Trump's Proposed Changes to Tax, Dodd-Frank, DOL Could Impact Executive Compensation

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President Donald Trump's campaign proposals included changes to tax rates and a promise to repeal the Dodd-Frank Act. If enacted, these proposals could have a significant impact on the way businesses handle executive compensation, permitting companies greater flexibility in structuring compensation arrangements. His staff also hinted at a reversal of Department of Labor (DOL) conflict of interest regulations. However, even if these proposals are enacted, some aspects of compensation programs that companies implemented to comply with current or, in the case of the DOL rules, anticipated requirements are likely here to stay given their popularity with institutional shareholders or due to the significant business restructuring already undertaken.

Tax Reform

President Trump's campaign proposals included a reduction of the maximum corporate tax rate to 15 percent (from 35 percent) and the elimination of the alternative minimum tax. If either President Trump's plan or a similar proposal from House Republicans moves forward (see "Business Tax Reform All but Certain in US, Europe"), companies may be less concerned by the $1 million limit on deductions of executive compensation under Section 162(m) of the Internal Revenue Code because the lower overall tax rate would reduce the value of the tax deduction. Nevertheless, performance-based compensation programs, which are not subject to the deduction limit, would likely remain the norm, driven by the expectations of institutional shareholders.

President Trump also proposed lowering individual tax rates, which likely would discourage the use of deferred compensation. Individuals would have less incentive to defer taxes with lower income tax rates in effect. In addition, individuals may choose to accelerate payment of previously deferred amounts, although any such acceleration could be subject to significant restrictions under applicable tax rules, including Section 409A of the Internal Revenue Code.

In recent years, there have been various proposals — including one by President Trump — to eliminate what has been described by many politicians as the carried interest tax "loophole." Carried interest, or profits interest, is an interest in a partnership that gives the holder the right to receive a portion of future profits from the partnership. Under current law, a profits interest holder is taxed annually on his or her allocable share of partnership income, if any, and the tax treatment of that income is the same for the holder as it is for the partnership. Therefore, to the extent the partnership's profits constitute long-term capital gains, an individual holder is taxed at the capital gains rate of 20 percent (rather than the 39.6 percent maximum ordinary income tax rate). If carried interest becomes subject to ordinary income tax rates, companies likely would seek alternative methods of structuring incentive compensation, unless tax rates on ordinary income are also dramatically reduced.

Repealing or Replacing Dodd-Frank

President Trump said he would eliminate or "change greatly" the Dodd-Frank Act. If this were to occur, the executive compensation-related rules in the act could be repealed, including the say-on-pay, say-on-frequency and say-on-golden-parachute rules currently in effect. The rules requiring disclosure of the pay ratio of the CEO's compensation to that of a company's "median" employee, scheduled to take effect in 2018, have been particularly controversial, and the progress of any repeal efforts may provide insight into how President Trump reconciles his pro-business and populist instincts. In addition, the proposed multiagency rules imposing significant new requirements on incentive

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compensation arrangements of covered financial institutions also may be targeted for revision or repeal. Because they have yet to be finalized, the proposed rules regarding disclosure of pay for performance may be the rules most likely to be repealed. Even if the act is repealed or significantly modified, the "real world" impact on company practices relating to say-on-pay and clawbacks of incentive compensation may ultimately be minimal. These measures are supported by institutional shareholders, and companies may continue to follow them to maintain positive relationships with them. (See "US Corporate Governance: Will Private Ordering Trump Political Change?")

DOL Fiduciary Rule

It is not yet clear whether or how the new administration might seek to block, delay or revise the DOL's conflict of interest regulations (the so-called DOL fiduciary rule), which were issued in April 2016 with compliance to begin in April 2017. Generally, the rule expands the types of communications with retirement plans and individual retirement accounts that could be construed as investment advice or a recommendation. Under the Employee Retirement Income Security Act, the person providing such advice or recommendation would be considered a fiduciary with respect to the retirement plan investor. While the president has not directly addressed the rule, a Trump adviser has indicated that the administration may initiate efforts to reverse or modify it. Some members of Congress also have indicated a desire to reverse the regulations and previously took legislative action, which President Barack Obama vetoed, to do so. The House Republicans' financial reform bill, the Financial CHOICE Act, proposes repealing the fiduciary rule, and Republicans in Congress are considering other ways to delay the effectiveness of the rule. President Trump also has generally indicated an intention to review and suspend current regulatory activity, which could implicate the rule. On January 20, 2017, the president's chief of staff sent the heads of executive departments and agencies a memorandum asking that the effective date of already published regulations that have not yet taken effect be postponed for review, for at least 60 days from the date of the memorandum. The memorandum did not specifically address any particular regulation, and because the DOL fiduciary rule is already "effective" with an "applicable date" of April 10, 2017, it is not clear whether the memorandum applies to it. However, there is some expectation among practitioners in the industry that the administration may soon take action to specifically postpone the DOL fiduciary rule. Even if the rule is delayed and perhaps eventually repealed or significantly amended, it appears likely that many of the practices already implemented by market participants in response to the DOL fiduciary rule will remain in place. On the whole, market participants appear to be continuing to analyze and work toward compliance with the rule while keeping an eye on political developments. (See "Change in Administration Presents Opportunity to Revisit DOL Fiduciary Rule.")

Conclusion

Depending on the magnitude of changes to the rules impacting executive compensation, companies will need to reconsider the design of their compensation programs and related disclosure. Companies should be driven by their established, guiding compensatory principles rather than by reactionary policy, while continuing to stay apprised of impending legal changes.