

## COMMENTS ON SEC GUIDANCE:

# Does “RingsEnd” Accomplish Anything?

**“...we find nothing in the RingsEnd plan to support an ownership objective and find it may undermine other incentive objectives such as retention, solely for the benefit of incremental executive tax efficiency.”**

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Last week (March 20<sup>th</sup>, 2013) Baker & Hostetler, LLP<sup>1</sup> received guidance from the SEC regarding the use of arms-length loans within an executive stock-purchase-and-loan plan (SPLP) for a client company, RingEnds Partners<sup>2</sup>. Of significance here is not the design of the plan or the ability of employers to effectively arrange credit for executives, but that complicated executive pay arrangements are being developed to circumvent tax policy to the potential detriment of companies and investors – with limited positive effect for the executives.

The RingsEnd program consists of:

- The company transfers stock award shares into an independent trust on behalf of the executive.
- The executive elects to recognize the grant value of the shares upon receipt by electing 83(b) treatment
- The trust immediately borrows money at arm's length from a bank, securitized by (and only by) the shares it holds, distributing cash to the executive approximating the income taxes owed

At this point, the executive's basis in the security is the grant value of the award, with all subsequent gains or losses subject to capital gains treatment. The executive's tax/vesting risk is effectively transferred to the trust and the company; if the shares do not vest, the executive is not liable for the loan used for tax payments or the interest on the loan. Assuming the shares vest, the trust will withhold shares at the vested value to repay the loan and interest, transferring the remaining shares to the executive without any further taxation until sale of the stock.

The executive benefits from two features of the plan.

1. Assuming the rate of appreciation exceeds the rate of interest on the loan obtained by the trust, the

executive benefits from the spread between the tax-effected loan interest rate and the equity growth rate, plus,

2. The effective deferral of taxation on appreciation in shares from grant date through vesting date until eventual sale on the shares.

For all the complexity of the arrangement, economic benefits are limited. In contrast:

- We believe there is a potential shareholder issue if in fact the employer is underwriting the financial risk associated with an executive's 83(b) election.
- We question whether an 83(b) election is even appropriate when an employer is effectively underwriting the risk.

Notwithstanding this caveat, there is little the plan provides that an executive could not achieve under the existing tax and regulatory framework. An 83(b) election to recognize income upon receipt of a stock award is already available. The only unique feature with RingsEnd is that, through a rather complicated trust arrangement, the company is underwriting the risk that the shares will not vest, relieving the executive of paying taxes on shares never received. Strangely, this effectively reduces the executive's negative consequences of leaving the company prior to vesting.

We believe that encouraging executive shareholding, particularly with limited liquidity during the term of employment, is good public policy. When executives hold a considerable portion of their total net worth in the form of illiquid shares of company stock, they are more inclined to have a balanced view of investor risk. However, we find nothing in the RingsEnd plan to support an ownership objective and find it may undermine other incentive objectives such as retention, solely for the benefit of incremental executive tax efficiency.

Companies are advised to be wary of programs that are inordinately complex, and avoid falling into the trap of allowing design elegance to distract you from actual program effectiveness.

<sup>1</sup> Prominent in the Baker & Hostetler, LLP request was Michael Oxley, the former Congressman and Chairman of the House Financial Services, and co-author of the Sarbanes-Oxley legislation, now Of Counsel with Baker & Hostetler, LLP.

<sup>2</sup> <http://www.sec.gov/divisions/corpfin/cf-noaction/2013/ringsend030413.htm>