

MODIFICATIONS TO CODE SECTION 162(M)

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Section 162(m) of the Internal Revenue Code limits the amount of compensation deductible by a public company to \$1 million per taxable year per covered employee. The Tax Cuts and Jobs Act of 2017 (“TCJA”) made significant changes to Section 162(m), including modifying which employees are covered employees subject to the \$1 million deduction limit. Post-TCJA, a public company’s covered employees for a taxable year generally include (i) an employee who is the CEO or CFO at any time during the taxable year, (ii) an employee who is among the three most highly compensated executive officers (other than an executive officer serving as CEO or CFO) serving at any time during the taxable year, and (iii) any employee who was a covered employee in any preceding taxable year beginning after December 31, 2016.

The American Rescue Plan Act of 2021 (“Act”) expands the number of employees treated as covered employees for purposes of the \$1 million deduction limit under Section 162(m). For taxable years beginning after December 31, 2026, a covered employee will also include any employee who is among the five highest compensated employees for a taxable year other than an employee described in (i) or (ii) above. Importantly, the “once a covered employee always a covered employee” provision described in (iii) above will not apply to this new category of covered employee under the Act.

On its face, the Act does not appear to restrict covered employee status to executive officers who have policymaking roles with the company. Since covered employee status is based on the executive compensation disclosure rules under the Securities Exchange Act of 1934, public companies may need to examine their tracking systems to take into account non-executive officers.

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