

TAX ALERT

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New IRS notice clarifies corporate tax deductibility of public company executive compensation arrangements



The IRS recently issued a notice that explains how the IRS will interpret IRC Section 162(m), as amended by last year's tax reform act. IRC Section 162(m) has always prohibited public companies from recognizing a tax deduction in excess of \$1 million with respect to compensation paid to "covered employees." Before the tax reform act, qualifying performance-based compensation was exempt from that \$1 million limit. After the tax reform act, the performance-based exception was eliminated. Amounts paid under certain preexisting arrangements, however, could be grandfathered under the prior rules, and thus may continue to remain deductible.

The recently issued notice helps explain some typical transition issues concerning executive compensation plans. Below you will find a description of issues that may arise as a part of the compensation discussion and proxy statement analysis. Following the description are actions that can be taken - particularly if the goal is to continue to maximize deductions with respect to executive compensation.

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- Determine whether there was a written binding contract in effect as of Nov. 2, 2017, to help determine whether payment under the contract could be deductible under the grandfathered rules.
- Implement measures to track covered employees. Once an executive is a covered employee under Code Section 162(m), that person remains a covered employee forever (including after termination of service and even after he or she is deceased), and thus subject to the \$1 million deduction limit. Covered employees are not necessarily the same as named executive officers under the proxy rules.
- Analyze agreements with Chief Financial Officers. Previously, CFOs were exempt from covered employee status. Now that CFOs are considered covered employees, it is important to evaluate their agreements to determine whether any payments are grandfathered under the prior rules or whether they will be subject to the deduction limits.
- Consider revising plans and agreements to reflect business goals. In this new tax environment, you may want to consider amending your plans to align compensation with pure business goals more closely, without having to worry about what tax law considers “performance-based” compensation. Before making any changes, however, be careful that any amendment will not cause a payment to lose its grandfathered status (and thus its exemption from the \$1 million deduction limit).
- Encourage covered employees to consider deferring larger amounts of compensation until termination of employment or later, when total compensation may be less than \$1 million (or consider mandating deferrals of executive compensation).
- Review your proxy statement disclosures and make any appropriate updates to reflect the changes that the Act and Notice made to Code Section 162(m).

Additional information about these changes can be found on our [Employee Benefits Law Report](#) blog.

We will continue to watch for additional IRS guidance. For more information please contact [Greg Daugherty](#), [Dave Tumen](#) or any member of Porter Wright’s [Tax Practice Group](#).