



**Feedback for Notice 2018-68 (Guidance on the Application of §162(m)<sup>1</sup> as of 10/30/2018**

<b>NOTICE 2018-68, SECTION NUMBER</b>	<b>SECTION TITLE or ISSUE TOPIC</b>	<b>RECOMMENDATION</b>	<b>ADDITIONAL EXPLANATION /QUERIES</b>
<b>Section III.B.</b>	Remuneration Provided Pursuant to a Written Binding Contract	Clarify that compliance with requirements of, or changes to, federal or state law does not result in the lack of a written binding contract or a material modification.	<p>For example, the Sarbanes Oxley Act allows the SEC to require “clawbacks” – or the recovery of compensation from executive officers in the event of fraud, malfeasance and/or a material financial restatement. Section 954 of the Dodd-Frank Act requires the SEC to issue rules to require companies to adopt clawback policies for current and former executive officers. Many companies have incorporated clawback rules in their incentive compensation plans and policies. Such provisions should not cause the arrangement to fail to be a written binding arrangement as of November 2, 2017.</p> <p>Additionally, in the event changes in law require amendments to contracts, such amendments are not discretionary and should not be considered modifications.</p>
<b>Section III.B.1.</b>	Remuneration Provided pursuant to a Written Binding Contract: Written Binding Contract	Clarify how renewal /termination of a contract mid-term affects grandfathering of compensation, i.e., that all compensation paid prior to the renewal / termination should remain eligible for grandfathering.	<p>The following examples help demonstrate this issue.</p> <p><u>Example:</u> A CFO’s employment agreement in effect on November 2, 2017</p>

<sup>1</sup> Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.



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		<p>Failure to preserve grandfathering for previously paid amounts could trigger significant adverse tax consequences for companies and/or an obligation to restate financial statements simply due to the renewal / termination of a grandfathered arrangement mid-term.</p>	<p>provides for a base salary of \$3 million for 2018, 2019, 2020, and 2021. The company and the CFO agree to terminate the agreement effective January 1, 2020. It is unclear under the proposed grandfathering rule whether the company would still be able to claim the compensation expense deduction associated with base salary payments paid in 2018 and 2019.</p> <p><u>Example:</u> Same facts as above, except the company and CFO agree to extend the term of the employment agreement through 2025. It is unclear under the proposed grandfathering rule whether the company would still be able to claim the compensation expense deduction associated with base salary payments paid in 2018 and 2019.</p>
		<p>Equity awards promised in contracts in effect on November 2, 2017, contingent on Board/ Compensation Committee approval should be considered granted pursuant to a written binding contract in effect on that date.</p>	<p>While Boards/Compensation Committees have ultimate administrative authority over equity plans, promises to grant equity awards subject to approval are generally regarded as binding the company to make such awards.</p> <p>This language often reflects the fact that the contract is entered into prior to the Board's/Compensation Committee's next</p>



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			meeting, at which point, the promised award will be officially granted.
		Clarify that objective formula-based incentive programs constitute written binding contracts. An objective formula-based incentive program that was in effect on November 2, 2017 should qualify for grandfathering; provided, that it is not subsequently modified.	
		<p>Clarify that a contractual obligation will be respected regardless of whether negative discretion exists.</p> <p>This rule could be implemented in a manner similar to how the §409A regulations address written binding contracts. Pursuant to Regs. §1.409A-1(b)(1):</p> <p>A service provider does not have a legally binding right to compensation to the extent that compensation may be reduced unilaterally or eliminated by the service recipient or other person after the services creating the right to the compensation have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the compensation is available or exercisable only upon a condition, or the discretion to reduce or eliminate the compensation lacks substantive significance, a service provider will be considered to have a</p>	<p>The new §162(m) rules do not apply to written binding contracts in place before 11/2/2017, provided they have not been materially modified after such date.</p> <p>Compensation committees are sometimes permitted (but not required) to exercise negative discretion (i.e., to reduce payments otherwise payable).</p> <p>Notice 2018-68, III., B., Example 3 can be read to suggest the IRS believes that broad-based negative discretion clauses are inconsistent with the existence of a payment obligation unless the contract provides a minimum amount, thus making at least a portion of such payments subject to the new §162(m) rules.</p>



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		<p>legally binding right to the compensation. Whether the discretion to reduce or eliminate the compensation lacks substantive significance depends on all the relevant facts and circumstances. However, where the service provider to whom the compensation may be paid has effective control of the person retaining the discretion to reduce or eliminate the compensation, or has effective control over any portion of the compensation of the person retaining the discretion to reduce or eliminate the compensation, or is a member of the family (as defined in section 267(c)(4) applied as if the family of an individual includes the spouse of any member of the family) of the person retaining the discretion to reduce or eliminate the compensation, the discretion to reduce or eliminate the compensation will not be treated as having substantive significance. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of a nondiscretionary, objective provision creating a substantial risk of forfeiture. Similarly, a service provider does not fail to have a legally binding right to compensation merely because the amount of compensation is determined under a formula that provides for benefits to be offset by benefits provided under another plan (including a plan that</p>	



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		<p>is qualified under section 401(a)), or because benefits are reduced due to actual or notional investment losses, or, in a final average pay plan, subsequent decreases in compensation.</p> <p>It is worth noting that negative discretion was not an issue in the past, and, as stated on page 5 of the Notice, “The text of [the grandfather rule] is almost identical to the text of pre-amendment section 162(m)(4)(D).” Since negative discretion was clearly permissible under old §162(m), which Congress was aware of, it should not be carved out as ineligible for grandfathering (especially since the Notice takes the position that state law determines what is and is not a “written binding contract”).</p>	
<b>Section III.B.2.</b>	Remuneration Provided pursuant to a Written Binding Contract: Material Modification	Given the immediate effective date and lack of clarity about what would constitute a “material modification” to an existing arrangement on or after November 2, 2017, the IRS should adopt a “good faith” transition rule under which certain minor modifications would not constitute a material modification, including (i) those deemed appropriate to address the impact of an acquired business on an existing performance award’s targets, or (ii) minor modifications that may ultimately result in a de minimis increase in pay-out, that were adopted between November 2, 2017 and the issuance of Notice 2018-68.	



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		<p>Where a plan provides for a deferral of payment where any additional amount is not based on an interest rate or actual investment, the entire payment should be grandfathered as this should be no different than tracking an actual investment. Alternatively, at a minimum, any amounts that would have been paid out even without the deferral of the payment would still be grandfathered under §162(m).</p>	<p>For example, a plan may provide for an additional payment based off of another objective measure such as Return on Equity, Total Shareholder Return, or return on a custom composite index.</p>
		<p>Clarify that deferred compensation notionally invested in investment alternatives offered under the plan qualifies as a predetermined actual investment; thereby, the returns on such notional investments are not considered material modifications.</p> <p>Instead, the ability to notionally invest deferred amounts should be treated as invested according to a predetermined actual investment.</p> <p>Likewise, the IRS should specify that the rate of return based on an indexed fund does not result in a material modification.</p>	
		<p>Clarify that the alteration of an amount payable by operation of company policies in effect prior to November 2, 2017, should not constitute a modification.</p>	<p>For example, the reduction in an amount payable based on the application of a detrimental conduct/malus policy that is outside of the contract but applicable to employees should not be considered a modification.</p>



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			While the Notice, (p. 14) defines a material modification as occurring “when the contract is amended to increase the amount of compensation payable to the employee,” it also provides an example of a material modification which does not involve increasing the amount of compensation payable (i.e., acceleration of payment – see p. 14) and clarification is needed.
		Clarify that in the event of an increase in compensation, the original amount of compensation does not lose grandfathered status.	Example 11 on page 20 of the Notice creates incentives for employers to shift salary increases to equity awards to avoid triggering a material modification.
<b>Additional Request for Comments On:</b>	Application of the definition of “publicly held corporation” to foreign private issuers, including the reference to issuers that are required to file reports under §15(d) of the Securities Exchange Act of 1934	Clarify that an issuer subject to Section 15(d) of the Securities Exchange Act of 1934, but that does not file reports due to an exemption, is not considered publicly held.	<u>Example:</u> A FPI is subject to Section 15(d), but does not have to file reports due to its relationship with its U.S. publicly traded parent. This FPI should not be covered by the rule since it does not file reports.
	Application of the definition of “covered employee” in a consolidated context	Neither the legislation nor the regulations address situations in which multiple entities could be tested separately within one taxpayer’s consolidated group. Treasury regulations should test covered employees on a U.S. consolidated return basis, which is consistent with multiple rules in the Internal Revenue Code, including recently enacted provisions such as interest disallowance rules,	Such a provision would cover both captive SEC-registrants of parent company SEC-registrants and predecessor employees in the mergers and acquisitions context.  Additionally, it should be clarified that an acquired company’s covered employees would be subject to the definition based on



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		GILTI, and presumably FDII as well as other long-standing calculations such as net operating losses.	<p>the new consolidated group. i.e., there is only one group of covered employees after acquisition/consolidation.</p> <p>The number of covered employees of a public company should not be increased merely because, for example, it has a financing subsidiary.</p>
<b>Miscellaneous</b>	Application of transition relief to participants in nonqualified defined benefit (NQDB) plans	Clarify that benefits payable to any individual who becomes a covered employee solely as a result of the Act's amendments to §162(m)(3) pursuant to a NQDB plan that such covered employee participated in on or prior to November 2, 2017 and that was not materially modified qualify for transition relief.	<p>The Notice does not address benefits payable from nonqualified defined benefit plans.</p> <p>The Notice suggests that future earnings on nonqualified defined contribution benefits may result in loss in grandfathering unless those earnings are based on a pre-specified rate of return or investment. Unlike NQDC plans, there is no specified earnings rate for post November 2, 2017 growth in benefits under a NQDB plan. Most of these plans base benefits on final average earnings and years of service. Therefore, it is unclear whether these benefits would qualify for grandfathering.</p> <p>Consistent with the transition relief, payments made from such arrangements should be considered paid pursuant to</p>





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			<p>written binding contracts in effect on November 2, 2017. Therefore, participants who become covered employees, solely due to the changes made to §162(m)(3), should qualify for transition relief.</p> <p><u>Example:</u> A CFO participates in a SERP in effect on November 2, 2017 that provides a benefit equal to 60% of her final average compensation (three highest years out of last five). The CFO retires on December 31, 2020 and her 2018, 2019, and 2020 final average earnings were the three highest years. The Notice does not address whether the CFO's SERP benefit would qualify for grandfathering. The IRS should specify that the entire benefit is grandfathered since it is paid pursuant to a formula set forth in a written binding contract in effect on November 2, 2017.</p>