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Portland to Impose Surtax on High CEO Pay Ratios

A new SEC rule will require publicly traded companies to disclose in their 2018 proxy how much their CEOs were paid relative to their median employees in fiscal year 2017. On December 7, Portland, Oregon approved a surtax on public companies reporting that they pay the CEO at least 100 times that of the median worker, becoming the first jurisdiction in the nation to impose a tax based on CEO pay ratios. Companies that do business in Portland will want to factor the new tax surcharge into their compliance strategies.

Background

Item 402 of Regulation S-K lays out executive compensation disclosure requirements for various SEC filings by public companies under the Securities Act and the Exchange Act. Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) directed the Securities and Exchange Commission (SEC) to amend Item 402 to require disclosure of: (1) the median of the annual total compensation of all company employees (excluding the CEO); (2) the annual total compensation of the company's CEO; and (3) the ratio of the median of the annual total compensation of all employees to the annual total compensation of the CEO.

In 2015, the SEC adopted a final rule requiring CEO pay ratio disclosures in registration statements, proxy and information statements, and annual reports that call for executive compensation disclosure under Item 402. Because the rule applies to a public company's first fiscal year beginning on or after January 1, 2017, a calendar year company will face the initial pay ratio disclosure of 2017 compensation in its 2018 proxy. (See our *For Your Information* from August 21, 2015.)

Portland's CEO Pay Surtax

In a 3-1 vote on December 7, the Portland city council approved a surtax on the city's existing Business License Tax for firms that do business in the city, are subject to SEC disclosure and reporting requirements, and have certain pay disparities between their CEO and average worker. This is the first local law in the nation to impose such a tax targeting income gaps the city considers excessive.

Comment. While Portland is not the first jurisdiction seeking to address income inequality between CEOs and their employees through tax policy, it is the first to actually tie the corporate tax rate to the CEO-worker pay ratio. In 2014, the California legislature considered but failed to pass a similar proposal. In the last Congress, Rep. Mark DeSaulnier (D-CA) introduced a bill to tie federal corporate tax rates to the CEO-worker pay ratio, but it failed to advance.

Under the Portland ordinance, a publicly traded company that pays its CEO at least 100 times more than its median worker will pay a 10 percent surcharge on top of the city's business license tax (currently 2.2 percent of adjusted net income), for tax years beginning on or after January 1, 2017. A company with a 250:1 or greater ratio will pay a 25 percent surcharge. The city will base its surcharge on the CEO-to-median worker pay ratios that publicly held companies will be required to report under the SEC's CEO pay ratio rule, starting with their 2017 pay figures. The city has already identified more than 500 corporations expected to be affected by the surtax, and estimates that the new tax will raise between $2.5 and $3.5 million annually.

Comment. The incoming Trump administration or the new Congress may look to undo some or all of Dodd-Frank. If they were to eliminate the CEO pay ratio reporting requirement, Portland would not have the compensation data available to implement its surtax.

In Closing

Whether other jurisdictions will follow Portland's lead remains to be seen. In the meantime, publicly traded companies subject to SEC disclosure and reporting requirements and covered by Portland's Business License Tax will want to factor the surtax into their compliance strategies.

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