

Tax Cuts and Jobs Act: Executive Compensation Update

November 21, 2017

Since the publication of our alert memorandum titled *Tax Cuts and Jobs Act Includes Significant Executive Compensation Changes, But Employers Should Proceed Incrementally in Revising Compensation Plans*, the U.S. House of Representatives' version of the Tax Cuts and Jobs Act was amended several times, and the U.S. Senate issued its own tax reform bill. The proposed legislation, which was passed in the House and approved by the Senate Finance Committee, respectively, continues to include executive compensation reforms that will impact compensation plan design. However, the comprehensive nonqualified deferred compensation reforms that were originally proposed by the House and the Senate have been removed from both bills.

A summary of the current state of the legislation as it relates to executive compensation tax reform is provided below. There continues to be uncertainty as to whether the proposed legislation will pass in the Senate and whether significant revisions will be made as part of the reconciliation process.

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

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999



Nonqualified Deferred Compensation

- ***Taxation upon Vesting.*** The proposal to repeal Sections 409A and 457A of the Internal Revenue Code (the “Code”) and tax compensation upon vesting was removed from both the House and the Senate bills via amendments.
- ***Exception for Private Company Options and Restricted Stock Units.*** While not included in the Senate bill as originally proposed, the bill was later amended to include a provision that would allow 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), consistent with the House version of the bill.

Limit on Excessive Compensation

Consistent with the House version of the bill, the Senate bill proposes various reforms to Section 162(m) of the Code, described below.

- ***Commissions and Qualified Performance-Based Compensation.*** The House and Senate bills propose repealing 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.
- ***Definition of Covered Employees.*** The House and Senate bills propose expanding 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 expands the number of impacted individuals under the rule.
- ***Definition of Publicly Held Corporation.*** Both the House and Senate bills propose expanding 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 Senate bill includes a transition rule which would grandfather compensation under written 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 would therefore continue to be exempt from the deductibility limit under the Senate version of the bill.

20% Excise Tax on Tax-Exempt Organizations

The House and Senate bills continue to include the proposal to subject tax-exempt organizations to a 20% excise tax 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 Senate bill also states that compensation will be treated as paid when it is no longer subject to a substantial risk of forfeiture. This clarification is not included in the House bill.

Catch-up Contributions

As originally proposed, the Senate bill would have prohibited employees from making catch-up contributions to certain qualified defined contribution plans if the employee received wages of \$500,000 or more for the preceding year. The Senate bill was later amended to remove this provision, and the House bill does not propose any changes to the current law on catch-up contributions.

Entertainment Expenses and Meals

Both the House and Senate bills repeal employer deductions for entertainment, amusement and recreation expenses, effective for amounts incurred or paid in 2018 or thereafter.

While the bills retain the 50% deduction for food and beverage expenses, the Senate bill includes a provision that would disallow an employer's 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. The Senate proposal on meals would apply to amounts incurred or paid in 2026 or thereafter. The House bill does not include a similar provision.

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.

...

CLEARY GOTTlieb

Employer FMLA Credit

Under current law, employers are not eligible to receive a credit for compensation paid to employees on leave. The Senate bill would allow 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 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.

The Senate proposal would be effective for wages paid in tax years beginning in 2018. The House bill does not include a similar provision.

Excise Tax on Stock Compensation in Inversions

The Senate bill proposes to increase the excise tax on stock compensation in an inversion from the current rate of 15% to 20%.

Carried Interest

The House and Senate bills include 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*.