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Theme: Joint Conference – Jamaica 2012

Joint CAA/IPEBLA Conference April 2012

Workshop 1

Executive Compensation – Comparing Incentives (IPEBLA)

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Our panel and audience covered the globe in discussing the range of choices from which private and public companies formulate their equity-based incentive compensation. Insights came about relevant tax, labor, and business considerations in Argentina, Canada, Ireland, Jamaica, the UK, and the US.

Our presentation began with mention of “the holy grail” of tax planning for incentive awards, namely: enabling employees to receive capital gain treatment without first recognizing ordinary income – often at twice the effective tax rate – for the incentive awards that they receive. Unfortunately, almost all incentives require income recognition in order to establish a tax basis for capital gains treatment.

Panelists discussed “appreciation-only” awards such as stock options and stock appreciation rights. These incentives became the award of choice in the 1990s both because they carried no accounting expense and because they presented employees with a chance to become the next Microsoft millionaires. After the tech bubble burst in the early 2000s and applicable accounting rules came to trigger expense recognition, a distinct shift began toward “whole value” awards with the most basic being restricted stock. These awards typically involve the earning and delivery of actual shares based on vesting conditions. Future employment is the simplest condition, vesting based on corporate or other performance goals has gained in usage and acclaim.

Our dialogue about tax policy highlighted the often localized tax policies that have at various times sought to encourage equity-based awards. However, in the wake of the 2008 financial crisis and continuing public anger about executive compensation, all noted that tax policy has tended toward the removal of tax-favored incentives. Further, courts have been quicker to protect employees against employers who pursue heavy-handed or imprecise tactics when coupling incentive awards with clawbacks, non-competes, and other forfeiture-for-misconduct provisions within award agreements.

Our panel closed with mention of awarding "profits interests" (also called "carried interests" among other terms), because these partnership-type awards have the potential to provide employees with income taxed at capital gains rates without any need for a preceding ordinary income event. Because nuanced and fact-specific in their suitability, profits interests are not quite a holy grail for optimal tax treatment.

Nevertheless, those designing equity and other incentive programs have a broadening – and ever more complex – array of choices to consider.

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