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Final Regulations on Amendments Under the Tax Cuts and Jobs Act

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IRS Issues Final Regulations on Amendments to Section 162(m) Under the Tax Cuts and Jobs Act (TCJA).

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On December 18, 2020, the IRS and Treasury Department issued final regulations amending Section 162(m) of the Internal Revenue Code (Code) to eliminate the deduction for certain employee remuneration in excess of \$1 million for federal income tax purposes. Section 162(m) disallows a deduction by any publicly held corporation for applicable employee remuneration paid or otherwise deductible to any covered employee to the extent that such remuneration exceeds \$1 million for the taxable year.

Prior to the enactment of the TCJA, there was an exception that allowed for deductibility of certain performance-based compensation. This exception was eliminated under TCJA, but written binding contracts in effect as of November 2, 2017 were grandfathered. While the IRS and the Treasury Department released proposed regulations on the changes to Section 162(m) made by the TJCA in 2018, and later issued guidance, several issues remained unclear. These issues included the impact of negative discretion provisions and some aspects of the grandfathering rules applicable to written binding contracts in effect on November 2, 2017.

The final regulations are largely consistent with the proposed regulations and generally do not expand the definition of “covered employee” or narrow the grandfathering rules provided for “written binding contracts.” Changes from the proposed regulations are limited and special applicability dates are provided for these changes, as detailed under VIII.B in the table below.

A summary of the major provisions of the final regulations is provided below. Note that these rules are complex. The summary does not purport to address every nuance of the regulations. Please consult with qualified tax professionals when determining how the final regulations impact your company’s specific facts and circumstances.

Paragraph in Preamble to Final Regulations	Issue	Final Regulations
II.A	Definition of “Publicly Held Corporation”	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Defined as corporations with securities required to be registered under Section 12 of the Exchange Act or required to file reports under Section 15(d) of the Exchange Act
II.B	Treatment of Affiliated Groups of Corporations	<p>Consistent with 1995 regulations and proposed regulations</p> <ul style="list-style-type: none"> Confirms that each corporation within an affiliated group has its own set of covered employees (<i>Also see V and VIII.B below</i>)
II.C	Treatment of Foreign Private Issuers (FPIs)	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Confirms that FPIs are subject to the limits on tax deductibility for covered employees
III.A	Definition of Covered Employees	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Defines a covered employee as the principal executive officer (PEO), principal financial officer (PFO), including persons acting in such capacities, and the three highest compensated officers for the taxable year (other than the PEO and PFO), even if the compensation of the officer is not required to be disclosed to shareholders (for example if the officer is not employed on the last day of the fiscal year)
III.B	Covered Employees Limited to Executive Officers	<p>Consistent with the disclosure rules of the Exchange Act</p> <ul style="list-style-type: none"> Covered employees must be executive officers, but executive officers of subsidiaries may be included

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III.C	Covered Employees after Separation from Service	<p>Consistent with the proposed regulations</p> <ul style="list-style-type: none"> Covered employees include former employees as well as current employees
IV.A	Applicable Employee Remuneration	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Confirms that compensation means the aggregate amount allowable as a deduction for the taxable year, including amounts paid to persons other than the covered employee, including after the death of the covered employee
IV.B	Compensation paid by a Partnership to a Covered Employee	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Publicly held corporation must take into account its distributive share of a partnership's deduction for compensation paid to the corporation's covered employees when determining the amount deductible for compensation to covered employees Additional limited transition relief is provided
IV.C	Compensation for Services in a Capacity other than as a Common Law Employee	<p>New information</p> <ul style="list-style-type: none"> Confirms that the limit on deductibility applies to all compensation for services performed by a covered employee, including as a common law employee, a director, or an independent contractor
V.	Privately Held Corporations that become Publicly Held	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Provides that the deduction limits apply to any compensation that is deductible for the taxable year ending on or after the date that the corporation becomes a publicly held corporation Clarifies that the transition relief available to a corporation that becomes a separate publicly held corporation on or before December 20, 2019 also applies to subsidiaries that are members of an affiliated group
VI.A	Grandfather Rule	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Tax deductibility is grandfathered only for amounts a corporation is obligated to pay under written binding contracts in effect on November 2, 2017, that have not been modified in any material respect on or after that date In Notice 2018-68, the IRS provided initial guidance on written binding contracts, requiring companies to show that the amount would be owed under state or other applicable law. The final regulations confirm the definitions of written binding contract and material modification but offer additional examples to supplement the initial guidance
VI.B	Compensation subject to Negative Discretion	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Confirms that a provision in a compensation agreement that allows for negative discretion limits grandfathering to amounts a corporation is obligated to pay under applicable law, such as state contract law

Paragraph in Preamble to Final Regulations	Issue	Final Regulations
VI.C	Recovery of Compensation	<p>Differs from proposed regulations</p> <ul style="list-style-type: none"> Provides that a corporation's right to recover compensation does not affect the determination of the amount of compensation the corporation has a written binding contract to pay under applicable law as of November 2, 2017
VI.D	Account and Non-Account Balance Plans	<p>Generally consistent with proposed regulations</p> <ul style="list-style-type: none"> Provides detailed rules for the treatment of non-qualified deferred compensation arrangements in effect on November 2, 2017 Clarifies that if the corporation has the right to terminate the plan, or discontinue future contributions, grandfathering is limited
VI.E	Ordering Rule for Payment consisting of Grandfathered and Non-Grandfathered Amounts Deductible for Taxable Years ending prior to December 20, 2019	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Confirms that the grandfathered amount is allocated to the first otherwise deductible payment, with any excess amount allocated to the next payment until the entire grandfathered amount has been paid
VI.F	Grandfathered Amount Limited to a Particular Plan or Arrangement	<p>New information</p> <ul style="list-style-type: none"> Provides that a grandfathered amount payable under a plan or arrangement applies solely to amounts paid under that plan or arrangement and cannot be applied to any other separate plan or arrangement
VI.G.1	Material Modification	<p>Consistent with proposed regulations</p> <ul style="list-style-type: none"> Confirms that a material modification occurs when a contract is amended to increase the amount of compensation payable to the employee Confirms that modifications to defer payment will not be treated as a material modification if a reasonable rate of interest or the performance of a pre-determined actual investment is used to credit interest, although such additional amounts will not be grandfathered Confirms that modification to offer additional or substitute pre-determined actual investment vehicles is not a material modification
VI.G.2	Extension of an Exercise Period for a Non-Statutory Stock Option	<p>New information</p> <ul style="list-style-type: none"> Recognizes that an employer may want to extend the exercise period of a stock option or stock appreciation right for bona fide business reasons Final regulation incorporates Section 409A regulatory provisions and provides that if an option or SAR is grandfathered, extension of the term is not a material modification if the extension complies with Section 409A

Paragraph in Preamble to Final Regulations	Issue	Final Regulations
VII.	Coordination with Section 409A	<p>New information</p> <ul style="list-style-type: none"> Acknowledges that the TCJA amendments to Section 162(m) require coordination with Section 409A rules Confirms that taxpayers may continue to rely on the preamble to the proposed Section 162(m) regulations until guidance under Section 409A is issued
VIII.A	General Applicability Dates	<p>New information</p> <ul style="list-style-type: none"> Final rules apply to taxable year beginning on or after their publication in the Federal Register but the taxpayer may choose to apply these rules to taxable years beginning after December 31, 2017 Final rules must be applied consistently and in their entirety
VIII.B	Special Applicability Dates	<p>New information</p> <ul style="list-style-type: none"> Provides a detailed discussion of special applicability dates applicable to: <ul style="list-style-type: none"> Definition of covered employee Definition of predecessor of a publicly held corporation Definition of compensation Application of Section 162(m) after a privately held corporation becomes a publicly held corporation Definitions of written binding contract and material modification



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Please contact us at (212) 921-9350 if you have any questions about the issues discussed above or would like to discuss your own executive compensation issues. You can access our website at www.capartners.com for more information on executive compensation.