FAST FOOD CEOs RAKE IN TAXPAYER-SUBSIDIZED PAY

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About the Author and IPS:

Sarah Anderson directs the Global Economy Project at the Institute for Policy Studies and has co-authored 20 IPS annual reports on executive compensation.

Cover design: Emily Norton.

The Institute for Policy Studies (IPS) is a multi-issue research center that has conducted path-breaking research on executive compensation for 20 years. The 2013 edition of their annual Executive Excess report received significant media coverage, including in the Wall Street Journal and Los Angeles Times. The May 2013 IPS report ‘Fix the Debt’ CEOs Enjoy Taxpayer-Subsidized Pay was the first to put a price tag on the tax breaks specific corporations have enjoyed from the “performance pay” loophole. IPS has also produced detailed analyses of the tax and executive retirement policies of CEOs engaged in the budget debate.

Institute for Policy Studies
1112 16th St. NW, Suite 600
Washington, DC 20036
202 234-9382
www.IPS-dc.org
Twitter: @IPS_DC
Find us on Facebook: http://www.facebook.com/InstituteforPolicyStudies
Email: sarah@ips-dc.org
Taxpayer Subsidies for CEO Pay in the Fast Food Industry

Fast food companies are pocketing massive taxpayer subsidies for CEO pay while working to keep low-level workers’ wages so low that many must rely on public assistance.

These CEO pay subsidies are the result of a loophole that allows firms to deduct unlimited amounts from their income taxes for the cost of stock options, certain stock grants, and other forms of so-called “performance pay” for top executives. Put simply: the more corporations pay their CEOs, the less they pay in federal taxes. And ordinary taxpayers wind up footing the bill.

- During the past two years, the CEOs of the top six publicly held fast food chains pocketed more than $183 million in fully deductible “performance pay,” lowering their companies’ IRS bills by an estimated $64 million.

- **YUM! Brands** enjoyed the biggest taxpayer subsidy for its CEO pay largesse. This firm, which owns Taco Bell, KFC, and Pizza Hut, paid CEO David Novak $94 million in fully deductible “performance pay” over the years 2011 and 2012. That works out to a $33 million taxpayer subsidy to YUM! – just for one executive’s pay.

- **McDonald’s** received the second-largest government handout. As CEO in 2011 and the first half of 2012, James Skinner pocketed $31 million in exercised stock options and other fully deductible “performance pay.” Incoming CEO Donald Thompson took in $10 million in performance pay in his first six months on the job. Skinner and Thompson’s combined performance pay translates into a $14 million taxpayer subsidy for McDonald’s.

For details, see table on following page.

Taxpayers are not only subsidizing excessive CEO pay at the fast food giants, they are also subsidizing these firms’ low-road business model. The fast food industry is notorious for low wages, lack of benefits, and limited work hours. This model boosts corporate profits – and CEO paychecks – by shifting social welfare costs onto ordinary U.S. taxpayers. A study by University of California-Berkeley researchers found that more than half of front-line fast food workers rely on at least one public assistance program — at a cost of nearly $7 billion per year.

The National Employment Law Project analyzed the fast food companies that employ the most U.S. workers and estimated the annual cost of public assistance provided to their employees. For example, McDonald’s employees turn to Medicaid and other anti-poverty programs for an estimated $1.2 billion in assistance per year. YUM Brands employees rely on nearly $650 million in such public assistance annually.

All of the fast food corporations included in this survey are members of the National Restaurant Association, which is aggressively working to block a raise in the federal minimum wage, as well as a raise in the federal minimum for tipped workers, which has remained at $2.13 per hour for the past 22 years.
# “Performance Pay” Tax Breaks for Top Six Fast Food Companies, 2011-2012

<table>
<thead>
<tr>
<th>Company (ranked by sales)</th>
<th>CEO</th>
<th>Total CEO compensation (taxable in year surveyed)</th>
<th>Portion of CEO compensation that is &quot;performance-based&quot;</th>
<th>Value of &quot;performance pay&quot; corporate tax break</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>McDonald's</strong> 2012 sales: $27.6bn 2012 profits: $5.4bn</td>
<td>Donald Thompson—2012 (succeeded Skinner on 6/30/12)</td>
<td>12,775,517</td>
<td>10,071,534</td>
<td>3,525,037</td>
</tr>
<tr>
<td></td>
<td>James A. Skinner—2012</td>
<td>35,683,583</td>
<td>23,297,721</td>
<td>8,154,202</td>
</tr>
<tr>
<td></td>
<td>James A. Skinner—2011</td>
<td>13,181,774</td>
<td>7,656,417</td>
<td>2,679,746</td>
</tr>
<tr>
<td></td>
<td>David C. Novak—2011</td>
<td>47,000,342</td>
<td>45,217,127</td>
<td>15,825,994</td>
</tr>
<tr>
<td></td>
<td>Roland Smith—2011</td>
<td>16,049,023</td>
<td>3,390,332</td>
<td>1,186,616</td>
</tr>
<tr>
<td><strong>Burger King</strong> 2012 sales: $1.9bn 2012 profits: $117.7mn</td>
<td>Bernardo Hees—2012 (Burger King was not a publicly traded company in 2011)</td>
<td>2,321,472</td>
<td>1,321,472</td>
<td>462,515</td>
</tr>
<tr>
<td></td>
<td>J. Patrick Doyle—2011</td>
<td>7,772,170</td>
<td>6,772,170</td>
<td>2,370,260</td>
</tr>
<tr>
<td><strong>Dunkin' Brands</strong> (Dunkin' Donuts and Baskin Robbins) 2012 sales: $658.2mn 2012 profits: $108.3mn</td>
<td>Nigel Travis—2012</td>
<td>22,960,678</td>
<td>21,960,678</td>
<td>7,686,237</td>
</tr>
<tr>
<td></td>
<td>Nigel Travis—2011</td>
<td>1,957,925</td>
<td>957,925</td>
<td>335,274</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>229,064,597</td>
<td>182,982,103</td>
<td>64,043,736</td>
</tr>
<tr>
<td><strong>Avg per CEO</strong></td>
<td></td>
<td>19,088,716</td>
<td>15,248,509</td>
<td>5,336,978</td>
</tr>
<tr>
<td><strong>Avg per company</strong></td>
<td></td>
<td>38,177,433</td>
<td>30,497,017</td>
<td>10,673,956</td>
</tr>
</tbody>
</table>

Source: Company 10-K reports and proxy statements. For details on methodology, see appendix.
Ending Taxpayer Subsidies for Excessive Executive Pay

The “performance pay” loophole was created in 1993, when Congress passed legislation that capped the tax deductibility of executive pay at $1 million – but with a huge exemption. Corporations could still deduct unlimited amounts of “performance-based” pay from their federal income taxes.

This loophole quickly led to an explosion of “performance-based” compensation, particularly stock options. This form of compensation encourages executives to carry out short-sighted, reckless actions aimed at boosting stock prices in order to inflate the value of their own options. And while often touted as a way to align the interests of executives and shareholders, in practice, boards often respond to declining share prices by doling out huge new options grants with lower exercise prices. For example, after the crash of 2008, Goldman Sachs handed executives nearly 36 million stock options — ten times the previous year’s total.

To close this perverse “performance pay” loophole, Senators Jack Reed (D-RI) and Richard Blumenthal (D-CT) have introduced the Stop Subsidizing Multimillion Dollar Corporate Bonuses Act (S. 1476). The bill would allow a publicly traded corporation to deduct only up to $1 million in pay per employee – with no exceptions. The Joint Committee on Taxation estimates this legislation would generate more than $50 billion over 10 years.

Rep. Barbara Lee (D-Calif.) has introduced a variation on the Reed-Blumenthal bill, the Income Equity Act (H.R. 199), that would deny all firms tax deductions on any executive pay that runs over 25 times the pay of a firm’s lowest-paid employee or $500,000, whichever is higher.

These bills do not set a ceiling on, or dictate in any way, how much corporations can pay their executives. Corporations could still freely pay their executives outlandishly large sums. But the federal government — and average American taxpayers — would no longer pick up the tab.

The Income Equity Act could have an important impact on lower-level workers as well. By including the option of limiting deductibility to no more than 25 times the pay of the lowest-paid employee, Rep. Lee’s bill would encourage corporations to raise pay at the bottom of the corporate pay ladder. The greater the pay for a company’s lowest-paid worker, the higher the tax-deductible pay for the company’s highest-paid executives.

These bills would build on precedents in the TARP and the Affordable Care Act that set a $500,000 deductibility cap on pay for bailout recipients and health insurance firms. The deductibility caps on health insurance firms, designed to discourage these corporations from using profits from premiums to overcompensate their executives, go into effect this year.
Appendix: Methodology

Total CEO Compensation

Institute for Policy Studies analysis based on corporate proxy statements. To analyze the tax implications, we included forms of pay that were taxable for the corporation in the years surveyed: salary, bonus, non-equity incentives, perks, and the value of options realized and vested stock. Corporations do not deduct the expense of stock options until the year in which they are exercised and do not deduct the expense of stock award grants until the year they “vest” (i.e., become the property of the employee).

Portion of compensation that is "performance-based":

Internal Revenue Code Section 162(m) imposes a $1 million deduction limit for compensation to a company’s CEO and its three other highest-paid executive officers (excluding the CFO), unless the compensation is “performance-based” and provided under a plan that has been approved by the shareholders. To analyze the tax implications in the years surveyed, we included forms of “performance” pay that were taxable for the corporation in those years.

Bonus: Included only if the proxy statement explicitly stated that the annual bonus had been configured to be 162(m)-compliant. Generally, this form of compensation is not considered performance-based because corporate boards typically do not award bonuses pursuant to a written plan approved by shareholders, one of the conditions for qualifying as “performance-based” under Section 162(m). In our sample, only Wendy’s CEO Roland Smith’s 2011 annual bonus was clearly configured to be tax-deductible.

Non-equity incentive plan compensation:
Similar to a bonus, but paid under a written plan and thus considered “performance-based.”

Stock options: We included the value of options exercised, rather than the estimated value of a stock options grant, since stock options do not become taxable until an executive exercises them. More than half of the “performance pay” of the CEOs surveyed was in the form of exercised options.

Stock grants: Considered “performance-based” under 162(m) only when tied to specific performance benchmarks. Purely time-based benchmarks do not qualify for the “performance-based” exemption. Like stock options, stock grants are not taxable in the year they are granted, but rather when they “vest” (i.e., become the property of the employee). For all of the CEOs surveyed who had vested stock in 2011 and/or 2012, the proxies clearly linked this compensation to specific performance criteria. (CEOs of Burger King and Dunkin’ were the only ones without vested stock.)

Salary, perks, pensions, and deferred compensation are not performance-based.

Value of “performance pay” corporate tax break:

Corporations can deduct up to $1 million of each executive’s compensation whether it is “performance-based” or not. Thus, for CEOs who had earned less than $1 million in non-performance-based pay, we deducted the difference from the performance pay total. (This was the case for Dunkin’ Brands and Burger King in all years surveyed and for Domino’s in 2011.) To compute the tax break on deducted executive pay, we then applied a 35 percent tax rate, the statutory federal corporate income tax rate.