Final Tax Bill: What's In and What's Out for Aspects of Executive Compensation

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (TCJA) into law. The following is a summary of the provisions:

While our prior summary outlined the proposed Section 409B, this summary looks at what TCJA actually does. Generally 4098B would have taxed nonqualified deferred compensation and other incentive compensation (including stock options) upon vesting rather than at payment. The TCJA preserves the current treatment of nonqualified deferred compensation, leaving Sections 409A, 457A, and 457(f) intact.

The TCJA adopted Section 83(i) as contained in the Proposed House Bill, which provides for the deferral of taxation on certain qualified equity grants, for up to five years after vesting, and clarifies that restricted stock units are not eligible for elections under Section 83(i). This provision provides tax benefits to employees of certain start-up companies. Generally, an employee may make a special election with respect to qualified stock transferred to them. The result is that no amount is included as income for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. Income taxation can be deferred by the employee until the earlier of (a) five years or (b) the occurrence of a specified event, such as the stock of the company being readily tradable on an established securities market or a revocation of the election. We do not see this being widely used, because of its narrow scope.

The final law includes the following changes:

- Limitations on deductible compensation paid to certain public company executive officers under Section 162(m), including repealing exceptions for performance-based compensation and commission-based compensation. This, then, appears to effectively result in all compensation paid to a covered employee that is greater than $1 million per year being non-deductible.

- Expanding the scope of covered employees to include the principal financial officer and to provide for continued application for all years in which a covered employee receives any compensation from the company.

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- The TCJA imposes an excise tax, equal to the corporate tax rate (set at 21%), on compensation in excess of $1 million paid to an applicable tax-exempt organization's five highest-paid employees, for a tax year (or any person who was such an employee in any tax year beginning after 2016).
    - The excise tax would also apply to parachute payments exceeding the portion of the base amount that is allocated to the payment. (The base amount is defined as the average annual compensation of the employee for the five tax years before the employee's separation from employment.) The tax on excess parachute payments applies only to payments made to employees who are highly compensated. The new law treats compensation as paid when rights to remuneration are not subject to a substantial risk of forfeiture. The TCJA exempts, from the definition of "compensation" for purposes of the tax, remuneration paid to licensed medical professionals in exchange for medical services performed. The tax applies to tax years beginning after 2017.

We will continue to review the new law and provide additional guidance as it develops.

Please share your thoughts!

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