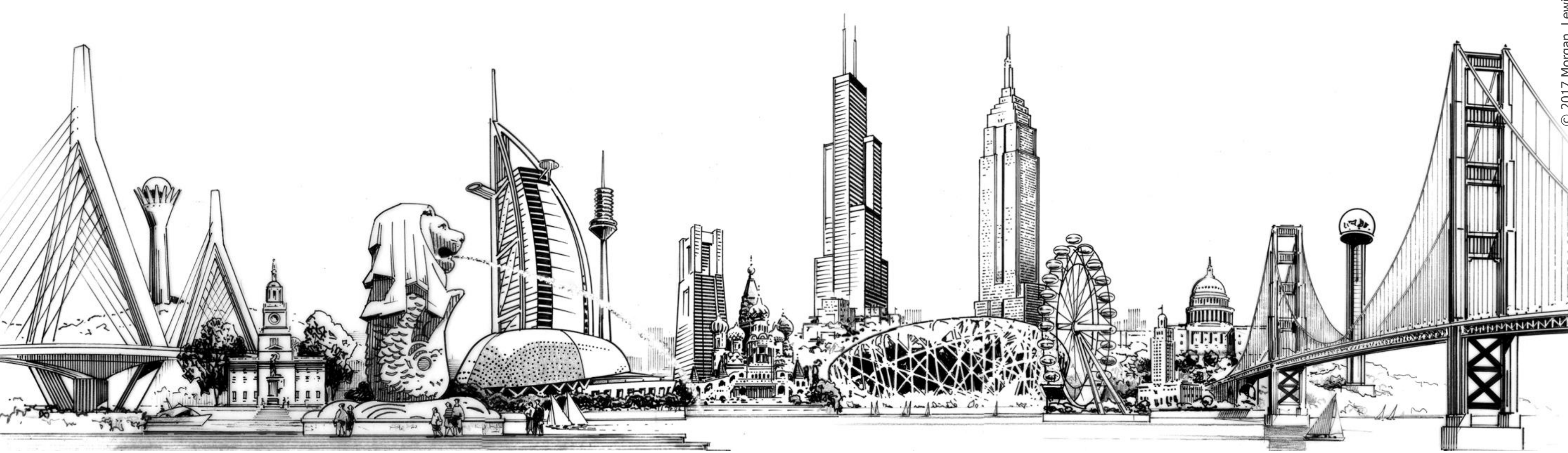
Morgan Lewis

PROPOSED EXECUTIVE COMPENSATION CHANGES IN TAX REFORM

ERISA Industry Committee
November 9, 2017

Mary B. Hevener
Rosina Barker
Jonathan Zimmerman



This call is being recorded.

To receive a copy of the call, please contact ERIC Member Services at memberservices@eric.org.

Participation Procedure

- Procedure for audience participation
- Audience will be in a “listen-only” mode
- If you wish to ask a question or make a comment, please press *6 on your telephone to “un-mute” your telephone
- After speaking, please press *6 again to re-enter “listen-only” mode

ERIC's Antitrust Policy

As a reminder, all ERIC meetings and activities are to be conducted in full compliance with the ERIC Antitrust Policy. The antitrust laws prohibit competitors from agreeing on prices to be charged or otherwise taking steps that harm free and fair competition among them. While ERIC's primary mission and activities are entirely consistent with the antitrust laws, if you have any concerns about a particular topic or discussion, please raise it with ERIC staff.

Tax Reform – Legislative Overview

- House Bill (H.R. 1) released last week.
- Senate proposal expected this week (perhaps during the dreaded period after we submit this deck and before the presentation)!
- If passed through budget reconciliation, only 51 votes needed in the Senate instead of 60.
- Total cost of House bill estimated to be $1.5 trillion over ten years; cannot exceed this amount if passed through budget reconciliation process.
- Goal is to sign this into law by year-end

Tax Reform – Sections 409A and 409B

- Section 409A would be repealed, effective for compensation earned for services performed after December 31, 2017.
  - For amounts deferred before 2018 (including amounts grandfathered from Section 409A?), current rules would remain in effect until 2025, at which point all vested and unpaid amounts would become taxable.
  - Withholdings on taxable amounts could be withdrawn in 2025.
  - Under regulations issued after enactment, distributions could be accelerated to 2025 without violating Section 409A.

Tax Reform – Sections 409A and 409B (cont.)

- Section 409B would tax deferred compensation as soon as it is no longer subject to a substantial risk of forfeiture.
  - Generally would apply to equity awards, including stock options and SARs, but transfers of property under Section 83 (other than stock options) would remain exempt.
    - Special exemption for certain equity awards issued by non-public companies.
  - Substantial risk of forfeiture would be limited to a requirement to perform future services. No other condition would qualify.
  - Short-term deferral exception would remain in effect, subject to the same definition of “substantial risk of forfeiture”
  - Earnings also would be subject to tax upon vesting

Tax Reform – Sections 409A and 409B (cont.)

- Key Questions
  - How should companies administer 2018 deferral elections?
  - Can distribution schedules be changed for amounts subject to Section 409A, to spread the tax hit over multiple years?
  - To what extent will the new rules apply to multi-year equity awards granted before 1/1/18?
  - Will we see more secular trusts?
  - Will options be treated as noncash compensation under Announcement 85-113?
  - How will underwater options be taxed?
  - Will the state tax blocker in 4 U.S.C. 114 apply to accelerated payouts of deferred compensation subject to Section 409A?

Tax Reform – Section 162(m)

- Eliminates the performance-pay exception.
- CFO again becomes a covered employee.
- Once a covered employee, always a covered employee.
- Tax-exempts will be subject to Section 162(m) through a 20% excise tax.
- Effective 1/1/18, so companies may push to accelerate performance plan deductions into 2017, and/or encourage exercise of stock options.
- Key Questions
  - How will companies change the structure of performance pay (timing, subjective targets, positive discretion, etc.)?
  - How will the new rules apply to multi-year awards like LTIPs?

Tax Reform – Fringe Benefits

- Eliminates tax preferences for many fringe benefits, including (but not limited to):
  - No deduction for entertainment activities (including business entertainment).
    - May affect corporate aircraft.
  - No deduction for transportation fringe benefits.
    - Including transit passes, pool cars and parking.
  - No deduction/exclusion for moving expenses.
  - No exclusion for qualified tuition or educational assistance.
  - No exclusion for adoption assistance benefits.
  - No exclusion for employee achievement awards.
- Original bill eliminated Dependent Care FSAs, but Brady amendment delays repeal to December 31, 2022

Tax Reform – Possible Legislative Fixes

- Drop these provisions!
- Add grandfather protection for agreements in place as of November 2, 2017.
  - Or, at minimum, protect agreements that vested before 2018.
- Transition rules permitting payout before 2025 of amounts subject to Section 409A.
- Modify the state tax blocker (through an amendment to Section 409B) to cover past and/or future deferred comp payments.
- Block taxation of options vesting on more than the spread (i.e., no Black Scholes method).
- Adopt withholding transition rules for all executive compensation, stock options, and cash reimbursements for fringe benefits until later in 2018 (similar to rules for non-cash fringes under Section 3501(b)).
- Suspend penalties for failing to withhold and/or timely deposit in 2018.

Our Global Reach

- Africa
- Asia Pacific
- Europe
- Latin America
- Middle East
- North America

Our Locations

- Almaty
- Astana
- Beijing*
- Boston
- Brussels
- Century City
- Chicago
- Dallas
- Dubai
- Frankfurt
- Hartford
- Hong Kong*
- Houston
- London
- Los Angeles
- Miami
- Moscow
- New York
- Orange County
- Paris
- Philadelphia
- Pittsburgh
- Princeton
- San Francisco
- Shanghai*
- Silicon Valley
- Singapore
- Tokyo
- Washington, DC
- Wilmington

Morgan Lewis

*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners.

THANK YOU