On December 2, 2017, the U.S. Senate passed its version of the Tax Cuts and Jobs Act (the “Senate Bill”). Our Benefits Law Advisors blog previously discussed some of the major provisions of a draft House of Representatives version of the bill. The House version subsequently underwent significant changes, including removal of previously proposed changes to the taxation of nonqualified deferred compensation, before its passage on November 16, 2017 (the “House Bill”). The Senate Bill differs from the House Bill in some respects; therefore, the bills must be reconciled by a joint committee of House and Senate members. Both bills would make significant changes to the Internal Revenue Code (“Code”) rules affecting executive compensation and employee benefits and would require some employers to review and, possibly, restructure their compensation arrangements, in some cases prior to 2018.

In this article, we focus on two key executive compensation provisions of the bills.

**New Excise Tax on “Excessive” Compensation Paid by Tax-Exempt Employers**

Tax-exempt employers (including entities covered under Code Sections 501(c)(3) and 501(c)(6)) will be subject to new excise taxes, payable by the employer, with respect
to certain compensation paid to covered employees.

- Both the House Bill and Senate Bill would impose a 20-percent excise tax on compensation exceeding $1 million paid by a tax-exempt employer to any of its five most-highly compensated employees (and such tax will apply to compensation paid even after the individual ceases to be a covered employee).

- Both bills also would impose a new 20-percent excise tax on “excess parachute payments” paid by a tax-exempt employer to any of its five most highly compensated employees (these rules are similar to existing golden parachute rules that apply to taxable corporations under Code Section 280G in a change of control). “Excess parachute payments” generally refers to payments contingent on separation from employment that exceed three times the employee’s five-year average annual compensation.

As noted, these taxes would be payable by the tax-exempt employer. If enacted, these new excise taxes would apply to compensation paid starting in 2018, without any grandfathering provisions or transition periods.

► **Action Item:** Tax-exempt entities should review their existing executive compensation arrangements now and consider whether any changes should be made if, and when, the legislation is enacted. Additionally, tax-exempt entities should consider including protective language in any new executive compensation arrangements that would allow them to modify or reduce compensation to the extent needed to avoid the new excise taxes (similar clauses are already used by some taxable corporations for excise taxes under Code Section 280G).

**Deductibility of “Excessive” Compensation under Code Section 162(m)**

Code Section 162(m) denies a corporate tax deduction for compensation in excess of $1 million paid to the top executive officers of publicly traded companies. However, current law provides an exception from this limitation for compensation that qualifies as “performance-based.”

Both the House Bill and the Senate Bill would:

- Repeal the exception for performance-based compensation (thus effectively imposing a “hard” tax-deductible compensation limit of $1 million for covered employees),

- Expand the group of covered employees to include a company’s chief financial officer,

- Provide that the limitation will continue to apply even after the individual ceases to be a covered employee, and

- Expand Code Section 162(m) to cover additional corporations not previously covered.

The Senate Bill would grandfather compensation paid under a written binding
contract in effect on November 2, 2017, that is not materially modified after such date. This would provide some relief to covered employers that have already implemented their executive compensation arrangements for 2018. However, the House Bill does not contain a similar provision.

It remains to be seen whether the grandfathering provision of the Senate Bill will survive the bills' reconciliation. Public corporations are still likely to continue use of performance-based compensation for non-tax reasons, and will need to weigh the loss of deduction under a modified Code Section 162(m) against reduced corporate tax rates in determining the impact of any lost tax deduction.

► Action Item: Covered employers should pay close attention as the bills move through reconciliation toward a final vote and be prepared to convene their compensation committees on short notice (possibly during this holiday season) to make important decisions on compensation arrangements for their top officers.

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The joint conference committee is expected to move quickly to reconcile the tax reform bills. Many provisions of the bills are scheduled to go into effect in 2018.

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