EXECUTIVE FRINGE BENEFITS

BRIAN L. CUMBERLAND, Dallas
Alvarez & Marsal

STEVEN W. MILTON, Irving
Kimberly-Clark Corporation

State Bar of Texas
EXECUTIVE COMPENSATION COURSE
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Dallas

CHAPTER 3
BIOGRAPHICAL INFORMATION

EDUCATION

- BBA in Finance, the University of Texas.
- Juris Doctorate, St. Mary’s School of Law.
- LL.M - Taxation from the University of Denver.

PROFESSIONAL ACTIVITIES

- National Managing Director - Compensation and Benefits, Alvarez & Marsal Taxand, Dallas, Texas.
- Member of the State Bar of Texas
- Member of American Bar Association (ABA)
- Member of Southwest Benefits Association

LAW RELATED PUBLICATIONS, ACADEMIC APPOINTMENT

Recent Articles / Publications

- “IRS Drops 162(m) Bomb,” Tax Advisor Weekly Newsletter, February 2008
- 2006 and 2007 “Change in Control Report,” by Brian L. Cumberland
- “There’re Here: 409A Final Deferred Compensation Regulations,” Tax Advisor Weekly Newsletter, June 2007
- “SEC Proposed Changes to Executive Pay Disclosure Requirements – What Companies may not have Focused on,” Tax Advisor Weekly Newsletter, April 2006

Recent Speeches

- Speaker for Southwest Benefits Association on Section 409A Final Regulations (May 2007)
- Speaker for the Tax Executive Institute (TEI) for the Dallas (May 2006 & May 2007), Houston (June 2007), Fort Worth (April 2007), South Florida (June 2007), Tulsa (September 2007), Carolina (December 2007) and San Jose (November 2006) Chapters on Executive Compensation Issues
- Speaker for Lorman Education Services on Executive Compensation Issues (November 2007).
Steve Milton joined Kimberly-Clark Corporation in August 2007 as Assistant Corporate Secretary and Counsel. Steve has significant expertise in corporate governance issues as well as related corporate and securities law matters.

Steve’s responsibilities include providing oversight regarding corporate governance issues and working with business teams to ensure a coordinated approach to the management of governance issues. His duties also include preparation of Kimberly-Clark’s annual proxy statement.

Steve formerly served as Assistant Corporate Secretary and Senior Counsel for RadioShack Corporation, headquartered in Fort Worth. Prior to this position, Steve was an associate with the law firm of Haynes and Boone, LLP, where he specialized in corporate, securities, mergers and acquisition, and general business law.

Steve graduated with a Bachelor of Business Administration in Accounting from the University of Texas. He also has a Juris Doctor degree from the University of Texas School of Law.

Steve, his wife and two children reside in Fort Worth, Texas.
Perquisite Treatment:
SEC Disclosure vs. Taxable Income

May 2, 2008

Brian L. Cumberland
National Managing Director,
Compensation and Benefits
214-438-1013
bcumberland@alvarezandmarsal.com

Steve W. Milton
Counsel and Assistant Secretary
Kimberly-Clark Corporation
972-281-1204
steve.milton@kcc.com
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## Agenda

- Identifying Perquisites
- SEC Requirements – Overview
- Tax Treatment – Overview
- Personal Use of Corporate Aircraft
- The Future of Perquisites
Some Common Possible Perquisites

- Car Allowance
- Car Insurance
- Club Dues
- Club Initiation
- Commission for Sale of Home
- Commuting Expenses
- Computer Equipment
- Corporate Residence
- Cost Associated with Expatriate Work Assignment
- Currency Exchange Arrangements
- Discounts on Company’s Products/Services Not Generally Available to All Employees
- Excess Liability Insurance
- Executive Office Benefits
- Financial Consulting Services
- Gas Allowance
- Goods and Services Differential (For Foreign Service)
- Home Office Costs
- Home Security
- Housing Allowance
- Legal Expenses
- Life Insurance Premiums
- Living Expenses
- Long Term Disability Insurance
- Medical and Dental Claims/Premiums
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... And Some Not-So-Common Ones

- Beer for personal use
- Use of company barber shop
- Free theme park tickets
- Vehicle “evaluation” program
SEC Requirements
SEC Requirements – Two-Prong Perquisites Test

1. Is the item “integrally and directly related” to performance of executive’s duties?
   - If so, not a perk and no need to disclose incremental cost
   - Does the executive need the item to do his or her job?
     - Does not cover items that merely facilitate job performance
     - Fact that there is a less expensive alternative does not make item a perk
   - Examples of items that may not be perks:
     - Blackberry or laptop
     - Bigger office
     - Additional administrative support (for business reasons)
     - Business trips on corporate aircraft
     - Business accommodations
     - Security service provided during business travel
SEC Requirements - Two-Prong Perquisites Test

2. Does the item “confer a direct or indirect benefit that has a personal aspect”?
   
o If so, it is a perk, unless it is generally available on a non-discriminatory basis to all employees

   o Determination that an item is an ordinary and necessary business expense for federal income tax purposes does not resolve whether it is a perk

   o Examples of perks (per SEC):
      
      – Club membership not used excessively for business entertainment
      – Personal use of company auto, airplane and housing
      – Security provided at personal residence
      – Administrative assistance for personal matters
      – Personal finance or tax advice
      – Housing or other living expenses
SEC Requirements – Perquisites Analysis Flowchart

Is the item “integrally and directly related” to job performance?

Yes

Does the item confer a direct or indirect benefit that has a personal aspect?

No

Not a Perquisite

Yes

Is the item generally available on a non-discriminatory basis to all employees?

No

Perquisite

Yes
SEC Requirements – Disclosure of Perquisites

• If the aggregate value of all perks is less than $10,000, no disclosure is required

• If the aggregate value is $10,000 or more:
  o Include the total value in the “All Other Compensation” column of the Summary Compensation Table
  o Footnotes to the table must identify perks by item or type
    – Identification must be specific, rather than general
    – i.e., “Theater Tickets” instead of “Travel and Entertainment Expense”
  o Quantify any perk with a value above the greater of $25,000 or 10% of the total aggregate value of the perks

• Disclosure requirements apply to perks for both named executive officers and directors
SEC Requirements - Valuing Perquisites

- Value of perk = aggregate incremental cost to the company

- This valuation is different from most other forms of compensation, which are disclosed on the basis of the amount earned by or paid to an executive

- The computation of the value of the perk for tax purposes is not relevant to the calculation

- Disclose the methodology used to compute the aggregate incremental cost
Tax Treatment
Fringe Benefit Background

- **Section 61** – Gross income includes the value of fringe benefits, unless specifically exclude
  - Section 1.61-21 – Any benefit provided by an employer to an employee that has a value should be included as compensation unless there is a specific exclusion

- **Section 102(c)** – Gifts to employee from employers are generally compensation

- **Interaction with Section 274** – Disallowance of employer deduction
  - Disallowance of employer deductions is not measurement of employee’s income inclusion
Excludible Fringe Benefits

- **Section 132 – Excludible Fringe Benefits**
  - De minimis fringe benefits
  - Working condition
  - On premise gym
  - Employee discounts
  - Transportation fringe/parking
  - No additional cost benefit
  - Line of business rules
  - Discrimination rules
Fair Market Value

- **General Valuation Rules**
  - What the employee would have to pay for the benefit in an arms length transaction (with a few exceptions)

- **Special Valuation Rules**
  - Regulation Section 1.61-21 has special exceptions
    - Automobiles
    - Airplane Use
IRS Initiative on Executive Compensation

- IRS Program started in 2003 to review executive compensation and benefit reporting and withholding
- One of the focus items is fringe benefits
- Currently included on IRS Information Data Requests (IDRs)
- IRS has stated that as part of the corporate audit, executives that returns will be reviewed
- Failure to report perks may result in:
  - Corporate Exposure
  - Amendments to executive’s tax returns
Payroll Tax Rules

- Taxable fringe benefits for employees and former employees must be reported on Form W-2 (From 1099-MISC for directors or independent contractors)

- Treat like other compensation – FICA and FIT withholding apply

- Announcement 85-113 gives employer choice of when to withhold
  - Quarterly, semi annually, or annually
  - Often done in last pay period
Personal Use of Corporate Aircraft
Airplanes - SEC Disclosure

• How should “incremental cost” to the company be calculated?
  o Practice varies among companies
  o Note: SIFL rates are not incremental costs

• Valuation should be based on variable flight costs
  o Personal use is typically such a low portion of overall aircraft use that fixed costs (e.g., insurance, hangar, etc.) can typically be excluded

• What variable costs should be included?
  o More obvious ones:
    – Fuel, landing fees, catering service
  o Gray areas:
    – Major maintenance
    – Dead-head (repositioning)
    – Disallowed deductions

• Footnote should describe methodology used to calculate incremental costs
Airplanes – Tax Treatment

• Valuation Methods
  o General Rule - Fair Market Value Method
    – Arm’s length cost to charter comparable flights, with allocation among executives on flight
  o Standard Industry Fare Level Formula (“SIFL”) Method
    – Formulaic formula
      ➢ Number of miles x SIFL cents/mile rate
      ➢ x Control employee multiple
        ▲ Control employee 400% vs. non-control employee 31.3%
      ➢ x size of plane multiple
      ➢ + terminal charge
    – Security Concern Exception
      ➢ If the bona-fide business security concern exception is satisfied, personal trip valued at 200%, rather than 400%
Airplanes – Tax Treatment

- **Combination purpose – Trip has business and personal purpose**
  - Impute income if primarily personal purpose
  - If trip has multiple destinations with some personal and some business:
    - If primarily for business, actual value of total trip less value of hypo trip to business destinations
    - If primarily for personal, hypo value of trip only of personal destinations
Airplanes – Tax Treatment

- If control person is not correctly identified, or if SIFL rates are not properly applied, general rules apply

- Guests on board
  - Allocate to all employees on flight, or
  - Allocate to the control employee on flight (person exercising control over the flight)
  - Usually shareholder, director, family member of control employee
  - If allocate to control employee, use control SIFL calculation

- 50% seating capacity rule
  - Regular seating capacity
  - 50% of more business flyers
  - If rule satisfied, guests fly free
Airplanes – Tax Treatment

- Reimbursement of personal use of corporate aircraft
  - Reimbursement is generally not feasible under FAA regulations, though alternative structures may be available that permit reimbursement
    - Reimbursement of aircraft expenses may require registration of issuer with FAA
The Future of Perquisites

• Looking at the bottom line: do the “benefits” outweigh the costs?

• Eliminate the frills
  o Can it be done?
    – Jet use is actually rising
    – Recruitment tool
    – Status symbol

• Perquisite Allowances
  o A significant number of companies maintain perk allowance programs, generally offering to reimburse executives for certain expenses