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Congress of the United States

JOINT COMMITTEE ON TAXATION
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JAN 07 2020

Honorable Lloyd Doggett
U.S. House of Representatives
2307 Rayburn House Office Building
Washington, D.C. 20515

Honorable Jack Reed
United States Senate
SH-728
Washington, D.C. 20510

Dear Mr. Doggett and Senator Reed:

This letter responds to your request of July 25, 2019, for an estimate of the revenue effects of S. 2268/H.R. 3970, the "Stop Subsidizing Multimillion Dollar Corporate Bonuses Act." This legislation denies the deduction for certain "excessive" remuneration paid to employees of publicly traded for-profit entities.

Under section 162 of the Internal Revenue Code (the "Code"), an employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. This includes remuneration paid or provided to employees such as salary, commissions, bonuses, taxable and nontaxable fringe benefits, deferred compensation, health benefits, equity compensation (such as stock options, restricted stock, or restricted stock units), and other cash and in-kind benefits and compensation.

Code section 162(m) provides an explicit limitation on the deductibility of compensation expenses in the case of an employer which is a "publicly held corporation," for compensation in excess of $1 million per year with respect to a "covered employee." A covered employee is an individual who is the principal executive officer or the principal financial officer at any time during the taxable year. The term also includes the three most highly compensated officers for the taxable year (other than the principal executive and principal financial officers) who are required to be reported on the company's proxy statement for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders). Additionally, any employee who was a covered employee of the taxpayer in a taxable year beginning after December 31, 2016, remains a covered employee of the taxpayer for all future years.

The proposal amends Code section 162 to generally deny an employer a deduction for compensation paid to any covered individual that exceeds $1 million during the taxable year. For this purpose, an employer includes all members of an aggregated group defined under Code sections 52(a), 52(b), 414(m), or 414(o), and debt-issuers as defined under section 15(d). The definition of covered individual is expanded to include any individual (employee or independent contractor) who performs services (directly or indirectly) for the employer (or any predecessor) for any taxable year beginning after December 31, 2019. Additionally, the definition of covered employee is modified to include any employee who was the principal executive officer or principal financial officer of the taxpayer (or any predecessor) at any time during any preceding taxable year beginning after December 31, 2016, and before January 1, 2020, or who is one of the three most highly compensated officers for the taxable year (other than the principal executive and principal financial officers) who are required to be reported on the company's proxy statement for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders). Employees generally include any U.S.-taxpayer employee or contractor, whether full-time, part-time, or seasonal.

The proposal also provides the Secretary of Treasury the authority to prescribe guidance, rules, or regulations as needed with respect to reporting and to prevent avoidance of these rules by providing compensation through a pass-through or other entity to claim the payee (the covered individual) is not an "individual."

We anticipate businesses will make substantial efforts to avoid the proposed deduction denial. These activities will likely consist of recharacterizing some current designs or forms of compensation to arrangements that would remain deductible. In addition, some employers will likely reduce compensation that is currently above the threshold in order to reduce the effects of the proposed deduction denial on their after-tax profits. Such reductions in compensation will reduce individual income tax and Medicare (hospital insurance) tax receipts.

The proposal applies to taxable years beginning after December 31, 2019. The following provides the estimated effect of the attached legislation on Federal fiscal year budget receipts:

Congress of the United States
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Washington, DC 20515–6453

Honorable Lloyd Doggett
Honorable Jack Reed
United States Congress

Fiscal Years
[Billions of Dollars]

2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2020-24	2020-29
1.9	2.7	2.7	2.8	2.8	2.8	2.8	2.8	2.9	2.9	12.8	27.1

NOTE: Details do not add to totals due to rounding.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

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cc: Dan Smith
James Ahn