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News Flash: Congress Approves Tax Overhaul

On December 20, 2017, Congress passed the final version of the Tax Cuts and Jobs Act

While the new Act is complex and includes many changes to personal and corporate tax rates, below we outline at a high-level the impact on Executive Pay:

- The Act as originally proposed would have significantly impacted executive pay, including dramatically influencing the usefulness of stock options and other forms of long-term pay; however, these provisions were removed from the final Act
- Still, under the final Act, significant changes are made to Section 162(m), which covers the $1M annual cap on corporate tax deductibility of executive compensation
  - Previously, an exception was in place for most stock options, share-appreciation rights, performance-based equity awards, and annual incentive awards, whereby payouts from these amounts could still be a deductible expense for the purpose of determining corporate tax
  - This performance-based compensation exception is now removed – meaning compensation over $1M paid to “covered executives” (broadly, the five highest paid employees) is non-deductible for public companies, and subject to excise tax for tax-exempt organizations
  - The “covered employee” definition is now expanded to include the CFO (previously this role was excluded)
  - Once an executive is designated to be a “covered employee” in any year (starting in 2017), compensation will be subject to Section 162(m) in all future years, including after termination
  - The Bill will “grandfather” compensation resulting from a written binding contract in effect on November 2, 2017 and not materially modified thereafter

What does this mean?

- On balance, US issuers should be significantly better off from the tax overhaul, as the lower federal corporate tax rate will likely outweigh the extra cost due to lost deductions under 162(m)
  - However, companies will no longer be able to manage the cap through pay mix (i.e., keeping salary under $1M, and having the majority of their compensation performance/equity based)
- For Canadian-based public issuers with “foreign private issuer” status (i.e., some operations and/or listings in the US), there appears to be no impact on executive pay, as these issuers are not governed by 162(m)
  - However, for Canadian-based companies who are already governed by 162(m) (primarily-listed in the US and do not have “foreign private issuer” status), changes will apply
- Historically, the introduction of 162(m) brought a dramatic increase in performance-based compensation versus fixed pay – how the changes will impact pay mix going forward remains to be seen. We will be monitoring this carefully
- As the full impact of the new rules becomes better understood, we will provide further insights and opinions

For more fulsome details, please see Steven Hall & Partners’ webpage here.