

2017 TAX REFORM § 162(M) CHANGES INITIAL BRIEFING

January 2018

§ 162(M) PRE-2018

Corporate deduction disallowed for -

Compensation paid in excess of \$1 million in a taxable year

by Publicly Held Corporations

to Covered Employees

Unless an exception applies

- Taxable compensation only
- U.S. publicly traded companies and certain ADRs
- CEO and 3 other most highly compensated executive officers other than CFO
- Status determined as of last day of year
- Performance based pay
- Commissions
- Newly public companies

➤ **Does not affect employee's tax treatment (no excise or additional tax like in 280G and 409A)**

SUMMARY OF CHANGES TO § 162(M)

- Expands companies covered
 - Now includes more ADRs & companies with publicly traded debt
- Expands executives covered
 - Covered employees **FOREVER** retain status as covered employees (even after termination of employment)
- Repeals performance pay & commission exceptions

TRANSITION RELIEF FOR CERTAIN EXISTING ARRANGEMENTS

- Under transition relief, amendments made to §162(m) by the legislation would not apply to-
 - **Written binding contracts** as of 11/2/2017
 - That are not modified in **material respects**
- Relief raises significant questions re-
 - Executive with individual employment letter or agreement
 - Outstanding equity awards
 - Non-qualified deferred compensation plans
 - Umbrella plans designed to meet performance pay exception

COVERED EMPLOYEE EXPANSION

KEY TAKEAWAY:

- 🔑 Any CEO/CFO (or acting CEO/CFO) and each top-3 highest paid officer for years starting in 2017 will *forever* remain a covered employee of the company.

EXPANSION OF “COVERED EMPLOYEE”

- CFO added back to list
- Covers CEO or CFO (or acting as such) at any point during the year (not just last day)
- Executives (starting in 2017) FOREVER retain status as covered employees
 - Even after termination of employment or death
 - Apparently even after company is acquired
 - Captures pay that previously avoided the reach of §162(m)
 - Deferred compensation
 - Death benefits
 - Golden parachutes

IMPACT ON DEFERRED COMPENSATION

(E.G., SERPS, EXCESS PLANS, SEVERANCE)

KEY TAKEAWAYS:

- 🔑 Deferred comp now will be limited by §162(m).
- 🔑 Extent to which transition relief protects current plans is not yet clear.
- 🔑 Employers may want to amend plans to maximize deduction. But existing §409A rules may limit the ability to do this.

DEFERRED COMPENSATION: SCOPE OF TRANSITION RELIEF

- Transition relief grandfathers “binding contracts” that are not “materially modified.” But some plans have-
 - Broad amendment authority, or
 - Restrictive covenants with broad company discretion to enforce,
- Assuming plan is a binding contract, does relief apply-
 - Only to vested amounts?
 - Only to existing accruals?
 - Only to existing participants?

DEFERRED COMPENSATION: DELAY TACTICS

- Delaying payments may be desirable (e.g., pay in installments rather than lump sums)
- Some plans may already allow for – or require – §162(m) delay
 - Most common in plans in which executives were permitted to elect in-service payments
 - But language might have been drafted too broadly, forever limiting an executive's post-termination compensation to \$1 million per year now that §162(m) was changed
- §409A limits the ability delay payments

DEFERRED COMPENSATION: CHALLENGES UNDER §409A

- Delay for §162(m) permitted under §409A as long as-
 - Payment is made either in first taxable year when deductible or upon separation from service
 - Delay is treated as subsequent deferral election (*5-year delay*), unless ALL scheduled payments are delayed that could be
 - Payments upon separation from service must still comply with 6-month delay for specified employees
 - Executives may not be given election to choose delay
- Administration of delay can be challenging
 - Determining order in which pay needs to be delayed

UMBRELLA PLANS (AKA “PLAN WITHIN A PLAN”)

KEY TAKEAWAYS:

- 🔑 Not relevant going forward because performance pay exception is eliminated.
- 🔑 Extent to which transition relief available is not clear – “negative discretion” might prevent availability of relief.

UMBRELLA PLANS: BACKGROUND

- Many companies meet performance-based pay rules by establishing an umbrella plan (or “plan within a plan” design)-
 - Shareholders approve the material terms of the umbrella plan based on simple performance metric (e.g., percentage of net income)
 - Comp Committee certifies goals have been satisfied
 - Comp Committee retains discretion to decrease individual awards and does so based on “inside plan” that determines actual payouts using specific performance goals
- Umbrella plans no longer relevant going forward, because performance pay exception is repealed

UMBRELLA PLANS: SCOPE OF TRANSITION RELIEF

- Transition relief is intended to grandfather existing performance pay, even if paid in future years
- Does “binding contract” concept accomplish this?
 - “Negative discretion” (to reduce awards) is expressly permitted under the existing performance pay exception and is a key component of most umbrella plans.
 - Executives may not have a “binding contract” in light of the negative discretion built into the umbrella plan.
 - Even if executives have a “binding contract” under the “inside plan,” that inside plan does not itself generally meet the performance pay exception.

CORPORATE TRANSACTIONS

KEY TAKEAWAYS:

- 🔑 Not clear whether covered employees of seller will automatically be covered employees of buyer.
- 🔑 Will need IRS relief to address how to handle multiple transactions (going private and then going public again).

CORPORATE TRANSACTIONS: INITIAL OBSERVATIONS

- New §162(m) would look back to covered employees of a “predecessor.” Not clear if this means-
 - Any seller/ target company,
 - Companies purchased in stock transaction only, and/or
 - Spin-offs, reorganizations, etc.
- In transaction between private and public company, may want private company to retain non-qualified plans & other obligations.
- Parachute payment deduction disallowance may be less meaningful to company (although 20% excise tax would still fall on executive).

NEXT STEPS & PLANNING OPPORTUNITIES

RECOMMENDED ACTION

- Determine what is covered (or potentially covered) by transition relief
 - Review plan documents, award agreements, and individual employee agreements covering future payments
 - Evaluate amendment authority provisions
 - For non-qualified plans, evaluate need and ability to separately track (and administer) grandfathered amounts
- Determine whether changes to existing plan documents will be needed
 - E.g., evaluate effect of existing §162(m) delay provisions

PLANNING OPPORTUNITIES

- Installment payments favored: company may want to change payment to installments or encourage election of installments for future accruals
- Company may want stock option exercises spaced out
- Consulting arrangements
- Qualified plan benefits exempt – QSERP
- Non-taxable benefits (e.g., retiree medical)
- Incorporated employee
- Partnership employs executive



IVINS, PHILLIPS & BARKER, founded by two of the original judges on the United States Tax Court in 1935, is the leading law firm in the United States exclusively engaged in the practice of federal income tax, employee benefits and estate and gift tax law. Our decades of focus on the intricacies of the Internal Revenue Code have led numerous Fortune 500 companies, as well as smaller companies, tax exempt organizations, and high net worth individuals to rely on the firm for answers to the most complicated and sophisticated tax planning problems as well as for complex tax litigation. We provide expert counsel in all major areas of tax law, and we offer prompt and efficient attention, whether with respect to the most detailed and intricate of issues or for rapid responses to emergency situations.

DISCLAIMER

This presentation, including any attachments, is intended to provide a general overview of the subject matter but is not intended to be legal advice and has not been written as a formal opinion of counsel. Unauthorized distribution or copying of this presentation, or of any accompanying attachments, is prohibited.