

## TAXATION OF EXECUTIVE COMPENSATION

**Business 225J – Early Spring 2008**

**Professor Wendy Davis**

Mondays	January 7 – February 25, 5:30 pm – 9:30 pm
Tuesday	January 22 (no class Monday, January 21), 5:30 pm – 9:30 pm
Saturdays	January 12 & February 9, 9 am – 1 pm
Office hours	30 minutes after class OR just call or e-mail
Office	Office hours to be held in classroom
Phone	(650) 843-5157
E-mail	<a href="mailto:wdavis@cooley.com">wdavis@cooley.com</a>
Course website	<a href="http://www.cob.sjsu.edu/nellen_a/Bus225J.htm">http://www.cob.sjsu.edu/nellen_a/Bus225J.htm</a> (to get active links)

**Description:** Tax aspects of executive compensation vehicles, including qualified and nonqualified stock options, full value stock awards, employee stock purchase plans, performance-based compensation, deferred compensation, golden parachutes, cafeteria plans, and fringe benefits.

**Prerequisites:** Bus 223A, graduate standing.

**Course objectives:** The key objectives for the class will be for students to learn the tax principles underlying specific executive compensation vehicles and to learn to structure executive compensation packages that meet the client's tax and business needs. Students will get practice researching primary and secondary sources of the tax law, identifying deficiencies in existing arrangements, developing alternative tax structures, and communicating all results in plain English in a manner that can be understood by the client.

**Texts:** There is no text book or course pack for this class. You are responsible for finding the assigned reading materials using CCH online services, RIA Checkpoint, your own copy of the current Code sections and Treasury Regulations and/or the links on the 225J Web Site.

**Grading:** Grades will follow the pattern of 90% or higher for an A, 80% or higher for a B, 70% or higher for a C, etc. Plus and minus grades will not be used. 45% of your grade is based on participation in in-class group assignments (5% per class), 20% of your grade is based on written homework (10% per assignment) and 35% of your grade is based on an in-class written final exam. No extra credit is offered. However, in the event of one absence due to an extraordinary personal emergency, you may make up the portion of your grade associated with that one missed class (i.e., 5% in-class group assignment) by submitting a written response to the hypothetical posed that day to the class.

**Attendance and homework:** If you have a conflict, please let me know in advance. If you will not be able to attend a class (which should be a very unusual event), you must email me the homework prior to the start of the class and you are responsible for getting notes from a classmate. Except as noted above in the case of one absence due to an extraordinary personal emergency, if you miss a class, you will forfeit the points for the in-class group assignment.

**Research:** All assignments can be completed using the primary and secondary sources that can be found using the Internet-based tools available from the SJSU Library, as well as materials available at various government web sites. The 225J website includes links to the sites you will need for this class. You will need to obtain a passcode to access CCH. You can get a passcode for RIA Checkpoint by following the links on the 225J website.

**The Internet-based research tools that require an SJSU-issued passcode are ONLY for use on MST coursework.**

**Professor Davis's Philosophy for Graduate Tax Study:**

- The best way to learn the material is to actually apply it.
- You can learn from working with fellow students in small groups to try to solve problems and come up with planning techniques. Everyone thinks and approaches problems differently and has something to offer to the group. Group work will take place during class.
- You must learn to communicate complicated tax issues in plain English and in a variety of ways so that each specific client will understand and be able to best use your expertise.
- You must come to class prepared in order to get the most of out class discussions and to be an effective group member.
- Graduate-level study should be challenging!

**Academic Integrity:** Your own commitment to learning, as evidenced by your enrollment at San José State University, and the University's Academic Integrity Policy requires you to be honest in all your academic course work. Faculty are required to report all infractions to the Office of Judicial Affairs. The SJSU policy on academic integrity can be found at <http://www.sjsu.edu/senate/S07-2.pdf>. You can link to it from Professor Nellen's 2007 Course Information webpage where you will also see some of the policy's key points highlighted.

**You will lose lots of points for copying without attribution, using summaries written by others or engaging in any other forms of plagiarism or cheating. Do not copy and turn in something found online or in a book or magazine. Be sure what you turn in is your individual work in your own words.**

**Students with Special Needs:** If you need course adaptations or accommodations because of a disability, or if you need special arrangements in case the building must be evacuated, please make an appointment with me as soon as possible, or see me during office hours. Presidential Directive 97-03 requires that students with disabilities register with the Disability Resource Center (DRC) on campus to establish a record of their disability.

**MST Program Learning Objectives**

1. To identify and understand complex tax issues within the context of the global business world.
2. To learn research skills that will assist in exploring both familiar and new areas of the tax law and communicate the findings clearly.
3. To be aware of multi-jurisdictional tax issues.
4. To develop conceptual and analytic skills with real world applications.
5. To develop an appreciation for tax policy issues that underpin our tax laws.
6. To understand the ethical implications of tax practice.

### Reading and Homework Schedule

Note: Adjustments in the assignments may need to be made by your professor, but such changes to the schedule or assignments will be discussed in class.

Date	Topic	Reading <sup>1</sup>	Group Assignment	Homework <sup>2</sup>
Monday 1/7	Introduction State of Play General principles <ul style="list-style-type: none"> <li>• Timing of income &amp; deductions</li> <li>• Withholding</li> </ul>	§61(a)(1) & Reg §1.61-1 and -2 §83 & Reg §1.83 §162(a) & Reg §1.162-1, -5, -7 thru -10 §451 & Reg §1.451-1 and -2 IRS's (Circular E) Employer's Tax Guide (Publication 15) - <a href="http://www.irs.gov/pub/irs-pdf/p15.pdf">http://www.irs.gov/pub/irs-pdf/p15.pdf</a> <i>Debunking Executive Compensation Myths</i> - <a href="http://www.watsonwyatt.com/research/deliverpdf.asp?catalog=2007-US-0218&amp;id=x.pdf">http://www.watsonwyatt.com/research/deliverpdf.asp?catalog=2007-US-0218&amp;id=x.pdf</a> <i>Executive Pay: Conflicts of Interest Among Compensation Consultants</i> - <a href="http://oversight.house.gov/documents/20071205100928.pdf">http://oversight.house.gov/documents/20071205100928.pdf</a>	Advise the VP of Human Resources regarding the tax issues in the agreement she sent to you.	--
Saturday 1/12	§409A Part I <ul style="list-style-type: none"> <li>• What is it?</li> <li>• Why do I care?</li> <li>• How do I avoid it?</li> <li>• How do I comply?</li> </ul>	§409A & Reg §1.409A-1, -2, -3 and -6 Treasury Notice 2007-86 - <a href="http://www.irs.gov/pub/irs-drop/n-07-86.pdf">http://www.irs.gov/pub/irs-drop/n-07-86.pdf</a> Treasury Notice 2007-89 - <a href="http://www.irs.gov/pub/irs-drop/n-07-89.pdf">http://www.irs.gov/pub/irs-drop/n-07-89.pdf</a> <i>Cooley Alert! Finally... Final 409A Regulations</i> - <a href="http://www.cooley.com/news/alerts.aspx?id=40580520">http://www.cooley.com/news/alerts.aspx?id=40580520</a>	Advise your client, a CEO candidate, on the 409A issues in the offer letter provided to him.	--

<sup>1</sup> For each class, please bring with you copies of all of the assigned reading materials for that class to use as a reference for your in-class group assignments.

<sup>2</sup> Homework must be typed and can be submitted by email prior to class or in person at the start of class.

Monday 1/14	<p>Equity compensation I</p> <ul style="list-style-type: none"> <li>• ISO v. NSO v. SAR</li> <li>• RS v. RSU</li> <li>• ESPP</li> </ul>	<p>§83 &amp; Reg §1.83  §421 &amp; Reg §1.421  §422 &amp; Reg §1.422  §423 &amp; Reg §1.423  §424 &amp; Reg §1.424  §6039(a)  About Stock Options -  <a href="http://content.members.fidelity.com/products/stockoptions/about/0,,0,00.html">http://content.members.fidelity.com/products/stockoptions/about/0,,0,00.html</a>  About Stock Appreciation Rights -  <a href="http://personal.fidelity.com/products/stockoptions/restrictedstocks.shtml.cvsr">http://personal.fidelity.com/products/stockoptions/restrictedstocks.shtml.cvsr</a>  About Restricted Stock Awards -  <a href="http://content.members.fidelity.com/products/stockoptions/restrictedstockawards/0,,0,00.html">http://content.members.fidelity.com/products/stockoptions/restrictedstockawards/0,,0,00.html</a>  About Restricted Stock Units -  <a href="http://content.members.fidelity.com/products/stockoptions/restrictedstockunits/0,,0,00.html">http://content.members.fidelity.com/products/stockoptions/restrictedstockunits/0,,0,00.html</a>  About Employee Stock Purchase Plans -  <a href="http://content.members.fidelity.com/products/stockoptions/stockpurchase/0,,0,00.html">http://content.members.fidelity.com/products/stockoptions/stockpurchase/0,,0,00.html</a>  <i>Post-Termination Issues - 225J Web Site</i></p>	<p>Prepare an oral presentation for the CEO to help him make decisions on his company's equity compensation program.</p>	<p>--</p>
Tuesday 1/22	<p>Equity compensation II</p> <ul style="list-style-type: none"> <li>• 409A basics</li> <li>• Use of promissory notes</li> <li>• The modern ESPP</li> </ul>	<p>§409A  Reg §1.409A-1(b)(5)  <i>Cooley Alert! Reduction or Cancellation of "Underwater" Note Results in Income to Employee -</i>  <a href="http://www.cooley.com/news/alerts.aspx?id=38530520">http://www.cooley.com/news/alerts.aspx?id=38530520</a>  <i>ESPP—An Alternative to Stock Option Plans? – 225J Web Site</i></p>	<p>Prepare for a meeting with the compensation committee of your company's board of directors in which they plan to grant stock options.</p>	<p>Prepare an explanatory comparative equity compensation table (form to be provided)</p>

Monday 1/28	<p>Performance compensation</p> <ul style="list-style-type: none"> <li>• Establishing metrics</li> <li>• Certifying results</li> <li>• Interplay with 409A</li> </ul>	<p>§162(m) &amp; Reg §1.162-27  §409A &amp; Reg §1.409A-1(e), -2  Treasury Notice 2007-49 - <a href="http://www.irs.gov/pub/irs-drop/n-07-49.pdf">http://www.irs.gov/pub/irs-drop/n-07-49.pdf</a>  <i>Cooley Alert! CFO Compensation No Longer Subject to \$1 Million Deduction Limit: But For How Long?</i> - <a href="http://www.cooley.com/news/alerts.aspx?id=40651420">http://www.cooley.com/news/alerts.aspx?id=40651420</a>  <i>Performance Equity Vehicles</i> – 225J Web Site</p>	<p>Prepare an oral report on the policies and procedures followed by your client in their attempts to comply with §162(m).</p>	
Monday 2/4	<p>Golden parachutes</p> <ul style="list-style-type: none"> <li>• Tax on employee</li> <li>• Loss of employer deduction</li> <li>• Solutions</li> </ul>	<p>§280G &amp; Reg §1.280G-1  §409A &amp; Reg §1.409A-3(i)(1)(v)  §4999  IRS Golden Parachute Audit Techniques Guide (02-2005) - <a href="http://www.irs.gov/businesses/corporations/article/0,,id=134890,00.html">http://www.irs.gov/businesses/corporations/article/0,,id=134890,00.html</a>  <i>When Shareholders Pay the CEO's Tax Bill</i> - <a href="http://www.businessweek.com/magazine/content/07_10/b4024060.htm">http://www.businessweek.com/magazine/content/07_10/b4024060.htm</a></p>	<p>The CEO, CFO and VP of HR want you to help them determine, on the eve of signing a merger agreement, whether or not they can make the “golden parachute” representation in the merger agreement.</p>	
Saturday 2/9	<p>§409A Part II</p> <ul style="list-style-type: none"> <li>• Fixing option backdating</li> <li>• Structuring severance arrangements</li> <li>• Elections under NQDC plans</li> </ul>	<p>Preamble to final Section 409A  §409A  Reg §1.409A-1, -2 and -3  Reg §1.414(q)-1T Q&amp;A 10  Reg §1.416-1 T&amp;A13  Reg §20.2031-2(f)  <i>Fixing the Fallout from Option Backdating</i> – 225J Web Site</p>	<p>Prepare for a meeting with your client to review the results of your 409A audit of their compensation programs</p>	<p>Hand mark the client's executive severance plan.</p>

Monday 2/11	<p>Cafeteria plans</p> <ul style="list-style-type: none"> <li>• General requirements</li> <li>• Permitted benefits</li> <li>• Nondiscrimination rules</li> </ul>	<p>§106 &amp; Reg §1.106  §125 &amp; Reg §1.125  §129  §137  §409A &amp; Reg §1.409A-2(a)(10)  Press release announcing new proposed cafeteria plan regulations - <a href="http://www.treas.gov/press/releases/hp526.htm">http://www.treas.gov/press/releases/hp526.htm</a>  Preamble to new proposed regulations – pages 1-31 of <a href="http://www.treas.gov/press/releases/reports/section125.pdf">http://www.treas.gov/press/releases/reports/section125.pdf</a>  <i>Ten Considerations For §125 Plans</i>  <a href="http://www.milliman.com/expertise/employee-benefits/publications/wp/PDFs/ten-considerations-about-section-WP12-01-07.pdf">http://www.milliman.com/expertise/employee-benefits/publications/wp/PDFs/ten-considerations-about-section-WP12-01-07.pdf</a></p>	<p>Help the VP of HR consider her alternatives in establishing a cafeteria plan.</p>	--
Monday 2/18	Fringe benefits	<p>§61(a) &amp; Reg §1.61-21  §62(a)(2) &amp; Reg §1.62-2  §79 &amp; Reg §1.79  §104(a)(3) &amp; Reg §1.104-1(d)  §105(b) &amp; Reg §1.105  §106 &amp; Reg §1.106  §127 &amp; Reg §1.127  §129  §132 &amp; Reg §1.132  §451 &amp; Reg §1.451-1 and -2  IRS's Employer's Tax Guide to Fringe Benefits (Publication 15-B) - <a href="http://www.irs.gov/pub/irs-pdf/p15b.pdf">http://www.irs.gov/pub/irs-pdf/p15b.pdf</a>  <i>Cooley Alert! IRS Announces Adjusted Plan Limits for 2008</i> - <a href="http://www.cooley.com/news/alerts.aspx?id=40848320">http://www.cooley.com/news/alerts.aspx?id=40848320</a>  <i>Disclosure rules lead firms to cut back on CEO perks</i> - <a href="http://www.mercurynews.com/salarysurvey/ci_6102511">http://www.mercurynews.com/salarysurvey/ci_6102511</a></p>	<p>Review the fringe benefit tax issues presented by the client's employee handbook</p>	--
Monday 2/25	Final Exam			--

If you are having difficulty understanding the primary sources assigned to you for any class, or if you are hungry for more information. I encourage you to seek out additional information. If you have access to the Tax Management Portfolios by BNAs, I've listed the applicable ones below in the order in which we will be covering the materials in class. These Portfolios are not required reading. If you don't have access to the BNA Portfolios, you can find similar information on the class topics in either RIA or CCH using their explanatory materials.

- Portfolio 390-4<sup>th</sup>: Reasonable Compensation
- Portfolio 385-4<sup>th</sup>: Deferred Compensation Arrangements
- Portfolio 381-3<sup>rd</sup>: Statutory Stock Options
- Portfolio 383-3<sup>rd</sup>: Nonstatutory Stock Options
- Portfolio 384-3<sup>rd</sup>: Restricted Property – Section 83
- Portfolio 396: Golden Parachutes
- Portfolio 397-3<sup>rd</sup>: Cafeteria Plans
- Portfolio 394-4<sup>th</sup>: Employee Fringe Benefits