

Relief for New Public Corporations Eliminated.

Prior to the TCJA, special transition relief was available to newly public corporations. Compensation paid under arrangements that pre-dated the corporation's initial public offering (IPO) and were disclosed to prospective shareholders was exempt from Section 162(m)'s deduction limitation for a limited period following an IPO. The final regulations eliminate this transition relief for corporations that became publicly-traded after December 20, 2019.

Scope of Individuals Covered Expanded.

The TCJA significantly expanded the scope of individuals covered by Section 162 (m). Under Section 162(m) as amended, Covered Employees include the CEO, CFO and three other most highly compensated executive officers of a public company. Any employee who served as the CEO or CFO at any time during the year is a Covered Employee and an employee does not need to be employed by the company at year-end to qualify as a Covered Employee (unlike pre-TCJA days). Any employee who was a Covered Employee for any taxable year beginning after December 31, 2016 continues to be a Covered Employee, meaning once an executive officer qualifies as a Covered Employee, he or she will continue to be treated as a Covered Employee under Section 162(m) indefinitely.

The final regulations further expanded the number of individuals covered by providing that an individual who was a Covered Employee of any predecessor to a publicly held corporation continues to be a Covered Employee of the corporation indefinitely.

Grandfathering Rules Further Clarified.

The changes made to Section 162(m) by the TCJA do not apply to compensation payable under a "written binding contract" that was in effect on November 2, 2017 and not materially modified after that date (the "Grandfather Rule"). The final regulations provide the following clarifications:

- A compensation arrangement that allows a company to exercise negative discretion to reduce an amount payable under an objective formula does not qualify for the Grandfather Rule (even if no changes or modifications are made to the arrangement).
- The existence of a clawback provision in a compensation arrangement giving a corporation the right to recover compensation if certain conditions occur does not affect the arrangement's grandfathered status. Further, a corporation's exercise of its right to recover compensation is not considered a material modification under the Grandfather Rule.
- The extension of the exercise period of otherwise grandfathered Stock Options and Stock Appreciation Rights will not result in loss of grandfathered status if the extension complies with Code Section 409A. Generally, an

extension complies with Section 409A if: (i) at the time of the extension the exercise price exceeds the fair market value of the underlying stock, and (ii) the exercise period is extended to a date no later than the earlier of (1) the original expiration date of the Stock Option/SAR, or (2) the 10th anniversary of the original grant date.

Applicability Dates

In general, the final regulations apply to taxable years beginning on or after December 30, 2020, but certain provisions have earlier effective dates such as the clarifications to the Grandfathered Rule and definition of Covered Employee.

IRS Issues Final Section 162 (m) Regulations on Companies' Ability to Deduct Executive Pay