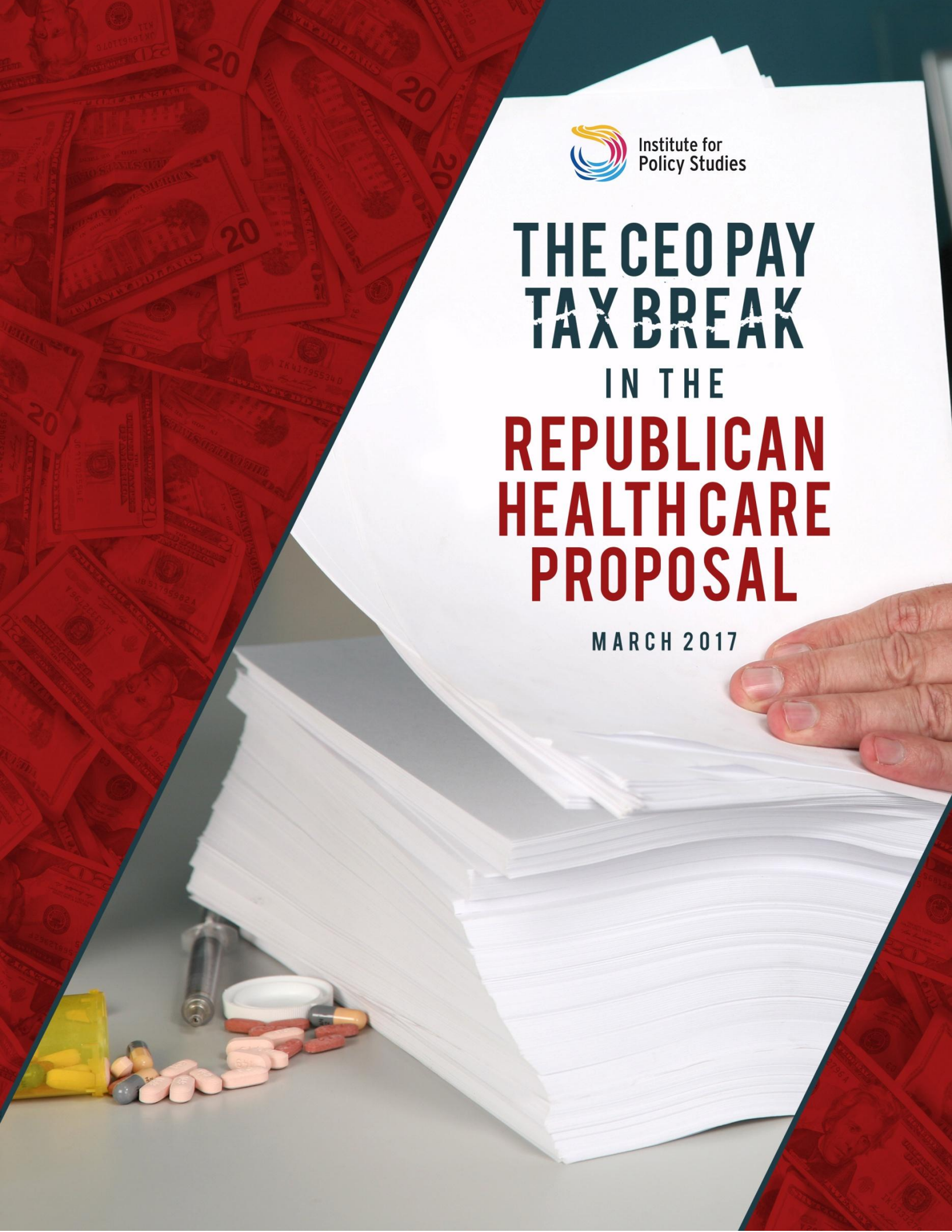




Institute for
Policy Studies

THE CEO PAY TAX BREAK IN THE REPUBLICAN HEALTHCARE PROPOSAL

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The **Institute for Policy Studies** (www.IPS-dc.org) is a 54-year-old multi-issue research center that has conducted path-breaking research on executive compensation for more than 20 years.

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Key findings

The House Republican plan to replace the Affordable Care Act would give health insurance companies a huge tax break on their executive compensation, encouraging them to dole out even larger pay packages to their already overpaid top managers.

The plan would re-introduce a tax loophole that allows corporations unlimited deductions for executive pay — as long as the pay is in the form of stock options or other so-called “performance” compensation. Obamacare eliminated this loophole for health insurance companies, imposing a strict \$500,000 limit on deductions for the expense of each executive’s compensation. This set an important precedent for reducing taxpayer subsidies for CEO pay.

To better understand the taxpayer savings from the Obamacare CEO pay reform, the Institute for Policy Studies has analyzed executive pay at the five largest U.S. publicly held health insurance companies in 2015, the most recent year for which data are available for all five firms.

- The ACA deductibility limits generated an estimated \$92 million in additional public revenue in 2015 from just these companies (Aetna, Anthem, Cigna, Humana, and UnitedHealth). On average, these corporations owed an extra \$3.5 million in taxes per executive.
- This \$92 million in savings from limiting pay-related deductions for just 26 executives is the equivalent of the average annual ACA premium subsidies for 28,500 Americans.
- The insurer that paid the most in federal taxes associated with their top five executives in 2015 was Cigna. The company paid an estimated \$33 million more than they would’ve if the Obamacare deductibility cap had not been in place.
- These figures provide an incomplete picture of potential taxpayer savings. The deductibility cap covers all employees, but pay information is available only for each firm’s top five executives. Moreover, in 2015 the cap did not apply to \$41 million in stock options gains because the options had been granted before Obamacare went into effect.
- The [Joint Committee on Taxation](#) estimates that eliminating the ACA cap would cost \$400 million over nine years. Our calculations suggest this is very conservative. The CEOs of these five firms are already sitting on \$268 million in outstanding stock options alone. At current market values, they would owe \$94 million under the ACA cap when these options become taxable. Without the cap, they would likely be fully deductible.

Instead of re-introducing this perverse “CEO bonus loophole” for health insurance companies, lawmakers should expand the Obamacare deductibility cap to all major U.S. corporations. This would save taxpayers at least [\\$50 billion over 10 years](#) while encouraging more reasonable executive pay levels.

Background on the Obamacare CEO pay reform

Some lawmakers who backed Obamacare worried that health insurance executives would profiteer from their expanded customer base by lining their own pockets instead of lowering rates and improving services. To discourage such profiteering, they eliminated what they called “[irresponsible tax breaks](#)” for millionaire health insurance executives.”

Specifically, the legislation tightened existing federal limits on how much executive pay corporations can deduct off their corporate income taxes. These existing limits had come into effect in 1993, amid an earlier wave of public outrage over runaway executive pay. Congress responded with Section 162(m) of the tax code, which capped the total executive pay corporations could deduct off their taxes at no more than \$1 million for each of their top four executives. Firms would still be free to pay their executives however much they wanted. But average American taxpayers would no longer pick up the tab for oversized paychecks.

Unfortunately, the 1993 tax deductibility cap came with a huge loophole — an exception for so-called “performance pay” — that has essentially rendered the cap meaningless. Thanks to this loophole, corporations can deduct unlimited amounts of stock options, as well as other stock awards and bonuses tied to “performance” targets.

Corporations responded to this loophole by handing out massive, fully deductible stock option and performance stock grants that dramatically boosted CEO pay levels. On average, about [80 percent](#) of executive compensation packages today are “performance-based.” These equity-based forms of pay also became a powerful incentive for reckless executive behaviors that jack up share prices in the short term and undermine corporate health and even the broader economy in the long term. The 2008 financial crisis is just the most extreme example.

By closing a tax loophole that benefits only a handful of individuals, the Affordable Care Act aimed to encourage more rational executive pay levels — or at least to increase corporate contributions to the tax base needed to support national infrastructure and vital public services. Thus far, we have not seen a measurable impact on pay levels. In fact in 2015, the five largest publicly held insurers awarded their CEOs average total compensation of \$14.6 million,

Key points of the Obamacare executive pay reform

For major health insurance companies, the law:

- lowers the cap on the deductibility of executive compensation from federal corporate income taxes from \$1 million to \$500,000 per executive per year
- eliminates an exception from the cap for stock options and other “performance-based” pay
- extends the cap to all employees of the firm. Previously, the cap applied only to four executives (the CEO and next three highest-paid officers, excluding the CFO)

including the estimated value of stock and options grants. That's up 33 percent from \$10.9 million in 2012, the year before the 2013 launch of the Affordable Care Act.

One obvious reason for this limited impact on pay levels: health insurance companies are recruiting from the same pool as firms that are not subject to this deductibility cap. Board members likely argue that a huge pay cut would result in the loss of "top talent" to firms in other sectors. Congress could easily address this worry by extending the Affordable Care Act deductibility limits to all corporations.

Proposals to eliminate the CEO bonus loophole for all firms

Senators Jack Reed (D-RI) and Richard Blumenthal (D-CT) have introduced the Stop Subsidizing Multimillion Dollar Corporate Bonuses Act ([S. 82](#)), legislation that would keep the \$1 million deductibility cap but remove the "performance pay" loophole and cover all employees of a corporation. Rep. Lloyd Doggett (D-TX) has introduced a companion bill ([H.R. 399](#)) in the U.S. House of Representatives, which has 43 co-sponsors. These bills would save taxpayers an estimated [\\$50 billion over 10 years](#).

The notion of limiting executive pay deductibility enjoys strong public support and even some bipartisan support. In 2014, then-House Ways and Means Chair Dave Camp, a Michigan Republican, [called for](#) the elimination of this CEO bonus loophole, arguing it was time to "stop subsidies for excessive compensation."

63 percent of Americans say they want to "Prevent corporations from avoiding taxes when they award their executives millions of dollars in stock options."

— [Hart Research Associates](#)

Expanding the Obamacare deductibility cap beyond health insurance firms makes a great deal of sense, since insurers are hardly the only large U.S. corporations to enjoy taxpayer subsidies. Indeed, almost every large corporation in the United States draws one form or another of subsidy.

Appendix 1: 2015 Taxpayer Benefits from the ACA Executive Pay Deductibility Cap, Top 5 Executives at the 5 Largest Health Insurance Companies

Executive	Deductible under ACA cap		Would've been deductible without ACA cap		Difference in allowable deductions	ACA Taxpayer Benefit (based on 35% tax rate)
	\$500,000 maximum	"Grandfathered" options (exercised in 2015 but granted before 2010)	Salary, other pay not tied to performance (up to \$1 million*)	Realized performance pay (unlimited)		
AETNA						
Mark Bertolini	500,000	5,801,165	1,000,000	26,621,871	21,320,706	7,462,247
Shawn M. Guertin	500,000	0	801,026	4,787,062	5,088,088	1,780,831
Gary W. Loveman	480,782	0	161,232	319,550	0	0
Karen S. Lynch	500,000	0	989,710	7,708,805	8,198,515	2,869,480
Francis S. Soistman	500,000	0	695,125	2,593,392	2,788,517	975,981
ANTHEM						
Joseph R. Swedish	500,000	0	1,000,000	14,179,144	14,679,144	5,137,700
Wayne S. DeVeydt	500,000	0	924,120	16,471,675	16,895,795	5,913,528
Peter D. Haytaian	500,000	0	744,448	3,660,226	3,904,674	1,366,636
Gloria M. McCarthy	500,000	0	863,139	8,024,254	8,387,393	2,935,588
Martin Silverstein	500,000	0	671,030	1,609,948	1,780,978	623,342
Kenneth R. Goulet	500,000	5,152,613	740,242	10,986,215	6,073,844	2,125,845
CIGNA						
David M. Cordani	500,000	20,375,519	1,000,000	47,466,027	27,590,508	9,656,678
Thomas A. McCarthy	500,000	438,972	748,267	3,866,695	3,675,990	1,286,597
Herbert A. Fritch	500,000	0	1,000,000	49,470,909	49,970,909	17,489,818
Nicole S. Jones	500,000	0	609,257	7,475,548	7,584,805	2,654,682
Matthew G. Manders	500,000	0	769,945	6,502,426	6,772,371	2,370,330
HUMANA						
Bruce D. Broussard	500,000	0	1,000,000	3,179,312	3,679,312	1,287,759
Brian A. Kane	500,000	0	767,551	0	267,551	93,643
James E. Murray	500,000	0	1,000,000	1,634,762	2,134,762	747,167
Jody Bilney	500,000	0	706,460	0	206,460	72,261
Timothy S. Huval	500,000	0	704,639	0	204,639	71,624
UNITEDHEALTH						
Stephen J. Hemsley	500,000	0	1,000,000	18,597,534	19,097,534	6,684,137
David S. Wichmann	500,000	9,404,060	1,294,724	28,877,298	20,267,962	7,093,787
Larry C. Renfro	500,000	0	1,000,000	19,473,238	19,973,238	6,990,633
Marianne D. Short	500,000	0	919,189	5,799,304	6,218,493	2,176,473
D. Ellen Wilson	500,000	0	784,101	4,734,075	5,018,176	1,756,362
TOTAL	12,980,782	41,172,329	21,894,205	294,039,270	261,780,364	91,623,127
AVERAGE	499,261	1,583,551	842,085	11,309,203	10,068,476	3,523,966

*CEOs are in bold, CFOs in italics. CFOs are excluded from the ordinary deductibility limits in the tax code, but not from the ACA deductibility cap.

Appendix 2: Sources and methodology

Sources: Institute for Policy Studies calculations based on proxy statements filed by the corporations with the U.S. Securities and Exchange Commission. Detailed methodology below is based on IRS “Proposed Rulemaking: The \$500,000 Deduction Limitation for Remuneration Provided by Certain Health Insurance Providers” [REG-106796-12](#).

DEDUCTIBLE UNDER ACA CAP

The Affordable Care Act amended the tax code through Section 162(m)(6) to set a \$500,000 limit on compensation deductions for all employees of health insurance providers that receive at least 25 percent of their gross premiums from providing “minimum essential coverage” (the type needed to meet individual responsibility requirements under the ACA). The limits apply to tax years beginning Jan. 1, 2013, but they also apply to compensation for services provided after 2009 that is received by the employee in 2013 or later. The rules also eliminate exceptions from the cap for commissions and performance-based compensation.

Options exercised in 2015 but granted before 2010: These awards are grandfathered (i.e., the new deductibility limits do not apply). We used Form 4 reports to determine the grant dates of stock options exercised in 2015. Options typically expire after 10 years while stock grants typically vest over three years.

DEDUCTIBLE WITHOUT ACA

These columns tally up the maximum amount that corporations could have claimed as deductible if the ACA were not in force.

Salary and other pay not tied to performance (up to \$1 million): Section 162(m) of the tax code imposes a \$1 million deduction limit for compensation to a company’s CEO and three other highest-paid executive officers (excluding the CFO), unless the compensation is “performance-based” and provided under a plan approved by the shareholders. Salary,

perks (listed as “all other compensation” in proxy statements), and bonuses that are not tied to performance criteria are included here.

Realized performance pay components:
Value realized from the exercise of stock options: We included the value of options exercised, rather than the estimated value of a stock options grant, since options are not taxable until an executive exercises them.

Value realized from vested stock: Like stock options, stock grants are taxable in the year they vest (i.e., become the possession of the executive). Unlike stock options, stock grants are considered “performance-based” under 162(m) only when tied to specific performance benchmarks approved by shareholders. Since these insurance companies had the option of structuring stock grants to be performance-based (but no longer had the tax incentive to do so under the ACA), we included all vested stock as potentially deductible “performance pay.”

Performance-based bonuses: This includes compensation reported in the “non-equity incentive plan” column of the summary compensation table.

ACA TAXPAYER BENEFITS

ACA taxpayer benefit: To compute the estimated additional revenues generated by the ACA’s tighter limits on the deductibility of executive pay, we applied the federal corporate tax rate of 35 percent to the difference in allowable deductions resulting from the ACA reform.

Appendix 3: Outstanding Options awards held by CEOs of top 5 firms

CEO	Number of securities underlying options	Exercise price	Stock price (close March 17, 2017)	Options value (as of March 17, 2017)
Mark Bertolini, AETNA	101,542	\$72.26	\$131.80	\$6,045,811
	203,084	\$72.26	\$131.80	\$12,091,621
	700,000	\$64.25	\$131.80	\$47,285,000
	253,480	\$100.50	\$131.80	\$7,933,924
subtotal	1,258,106			\$73,356,356
Joseph R. Swedish, ANTHEM	102,303	\$67.44	\$168.27	\$10,315,211
	95,083	\$89.44	\$168.27	\$7,495,393
	38,747	\$146.93	\$168.27	\$826,861
	16,064	\$131.80	\$168.27	\$585,854
	19,017	\$89.44	\$168.27	\$1,499,110
	38,748	\$146.93	\$168.27	\$826,882
	80,324	\$131.80	\$168.27	\$2,929,416
subtotal	390,286			\$24,478,728
David M. Cordani, CIGNA	190,180	\$34.65	\$151.89	\$22,297,654
	189,610	\$42.19	\$151.89	\$20,800,217
	200,229	\$44.43	\$151.89	\$21,517,609
	206,843	\$58.73	\$151.89	\$19,269,494
	152,970	\$78.04	\$151.89	\$11,297,599
	53,129	\$120.90	\$151.89	\$1,646,733
	76,473	\$78.04	\$151.89	\$5,647,913
	106,259	\$120.90	\$151.89	\$3,293,498
	142,801	\$139.22	\$151.89	\$1,809,289
subtotal	1,318,494			\$107,580,007
Bruce D. Broussard, HUMANA	17,335	\$72.84	\$218.90	\$2,531,950
	25,143	\$102.16	\$218.90	\$2,935,320
	39,542	\$164.65	\$218.90	\$2,145,351
	25,143	\$102.16	\$218.90	\$2,935,320
	79,084	\$164.65	\$218.90	\$4,290,702
	117,441	\$167.81	\$218.90	\$6,000,648
subtotal	303,688			\$20,839,291
Stephen J. Hemsley, UNITEDHEALTH	20,979	\$70.24	\$169.70	\$2,086,571
	49,656	\$57.38	\$169.70	\$5,577,362
	114,036	\$33.00	\$169.70	\$15,588,721
	103,678	\$108.97	\$169.70	\$6,296,365
	62,939	\$70.24	\$169.70	\$6,259,913
	49,656	\$57.38	\$169.70	\$5,577,362
subtotal	400,944			\$41,386,294
TOTAL				\$267,640,676
Tax liability under ACA cap				\$93,674,237
Tax liability without ACA cap				\$0

Note: Includes only options granted after 2009 with expiration dates after 2017. Figures for Anthem, Cigna, and Humana are from 2017 proxies, while figures for UnitedHealth and Aetna are from 2016 proxies (most recent). Tax liability without ACA cap assumes that each CEO has at least \$1 million in non-performance pay.