

December 23, 2020

IRS Issues Final Section 162(m) Regulations

On December 18, 2020, the IRS finalized regulations implementing provisions of the 2017 Tax Cuts and Jobs Act that eliminated the performance-based exception to the \$1 million annual executive compensation deduction limit under §162(m) of the Internal Revenue Code (“§162(m)”). The [final regulations](#) largely track the 2019 [proposed regulations](#), but include some notable clarifications.

Covered Employees. The final regulations confirm that an employee whose compensation is subject to the \$1 million annual limit will remain a “covered employee” in future years, not only in respect of the initial public company employer, but also following many corporate transactions involving that employer – which could include its acquisition by another public company– and in respect of any newly publicly held company to which such employee is transferred in connection with a spin-off of a subsidiary.

Expiration of IPO Transition Relief. In an expected but disappointing development, the final rules decline to allow privately held companies that become publicly held after December 20, 2019 to rely on the transition relief provision of the pre-amended §162(m).

Grandfathered Arrangements. The final regulations generally preserve the key rules set forth in the proposed regulations permitting certain previously promised compensation to remain deductible (see [our memoranda of August 23, 2018](#) and [December 19, 2019](#) for our discussion of these and other topics in the previously proposed guidance).

December 31, 2020 Deadline for §409A Amendments. The proposed regulations provided a two-year period ending December 31, 2020, during which public companies can amend deferred compensation arrangements to remove terms allowing for a deferral of payments until they become tax deductible under §162(m). While in our experience such terms are uncommon, companies whose plans still contain these terms should remove them prior to year-end, in order to avoid potential perpetual deferrals of compensation.

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The preservation of deductions for compensation under the amended §162(m) has not been a driver of compensation design since its enactment in 2017, and we do not expect these final rules to impact that trend. Nevertheless, because the scope of employees subject to §162(m) is potentially large, and spans an indefinite number of years and possible public company employers, public companies should keep careful track of these employees. Companies engaged in corporate transactions will need to take particular care to conduct the necessary analysis to identify covered employees, so as not to inadvertently take unauthorized tax deductions.

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