 and 4 of Title I (pertaining to participation, vesting, funding and fiduciary responsibilities, respectively) for "a plan which is unfunded and is maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" (commonly referred to as a "top-hat" plan). It is the longstanding view of the Department that in providing relief for "top-hat" plans from the broad remedial provisions of ERISA, Congress recognized that

### Page 2

certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan.

Currently the Department does not have plans to issue guidance or regulations in this area. In light of existing resource constraints at the Department, existing priority regulatory and guidance projects in development, and the absence of evidence of systematic abuses involving such plans or that ERISA's claims procedure rules and judicial remedies are inadequate to protect participants' benefit rights, the Department does not believe it would be advisable to shift resources from other projects to undertake guidance or regulations as described in the draft report.

However, the Department will, as priorities and resources permit, engage with interested stakeholders to discuss the issues presented in the report.



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Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely

Preston Rutledge

Assistant Secretary

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U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, DC 20548

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## Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, [spel@gao.gov](mailto:spel@gao.gov), (202) 512-4707  
U.S. Government Accountability Office, 441 G Street NW, Room 7814,  
Washington, DC 20548



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