

Tax Cuts and Jobs Act: Executive Compensation Provisions of the Final Bill

December 21, 2017

On December 20, 2017, the House and Senate each approved and passed the final version of the tax reform legislation (the “Final Bill”)¹. The Final Bill continues to include executive compensation reforms that will impact compensation plan design. The Final Bill does not include the comprehensive nonqualified deferred compensation reforms that were originally proposed by the House and the Senate, but subsequently removed.

A summary of the Final Bill as it relates to executive compensation tax reform is provided below. President Trump is expected to sign the Final Bill into law in the coming days.

If you have any questions concerning this memorandum, please reach out to your regular firm contacts in the [Executive Compensation and ERISA](#) group.

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¹ The Final Bill is available at: <https://www.congress.gov/bill/115th-congress/house-bill/1/text>.



Nonqualified Deferred Compensation

- ***No Change to Taxation upon Vesting.*** The Final Bill does not repeal Sections 409A and 457A of the Internal Revenue Code (the “Code”) and tax compensation upon vesting
- ***New Exception for Private Company Options and Restricted Stock Units.*** The Final Bill includes a provision allowing private company employees who receive stock in connection with the exercise of an option or the settlement of a restricted stock unit award to elect to defer tax for up to five years post-vesting (subject to certain eligibility requirements).

Limit on Excessive Compensation

The Final Bill includes various reforms to Section 162(m) of the Code, described below.

- ***Deletion of Commissions and Qualified Performance-Based Compensation Exceptions.*** The Final Bill repeals the commission and qualified performance-based compensation exceptions (including for stock options) under Section 162(m), such that performance-based compensation would be included in compensation subject to the \$1 million deductibility limit.
- ***Expanded Definition of Covered Employees.*** The Final Bill expands the definition of covered employees to include the CFO. Additionally, once an executive qualifies as a covered employee, the deduction limitation applies indefinitely, which significantly increases the number of impacted individuals under the rule.
- ***Expanded Definition of Publicly Held Corporation.*** The Final Bill expands the companies subject to Section 162(m) to include issuers of securities required to file reports under Section 15(d) of the Exchange Act (e.g., companies with registered debt securities).

The Final Bill includes a transition rule preserving the deductibility of compensation under written binding contracts in effect on November 2, 2017 and not materially modified thereafter. Performance-based

awards, such as stock options, that are outstanding as of November 2, 2017 and that are not subsequently materially modified will therefore continue to be exempt from the deductibility limit under the Final Bill. However, the transition rule does not apply to amounts payable under a written binding plan that is subject to discretion or written binding plans in effect prior to November 2, 2017 but renewed after such date or that may be terminated at will by either party.

Excise Tax on Tax-Exempt Organizations

The Final Bill subjects tax-exempt organizations to an excise tax at the corporate tax rate (21%) on compensation in excess of \$1 million paid to each of their five highest paid current or former employees in a taxable year or any prior taxable year beginning after December 31, 2016. The excise tax would also apply to excess “parachute payments” (i.e., payments that are contingent on an employee’s termination and that have an aggregate present value equal to at least three times the employee’s base compensation).

The Final Bill provides that compensation will be treated as paid when it is no longer subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) of the Code. The Final Bill also exempts from tax compensation attributable to medical services of certain qualified medical professionals.

Catch-up Contributions

The Final Bill does not include any changes to the current law on catch-up contributions under tax-qualified defined contribution plans.

Entertainment Expenses and Meals

The Final Bill repeals employer deductions for entertainment, amusement and recreation expenses, effective for amounts incurred or paid in 2018 or thereafter.

The Final Bill provides for a 50% deduction for food and beverage expenses by employers, but, with respect to amounts incurred or paid in 2026 and thereafter, disallows any deduction for expenses associated with meals provided for the convenience of the employer on the employer’s business premises, or provided on or

near such premises through an employer-operated facility.

Employer FMLA Credit

Under current law, employers are not eligible to receive a credit for compensation paid to employees on leave. Effective for wages paid in tax years beginning in 2018, the Final Bill allows eligible employers to claim a business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment is at least 50% of the wages normally paid to the employee. The credit will be increased by 0.25 percentage points (subject to a cap of 25%) for each percentage point by which the rate of payment exceeds 50%. The maximum amount of leave that may be taken into account for purposes of the credit is capped at 12 weeks.

Excise Tax on Stock Compensation in Inversions

The Final Bill increases the excise tax on stock compensation in an inversion from the current rate of 15% to 20%.

Carried Interest

The Final Bill includes a carried interest provision that imposes a three-year holding period requirement in order to qualify for long-term capital gains treatment with respect to certain partnership interests received in connection with the performance of services. The provision is described in further detail in our alert memorandum titled *Tax Cuts & Jobs Act: Considerations for Funds*.

If you have any questions or would like to discuss this further, please do not hesitate to contact your regular contacts in the [Executive Compensation and ERISA](#) group.

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