



GMS Flash Alert

Global Compensation Edition

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United States – Update on H.R. 1 Provisions on Section 162(m)

Originally named the *Tax Cuts and Jobs Act*, the recently signed tax reform law, H.R. 1 (“2017 Act”), makes several sweeping changes to section 162(m) of the U.S. Internal Revenue Code of 1986, as amended (the Code), which will impact publicly held corporations that maintain incentive-based compensation programs and similar arrangements for their key employees and executives.

This *GMS Flash Alert* updates our prior report on the same subject by summarizing those changes. (For prior coverage, see [GMS Flash Alert 2017-180](#) (December 7, 2017).)

WHY THIS MATTERS

The revisions under the 2017 Act effectively expand the scope of section 162(m) and eliminate important exemptions that previously applied to section 162(m).

This could make administrative information gathering more burdensome and affect compensation-related costs for employers, since the changes limit deductions going forward as well as eliminate the popular exception for performance-based compensation. This could also lead to complicated tracking of existing arrangements that cross over the transition period – which we discuss below – as well as tracking payments to covered employees.

Overview of Pre-2017 Act Status in Brief

Section 162(m) generally limits to \$1 million the amount of current compensation paid to a Named Officer (described as a “covered employee” in section 162(m)) that can be deducted by a publicly traded corporation in a taxable year. Furthermore, under the original rules, the “performance-based compensation” exemption was the most important exemption from the impact of section 162(m). If the incentive compensation plans are approved by shareholders and, except in the case of stock options and stock appreciation rights, subject to “objective performance goals” established

by outside directors at the beginning of the period to which the performance relates, then generally the compensation is exempt from the section 162(m) limitations.

For additional background, refer to [GMS Flash Alert 2017-180](#) (December 7, 2017).

Key Changes under the 2017 Act

Many of the changes in their “proposed” form were passed into law, and readers may refer back to our earlier report, [GMS Flash Alert 2017-180](#) (December 7, 2017). In brief, the key changes include:

- Expansion of section 162(m) to include CFOs in addition to chief executive officers (CEOs) and the next three highest compensated named executives.
- Once someone is identified as a covered employee (identified as of the 2017 tax year forward), the limitation continues to apply to payments made to that employee in all future years even if the employee would not otherwise be classified as a covered employee in such years, under the pre-2017 Act rules – thereby impacting severance pay and other arrangements that normally were not subject to section 162(m). Public companies subject to section 162(m) rules now will include certain foreign filers and potentially large private companies, as well as S corporations.
- Repeal the performance-based compensation exemption.
- A transition period under which section 162(m) expansion would not apply to compensation under a written binding contract in effect on November 2, 2017, that was not materially modified.

KPMG NOTE

The 2017 Act revisions to section 162(m) represent a restriction of an employer’s ability to deduct for executive compensation to certain executives.

Employers should consider whether existing arrangements may be grandfathered under the transition rule.

They may also wish to undertake benchmarking and compensation and benefits design review, as a way to help assure they are competitive in the marketplace.

FOOTNOTE:

1 For the text and status of H.R. 1, [click here](#).

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