Bill Aims To Vary Corporation Tax Rate Based On Pay Ratio

By Keith Paul Bishop on April 29, 2014 in Corporate Governance

If Senator DeSaulnier gets his way, the SEC’s Summary Compensation Table could cost some corporations a lot of money. His bill, SB 1372, would if enacted change the corporation tax rate for publicly traded corporations, including wholly owned subsidiaries, according to the following ratio of (i) the greater of the chief operating officer or highest paid employee’s pay for the calendar year before the current taxable year to (ii) the median compensation of all employees’ employed by the taxpayer in the United States. The tax rate would range from 7% to 13%. If, for example, the ratio is over 25 but not over 50, then the tax rate would be 7.5% upon the basis of net income and if the ratio is over 400, then the tax rate would be 13% on the basis of net income (the bill includes a table of rates).

A chief operating officer’s or highest paid employee’s compensation is that person’s total compensation as reported in the Summary Compensation Table and would therefore include not just salary but bonuses and the value of equity compensation awards. Employee compensation, on the other hand, is defined as “wages” as set forth in Section 3121(a) of the Internal Revenue Code.

The bill also seeks to increase the taxes of corporations that move employment outside of the United States. If a company reduces employment on a full-time equivalent basis in the United States by more than 10% over the previous year, and increase contracted employees or foreign full-time employees for the same period, the rate specified in the table by 50%.

According to the author, the purpose of SB 1372 is to provide “an incentive to corporations to reduce the disparity in the amount of money they pay their CEO and the amount they pay their average worker”. However, there may be another, unintended incentive – for corporations to leave the state entirely. See Toyota to move jobs and marketing headquarters from Torrance to Texas, Los Angeles Times (April 27, 2014).

The analysis prepared by the Senate Governance and Finance Committee cites other problems with the bill:

[F]irms will have to accurately compute the rate based on wages and other forms of compensation paid for all of its non-contract employees across its unitary group, and FTB will have to make sure that each taxpayer correctly calculated this ratio, in addition to its current responsibilities to verify apportionment formulas, credits, and a myriad other issues [sic]. Firms would also file claims for refund for past taxes paid if it thinks its
calculations regarding the compensation amounts that derived the rate weren’t accurate at the time it filed the return. It’s unclear what resources will be needed should SB 1372 be enacted, or whether FTB can hire enough people or divert sufficient existing resources to ensure that taxpayers are calculating its new rate accurately. The Committee may wish to consider whether FTB can administer SB 1372, as well as the burden it would cause taxpayers.

Nonetheless, the bill passed out of committee on a 5-2 vote and will next be heard by the Senate Standing Committee on Appropriations.