# UNCAPPING EXECUTIVE PAY

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*This Article sets out the case for repealing the $1 million tax cap on executive pay. The cap is easily avoided and, when not avoided, widely ignored. Since enactment in 1993, the cap has had little effect in reducing executive pay or in linking pay to performance. Even worse, the cap increases corporate tax liabilities—liabilities that likely burden workers and investors. In effect, the cap punishes rank-and-file employees and shareholders for pay deals made by directors and executives. This Article demonstrates why prominent reform proposals would be ineffective and counterproductive. It then devises a novel reform approach—a confiscatory tax on excessive executive pay—that would limit executive pay without burdening workers or investors. But this Article rejects the confiscatory tax because of the serious distortions that it would cause for business-organization and labor-supply decisions. Ultimately, the superior policy position is to repeal the cap. Concerns about income inequality are better addressed through robust progressive taxation, and concerns about corporate governance are better addressed through non-tax mechanisms, such as reform of the business-judgment rule and expansion of director liability.*

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## INTRODUCTION

Everything old is new again, and concerns about executive compensation have once more pushed to the policy foreground. During his presidential campaign, Senator Bernie Sanders repeatedly attacked the disparity between the average compensation for executives and the average compensation for rank-and-file workers, pointing out that chief executive officers typically earn almost three hundred times what blue-collar workers earn.[1] Former Secretary of State Hillary Clinton echoed those complaints during her presidential campaign.[2] Mainstream news media routinely refer to "excessive" or "out of control" executive compensation.[3] Governor Jeb Bush once called high compensation for bank executives a "threat to capitalism."[4] And even President Donald Trump, himself a longtime corporate executive, has said that executive pay is "disgraceful."[5] These criticisms—from left, right, and center—play out against a background of grave concerns about rising income inequality in the United States and persistent skepticism about the quality of corporate governance. The time

1. *See, e.g.*, Press Release, Senator Bernie Sanders, Sanders Statement on CEO Pay Rule (Aug. 5, 2015), http://www.sanders.senate.gov/newsroom/recent-business/sanders-statement-on-ceo-pay-rule.

2. Caren Bohan et al., *Hillary Clinton Surprises with Early Attack on CEO Pay*, REUTERS (Apr. 13, 2015, 7:29 PM), http://reut.rs/1O7eNz8.

3. *See, e.g.*, The Editorial Board, Opinion, *How Excessive Executive Pay Hurts Shareholders*, N.Y. TIMES (July 14, 2016), https://www.nytimes.com/2016/07/14/opinion/how-excessive-executive-pay-hurts-shareholders.html; Robert Reich, *Robert Reich: American CEO Pay Is Completely out of Control*, SALON (Aug. 12, 2015, 6:30 AM), http://www.salon.com/2015/08/12/robert_reich_american_ceo_pay_is_completely_out_of_control.

4. Rik Kirkland, *The Real CEO Pay Problem*, FORTUNE (June 30, 2006, 2:05 PM), http://archive.fortune.com/magazines/fortune/fortune_archive/2006/07/10/8380799/index.htm.

5. Krista Hughes et al., *Trump Says High Pay for CEOs Is a Joke and 'Disgraceful*,*'* REUTERS (Sept. 13, 2015, 1:21 PM), http://reut.rs/1iGR2Fs.

appears right for policymakers to take action on executive pay.[6]

But everything new is still old, and executive compensation is no exception. In 1993, Congress enacted § 162(m) of the Internal Revenue Code—its most aggressive effort to limit what companies pay their executives.[7] Section 162(m) caps at $1 million the corporate deduction for annual compensation paid to each senior manager.[8] This limitation, proponents variously argued, would rein in manager pay, push companies to condition executive compensation on corporate and individual performance, restore balance between the pay of executives and the pay of rank-and-file workers, and, if nothing else, impose a significant penalty on companies that persisted in lavishing high levels of performance-insensitive compensation on their senior managers.[9] After more than two decades, § 162(m) has proven a spectacular policy failure. Stalwart defenders of the provision propose reforms, both large and small, to improve § 162(m).[10] Although well intentioned, those proposals are deeply misguided. The better approach is to repeal § 162(m) outright.

The track record of the $1 million deduction limit has proven its original proponents wrong on almost every point. Executive compensation has increased substantially over the last two decades, in both absolute and relative terms. When Congress enacted § 162(m) in 1993, a typical large company in the United States paid its chief executive officer ("CEO") compensation of $3.05 million (in 2016 dollars),[11] or about 195 times the compensation paid to a blue-collar worker.[12] By 2014, a typical large United States company paid its CEO compensation of $10.44 million (again in 2016 dollars),[13] or about 373 times the compensation paid to a blue-collar

6. *See* Dylan F. Moroses, *Election Could Shape Debate over Tax Breaks for Executive Pay*, 152 TAX NOTES 1350, 1350 (2016).

7. Concerns about executive pay crossed party lines in the 1992 elections, just as they did in the 2016 elections. *See, e.g.*, Jeffrey H. Birnbaum, *Campaign '92: From Quayle to Clinton, Politicians Are Pouncing on the Hot Issue of Top Executives' Hefty Salaries*, WALL ST. J., Jan. 15, 1992, at A14.

8. I.R.C. § 162(m)(1) (2012).

9. *See infra* Part I.A.

10. *See infra* Part II.

11. In 1993, the median compensation of CEOs at S&P 500 companies, adjusted to 2000 dollars, was $2.2 million. Carola Frydman & Dirk Jenter, *CEO Compensation*, 2 ANN. REV. FIN. ECON. 75, 78 tbl.1 (2010). Throughout this paper, all inflation adjustments were performed using the Consumer Price Index. *See CPI Inflation Calculator*, BUREAU OF LAB. STAT., https://data.bls.gov/cgi-bin/cpicalc.pl (last visited May 17, 2017).

12. *Executive Paywatch 2014*, AFL-CIO, http://ftp.workingamerica.org/Corporate-Watch/Paywatch-2014 (last visited May 17, 2017).

13. In 2014, the median compensation of CEOs at S&P 500 companies was $10.15 million. Aubrey Bout, *Trends in S&P 500 CEO Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 30, 2015), https://corpgov.law.harvard.edu/2015/12/30/trends-in-sp-500-ceo-compensation.

worker.[14] Grants of stock options and stock appreciation rights, which are broadly exempt from § 162(m) but which are only loosely tied to corporate and individual performance, increased substantially after 1993, reaching 49% of total CEO pay just before the end of the information-technology bubble in 2000.[15] Companies also discovered very quickly that they could shelter executive compensation from § 162(m) by deferring payment until an executive's retirement.[16] And many companies simply pay their managers non-deductible salaries, bonuses, and other amounts above the $1 million cap.[17] Although that practice at least increases tax receipts for the federal government, the revenue comes mainly from an indirect tax on rank-and-file workers and investors.[18] Directors and executives bear few or none of the consequences of ignoring or defying § 162(m).

Despite the substantial shortcomings of § 162(m), many who remain faithful to the idea of a tax cap on executive compensation have proposed reforms to the deduction limit.[19] Most prominent among these are proposals to narrow or to eliminate the existing exceptions for performance-based and deferred compensation. Alternatively, there is a plausible argument for retaining § 162(m) as it is, warts and all, in order to generate federal tax receipts and to make a symbolic statement against excessive executive compensation. But both approaches—reforms targeting the exceptions and simple continuation of the status quo—share a significant limitation. They both rely on the denial of corporate tax deductions for executive pay above the $1 million cap, but companies have demonstrated a widespread willingness to shrug off those lost deductions. This likely increases the economic burden on workers and investors without meaningfully affecting executive compensation. By aiming the tax sanction at the companies that pay excessive compensation rather than at the executives who receive it, these approaches double down on an existing policy failure.

An effective tax mechanism for limiting executive pay would have to target executives directly. Previous legislative responses to excess golden-parachute payments and aggressive deferred-compensation arrangements show that standard penalty taxes imposed on executives improve only slightly (if at all) on disallowed corporate deductions. By contrast, a

14. *Executive Paywatch 2015*, AFL-CIO, http://ftp.workingamerica.org/Corporate-Watch/Paywatch-2015 (last visited May 17, 2017).

15. Frydman & Jenter, *supra* note 11, at 81.

16. *See infra* Part I.B.

17. *Id.*

18. *Id.*

19. *See infra* Part II.

confiscatory tax—that is, a tax equal to 100 percent of excessive executive pay—would impose an effective, hard limit on manager compensation. Rather than attempting simply to discourage payments above a designated amount, a confiscatory tax would tax away such payments in full. But precisely because it would be effective, a confiscatory tax would be highly objectionable. A confiscatory tax would introduce serious distortions and disruptions into fundamental decisions about business organization and labor supply, particularly among highly capable individuals, and it would put government in the challenging position of setting actual pay levels in the private sector.

In the end, the better policy approach is to remove any tax limitation on executive compensation. Policymakers should recognize that market failures in the setting of manager pay are not a tax-policy problem and are not properly resolved through the tax law. From a tax perspective, the right answer is to repeal § 162(m). Nonetheless, legitimate policy concerns about income inequality and corporate governance should be addressed. Although § 162(m) is a poor mechanism for mitigating income inequality, robust progressive tax rates—particularly when applied to a broad base—can effectively reduce the income disparities that have emerged as a pressing problem in recent years. And although § 162(m) has little apparent effect on corporate governance, meaningful reform to corporate law—such as narrowing the business-judgment rule and expanding director liability—can effectively discipline board decisions about how much to pay executives and how closely to link that pay to corporate and individual performance.

This Article sets out the argument against § 162(m) as follows. Part I examines § 162(m) and, more importantly, its unexpected consequences and its failures. Part II considers the case for reforming § 162(m) from within—that is, for retaining the basic structure of § 162(m) but changing the parameters of what compensation is or is not deductible. Part III considers the case for reforming § 162(m) from without—that is, for scrapping the basic structure of § 162(m) in favor of something that would be very effective in limiting manager pay: a confiscatory tax. Part III argues that, although effective, a confiscatory tax would be highly objectionable and that the superior policy answer is to impose no tax limitation on manager compensation but to address income inequality and corporate governance through progressive tax rates and corporate-law reform.

## I. THE FAILURE OF SECTION 162(M)

Congress enacted § 162(m) with high hopes. In the early 1990s, many at the political center and on the political left believed that fiscal policy under the Reagan and Bush administrations had tilted too much in favor of higher-income taxpayers and had led to imprudent annual deficits in the federal budget. The tax plan of the new Clinton administration signaled a decided shift in federal tax policy, anchored by higher individual marginal tax rates.[20] A proposal to cap the corporate tax deduction for executive compensation at $1 million fit well with the new political zeitgeist. Proponents of the deduction limitation variously promised that it would lower overall levels of executive pay, reduce income inequality, make manager compensation more sensitive to corporate and individual performance, and effectively penalize companies that chose to disregard the new rule.[21] But matters have turned out differently. Since 1993, executive pay has increased markedly, in both absolute and relative terms; executive compensation, at least to many critics, has not become more dependent on corporate and individual performance; and companies regularly avoid or ignore the deduction cap.[22]

### A. MECHANICS AND OBJECTIVES

The general rule of § 162(m) denies a tax deduction to a public corporation for compensation in excess of $1 million paid during a single year to any of the corporation's four highest-paid officers.[23] The statute exempts "performance-based compensation" from the deduction limitation.[24] This exception has attracted outsized policy and academic attention. It waives the $1 million deduction cap for compensation "payable solely on account of the attainment of one or more performance goals," as long as the performance goals are set by a committee of outside directors, the performance goals and the other "material terms" of the compensation are disclosed to shareholders and approved by them, and the committee of outside directors certifies that the performance goals have been satisfied before the compensation is paid.[25] Congress later extended modified versions of the pay cap—with the deduction limit set at $500,000, rather than

20. *See* U.S. DEP'T OF THE TREASURY, SUMMARY OF THE ADMINISTRATION'S REVENUE PROPOSALS (1993).

21. *See infra* Part I.A.

22. *See infra* Part I.B.

23. The statute actually denies the deduction for compensation paid to a "covered employee," defined in § 162(m)(3) as the CEO of the corporation and the four highest-paid officers of the corporation (other than the CEO) whose compensation must be reported to shareholders under the Securities Exchange Act of 1934. I.R.C. § 162(m)(1) (2012). Because of a regulatory change made by the Securities and Exchange Commission in 2006, the Internal Revenue Service now interprets § 162(m)(3) as reaching only four managers, rather than five. *See* I.R.S. Notice 2007-49, 2007-1 C.B. 1429.

24. I.R.C. § 162(m)(4)(C). Similarly, the statute exempts compensation paid on a commission basis. § 162(m)(4)(B).

25. *Id.* § 162(m)(4)(C).

$1 million—to certain employers participating in the Troubled Asset Relief Program under the Emergency Economic Stabilization Act of 2008 and to certain providers of health insurance regulated by the Patient Protection and Affordable Care Act of 2010.[26]

The policy objectives articulated by proponents of § 162(m) were muddled; it was never clear whether the aim was to discourage excessive executive compensation generally, to discourage performance-insensitive executive compensation in particular, to deny tax benefits for excessive executive compensation, to deny tax benefits for performance-insensitive executive compensation, or to achieve some combination of those goals.[27] The objective of reducing the absolute levels of executive pay is distinct from—and in tension with—the objective of linking executive pay to performance. As Kevin Murphy observes: "[I]ncreasing pay-performance sensitivities ultimately implies higher, not lower, levels of pay," and "restrict[ing] pay levels inevitably results in lower incentives and a loss of scarce managerial talent in the corporate sector."[28] The inability of those promoting § 162(m) to define a clear goal for their efforts helped set the provision up for failure.

Early versions of the deduction cap introduced near the end of the Bush administration suggested an ambitious effort to reshape corporate compensation practices by tying executive pay levels to rank-and-file pay levels. Representative Martin Sabo's Income Disparities Act of 1991 would have denied a deduction for compensation paid by an employer to the extent that the compensation for any one employee exceeded twenty-five times the lowest compensation for any other employee.[29] That proposal, modified to a flat $1 million deduction cap for compensation paid to officer employees, was included in the Tax Fairness and Economic Growth Act of 1992, which President Bush vetoed.[30]

The new Clinton administration formally proposed a $1 million deduction limitation for executive pay in February of 1993; it articulated the justification for the cap primarily, although not exclusively, in tax-policy

26. *Id.* § 162(m)(5)–(6).

27. From the beginning, Graef Crystal cautioned that the policies underlying a deduction cap for executive pay were unsound. Graef Crystal, *Capping Exec Pay Deduction Bad Tax Policy*, 20 PENSIONS & INV. 11, 11 (1992).

28. Kevin J. Murphy, *Politics, Economics, and Executive Compensation*, 63 U. CIN. L. REV. 713, 715 (1995).

29. Income Disparities Act of 1991, H.R. 3056, 102d Cong. (1991).

30. Tax Fairness and Economic Growth Act of 1992, H.R. 4210, 102d Cong. (1992).

terms.[31] The law in existence before § 162(m), the administration argued, set "no limitation on the amount of tax benefit provided for executive compensation."[32] The administration levered this tax-policy criticism into a corporate-governance objection, asserting that the "unlimited tax benefit is particularly troubling in light of concerns that, in some cases, the compensation paid to corporate executives has increased despite a decline in business performance."[33] The proposed $1 million cap on deductible compensation, the administration argued, "would limit the tax benefit for salaries paid to executives and would provide a strong incentive for corporations to explicitly link compensation to productivity."[34] This represented a rightward shift from the 1992 Clinton-Gore campaign manifesto, which had promised simply to eliminate all tax deductions for "excessive executive pay."[35]

In mulling over the administration's proposal, Congress discounted the "tax benefit" argument. Instead, the House Budget Committee noted that the levels of executive compensation had become "the subject of scrutiny and criticism" and optimistically asserted that enactment of the $1 million cap on deductible executive pay would effect a reduction in "excessive compensation."[36] Thus, the policy goal, as understood by key members of Congress, was not to limit tax benefits or to raise revenue but to influence corporate governance by targeting both the amounts and the components of executive compensation. As such, the legislation was meant to promote the interests of corporate shareholders and rank-and-file workers. After enactment, even administration officials agreed that § 162(m) was meant to operate principally as a Pigovian tax—not to raise tax revenue for the federal government but to change objectionable corporate pay practices.[37]

31. *See* U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

32. *Id. See also* David E. Rosenbaum, *Business Leaders Urged by Clinton to Back Tax Plan*, N.Y. TIMES (Feb. 12, 1993), http://www.nytimes.com/1993/02/12/us/business-leaders-urged-by-clinton-to-back-tax-plan.html. I.R.C. § 162(a), which permits a corporation to deduct compensation paid to its managers and other employees, limits the deduction to amounts that are "reasonable." I.R.C. § 162(a) (2012). But that limitation has proven very soft, and disallowances of the deduction for unreasonable compensation paid to managers of public companies are rare.

33. U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

34. *Id.*

35. During the campaign, Clinton and Gore had argued that "[t]oday, the average CEO at a major American corporation is paid 100 times more than the average worker. Our government rewards that excess with a tax break for executive pay, no matter how high it is, no matter what performance it reflects." BILL CLINTON & AL GORE, PUTTING PEOPLE FIRST: HOW WE CAN ALL CHANGE AMERICA 67 (1992). The campaign proposal was to "[e]liminate *tax deductions for excessive executive pay*." *Id.* at 68. *See also id.* at 127.

36. H.R. REP. NO. 103-111, at 646 (1993).

37. Meegan M. Reilly, *Former Treasury Official Discusses Executive Compensation Cap*, 62 TAX

### B. IMPLEMENTATION AND OUTCOMES

Matters have not turned out as intended. Executive pay levels have continued to increase since 1993; in fact, the rate of annual increase has accelerated since the enactment of § 162(m).[38] Expressed in 2016 dollars, the median compensation of CEOs at S&P 500 corporations in 1993 was $3.05 million, and their average compensation was $4.44 million.[39] Again expressed in 2016 dollars, the median compensation of CEOs at S&P 500 corporations in 2008 had risen to $8.46 million, and their average compensation had risen to $11.38 million.[40] Thus, during the first 15 years after enactment of § 162(m), the median compensation for these CEOs nearly tripled in real terms, and the average compensation for these CEOs more than doubled in real terms. In some years, the annual increase in CEO pay exceeded 10%.[41] The median and average numbers, however, do not focus one's attention quite as well as the total compensation figures for the highest-paid executives—such as, for 2014, the $156 million paid to the CEO of Discovery Communications, the $84 million paid to the CEO of Microsoft, and the $67 million paid to the CEO of Oracle.[42]

NOTES 747, 747 (1994).

38. *See generally* Steven Balsam & David H. Ryan, *Limiting Executive Compensation: The Case of CEOs Hired after the Imposition of 162(m)*, 22 J. ACCT. AUDITING & FIN. 599 (2007) [hereinafter Balsam & Ryan, *Limiting Executive Compensation*]; Steven Balsam & David Ryan, *The Effect of Internal Revenue Code Section 162(m) on the Issuance of Stock Options*, *in* 18 ADVANCES IN TAXATION 3 (Suzanne M. Luttman ed., 2008) [hereinafter Balsam & Ryan, *Effect of Internal Revenue Code*]; Lucian Bebchuk & Yaniv Grinstein, *The Growth of Executive Pay*, 21 OXFORD REV. ECON. POL. 283 (2005); Kenneth R. Ferris & James S. Wallace, *IRC Section 162(m) and the Law of Unintended Consequences*, 25 ADVANCES ACCT. 147 (2009); Frydman & Jenter, *supra* note 11; Brian J. Hall & Jeffrey B. Liebman, *The Taxation of Executive Compensation*, 14 TAX POL'Y & ECON. 1 (2000); Kevin J. Murphy, *The Politics of Pay: A Legislative History of Executive Compensation*, *reprinted in* RESEARCH HANDBOOK ON EXECUTIVE PAY 25 (Randall S. Thomas & Jennifer G. Hill eds., 2012); Todd Perry & Marc Zenner, *Pay for Performance? Government Regulation and the Structure of Compensation Contracts*, 62 J. FIN. ECON. 453 (2001); Marilyn F. Johnson et al., *Stakeholder Pressure and the Structure of Executive Compensation* (Nov. 14, 1997) (unpublished manuscript), https://ssrn.com/abstract_id= 41780. *But see* Steven N. Kaplan, *The Real Story Behind Executive Pay: The Myth of Crony Capitalism*, 92 FOREIGN AFF., May–June 2013 at 20, 20–22 [hereinafter Kaplan, *The Real Story Behind Executive Pay*]; Nancy L. Rose & Catherine Wolfram, *Regulating Executive Pay: Using the Tax Code to Influence Chief Executive Officer Compensation*, 20 J. LAB. ECON. S138 (2002); Steven N. Kaplan, *Executive Compensation and Corporate Governance in the U.S.: Perceptions, Facts and Challenges* 2–8, 28 (Nat'l Bureau of Econ. Research, Working Paper No. 18395, 2012) [hereinafter Kaplan, *Executive Compensation and Corporate Governance in the U.S.*].

39. In 1993, the median compensation of CEOs at S&P 500 companies, adjusted to 2000 dollars, was $2.2 million; their average compensation, also adjusted to 2000 dollars, was $3.2 million. Frydman & Jenter, *supra* note 11, at 78–79 tbl.1.

40. In 2008, the median compensation of CEOs at S&P 500 companies, adjusted to 2000 dollars, was $6.1 million; their average compensation, adjusted to 2000 dollars, was $8.2 million. *Id.*

41. *Id.*

42. Jena McGregor, *The Average S&P CEO Makes More Than 200 Times the Median Worker*,

Executive pay has also increased in relative terms, as measured against the pay of rank-and-file workers. In 1980, average CEO pay was 42 times that of average blue-collar pay;[43] in 1993, average CEO pay was 195 times that of average blue-collar pay; [44] and in 2014, average CEO pay was 373 times that of average blue-collar pay.[45] Again, the cases at the high end command attention: in 2014, the CEOs of Discovery Communications, Chipotle, CVS Health, and Walmart all made more than 1,000 times the average pay for the workers at those companies.[46] By quaint comparison, Representative Sabo's Income Disparities Act of 1991, the legislative forerunner of § 162(m), would have denied a tax deduction if an employee's pay was more than twenty-five times that of the employer's lowest-paid employee.[47]

Of course, it is difficult to determine what, if any, direct effect § 162(m) has had on the continued increase in executive pay since 1993. It is possible that the present high levels of manager compensation would have been higher still in the absence of § 162(m). Perhaps directors and managers are genuinely concerned about the effect of lost deductions on corporate bottom lines and § 162(m) in fact constrains executive-compensation arrangements. That seems most plausible, however, only when non-deductible manager pay represents a substantial portion of the corporation's revenues or profits. But the policy concerns about executive pay center on the largest public companies, and the revenues and profits of the largest public companies can be enormous. Consider ExxonMobil, for example. In 2014, the company paid its CEO total compensation of $33 million; that included a base salary of $2,867,000.[48] In other words, ExxonMobil could not deduct at least $1,867,000—and possibly more—of the CEO's $33 million pay. But in 2014 the company had $412 billion in revenues and $32.5 billion in profits.[49] It is hard to imagine that the directors and the CEO worried much about the effect of § 162(m) on the company's bottom line.

WASH. POST (Aug. 25, 2015), https://www.washingtonpost.com/news/on-leadership/wp/2015/08/25/the-average-sp-500-ceo-makes-more-than-200-times-the-median-worker/?utm_term=.1b919cdb0763.

43. Christopher D. Jones, *The Million-Dollar Question: Has Congress Missed the Mark with I.R.C. §162(m) Compensation Deduction Caps?* 1 (Feb. 25, 2015) (unpublished manuscript), https://ssrn.com/abstract_id=2048810.

44. *Executive Paywatch 2014*, *supra* note 12.

45. *Executive Paywatch 2015*, *supra* note 14.

46. McGregor, *supra* note 42.

47. Income Disparities Act of 1991, H.R. 3056, 102d Cong. (1991).

48. ExxonMobil Co., Proxy Statement (Form DEF 14A) (Apr. 14, 2015).

49. Ken Cohen, *So How Did ExxonMobil Do in 2014?*, EXXONMOBIL: PERSP. (Feb. 3, 2015), http://www.exxonmobilperspectives.com/2015/02/03/so-how-did-exxonmobil-do-in-2014/.

It is entirely possible, then, that § 162(m) has had little or no limiting effect on executive pay. At least in certain cases, however, § 162(m) apparently has induced an *increase* in executive pay. Many companies that previously paid their executives base salaries of less than $1 million raised those salaries to $1 million after enactment of § 162(m), effectively treating the deduction cap as a floor.[50] The proponents of § 162(m) almost certainly did not anticipate that result. And companies that have made use of the exception for performance-based compensation generally have increased the absolute amounts paid to their executives to compensate for the additional risk borne by executives.[51]

Additionally, the components of executive-pay packages have shifted noticeably since enactment of the $1 million deduction limitation. In particular, corporations have increased sharply their grants of stock options to executives, again both in absolute and in relative terms. Expressed in 2016 dollars, the average Black-Scholes value of stock options granted to the CEOs of S&P 500 corporations in 1992 was just over $636,000.[52] Expressed in 2016 dollars, the average Black-Scholes value of stock options granted to those CEOs rose to $4.34 million in 2000 (just prior to the end of the information-technology bubble), before falling to $2.7 million in 2008.[53] In 1992, salary represented 42% of median executive pay, and stock options represented 20%; by 2000, salary represented only 17% of median executive pay, and stock options represented 49%.[54] Because compensation attributable to stock options ordinarily satisfies the § 162(m) exception for performance-based compensation and is fully deductible regardless of amount, many academic and policy commentators assume that § 162(m) must have contributed to the rising prominence of stock options during the 1990s.[55] As an empirical matter, however, the relationship between § 162(m)

50. *See* David C. Harris & Jane R. Livingstone, *Federal Tax Legislation as an Implicit Contracting Cost Benchmark: The Definition of Excessive Executive Compensation*, 77 ACCT. REV. 997, 998 (2002).

51. *See* Murphy, *supra* note 28, at 739.

52. *See* Frydman & Jenter, *supra* note 11, at 80–81 & fig.2b.

53. *See id.*

54. *See id.*

55. *See, e.g.*, Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 CORNELL J.L. & PUB. POL'Y 383, 407–10 (2008); Kathryn J. Kennedy, *Excessive Executive Compensation: Prior Federal Attempts to Curb Perceived Abuses*, 10 HOUS. BUS. & TAX L.J. 196, 220–21 (2010); Kathryn J. Kennedy, *The Use of Federal Law to Curb Excessive Executive Compensation: Lessons in Past Failures and Lessons for the Future*, 57 VILL. L. REV. 551, 558 (2012); David M. Schizer, *Tax and Corporate Governance: The Influence of Tax on Managerial Agency Costs*, *in* THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE (Jeffrey Gordon & Wolf-George Ringe eds.) (forthcoming 2018) [hereinafter Schizer, *Tax and Corporate Governance*] (manuscript at 5), http://www.law.columbia.edu/sites/default/files/microsites/millstein-center/panel_3_schizer_taxgovernance17.doc.pdf; Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of*

and the increased issuance of stock options remains contested.[56]

Whether or not § 162(m) facilitated the greater prevalence of stock options, the administrative interpretation and implementation of § 162(m) by the Treasury Department has demanded only a tenuous connection between stock options and corporate or individual performance. Treasury Regulations under § 162(m) provide that stock-option compensation automatically constitutes performance-based pay, which is exempt from the $1 million deduction cap, if two fairly permissive conditions are satisfied. First, the options must be granted by a committee of outside directors under a shareholder-approved plan that sets out the maximum number of shares for which options may be granted to any one employee.[57] Second, the compensation that could be received on exercise of the option must depend "solely" on an increase in the stock price after the grant date.[58] That is, the option must be issued at or out of the money.[59] Critics have pointed out repeatedly that these rules give stock-option compensation a pass under § 162(m) if the stock price for a particular company rises with the market as a whole—indeed, even if the stock price of the company rises with the market as a whole but nonetheless lags behind the stock prices of the company's competitors.[60] In other words, the rules fail to distinguish between a manager's performance and the manager's dumb luck of holding

*Executive Compensation Reform*, 62 SMU L. REV. 299, 346 (2009); David I. Walker, *Who Bears the Cost of Excessive Executive Compensation (and Other Corporate Agency Costs)?*, 57 VILL. L. REV. 671, n.80 (2012) [hereinafter Walker, *Who Bears the Cost of Excessive Executive Compensation*]. *Cf. Enron: Joint Committee on Taxation Investigative Report on Compensation-Related Issues: Hearing Before the S. Comm. on Finance*, 108th Cong. 7–10 (2003) (statement of Pamela F. Olson, Assistant Sec'y of the Treasury); Lucian Ayre Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 792 (2002); Perry & Zenner, *supra* note 38, at 486–87; David M. Schizer, *Executives and Hedging: The Fragile Legal Foundation of Incentive Compatibility*, 100 COL. L. REV. 440, 468 (2000) [hereinafter Schizer, *Executives and Hedging*]; Aspen Gorry et al., *The Response of Deferred Executive Compensation to Changes in Tax Rates* 4, 21 (Nat'l Bureau of Econ. Research, Working Paper No. 21516, 2015).

56. Some academics argue that § 162(m) has led to increased grants of stock options. *See, e.g.*, Balsam & Ryan, *Limiting Executive Compensation*, *supra* note 38, at 601; Balsam & Ryan, *Effect of Internal Revenue Code*, *supra* note 38, at 25; Ferris & Wallace, *supra* note 38 at 148; Gorry et al., *supra* note 55 at 4, 21; Murphy, *supra* note 38, at 18; Perry & Zenner, *supra* note 38, at 456. Others disagree. *See, e.g.*, Brian J. Hall & Kevin J. Murphy, *The Trouble with Stock Options*, 17 J. ECON. PERSP. 49, 53 (2003); Hall & Liebman, *supra* note 38, at 1–2; Rose & Wolfram, *supra* note 38, at S138.

57. Treas. Reg. § 1.162-27(e)(2)(vi)(A) (2016).

58. *Id.*

59. Compensation attributable to an option issued in the money does not necessarily fail the exception for performance-based compensation, but the grant or the vesting of the option must be made contingent on the satisfaction of a performance goal. *Id.*

60. *See, e.g.*, Schizer, *Tax and Corporate Governance*, *supra* note 55, at 10–11.

stock options during a bull market.[61]

This generous treatment of stock options reflects the generally lax interpretation of the § 162(m) exception for performance-based compensation. Treasury Regulations provide that an acceptable performance goal under § 162(m) can be based on criteria as broad as "stock price, market share, sales, earnings per share, return on equity, or costs."[62] Such a performance goal need not require a "positive result."[63] Simply "maintaining the status quo or limiting economic losses" is sufficient.[64] Somewhat remarkably, then, a corporation can avoid the $1 million deduction cap for compensation paid to a senior executive as long as a committee of outside directors mandates that the compensation not be paid if the corporation loses *too* much money. The regulations do not even require that the company's losses occur under challenging economic or business conditions. With good planning, a company may pay its senior managers deductible performance-based compensation throughout a continued downward spiral in revenues, earnings, or share price. And, from the perspective of the executive, performance-based compensation may require little actual risk of nonpayment. In other words, performance-based compensation may serve as a very nearly perfect substitute for salary or other fixed compensation.

The capacious exception for performance-based compensation is not the only available strategy for avoiding the deduction limitation. Deferring payment of an executive's compensation until retirement or other termination of employment provides another exit.[65] Section 162(m) disallows the corporation's deduction only for compensation paid to a "covered employee,"[66] and the statute and regulations define "covered employee" as the chief executive officer and the other officers whose compensation must be reported to shareholders[67] on what the Securities and Exchange Commission calls the "summary compensation table."[68]

61. Critics have also pointed out that indexed stock options—under which a manager receives a payoff only if the stock price of the manager's company beats the stock prices of competitors—generally do not satisfy the special rule for stock options. Instead, for an indexed stock option to fit within the exception for performance-based compensation, the grant or vesting of the option must be made contingent on satisfaction of a performance goal. *Id.*

62. Treas. Reg. § 1.162-27(e)(2)(i).

63. *Id.*

64. *Id. See also* Reilly, *supra* note 37.

65. Michael Doran, *The Puzzle of Non-Qualified Retirement Pay*, 70 TAX L. REV. (forthcoming 2017) (manuscript at 27–29) (on file with author); Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 893–94 (2007).

66. I.R.C. § 162(m)(3) (2012).

67. *Id.*; Treas. Reg. § 1.162-27(c)(2); 17 C.F.R. § 229.402(a)(3) (2016).

68. 17 C.F.R. § 229.402(c).

Importantly, this includes only *current* employees of the corporation; it does not include *former* employees.[69] Furthermore, § 162(m) only reaches amounts that otherwise would be deductible by the company during the current year.[70] But deferred compensation is deductible when paid out to a manager, not when earned.[71] In short, retirement pay and other deferred compensation received after the manager has retired or otherwise terminated employment completely escapes the deduction limitation of § 162(m). There is, then, an implicit exception for deferred compensation in addition to the explicit exception for performance-based compensation.

The easy avoidance of the $1 million cap allowed by the exceptions for performance-based and deferred compensation suggests a cynical reading of the legislative process behind the enactment of § 162(m). The early iterations of the deduction limitation, including Representative Sabo's proposed Income Disparities Act of 1991 and the Clinton-Gore campaign manifesto in 1992, would have imposed a flat cap on corporate deductions for excessive executive compensation. The exceptions for performance-based and deferred compensation were added by the Clinton administration in February of 1993[72] and by Congress as the deduction cap moved through the House and the Senate.[73] Perhaps the exceptions actually were intended to swallow

69. The Treasury Regulations are perfectly clear on this point. Under Treasury Regulations § 1.162-27(b)(2)(i), a "covered employee" of a corporation is "any individual who, *on the last day of the taxable year*, is . . . [t]he chief executive officer of the corporation or is acting in such capacity; or . . . [a]mong the four highest compensated officers (other than the chief executive officer)." Treas. Reg. § 1.162-27(b)(2)(i) (emphasis added). Internal Revenue Service Notice 2007-49, which takes account of a later regulatory change by the Securities and Exchange Commission, is also clear on this point. It provides as follows: "The IRS will interpret the term 'covered employee' for purposes of § 162(m) to mean any employee of the taxpayer if, *as of the close of the taxable year*, such employee is the principal executive officer . . . of the taxpayer or an individual acting in such a capacity, or if the total compensation of such employee for that taxable year is required to be reported to shareholders under the Exchange Act by reason of such employee being among the 3 highest compensated officers for the taxable year (other than the principal executive officer or the principal financial officer)." I.R.S. Notice 2007-49, 2007-1 C.B. 1429 (emphasis added). The SEC Regulations are also clear on this point. Under SEC Regulation S-K, Item 402(a)(3), the individuals for whom securities disclosure must be made are limited to those who were employees "during" or "at the end of" the corporation's "last completed fiscal year." 17 C.F.R. § 229.402(a)(3).

70. Treas. Reg. § 1.162-27(c)(3).

71. I.R.C. §§ 83(h), 404(a)(5) (2012); Albertson's, Inc. v. Comm'r, 42 F.3d 537, 546 (9th Cir. 1994).

72. *See* U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

73. The $1 million deduction cap in the Tax Fairness and Economic Growth Act of 1992, which President Bush vetoed, did not include an exception for either performance-based compensation or deferred compensation. *See* H.R. REP. 102-461, at 80–81 (1992) (Conf. Rep.). The conference report for that legislation specifically indicated that the cap would apply "to compensation paid to former employees (e.g., nonqualified deferred compensation that is not paid until after termination of employment) as well as current employees." *Id.* at 438. Thus, the exception for deferred compensation in § 162(m) as enacted

the rule. Perhaps the Clinton administration and Congress wanted *to appear* to limit executive compensation without actually limiting executive compensation.[74] Perhaps the enactment of § 162(m) exemplifies what David Schizer describes as the "politically expedient" approach of passing legislation that targets a controversial practice "while allowing an obscure way for it to continue."[75]

Despite the broad exceptions for performance-based and deferred compensation, many companies simply ignore or defy the $1 million cap and pay non-deductible compensation to their executives. In other words, corporations willingly forfeit tax deductions by paying salaries, bonuses, and other forms of compensation in excess of $1 million that do not satisfy the exceptions for performance-based and deferred compensation. Early studies of compensation practices determined that approximately 40% of public companies pay their senior managers compensation for which § 162(m) denies a deduction.[76] These companies pay a mix of deductible and non-deductible compensation, but the non-deductible compensation appears to be substantial. One recent analysis found that approximately 24% of the total compensation payments to senior executives exceed the § 162(m) limitation.[77] And a review of tax-return data by the Office of Tax Analysis of the United States Treasury Department estimated that 27% of public companies provided compensation in excess of the $1 million deduction cap in 2013, paying an average of $2.6 million in non-deductible compensation.[78]

in 1993 could not have been an oversight.

74. *See, e.g.*, Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863, 921–22 (2004).

75. Schizer, *Tax and Corporate Governance*, *supra* note 55, at 4. *See also* Schizer, *Executives and Hedging*, *supra* note 55, at 468.

76. *Executive Compensation: Backdating to the Future: Hearing on Oversight of Current Issues Regarding Executive Compensation, Including Backdating of Stock Options and Tax Treatment of Executive Compensation, Retirement, and Benefits Before the S. Comm. on Fin.*, 109th Cong. 39–45 (2006) (statement of Steven Balsam, Professor of Accounting, Temple University, Fox School of Business); Steven Balsam & Qin Jennifer Yin, *Explaining Firm Willingness to Forfeit Tax Deductions Under Internal Revenue Code Section 162(m): The Million-Dollar Cap*, 24 J. ACCT. & PUB. POL'Y 300, 321–23 (2005). *See also* Balsam & Ryan, *Effect of Internal Revenue Code*, *supra* note 38, at 7; Austin Reitenga et al., *CEO Bonus Pay, Tax Policy, and Earnings Management*, 24 J. AM. TAX'N ASS'N 1, 1–3 (2002).

77. *See* Allan Sloan, *How We Analyzed Executive Pay*, PROPUBLICA (Feb. 12, 2016, 7:59 AM), https://www.propublica.org/article/how-we-analyzed-executive-pay. *See also* STEVEN BALSAM, ECON. POLICY INST., BRIEFING PAPER NO. 344, TAXES AND EXECUTIVE COMPENSATION 1, 1–3 (2012), http://www.epi.org/files/2012/BP344_Taxes_and_Executive_Compensation.pdf.

78. OFFICE OF TAX ANALYSIS, U.S. DEP'T OF THE TREASURY, REVENUE CONSEQUENCES OF 162(m) 2, 5 (2016). *See also* Austin Frerick, *Executive Pay Excess Raises Fiduciary Concerns*, TAX

My own review of compensation data shows that more than half the S&P 500 companies paid at least some non-deductible compensation to their CEOs for 2014. I focus exclusively on CEO base salary because—unlike bonuses, stock options, restricted stock, and deferred compensation—base salary *cannot* satisfy the § 162(m) exceptions for performance-based and deferred compensation. Stated differently, CEO base salary is always subject to the $1 million deduction cap. The influence of § 162(m) is readily apparent from the data, which are set forth in the Appendix. Of the 498 companies in the S&P 500 for which 2014 salaries are reported in Compustat's ExecuComp database, only 211 companies—or 42% of the total—paid their CEOs salaries of $1 million or less.[79] Of these, forty-two companies paid their CEOs base salaries of exactly $1 million.[80] By contrast, 287 companies—or 58% of the total—paid their CEOs base salaries of *more* than $1 million.[81] Of these, 265 companies paid base salaries of more than $1 million but less than $2 million, fifteen companies paid base salaries of $2 million or more but less than $3 million, and seven companies paid base salaries of $3 million or more.[82] Stated directly, the 287 companies that paid their CEOs base salaries in excess of $1 million simply ignored or defied the § 162(m) deduction cap and thereby forfeited tax deductions. Because my analysis includes only base salary and excludes other components of executive-pay packages that may have exceeded the $1 million cap, these results should be considered conservative.

In some cases, the non-deductible payments that companies make to their executives are extremely large, whether considered alone or in comparison to deductible payments. For 2014, Apple paid five senior managers a total of $55 million in non-deductible compensation and $56 million in deductible compensation, General Electric paid four senior managers a total of $31 million in non-deductible compensation and $23 million in deductible compensation, and Medtronic paid four senior managers a total of $49 million in non-deductible compensation and $20 million in deductible compensation.[83] This practice is both broad and enduring. Companies have exceeded or ignored the § 162(m) limitation since the provision was first enacted;[84] if anything, evidence suggests that they

NOTES TODAY, Oct. 3, 2016, at 85, 88.

79. *See* Appendix.

80. *See id.*

81. *See id.*

82. *See id.*

83. Allan Sloan, *supra* note 77.

84. *See, e.g.*, MARILYN F. JOHNSON & SUSAN PORTER, HOW FIRMS RESPONDED TO THE NEW TAX LAW LIMITING THE DEDUCTIBILITY OF CERTAIN EXECUTIVE COMPENSATION 1, 8, 13–17 (1997),

have become more willing to exceed the deduction cap over time.[85] No doubt that trend reflects the decreasing value, in real terms, of the $1 million cap (which has never been adjusted for inflation), market pressure for higher manager pay, and a recognition that corporations making non-deductible compensation payments suffer little (if any) investor backlash. Shareholder lawsuits challenging the payment of non-deductible compensation as a breach of fiduciary duties by company directors have not been successful.[86]

One might argue that the prevalence of forfeited deductions shows that § 162(m) works more or less as intended. At least certain proponents of the deduction limitation during the early 1990s wanted to impose a tax penalty on excessive executive compensation, and denying corporate tax deductions does exactly that.[87] Also, because many companies pay compensation in excess of the $1 million limit, the disallowance of corporate deductions raises revenue for a chronically impecunious federal government—perhaps more than $1 billion each year, according to the United States Treasury Department's Office of Tax Analysis.[88] But the argument is misplaced. Every tax dollar collected under § 162(m) points to an underlying policy failure. Again, the official congressional objective behind § 162(m) was not to raise tax revenue but to change corporate behavior on executive pay.[89] The policy goal was compliance with § 162(m) in the form of executive-pay packages that were either smaller or more oriented to corporate and individual performance.[90] The collective shrugging off of the deduction limitation by public companies in the years since its enactment underscores that the champions of § 162(m) badly miscalculated the consequences of

https://files.taxfoundation.org/legacy/docs/fb7e0c506bf1edd5782aa96516c62c98.pdf; Reitenga et al., *supra* note 76; *1994 Corporate Law Symposium: Presentations and Panel Discussion*, 63 U. CIN. L. REV. 769, 781–82 (1995) (remarks of Linda C. Quinn, Director of SEC Division of Corporate Finance).

85. BALSAM, *supra* note 77. *See also* Allan Sloan, *The Executive Pay Cap that Backfired*, PROPUBLICA (Feb. 12, 2016, 7:00 AM), https://www.propublica.org/article/the-executive-pay-cap-that-backfired.

86. *See, e.g.*, Freedman v. Adams, 58 A.3d 414, 417 (Del. 2013); Friedman v. Khosrowshahi, No. 9161–CB, 2014 WL 3519188, at *1 (Del. Ch. July 16, 2014); Seinfeld v. Slager, No. 6462–VCG, 2012 WL 2501105, at *8–10 (Del. Ch. June 29, 2012). *See also* DAVIS POLK, RECENT DEVELOPMENTS IN EXECUTIVE COMPENSATION LITIGATION 10–13 (2013).

87. Backers of section 162(m) more likely would describe the denial of the corporate deduction not as a tax dispreference but as the removal of a tax benefit. But that position is misleading. Under an income tax, the baseline rule is that profit-making business enterprises deduct the ordinary and necessary expenses of producing income; those ordinary and necessary expenses include salaries, bonuses, and other compensation paid to employees. Allowing a deduction for compensation does not confer a tax benefit; but denying that deduction does impose a tax dispreference.

88. *See* OFFICE OF TAX ANALYSIS, *supra* note 78, at 1.

89. Reilly, *supra* note 37.

90. *Id.*

their policy intervention.

The failure of § 162(m) is actually much worse than it seems. A company that pays an executive non-deductible compensation increases its own corporate tax liability.[91] But the economic burden of that increased tax liability likely falls on rank-and-file workers and investors. This point is critical to understanding and assessing § 162(m). The taxpayer nominally paying the corporate income tax is, of course, the corporation itself. However, an elemental principle of tax economics—on which there is no disagreement among economists—is that a corporation does not bear the actual burden of the taxes that it pays.[92] Indeed, a corporation *cannot* bear the burden of the corporate income tax because a corporation is a legal fiction used to describe a series of complex contractual relationships among natural persons such as investors, directors, managers, workers, suppliers, and consumers. The legal fiction is often indulged in the extreme; policymakers and others regularly speak of corporations paying too much or too little tax. But the basic point remains that corporations and other legal fictions do not and cannot actually bear tax burdens.

Unfortunately, consensus breaks down at that point. Although they agree that a corporation cannot bear the burden of the corporate tax, economists disagree sharply about which natural persons having some direct or indirect connection to the corporation actually bear the burden. That said, it appears reasonably clear that, in the United States and other open economies,[93] the corporate tax burden is borne by some combination of labor and capital.[94] In other words, the corporate income tax reduces the incomes

91. The result is different if the company has no tax liability—for example, if its deductible losses exceed its gross income.

92. *See* DANIEL N. SHAVIRO, DECODING THE U.S. CORPORATE TAX 57–71 (2009). Alan Auerbach puts the point in the following terms: "[T]he cardinal rule of incidence analysis [is] that only individuals can bear the burden of taxes and that all tax burdens should be traced back to individuals." Alan J. Auerbach, *Who Bears the Corporate Tax? A Review of What We Know* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 11686, 2005).

93. An "open economy" is one in which capital, labor, goods, services can move across national borders.

94. *See* SHAVIRO, *supra* note 92, at 57–77; Rosanne Altshuler et al., *Capital Income Taxation and Progressivity in a Global Economy*, 30 VA. TAX REV. 355, 356–60 (2010); Kimberly A. Clausing, *Who Pays the Corporate Tax in a Global Economy?*, 66 NAT'L TAX J. 151, 151–53 (2013); Jennifer Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis*, 66 NAT'L TAX J. 185, 185–86 (2013) [hereinafter Gravelle, *Review of General Equilibrium Estimates and Analysis*]; Jane G. Gravelle & Kent A. Smetters, *Does the Open Economy Assumption Really Mean That Labor Bears the Burden of a Capital Income Tax?*, 6 ADVANCES ECON. ANALYSIS & POL'Y 1, 1–4 (2006); Arnold C. Harberger, *Corporation Tax Incidence: Reflections on What Is Known, Unknown, and Unknowable*, *in* FUNDAMENTAL TAX REFORM: ISSUES, CHOICES, AND IMPLICATIONS 283, 288–92 (John W. Diamond & George R. Zodrow eds., 2008); Arnold C. Harberger, *The ABCs of Corporate Tax Incidence: Insights*

of workers, who receive lower wages than they otherwise would, and of shareholders and other investors, who receive lower dividends and other returns on their investment than they otherwise would.[95] Because capital is more mobile than labor—that is, because investors can move their money from one country to another in pursuit of higher returns more easily than workers can move themselves from one country to another in pursuit of higher wages—it seems likely that labor shoulders more of the burden of the corporate tax than capital.[96] Still, determining the exact incidence of the

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*into the Open-Economy Case*, *in* POLICY AND ECONOMIC GROWTH 51, 54–55 (1995) [hereinafter Harberger, *The ABCs of Corporate Tax Incidence*]; Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215, 215–17 (1962) [hereinafter Harberger, *The Incidence of the Corporation Income Tax*]; Arnold C. Harberger, *The Incidence of the Corporation Income Tax Revisited*, 61 NAT'L TAX J. 303, 304–06 (2008); Matthew H. Jensen & Aparna Mathur, *Corporate Tax Burden on Labor: Theory and Empirical Evidence*, TAX NOTES 1083 (2011); Li Liu & Rosanne Altshuler, *Measuring the Burden of the Corporate Income Tax Under Imperfect Competition*, 66 NAT'L TAX J. 215, 215–17 (2013); James R. Melvin, *The Corporate Tax in an Open Economy*, 17 J. PUB. ECON. 393, 399–401 (1982); John Mutti & Harry Grubert, *The Taxation of Capital Income in an Open Economy: The Importance of Resident-Nonresident Tax Treatment*, 27 J. PUB. ECON. 291, 291–93 (1985); Wiji Arulampalam et al., *The Direct Incidence of Corporate Income Tax on Wages* 2–4 (Oxford Univ. Ctr. for Bus. Taxation, Working Paper No. 5293, 2009); Auerbach, *supra* note 92; R. Alison Felix, *Passing the Burden: Corporate Tax Incidence in Open Economies* 1–2 (Fed. Reserve Bank of Kan. City, Working Paper No. RRWP 07-01, 2007), https://www.kansascityfed.org/Publicat/ RegionalRWP/RRWP07-01.pdf; Jennifer C. Gravelle, *Corporate Tax Incidence: A Review of Empirical Estimates and Analysis* 29 (Cong. Budget Office, Working Paper No. 2011-01, 2011) [hereinafter Gravelle, *A Review of Empirical Estimates and Analysis*]; William M. Gentry, *A Review of the Evidence on the Incidence of the Corporate Income Tax* 1–3 (Office of Tax Analysis, Working Paper No. 101, 2007); Kevin A. Hassett & Aparna Mathur, *Taxes and Wages* 1–4 (Am. Enter. Inst. For Pub. Policy Research, Working Paper No. 128, 2006) [hereinafter Hassett & Mathur, *Taxes and Wages*]; William C. Randolph, *International Burdens of the Corporate Income Tax* 2–6 (Cong. Budget Office, Working Paper 2006-09, 2006); Mihir A. Desai et al., *Labor and Capital Shares of the Corporate Tax Burden: International Evidence* 3–6 (Dec. 18, 2007) (unpublished manuscript), https://www.aeaweb.org/ conference/2011/retrieve.php?pdfid=326; Kevin A. Hassett & Aparna Mathur, *Spatial Tax Competition and Domestic Wages* 1–4 [hereinafter Hassett & Mathur, *Spatial Tax Competition and Domestic Wages*] (Dec. 1, 2010) (unpublished manuscript), https://ssrn.com/abstract_id=2212975.

95. Economists generally agree that, to the extent that the corporate income tax is borne by investors, it is borne by investors in both the corporate and the non-corporate sector. *See generally* Harberger, *The Incidence of the Corporation Income Tax*, *supra* note 94 (demonstrating that, although unevenly affected by the corporation income tax, investors in both the corporate and the non-corporate sectors bear the incidence of the tax).

96. In one open-economy model, domestic labor bears approximately 70% of the burden of the U.S. corporate income tax, and domestic capital bears approximately 30% of that burden. Randolph, *supra* note 94, at 25. And empirical investigation finds that labor bears between 45% and 75% of the corporate tax burden. Desai et al., *supra* note 94, at 2. *See also* Harberger, *The ABCs of Corporate Tax Incidence*, *supra* note 94; Liu & Altshuler, *supra* note 94, at 233; Arulampalam et al., *supra* note 94, at 28–29; Felix, *supra* note 94, at 7–8; Gentry, *supra* note 94, at 13–14; Hassett & Mathur, *Taxes and Wages*, *supra* note 94, at 3–5; Hassett & Mathur, *Spatial Tax Competition and Domestic Wages*, *supra* note 94, at 2–4. But there are contrary views. *See* Clausing, *supra* note 94, at 167–72; Gravelle, *Review of General Equilibrium Estimates and Analysis*, *supra* note 94, at 211; Gravelle & Smetters, *supra* note 94, at 4; Gravelle, *A Review of Empirical Estimates and Analysis*, *supra* note 94.

corporate income tax—that is, determining precisely how much of the tax is borne by workers and precisely how much of it is borne by investors—remains a challenging problem of public-finance theory.[97]

But that last point—the exact distribution of the burden between workers and investors—is not particularly important to understanding the effects of § 162(m). What matters here is that the economic burden of disallowed tax deductions falls far more heavily on some combination of workers and investors than on the executives whose compensation was supposed to be in the policy crosshairs.[98] In a thoughtful article, Joy Sabino Mullane makes essentially this point, arguing that the incidence of the corporate tax could serve as a "proxy" for the incidence of executive-compensation tax dispreferences such as § 162(m).[99] If anything, her position seems understated. A deduction disallowed by § 162(m) adds to the corporation's federal income tax liability, and analysis of the incidence of the corporate tax should be *directly* applicable in determining the incidence of the tax cost of the disallowed deduction. [100]

Arguably, the disallowance of the corporate deduction under § 162(m) should be analyzed as a wage tax on any compensation above the $1 million cap. Economic theory assumes that most or all of a wage tax may be borne by the wage recipient; as applied here, that would suggest that managers bear the burden of the disallowed deductions in the form of lower overall compensation. But there is good reason to think that the standard assumption does not apply in this case. Executive compensation comprises many components, including salary, bonuses, stock options and stock appreciation rights, restricted stock, and non-qualified deferred compensation. That allows for substitution among different parts of an executive's pay package. In particular, the lax regulatory rules for performance-based compensation, which is exempt from the $1 million deduction cap, make performance-based compensation a very nearly perfect substitute for salary, which is subject to the $1 million cap. By setting the performance conditions on a cash bonus within an executive's easy reach, a company can convert non-deductible salary into deductible performance-based compensation. It seems

97. *See* Gravelle & Smetters, *supra* note 94, at 34; Auerbach, *supra* note 92, at 40–41.

98. Of course, executives and directors would bear a small portion of the burden in their capacities as employees (in the case of executives) and investors (in the case of both executives and directors).

99. Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 485, 534 n.210 (2009).

100. *Id.* at 534. In 2004, I suggested that the penalty tax under § 409A of the Internal Revenue Code might be borne by corporate shareholders rather than executives. Michael Doran, *Executive Compensation Reform and the Limits of Tax Policy* 13–14 (Urban-Brookings Tax Policy Ctr., Discussion Paper No. 18, 2004). In retrospect, that position took too narrow a view of the incidence problem.

implausible, then, that a manager whose compensation triggers the loss of corporate deductions under § 162(m) actually must accept lower overall compensation.

In short, the burden of disallowed corporate deductions under § 162(m) likely falls on the corporation not the executive, and thus is much more a tax on employees and investors than a tax on the executives who receive non-deductible compensation or even on the directors who agree to pay non-deductible compensation. The deduction cap hurts precisely the people it was supposed to help. Certainly, the proponents of § 162(m) did not foresee or appreciate that outcome.

### C. SUMMARY

Section 162(m) should be a finalist in the crowded competition for the worst tax-policy development since the Tax Reform Act of 1986. It was intended to rein in high levels of executive compensation; instead, the rate of growth in executive pay has increased. It was intended to link executive compensation more closely to corporate and individual performance; instead, most executive pay remains only loosely connected to favorable business outcomes. Corporations, directors, and executives have found it child's play to avoid § 162(m) by setting lax performance goals and by deferring executive pay to retirement or other termination of employment. And perhaps most strikingly, corporations have demonstrated a broad and persistent willingness to pay compensation that simply fails § 162(m). The corporate deductions lost to the $1 million cap increase a corporation's tax liability, but that liability is borne by labor and capital. It is as though Congress had told directors and executives: unless you bring your executive compensation down to the $1 million cap, we will penalize your workers and your shareholders. That obviously makes little sense.

## II. THE CASE FOR REFORMING SECTION 162(M)

Identifying a policy failure is one matter; determining what, if anything, to do about it is something altogether different. The objectives behind § 162(m) may have merit, or they may not. But surely the original proponents of the deduction cap did not deliberately put in place a set of flawed rules. Every indicator in the legislative record suggests that the architects of § 162(m) sincerely believed that the provision would tighten the link between executive pay and corporate or individual performance, would reduce the absolute or relative levels of executive pay, or possibly both. Nothing in the record anticipates an acceleration in the increase of executive pay, a widening gap between the compensation of senior managers and that of rank-and-file workers, or a broad tendency to shrug off lost deductions. And nothing in the record reveals an intent to impose an economic burden on workers and investors.

Perhaps § 162(m) could be salvaged through "internal" reform—that is, by leaving the basic statutory structure in place but making appropriate changes to the provision's specific terms, conditions, and exceptions. Perhaps the underlying policy goals—somewhat confused as they are between corporate-governance policy and tax policy—could be sorted out into a more coherent ordering of legislative principles and matched to a tighter statutory and regulatory scheme. Perhaps a reformed § 162(m) could achieve most, if not all, of whatever Congress really wants to achieve here. The purpose of this Part is to work through those possibilities by analyzing the different policy justifications for § 162(m) and assessing potential statutory and regulatory reforms aimed at furthering them. Most of the potential reforms considered in this Part have been suggested by other commentators in the academic and policy literature, although not always with the benefit of a clear policy framework. In the end, however, every potential reform internal to § 162(m) runs into the same buzzsaw: the incidence of the corporate income tax. As long as the tax dispreference on excessive executive compensation is directed at the corporation, that dispreference will increase the economic burden on workers and investors. In short, the case for internal reform of § 162(m) is bound to fail.

### A. STRENGTHENING THE LINK BETWEEN PAY AND PERFORMANCE

Many commentators and policymakers who are sympathetic to § 162(m) but who are aware of its shortcomings would reform the $1 million cap by attempting to strengthen the link between executive pay and corporate or individual performance. In certain respects, this approach represents the most measured reform initiative. It would preserve the existing framework of § 162(m), but it would tighten the loose standards for what constitutes performance-based compensation. The reform builds on elements of the original policies behind § 162(m) and taps into a broader academic criticism identifying excessive executive compensation with extraordinary managerial power. But the reform inevitably confronts two intractable problems: appropriately defining "performance" through statute and regulation and grappling with the incidence of the corporate tax.

The early proposals to limit corporate tax deductions for executive pay, including the Clinton-Gore campaign manifesto, generally did not treat performance-based compensation differently from other compensation.[101] But the Clinton administration's 1993 formal legislative proposal to Congress argued that the "unlimited tax benefit" attributable to deductible executive compensation "is particularly troubling in light of concerns that, in some cases, the compensation paid to corporate executives has increased despite a decline in business performance."[102] With an exception for performance-based compensation, the administration promised, a $1 million cap on deductible compensation "would provide a strong incentive for corporations to explicitly link compensation to productivity."[103]

The Clinton administration's emphasis on tethering executive pay to performance anticipated a broader and sharper critique of manager compensation—known as the "managerial-power theory"—that emerged in the legal academic literature toward the end of the 1990s. The managerial-power theory understands executive pay to be a manifestation of the familiar agency problem associated with executives of public companies. Managers, so the theory runs, exercise outsized influence in setting their own pay.[104] Rather than bargain at arm's length with directors for compensation arrangements that encourage them to perform in the interests of investors, managers conspire with directors to extract rents from corporate assets.[105] Because compensation based on corporate or individual performance is inherently risky, rent-extracting managers and accommodating directors strongly prefer performance-insensitive pay. But such pay arrangements, of course, cut against the interest of shareholders and other investors. Thus, if § 162(m), either as enacted or as reformed, could distinguish meaningfully between performance-based compensation and other compensation, it would mitigate the longstanding agency problem and promote better corporate governance.

101. *See* CLINTON & GORE, *supra* note 35, at 67–69.

102. U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

103. *Id.*

104. Lucian Arye Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71, 75 (2003); Bebchuk et al., *supra* note 55, at 754, 784–86, 846; Lucian Arye Bebchuk & Jesse M. Fried, *Stealth Compensation via Retirement Benefits*, 1 BERKELEY BUS. L.J. 291, 293, 296 (2004) [hereinafter Bebchuk & Fried, *Stealth Compensation via Retirement Benefits*]; Robert J. Jackson, Jr., *Private Equity and Executive Compensation*, 60 UCLA L. REV. 638, 643–44 (2013); Robert J. Jackson, Jr. & Colleen Honigsberg, *The Hidden Nature of Executive Retirement Pay*, 100 VA. L. REV. 479, 484–85 (2014); David I. Walker, *A Tax Response to the Executive Pay Problem*, 93 B.U. L. REV. 325, 332–35 (2013) [hereinafter Walker, *A Tax Response to the Executive Pay Problem*]; Walker, *Who Bears the Cost of Excessive Executive Compensation*, *supra* note 55, at 655–58.

105. Bebchuk et al., *supra* note 55, at 754, 784–86, 846; Bebchuk & Fried, *Stealth Compensation via Retirement Benefits*, *supra* note 104, at 293, 296; Jackson & Honigsberg, *supra* note 104, at 485; Walker, *A Tax Response to the Executive Pay Problem*, supra note 104; Walker, *Who Bears the Cost of Excessive Executive Compensation*, *supra* note 55, at 655–58.

This reform approach can be stated rather simply. The basic rule under § 162(m) would be revised to allow a corporation to deduct compensation paid to a senior manager in excess of $1 million only if that compensation is based on corporate or individual performance. Additionally, the definitional rule for "performance" would be revised to implement a robust and demanding conception that requires an executive substantially to advance the interests of the company and its investors. The objective would be a better and truer version of § 162(m)—a version that eliminates existing loopholes and that tightens the current lax standards. By requiring genuine and meaningful performance from managers in order for a company to pay deductible compensation above the $1 million cap, legislators and regulators would validate one of the original policy goals behind § 162(m) and would address the substantial criticisms of managerial power developed in the legal academy over the last two decades.

Implementing this reform would require two broad changes under § 162(m). First and less obviously, Congress would have to expand the scope of § 162(m) to reach compensation deferred by or on behalf of a manager whose pay is otherwise subject to the deduction limitation. In its current form, § 162(m) applies only for the period of a manager's employment; once she retires or otherwise ends her employment, the company may deduct all compensation paid to her, including compensation that would not have been deductible if paid at the time it was earned. This allows a company to avoid § 162(m) for a manager's non-qualified deferred compensation, which can amount to tens or even hundreds of millions of dollars[106] and which typically has no connection to corporate or individual performance.[107] There is plainly no point in tightening the exception for performance-based compensation if a company can continue to sidestep § 162(m) simply by deferring payment. Certain past legislative proposals would have made this change.[108]

106. *See, e.g.*, Brian Cadman & Linda Vincent, *The Role of Defined Benefit Pension Plans in Executive Compensation*, 24 EUR. ACCT. REV. 779, 780 (2015); Alex Edmans & Qi Liu, *Inside Debt*, 15 REV. FIN. 75, 76 n.3 (2011); Alex Edmans & Xavier Gabaix, *Is CEO Pay Really Inefficient? A Survey of New Optimal Contracting Theories*, 15 EUR. FIN. MGMT. 486, 492 n.8 (2009); Rangarajan K. Sundaram & David L. Yermack, *Pay Me Later: Inside Debt and Its Role in Managerial Compensation*, 62 J. FIN. 1551, 1552–54 (2007). *See also* Dan Fitzpatrick, *Retirement Benefits for BofA's Lewis: $83 Million*, WALL ST. J. (Feb. 27, 2010, 12:01 AM), http://www.wsj.com/articles/SB10001424052748704625004575089742035304; Peter Loftus, *J&J Chief to Receive $143 Million Farewell*, WALL ST. J. (Mar. 15, 2012, 11:44 AM), https://www.wsj.com/articles/SB10001424052702304459804577281560545538288.

107. *See generally* Doran, *supra* note 65.

108. *See, e.g.*, H.R. 1591, 110th Cong. § 544 (2007) (as passed by Senate, Mar. 29, 2007); S. 349, 110th Cong. § 214 (2007); H.R. 2, 110th Cong. § 234 (2007). *See also* LAWRENCE MISHEL & ALYSSA DAVIS, ECON. POLICY INST., ISSUE BRIEF NO. 399, TOP CEOS MAKE 300 TIMES MORE THAN TYPICAL

Second and more obviously, either Congress or the Treasury Department would have to restrict what types of compensation constitute performance-based compensation. Prior legislative proposals would have attempted to do just that.[109] Section 162(m) itself says very little about performance-based compensation. Under the statute, a sales commission counts as performance-based compensation;[110] so too does any compensation "payable solely on account of the attainment of one or more performance goals," as long as the performance goals are set *ex ante* by a committee of outside directors, are certified *ex post* by that committee, are disclosed to shareholders, and are approved by shareholders in an up-or-down vote.[111] Because this statutory framework is skeletal, the heavy lifting on performance-based compensation—the source of the real mischief—is in the Treasury Regulations.

Specifically, two provisions in the regulations establish a notably lax regime for performance-based compensation. First, the regulations state that a performance goal "can be based on" any individual, unit, or corporate business criterion, including "stock price, market share, sales, earnings per share, return on equity, or costs."[112] That standard is very forgiving; it requires only that the performance goal incorporate or reference the business criterion in some manner. Thus, linking an executive's bonus to a specified percentage of the company's net profits or increased sales is sufficient,[113] even if the company's overall performance is poor. Second, the regulations state that the performance goal "need not . . . be based upon an *increase* or *positive result* under a business criterion and could include, for example, *maintaining the status quo* or *limiting economic losses*."[114] In other words, even failure may count as performance. These provisions, although perhaps vexing to managerial-power theorists, are not nonsense. They recognize that a steady hand on the rudder may amount to satisfactory or even superior performance in challenging business conditions. But they nonetheless lend themselves to abuse when used to satisfy the exception for performance-

WORKERS: PAY GROWTH SURPASSES STOCK GAINS AND WAGE GROWTH OF TOP 0.1 PERCENT 12 (2015), http://www.epi.org/files/2015/top-ceos-make-300-times-more-than-typical-workers.pdf. *Cf.* STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., PRESENT LAW AND BACKGROUND RELATING TO EXECUTIVE COMPENSATION 9 (Comm. Print 2006).

109. *See, e.g.*, H.R. 2101, 108th Cong. § 602 (2003); H.R. 5160, 107th Cong. § 301 (2002). *Cf.* STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., *supra* note 108, at 8–9.

110. I.R.C. § 162(m)(4)(B) (2012).

111. *See id.* § 162(m)(4)(C).

112. Treas. Reg. § 1.162-27(e)(2)(i) (2012).

113. *Id.* § 1.162-27(e)(2)(vii).

114. *Id.* § 1.162-27(e)(2)(i) (emphasis added).

based compensation without regard to such conditions. Because they are so expansive, these provisions can be used to justify compensation paid even to bad managers. And, no less significantly, there may be little risk of non-payment associated with performance-based compensation, making that compensation an acceptable substitute, from the manager's perspective, for salary or other fixed compensation.

This reform approach also would require a change to the rules for stock options and stock appreciation rights. Currently, the Treasury Regulations treat the compensation payable to a manager under a stock option or a stock appreciation right as automatically satisfying the exception for performance-based compensation if the option or right is granted to the manager at or out of the money.[115] The rationale is simple, if misguided: because compensation becomes payable under such an option or right only if the company's share price increases, the compensation necessarily constitutes performance-based compensation. Again, this rule is too lax. In a rising market, the share prices of many companies will rise, and managers of companies that perform poorly in relative terms nonetheless may receive compensation from the exercise of their stock options and stock appreciation rights. No less oddly, the regulations under § 162(m) make it more difficult for the gains attributable to indexed stock options and indexed stock appreciation rights to qualify as performance-based compensation than the gains attributable to unindexed stock options and unindexed stock appreciation rights.[116] This is precisely the opposite of what one would expect if the point were to distinguish between good performance and poor performance.

Nonetheless, this approach to reforming § 162(m) faces very serious problems. First, a policy decision to permit deductions above the $1 million cap only for performance-based compensation would put tremendous pressure on the concept of performance. That, in turn, almost inevitably would lead either to over-inclusiveness or under-inclusiveness. Start by considering the shortcomings, outlined above, of the existing Treasury Regulations. In their current form, the regulations are over-inclusive: they are sufficiently forgiving to permit compensation linked to corporate and

115. *Id.* § 1.162-27(e)(2)(vi).

116. The reason for that somewhat surprising outcome is as follows. To satisfy the automatic exception, the compensation payable under a stock option or stock appreciation right must be "based solely on an increase in the value of the stock after the date of the grant or award." *Id.* § 1.162-27(e)(2)(vi)(A). However, an indexed stock option or an indexed stock appreciation right can pay out compensation even if the share price falls after the date of the grant or award—provided that the share price beats the relevant index. The compensation payable under an indexed stock option or an indexed stock appreciation right may still be made to qualify as performance-based compensation under the general rule. *See id.*

individual failure to satisfy the exception for performance-based compensation. The Treasury Department could try to remedy that problem by narrowing the regulations to validate only compensation paid when the company's earnings, share price, or market share has increased relative to its competitors. But such rules certainly would be under-inclusive, eliminating instances of genuine corporate or individual success—as when a corporation sustains only small losses during a broad economic downturn.

The root of the problem is that "performance" is inherently qualitative, imprecise, and dependent on context. Any legislative or regulatory effort to pin the concept down *ex ante* necessarily will exclude certain conduct that turns out to be highly meritorious when assessed within its proper business and financial setting. But any legislative or regulatory effort to permit flexibility, as under the current regulations, creates substantial opportunities for abuse, allowing payment made for mediocre or poor conduct to benefit from the exception. To put the problem in familiar academic terms, the exception for performance-based compensation demands a standard rather than a rule. But a standard allows discretion, and discretion invites abuse. The problem is inescapable.

Furthermore, this reform approach remains fully exposed to the problematic incidence of the corporate tax. Even if the associated definitional problems could be resolved (they cannot), an exception for performance-based compensation still would require a mechanism for penalizing any compensation in excess of the $1 million cap. As long as that mechanism remains the denial of the corporate tax deduction, the burden likely will fall on workers and investors. The net effect of this reform, then, would be a rule imposed by the government on directors and executives that works as follows: if any senior manager receives compensation over $1 million that is not truly based on performance, rank-and-file workers and investors will earn lower wages and receive lower investment returns. It is very difficult to see why that approach would induce fewer companies to shrug off the lost deductions under § 162(m) than does current law.

### B. LIMITING ABSOLUTE PAY AND MITIGATING INCOME INEQUALITY

A second reform proposal would greatly expand the scope of § 162(m). Rather than chase an elusive distinction between performance-based and other compensation, the reform would eliminate that distinction entirely by denying a deduction for *any* compensation in excess of the $1 million cap. This approach would aim less at improving corporate governance and more at mitigating broad income inequality. Although it would require extensive changes to current law, the reform in certain ways would improve the administrability of § 162(m). But it also would further encourage directors and managers to ignore the deduction limitation and, thus, likely would increase still more the economic burden on workers and investors. Additionally, the reform's effect on income inequality in the economy as a whole likely would be negligible.

Particular strands in the legislative history of § 162(m) support eliminating the exception for performance-based compensation. Representative Sabo's Income Disparities Act of 1991 made no allowance for performance-based compensation.[117] Similarly, the 1992 Clinton-Gore campaign proposed to limit the tax deduction for executive pay with no exception for performance-based compensation.[118] More broadly, eliminating the exception for performance-based compensation would address the Clinton administration's stated tax-policy concern that the law before § 162(m) set "no limitation on the amount of tax benefit provided for executive compensation."[119] Repealing the exception for performance-based compensation would move the law closer (at least superficially) to putting a ceiling on the "tax benefit" for manager pay.

Framed in more general policy terms, this reform would be justified by its intended effect on income inequality rather than by its intended effect on corporate governance. Many academic critics of executive-pay arrangements, including many who endorse the managerial-power theory, do not condemn the absolute amounts paid to corporate managers; rather, they condemn what they see as a very attenuated link between executive pay and corporate or individual performance.[120] Removing the § 162(m) exception for performance-based compensation likely would attenuate that link even more. The reform could be expected to induce some shift of pay from performance-based compensation to salaries and non-performance bonuses, thus reducing or even eliminating whatever modest incentives § 162(m) currently provides to align pay with performance. In short, this reform would undermine the corporate-governance objectives associated with § 162(m) in its present form.

By contrast, this reform would aim directly at the problem of income inequality in the United States by attempting to reduce the total amount of compensation paid to senior corporate managers. The gap in annual income

117. Income Disparities Act of 1991, H.R. 3056, 102d Cong. (1991).

118. CLINTON & GORE, *supra* note 35, at 67–68, 127.

119. U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

120. *See, e.g.*, MISHEL & DAVIS, *supra* note 108, at 6–10. *But see* Murphy, *supra* note 28, at 725–27.

between the wealthiest segment and the remainder of the population increased substantially during the two decades before the financial crisis of 2008.[121] Since the beginning of the post-crisis recovery, that income gap has only widened.[122] If one takes § 162(m) seriously, one would assume that denying a tax deduction for compensation in excess of $1 million would have *some* effect in reducing executive pay. If so, that should help mitigate income inequality, although by clipping incomes at the top rather than by raising incomes at the bottom. Those concerned about income inequality should endorse a reformed § 162(m) that takes at least tentative steps in that direction. In short, the reform would attempt to correct the sharp income imbalances that have emerged as a contemporary policy problem.

This approach to reforming § 162(m), then, is entirely straightforward. The rules under § 162(m) would be revised to allow a corporation to deduct only the first $1 million of compensation paid to each of its senior managers, regardless of the conditions under which the compensation is paid. The objective would be twofold: first, to impose a tax dispreference on excessive manager pay; second, to reduce income inequality in the broader economy. The reform would convert § 162(m) from the corporate-governance provision envisioned by some in 1993 to an income-levelling provision that arguably fits better with twenty-first century concerns about tax policy and income inequality.

Implementation of this reform would require legislative action. First, Congress would have to repeal the provisions that exempt commissions and other performance-based compensation from the $1 million deduction limitation.[123] Second, Congress would have to widen the deduction limitation to pick up compensation deferred until the manager's retirement or other termination of employment. With the exceptions for performance-

121. CONG. BUDGET OFFICE, TRENDS IN THE DISTRIBUTION OF HOUSEHOLD INCOME BETWEEN 1979 AND 2007, at ix–xiii (2011). *See also* Peter Gottschalk & Sheldon Danziger, *Inequality of Wage Rates, Earnings and Family Income in the United States, 1975–2002*, 51 REV. INCOME & WEALTH 231, 236–41 (2005); Wojciech Kopczuk et al., *Earnings Inequality and Mobility in the United States: Evidence from Social Security Data Since 1937*, 125 Q. J. ECON. 91, 104–06 (2010); Wojciech Kopczuk, *Recent Evolution of Income and Wealth Inequality: Comments on Piketty's* Capital in the Twenty-First Century, 68 TAX L. REV. 545, 547–52 (2015); Jon Bakija et al., *Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from U.S. Tax Return Data* 2–4 (Apr. 2012) (unpublished manuscript), http://web.williams.edu/Economics/wp/BakijaColeHeimJobsIncomeGrowthTopEarners.pdf; Thomas L. Hungerford, *Changes in Income Inequality Among U.S. Tax Filers Between 1991 and 2006: The Role of Wages, Capital Income, and Taxes* 2–5 (Jan. 23, 2013) (unpublished manuscript), https://ssrn.com/abstract_id=2207372.

122. FED. RESERVE, CHANGES IN U.S. FAMILY FINANCES FROM 2010 TO 2013: EVIDENCE FROM THE SURVEY OF CONSUMER FINANCES 1–2 (2014).

123. I.R.C. § 162(m)(4)(B)–(C) (2012).

based and deferred compensation eliminated, § 162(m) would disallow the corporate deduction for *all* compensation in excess of $1 million paid to a senior manager for a single year. The result would be a simpler, more administrable rule for executive pay.

The most prominent recent reform proposal for § 162(m) took exactly this approach. The Tax Reform Act of 2014, proposed by former Chairman of the House Ways and Means Committee David Camp, would have eliminated the exceptions for performance-based and deferred compensation from § 162(m).[124] Camp's proposal, in turn, built on recent statutory tinkering with § 162(m). The extension of § 162(m) (in modified form) to employers participating in the Troubled Asset Relief Program under the Emergency Economic Stabilization Act of 2008 and the extension of § 162(m) (again in modified form) to providers of health insurance under the Patient Protection and Affordable Care Act of 2010 both eliminated the exceptions for performance-based and deferred compensation.[125]

Separately, there would be a good argument under this reform approach for making an upward adjustment to the $1 million threshold. The exceptions in current law for performance-based and deferred compensation effectively allow a company to deduct pay substantially in excess of $1 million. Reworking § 162(m) into a flat $1 million limitation would represent a substantial cutback on deductible compensation, as evidenced by the estimated $12 billion that Camp's proposed revision was projected to raise over the ten years following enactment.[126] When Congress passed § 162(m) in 1993, median and average CEO pay at the S&P 500 corporations was $3.05 million and $4.44 million, respectively (in 2016 dollars); just fifteen years later, median and average CEO pay at the S&P 500 corporations was $8.46 million and $11.38 million, respectively (again in 2016 dollars).[127] Additionally, the $1 million cap has never been indexed for inflation. If the point of reforming § 162(m) were to discourage *excessive* manager

124. H.R. 1, 113th Cong. § 3802 (2014). For similar proposals, see S. 2677, 114th Cong. § 503 (2016); H.R. 4144, 114th Cong. § 4 (2015); H.R. 4012, 114th Cong. § 4 (2015); S. 2251, 114th Cong. § 4 (2015); H.R. 2103, 114th Cong. § 2 (2015); S. 1127, 114th Cong. § 2 (2015); S. 2162, 113th Cong. § 5 (2014); H.R. 3970, 113th Cong. § 2 (2014); S. 1476, 113th Cong. § 2 (2013); S. 3675, 110th Cong. § 2 (2008); H.R. 4124, 104th Cong. § 1 (1996). *See also* Robert B. Reich, *Raising Taxes on Corporations that Pay Their CEOs Royally and Treat Their Workers Like Serfs*, ROBERT REICH (Apr. 21, 2014), http://robertreich.org/post/83456610643. *Cf.* STAFF OF THE J. COMM. ON TAXATION, 109TH CONG., *supra* note 108, at 8–9.

125. I.R.C. § 162(m)(5)–(6).

126. STAFF OF THE J. COMM. ON TAXATION, 113TH CONG., ESTIMATED REVENUE EFFECTS OF THE "TAX REFORM ACT OF 2014" 11 (Comm. Print 2014).

127. Frydman & Jenter, *supra* note 11, at 78–79 tbl.1. *See also supra* notes 39–40.

compensation, it would make sense to reset the deduction cap at a higher number that more plausibly reflects the prevailing wage for managerial services and to index that higher number for future growth in wages (or at least in prices). Continuing to adhere to the unrealistic $1 million cap while eliminating the exceptions for performance-based and deferred compensation potentially reduces the underlying policy objectives to irrelevance.

That said, there are again substantial problems with this reform. First is the now familiar difficulty of companies shrugging off the lost deductions and passing the burden of the tax dispreference along to workers and investors. Using a reformed § 162(m) to mitigate income inequality would work—to the extent it would work at all—only by successfully encouraging corporations to limit the compensation paid to senior managers. But the widespread practice under current § 162(m) of paying non-deductible compensation suggests that a § 162(m) without exceptions for performance-based and deferred compensation might lead companies simply to pay *more* non-deductible compensation. Reformers could hope that an effectively lower limit on deductible compensation would moderate high pay, but the broad indifference to losing deductions under current law suggests that those hopes would be misplaced.

To the extent that companies respond to a reformed § 162(m) by shifting what is currently deductible compensation into non-deductible compensation, this approach likely would have the highly undesirable effect of increasing the economic burden on rank-and-file workers and investors. That, in turn, would actually exacerbate income inequality rather than reduce it. Such unwelcome effects could be addressed in part, although not entirely, by raising and indexing the dollar limit on deductible compensation. Indeed, at the extreme, a Congress that wanted to eliminate the exceptions for performance-based and deferred compensation could set the dollar limitation under § 162(m) high enough to leave the overall change revenue neutral, thereby ensuring that the reform, in the aggregate, would not increase the burden on labor and capital.

Even so, there is a serious question about how much a reformed § 162(m) could mitigate income inequality in the broader economy. Indulge the assumption that Congress eliminates the exceptions for performance-based and deferred compensation; indulge the assumption that Congress sets the dollar limit under § 162(m) at a level that ensures no additional burden on workers and investors; and indulge the assumption that companies, for whatever reason, generally adhere to the parameters of the reformed § 162(m) and reduce manager pay. Still, how large could the overall effect really be? Many high earners are not subject to § 162(m) and never will be subject to § 162(m). These include managers at non-public corporations and partnerships, hedge-fund and private-equity managers, sports and entertainment celebrities, professionals practicing in law and medicine, lobbyists, authors, software developers, and many others. It stretches belief to think that taking down the pay of the top four or five managers for each public company could appreciably change the substantial income inequality that raises such serious contemporary policy concerns.

### C. Raising Revenue and Reproving Executive-Pay Practices

A third reform approach (in truth, not strictly a reform at all) would make a virtue of the faults in current § 162(m). Rather than attempt to strengthen the tie between compensation and performance, and rather than reconfigure the deduction cap into an overall limitation on all executive pay, this approach would simply let current § 162(m) stand, both as a vehicle for raising federal revenue and as a policy statement against inappropriate or excessive manager compensation. Congress could determine that continuing the § 162(m) revenue stream and maintaining the associated condemnation of large pay packages supplant concerns about improving corporate governance and mitigating income inequality. In its simplest form, this approach would require no statutory or regulatory change, although the revenue-raising and symbolic functions of § 162(m) could be enhanced by fairly modest statutory revisions. But this approach nonetheless would perpetuate the worst aspects of § 162(m), distorting executive-pay practices and punishing labor and capital for the decisions made by directors and managers.

Treating § 162(m) primarily as a means of raising revenue has scant support in the legislative history. Early proponents of a cap on deductible executive compensation understood the point of their efforts to be more about influencing corporate governance than about increasing tax collections.[128] Although the Clinton administration's formal proposal to Congress presented § 162(m) in tax-policy terms, the articulated concern was to limit the "tax benefit" for executive pay, rather than to increase federal revenue.[129] And after § 162(m) worked its way through Congress, even administration officials agreed that it should operate principally as a Pigovian tax.[130]

128. *See* H.R. 4210, 102nd Cong. § 3006 (1992); H.R. 3056, 102nd Cong. § 2 (1991); U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40; CLINTON & GORE, *supra* note 35, at 67–68, 127.

129. U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40.

130. *See* Reilly, *supra* note 37. As Steven Bank says of the exception for performance-based

But with more than two decades of experience now behind § 162(m), the policy justifications for enacting the deduction cap need not serve as the policy justifications for retaining it. The effort to change executive pay practices has been a qualified failure. Although companies have increased nominally performance-based compensation through large grants of stock options and stock appreciation rights, overall executive-pay levels have risen substantially, and the link between compensation and performance remains highly contested. Similarly, the effort to mitigate income inequality, even within the corporate setting, has misfired badly. The ratio of executive pay to rank-and-file pay has almost quadrupled since 1993.[131] It would seem wholly reasonable, then, for Congress at this point to determine that it should salvage what it can by looking to § 162(m) for revenue and a symbolic statement against high manager pay.[132] Although this approach would implicitly acknowledge the flaws of § 162(m), it also would determine that an unreformed deduction limitation is at least no worse than reformed versions aimed at more ambitious policy goals.

Congress could pursue this approach simply by maintaining the status quo under § 162(m). As it stands now, § 162(m) makes little policy sense other than as a mechanism for raising revenue and expressing a clear, if ineffective, disapproval of inappropriate or excessive executive pay. Alternatively, Congress also could consider minor changes to emphasize either the revenue or the symbolic aspect of § 162(m). For example, if Congress wanted to increase federal tax receipts under § 162(m), it could lower the deduction limit to zero, effectively denying a corporate deduction for all non-performance and non-deferred compensation. In the same vein, Congress could eliminate the exception for deferred compensation. Congress similarly could increase receipts by eliminating the exception for performance-based compensation, although doing so would undermine any symbolic statement about tethering manager pay to corporate and individual performance.

A move in the other direction—for example, to increase the deduction limit above $1 million—would allow Congress to recalibrate its symbolic statement about the appropriate level of executive compensation. Congress could decide, for example, that the deduction threshold should be set at $5 million or $10 million—or that the deduction limitation should be indexed

compensation: "[T]he exception was designed to swallow the rule." Steven A. Bank, *Tax, Corporate Governance, and Norms*, 61 WASH. & LEE L. REV. 1159, 1229 (2004).

131. *See supra* Part I.B.

132. Polsky, *supra* note 65, at 915. *See also* Kirsch, *supra* note 74, at 921–27.

to the growth in wages for rank-and-file workers. The broader point is that, once Congress accepts that § 162(m) in its current form serves no defensible policy goal beyond raising federal revenues and making a purely symbolic statement about inappropriate or excessive executive compensation, it could freely adjust the deduction limitation and the exceptions in order to balance revenue considerations against symbolic ones.

Once again, however, the problems associated with this approach are serious. Admittedly, § 162(m) in its current form yields tax receipts for a chronically underfunded federal government; and, admittedly, § 162(m) in its current form expresses at least *pro forma* disapproval of large executive-pay packages that are not tied to corporate or individual performance. But the economic burden of § 162(m) likely falls on workers and investors. Moreover, that burden is effectively obscured by the poor understanding, even among policymakers, of who bears the incidence of the corporate income tax. Congress may *appear* to reprimand corporations and their senior managers for agreeing to inappropriate or excessive compensation arrangements, but the burden of the reprimand likely falls on labor and capital. Surely that makes no sense.

Additionally, continuing § 162(m) in its current (or even a slightly modified) form would perpetuate the distortions that it causes. The exception for deferred compensation encourages a company to pay its manager later for services that the manager performs currently, whether or not deferral otherwise makes sense for the company and the manager. The exception for performance-based compensation encourages a company to pay its manager in stock options and stock appreciation rights, again without regard to the optimum levels of options and rights. And, to boot, § 162(m) imposes compliance costs—as companies must pay for lawyers, compensation consultants, and accountants to structure pay packages around the deduction limitations and its exceptions, to draft the necessary agreements and plans, to prepare shareholder disclosures and voting documents, and to determine how much pay is deductible and how much is not deductible.

### D. SUMMARY

Policymakers understandably may want to make § 162(m) work better or at least salvage whatever they can from the provision. The numerous reform proposals introduced in Congress over the last two decades underscore that policy inclination. The original objective of encouraging companies to make better executive-pay decisions suggests that the path forward lies in tightening the existing exceptions, particularly in making sure that any compensation above the $1 million cap is actually based on corporate or individual performance. The different but still defensible objective of mitigating income inequality points toward removing all exceptions from § 162(m) so that companies lose their deductions for any manager compensation above the $1 million threshold. And the more pedestrian approach of simply accepting the limited policy payoffs that § 162(m) currently provides leans toward leaving the rules more or less as they are. Each approach, however, is fundamentally unsatisfactory. Although the associated problems vary in details, the most serious and most persistent difficulty is the likelihood that the tax penalty imposed by § 162(m) falls on workers and investors. That makes paying non-deductible compensation and shrugging off the effects of § 162(m) a viable and even attractive strategy for corporations and executives, and it harms those in whose interests Congress originally enacted the pay cap.

## III. THE CASE FOR REPEALING SECTION 162(M)

The case for enacting § 162(m) never was compelling. Policymakers in the legislative and executive branches had generalized misgivings about executive pay during the late 1980s and the early 1990s, but they could not articulate a coherent policy objective to direct their efforts. To compound the problem, they chose a poorly designed penalty mechanism—one that cannot be salvaged through internal reform. Perhaps, then, the right approach would be "external" reform—that is, replacing the disallowance of the corporate tax deduction with an entirely different tax dispreference mechanism. Specifically, Congress could effect a meaningful change either by proscribing inappropriate or excessive executive pay or by imposing a confiscatory tax on inappropriate or excessive executive pay. But any such prohibition on particular forms or levels of manager compensation would introduce serious disruptions and distortions into basic decisions about business organization and labor supply. The superior tax-policy approach is to repeal § 162(m) and simply uncap executive pay. Legitimate concerns about income inequality and corporate governance are better addressed through progressive marginal tax rates and more robust fiduciary liability for corporate directors.

### A. REJECTING THE DEDUCTION DISPREFERENCE

As shown in Part I, the status quo under § 162(m) has myriad problems and shortcomings; as shown in Part II, prominent proposals for internal reforms of § 162(m) have myriad problems and shortcomings as well. Even so, a common thread runs throughout the analysis to this point: the wholesale inadequacy of denying the corporate tax deduction as the mechanism for penalizing inappropriate or excessive executive compensation. The basic difficulty centers on a mismatch of the parties who engage in the conduct that Congress wants to change and the parties who likely bear the burden of the disallowed deduction. The compensation of a senior corporate manager is set by contractual arrangement between the manager and the directors of the corporation. Whether the arrangement reflects the market price for the manager's services or rents extracted from company assets, only the manager and the directors with whom the manager bargains have the legal authority to establish and to modify the manager's pay package. The company's investors, the company's rank-and-file workers, and the government have no formal role in that process.

For that reason, the dispreference mechanism that Congress has chosen ultimately constitutes more of a bothersome sideshow than a genuine constraint in setting a manager's pay. The effect of disallowing the corporate deduction is to increase the company's federal tax liability, but neither the executive nor the directors with whom the executive negotiates bear a meaningful share of that increased federal tax liability. Instead, the economic burden of the company's tax liability, including any marginal increase in that burden attributable to § 162(m), likely falls on workers and investors. Managers (as both workers and investors) and directors (as investors) share in that burden; but their share is too small to affect decisions about manager compensation. For executives and directors, the potential rewards from reaching desirable executive-pay outcomes far exceed the incremental cost of smaller corporate deductions.

This is objectionable for two reasons. First, it encourages managers and directors to shrug off § 162(m) and reduce the provision to an exercise in pointlessness. The intended effect of the § 162(m) dispreference is to push managers and directors to do something they otherwise would not do—to limit or at least to restructure executive compensation. But the easy response is to exploit the exceptions for performance-based and deferred compensation, to pay non-deductible compensation, or to pursue some combination of those approaches. Second, it burdens parties who, at least in theory, are the ones harmed by inappropriate or excessive manager compensation in the first place. Although Congress in 1993 expressed its objections to executive pay in terms of unfairness toward workers and investors, it reacted by punishing them rather than executives and directors. Section 162(m) thus presents the bizarre spectacle of government sanctioning workers and investors in order to reprove the conduct of managers and directors—largely because of the harm that managers and directors supposedly impose on workers and investors. The first policy response to § 162(m), then, should be to reject the deduction dispreference. It represents a badly mistaken policy approach, and Congress should abandon it.[133]

Naturally, those who still object to what they consider inappropriate or excessive executive pay would want to replace the deduction limitation with a different dispreference mechanism. One approach, advocated by David Walker, would be a penalty tax imposed directly on managers.[134] Congress has pursued this approach in related contexts. In 1984, Congress enacted tax sanctions for excess golden parachutes paid to executives in connection with corporate takeovers and other changes in corporate control. The sanctions include both a disallowed tax deduction for any company making an excess golden-parachute payment and a 20 percent penalty tax on any manager receiving an excess golden-parachute payment.[135] Similarly, Congress in 2004 enacted a 20 percent penalty tax on a manager for non-qualified deferred compensation that fails to meet certain statutory requirements.[136] There are precedents, then, for directing tax sanctions directly at the executives entitled to receive compensation that Congress finds objectionable.

But this approach likely would offer little or no improvement over the disallowance of the corporate deduction. Although the law currently imposes golden-parachute and deferred-compensation penalty taxes directly on managers, managers and directors in turn readily shift the burden of those taxes onto workers and investors.[137] This practice is straightforward and commonplace. As part of an executive's negotiated pay package, the

133. The same objections would apply to a surtax imposed on a corporation that pays compensation in excess of $1 million to an executive, as Andrew Lund proposes. *See* Andrew C.W. Lund, *Tax's Triviality as a Pay-Reforming Device*, 57 VILL. L. REV. 571, 585 (2012).

134. Walker, *A Tax Response to the Executive Pay Problem*, *supra* note 104, at 350–51. *Cf.* Schizer, *Tax and Corporate Governance*, *supra* note 55, at 3–6.

135. I.R.C. §§ 280G, 4999 (2012).

136. *Id.* § 409A.

137. *See, e.g.*, Mullane, *supra* note 99, at 517–19; James R. Raborn, *Executive Compensation: Much to Do About . . .* , 10 HOUS. BUS. & TAX L.J. 262, 272–77 (2010); Walker, *A Tax Response to the Executive Pay Problem*, *supra* note 104, at 354–58; David I. Walker, *Is Equity Compensation Tax Advantaged?*, 84 B.U. L. REV. 695, 762 n. 229 (2004); Bruce A. Wolk, *The Golden Parachute Provisions: Time for Repeal?*, 21 VA. TAX REV. 125, 139–42 (2001). David Walker argues that a penalty tax on excessive executive pay is less likely to be shifted from the executive to the company by means of an indemnification arrangement than the penalty tax on excess golden-parachute payments. Walker, *A Tax Response to the Executive Pay Problem*, *supra* note 104, at 355–59. In part, he argues that "outrage" constraints likely would prevent a company from covering a surtax imposed on the compensation paid to its managers. *Id.* at 354 n.132. But that position is difficult to reconcile with the pervasive practice under existing law of paying compensation for which § 162(m) disallows a corporate deduction. Why would a company's board of directors be willing to defy § 162(m) but shy away from defying a penalty tax?

company (acting through its directors) agrees with the executive that the company will indemnify the executive for any penalty taxes imposed on the executive's excess golden-parachute payments and non-qualified deferred compensation.[138] This can be an expensive undertaking: the rules on excess golden parachutes treat any indemnification payment made by the company as an additional golden-parachute payment that itself attracts the 20 percent penalty tax.[139] Thus, if an executive receives an excess golden-parachute payment of $50 million and incurs a penalty tax of $10 million, the company must pay the executive an additional $12.5 million to cover the penalty tax on the original excess golden-parachute payment and the penalty tax on the indemnification payment. The cost is higher still if the company indemnifies the executive for income and employment taxes on the indemnification payment.[140]

As the rate of the penalty tax increases, the directors' willingness to provide full indemnification should decrease (at least in theory). If the golden-parachute penalty tax were increased from 20 percent to 50 percent, for example, the total cost of providing a manager with a $50 million golden-parachute payment, net of the penalty tax (but not of income and other taxes), would increase to $100 million. Perhaps the frequency of indemnification arrangements would approach zero asymptotically as the penalty-tax rate increases. But the basic point remains that, as penalty taxes on managers are currently configured, companies can and do pay those taxes on behalf of their managers. And the economic burden of indemnification payments, like the economic burden of the § 162(m) deduction disallowance, falls on workers and investors.

In his excellent article, David Walker argues that the indemnification problem could be mitigated or eliminated by combining a penalty tax on the executive with what he calls "investor tax relief."[141] Walker envisions providing such relief either in the form of a reduction in corporate taxes (delivered through refundable corporate tax credits) or a reduction in shareholder taxes (delivered through lower taxes on dividends or capital gains).[142] But there are problems with this approach. Assume that the government were to impose a penalty tax on excessive executive

138. *See, e.g.*, Wolk, *supra* note 137.

139. *Id.*

140. For example, assuming federal and state income and employment taxes of 50 percent and a penalty tax on excess golden parachutes of 20 percent, the company would have to pay the executive $166.67 million to leave the executive with $50 million net of all taxes.

141. Walker, *A Tax Response to the Executive Pay Problem*, *supra* note 104, at 371–73.

142. *Id.*

compensation and that a company agreed to indemnify an executive for the penalty tax. In the absence of investor tax relief, the indemnification, like the corporate tax, would burden the company's workers and investors. Under Walker's approach, the government could provide either partial or full relief for that burden. If the government provided partial relief, transferring some but not all the amount collected under the penalty tax to the company or its investors, the government at most would have mitigated but would not have eliminated the problem. The workers and investors still would bear the cost of the indemnification to the extent that the government retained the penalty tax. Partial relief would affect only the scale; the problem itself would remain.

If the government instead were to provide full relief, transferring the entire amount collected under the penalty tax to the company or its investors, there would be two possible outcomes, both of which are unattractive. First, if the relief were provided directly to the company's shareholders, the company's workers would have borne part of the burden of the indemnification but would have received no relief.[143] The shareholders would have been over-compensated, and the workers would have been under-compensated.[144] Second, if the relief were provided to the company (for example, through refundable corporate tax credits), the flow of funds would have been fully circular: the government would have collected a penalty tax from the executive; the company would have made an indemnification payment to the executive out of the company's assets; and the government then would have returned the penalty tax to the company.[145]

What is needed is a dispreference on inappropriate or excessive executive pay that cannot be shifted from the manager to the company. Two

143. Additionally, unless the relief were treated for tax purposes as the payment of a dividend, the shareholders effectively would have withdrawn assets from the company without paying the shareholder-level tax normally imposed on dividends.

144. Although the government could divide the relief between investors and workers—giving the former a reduction in taxes on dividends or capital gains and giving the latter a wage subsidy—there is absolutely no reason to suppose that the government could determine the actual incidence of the corporate tax with sufficient accuracy to ensure that the relief matches the burden.

145. Consider the following example, assuming a penalty tax rate of 50 percent on excessive executive compensation and (for simplicity) ignoring corporate and individual income taxes. Company A pays Executive M excessive compensation of $10 million, and the government imposes a penalty tax of $5 million on Executive M. Pursuant to an agreement between Company A and Executive M, Company A makes a $5 million indemnification payment to Executive M. To provide full investor tax relief, the government pays $5 million to Company A (for example, in the form of refundable corporate tax credits). In the end, Company A, Executive M, and the government are no wealthier and no poorer than they would be if Company A had paid Executive M excessive compensation of $10 million but the government had not imposed a penalty tax.

possibilities emerge here. First, the dispreference could take the form of a criminal penalty.[146] Although a manager may be able to adjust her pay package such that the company covers the cost of her penalty taxes, she cannot adjust her pay package such that the company (much less its workers and investors) serves a prison sentence imposed on her. However odd it may seem, Congress in recent years has criminalized certain executive-pay practices. Section 402 of the Sarbanes-Oxley Act of 2002 makes it a federal crime for a public company to loan money to certain of its senior executives.[147] At least in theory, then, Congress could impose criminal penalties on executives who receive compensation in excess of the limitations set out by § 162(m). But that approach seems more than a bit too much. It was overkill in the case of executive loans, and it would be overkill in the case of executive pay more broadly.

A second approach, which I believe has never been suggested before in the literature, would be to push the penalty tax to its logical extreme. Rather than impose a 20 percent penalty tax that can be shifted to the company rather painlessly or a 50 percent penalty tax that can be shifted to the company rather more painfully, Congress could impose a 100 percent penalty tax and simply confiscate any compensation in excess of the § 162(m) limit. This approach would have the full prohibitory effect of a criminal penalty without the attendant policy concerns raised by criminalizing ordinary compensation contracts. Although ultimately no more acceptable than § 162(m) in its current form, the confiscatory tax merits closer consideration—largely because, unlike both current law and the other approaches considered so far, it actually would work.

### B. EVALUATING A CONFISCATORY TAX ON EXECUTIVE PAY

The mechanics of a confiscatory tax on executive pay would be reasonably simple. Congress would impose a 100 percent tax, in lieu of any income, employment, or other taxes, on any compensation paid by a designated employer to a designated employee in excess of a designated limit. For ease of discussion, assume initially that the designated employers, employees, and limits for the confiscatory tax would be the same as those under current § 162(m). Thus, assume that the confiscatory tax would apply to compensation in excess of $1 million paid by a public company to its chief executive officer and its other senior managers whose pay must be reported

146. Mullane suggests this possibility, without necessarily endorsing it. *See* Mullane, *supra* note 99, at 551.

147. Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §78m(k) (2012)).

on the summary compensation table required by Security and Exchange Commission regulations.

Congress could adjust any one of those elements—picking up, for example, a broader class of employers or managers or setting a higher or lower dollar limitation. Additionally, Congress could impose the confiscatory tax with or without the § 162(m) exceptions for performance-based and deferred compensation. Including those exceptions would put enormous pressure on their operative terms, as the stakes for what compensation satisfies them would become much greater. Not including the exceptions would simplify the administration of the confiscatory tax but would put substantial upward pressure on the dollar limit. For example, the chief executive officer of Discovery Communications, Inc. received more than $156 million in total compensation for 2014,[148] and it is not plausible that Congress could have taxed away $155 million of that pay without substantial pushback. Without the exceptions for performance-based or deferred compensation, Congress might set the dollar limitation at a figure higher than the current cap under § 162(m).

The confiscatory tax would have two other important components. First, any payment made by a company to an executive in respect of the tax would itself be subject to the tax. Assume, for example, that Congress were to enact a confiscatory tax generally modeled on § 162(m) but without exceptions for performance-based and deferred compensation and with the limitation set at $15 million. Under that regime, *any* compensation payment from a company to a senior manager in excess of $15 million would be taxed away entirely. If Corporation X were to pay Executive A compensation of $20 million, the executive would owe a tax to the government equal to $5 million (100 percent of the amount paid to Executive A over the $15 million cap). If Corporation X were to pay the $5 million tax on behalf of Executive A, Executive A would owe a total tax of $10 million (100 percent of the amount paid directly to Executive A over the $15 million cap and 100 percent of the amount paid to the government on behalf of Executive A).

Second, the confiscatory tax would not deny the corporation a tax deduction for compensation in excess of the dollar limitation. In this respect, the treatment of inappropriate or excessive executive compensation under the confiscatory tax would differ from the treatment of excess golden-parachute payments under current law. The golden-parachute rules impose a 20 percent penalty tax on the executive and deny the corporation a deduction.

148. McGregor, *supra* note 42.

But denying a tax deduction is neither necessary nor appropriate in the case of the confiscatory tax. As shown above, denial of a corporate tax deduction likely increases the tax burden on workers and investors. Also, with the full amount of the excessive executive compensation taxed away by the confiscatory tax, the denial of a corporate tax deduction would have no marginal benefit in discouraging the payment of such compensation in the first instance.

The advantages of the confiscatory tax are clear. Unlike the disallowance of corporate deductions and the imposition of penalty taxes under current law, the confiscatory tax would be both effective and non-shiftable. At a 100 percent rate, the tax would simply impound any compensation payment in excess of the designated limit. Although a company could *pay* its manager compensation that exceeds the cap, the portion above the cap would be taxed away by the government. The confiscatory tax therefore would succeed where § 162(m) and the golden-parachute penalty tax fail.[149] The confiscatory tax would work not by *discouraging* particular behavior by companies and managers; instead, it would work by *commandeering* the full benefit of that behavior.[150]

Additionally, the economic burden of the confiscatory tax would stay exactly where it is intended to stay. Because any compensation payment in excess of the limit, including a payment in respect of the confiscatory tax, would be subject to the confiscatory tax, the company and the executive could not bargain for the burden to be shifted from the executive to the company by way of an indemnification agreement. Again, this distinguishes the confiscatory tax from § 162(m) and the golden-parachute penalty tax. Those tax dispreferences fall on the company—or easily can be shifted to the company—and thus likely burden workers and investors. By contrast, corporate assets could never be used to relieve the manager of the confiscatory tax, no matter how favorably disposed the board of directors

149. It seems, then, an overstatement to argue that "[i]t is not likely that a Code-based approach to regulating executive compensation would be workable." Joy Sabino Mullane, *The Unlearning Curve: Tax-Based Congressional Regulation of Executive Compensation*, 60 CATH. U. L. REV. 1045, 1081 (2011).

150. Strictly speaking, the tax need not necessarily be a confiscatory tax in order to prevent the payment of excessive or inappropriate executive compensation. It may well be, for example, that taxing excessive or inappropriate compensation at a rate of 90 percent or 95 percent would have the same effect as taxing such compensation at a rate of 100 percent. At some point between a tax of 0 percent and a tax of 100 percent, the company and the executive would agree to a pay arrangement that does not include excessive or inappropriate pay—that is, at some point the tax would function as an effective limit on executive pay. But all the policy objections outlined below to a 100 percent tax would apply with equal force in such a case.

might be to the manager.

Moreover, the confiscatory tax would be flexible enough to be paired with almost any of the various policy objectives underlying § 162(m). If Congress wanted to replicate existing § 162(m), it could replace the disallowance of the corporate deduction with the 100 percent tax for any compensation in excess of $1 million, retaining the exceptions for performance-based and deferred compensation. If Congress wanted to strengthen the tie between executive pay and corporate or individual performance, Congress could impose the confiscatory tax on any compensation in excess of the $1 million limit, retaining only the exception for performance-based compensation. In so doing, Congress might see fit also to tighten the standards for what constitutes performance-based compensation (although, as argued in Part II, this creates its own difficulties). Or, at the extreme, if Congress wanted to use the confiscatory tax as a broad leveling device—as a strong hammer against income inequality—it could impose the tax on *any* compensation in excess of $1 million (or some other designated limit), with no exceptions at all.

Nonetheless, the confiscatory tax would have very serious drawbacks that would make it unacceptable as a policy matter. First, the tax would introduce significant distortions and disruptions into the choice of business form.[151] Assume, for example, that the executives subject to the confiscatory tax would be those who work for public companies, as under current § 162(m). An effective and binding limitation under the confiscatory tax on what could be paid to senior managers of public companies would cause some businesses to transform themselves from public to private companies and other businesses never to change from private companies to public companies in the first place. Such distortions and disruptions would play out along whatever margin Congress were to use in defining the scope of the tax. If the tax applied to executives of all subchapter C corporations, whether public or private, more businesses would elect subchapter S status or would operate as partnerships under subchapter K. Considerations of economic efficiency in the choice of business form would become secondary to the simple imperative of avoiding the confiscatory tax and the limitation on manager compensation.

Second, the tax would introduce serious distortions and disruptions into the high end of the labor market.[152] An effective and binding limitation under the confiscatory tax on what executives may earn would push talented young

151. *See* Walker, *A Tax Response to the Executive Pay Problem*, *supra* note 104, at 365–67.

152. *See id.* at 367–68.

men and women away from business and into other careers. An outstanding graduate of Wharton or Kellogg might express a strong preference for starting her career at a private consulting firm rather than a public company. An outstanding college graduate who might otherwise have matriculated at Wharton or Kellogg may instead pursue advanced study in law or medicine; or he might skip graduate school altogether and look for career opportunities in lobbying or real-estate development. Older men and women already in business careers at the introduction of the confiscatory tax would want to move out of the sectors where their pay is limited (for example, public companies) and into sectors where their pay remains unlimited (for example, private companies and partnerships). At the extreme, they might even prefer to transfer to foreign employers. The point is straightforward but important: imposing a confiscatory tax on excessive executive pay would discourage the most capable individuals from seeking or continuing careers in business management. The tax thus should lead to inferior labor supply for managerial positions.[153]

Third, there is a basic problem of institutional competence in setting executive pay at an appropriate level.[154] Under current law, manager compensation is determined by the market with only minimal interference from the government. Admittedly, some critics (such as the advocates of the managerial-power theory) argue that current law ignores substantial market failures in the bargaining between managers and directors. But the introduction of a confiscatory tax on excessive executive pay goes well beyond what might be necessary to correct any such problems. Instead, it substitutes Congress, probably with the assistance of the Treasury Department, as the final arbiter of manager compensation. Why would Congress—a wholly political institution with no expertise in corporate governance or business management—be able to identify the "right" amount of executive pay? Why would the Treasury Department—a wholly bureaucratic institution with very limited expertise in corporate governance and business management—be any better suited to the task? Surely, whatever the market does here, government would only do worse.

Finally, there is the separate problem of distinguishing between manager pay that is inappropriate or excessive and manager pay that is appropriate and not excessive. One approach would set a single dollar

153. *Cf.* Kaplan, *Executive Compensation and Corporate Governance in the U.S.*, *supra* note 38, at 15–21 (analyzing the historical earnings and managerial power problems of CEOs against comparable groups, such as corporate lawyers, hedge fund investors, and private equity investors).

154. *See* Schizer, *Tax and Corporate Governance*, *supra* note 55, at 4.

limitation for all companies, as § 162(m) currently does. But why would it be acceptable policy to tell the chief executive officer of the largest public company that her pay is capped at the same amount as the pay for the chief executive officer of the smallest public company? And if Congress or the Treasury Department were to set different limits based on the size of the company, how could the government possibly determine what the proper amounts should be? The best that one could hope for would be a generic, bureaucratic pay scale such as that used for the government's own employees—a pay scale that bears little resemblance to market value or merit.

### C. UNCAPPING EXECUTIVE PAY

The best approach is outright repeal of § 162(m).[155] Congress should repudiate the policy of using the tax code as a vehicle for addressing what it considers inappropriate or excessive executive compensation. It should not use the tax law to limit, constrain, discourage, or prohibit particular forms or amounts of manager compensation. It should not attempt to reform § 162(m), and it should not replace § 162(m) with a penalty tax or a confiscatory tax. For good measure, Congress should repeal the rules denying corporate tax deductions for excessive golden-parachute payments,[156] imposing penalty taxes on excessive golden-parachute payments,[157] and imposing penalty taxes on certain types of non-qualified deferred compensation.[158] Corporate directors and managers should be permitted to set the terms of manager compensation through negotiation. But Congress should not hesitate to address overall income inequality through progressive tax rates and corporate-governance problems through broadened fiduciary liability for directors.

There are two basic arguments for uncapping executive pay under the tax code. First, repealing § 162(m) is right as a matter of tax policy. Although the contemporary United States income tax incorporates certain elements of a consumption tax, the basic structure and organizing principle remain those of an income tax—that is, a tax on *net income*. The point of an income tax is

155. Other commentators have argued for repeal of section 162(m). *See, e.g.*, Conway, *supra* note 55, at 425–29. So too has the staff of the Joint Committee on Taxation. *See* STAFF OF THE J. COMM. ON TAXATION, 113TH CONG., *supra* note 126, at 20, 42–43.

156. I.R.C. § 280G (2012).

157. *Id.* § 4999.

158. *Id.* § 409A. Note that here Congress should repeal the 20 percent penalty tax, which is wholly unsound as a policy matter, but not the rules requiring early inclusion of non-qualified deferred compensation and imposing an interest surcharge on non-qualified deferred compensation. The early-inclusion and interest-surcharge rules are perfectly sensible.

to tax the difference between gross income and the cost of producing that income. Compensation that a company pays to its workers—including the amounts paid to the most highly compensated senior managers—represents an economic cost of producing taxable income for the company. Such compensation is properly deductible under an income tax. The Clinton administration thus made a fundamental conceptual mistake in articulating its justification for § 162(m) as the removal of a tax preference. The administration argued that the law before § 162(m) set "no limitation on the amount of *tax benefit* provided for executive compensation."[159] A deduction for executive and other employee compensation is not a "tax benefit" at all; it is an adjustment necessary to impose tax only on net income.

That is not to say that disallowing a deduction for executive pay or imposing a penalty or confiscatory tax on executive pay could never be justified under an income tax. But it is to say that disallowing a deduction for executive pay or imposing a penalty or confiscatory tax on executive pay is not the same as removing a tax benefit or a tax preference; instead, under an income tax, it is imposing a tax penalty or a tax dispreference.[160] To maintain otherwise, as the Clinton administration did, is simply incorrect. Certainly, one might advance a cogent argument for departing from the income-tax baseline on executive pay, although the Clinton administration, Congress, and numerous policymakers since 1993 have failed to do so. To the extent that Congress perceives a market failure in the process of setting executive pay, the right response would be to address that market failure directly as a matter of corporate-governance law. Nothing good has come from using the tax code to penalize executive pay.

Second, the various approaches to imposing a cap on executive pay are all seriously deficient. Section 162(m) represents the policy status quo; it is both wrong on policy and ineffective in practice. Directors and managers find it comparatively easy to avoid the § 162(m) limitation by exploiting the broad exceptions for performance-based and deferred compensation. Additionally, directors and managers find it painless to ignore the § 162(m) limitation because the cost of doing so likely falls on workers and investors. Executive-pay practices under the status quo, sometimes even within a single firm, thus represent a mixture of both dodging and defying § 162(m).

Proposals for internal reform of § 162(m) by tightening or eliminating the exceptions for performance-based and deferred compensation also would be wrong on policy and ineffective in practice. Any attempt to narrow the

159. U.S. DEP'T OF THE TREASURY, *supra* note 20, at 40 (emphasis added).

160. Polsky, *supra* note 65, at 884 n.33.

scope of performance-based compensation would put the government in the untenable position of trying to determine, in generally applicable terms, what constitutes corporate or individual success. That exercise would be all but certain to produce either over-inclusive or under-inclusive rules. Furthermore, the continued practice of disallowing corporate deductions for compensation above the cap likely would put the economic burden on workers and investors rather than executives and directors.

By contrast, external reform of § 162(m)—such as replacing the disallowance of corporate deductions with a confiscatory tax imposed on the executive—would be effective in practice but still wrong on policy. Although directors and managers could not shift the burden of the confiscatory tax to workers and investors, the tax would impose highly objectionable distortions and disruptions into decisions about business organization and labor supply, particularly for highly capable individuals. The problem stems from the inherent effectiveness of the confiscatory tax. Because there would be no getting around it and no shifting of its burden, the confiscatory tax necessarily would limit what an executive could receive as compensation. Any amount in excess of the designated cap would be taxed away by the government, and that would drive both businesses and individuals to exit the sectors in which the government limits manager compensation.

In the end, the right answer is to repeal § 162(m) and to uncap executive pay. Using the tax law to address concerns about executive compensation has been fundamentally misguided. Inappropriate or excessive executive pay is not a tax-policy problem, and it should not be addressed through the tax law. Certainly high executive compensation may contribute to overall income inequality, and certainly overall income inequality may be a legitimate policy concern. The correct response is not to target executives specifically but to pursue more robust taxation under progressive marginal tax rates that apply to all high earners—whether they are corporate executives, hedge-fund managers, professional athletes, entertainment celebrities, or successful doctors or lawyers. Additionally, high executive compensation may represent a breakdown in proper corporate governance, with directors agreeing for whatever reasons to pay arrangements that do not advance investor interests as well as they should. The correct response in that case is not to impose tax burdens on workers and investors but to reform corporate law. Proper narrowing of the business judgment rule and expansion of director liability hold greater potential to discipline director decisions about how much to pay executives and how closely to link that pay to corporate and individual performance.

# APPENDIX

TABLE 1. Base Salaries in 2014 for S&P 500 Chief Executive Officers (in USD)[161]

| *Rank* | *Company* | *CEO* | *Base Salary* |
|---|---|---|---|
| 1. | Wynn Resorts | Stephen A. Wynn | 4,000,000 |
| 2. | Bed Bath & Beyond | Steven H. Temares | 3,967,500 |
| 3. | Viacom | Philippe P. Dauman | 3,871,154 |
| 4. | General Electric | Jeffrey R. Immelt | 3,750,000 |
| 5. | CBS | Leslie Moonves II | 3,513,461 |
| 6. | Twenty-First Century Fox | James Rupert Murdoch | 3,000,000 |
| 7. | Discovery Communications | David M. Zaslav | 3,000,000 |
| 8. | Netflix | Reed Hastings | 2,961,539 |
| 9. | ExxonMobil | Rex W. Tillerson | 2,867,000 |
| 10. | Comcast | Brian L. Roberts | 2,857,315 |
| 11. | Wells Fargo | John G. Stumpf | 2,800,000 |
| 12. | Disney | Robert A. Iger | 2,500,000 |
| 13. | Michael Kors Holdings | John D. Idol | 2,500,000 |
| 14. | Activision Blizzard | Robert A. Kotick | 2,196,616 |
| 15. | Boeing | W. James McNerney, Jr. | 2,004,231 |
| 16. | American Express | Kenneth I. Chenault | 2,000,000 |
| 17. | Procter & Gamble | Alan George Lafley | 2,000,000 |
| 18. | Ford Motor | William Clay Ford, Jr. | 2,000,000 |
| 19. | Time Warner | Jeffrey L. Bewkes | 2,000,000 |
| 20. | Goldman Sachs Group | Lloyd C. Blankfein | 2,000,000 |
| 21. | News Corporation | Robert J. Thomson | 2,000,000 |
| 22. | Cablevision Systems | James L. Dolan | 2,000,000 |
| 23. | Abbott Laboratories | Miles D. White | 1,973,077 |
| 24. | L Brands | Leslie H. Wexner | 1,924,000 |

161. COMPUSTAT - CAPITAL IQ, EXECUCOMP ANNUAL COMPENSATION, https://wrds-web.wharton.upenn.edu/wrds (last visited May 17, 2017) (data set on file with author).

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|---|---|---|---|
| 25. | Dow Chemical | Andrew N. Liveris | 1,921,433 |
| 26. | United Technologies | Louis R. Chenevert | 1,869,583 |
| 27. | Honeywell International | David M. Cote | 1,865,769 |
| 28. | Chevron | John S. Watson | 1,825,500 |
| 29. | Pfizer | Ian C. Read | 1,815,000 |
| 30. | Apache | G. Steven Farris | 1,750,000 |
| 31. | Estee Lauder | Fabrizio Freda | 1,750,000 |
| 32. | Ralph Lauren | Ralph Lauren | 1,750,000 |
| 33. | Apple | Timothy D. Cook | 1,748,462 |
| 34. | Bristol-Myers Squibb | Lamberto Andreotti | 1,700,000 |
| 35. | Schlumberger | Paal Kibsgaard | 1,700,000 |
| 36. | ConocoPhillips | Ryan M. Lance | 1,700,000 |
| 37. | AT&T | Randall L. Stephenson | 1,691,667 |
| 38. | McKesson | John H. Hammergren | 1,680,000 |
| 39. | Halliburton | David J. Lesar | 1,630,000 |
| 40. | Philip Morris | Andr Calantzopoulos | 1,615,871 |
| 41. | Gilead Sciences | John C. Martin | 1,605,017 |
| 42. | Caterpillar | Douglas R. Oberhelman | 1,600,008 |
| 43. | Coca-Cola | Muhtar Kent | 1,600,000 |
| 44. | Macy’s | Terry J. Lundgren | 1,600,000 |
| 45. | Pepsico | Indra K. Nooyi | 1,600,000 |
| 46. | Mondelez International | Irene B. Rosenfeld | 1,600,000 |
| 47. | AbbVie | Richard A. Gonzalez | 1,595,961 |
| 48. | LyondellBasell Industries | James L. Gallogly | 1,594,039 |
| 49. | Precision Castparts | Mark Donegan | 1,585,000 |
| 50. | Verizon Communications | Lowell C. McAdam | 1,580,769 |
| 51. | TJX Companies | Carol M. Meyrowitz | 1,575,002 |
| 52. | General Motors | Mary T. Barra | 1,567,803 |
| 53. | General Dynamics | Phebe N. Novakovic | 1,560,000 |
| 54. | Nike | Mark G. Parker | 1,550,000 |
| 55. | Universal Health Services | Alan B. Miller | 1,537,560 |
| 56. | Marathon Petroleum | Gary R. Heminger | 1,537,500 |

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|---|---|---|---|
| 57. | Baxter International | Robert L. Parkinson, Jr. | 1,535,000 |
| 58. | Northrop Grumman | Wesley G. Bush | 1,524,231 |
| 59. | Phillips 66 | Greg C. Garland | 1,510,427 |
| 60. | Monsanto | Hugh Grant | 1,506,269 |
| 61. | Amgen | Robert A. Bradway | 1,505,769 |
| 62. | Dollar Tree | Bob Sasser | 1,505,769 |
| 63. | Medtronic | Omar S. Ishrak | 1,503,123 |
| 64. | HP | Margaret C. Whitman | 1,500,058 |
| 65. | Hewlett Packard Enterprise | Margaret C. Whitman | 1,500,058 |
| 66. | Wyndham Worldwide | Stephen P. Holmes | 1,500,008 |
| 67. | International Business Machines | Virginia M. Rometty | 1,500,000 |
| 68. | Hess | John B. Hess | 1,500,000 |
| 69. | Merck | Kenneth C. Frazier | 1,500,000 |
| 70. | Starbucks | Howard D. Schultz | 1,500,000 |
| 71. | J.P. Morgan Chase | James Dimon | 1,500,000 |
| 72. | Johnson & Johnson | Alex Gorsky | 1,500,000 |
| 73. | Bank of America | Brian T. Moynihan | 1,500,000 |
| 74. | Eli Lilly | John C. Lechleiter | 1,500,000 |
| 75. | Morgan Stanley | James P. Gorman | 1,500,000 |
| 76. | Occidental Petroleum | Stephen I. Chazen | 1,500,000 |
| 77. | Gap | Glenn K. Murphy | 1,500,000 |
| 78. | Time Warner Cable | Robert D. Marcus | 1,500,000 |
| 79. | AON | Gregory C. Case | 1,500,000 |
| 80. | Citigroup | Michael L. Corbat | 1,500,000 |
| 81. | Lockheed Martin | Marillyn A. Hewson | 1,497,692 |
| 82. | Deere | Samuel R. Allen | 1,495,204 |
| 83. | Tesoro | Gregory J. Goff | 1,495,000 |
| 84. | DuPont de Nemours | Ellen J. Kullman | 1,477,833 |
| 85. | Symantec | Michael A. Brown | 1,473,077 |
| 86. | Equifax | Richard F. Smith | 1,450,000 |
| 87. | Int'l Paper | Johan V. Faraci | 1,450,000 |

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| 88. | Yum Brands | David C. Novak | 1,450,000 |
| 89. | Devon Energy | John Richels | 1,447,385 |
| 90. | Whirlpool | Jeff M. Fettig | 1,444,375 |
| 91. | Aflac | Daniel P. Amos | 1,441,100 |
| 92. | Alcoa | Klaus-Christian Kleinfeld | 1,440,000 |
| 93. | Salesforce.com | Marc Benioff | 1,440,000 |
| 94. | Scripps Networks Interactive | Kenneth W. Lowe | 1,420,000 |
| 95. | Dominion Resources | Thomas F. Farrell II | 1,411,744 |
| 96. | Interpublic Group of Cos. | Michael Isor Roth | 1,400,000 |
| 97. | Marsh & McLennan | Daniel S. Glaser | 1,400,000 |
| 98. | Johnson Controls | Alex A. Molinaroli | 1,400,000 |
| 99. | Prudential Financial | John Robert Strangfeld, Jr. | 1,400,000 |
| 100. | PPG Industries | Charles E. Bunch | 1,393,333 |
| 101. | 3M | Inge G. Thulin | 1,392,560 |
| 102. | American International | Robert Herman Benmosche | 1,384,615 |
| 103. | Archer-Daniels-Midland | Patricia A. Woertz | 1,383,459 |
| 104. | Celgene | Robert J. Hugin | 1,380,000 |
| 105. | Biogen | George A. Scangos | 1,375,000 |
| 106. | Freeport-McMoran | Richard C. Adkerson | 1,354,167 |
| 107. | Kohl’s | Kevin Mansell | 1,352,700 |
| 108. | CVS Health | Larry J. Merlo | 1,350,000 |
| 109. | PVH | Emanuel Chirico | 1,350,000 |
| 110. | L-3 Communications Holdings | Michael T. Strianese | 1,350,000 |
| 111. | FirstEnergy | Anthony J. Alexander | 1,340,000 |
| 112. | MetLife | Steven A. Kandarian | 1,325,000 |
| 113. | Dollar General | Richard W. Dreiling | 1,323,789 |
| 114. | Cardinal Health | George S. Barrett | 1,314,630 |
| 115. | Stanley Black & Decker | John F. Lundgren | 1,304,167 |
| 116. | Emerson Electric | David N. Farr | 1,300,000 |
| 117. | Hasbro | Brian D. Goldner | 1,300,000 |

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| 118. | UnitedHealth Group | Stephen J. Hemsley | 1,300,000 |
| 119. | Delphi Automotive | Rodney O'Neal | 1,300,000 |
| 120. | Anadarko Petroleum | R.A. Walker | 1,300,000 |
| 121. | Kimberly-Clark | Thomas J. Falk | 1,300,000 |
| 122. | Parker-Hannifan | Donald E. Washkewicz | 1,300,000 |
| 123. | VF | Eric C. Wiseman | 1,300,000 |
| 124. | NRG Energy | David W. Crane | 1,297,577 |
| 125. | Murphy Oil | Roger W. Jenkins | 1,295,833 |
| 126. | Motorola Solutions | Gregory Q. Brown | 1,287,500 |
| 127. | Praxair | Stephen F. Angel | 1,287,500 |
| 128. | WEC Energy Group | Gale E. Klappa | 1,283,040 |
| 129. | Lowe's | Robert A. Niblock | 1,280,000 |
| 130. | Alexion Pharmaceuticals | Leonard Bell | 1,280,000 |
| 131. | Colgate-Palmolive | Ian M. Cook | 1,273,333 |
| 132. | Henry Schein | Stanley M. Bergman | 1,268,846 |
| 133. | FedEx | Frederick W. Smith | 1,266,960 |
| 134. | Jacobs Engineering Group | Craig L. Martin | 1,266,827 |
| 135. | Corning | Wendell P. Weeks | 1,261,923 |
| 136. | Comerica | Ralph W. Babb, Jr. | 1,261,154 |
| 137. | Thermo Fisher Scientific | Marc N. Casper | 1,254,808 |
| 138. | Vulcan Materials | Donald M. James | 1,250,004 |
| 139. | Cummins | N. Thomas Linebarger | 1,250,000 |
| 140. | Ingersoll-Rand | Michael W. Lamach | 1,250,000 |
| 141. | McDonald's | Donald Thompson | 1,250,000 |
| 142. | XL Group | Michael S. McGavick | 1,250,000 |
| 143. | Starwood Hotel & Resorts | Frits D. van Paasschen | 1,250,000 |
| 144. | Union Pacific | John J. Koraleski | 1,250,000 |
| 145. | AutoNation | Michael J. Jackson | 1,250,000 |
| 146. | Tenet Healthcare | Trevor Fetter | 1,250,000 |
| 147. | PG&E | Anthony F. Earley, Jr. | 1,250,000 |
| 148. | Simon Property Group | David E. Simon | 1,250,000 |
| 149. | Chesapeake Energy | Robert Douglas Lawler | 1,250,000 |

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|---|---|---|---|
| 150. | Anthem | Joseph R. Swedish | 1,250,000 |
| 151. | Staples | Ronald L. Sargent | 1,249,208 |
| 152. | Constellation Brands | Robert S. Sands II | 1,247,454 |
| 153. | DTE Energy | Gerard M. Anderson | 1,243,269 |
| 154. | Altria Group | Martin J. Barrington | 1,241,667 |
| 155. | Transocean | Steven L. Newman | 1,241,667 |
| 156. | American Electric Power | Nicholas K. Akins | 1,240,754 |
| 157. | Pinnacle West Capital | Donald E. Brandt | 1,240,000 |
| 158. | Baker Hughes | Martin S. Craighead | 1,236,538 |
| 159. | Marriott International | Arne M. Sorenson | 1,236,000 |
| 160. | Express Scripts Holding | George Paz | 1,235,385 |
| 161. | Fluor | David T. Seaton | 1,228,310 |
| 162. | Pentair | Randall J. Hogan III | 1,226,726 |
| 163. | Roper Technologies | Brian D. Jellison | 1,225,000 |
| 164. | International Flavors & Fragrances | Douglas D. Tough | 1,223,940 |
| 165. | Sherwin-Williams | Christopher M. Connor | 1,221,987 |
| 166. | Danaher | H. Lawrence Culp, Jr. | 1,217,778 |
| 167. | Nextera Energy | James L. Robo | 1,215,000 |
| 168. | GameStop | J. Paul Raines | 1,201,346 |
| 169. | Wal-Mart Stores | C. Douglas McMillon | 1,200,930 |
| 170. | General Mills | Kendall J. Powell | 1,200,650 |
| 171. | Newell Rubbermaid | Michael B. Polk | 1,200,000 |
| 172. | Exelon | Christopher M. Crane | 1,200,000 |
| 173. | Mosaic | James T. Prokopanko | 1,200,000 |
| 174. | Davita Healthcare Partners | Kent J. Thiry | 1,200,000 |
| 175. | PulteGroup | Richard J. Dugas, Jr. | 1,200,000 |
| 176. | XCEL Energy | Benjamin G. S. Fowke III | 1,200,000 |
| 177. | Coca-Cola Enterprises | John Franklin Brock III | 1,200,000 |
| 178. | Chipotle Mexican Grill | Montgomery F. Moran | 1,200,000 |
| 179. | Duke Energy | Lynn J. Good | 1,200,000 |
| 180. | CSX | Michael Jon Ward | 1,200,000 |

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|---|---|---|---|
| 181. | Chubb | Evan G. Greenberg | 1,200,000 |
| 182. | Hanesbrands | Richard A. Noll | 1,200,000 |
| 183. | General Growth Properties | Sandeep Lakhmi Mathrani | 1,200,000 |
| 184. | US Bancorp | Richard K. Davis | 1,200,000 |
| 185. | Edison International | Theodore F. Craver, Jr. | 1,200,000 |
| 186. | Eaton | Alexander M. Cutler | 1,200,000 |
| 187. | Eversource Energy | Thomas J. May | 1,196,325 |
| 188. | Sysco | William J. Delaney III | 1,194,583 |
| 189. | Harman International Industries | Dinesh C. Paliwal | 1,193,513 |
| 190. | Kellogg | John A. Bryant | 1,192,156 |
| 191. | Southern | Thomas A. Fanning | 1,192,067 |
| 192. | Harley-Davidson | Keith E. Wandell | 1,191,667 |
| 193. | CarMax | Thomas J. Folliard | 1,191,062 |
| 194. | Waste Management | David P. Steiner | 1,186,785 |
| 195. | AmerisourceBergen | Steven H. Collis | 1,185,962 |
| 196. | Ross Stores | Barbara Rentler | 1,182,723 |
| 197. | Rockwell Automation | Keith D. Nosbusch | 1,182,414 |
| 198. | Ametek | Frank S. Hermance | 1,181,500 |
| 199. | Mylan | Heather Bresch | 1,180,769 |
| 200. | Accenture | Pierre Nanterme | 1,179,798 |
| 201. | Best Buy | Hubert Joly | 1,175,000 |
| 202. | Coach | Victor Luis | 1,175,000 |
| 203. | TE Connectivity | Thomas J. Lynch | 1,172,308 |
| 204. | Hershey | John P. Bilbrey | 1,164,462 |
| 205. | Seagate Technology | Stephen J. Luczo | 1,153,886 |
| 206. | Mattel | Bryan G. Stockton | 1,150,000 |
| 207. | Valero Energy | Joseph W. Gorder | 1,150,000 |
| 208. | Sealed Air | Jerome A. Peribere | 1,150,000 |
| 209. | Ball | John A. Hayes | 1,149,327 |
| 210. | UNUM Group | Thomas R. Watjen | 1,145,154 |

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|---|---|---|---|
| 211. | Public Service Enterprise Group | Ralph Izzo | 1,142,307 |
| 212. | Allstate | Thomas J. Wilson II | 1,141,346 |
| 213. | Consolidated Edison | John McAvoy | 1,140,000 |
| 214. | Lincoln National | Dennis R. Glass | 1,135,000 |
| 215. | AES | Andrs Ricardo Gluski Weilert | 1,130,000 |
| 216. | Brown Forman | Paul C. Varga | 1,128,370 |
| 217. | Spectra Energy | Gregory L. Ebel | 1,127,500 |
| 218. | PPL | William H. Spence | 1,126,760 |
| 219. | Cigna | David M. Cordani | 1,125,185 |
| 220. | Noble Energy | Charles D. Davidson | 1,125,000 |
| 221. | Cameron International | Jack B. Moore | 1,125,000 |
| 222. | Sempra Energy | Debra L. Reed | 1,124,600 |
| 223. | Grainger | James T. Ryan | 1,123,500 |
| 224. | Kroger | W. Rodney McMullen | 1,123,393 |
| 225. | Humana | Bruce D. Broussard | 1,118,954 |
| 226. | Perrigo | John C. Papa | 1,117,500 |
| 227. | Frontier Communications | Mary Agnes Wilderotter | 1,110,417 |
| 228. | CMS Energy | John G. Russell | 1,110,000 |
| 229. | Scana | Kevin B. Marsh | 1,107,287 |
| 230. | Texas Instruments | Richard K. Templeton | 1,107,083 |
| 231. | Ecolab | Douglas M. Baker, Jr. | 1,103,277 |
| 232. | Entergy | Leo P. Denault | 1,103,173 |
| 233. | CenturyLink | Glen F. Post III | 1,100,000 |
| 234. | Conagra Foods | Gary M. Rodkin | 1,100,000 |
| 235. | Xerox | Ursula M. Burns | 1,100,000 |
| 236. | American Tower | James D. Taiclet, Jr. | 1,100,000 |
| 237. | Vertex Pharmaceuticals | Jeffrey M. Leiden | 1,100,000 |
| 238. | Cisco Systems | John T. Chambers | 1,100,000 |
| 239. | HCA Holdings | R. Milton Johnson | 1,099,979 |
| 240. | St. Jude Medical | Daniel J. Starks | 1,097,574 |
| 241. | Avery Dennison | Dean A. Scarborough | 1,095,000 |

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|---|---|---|---|
| 242. | Tyson Foods | Donnie Smith | 1,092,107 |
| 243. | Bard (C.R.) | Timothy M. Ring | 1,092,000 |
| 244. | Genuine Parts | Thomas C. Gallagher | 1,091,750 |
| 245. | Molson Coors Brewing | Peter S. Swinburn | 1,091,667 |
| 246. | PNC Financial Services | William S. Demchak | 1,089,615 |
| 247. | O'Reilly Automotive | Gregory L. Henslee | 1,087,500 |
| 248. | Illinois Tool Works | E. Scott Santi | 1,083,525 |
| 249. | Goodyear Tire & Rubber | Richard J. Kramer | 1,083,333 |
| 250. | Mohawk Industries | Jeffrey S. Lorberbaum | 1,082,144 |
| 251. | Leggett & Platt | David S. Haffner | 1,081,923 |
| 252. | Alliance Data Systems | Edward J. Heffernan | 1,081,500 |
| 253. | Textron | Scott C. Donnelly | 1,080,000 |
| 254. | Endo International | Rajiv K.L. De Silva | 1,079,167 |
| 255. | Newmont Mining | Gary J. Goldberg | 1,075,000 |
| 256. | Dr Pepper Snapple Group | Larry D. Young | 1,075,000 |
| 257. | Williams Cos. | Alan S. Armstrong | 1,072,308 |
| 258. | Regeneron Pharmaceuticals | Leondard S. Schleifer | 1,071,200 |
| 259. | Owens-Illinois | Albert P.L. Stroucken | 1,070,750 |
| 260. | Qualcomm | Steven M. Mollenkopf | 1,069,239 |
| 261. | Autodesk | Carl Bass | 1,060,323 |
| 262. | Mastercard | Ajaypal S. Banga | 1,058,333 |
| 263. | Raytheon | Thomas A. Kennedy | 1,057,698 |
| 264. | Stryker | Kevin A. Lobo | 1,055,000 |
| 265. | Western Digital | Stephen D. Milligan | 1,050,000 |
| 266. | Zoetis | Juan Ramn Alaix | 1,050,000 |
| 267. | Agilent Technologies | William P. Sullivan | 1,050,000 |
| 268. | SL Green Realty | Marc Holliday | 1,050,000 |
| 269. | Intercontinental Exchange | Jeffrey C. Sprecher | 1,050,000 |
| 270. | Ventas | Debra A. Cafaro | 1,050,000 |
| 271. | Quest Diagnostics | Stephen H. Ruschowksi | 1,050,000 |
| 272. | Fifth Third Bancorp | Kevin T. Kabat | 1,046,977 |

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| 273. | Cerner | Neal L. Patterson | 1,044,712 |
| 274. | Flowserve | Mark A. Blinn | 1,044,221 |
| 275. | Extra Space Storage | Spencer F. Kirk | 1,043,130 |
| 276. | Campbell Soup | Denise M. Morrison | 1,041,667 |
| 277. | FMC | Pierre R. Brondeau | 1,040,000 |
| 278. | Marathon Oil | Lee M. Tillman | 1,036,346 |
| 279. | Sandisk | Sanjay Mehrotra | 1,028,846 |
| 280. | Allergan | Paul M. Bisaro | 1,025,000 |
| 281. | Pepco Holdings | Joseph M. Rigby | 1,015,000 |
| 282. | Laboratory Corporation of America | David P. King | 1,013,000 |
| 283. | Snap-On | Nicholas T. Pinchuk | 1,012,500 |
| 284. | PerkinElmer | Robert F. Friel | 1,005,769 |
| 285. | Micron Technology | D. Mark Durcan | 1,005,289 |
| 286. | Iron Mountain | William L. Meaney | 1,003,846 |
| 287. | Hormel Foods | Jeffrey M. Ettinger | 1,000,220 |
| 288. | Omnicom | John D. Wren | 1,000,000 |
| 289. | Kraft Heinz | Bernardo Vieira Hees | 1,000,000 |
| 290. | Carnival | Arnold W. Donald | 1,000,000 |
| 291. | Public Storage | Ronald L. Havner, Jr. | 1,000,000 |
| 292. | Intuit | Brad D. Smith | 1,000,000 |
| 293. | E-Trade Financial | Paul Thomas Idzik | 1,000,000 |
| 294. | Yahoo | Marissa A. Mayer | 1,000,000 |
| 295. | Travelers | Jay S. Fishman | 1,000,000 |
| 296. | State Street | Joseph L. Hooley | 1,000,000 |
| 297. | Bank of New York Mellon | Gerald L. Hassell | 1,000,000 |
| 298. | BB&T | Kelly S. King | 1,000,000 |
| 299. | Church & Dwight | James R. Craigie | 1,000,000 |
| 300. | KeyCorp | Beth E. Mooney | 1,000,000 |
| 301. | Western Union | Hikmet Ersek | 1,000,000 |
| 302. | Lennar | Stuart A. Miller | 1,000,000 |
| 303. | EMC | Joseph M. Tucci | 1,000,000 |

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| 304. | Navient | John F. Remondi | 1,000,000 |
| 305. | Discover Financial Services | David W. Nelms | 1,000,000 |
| 306. | Nasdaq | Robert Greifeld | 1,000,000 |
| 307. | Leucadia National | Richard B. Handler | 1,000,000 |
| 308. | McCormick | Alan D. Wilson | 1,000,000 |
| 309. | Republic Services | Donald W. Slager | 1,000,000 |
| 310. | Norfolk Southern | Charles W. Moorman IV | 1,000,000 |
| 311. | Fidelity National Information Services | Frank R. Martire | 1,000,000 |
| 312. | Intel | Brian M. Krzanich | 1,000,000 |
| 313. | Charles Schwab | Walter W. Bettinger II | 1,000,000 |
| 314. | AutoZone | William C. Rhodes III | 1,000,000 |
| 315. | CME Group | Phupinder S. Gill | 1,000,000 |
| 316. | Macerich | Arthur M. Coppola | 1,000,000 |
| 317. | eBay | John J. Donahoe II | 1,000,000 |
| 318. | Assurant | Robert B. Pollock | 1,000,000 |
| 319. | CA | Michael P. Gregoire | 1,000,000 |
| 320. | Huntington Bancshares | Stephen D. Steinour | 1,000,000 |
| 321. | Willis Towers Watson | Dominic J. Casserley | 1,000,000 |
| 322. | Expedia | Dara Khosrowshahi | 1,000,000 |
| 323. | Royal Caribbean Cruises | Richard D. Fain | 1,000,000 |
| 324. | Vornado Realty Trust | Steven Roth | 1,000,000 |
| 325. | Moody’s | Raymond W. McDaniel, Jr. | 1,000,000 |
| 326. | Amphenol | Richard Adam Norwitt | 1,000,000 |
| 327. | Tegna | Gracia C. Martore | 1,000,000 |
| 328. | Mead Johnson Nutrition | Peter Kasper Jakobsen | 1,000,000 |
| 329. | Dover | Robert A. Livingston | 1,000,000 |
| 330. | Nielsen Holdings | Dwight Mitchell Barns | 998,462 |
| 331. | Nvidia | Jen-Hsun Huang | 998,418 |
| 332. | Tiffany & Co. | Michael J. Kowalski | 997,315 |
| 333. | Aetna | Mark T. Bertolini | 996,169 |
| 334. | People’s United Financial | John P. Barnes | 994,712 |

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|---|---|---|---|
| 335. | Regions Financial | O.B. Grayson Hall, Jr. | 993,750 |
| 336. | Tyco International | George R. Oliver | 993,750 |
| 337. | Adobe Systems | Shantanu Narayen | 991,667 |
| 338. | Quanta Services | James F. O'Neil III | 987,500 |
| 339. | Eastman Chemical | Mark J. Costa | 987,316 |
| 340. | Home Depot | Francis S. Blake | 987,000 |
| 341. | Becton Dickinson | Vincent A. Forlenza | 985,000 |
| 342. | H&R Block | William C. Cobb | 984,948 |
| 343. | Pioneer Natural Resources | Scott Douglas Sheffield | 984,769 |
| 344. | Broadcom | Scott A. McGregor | 983,769 |
| 345. | Principal Financial Group | Larry Donald Zimpleman | 982,692 |
| 346. | Applied Materials | Gary E. Dickerson | 980,000 |
| 347. | J.M. Smucker | Richard K. Smucker | 980,000 |
| 348. | Level 3 Communications | Jeffrey K. Storey | 978,846 |
| 349. | Plum Creek Timber | Rick R. Holey | 978,500 |
| 350. | Loews | James S. Tisch | 975,000 |
| 351. | Northern Trust | Frederick H. Waddell | 975,000 |
| 352. | United Continental Holdings | Jeffrey A. Smisek | 975,000 |
| 353. | FMC Technologies | John T. Gremp | 974,167 |
| 354. | PACCAR | Ronald E. Armstrong | 972,115 |
| 355. | AGL Resources | John W. Somerhalder II | 969,506 |
| 356. | Borgwarner | James R. Verrier | 967,500 |
| 357. | Keurig Green Mountain | Brian P. Kelley | 966,807 |
| 358. | NetApp | Thomas Georgens | 962,500 |
| 359. | Rockwell Collins | Robert K. Ortberg | 955,769 |
| 360. | Visa | Charles W. Scharf | 950,037 |
| 361. | M&T Bank | Robert G. Wilmers | 950,000 |
| 362. | United Rentals | Michael J. Kneeland | 950,000 |
| 363. | Weyerhaeuser | Doyle R. Simons | 950,000 |
| 364. | Oracle | Mark Vincent Hurd | 950,000 |
| 365. | AvalonBay Communities | Timothy J. Naughton | 950,000 |

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| 366. | Nucor | John J. Ferriola | 950,000 |
| 367. | Ameriprise Financial | James M. Cracchiolo | 950,000 |
| 368. | Nisource | Robert C. Skaggs, Jr. | 946,667 |
| 369. | Columbia Pipeline Group | Robert C. Skaggs, Jr. | 946,667 |
| 370. | Dentsply International | Bret W. Wise | 940,000 |
| 371. | Zimmer Biomet Holdings | David C. Dvorak | 934,919 |
| 372. | Crown Castle International | W. Benjamin Moreland | 934,808 |
| 373. | Varian Medical Systems | Dow R. Wilson | 934,616 |
| 374. | Tractor Supply | Gregory A. Sandfort | 934,615 |
| 375. | Advance Auto Parts | Darren R. Jackson | 930,288 |
| 376. | Martin Marietta Materials | C. Howard Nye | 928,755 |
| 377. | Host Hotels & Resorts | W. Edward Walter | 925,000 |
| 378. | SunTrust Banks | William Henry Rogers, Jr. | 925,000 |
| 379. | Cincinnati Financial | Steven J. Johnston | 922,846 |
| 380. | Boston Scientific | Michael F. Mahoney | 921,302 |
| 381. | Harris | William M. Brown | 921,154 |
| 382. | Zions Bancorporation | Harris H. Simmons | 920,000 |
| 383. | Microsoft | Satya Nadella | 918,917 |
| 384. | Hartford Financial Services | Christopher John Swift | 912,500 |
| 385. | Westrock | Steven C. Voorhees | 907,917 |
| 386. | EOG Resources | William R. Thomas | 906,731 |
| 387. | Mallinckrodt | Mark Christopher Trudeau | 905,769 |
| 388. | Range Resources | Jeffrey L. Ventura | 904,275 |
| 389. | ADT | Naren K. Gursahaney | 900,026 |
| 390. | Automatic Data Processing | Carlos A. Rodriguez | 900,000 |
| 391. | Centerpoint Energy | Scott M. Prochazka | 900,000 |
| 392. | Equity Residential | David J. Neithercut | 900,000 |
| 393. | Citrix Systems | Mark B. Templeton | 900,000 |
| 394. | Red Hat | James M. Whitehurst | 900,000 |

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| 395. | Blackrock | Laurence Douglas Fink | 900,000 |
| 396. | Allegion | David D. Petratis | 900,000 |
| 397. | Southwestern Energy | Steven L. Mueller | 900,000 |
| 398. | Edwards Lifesciences | Michael A. Mussallem | 900,000 |
| 399. | McGraw Hill Financial | Douglas L. Peterson | 900,000 |
| 400. | KLA-Tencor | Richard P. Wallace | 900,000 |
| 401. | Paychex | Martin Mucci | 893,231 |
| 402. | Pitney Bowes | Marc B. Lautenbach | 891,667 |
| 403. | Cabot Oil & Gas | Dan O. Dinges | 885,592 |
| 404. | Synchrony Financial | Margaret M. Keane | 881,250 |
| 405. | Electronic Arts | Andrew Wilson | 880,769 |
| 406. | Kansas City Southern | David L. Starling | 875,500 |
| 407. | Airgas | Michael L. Molinini | 875,500 |
| 408. | CBRE Group | Robert E. Sulentic | 875,000 |
| 409. | National Oilwell Varco | Clay C. Williams | 871,154 |
| 410. | Reynolds American | Susan M. Cameron | 866,667 |
| 411. | CF Industries Holdings | W. Anthony Will | 860,000 |
| 412. | Verisk Analytics | Scott G. Stephenson | 860,000 |
| 413. | Illumina | Jay T. Flatley | 859,192 |
| 414. | Signet Jewelers | Michael W. Barnes | 858,248 |
| 415. | Ameren | Warner L. Baxter | 854,647 |
| 416. | Juniper Networks | Shaygan Kheradpir | 854,167 |
| 417. | Dun & Bradstreet | Robert P. Carrigan | 850,000 |
| 418. | Newfield Exploration | Lee K. Boothby | 850,000 |
| 419. | Prologis | Hamid R. Moghadam | 850,000 |
| 420. | EQT | David L. Porges | 850,000 |
| 421. | Cimarex Energy | Thomas E. Jorden | 845,048 |
| 422. | Masco | Keith J. Allman | 842,788 |
| 423. | Cintas | Scott D. Farmer | 840,474 |
| 424. | Fiserv | Jeffery W. Yabuki | 840,000 |
| 425. | Baxalta | Ludwig N. Hantson | 833,846 |

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| 426. | Diamond Offshore Drilling | Marc Gerard Rex Edwards | 833,333 |
| 427. | United Parcel Service | D. Scott Davis | 830,835 |
| 428. | Avago Technologies | Hock E. Tan | 827,692 |
| 429. | Total System Services | Phillip W. Tomlinson | 827,000 |
| 430. | Torchmark | Larry M. Hutchison | 821,058 |
| 431. | Equinix | Stephen M. Smith | 804,231 |
| 432. | LAM Research | Martin B. Anstice | 803,846 |
| 433. | HCP | Lauralee E. Martin | 800,000 |
| 434. | Kimco Realty | David B. Henry | 800,000 |
| 435. | Realty Income | John P. Case | 800,000 |
| 436. | Teradata | Michael F. Koehler | 800,000 |
| 437. | Waters | Douglas A. Berthiaume | 797,258 |
| 438. | Delta Air Lines | Richard H. Anderson | 790,625 |
| 439. | Invesco | Martin L. Flanagan | 790,000 |
| 440. | Xilinx | Moshe N. Gavrielov | 787,500 |
| 441. | TECO Energy | John B. Ramil | 785,000 |
| 442. | Franklin Resources | Gregory Eugene Johnson | 780.132 |
| 443. | Helmerich & Payne | John W. Lindsay | 769,949 |
| 444. | Ryder System | Robert E. Sanchez | 753,750 |
| 445. | Verisign | D. James Bidzos | 752,885 |
| 446. | Progressive | Glenn M. Renwick | 750,000 |
| 447. | Affiliated Managers Group | Sean Michael Healey | 750,000 |
| 448. | Priceline Group | Darren R. Huston | 750,000 |
| 449. | Boston Properties | Owen D. Thomas | 750,000 |
| 450. | First Solar | James A. Hughes | 750,000 |
| 451. | Skyworks Solutions | David J. Aldrich | 747,769 |
| 452. | Analog Devices | Vincent T. Roche | 743,846 |
| 453. | Consol Energy | Nicholas J. Deiuliis | 738,500 |
| 454. | FLIR Systems | Andrew C. Teich | 726,692 |
| 455. | Nordstrom | Blake W. Nordstrom | 722,986 |
| 456. | Xylem | Patrick K. Decker | 711,538 |

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| 457. | ONEOK | Terry K. Spencer | 700,000 |
| 458. | J.B. Hunt Transport Services | John N. Roberts III | 695,000 |
| 459. | American Airlines | William Douglas Parker | 687,884 |
| 460. | Southwest Airlines | Gary C. Kelly | 675,000 |
| 461. | Garmin | Clifton A. Pemble | 665,002 |
| 462. | Costco Wholesale | W. Craig Jelinek | 650,000 |
| 463. | Cognizant Technology Solutions | Francisco D'souza | 626,000 |
| 464. | Microchip Technology | Stephen Sanghi | 624,897 |
| 465. | Patterson Companies | Scott P. Anderson | 619,353 |
| 466. | Monster Beverage | Rodney C. Sacks | 600,000 |
| 467. | Apartment Investment & Management | Terry Considine | 600,000 |
| 468. | Target | Brian C. Cornell | 595,000 |
| 469. | Welltower | Thomas J. DeRosa | 590,721 |
| 470. | Intuitive Surgical | Gary S. Guthart | 587,083 |
| 471. | Fastenal | Willard D. Oberton | 570,000 |
| 472. | Linear Technology | Lothar Maier | 550,962 |
| 473. | Essex Property Trust | Michael J. Schall | 550,000 |
| 474. | Ensco | Carl G. Trowell | 544,985 |
| 475. | Robert Half International | Harold Max Messmer, Jr. | 525,000 |
| 476. | Clorox | Benno Dorer | 522,669 |
| 477. | CSRA | Lawrence B. Prior III | 505,077 |
| 478. | Legg Mason | Joseph A. Sullivan | 500,000 |
| 479. | Tripadvisor | Stephen Kaufer | 500,000 |
| 480. | D.R. Horton | David V. Auld | 500,000 |
| 481. | Whole Foods Market | Walter E. Robb III | 472,350 |
| 482. | Darden Restaurants | Clarence Otis, Jr. | 469,212 |
| 483. | C.H. Robinson Worldwide | John P. Wiehoff | 410,000 |
| 484. | F5 Networks | Manuel F. Rivelo | 405,563 |
| 485. | Stericycle | Charles A. Alutto | 379,615 |

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| 486. | T. Rowe Price Group | James Aloysius Charles Kennedy | 350,000 |
| 487. | Air Products & Chemicals | Seifollah Ghasemi | 295,385 |
| 488. | PayPal Holdings | Daniel H. Schulman | 204,231 |
| 489. | Expeditors International of Washington | Jeffrey S. Musser | 100,000 |
| 490. | Berkshire Hathaway | Warren E. Buffett | 100,000 |
| 491. | Amazon.com | Jeffrey P. Bezos | 81,840 |
| 492. | Under Armour | Kevin A. Plank | 26,000 |
| 493. | Kinder Morgan | Richard D. Kinder | 1 |
| 494. | Urban Outfitters | Richard A. Hayne | 1 |
| 495. | Akamai Technologies | F. Thomson Leighton | 1 |
| 496. | Alphabet | Lawrence Edward Page | 1 |
| 497. | Facebook | Mark Zuckerberg | 1 |
| 498. | Capital One Financial | Richard D. Fairbank | 0 |