



Code Section 162(m) Planning Strategies

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Companies are exploring possible ways to avoid the newly-expanded deduction limitation. We continue to think that Code Section 162(m) does not apply to payments made after termination of employment. See IPB Comment Letter [Here](#) are eight other ideas to reduce or eliminate Code Section 162(m) disallowance. Three of these call for organizational changes, and the other five deal with changes in compensation structure.

1. Nonqualified deferred compensation payments. Limit deferred payments so that payouts are not more than \$1 million per year. The Code Section 409A regulations permit plans to add a delay even if the plan did not contemplate this kind of delay originally. However, the delay must apply to all Section 409A deferrals (Treas. Reg. 1.409A-2(b)(7)(i)), and the employer's right to add a payout delay for prior deferrals might be constrained by the plan's amendment provision.
2. Add other payment delays. Extend restricted stock unit (RSU) and/or performance stock unit (PSU) payments to fall under the Code Section 162(m) limit. Of course, extending RSU and PSU payments in this fashion may bring these arrangements under Code Section 409A.
3. QSERP. A QSERP is an arrangement where a nonqualified plan obligation is transferred into a tax-qualified pension plan. Qualified plan distributions are excluded from Code Section 162(m). Of course, adding benefits to a qualified plan for a few a highly-compensated employees must satisfy the nondiscrimination rules of Code Section 401(a)(4). The IRS proposed regulations in 2016 that would have killed QSERPs, but the proposal was withdrawn a couple of months later for further consideration. The "substitution" rule under Code Section 409A also must be taken into account if a SERP benefit is transferred to a qualified plan.



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4. Tax-free income. Maximize non-taxable benefits, such as retiree medical and for life benefits for executives and/or their dependents.
5. Consulting arrangement. Provide post-employment pay under a consulting arrangement rather than under a standard nonqualified deferred compensation plan. The consulting payments then would be attributable to the individuals' post-employment consulting work and arguably are treated as independent contractor pay outside of the scope of Code Section 162(m), rather than compensation attributable to prior employment.
6. Incorporate the "covered employee." The executive's wholly-owned corporation would employ the executive, and the publicly-traded company would pay the corporation and not the executive. This approach arguably avoids the deduction limit because the Code Section 162(m) regulations provide that a "covered employee" must be an "individual." Reg. 1.162-27(c)(2). The publicly-traded company would have to decide how to treat the situation for SEC purposes. This could call for the SEC office reporting of the personal service corporation, the individual executive, or skipping the personal service corporation and naming a different executive. Personal service corporations have sometimes been honored and other times disregarded under the case law, so the approach could be challenged. Compare *Sargent v. Commissioner*, 929 F.2d 1252 (8th Cir. 1991), with *Johnson v. Commissioner*, 78 T.C. 882 (1982), aff'd 734 F.2d 20 (9th Cir. 1982).
7. Use non-controlled group entity. Establish a 79%-owned subsidiary to employ and compensate the top executives. This management services subsidiary is not treated as publicly traded because it is not part of the publicly-traded parent corporation's-controlled group and therefore is not the deduction limit. But the subsidiary executives could perform policy-making functions for the parent corporation and may still need to be listed in the parents' proxy for that reason. See, 17 C.F.R. 240.3b-7 (definition of "executive officer").
8. Partnership. Parent corporation establishes a partnership and the partnership employs the executives. As with a 79% corporation, the partnership is not part of the corporation's-controlled group so that Section 162(m) does not apply, but partnership executive probably might still need to be listed as an executive of the parent corporation for SEC purposes. The IRS has addressed partnership employees in the context of Code Section 162(m) in several private rulings (PLRs 200837024 (Sept. 12, 2008); 200727008 (April 2, 2007); 200614002 (April 4, 2006) (neither partnership compensation deduction nor a corporate parent's share of a partnership's compensation deductions were subject to Code Section 162(m)).