

# Impact of Tariffs on 2025 and 2026 Incentives



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## Introduction

The impact of tariffs and potential tariff refunds will require companies to closely examine 2025 and 2026 incentive plan payouts to ensure fairness to management and shareholders. The unfortunate timing of both the imposition of new tariffs in 2025 and the possibility of a tariff refund—should the Supreme Court determine the new tariffs were illegal in the coming weeks—makes it highly unlikely that incentive plan targets incorporated these unplanned events. This may require after the fact compensation committee decision-making and possibly the exercise of discretion to ensure a fair outcome. To the extent companies have incorporated certain tariffs into 2026 incentive plan targets that turn out to be illegal, adjustments may also need to be made to those targets.

## Discussion

President Trump declared April 2, 2025 to be Liberation Day and announced the implementation of tariffs on the U.S.'s trading partners under the International Emergency Economic Powers Act (IEEPA). According to the Tax Foundation, the estimated 2025 tariffs collected under IEEPA were approximately \$130 billion.<sup>1</sup>

Many companies had already established their 2025 annual and long-term incentive plan targets long before Liberation Day, and the impact of these additional tariffs were not contemplated in their operating plans. Because tariffs are generally considered a normal operating expense, many of these companies' incentive plans did not include a provision for adjusting financial results for incentive plan purposes due to unexpected tariffs.

Throughout 2025, some companies monitored the results of unplanned tariffs and their impact on 2025 annual incentives, as well as on prior years' long-term incentive awards that included 2025 in the performance period. In some cases, companies found the new tariffs to have a net positive impact on financial results, as the threat of these added costs accelerated orders and resulted in higher than expected sales and profits.



In other cases, the impact of the new tariffs on incentive payouts was relatively modest, and it is possible no adjustment will be requested by management. For some companies, however, the impact may be significant, and both management and the Board may be conflicted about whether an adjustment should be made as they try to balance fairness to both management and shareholders. As companies file their 2026 proxies, we may learn much more about how they handled these unplanned tariffs in determining incentive plan payouts.

Adding to the tariff uncertainty, several small businesses sued the Trump Administration over the implementation of tariffs under IEEPA, arguing that the 1977 law was meant for use during national emergencies and was not intended to be used to renegotiate trade agreements with the U.S.'s trading partners. The Supreme Court heard oral arguments on November 5, 2025, and according to legal commentators, both liberal and conservative justices seemed skeptical of the legality of the tariffs. The Supreme Court is expected to issue its decision in the coming weeks and hopefully well before the Court's session ends later this June. Assuming the Court rules that the tariffs are illegal, companies may be able to obtain refunds, although the process for doing so remains unclear. Also unclear is how the Administration might respond and what other tools it may use to claw back some or all of these tariffs.

Based on accounting literature, if the Supreme Court rules that the tariffs were illegal and must be refunded, they will be reported as income (reduction in expense) in 2026 when a refund is probable, provided they were fully expensed in 2025. If the tariffs were capitalized in inventory in 2025, the portion of the inventory sold in 2025/2026 before the Supreme Court decision—when a refund becomes probable—will result in a reduction in Cost of Goods Sold in 2026. Any remaining tariffs capitalized in unsold inventory will be deducted from the cost of inventory as a balance sheet adjustment and will not impact earnings.

Similar to last year's timing of Liberation Day when tariffs were first implemented, many companies may have already established their 2026 annual and long-term incentive plan targets at the time the potential tariff refund was announced and were unlikely to have considered such an impact when setting these targets. In light of this, how should companies think about the impact of a potential tariff refund on 2026 incentive plan payouts? A simple answer might be consistency: if you **did not** adjust 2025 incentive plan payouts for the impact of tariffs, **do not** adjust 2026 incentive plan payouts for the refund. Likewise, if you **did** adjust 2025 incentive plan payouts for the impact of tariffs, **adjust** 2026 incentive plan payouts for the impact of the refund.

Of course, "simple" and "incentive plan adjustments" rarely belong in the same sentence. For example, what if the company uses a cash flow measure and the refund—while probable for accounting purposes—may not be received until 2027 or an even later year? What about companies that altered their performance curves between years, where the impact of the tariffs on 2025 incentive plan payouts was much different from the impact of the refund on 2026 incentive plan payouts?



Another unclear issue is how IEEPA tariffs that were included in 2026 incentive plan targets should be addressed if the Supreme Court declares them illegal. A simple approach might be to reset the targets by removing the planned tariffs; however, given the uncertainty of new tariffs (or fees) that could be imposed under other rules, it may make sense for companies to take a wait and see approach until year end when the legal landscape is clearer.

## Conclusion

We expect that in many cases, the impact of tariffs and tariff refunds on incentive plan payouts will be easily resolved due to immateriality or well established protocols for addressing unexpected events. For situations where the best approach is unclear, management should prepare a thorough analysis of the impact of tariffs and tariff refunds across years to allow the compensation committee to determine a fair outcome.

*This Viewpoint is intended to inform compensation committees, executives, and compensation professionals about developments that may affect their companies; it should not be relied on as specific company advice or as a substitute for legal, accounting, or other professional advice.*

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<sup>1</sup>Erica York and Alex Durante. Trump Tariffs: Tracking the Economic Impact of the Trump Trade War. Tax Foundation. January 23, 2026. <https://taxfoundation.org/research/all/federal/trump-tariffs-trade-war/>