Feedback for REG-122180-18: Certain Employee Remuneration in Excess of $1,000,000 under Internal Revenue Code §162(m)[1]

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Prop. Regs. §1.162–33	**Certain employee remuneration in excess of $1,000,000 not deductible for taxable years beginning after December 31, 2017**			
Prop. Regs. §1.162–33(c)	**Definitions**	Application of the definition of "publicly held corporation" to foreign private issuers (Prop. Regs. §1.162-33(c)(1))	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, GILTI and FDII as well as other long-standing calculations such as net operating losses and the prior law domestic production deduction.	Regarding the expanded definition, Treasury states that "the legislative history clarifies that the flush language was intended to apply more broadly … (even) to a corporation that does not file a proxy statement for the year because it delists its securities." While such broad legislative intent is stipulated, neither the legislation nor the regulations address situations in which multiple entities could be tested separately within one taxpayer's consolidated group. Testing on a U.S. consolidated return basis would cover both captive SEC-registrants of parent company SEC-registrants and

[1] 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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				predecessor employees in the mergers and acquisitions context.
		Extension of covered employee definition to executives not listed in the annual report (Prop. Regs. §1.162-33(c)(2)(i)(B))	Recommend withdrawal of Prop. Regs. §1.162-33(c)(2)(i)(B))	The proposed regulations are contrary to the language of the statute and the express legislative history. While the preamble to the proposed regulations purports to rely on the legislative history to the flush language added to §162(m) and the SEC executive compensation rules in 17 CFR 229.402(a)(3) ("Item 402") in extending the definition of covered employee to executive officers not employed at the end of the year to which the proxy disclosure relates, this misconstrues the purpose of the flush language as expressed in the legislative history and therefore exceeds the scope of the statute. • The legislative history confirms that the flush language intends merely to include within the scope of covered employees "such officers of a corporation not required to file a proxy statement but which otherwise falls within the revised definition of a publicly held corporation, as well as such officers of a publicly traded

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				corporation that would otherwise have been required to file a proxy statement for the year (for example, but for the fact that the corporation delisted its securities or underwent a transaction that resulted in the nonapplication of the proxy statement requirement)." H.R. Conf. Rep. No. 116-466, 489 (Dec. 15, 2017). • Thus, the flush language focuses on the nature of the corporate issuer itself as not subject to the Item 402 disclosure requirements but nonetheless subject to §162(m), rather than on the pool of executives of a corporate issuer that is expressly subject to Item 402 disclosure. • Consequently, the effect of the flush language only treats the relevant executives of a non-proxy-filing "publicly traded corporation" as if their compensation required disclosure in a proxy statement. It does not expand the scope of executives of a proxy-filing publicly traded corporation whose compensation is

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				subject to §162(m) beyond those disclosed under Item 402. • By potentially limiting deductibility of compensation paid to executives who are not required to be listed in a publicly traded corporation's filed Item 402 disclosure the proposed regulation extends the scope of the statute beyond Congress' limited intent. The proposed regulations should not burden companies with the task of identifying employees who are not listed in their disclosure.
		Remuneration paid by a partnership (Prop. Regs. §1.162-33(c)(3)(ii))	Recommend withdrawal of Prop. Regs. §1.162-33(c)(3)(ii).	The proposed regulations significantly depart from consistent and longstanding interpretation of §162(m) as only applicable to pay from publicly traded corporations ("Public Corporations") with no change in the statutory language to support this fundamental change in interpretation. • Nothing in the §162(m) legislative history, either in the 1993 enacting legislation or in the TCJA, supports intent for §162(m) to apply to entities other than Public Corporations. • From enactment to issuance of these rules, no regulations or other guidance

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				suggested that §162(m) should apply to partnerships generally. • In the preamble to the 1993 original §162(m) proposed regulations, Treasury considered whether master limited partnerships with publicly traded equity should be subject to the §162(m) limitation due to their public trading. The preamble states "Whether these partnerships would be publicly held corporations within the meaning of section 162(m) . . . is currently under study and is not addressed in these proposed regulations. If necessary, guidance as to the application of section 162(m) to these entities will be provided in the future." Thus, while Treasury clearly considered whether pay from partnerships should be subject to the §162(m) limitation, at most the limitation would have applied to only partnerships required to register their own equity securities under the Exchange Act. Treasury focused only on these entities being publicly traded, and not that they were taxed as partnerships, consistent with restricting the limitation to entities that are

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				themselves publicly traded. Treasury never issued guidance on the issue, beyond this preamble statement. • IRS interpretations of §162(m) in private rulings consistently conclude §162(m) does not apply to remuneration from partnerships. The TCJA amendments to §162(m) expand the scope of *corporations* subject to the provision, and do not expand the scope of coverage beyond corporations. • In Notice 2018-68, 2018-36 I.R.B. 418, Treasury and the IRS issued interim guidance on the TCJA amendments to §162(m) and further stated they "anticipate that further guidance on the amendments made by section 13601 of the Act will be issued in the form of proposed regulations, which will incorporate the guidance provided in this notice." They provided no guidance and requested no comment on extending coverage to pay from a partnership to a covered employee of a corporate partner. The limited scope of the interim guidance and proposed regulations that they anticipated issuing to address only the changes made by

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				TCJA acknowledges there is no statutory basis for extending the scope of §162(m) beyond public corporations.
Prop. Regs. §1.162–33(g)	**Transition rules**	Scope of application of transition rule	Extend transition rule to remuneration paid by pre-existing partnership (i.e., "grandfathering" of existing partnership structures and compensation arrangements).	Treasury and the IRS can employ a variety of regulatory mechanisms to ensure partnerships and their associated compensation structures established and maintained based on current law are permanently grandfathered, including a limited exception for renumeration paid by operating partnerships in existence on the TCJA date of enactment. Expanding transition relief is appropriate given the lack of notice to taxpayers on such a fundamental change to current law and the inability of taxpayers to modify longstanding business and associated compensation arrangements established and maintained based on current law. Any grandfathering exception can be structured to ensure it prevents abuse. For pre-existing partnerships, any exception would apply only to partnerships engaged in the conduct of an active business on the TCJA date of enactment, for remuneration paid to an employee of the partnership. This limited scope of eligible entities would acknowledge that these partnerships were not formed or deployed to avoid §162(m). These entities would be partnerships with active business

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				operations in their own right, with managers historically paid directly by the partnership. After operating in partnership form for an extended period, these companies may have adopted a structure that included a publicly-traded corporation as a significant partner (e.g., an "up-C" structure) to access the capital markets more efficiently and attract a broader range of investors with sensitivities to investing directly in an operating partnership. After adopting the new organizational structure, the managers of the partnership, now likely officers of the public company, would be paid by the operating partnership for the services they continued to perform directly for the partnership. Further, these pre-existing organizational structures demonstrate compelling business reasons for their structure unrelated to §162(m); since this proposed exception would apply only to pay from a partnership to persons in their capacity as employees of the partnership, adopting this limited exception presents no significant potential for avoidance of the newly expanded scope of §162(m) as envisioned by the proposed rules.

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		Material modifications	Adopt a transition rule such that certain deferral elections made from November 2, 2017 through the release of Notice 2018-68 would not be considered a material modification. In the alternative, if the above suggested transition rule is not adopted, the Chamber proposes a transition rule under which, with respect to any material modification from November 2, 2017 through the release of Notice 2018-68, only the incremental amount above the originally grandfathered amount would be treated as not being grandfathered.	The general rule of Prop. Regs. §1.162–33(g)(1)(i) provides: This section does not apply to the deduction for remuneration payable under a written binding contract that was in effect on November 2, 2017, and that is not modified in any material respect on or after such date (a grandfathered amount). Prop. Regs. §1.162–33(g)(2)(ii) provides: A modification of the contract that accelerates the payment of compensation is a material modification unless the amount of compensation paid is discounted to reasonably reflect the time value of money. If the contract is modified to defer the payment of compensation, any compensation paid or to be paid that is in excess of the amount that was originally payable to the employee under the contract will not be treated as resulting in a material modification if the additional amount is based on applying to the amount originally payable either a reasonable rate of interest or the rate of return on a predetermined actual investment as

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				defined in §31.3121(v)(2)-1(d)(2)(i)(B) of this chapter, (whether or not assets associated with the amount originally owed are actually invested therein) such that the amount payable by the employer at the later date will be based on the reasonable rate of interest or the actual rate of return on the predetermined actual investment (including any decrease, as well as any increase, in the value of the investment). The definition of "material modification" in the proposed rules is proposed to apply to taxable years ending on or after September 10, 2018, the publication date of Notice 2018-68. For a calendar year taxpayer, this means the definition is effective as of January 1, 2018. Prop. Regs. §1.162–33(g)(2)(i) provides: If a written binding contract is materially modified, it is treated as a new contract entered into as of the date of the material modification. Thus, amounts received by an employee under the contract before a material modification are not affected, but

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				amounts received subsequent to the material modification are treated as paid pursuant to a new contract, rather than as paid pursuant to a written binding contract in effect on November 2, 2017. It appears that if a covered employee of a calendar year taxpayer elects to defer or re-defer the payment of a grandfathered amount after January 1, 2018 and earns in excess of a "reasonable rate of interest" on the grandfathered amount pursuant to plan provisions that were in effect on and not modified after November 2, 2017, the deferral or re-deferral election would still result in a material modification of the contract that would cause the entire amount of compensation to cease to be a grandfathered amount under the general rule. The TCJA makes no provision for this type of deferral or re-deferral to be considered a "material modification." Although the existing regulations under §162(m) include a similar rule for pre-1993 grandfathered amounts, the first time Treasury and IRS publicly identified that this rule would be applied to amended §162(m) was in Notice 2018-68, which was

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				issued on September 10, 2018. Taxpayers with existing deferred compensation plans that allowed deferrals or re-deferrals to earn amounts in excess of a "reasonable rate of interest" were put in the difficult position of choosing whether to honor the pre-existing arrangements without the benefit of any IRS guidance. As such, a transition rule is needed. Furthermore, the proposed regulations provide that a material modification to a contract is treated as a new contract, meaning that any material modification results in all amounts under the contract no longer being grandfathered, rather than only the amounts added by the material modification. For example, in the case of a deferral or re-deferral under a deferred compensation plan, this means that even a small amount of interest in excess of a reasonable rate of interest would result in the entire account balance no longer being grandfathered. Although the existing regulations under §162(m) include a similar rule for pre-1993 grandfathered amounts, it was not clear before Notice 2018-68 that this same concept would apply to amended §162(m).

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				Therefore, if the transition rule suggested above is not adopted, the Chamber proposes a transition rule under which, with respect to any material modification from November 2, 2017 through the release of Notice 2018-68, only the incremental amount above the originally grandfathered amount would be treated as not being grandfathered. In the case of a deferral or re-deferral under a deferred compensation plan with an interest rate that is not considered reasonable, this would mean that only the incremental interest above a reasonable interest rate would be treated as not being grandfathered.
Prop. Regs. §1.162–33(h)	**Effective/ applicability dates**	Application of §162(m) to partnership compensation	The effective retroactive application of the regulations should be reversed with the final regulations not applying until taxable years beginning after 2020 at the earliest.	The proposed regulations posit a new approach to applying §162(m) to partnership compensation for which taxpayers had little time to analyze or apply.
		Taxpayers that received PLRs	The retroactive authority of §7805(b) should be tempered by allowing a long, e.g. 10-year, transitional rule, with respect to the application of §162(m) to compensation paid by a partnership.	Taxpayers that received PLRs should receive even more generous transitional rules since they played by the rules and received IRS' confirmation of the application of §162(m) to their particular factual situation. The IRS should encourage taxpayers to raise issues with them through the PLR process so that the IRS is aware of potential tax administration

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				issues that the IRS might want to address through public guidance. Applying a regulatory change to taxpayers who have gone through the PLR process to the same extent as those taxpayers who have not done so could discourage taxpayers from seeking PLRs in the first place, which would be detrimental to tax administration. Additionally, the IRS should recognize that taxpayers who raised an issue with the IRS by seeking a private ruling and then accepting the IRS' conclusions in a PLR should be afforded more flexibility when it changes its decisions about the conclusions reached in the PLR, in particular when, as here the change in position is made not by statute but by change in the IRS' interpretation, to apply §162(m) to partnership employees. Nothing in the 2017 tax bill changed with respect to this issue. Instead, the IRS is taking the opportunity under the 2017 bill to make this interpretative change.