



Executive Pay Ratio Business Surtax

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Revenue Division

Bureau of Revenue and Financial Services

Office of Management and Finance

Background

This document will briefly review the feasibility of instituting a Business License Tax (PCC 7.02) surtax on publicly traded companies subject to new Securities and Exchange Commission (SEC) reporting requirements pertaining to the ratio of CEO to median employee compensation. The surtax would apply to ratios deemed excessive by the Portland City Council, should it choose to adopt an ordinance enacting the surtax.

On August 5, 2015, the SEC adopted a final rule that requires publicly traded companies subject to SEC reporting requirements to disclose the ratio of the compensation of chief executive officers (CEOs) to the median compensation of their employees. The new rule, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, is intended to provide shareholders with information they can use to evaluate a CEO's compensation and will require disclosure of the pay ratio in registration statements, proxy and information statements, and annual reports that call for executive compensation disclosure. Companies will be required to provide disclosure of their pay ratios for their first fiscal year beginning on or after January 1, 2017.¹

In 2014 the California State Senate considered but did not pass Senate Bill 1372 which would have enacted a new, higher tax rate on all publicly traded corporations. The bill also proposed reducing the corporate tax rate *for publicly traded corporations in which the CEO's pay was less than 100 times that of the median worker*. The lowest tax rate would have been seven (7) percent for any company whose chief executive is paid less than 25 times the median.²

In 2014 the Rhode Island State Senate passed a bill that would give preference in state contracts to companies with small differences between CEO and worker pay, but the legislation was defeated in the House of Representatives. Switzerland and Massachusetts have also shown interest in enacting similar measures.³

Legal Considerations

Summary of Estimated Revenues

The Revenue Division computed potential surtax revenues using a surtax of 10% for taxpayers with a CEO to median worker compensation ratio of 100:1 or greater, and 25% for taxpayers with a ratio of 250:1 or greater.

There are currently at least 545 publicly traded companies subject to and paying the City of Portland Business License Tax that would be subject to the proposed surtax.⁵ Collectively, their Portland tax liability was \$17.9 million based on recent tax filings.⁶ CEO compensation derived from Annual Proxy Statements and information gathered from the

¹ SEC press release, "SEC Adopts Rule for Pay Ratio Disclosure," August 4, 2015. SEC website, <http://www.sec.gov/news/pressrelease/2015-160.html> : accessed January 12, 2016.

² CBS SF Bay Area, "California Lawmakers Reject Bill To Tie Corporate Tax Rate with CEO Pay," May 28, 2014, <http://sanfrancisco.cbslocal.com/2014/05/28/california-lawmakers-reject-bill-to-tie-corporate-tax-rate-with-ceo-pay-wealth-gap-income-inequality-taxes-executive-compensation-workers-salary/> : accessed January 12, 2016.

³ The Boston Globe, "Efforts to regulate CEO pay gain traction," October 26, 2014, <https://www.bostonglobe.com/business/2014/10/25/growing-effort-limit-ceo-pay/1VKKZCuZMkXJvaQRmUb4RN/story.html> : accessed March 17, 2016.

⁵ 160 of these are Fortune 500 companies paying a combined \$6.7 million.

⁶ Revenue Division data extracted from the Business License Information System based on tax year 2013 and 2014 filings. \$17.9 million is a little under 20% of total Business License Tax revenues from all business activity in Portland.

Economic Policy Institute was used to estimate CEO to median worker compensations ratios, and therefore whether each company would be subject to 10%, 25% or no surtax.⁷

Based on our analysis of identified subject taxpayers, annual tax revenues are projected to be between \$2.5 million and \$3.5 million. 88% of projected tax revenues are expected to come from the top 10% of taxpayers, and 96% is expected to come from the top 20% of the taxpayers. Compliance is expected to be 95% or higher.

Surtax Structure Recommended

For ease of administration and taxpayer understanding, the Revenue Division recommends adopting a surtax methodology instead of a differential tax rate. The Revenue Division has experience administering a similar surtax for school funding in tax years 2002 through 2007. A surtax is a tax upon a tax; in this case computed by multiplying the surtax rate by the base tax liability (in contrast to reported net income). Under this approach, a company that has no tax liability will have no surtax owed even if their CEO pay ratio is above the threshold Council sets, unless a minimum flat surtax assessment is adopted as well.⁸

City Administrative Expenses and Workload

Administration of such a tax would include modifying tax report forms to include CEO compensation as reported to the SEC, verifying reported ratio information with the SEC, and data entry work. Total additional workload is estimated at approximately 0.5 FTE, or about \$50,000 annually plus modest one-time expenses to modify data systems. The program could not start before tax year 2017 (due in 2018) because the SEC reporting requirement does not begin until fiscal years beginning on or after January 1, 2017.

⁷ EPI Report, "Methodology for measuring CEO compensation and the ratio of CEO-to-worker compensation, 2012 data update," June 26, 2013. EPI website, <http://www.epi.org/publication/methodology-measuring-ceo-compensation-ratio/>; accessed March 17, 2016.

⁸ An alternative minimum flat surtax structure may need additional legal review.