

Tax Reform Bills – Executive Compensation Provisions

Insight — December 7, 2017

The Senate passed a tax reform bill over the weekend that aligns closely with the republican House proposal from November (*see below for more information on the November proposal). Below is an update on the executive compensation related changes being proposed in the Tax Cuts and Jobs Act. These proposed changes are of particular importance to publicly traded companies:

- The proposal to modify the taxation of deferred compensation, including **nonqualified deferred compensation plans, stock options, stock appreciation rights, and restricted stock units**, has been removed from both bills. So, those types of arrangements and awards will continue to be taxed as they are taxed under existing law (i.e., IRC Section 409A and IRC Section 83, but note the proposed addition of a new IRC Section 83(i) in the Senate bill discussed below).
- The proposed changes to the IRC Section 162(m) limitations on deducting named executive officer compensation remain in some form in both the House and Senate bills, including:
 - Extending the IRC Section 162(m) compensation deduction limitation to the principal financial officer of the employer (and expanding the deduction limitation to payments made to the beneficiary of a named executive officer covered by IRC Section 162(m) (e.g., payments made upon the death of the named executive officer)).
 - Eliminating the performance-based compensation exception to the IRC Section 162(m) compensation deduction limit.
 - Adding a provision that causes a covered employee subject to the IRC Section 162(m) deduction limitation to remain subject to the limitation for any period during which the employee receives compensation from the covered employer (e.g., post termination).
 - Expanding the coverage of IRC Section 162(m) from companies with publicly traded stock to now include companies with publicly traded debt and possibly even foreign private issuers.

Note the Senate bill has a special grandfathering provision that excludes from the IRC Section 162(m) changes described above compensation paid pursuant to contracts entered into on or before November 2, 2017 (that have not been materially modified after November 2, 2017).

The Senate version of the bill (but not the House version) adds a new IRC

Section 83(i) that would allow private company employees participating in a broad-based equity plan (i.e., a plan that covers 80% of the employer's full-time U.S. employees) to be able to elect to defer taxation on vested equity awards for a period of up to five years after the vesting date. CEO and some highly compensated employees would not be eligible for this tax deferral of equity award gains.

If you would like more information, please feel free to contact one of our Benefits attorneys.

**The House "Tax Cuts and Jobs Act" announced in November proposes to:*

- *Eliminate the performance based compensation exception to IRC Section 162(m) deduction limit.*
- *Extend 162(m) restrictions to the principal financial officer.*
- *Make stock options and stock appreciation rights taxable upon vesting (i.e., prior to exercise).*
- *Make contributions to nonqualified deferred compensation plans taxable upon vesting.*
- *Proposes to make severance taxable upon termination of employment (even if payable over time).*

In its current form the legislation would provide for a transition period in which all deferred compensation (including options and SARs) would have to be treated as taxable by the later of the date the deferred compensation vests or 2026. There is also proposed a limited period in which deferred compensation plans and arrangements may be amended to accelerate payment of any deferred compensation that is subject to the rule, which would allow employers to unwind these plans.

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