

Meridian Client Update

Status of Proposals to Link State and Local Corporate Taxes to CEO Pay Ratio

As we reported last March, several jurisdictions have proposed (and one has enacted) tax surcharges, higher corporate income tax rates or fees tied to a public company’s CEO pay ratio. Since then, these proposals seem to have gained little legislative traction. This Update examines whether the ongoing public disclosures of CEO pay ratios have proven to be a catalyst for legislative action and whether other jurisdictions have proposed similar taxes.

New Proposal – California Proposes Scaled Corporate Income Tax Rate Tied to a Public Company’s “Compensation Ratio”

California is the sole jurisdiction to propose linking corporate income tax to a public company’s compensation ratio since last March. Submitted to the California Senate earlier this year, the proposal would introduce a scaled corporate income tax rate structure, with a top rate of 13.00% for public companies whose “compensation ratio” exceeded 300 (for financial institutions, the top corporate income tax rate would be 15.00%). This corporate income tax rate would be the highest in the nation. Currently, California’s corporate income tax rate is a flat 8.84% (10.84% for financial institutions) on net income attributable to business transacted in California.

Under the proposal, a public company’s compensation ratio would describe the relationship between

- the total compensation paid to the company’s chief operation officer (“COO”) or, if greater, the highest paid employee, as reported in the company’s Summary Compensation Table, and
- the median compensation of all U.S.-based employees, including those workers contracted from a third-party (for this purpose, an employee’s compensation would be based on Social Security wages).

It is unclear why the proposed legislation bases the compensation ratio on COO compensation (instead of CEO compensation), since a public company is not required to disclose the COO position in its proxy and many companies do not employ COOs. It is possible this reflects a drafting error rather than the actual intent of the legislation.

The chart below shows the **proposed** corporate income tax rate by compensation ratio:

Compensation Ratio	Proposed California Corporate Income Tax Rate	
	Non-Financial Institution	Financial Institution
Not over 50	8.84%	10.84%
Over 50 but not over 100	10.00%	12.00%
Over 100 but not over 200	11.00%	13.00%
Over 200 but not over 300	12.00%	14.00%
Over 300	13.00%	15.00%

The proposed legislation would also impose a tax surcharge of 50% on these scaled corporate income tax rates for a public company that during a tax year reduced its U.S. full-time workforce by more than 10% and increased its foreign-based full-time workforce by any number.

For passage, two-thirds of the California Senate and Assembly must approve the legislation. If enacted, the proposed legislation would be effective for taxable years beginning on and after January 1, 2019.

Status of Prior Proposals/Enactments of Taxes Tied to CEO Pay Ratio

California joins six other jurisdictions with proposed legislation that would impose tax surcharges, higher corporate income tax rates or fees based on a public company's CEO pay ratio. To date, only the City of Portland, Oregon, has actually enacted such legislation (i.e., tax surcharge based on a company's CEO pay ratio). The following table summarize the proposed and enacted legislation.

Jurisdiction	Type of Tax	Description of Proposed/Enacted Legislation	Current Status
Proposed Connecticut	Surtax	Corporate income tax rate is based on CEO pay ratio as follows: <ul style="list-style-type: none"> 5% for a ratio of 25:1 or less 7.5% for a pay ratio of > 25:1 but ≤ 100:1 10% for a ratio of > 100:1 but ≤ 250:1 25% for ratio of > 250:1 	Referred to Joint Committee on Finance, Revenue and Bonding
Illinois	Annual fee	Annual fee is based on CEO pay ratio as follows: <ul style="list-style-type: none"> \$1,500 annual fee if CEO pay ratio between 100:1 and 250:1 \$2,500 annual fee if CEO pay ratio is > 250:1 	Referred to General Assembly's Rules Committee
Massachusetts	Surtax	A 2% corporate surtax is imposed if CEO or highest paid employee, whichever is greater, pay ratio is over 100:1 (based solely on U.S. workforce)	Referred to the Committee on Revenue; hearing held in May 2017
Minnesota	Surtax	A corporate surtax based on CEO pay ratio: <ul style="list-style-type: none"> 10% increase in corporate income tax rate if CEO pay ratio is at least 100:1 but < 250:1 25% increase in corporate income tax rate if CEO pay ratio is 250:1 or greater 	Referred to the House Committee on Taxes
Rhode Island	Surtax	A corporate surtax based on CEO pay ratio: <ul style="list-style-type: none"> 10% increase in corporate income tax rate if CEO pay ratio is at least 100:1 but < 250:1 25% increase in corporate tax rate if CEO pay ratio is 250:1 or greater 	Referred to House Finance Committee, recommended that the measure be held for further study
San Francisco, CA	Not known yet	City Attorney's Office requested to draft tax legislation related to a company's pay ratio	Under consideration
Enacted Portland, OR	Surtax	A corporate surtax based on CEO pay ratio: <ul style="list-style-type: none"> 10% increase in business license fee if CEO pay ratio is at least 100:1 but < 250:1 25% increase in business license fee if the CEO pay ratio is 250:1 or greater 	Enacted; effective in 2017

Meridian Comment. The recent disclosures of CEO pay ratios has neither caused a flood of new jurisdictions proposing taxes linked to a company’s CEO pay ratio nor any meaningful movement on outstanding legislative proposals. We believe this reflects the largely symbolic nature of these tax proposals, which do not appear to have broad-based legislative support. In fact, the California proposal is the third attempt to pass such legislation in that jurisdiction. At this juncture, we would be surprised if any of these proposals were enacted.

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The **Client Update** is prepared by Meridian Compensation Partners’ Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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