



Code Section 162(m) Grandfathering Rule Under TCJA

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Many practitioners are applying the Treasury's 162(m) guidance in ways that unnecessarily narrow the scope of the grandfathering protection and therefore could lead to unnecessary tax charges. For example:

- **Contracts for Performance Pay with Negative Discretion.**

Notice 2018-68 does not explicitly conclude whether the existence of "negative discretion" causes an amount to lose grandfathering. To the contrary, the Notice provides that the analysis depends on applicable law. There appears to be confusion regarding which law applies; depending on the arrangement, federal common law, the state identified in a governing law provision, or another state's law could apply to determine whether there is a contract.

- **Earnings on Deferred Compensation.** Many have concluded that earnings on deferred compensation are not grandfathered if the employer has discretion to eliminate future earnings credits. However, again, the relevant examples provided by Treasury assume the question - that those earnings are not protected under applicable contract law. In many cases, we expect that federal common law, securities laws, and/or other applicable law could protect earnings adjustments, assuming the individual continues to work and payment continues to be deferred.



| 2 | Code Section 162(m) Grandfathering Rule Under TCJA

- **Irrevocable Deferrals of Performance or Non-Performance Pay.** Notice 2018-68 repeatedly contemplates that a "binding contract" corresponds to a specific amount. But, in fact, the grandfather rule could protect binding contracts that are not tied to a particular amount and are instead tied to timing of payment. For example, a pre-11/2/17 irrevocable election to defer pay until after termination of employment may well be a binding contract sufficient to preserve the statutory standard for grandfathered status even if the underlying pay is not itself contractually obligated. Because Treasury does not anticipate this possibility, it is not clear how the "material modification" standard might apply to it (for example, if the amount of the underlying pay is significantly changed).