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KPMG report: Year-end deadline to remove mandatory section 162(m) delay provisions in deferred compensation arrangements

Through the end of this calendar year, employers have additional leeway to amend nonqualified deferred compensation (NQDC) arrangements, to remove outdated provisions requiring the delay of payments expected to be nondeductible under section 162(m).

Generally, section 162(m) limits a publicly held corporation’s deduction for compensation paid to each of its “covered employees” to $1 million per year. In light of significant changes made to section 162(m) by the 2017 tax law (Pub. L. No. 115-97), or the law that is often referred to as the “Tax Cuts and Jobs Act” (TCJA), these mandatory delay provisions may no longer be practical and, in some situations, may effectively require that payments be delayed in perpetuity.

These amendments must be made no later than December 31, 2020. If the corporation would be required to make one or more payments by the end of this year under the amended plan, then those payment(s) must also be made no later than December 31, 2020.

In the preamble to the section 162(m) proposed regulations, the Treasury Department and IRS stated that amendments made in line with these provisions: (1) will not result in an impermissible acceleration of the payment for purposes of section 409A; and (2) will not be considered a material modification that affects grandfathering for purposes of section 162(m). Because only NQDC payments subject to the limitations of section 162(m) as amended are in this predicament, corporations may continue to delay payment of any grandfathered amounts.

Treasury and the IRS intend to incorporate these modifications into the section 409A regulations. Until proposed regulations are issued, employers may rely on the guidance and relief provided in the preamble to the for tax years beginning after December 31, 2017.

Background

Prior to the TCJA, covered employees for section 162(m) purposes were determined anew on a yearly basis (without any mandatory carry-over from prior years), and generally it was required that the individual hold the covered employee position as of the last day of the tax year. If a payment were deferred until the individual terminated employment, it would no longer be subject to the limitations of section 162(m).

Section 409A places restrictions on the time and form of payment of NQDC, and the applicable payment schedule must generally be determined and designated in writing before the NQDC is earned. Payment timing is generally limited to specified permissible payment events, and there is very limited flexibility to accelerate or to further defer NQDC from the originally scheduled payment event(s) except as provided in the plan. However, under section 409A, employers may permit or require that payment be deferred beyond the originally scheduled payment date if, at the time of the scheduled payment, the employer reasonably anticipates that the related deduction would not be subject to limitation under section 162(m).

As amended, section 162(m) covered employees now include any individual who was a covered employee of the employer or any predecessor for any preceding tax year beginning after December 31, 2016. In other words, under section 162(m) as amended by the TCJA, covered employees maintain that status for all future years. This "forever" covered employee status extends to payments made after termination of employment and even applies to payments made following the individual's death. As such, payments of NQDC that are subject to the amended rules may continue to be subject to the limitations of section 162(m) no matter how many years into the future the payment is delayed. If the arrangement does not permit payment of the NQDC at a time when section 162(m) would disallow taking a full deduction, the compensation may never become payable under the plan as originally drafted.

KPMG observation

Employers that may be affected by these measures under section 162(m) need to consider reviewing the terms of their NQDC arrangements and whether any amendments (and related payments) need to be made before year-end.

Read the following reports from KPMG for more information about section 162(m):

- **What's News in Tax: Widening the Net—Proposed Regulations Expand Scope of $1 Million Section 162(m) Deduction Limitation on Certain Executive Compensation Paid by Public Companies** [PDF 272 KB]

- **REITs and section 162(m): Application of the $1 million deduction limitation to executive compensation paid by lower-tier partnerships** [PDF 257 KB]

For more information, contact a KPMG tax professional:

Robert Delgado | +1 (858) 750-7133 | rdelgado@kpmg.com

Erinn Madden | +1 (202) 533-3757 | erinnmadden@kpmg.com

Terri Stecher | +1 (202) 533-4830 | tstecher@kpmg.com

Gary Cvach | +1 (202) 533-3116 | gcvach@kpmg.com

Michael Bussa | +1 (212) 954-1811 | mbussa@kpmg.com

Jill Hemphill | +1 (212) 954-1942 | jhemphill@kpmg.com

Kathy Lo | +1 (415) 963-8988 | kathylo@kpmg.com

Terrance Richardson | +1 (214) 840-2532 | trichardson@kpmg.com

Parmjit Sandhu | +1 (212) 954-4063 | parmjitsandhu@kpmg.com