



# TaxNewsFlash

## United States

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### **Notice 2018-68: Guidance on deduction limitation for remuneration paid to “covered employee” under section 162(m) (new tax law)**

The IRS today released an advance version of Notice 2018-68 as initial guidance on the application of section 162(m)—as amended by the new U.S. tax law (Pub. L. No. 115-97, enacted December 22, 2017)—concerning the allowable deduction for remuneration paid by any publicly held corporation with respect to a “covered employee.”

[\*\*Notice 2018-68\*\*](#) [PDF 79 KB] provides guidance with respect the amendments made to section 162(m) and provides a transition rule applicable to certain outstanding arrangements (referred to as the “grandfather rule”).

#### **Background**

Section 162(m) disallows the deduction by any publicly held corporation for applicable employee remuneration paid to any covered employee to the extent that such remuneration for the tax year exceeds \$1 million. The new tax law expanded the scope and repealed exceptions to the section 162(m) deduction limitation of \$1 million.

The new law’s provisions expanded the definition of “covered employee” to include the principal executive officer, principle financial officer, and the top three other highest-paid officers. Once an employee is treated as a covered employee, the individual retains that status for all future years, including with respect to payments made after retirement, death, etc. The new law expanded the definition of “publicly held corporation” to include all domestic publicly traded corporations and certain publicly trade foreign companies.

The new law provided a transition rule for the section 162(m) changes. The new provisions do not apply to any remuneration paid under a written, binding contract in effect on November 2, 2017, which was not materially modified on or after that date.

## **Notice 2018-68**

According to today's release, stakeholders requested initial guidance on certain aspects of the amendments made to section 162(m)—in particular on the amended rules for identifying covered employees and the operation of the grandfather rule, including when a contract will be considered materially modified so that it is no longer grandfathered. Notice 2018-68 addresses these limited issues.

Notice 2018-68 also examines the term “written binding contract” for purposes of grandfathering. Remuneration is grandfathered if it is payable under a written binding contract that was in effect on November 2, 2017, and not materially modified after that date, only to the extent the corporation is obligated under applicable law (such as state contract law) to pay the remuneration under the contract if the employee performs services or satisfies the vesting conditions. Further, a “material modification” occurs when the contract is amended to increase the amount of compensation payable to the employee. Several examples are provided to illustrate these measures, including examples addressing contract renewals.

Notice 2018-68 provides that the covered employees who are the three highest compensated executive officers for the tax year (other than the principal executive officer (PEO) or principal financial officer (PFO) or an individual acting in that capacity) are determined regardless of whether the executive officer is serving at the end of the publicly held corporation's tax year and regardless of whether the executive officer's compensation is subject to disclosure for the last completed fiscal year under applicable rules of the U.S. Securities and Exchange Commission (SEC). The IRS notice provides examples to illustrate how the covered employee rules are to apply. Based on the examples provided in the notice, the three highest executive officers could be individuals who for various reasons are not on the SEC disclosure, but are still one of the three highest compensated executive officers during the year.

The IRS and Treasury have requested comments on the application of the SEC disclosure rules to determine the three most highly compensated executive officers for a tax year that does not end on the same date as the last completed fiscal year.

Lastly, Notice 2018-68 states that the IRS and Treasury Department expect to issue further guidance on the amendments to section 162(m) in the form of proposed regulations that would incorporate the guidance provided today by Notice 2018-68. Comments are requested on additional issues on a variety of section 162(m) issues that will be addressed in future guidance. Comments may be submitted through November 9, 2018.

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