



Executive Compensation Under the Trump Administration - What's the Same, What's New and What's Still in Process

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Overview: Topics for Discussion

- Status of Tax Reform - Generally
- Status of Tax Rules on Executive Compensation ("EXCO")
 - 409A - Non-Qualified Deferred Compensation
 - 162(m) - Million Dollar Rule
- Status Dodd-Frank Rules on EXCO
 - Say on Pay
 - Pay Ratio
 - Clawback
- Odds and Ends
 - Incentive Stock Options
 - Golden Parachute Payments
 - Etc.

Status of Tax Reform:

- Trump's Views
 - Now is the time for "real tax reform" with a corporate rate of 15% to make U.S. businesses "highly competitive" with overseas companies (Jun. 2017)
 - "There will be NO change to 401(k)" (Oct. 2017)
- Senate FY 2018 Budget Resolution (Oct. 2017)
 - Opens the door for tax reform to proceed under budget reconciliation process for up to \$1.5 trillion in tax cuts over a 10-year budget window
 - Simple majority can effect reform (no 60-vote filibuster rule in Senate)
 - Reform could be implemented for 10-year budget window and then provisions sunset
 - House set to vote on Senate Budget Resolution (Oct. 2017)
- House Ways and Means Committee to Release Tax Bill (Early Nov. 2017)

Status of Tax Reform (*cont'd*):

- House Ways and Means Committee / Senate Finance Committee / Trump Administration - Tax Reform Framework (Sept. 2017)
 - Corporate tax rate of 20% (below 22.5% average of industrialized world)
 - Small business partnerships and s-corporations maximum rate of 25%
 - Elimination of Alternative Minimum Tax ("AMT")
 - Note: Elimination recommended by IRS and Joint Committee on Taxation
 - Individual tax rates consolidated to 3 brackets
 - Highest bracket of 35%

Status of Tax Rules on EXCO:

- 409A - Deferred Compensation Rules
 - Tax Reform
 - Possible rate reduction for highest tax brackets diminishes attractiveness of non-qualified deferred compensation ("NQDC")
 - IRS Guidance
 - Chief Counsel Advice
 - Back to back arrangements - a less common type of 409A NQDC (Jul. 2017)
 - » Ultimate service recipient cannot be paying more under the back-to-back arrangement than the intermediate service recipient
 - Creation of substantial risk of forfeiture on salary deferrals (Nov. 2016)
 - » Possible 25% baseline rule for when salary deferrals can avoid being vested at deferral
 - Proposed Regulations (Jul. 2016)
 - Similar 25% baseline rule for redeferrals in 457(f) proposed regulations that were issued at the same time as proposed 409A regulations

Status of Tax Rules on EXCO (*cont'd*):

- 409A - Deferred Compensation Rules (*cont'd*)
 - Other Possibilities for Reform
 - 409B "Dave Camp" Proposal (R-Mich, *retired* House Ways and Means Committee Chair)
 - 2014 Republican proposal to overhaul 409A (this has not been enacted into law, but was projected to raise \$9 billion in tax revenue over 10 years)
 - » General rule, taxation upon lapse of substantial risk of forfeiture (i.e., vesting event)
 - » Applies even for options and SARs (i.e., a step beyond FICA rules on NQDC)
 - » Would apply for past deferrals after lapse of grace period
 - » Unintended consequences could involve greater use of "secular" trusts
 - Very little discussion on 409B since its release - unclear if it's going anywhere

Status of EXCO Tax Rules (*cont'd*):

- 162(m) - Million Dollar Rule
 - Tax Reform
 - Possible significant corporate rate reduction makes 162(m) compliance less of an issue (aside: further reducing the need for the law)
 - House AHCA bill eliminated 162(m)(6) provisions that were added under PPACA
 - Eliminated \$500K deduction limit for all employees of certain health insurance providers (similar to TARP 162(m)(5) provision that was added to 162(m) in 2008)
 - IRS Guidance
 - Private Letter Rulings
 - Outside director status for filling in as CFO without pay on emergency basis for set period
 - Coverage of individual who serves as CEO for part of year and is not among 3 highest paid

Status of EXCO Tax Rules (*cont'd*):

- 162(m) - Million Dollar Rule (*cont'd*)
 - Other Possibilities
 - "Dave Camp" Proposal (R-Mich, *retired* House Ways and Means Committee Chair)
 - 2014 Republican proposal to overhaul 162(m) (this has not been enacted into law, but was projected to raise \$12 billion in tax revenue over 10 years)
 - » Eliminate performance based exception
 - » Applies for former covered officers
 - Consistent with TARP and PPACA 162(m) updates
 - » Proposal would not have been as expansive as above 162(m)(6) / PPACA provisions
 - » Makes 162(m) reform more tenable for the general public

Current EXCO Status Dodd-Frank:

- Trump's Views
 - Dodd-Frank is a "disaster" and they are "going to be doing a big number" on it (Campaign 2016)
- Executive Order (Feb. 2017) - Review Dodd-Frank and report back on how it's working and where it can be revised
 - Executive order cannot reverse a law already enacted by Congress
 - Reopened comments on CEO Pay Ratio rule
 - Comments generally in favor of rule, which came as a surprise

Current EXCO Status Dodd-Frank (*cont'd*):

- Financial Choice Act ("2.0") of 2017 (Jun. 2017)
 - Features
 - Only require say-on-pay in years where material changes are made to executive compensation and elimination of say-on-frequency vote
 - Repeal CEO pay ratio disclosure requirement
 - Elimination of no-fault clawback (clawback only to apply in situations where executive had control over reporting of financials that were required to be restated)
 - Difficult to pass the in the Senate under current rules (60-vote filibuster rule)
- Likelihood that Dodd-Frank will be changed on a piecemeal basis or via SEC
 - Recognizing difficulty of getting Democratic votes for any major overhaul

Current EXCO Status Dodd-Frank (*cont'd*):

- Pay Ratio
 - SEC Guidance (Sept. 2017)
 - Pay ratio precision needs to meet reasonable / good faith standard
 - Ultimately, the pay ratio is a reasonable estimate and can be described as such in SEC filings
 - Median employee compensation may be determined based on a combination of internal records, statistical sampling and other reasonable methods
 - Additional guidance on permissible statistical sampling and other reasonable methods
 - » Examples of how to apply these methods to various fact patterns
 - » May result in range of employees being the median employee for pay ratio purposes
 - Employee determinations can be based on application of other laws generally used for such purposes (e.g., tax law, employment law, home country law, etc.)
 - Mix and matching of US and international laws should be acceptable if done in good faith
 - Leased employees and similar types of independent contractors can be ignored

Current EXCO Status Dodd-Frank (*cont'd*):

- Pay Ratio (*cont'd*)
 - ISS 2017-2018 Benchmark Voting Policy Survey
 - Most institutional investors are planning on utilizing pay ratio for investment decisions
 - Compare (i) ratios among companies in the same industry, (ii) changes in the ratio over time for individual companies and (iii) differences among ratios for companies in different industries
 - » Shoots down argument that pay ratio rules are designed for social engineering purposes

Current EXCO Status Dodd-Frank (*cont'd*):

- Clawback
 - SEC proposed regulation guidance from 2015 looks to be going nowhere
 - Proposed regulations required clawbacks:
 - When company financials needed to be restated to correct a major error;
 - With respect to excess incentive-based compensation related to company financials; and
 - For a broader group of current and former key employees than just the executive officer group.
 - » Regardless of whether the individual was a bad actor with respect to company financials.
 - Despite status of proposed regulations, idea of clawback applying when companies are in difficult situations has caught on
 - Equifax media and politician outrage leading to board of directors review of pay for ousted CEO and ousted chief security officer
 - United lawsuit against board of directors for severance package of ousted CEO

Odds and Ends:

- Incentive Stock Options (ISOs)
 - Tax Reform
 - Likely elimination of AMT may make issuances of ISOs more widespread
 - AMT results in ISOs being treated like non-qualified stock options
 - » In many ways, AMT was treating ISO's like non-qualified stock options (with AMT taxation applying to the ISO spread)
- Golden Parachute Payments (280G/4999)
 - IRS Guidance (Golden Parachute Audit Guide) (Jan. 2017)
 - Nine-step process for the IRS to audit 280G/4999 matters
 - Represents a good set of steps to follow when analyzing 280G/4999 (even outside of an audit)
 - Listing of materials the IRS would want to review in connection with the audit
 - Represents good set of reminders from where 280G/4999 payments may arise

Odds and Ends (*cont'd*):

- FICA
 - IRS Guidance (Chief Counsel Memorandum) (Jan. 2017)
 - IRS will not enter into closing agreements with employers that fail to apply the special timing rule to non-qualified deferred compensation payments as they become vested
 - Guidance indicates that failure to follow the special timing rule results in general timing rule applying automatically by statute and regulation
 - » Because the statute/regulation already prescribes what should happen upon failure to follow the special timing rule; there is no need for a closing agreement in this context
 - » Query: Does this guidance suggest that the Davidson v. Henkel court was correct in holding that employers are free to choose to apply the special or general timing rule, such that, failure to follow the special timing rule does not result in a tax law violation?
- Etc. (Time Permitting)

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