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The Impact of the Tax Cuts and Jobs Act on Executive Compensation

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On November 9, 2017, the House Ways and Means Committee approved the House's version of the tax reform bill (the "House Bill") and voted to report it to the House floor for a full House vote. On the same day, the Senate Finance Committee released the Description of the Chairman's Mark of the "Tax Cuts and Jobs Act" (the "Senate Finance Committee Mark"), which sets forth a summary of the Senate's proposed tax reform legislation. The Senate Finance Committee Mark will be marked up by the Senate Finance Committee beginning Monday, November 13, 2017.

Two provisions are being considered that, if enacted, would significantly change the landscape of executive compensation.

Nonqualified Deferred Compensation

Under the Senate Finance Committee Mark, a service provider would be taxed on any compensation deferred under a nonqualified deferred compensation plan (including nonqualified stock options and stock appreciation rights) when there is no substantial risk of forfeiture of the service provider's rights to such compensation (i.e., receipt of the compensation is not subject to future performance of substantial services). Under the proposal, a condition other than the future performance of substantial services (such as the achievement of a performance goal or a covenant not to compete) would not create a substantial risk of forfeiture. This would be a significant change to the taxation of practically all nonqualified deferred compensation arrangements—amounts would be taxed under those arrangements when earned and vested, rather than when they are paid. The proposal generally applies to amounts attributable to services performed after December 31, 2017.

The House Bill initially contained a similar provision, but it was removed shortly before the House Ways and Means Committee approved the House Bill. Thus, the House Bill to be voted on by the full House does not contain this provision.

The markups to the Senate Finance Committee Mark could have an impact on the ultimate fate of this provision. If, as in the House, the provision is eliminated, then it likely will not appear in the final form of tax reform. However, if the final Senate bill contains this provision, then the two chambers will have to reconcile their differences on this provision. It should be noted that as of November 13, 2017, Senators Portman and Toomey have filed proposed amendments to the Senate Finance Committee Mark that would repeal (Portman) or modify (Toomey) this provision if adopted.

Code Section 162(m)

Both the Senate Finance Committee Mark and the House Bill eliminate the exceptions for commissions and performance-based compensation from the definition of compensation subject to the $1 million deduction limit under Section 162(m) of the Internal Revenue Code. Thus, under both proposals, public companies will no longer be able to deduct compensation in excess of $1 million paid in one year to any "covered employee," even if the compensation is performance-based. Both proposals revise the definition of covered employee to include both the principal executive officer and the principal financial officer. In addition, both proposals provide that an individual is a covered employee if the individual holds one of these positions at any time during the taxable year, and if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years.

Bracewell's Employee Benefits/ERISA group will continue to closely monitor the Senate Finance Committee Mark and the House Bill and communicate new developments with respect to these provisions.