

October 31, 1997
L-97-44

TO : Peter A. Larson
Chief Financial Officer

FROM : Catherine C. Cook
General Counsel

SUBJECT : Compensation
Deferred Performance Awards
Consolidated Rail Corporation

This is in reply to your memorandum of October 3, 1997, regarding the reporting of amounts earned by Conrail employees under an Annual Performance Achievement Reward Program.

You advise that employees may earn a reward denominated in cash and held in restricted shares of Conrail stock, and can elect either to be paid immediately in cash or to defer all or part of the reward for one to five years. If the employee elected to be paid immediately, Conrail reported the full amount as creditable compensation, and paid appropriate taxes under the Railroad Retirement Tax Act. Conrail did not report as creditable compensation nor withhold taxes on deferred rewards. You inquire whether such deferred rewards should be reported as creditable compensation and service and, if so, when, and whether this matter should be referred to your Internal Revenue Service liaison.

This case seems to me to be substantially similar to that examined in legal opinion L-97-16, wherein it was determined that an award denominated in stock but paid in cash did not squarely meet the definition of compensation under the Railroad Retirement Act or the Railroad Unemployment Insurance Act. However, that opinion also found that such awards would constitute compensation under the appropriate Department of the Treasury regulation and further stated that the RRB has construed the definition of compensation under the Railroad Retirement Act and the Railroad Unemployment Insurance Acts in such a way as to conform the treatment of payments under those acts to that under the Railroad Retirement Tax Act. It should be noted that section 3231(e)(8) of the Railroad Retirement Tax Act incorporates section 3121(v) of the Internal Revenue Code which provides that a deferred payment is considered paid at the later of when the services are performed or when there is no substantial risk of forfeiture. Therefore, if, at the time the stock is awarded, there is no substantial risk of forfeiture, then the value of the stock is compensation at that time.

Legal Opinion L-97-16 states "The employer concedes that if it were agreed upon in advance that

the performance of certain services, e.g., perfect attendance, would result in an award denominated in dollars but paid in stock whose fair market value equaled the denominated amount, then the fair market value of the stock would be considered compensation." In the instant case, it appears that the reward is denominated in dollars but paid in stock whose fair market value equaled the denominated amount and, in any case, the employer, by its reporting of the reward payments, concedes their creditability. Title to stock representing the deferred payments is transferred, which includes the right to vote the stock and to receive dividends, subject to a condition subsequent, which is that the right to the stock or a portion of it may be lost if the employee is dismissed for cause, retires, etc.

Although it appears to me that the deferred reward is paid when the deferral is elected, I agree that this matter should be coordinated with the Internal Revenue Service.