



Executive Compensation and Benefits Alert

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Executive Compensation Under the Tax Cuts and Jobs Act: Chairman's Amendment Impacts Carried Interests, Private Company Stock Options and Restricted Stock Units

The November 6, 2017, House Ways and Means Committee Chairman Kevin Brady's Amendment to the Amendment in the Nature of a Substitute to H.R. 1, the Tax Cuts and Jobs Act (originally proposed November 2, 2017) (the "Chairman's Amendment") impacts several provisions relating to executive compensation.

The Chairman's Amendment:

- permits certain employees of private companies to elect to defer compensation relating to stock options and restricted stock units granted under broad-based equity plans; and
- imposes a three-year holding period in order for holders of certain so-called "carried interests" to qualify for capital gains treatment.

Deferral of Compensation Under the Act

As originally proposed, under the Tax Cuts and Jobs Act, most compensation is included in income upon vesting. (Only service-based vesting is recognized; performance-based vesting is disregarded.) This would effectively put an end to many of the most widely used forms of executive compensation, including stock options and deferred restricted stock units.

The Chairman's Amendment introduces an important exception to this general rule. It permits qualified employees, under certain circumstances, to elect to defer the inclusion in income of compensation from illiquid private company stock acquired in connection with the exercise of options or the settlement of restricted stock units for up to five years after the vesting of these awards.

The election can be made only with respect to options or restricted stock units granted under a private company plan under which, in the year of the grant of the options or restricted stock units, not less than 80 percent of all full-time U.S. employees are granted stock options or restricted stock units with the same rights and privileges. The participating employees are not required to all receive the same amount of options or restricted stock units but must receive more than a de minimis amount.

The election is unavailable to any employee who (1) is or has ever been the CEO or the chief financial officer, or an employee who is related to an employee who is or has ever been the CEO or CFO, or (2) was at any time in the prior 10 years one of the top four highest-compensated employees or a 1 percent owner of the company.

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Carried Interest Holding Period

In addition, the Chairman's Amendment provides that the holders of certain carried interests issued in exchange for services will not qualify for long-term capital gain treatment with respect to the interests unless the interests are held for at least three years.

Importantly, this rule only applies to carried interests issued in exchange for certain types of services consisting generally of raising capital and investing in, disposing of or developing stock or securities or real estate assets (*e.g.*, typical carried interests granted to private equity fund managers).

The Tax Cuts and Jobs Act is likely to change, perhaps drastically, in the coming days, with the Senate expected to release its own version of the tax reform bill later in the week. We will provide updates on this legislation as material changes to executive compensation and benefits become known.

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