AMERICANS FOR TaxFairness

Tax Subsidies for CEO Pay

Overview

Most American taxpayers would be shocked to learn that they subsidize CEO bonuses. A tax loophole allows corporations to deduct from their taxable income any amount paid to CEOs and their executives, as long as the pay is "performance-based." This means that the more they pay their executives, the less they pay in federal taxes.

Why does this tax loophole exist?

The CEO pay loophole defies common sense, but Congress thought was doing the right thing when it passed legislation in 1993 that capped the tax deductibility of executive pay at $1 million. But there was a huge loophole – the cap doesn't apply to "performance-based" pay, which includes stock options. Incentive bonuses were supposed to make CEOs better stewards of shareholders' money. This theory has proved false, with the 2008 financial crisis being only the most severe example of how huge performance bonuses can encourage risky activities that endanger single companies and the broader economy.

How much does this loophole cost taxpayers?

Closing the CEO pay loophole would save taxpayers $50 billion over 10 years, according to the non-partisan Joint Committee on Taxation.

What could $50 billion buy?

Rather than subsidize corporate executive pay, other pressing needs could be funded such as:

- Two-thirds of the $75 billion cost of President Obama's plan to provide all low- and moderate-income 4-year-olds with high-quality publicly funded preschool over 10 years.
- Food and Drug Administration funding over 10 years to ensure that our food, prescription drugs and many other products are safe.
- Eliminating the highway and mass transit trust fund shortfalls for the next 2½ years.

What are other benefits of closing the loophole?

Eliminating the loophole would give corporations less incentive to shower executives with lavish bonuses – money that could be used to increase pay for average workers. It would also reduce incentives for CEOs to take wild risks with their companies in order to get multi-million dollar "performance-based" bonuses.

Executive compensation experts found that pay arrangements relying heavily on "performance pay" are leading managers to focus excessively on the short term, motivating them to boost short-term results at the expense of long-term value.

Key Facts

Closing the CEO pay loophole would save taxpayers $50 billion over 10 years.

Walmart dodged $104 million in federal taxes over the past six years by exploiting the CEO pay loophole.

Voters strongly oppose the CEO pay loophole. By nearly 2 to 1 (63%-34%) they want to "Prevent corporations from avoiding taxes when they award their executives millions of dollars in stock options." Hart Research, Q. 12

CEOs of major corporations earn nearly 300 times more than an average worker. This is 10 times more than the CEO to worker pay ratio in 1978 when CEOs earned 30 times more.

CEOs often get their "performance-based" bonuses even when they don't reach performance goals.

News Coverage

How Taxpayers Subsidize Millions in CEO Pay, CBS News Moneywatch

Walmart Slashed Tax Bill By Giving Top Execs Big Bonuses, Forbes

Restaurant chains slash tax bill with executive pay deduction, The Hill

Tax Benefits From Options as Windfall for Businesses, The New York Times

Tax Breaks for CEOs Pay for Million-dollar Salaries, The Guardian

Executive Pay Of Austerity Advocates Saves Companies More Than $1 Billion Via Tax Loophole, The Huffington Post

Retailer's Executive Pay Plan Exploits Tax Break, Study Says, Bloomberg

You're Secretly Subsidizing A Fast Food CEO's Million-Dollar Salary, The Huffington Post

The CEO pay loophole debate

Corporate lobby groups often try to confuse the debate by arguing that Congress shouldn't tell corporations how much they can pay their CEOs. Under proposed reforms in Congress, corporations will still be free to shower their CEOs with huge bonuses. It's just that taxpayers won't have to pick up the tab.

Some conservatives say corporations should face no limits whatsoever on the deductibility of CEO pay since the executives also pay individual income taxes on this compensation. This is not a matter of "double taxation." Corporations and their employees are separate entities and it is the norm to tax money when it changes hands. For example, individuals pay taxes on their earnings and when they spend money at a store that business pays taxes on the income.

What is happening in Congress?

Sen. Jack Reed (D-RI) and Sen. Richard Blumenthal (D-CT) have introduced the Stop Subsidizing Multimillion Dollar Corporate Bonuses Act (S. 1476). Rep. Lloyd Doggett (D-TX) has introduced a companion bill (H.R. 3970) in the U.S. House of Representatives. Both bills would save taxpayers $50 billion.

Rep. Dave Camp (R-MI), Chairman of the House Ways & Means Committee, has produced a tax reform plan that would stop taxpayer subsidies for a company's top five executive officers. It would generate $12 billion over 10 years (Sec. 3802).

These bills would build on precedents in the Troubled Assets Relief Program (TARP) and the Affordable Care Act that set a $500,000 deductibility cap on pay for bailout recipients and health insurers.

Talking points

- Under the CEO pay tax loophole, the bigger the bonuses corporations give to their executives the less the company pays in taxes. That means average taxpayers have to pick up the tab.
- Corporate profits are soaring, CEO pay is skyrocketing, but workers' wages are standing still. It's outrageous that average Americans are subsidizing the lavish bonuses of their bosses.
- Tax loopholes like this make voters feel that the system is rigged against them. And they are right. We need a tax system where everyone plays by the same set of rules.
- When giant corporations don't pay their fair share, small businesses and working families have to make up the difference. The $50 billion cost of this loophole could pay for a lot of things we need – educating our kids, rebuilding roads and bridges and finding new cures for diseases.
- The CEO pay loophole encourages the reckless risk-taking that helped cause the 2008 financial crash. The more CEO bonuses are linked to stock prices and other short-term measures of "performance," the more incentive CEOs have to take giant risks.

Taxpayers Subsidize CEO Pay, Report Says, ABC News

Senators Seek To End Taxpayer Subsidy For Exorbitant CEO Pay, ThinkProgress

Opinion

Ending the Taxpayer Subsidy for Exorbitant Executive Bonuses, The Austin American-Statesman

The CEO Aristocracy: Big Bucks for the Big Boss, The Washington Post

Pro-austerity CEOS rake in millions in taxpayer-subsidized 'performance' pay, The Raleigh News and Observer

Walmart's Top-to-Bottom Taxpayer Subsidies, Common Dreams

Resources

Walmart Executive Bonuses Cost Taxpayers Millions, Americans for Tax Fairness & Institute for Policy Studies

Executive-Pay Tax Break Saved Fortune 500 Corporations $27 Billion Over the Past Three Years, Citizens for Tax Justice

Restaurant Industry Pay: Taxpayers' Double Burden, Institute for Policy Studies

'Fix the Debt' CEOs Enjoy Taxpayer-Subsidized Pay, Institute for Policy Studies

CEO Pay Continues to Rise as Typical Workers Are Paid Less, Economic Policy Institute

Taxes and Executive Compensation, Economic Policy Institute

Contact

Harry Gural
hgural@americansfortaxfairness.org

Americans for Tax Fairness *is a diverse coalition of 425 national and state organizations that collectively represent tens of millions of members. ATF was formed on the belief that the country needs comprehensive, progressive tax reform that results in greater revenue to meet our growing needs.*