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Global Rewards Update
United States of America

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Tax Reform – Proposed Legislation and Focus on Employee Share Plans

Background

On November 2, 2017, lawmakers in the U.S. House of Representatives released H.R. 1, the Tax Cuts and Jobs Acts ("the Bill"). While the Bill is still in draft form (and is proceeding through the review, amendment, and more general legislative adoption process), the proposed provisions impact a range of entities (e.g. corporations, partnerships, and others) as well as individual taxpayers. In this update we focus on a few of the more notable provisions that have an impact on employee share plan design and operations, and provide a broad overview of the general impact of these provisions.

Key Provisions

Sections 3801, 3802, and 3803 of the Bill address "Compensation." With respect to §§ 3801 and 3802 specifically, which address "Nonqualified deferred compensation" (NQDC) and "Modification of limitation on excessive employee remuneration" respectively:

- The Bill would create a new "Section 409B" which, broadly, would tax NQDC, for federal income tax (FIT) purposes, at the time such compensation is no longer subject to a substantial risk of forfeiture (typically referred to as "vesting").

- Notably, proposed 409B(b)(2)(B) provides that in the context of equity-based compensation, NQDC includes stock appreciation rights (SARs) and stock options, as well as those rights "to compensation based on the value of, or appreciation in value of, a specific number of equity units of the service recipient, whether paid in cash or equity" which should capture vehicles such as restricted stock units and performance share units.

- However, property (other than stock options) described in current §83, such as restricted stock, will not fall within the definition of NQDC (this is less impactful as such property is subject to FIT taxation today when there is no longer a substantial risk of forfeiture).

- There is limited grandfathering for outstanding deferred compensation. New proposed section 409B would apply to amounts attributable to services performed after 2017 (e.g. if there is a service condition to be satisfied in 2018 or later). Existing deferred compensation would be includable in income by the last tax year beginning before 2026.

- The Bill expands the current limitation on deduction of compensation paid to 'covered employees' under section 162(m) by (1) eliminating the exclusions for commissions or performance-based compensation, including performance-based bonus plans, stock options, and stock appreciation rights, (2) including the CFO as a covered employee subject to limitation, along with the CEO and three most highly compensated officers as shown in SEC disclosures, and (3) providing that status as a covered employee continues following a separation from service. The provision would be effective for tax years beginning after 2017.

Note, pursuant to proposed §3803 certain programs sponsored by tax-exempt entities would be subject to a potential 20% excise tax (payable by the employer) on payments in excess of $1,000,000 to covered employees (there are a limited set of payments that are excludable).

Summary of Potential Impact - Common Equity Vehicles

Vehicle	Today's FIT Tax Point	Proposed FIT Tax Point Under the Bill
RSUs	**Transfer of property not subject to SRF (typically distribution)**	**Vesting**
Stock Options	**Transfer of property not subject to SRF (typically exercise)**	**Vesting**
PSUs	**Transfer of property not subject to SRF (typically distribution)**	**Vesting**
RSAs	**Vesting (unless 83(b) election)**	**Vesting**

Observations

- The amendment process has already begun with respect to the Bill more generally. However, plan sponsors should immediately review their programs, including outstanding NQDC plans to assess the impact of the proposed provisions, should they be enacted, on their plan design going forward, outstanding share-based awards, and plan administration (including stock administration platform and capabilities to address new potential timing of taxation).
- Notably proposed amendments have already been introduced which provide for potential deferral of income recognition in the context of stock options and RSUs where the underlying stock is not readily tradable on established securities market.
- Plan sponsors should continue to monitor the proposed amendments as those provisions impacting NQDC are coming under increased scrutiny.

People to contact

For assistance in this matter, or any other issue related to the operation of your global rewards plans, please contact your local Deloitte Global Rewards consulting services advisor or one of the following members of the Deloitte Global Rewards team in the U.S.:

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