## Executive Compensation 'Clawback' May Encourage Companies to Look for Tax Savings, Study Finds (February 7, 2020)

Accounting & Compliance Alert--Complete Edition (WG&L)

WG&L Accounting & Compliance Alert

**Friday, February 07, 2020**

Volume 14, No. 26

ISSN 1935-9721

# Today's News

**SEC News**

**Executive Compensation 'Clawback' May Encourage Companies to Look for Tax Savings, Study Finds**

**Topic(s): SEC, Executive Compensation, Sarbanes-Oxley, Tax, Financial Reporting, Cost Management, Dodd-Frank Act, Disclosure, Financial Management**

***Summary:*** *As the SEC is finally trying to make some progress in writing a Dodd-Frank mandated rule related to so-called executive compensation "clawbacks," an academic study says that clawback policies may encourage other undesirable behavior. Companies that have voluntarily adopted a clawback rule are significantly more likely to buy auditor-provided tax services, increase connections to other low-tax companies, and use tax havens, the study found.*

**By Soyoung Ho**

As the SEC is finally trying to make some progress in writing a Dodd-Frank mandated rule related to so-called executive compensation "clawbacks," an academic study says that such policies may encourage other undesirable behavior. **Sec. 954 of PL111-203**

"We suggest that reducing income tax expense is a means of meeting earnings expectations," Thomas Kubick and Thomas Omer of the University of Nebraska in Lincoln and Zac Wiebe of the University of Arkansas, wrote in their study, which appears in the January 2020 edition of *The Accounting Review*, a bimonthly journal published by the American Accounting Association.

"We find that effective tax rates are lower after clawback adoption due to increased investments in tax planning," the study states.

The authors compared 233 companies that have voluntary clawback policies to those that do not. They found that soon after instituting a clawback rule, companies are significantly more likely to buy auditor-provided tax services, increase connections to other low-tax companies, and use of tax havens.

Companies are constantly under pressure to meet earnings expectations as they tend to move stock prices. And "capital market pressures to meet earnings expectations do not subside after clawback adoption, and recent research suggests that executives subject to clawback policies seek alternatives to aggressive accruals for meeting earnings expectations," the study notes. But "the potential costs of these [accrual-based] strategies are higher in a clawback environment because aggressive accruals can attract regulatory scrutiny and lead to forfeited compensation…Reducing income-tax expense is an attractive alternative."

The research found that the 233 companies lowered their effective tax rates enough to save on average of about $18 million. This is about 1.6 percent of their average pre-tax income of $1.1 billion and a decrease of income tax bill of about $4.2 billion total.

The study also found that the lower rates were not only achieved in the first year but also lasted through at least two following years.

Even though it has been almost 10 years since Dodd-Frank became law in July 2010, the SEC had put the clawback rule on the back burner until recently because of complaints by businesses. The commission put the rulemaking project back on its short-term agenda, and it is planning to issue a revised proposal around Fall of 2020. The market regulator is not quite ready to adopt the rule. **Sec. 954 of PL111-203**

In July 2015, the SEC issued **Release No. 33-9861** , *Listing Standards for Recovery of Erroneously Awarded Compensation*, to propose requiring public companies to recoup bonuses paid to executives if the company is found to have misstated its financial results. Section 954 of Dodd-Frank is intended to discourage executives from taking questionable actions that temporarily boost share prices but ultimately result in a correction of financial statements. **Sec. 954 of PL111-203**

The proposal is more stringent and broader in scope than the clawbacks under the **Section 304** of the **Sarbanes-Oxley Act of 2002** . The requirements would be triggered by an accounting restatement, cover a wider group of executives, not just CFOs and CEOs. Executives would also not need to be found guilty of misconduct to return the compensation. Companies that fail to comply with the rule risk losing their stock exchange listing.