

# Memorandum

## Treasury Releases Final Section 162(m) Regulations

December 23, 2020

### Overview

This memorandum summarizes some of the key issues raised by the final regulations under Section 162(m) of the Internal Revenue Code (“Section 162(m)”) regarding the \$1 million cap on deductible compensation paid to covered employees of public corporations.

On December 18, 2020, the Treasury Department promulgated [final regulations](#) under Section 162(m) which mostly follow the similar proposed regulations that Treasury released a year ago, in December 2019. These regulations finalize the rules that became applicable in light of the amendments to Section 162(m) that were implemented by the 2017 Tax Cuts and Jobs Act (the “Jobs Act”). As amended by the Jobs Act, Section 162(m) generally limits a public corporation’s annual deductions to \$1 million for compensation paid to each of the corporation’s principal executive officer (“PEO”), principal financial officer (“PFO”) and three highest-paid executive officers other than its PEO and PFO. The Jobs Act eliminated the prior exception that existed under Section 162(m) for the deductibility of “performance-based compensation,” other than in the case of certain grandfathered arrangements that were in effect as of November 2, 2017.

The preamble to the final regulations noted several areas where commentators sought changes to the proposed regulations. However, Treasury ultimately rejected most of those requests and determined to leave the proposed regulations largely intact. Some of the more salient rule affirmations in the final regulations include the following:

- **Inclusion of Foreign Private Issuers.** The regulations confirm that foreign private issuers will be considered “publicly held corporations” subject to Section 162(m) if they are required to register securities under Section 12 of the Exchange Act or file reports under Section 15(d) of the Exchange Act, regardless of whether or not the foreign private issuers are required to disclose compensation of their officers on an individual basis.
- **“Covered Employee” Determinations.** The term “covered employee” continues to include (i) any employee serving as PEO or PFO at any time during the taxable year, (ii) the three highest paid executive officers for the taxable year other than the PEO and PFO (regardless of whether or not such officers continue serving through year-end and regardless of whether SEC rules require disclosure of such executive’s compensation) and (iii) any individual who was a “covered employee” of the taxpayer for any preceding taxable year beginning after December 31, 2016.

- **Compensation Paid by Partnerships.** Despite numerous requests to revise the proposed regulations' rule related to compensation paid by partnerships, the final regulations generally affirmed that when a publicly held corporation holds a partnership interest (*e.g.*, in an "up-C" corporate structure), the corporation must take into account its distributive share of the partnership's deduction for compensation paid to covered employees of the corporation. However, Treasury partially acceded to the requests for additional transition relief in application of the partnership compensation rule by delaying the effectiveness of this rule to compensation paid after December 18, 2020, while also retaining the transition relief under the proposed regulations for compensation that may continue to be paid pursuant to binding contracts that were in effect on December 20, 2019 (and not materially modified after that date). The final regulations also clarified that Section 162(m) generally will not apply to compensation paid to a publicly held corporation's covered employee by a corporate subsidiary of a partnership for services performed as an employee of the subsidiary because, in this circumstance, the corporate subsidiary would not be a member of the publicly held corporation's affiliated group.
- **Extension of Exercise Period for Grandfathered Stock Options.** The final regulations clarify that a "grandfathered" stock option which is exempt from the Section 162(m) deduction limitations by virtue of having been granted prior to November 2, 2017 will not be deemed to have been "materially modified"—and therefore will not lose its "grandfathered" status—if the stock option exercise period is extended in a manner that would be permitted under Section 409A of the Code (*e.g.*, allowing a terminating employee to retain the stock option until the end of the full 10 year option term, rather than applying the normal early option termination provisions applicable to a terminating employee).

The final regulations also include numerous updated examples regarding the application of general grandfathering rules, the treatment of affiliated groups and the treatment of predecessor corporations in connection with corporate transactions.

For more information regarding Section 162(m), please contact a member of the Firm's Executive Compensation and Employee Benefits Practice Group.

NEW YORK CITY

---

**Andrew Blau**  
+1-212-455-2380  
[andrew.blau@stblaw.com](mailto:andrew.blau@stblaw.com)

**Gregory T. Grogan**  
+1-212-455-2477  
[ggrogan@stblaw.com](mailto:ggrogan@stblaw.com)

**Jeannine McSweeney**  
+1-212-455-3349  
[jeannine.mcsweeney@stblaw.com](mailto:jeannine.mcsweeney@stblaw.com)

**Laurence M. Moss**  
+1-212-455-2280  
[larry.moss@stblaw.com](mailto:larry.moss@stblaw.com)

**Brian D. Robbins**  
+1-212-455-3090  
[brobbins@stblaw.com](mailto:brobbins@stblaw.com)

**David E. Rubinsky**  
+1-212-455-2493  
[drubinsky@stblaw.com](mailto:drubinsky@stblaw.com)

**Jamin R. Koslowe**  
+1-212-455-3514  
[jkoslowe@stblaw.com](mailto:jkoslowe@stblaw.com)

PALO ALTO

---

**Tristan Brown**  
+1-650-251-5140  
[tbrown@stblaw.com](mailto:tbrown@stblaw.com)

*The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, [www.simpsonthacher.com](http://www.simpsonthacher.com).*