

(other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any unnecessary health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(i) *Exceptions.* The following information may be included and is not required to be redacted from filings:

(A) The last four digits of a financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(B) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(C) Business telephone numbers; and

(D) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(f) *Certification.* Any filing made pursuant to this section, other than the record upon which the action complained of was taken, must include a certification that any information described in paragraph (e)(2) of this section has been omitted or redacted from the filing.

■ 13. Section 201.440 is amended by revising paragraph (d) and adding paragraph (e) to read as follows:

§ 201.440 Appeal of determinations by the Public Company Accounting Oversight Board.

* * * * *

(d) *Certification of the record; service of the index.* Within fourteen days after receipt of an application for review, the Board shall certify and file electronically in the form and manner to be specified by the Office of the Secretary in the materials posted on the Commission's website one unredacted copy of the record upon which it took the complained-of action.

(1) The Board shall file electronically with the Commission one copy of an index of such record, and shall serve one copy of the index on each party. If such index contains any sensitive personal information, as defined in paragraph (d)(2) of this section, the Board also shall file electronically with the Commission one redacted copy of such index, subject to the requirements of paragraphs (d)(2) of this section.

(2) *Sensitive personal information.* Sensitive personal information is defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued

identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any unnecessary health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(i) *Exceptions.* The following information may be included and is not required to be redacted from filings:

(A) The last four digits of a financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(B) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(C) Business telephone numbers; and

(D) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(e) *Certification.* Any filing made pursuant to this section, other than the record upon which the action complained of was taken, must include a certification that any information described in paragraph (d)(2) of this section has been omitted or redacted from the filing.

By the Commission.

Dated: November 17, 2020.

J. Matthew DeLesDernier,

Assistant Secretary.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9932]

RIN 1545-BO95

Certain Employee Remuneration in Excess of \$1,000,000 Under Internal Revenue Code Section 162(m)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document sets forth final regulations under section 162(m) of the Internal Revenue Code (Code), which for Federal income tax purposes limits the deduction for certain employee remuneration in excess of \$1,000,000. These final regulations implement the amendments made to section 162(m) by the Tax Cuts and Jobs Act and finalize

the proposed regulations published on December 20, 2019. These final regulations affect publicly held corporations.

DATES:

Effective Date: These regulations are effective on December 30, 2020.

Applicability Dates: For dates of applicability, see § 1.162-33(h).

FOR FURTHER INFORMATION CONTACT: Ilya Enkishev at (202) 317-5600 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations ("Treasury regulations" (26 CFR part 1) under section 162(m)). Section 162(m)(1) disallows a deduction by any publicly held corporation for applicable employee remuneration paid or otherwise deductible with respect to any covered employee to the extent that such remuneration for the taxable year exceeds \$1,000,000. Section 162(m) was added to the Code by section 13211(a) of the Omnibus Budget Reconciliation Act of 1993, Public Law 103-66. Proposed regulations under section 162(m) were published in the **Federal Register** on December 20, 1993 (58 FR 66310) (1993 proposed regulations). On December 2, 1994, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued amendments to the proposed regulations (59 FR 61884) (1994 proposed regulations). On December 20, 1995, the Treasury Department and the IRS issued final regulations under section 162(m) (TD 8650) (60 FR 65534) (1995 regulations).

Section 162(m) was amended by section 13601 of the Tax Cuts and Jobs Act (TCJA) (Pub. L. 115-97, 131 Stat. 2054, 2155 (2017)). Section 13601 of TCJA amended the definitions of covered employee, publicly held corporation, and applicable employee remuneration in section 162(m). Section 13601 also provided a transition rule applicable to certain outstanding compensatory arrangements (commonly referred to as the grandfather rule). On August 21, 2018, the Treasury Department and the IRS released Notice 2018-68 (2018-36 I.R.B. 418), which provides guidance on certain issues under section 162(m).

On December 20, 2019, the Treasury Department and the IRS published proposed regulations (REG-122180-18) relating to the amendments TCJA made to section 162(m) in the **Federal Register** (84 FR 70356) (the proposed regulations). The changes to section 162(m) made by section 13601 of TCJA and the initial guidance provided by

Notice 2018–68 are described in detail in the preamble to the proposed regulations.

A public hearing was held on March 9, 2020. The Treasury Department and the IRS also received written comments with respect to the proposed regulations. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request. After full consideration of the comments received on the proposed regulations and the testimony heard at the public hearing, this Treasury decision adopts the proposed regulations with modifications in response to certain comments and testimony, as described in the Summary of Comments and Explanation of Revisions section. Comments outside of the scope of the proposed regulations generally are not addressed in this preamble but may be considered in connection with future guidance projects.

Summary of Comments and Explanation of Revisions

I. Overview

Section 13601 of TCJA significantly amended section 162(m). Consistent with the proposed regulations, these final regulations add a section to the Treasury regulations to reflect these amendments. Amended section 162(m) applies to taxable years beginning after December 31, 2017, except to the extent transition and grandfather rules described in section VI of this preamble apply. Because the 1995 regulations continue to apply to deductions related to amounts of remuneration to which the grandfather rule applies, the 1995 regulations are retained as a separate section in the Treasury regulations under section 162(m).

These final regulations retain the basic approach and structure of the proposed regulations, with certain revisions (including revised examples). This Summary of Comments and Explanation of Revisions discusses those revisions, as well as comments received in response to the proposed regulations.

II. Publicly Held Corporation

A. In General

As amended by TCJA, section 162(m)(2) defines the term “publicly held corporation” as any corporation that is an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (Exchange Act)) of securities that are required to be registered under section 12 of the Exchange Act, or that is required to file reports under section 15(d) of the Exchange Act. These final

regulations adopt the rule in the proposed regulations providing that, for ease of administration, a corporation is a publicly held corporation if, as of the last day of its taxable year, its securities are required to be registered under section 12 of the Exchange Act or it is required to file reports under section 15(d) of the Exchange Act.

These final regulations also adopt the rules set forth in the proposed regulations for determining whether a publicly traded partnership, a corporation that owns an entity that is disregarded as an entity separate from its owner within the meaning of § 301.7701–2(c)(2)(i), or an S corporation (including an S corporation parent of a qualified subchapter S subsidiary (as defined in section 1361(b)(3)(B)) (QSub) is a publicly held corporation as defined in section 162(m)(2). Consistent with the proposed rules, these final regulations also provide that a real estate investment trust (REIT), as defined in section 856(a), that owns a qualified real estate investment trust subsidiary as defined in section 856(i)(2) (QRS), is a publicly held corporation if the QRS issues securities required to be registered under section 12(b) of the Exchange Act, or is required to file reports under section 15(d) of the Exchange Act.

B. Affiliated Groups

These final regulations adopt the rules set forth in the 1995 regulations and the proposed regulations providing that the term “publicly held corporation” includes an affiliated group of corporations (affiliated group), as defined in section 1504 (determined without regard to section 1504(b)), that includes one or more publicly held corporations, and that a subsidiary corporation that meets the definition of publicly held corporation is separately subject to section 162(m). These final regulations also adopt the rules set forth in the proposed regulations providing that an affiliated group includes a parent corporation that is privately held if one or more of its subsidiary corporations is a publicly held corporation, and that an affiliated group may include more than one publicly held corporation as defined in section 162(m)(2).

In response to the proposed regulations, a commenter suggested that an affiliated group with more than one publicly held corporation should have only one set of covered employees for the affiliated group (instead of one set of covered employees for each separate publicly held corporation that is a member of the affiliated group). These final regulations do not adopt this

suggestion because each corporation in an affiliated group is a separate taxpayer and section 162(m)(3) provides that each taxpayer that is a publicly held corporation has its own set of covered employees. Instead, as provided in the 1995 regulations and in the proposed regulations, these final regulations provide that, in an affiliated group, each corporation that is a publicly held corporation is separately subject to section 162(m) and, therefore, has its own set of covered employees.

These final regulations adopt the rules set forth in the 1995 regulations and the proposed regulations addressing situations in which a covered employee of a publicly held corporation that is a member of an affiliated group performs services for another member of the affiliated group. These final regulations provide that compensation¹ paid by all members of the affiliated group is aggregated and that any amount disallowed as a deduction by section 162(m) is prorated among the payor corporations in proportion to the amount of compensation paid to the covered employee by each corporation in the taxable year. For situations in which a covered employee is paid compensation during a taxable year by more than one publicly held corporation that are members of the same affiliated group, these final regulations adopt the rules set forth in the proposed regulations providing that the amount of the deduction that is disallowed for compensation paid to a covered employee is determined separately with respect to each payor corporation that is a publicly held corporation. These final regulations clarify that compensation paid by a member of an affiliated group that is not a publicly held corporation to an employee who is a covered employee of two or more other members of the affiliated group is prorated for purposes of the determining the deduction disallowance among the members that are publicly held corporations of which the employee is a covered employee.

C. Foreign Private Issuers

Pursuant to the amended definition of publicly held corporation in section 162(m)(2), the proposed regulations provide that a foreign private issuer² (FPI) is a publicly held corporation if it is required to register securities under section 12 of the Exchange Act or file reports under section 15(d) of the

¹ For simplicity, where possible, these final regulations use the term “compensation” instead of “applicable employee remuneration.” These terms have the same meaning in these final regulations.

² The term “foreign private issuer” is defined in 21 CFR 240.3b–4(c).

Exchange Act. The legislative history to TCJA indicates that Congress intended section 162(m) to apply to FPIs.³

In response to Notice 2018–68, commenters suggested that the proposed regulations provide that section 162(m) does not apply to FPIs because FPIs are not required to disclose compensation of their officers on an individual basis under the Exchange Act, unless similar disclosure is required by their home country.⁴ The commenters asserted that determining compensation on an individual basis (in order to determine the three most highly compensated executive officers) would require the FPIs to expend significant time and money in adopting the necessary internal procedures to make the determination consistent with Exchange Act requirements that are inapplicable to them. The proposed regulations do not adopt these suggestions.

However, the preamble to the proposed regulations requested comments as to whether a safe harbor exemption from the definition of a publicly held corporation under section 162(m) was appropriate for FPIs that are not required to disclose compensation of their officers on an individual basis in their home countries and, if so, how such a safe harbor could be designed. In response to this request for comments a commenter suggested that these final regulations should exempt any FPI from the definition of publicly held corporation, unless the FPI is required to disclose compensation of its officers on an individual basis in its home country. Another commenter suggested that these final regulations should exclude FPIs from the definition of publicly held corporation because determining compensation on an individual basis (in order to determine the three most highly compensated

executive officers) requires extensive calculations consistent with executive compensation disclosure rules under the Exchange Act that are not applicable to FPIs. The commenters did not provide any analysis in support of a safe harbor rule or address how a safe harbor could be designed and administered. These final regulations do not adopt these suggestions because the scope of the exemption suggested for FPIs from the definition of publicly held corporation is inconsistent with the statutory language and the legislative history. Rather, these final regulations adopt the rules set forth in the proposed regulations providing that a FPI is a publicly held corporation if it is required to register securities under section 12 of the Exchange Act or file reports under section 15(d) of the Exchange Act.

III. Covered Employee

A. In General

As amended by TCJA, section 162(m)(3) defines the term “covered employee” as an employee of the taxpayer if (1) the employee is the principal executive officer (PEO) or principal financial officer (PFO) of the taxpayer at any time during the taxable year, or was an individual acting in such a capacity, (2) the total compensation of the employee for the taxable year is required to be reported to shareholders under the Exchange Act by reason of the employee being among the three highest compensated officers for the taxable year (other than the PEO and PFO), or (3) the individual was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016. TCJA also added flush language to provide that a covered employee includes any employee of the taxpayer whose total compensation for the taxable year places the individual among the three highest compensated officers for the taxable year (other than any individual who is the PEO or PFO of the taxpayer at any time during the taxable year, or was an individual acting in such a capacity) even if the compensation of the officer is not required to be reported to shareholders under the Exchange Act.

These final regulations adopt the rules set forth in the proposed regulations providing that a covered employee for any taxable year means any employee of the publicly held corporation who is among the three highest compensated executive officers for the taxable year, regardless of whether the executive officer is serving as an executive officer at the end of the publicly held

corporation’s taxable year, and regardless of whether the executive officer’s compensation is subject to disclosure for the publicly held corporation’s last completed fiscal year under the applicable SEC rules. The determination that an officer is a covered employee because the officer is one of the three highest compensated executive officers, even if the officer’s compensation is not required to be disclosed under the SEC rules, is based on the flush language to section 162(m)(3), the legislative history,⁵ and the SEC executive compensation disclosure rules.⁶ These final regulations also adopt the rule in the proposed regulations providing that the amount of compensation used to identify the three most highly compensated executive officers is determined pursuant to the executive compensation disclosure rules under the Exchange Act, substituting the publicly held corporation’s taxable year for references to the corporation’s fiscal year for purposes of applying the disclosure rules under the Exchange Act.

In response to the proposed regulations, a commenter suggested that, with respect to the three highest compensated executive officers (other than the PEO and PFO), the term “covered employee” should include only executive officers whose compensation is required to be disclosed pursuant to the SEC executive compensation disclosure rules. These final regulations do not adopt this suggestion because it is inconsistent with the flush language of section 162(m)(3) providing that, even if the compensation of an executive officer is not required to be reported to shareholders under the Exchange Act, the officer is a covered employee if the officer’s total compensation for the taxable year, determined in accordance with the SEC disclosure rules, places the officer among the three highest compensated officers for the taxable year (other than the PEO and PFO).

Section 162(m)(3)(C) provides that the term “covered employee” includes any employee who was a covered employee of any predecessor of the publicly held corporation for any preceding taxable year beginning after December 31, 2016. The proposed regulations provide rules for determining the predecessor of a publicly held corporation for various corporate transactions. With respect to asset acquisitions, the proposed regulations provide that, if an acquiror

³ The legislative history to TCJA provides that the amendment to the definition of publicly held corporation under section 162(m) “extends the applicability of section 162(m) to include . . . all foreign companies publicly traded through ADRs.” House Conf. Rpt. 115–466, 489 (2017). The Blue Book similarly states that “the provision extends the applicability of section 162(m) to include all foreign companies publicly traded through ADRs.” Staff of the Joint Committee on Taxation, General Explanation of Public Law 115–97 (Blue Book), at 261 (December 20, 2018).

⁴ Before TCJA, the IRS ruled in several private letter rulings that section 162(m), as in effect at that time, did not apply to FPIs because FPIs are not required to disclose compensation of their officers on an individual basis under the Exchange Act, and, therefore, did not have covered employees. A private letter ruling may be relied upon only by the taxpayer to whom the ruling was issued and does not constitute generally applicable guidance. See section 11.02 of Revenue Procedure 2020–1, 2020–01 I.R.B. 144. TCJA amended section 162(m) to provide that a requirement to disclose compensation is not determinative of whether an officer is a covered employee.

⁵ See House Conf. Rpt. 115–466, 489 (2017).

⁶ 17 CFR 229.402(a)(3) (Item 402 of Regulation S–K).

corporation acquires at least 80% of the operating assets (determined by fair market value on the date of acquisition) of a publicly held target corporation, then the target corporation is a predecessor of the acquirer corporation. A commenter suggested that these final regulations clarify that the operating assets refer to gross operating assets instead of net operating assets. These final regulations adopt this suggestion.

The proposed regulations also provide rules for determining the covered employees of an owner of a disregarded entity, and an S corporation that owns a QSub. No comments were received with respect to these provisions of the proposed regulations. Accordingly, these final regulations adopt the rules set forth in the proposed regulations and, consistent with those rules, provide additional rules for purposes of determining the covered employees of a REIT that owns a QRS.

B. Covered Employees Limited to Executive Officers

Under the definition of covered employee in section 162(m)(3) as amended by TCJA, a PEO and PFO are covered employees by virtue of holding those positions or acting in those capacities. The three highest compensated officers (other than the PEO or PFO) are covered employees by reason of their compensation. Pursuant to section 162(m)(3)(B), the three highest compensated officers are determined based on the methods by which these officers are identified for purposes of the executive compensation disclosure rules under the Exchange Act. With respect to the three highest compensated officers for a taxable year, consistent with the disclosure rules under the Exchange Act, the proposed regulations provide that only an executive officer, as defined in 17 CFR 240.3b-7 (Rule 3b-7), may qualify as a covered employee. In relevant part, Rule 3b-7 provides that “[e]xecutive officers of subsidiaries may be deemed executive officers of the registrant if they perform . . . policy making functions for the registrant.” A commenter suggested that these final regulations provide that an executive officer of a subsidiary may be a covered employee of the publicly held corporation that is the registrant only if the officer is also an officer of that publicly held corporation. These final regulations do not adopt this suggestion because it is inconsistent with Rule 3b-7.

C. Covered Employees After Separation From Service

Section 162(m)(3)(C), as amended by TCJA, provides that a covered employee includes “a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.” The legislative history to TCJA provides that:

if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years. Thus, an individual remains a covered employee with respect to compensation otherwise deductible for subsequent years, including for years during which the individual is no longer employed by the corporation and years after the individual has died.

(House Conf. Rpt. 115-466, 489 (2017)). The Blue Book reiterated the legislative history in explaining the amended definition of covered employee. See Blue Book at page 260.

Consistent with section 162(m)(3)(C), as amended by TCJA, and the legislative history, the proposed regulations provide that a covered employee identified for taxable years beginning after December 31, 2016, will continue to be a covered employee for all subsequent taxable years, including years during which the individual is no longer employed by the corporation and years after the individual has died. A commenter suggested that, based on the statutory text of both section 162(m) and section 4960, which was enacted by TCJA, Congress intended the term “employee” in section 162(m) to be limited to a current employee. The commenter pointed out that section 4960(c)(2) provides, in relevant part, that “the term ‘covered employee’ means any employee (including any former employee)” and noted that the words “including any former employee” are absent from the definition of covered employee in section 162(m)(3). The commenter reasoned that, because Congress enacted section 4960 and amended the definition of covered employee in section 162(m) in the same legislation (TCJA), the absence of these words limits the definition of covered employee to a current employee for purposes of section 162(m).

The Treasury Department and the IRS have concluded that the better analysis is that Congress intended to apply both section 162(m) and section 4960 to current and former employees. Congress may accomplish the same objective in two separate legislative provisions without using identical statutory language. As explained in section III.D of the preamble to the proposed

regulations, the reference to an employee in section 162(m) provides no indication that the term “employee” is limited to a current employee, since a reference in the Code to an “employee” has frequently been interpreted in regulations as a reference to both a current and a former employee.⁷ In addition, as previously noted, the legislative history to section 162(m) makes clear that Congress intended the term “covered employee” to include a former employee.⁸ Accordingly, these final regulations adopt the proposed regulations without change.

IV. Applicable Employee Remuneration

A. In General

Section 162(m)(4)(A) defines the term “applicable employee remuneration” with respect to any covered employee for any taxable year as the aggregate amount allowable as a deduction for the taxable year (determined without regard to section 162(m)) for remuneration for services performed by such employee (whether or not during the taxable year). Section 162(m)(4)(F) provides that remuneration shall not fail to be applicable employee remuneration merely because it is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee. For simplicity, the proposed regulations and these final regulations use the term “compensation” instead of “applicable employee remuneration” wherever possible. Like the proposed regulations, these final regulations provide that compensation means the aggregate amount allowable as a deduction under chapter 1 of the Code for the taxable year (determined without regard to section 162(m)) for remuneration for services performed by a covered employee, whether or not the services were performed during the taxable year, and that compensation includes an amount that is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee.

B. Compensation Paid by a Partnership to a Covered Employee

Section 162(m)(1) provides that “[i]n the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee.” As

⁷ See section III.D of the preamble to the proposed regulations. For example, under § 1.105-11(c)(3)(iii), the nondiscrimination rules of section 105(h)(3) apply to former employees even though the Code uses only the term “employees.”

⁸ House Conf. Rpt. 115-466, *supra*, at 489.

explained in section IV.B of the preamble to the proposed regulations, this statutory provision serves as the basis for the rule in the proposed regulations that a publicly held corporation that holds a partnership interest must take into account its distributive share of the partnership's deduction for compensation paid to the publicly held corporation's covered employee and aggregate that distributive share with the corporation's otherwise allowable deduction for compensation paid directly to that employee in applying the deduction limitation under section 162(m).

In response to this provision of the proposed regulations, commenters suggested that remuneration paid by a partnership is not compensation for purposes of section 162(m) because the partnership is neither a publicly held corporation nor a member of an affiliated group. Section 162(m) does not limit the application of section 162(m) in that manner. Rather, section 162(m) applies to all compensation, which includes "all amounts allowable as a deduction . . . for remuneration for services performed by such employee (whether or not during the taxable year)." While the comments suggest a reading of section 162(m)(1) that services must be performed in the employee's capacity as an employee and must be performed for the publicly held corporation, neither of these requirements appear in the statute. In addition, adoption of the commenters' suggestion could lead to the use of partnerships as a method of avoiding application of section 162(m), a result that the Treasury Department and IRS conclude is not intended by the statute.

Commenters also suggested that remuneration paid by a partnership should be compensation for purposes of section 162(m) only if the publicly held corporation has an 80% or greater interest in the partnership because the definition of an affiliated group requires 80% ownership by vote and value among the members of the affiliated group. The Treasury Department and the IRS did not adopt this rule because the analogy to the affiliated group proffered by the commenters does not take into account that the tax treatment of a partner in a partnership differs from the tax treatment of a corporation that owns stock in another corporation. Although a consolidated group of corporations may obtain a tax result similar to a deduction flow through, a subsidiary's compensation deduction does not flow through to the parent corporation in a non-consolidated group of corporations. In contrast, when a publicly held corporation is a partner in

a partnership, a share of the partnership's items of income, gain, loss, and deduction generally is allocated to the publicly held corporation in accordance with partnership agreement, subject to section 704. Furthermore, that allocation may occur regardless of the level of ownership by the publicly held corporation.

These final regulations adopt the provisions of the proposed regulations and provide that a publicly held corporation must take into account its distributive share of a partnership's deduction for compensation paid to the publicly held corporation's covered employee in determining the amount allowable to the corporation as a deduction for compensation under section 162(m). Consistent with an example in the proposed regulations and incorporated into these final regulations, these final regulations clarify that the publicly held corporation's distributive share of the partnership's deduction for compensation paid by the partnership to a covered employee in connection with the performance of services includes the partnership's deduction for a payment to the covered employee for services under section 707(a) or section 707(c).

In response to a commenter's request for clarification on the application of the rule that a publicly held corporation must take into account its distributive share of a partnership's compensation payment to the publicly held corporation's covered employee, the Treasury Department and the IRS confirm that these final regulations address only application of the section 162(m) compensation deduction limitation to the publicly held corporation's distributive share of the payment. The commenter also noted that this partnership rule results in a different application of section 162(m) depending on whether a publicly held corporation's covered employee receives compensation for services from a partnership in which the publicly held corporation is a partner or from a corporate subsidiary of the partnership. Assuming the partnership is respected for U.S. Federal income tax purposes, section 162(m) generally would 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.

In recognition of the prior lack of clarity in this area, the proposed

regulations provide a special applicability date for this rule, as well as limited transition relief applicable to arrangements in which a publicly held corporation holds a partnership interest. Specifically, to ensure that compensation agreements were not formed or otherwise structured to circumvent the rule regarding partnerships after publication of the proposed regulations and prior to the publication of these final regulations, the proposed regulations set forth a special applicability date that would apply the rule to any deduction for compensation paid by a partnership that is otherwise allowable for a taxable year ending on or after December 20, 2019 (the publication date of the proposed regulations), but would not apply the rule to compensation paid pursuant to a written binding contract in effect on December 20, 2019 that is not materially modified after that date.

Commenters requested additional transition relief for this rule. A commenter suggested a transition relief period of 7 years from the date of publication of these final regulations.⁹ Other commenters suggested that transition relief should apply for taxable years beginning before the publication of these final regulations. In the alternative, these commenters suggested transition relief for compensation arrangements in effect on December 22, 2017 (the date of TJCA enactment), regardless of whether the partnership is obligated to pay the amount of compensation under applicable law, which would provide for more expansive transition relief than set forth in the proposed regulations.

As the preamble to the proposed regulations explains, the transition relief for this definition of compensation must be designed to ensure that compensation agreements are not formed or otherwise structured to circumvent the proposed rules after publication of the proposed regulations and prior to the publication of these

⁹ This commenter also suggested a transition relief period of 10 years for taxpayers that, prior to the IRS first announcing the no-rule position on this issue in Revenue Procedure 2010-3, received private letter rulings providing that section 162(m) did not limit the deduction of the publicly held corporation for compensation paid to a covered employee by a partnership in which the publicly held corporation held a partnership interest. The IRS announced the no-rule position in 2010 in section 5.06 of Revenue Procedure 2010-3, 2010-1 I.R.B. 110, which provided that "[w]hether the deduction limit under § 162(m) applies to compensation attributable to services performed for a related partnership" was an area under study in which rulings or determination letters will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise.

final regulations. In consideration of commenters' requests for additional transition relief, these final regulations modify the applicability date of the definition of compensation under § 1.162–33(c)(3)(ii) to provide additional limited transition relief. Under these final regulations, the definition of compensation under § 1.162–33(c)(3)(ii) includes an amount equal to a publicly held corporation's distributive share of a partnership's deduction for compensation expense attributable to the compensation paid by the partnership after December 18, 2020, the date on which these final regulations were made publicly available on the IRS website at <http://www.irs.gov>. Because the date that these final regulations are made publicly available is prior to the date that they are published in the **Federal Register**, using the earlier date for the expiration of the additional transition relief is appropriate to ensure that compensation is not paid to circumvent these final regulations. In addition, these final regulations continue to provide that this aspect of the definition of compensation does not apply to compensation paid after December 30, 2020 if the compensation is paid pursuant to a written binding contract that is in effect on December 20, 2019, and that is not materially modified after that date.

C. Compensation for Services in a Capacity Other Than as a Common Law Employee

The proposed regulations provide that compensation subject to section 162(m) includes remuneration for services performed by a covered employee in any capacity, including as a common law employee, a director, or an independent contractor. As explained in section IV. C of the preamble to the proposed regulations, this rule is based on the lack of a specific limitation in the statutory language regarding the capacity in which the covered employee must perform the services for which remuneration is paid, and it is supported by the legislative history to the enactment of section 162(m) in

1993¹⁰ and the preamble to the 1993 proposed regulations.¹¹

In response to the proposed regulations, commenters suggested that, based on the language of section 162(m)(4)(A), compensation subject to section 162(m) should include only compensation for services performed by a covered employee as an employee of the publicly held corporation. The commenters reasoned that, because section 162(m)(4)(A) uses the phrase “for remuneration for services performed by such *employee*” (emphasis added) in defining compensation subject to section 162(m), only compensation for services provided as an employee is subject to section 162(m).¹²

While the statute may be read in the manner suggested by the commenters, there is nothing in the language that compels this reading, nor does the legislative history to the enactment of section 162(m) suggest that compensation subject to section 162(m) was intended to include only compensation for services as an employee. Section 162(m)(4)(A), which was not amended by TCJA, provides that “the term ‘applicable employee remuneration’ means, with respect to any covered employee for any taxable year, the aggregate amount allowable as a deduction under this chapter for such taxable year . . . for remuneration for services performed by such employee (whether or not during the taxable year).” The legislative history provides that section 162(m) “applies to all

compensation . . . regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned.”¹³ Consistent with this legislative history, the 1995 regulations defined the term compensation as “the aggregate amount allowable as a deduction . . . for remuneration for services performed by a covered employee, whether or not the services were performed during the taxable year.”¹⁴ Thus, neither the statute nor the 1995 regulations specifically limit the compensation subject to section 162(m) to remuneration paid to the covered employee for services as an employee.

Commenters also suggested that section 162(m) does not apply to compensation for services as an independent contractor because by excluding from the definition of compensation payments that may be made only to an employee, section 162(m)(4)(C) indicates that compensation subject to section 162(m) is limited to compensation for services as an employee. Section 162(m)(4)(C) excludes from the definition of compensation: “(i) any payment referred to in so much of section 3121(a)(5) as precedes subparagraph (E) thereof, and (ii) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from gross income under this chapter.”

Section 162(m)(4)(i), by cross-referencing sections 3121(a)(5)(A)–(D), generally excludes from compensation contributions by an employer on an employee's behalf to certain types of qualified retirement plans and payments from those types of plans to the employee. Thus, contributions to these arrangements for which an employer would otherwise have a deduction available will not be treated as compensation and the deduction will not be limited by section 162(m). Section 162(m)(4)(C)(ii) serves a similar function by excluding from compensation (and thus not limiting the compensation deduction) certain employee benefits that would be excludible from the employee's income. These exclusions of benefit payments from the definition of “applicable employee remuneration” reflect only that an individual must be an active employee of the publicly held corporation (or a predecessor) at some

¹⁰ The legislative history to the enactment of section 162(m) provides that:

Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned.

House Conf. Rpt. 103–213, 585 (1993).

¹¹ The preamble to the 1993 proposed regulations provides that, “[t]he deduction limit of section 162(m) applies to any compensation that could otherwise be deducted in a taxable year, except for enumerated types of payments set forth in section 162(m)(4)” (58 FR 66310, 66310).

¹² In suggesting that the statute should be read to exclude payments for services performed as an independent contractor from compensation subject to section 162(m), commenters point to a private letter ruling issued in 1997 (PLR 9745002). In the letter ruling, based on the facts presented, the IRS ruled that, for purposes of section 162(m), compensation excludes consulting fees for services performed by a covered employee as an independent contractor. A private letter ruling may be relied upon only by the taxpayer to whom the ruling was issued and does not constitute generally applicable guidance. See section 11.02 of Revenue Procedure 2020–1, 2020–01 I.R.B. 144.

¹³ House Conf. Rpt. 103–213, 585 (1993).

¹⁴ Section 1.162–27(c)(3)(i). The preamble to the 1993 proposed regulations reiterates this principle, as quoted earlier.

point in order to become a covered employee, and that the individual typically would participate in these types of employee benefit arrangements as an employee (often continuing participation that started before the individual became a covered employee).

Importantly, the TCJA amendments to section 162(m) changed the context in which the question as to whether non-employee compensation is subject to the deduction limitation is analyzed. Prior to TCJA, the section 162(m) deduction limitation could be avoided by ensuring that any compensation in excess of \$1,000,000 paid to a covered employee qualified as performance-based compensation or was paid to the covered employee after separation from service or after termination of the individual's status as a covered employee. For example, if a PEO ceased serving as PEO or as an executive officer but continued as an employee of the publicly held corporation for later taxable years, the former PEO could be compensated without taking into account the potential for a limitation on the deduction due to section 162(m).

The TCJA amendment of section 162(m) eliminates the exclusion from the deduction limitation for compensation paid after the individual is no longer a covered employee. Under the amended section 162(m) rules, once an individual is identified as a covered employee, the individual continues to be a covered employee, and all compensation paid to that individual is subject to the deduction limitation, even after the individual is no longer employed by the publicly held corporation. As explained in the legislative history, this result was intended.¹⁵

The commenters' suggestion that section 162(m) does not apply to compensation for services as an independent contractor would lead to uncertainty and administrative burdens for both the taxpayer and the IRS, as well as to the potential for abusive arrangements structured to avoid the application of section 162(m) to covered employees who have terminated employment (or who have purportedly terminated employment). Given that the amendments to section 162(m) no longer limit the deduction disallowance to taxable years in which a covered employee is employed on the last day of the taxable year, and the lack of statutory language or legislative history specifically indicating an intent to restrict the deduction limitation to compensation earned by the individual in the capacity as an employee, the

Treasury Department and the IRS have determined that the more appropriate construction of the statutory language defining "applicable employee remuneration" is to include all compensation paid to a covered employee regardless of the capacity in which the covered employee performed services to earn that compensation.

V. Privately Held Corporations That Become Publicly Held

These final regulations adopt the rules set forth in the proposed regulations providing that, in the case of a privately held corporation that becomes a publicly held corporation, section 162(m) limits the deduction for any compensation that is otherwise deductible for the taxable year ending on or after the date that the corporation becomes a publicly held corporation, and that a corporation is considered to become publicly held on the date that its registration statement becomes effective under the Securities Act or the Exchange Act. These final regulations also adopt the transition relief set forth in the proposed regulations providing that a privately held corporation that becomes a publicly held corporation on or before December 20, 2019, generally may rely on the transition rules provided in § 1.162–27(f)(1) and (2) of the 1995 regulations.¹⁶ In response to a question from a commenter, these final regulations clarify that a subsidiary that is a member of an affiliated group may rely on transition relief provided in § 1.162–27(f)(4) of the 1995 regulations if it becomes a separate publicly held corporation (for example, in a spin-off transaction) on or before December 20, 2019.

Consistent with comments received prior to issuance of the proposed regulations, a commenter suggested that these final regulations should continue to provide transition relief similar to that provided in § 1.162–27(f)(1) and (2) of the 1995 regulations for privately held corporations that become publicly held after December 20, 2019. Those sections of the 1995 regulations were formulated based on the legislative history to the enactment of section 162(m) and were intended to permit a transition period to meet the shareholder approval requirement for qualified performance-based

compensation so that the resulting compensation would not be subject to the deduction limitation under section 162(m). TCJA eliminated the exclusion from the definition of compensation for qualified performance-based compensation. Thus, a transition period to accommodate a shareholder approval process is no longer needed. There is no indication in the language of the amended section 162(m) or the legislative history to the amendments that the transition period was intended be extended even though the original basis for its adoption no longer exists. Accordingly, the suggestion is not adopted in these final regulations.

VI. Grandfather Rule

A. In General

Section 13601(e) of TCJA generally provides that the amendments to section 162(m) apply to taxable years beginning after December 31, 2017. However, it further provides that those amendments do not apply to compensation that is payable pursuant to a written binding contract that was in effect on November 2, 2017, and that was not modified in any material respect on or after that date (the grandfather rule).

As discussed in section VI. A of the preamble to the proposed regulations, the text of section 13601(e) of TCJA is almost identical to the text of pre-TCJA section 162(m)(4)(D), which provided a transition rule in connection with the enactment of section 162(m) in 1993 (the 1993 grandfather rule). Under the 1993 grandfather rule, section 162(m) did not apply to compensation payable under a written binding contract that was in effect on February 17, 1993, and that was not modified thereafter in any material respect before the compensation was paid. Section 1.162–27(h) provides guidance on the definitions of written binding contract and material modification for purposes of applying the 1993 grandfather rule. The proposed regulations adopt those definitions for purposes of the grandfather rule under section 13601(e) of TCJA. These final regulations adopt the provisions of the proposed regulations and retain these definitions, including that compensation is payable under a written binding contract that was in effect on November 2, 2017, only to the extent that the corporation is obligated under applicable law to pay the compensation if the employee performs services or satisfies the applicable vesting conditions. Section 162(m), as amended, applies to any amount of compensation that exceeds the amount that applicable law obligates the corporation to pay under a written

¹⁶ Specifically, a privately held corporation that becomes a publicly held corporation before December 20, 2019, may rely on the transition rules provided in § 1.162–27(f)(1) until the earliest of the events described in § 1.162–27(f)(2). As provided in the 1995 regulations, a corporation that is a member of an affiliated group that includes a publicly held corporation is considered publicly held and, thus, may not rely on the transition relief provided in § 1.162–27(f)(1).

¹⁵ House Conf. Rpt. 115–466, 489 (2017).

binding contract that was in effect on November 2, 2017.

In response to the proposed regulations, a commenter requested that these final regulations adopt a safe harbor based on Generally Acceptable Accounting Principles (GAAP). The same suggestion had been made prior to issuance of the proposed regulations, and section VI. A of the preamble to the proposed regulations describes a number of issues with a GAAP safe harbor and asks for comments on how and whether these issues could be addressed. The commenter did not address any of these issues related to the formulation and application of a GAAP safe harbor. Accordingly, these final regulations do not adopt a GAAP safe harbor rule.

Another commenter suggested a safe harbor that would grandfather an amount of compensation paid pursuant to a compensation arrangement that satisfied three requirements on or before November 2, 2017: (1) The arrangement was memorialized in some form of media (for example, presentation slides or spreadsheet); (2) the arrangement was communicated to its participants (for example, disseminated in hard copy, electronically, or via presentation format); and (3) participants in the arrangement had a reasonable expectation that they were eligible to receive compensation pursuant to the arrangement. This suggested safe harbor would require an intensive facts and circumstances analysis and raise administrability issues about how to determine the participants' expectations regarding the compensation arrangement and whether those expectations were reasonable. Furthermore, the suggested safe harbor arguably is inconsistent with the statutory language that grandfathers an amount of compensation only if the corporation was obligated to pay it under applicable law pursuant to a written binding contract in effect on November 2, 2017, and not, for example, if an employee merely had a reasonable expectation of payment (without regard to the corporation's obligation under applicable law). For these reasons, these final regulations do not adopt this safe harbor.

B. Compensation Subject to Negative Discretion

These final regulations adopt the rule set forth in the proposed regulations providing that a provision in a compensation agreement that purports to provide the employer with the discretion to reduce or eliminate a compensation payment (negative discretion) is taken into account only to

the extent the corporation has the right to exercise the negative discretion under applicable law (for example, applicable state contract law). If a compensation arrangement allows the corporation to exercise negative discretion, compensation payable under the arrangement is not grandfathered to the extent the corporation is not obligated to pay it under applicable law.

In response to the proposed regulations, a commenter suggested that negative discretion provisions should be disregarded in determining whether compensation is grandfathered because numerous performance-based compensation arrangements provide corporations with such discretion. However, the practice of including negative discretion provisions in compensation arrangements is based on a well-known and longstanding regulatory provision, and Congress could have provided for a grandfather rule that addressed performance-based compensation arrangements that include a negative discretion provision, but it did not. Instead, the grandfather rule refers only to compensation paid pursuant to a legally binding contract in effect on the transition date. Thus, whether a performance-based compensation arrangement that includes a negative discretion provision is a legally binding contract is determined based on applicable law.

Another commenter suggested that a corporation should be deemed not to have a right to exercise negative discretion if the terms of the agreement provide that the corporation may not exercise this discretion if doing so would result in the payment of compensation that would not be deductible by reason of section 162(m). Whether a compensation agreement that includes a negative discretion provision of this sort would be a written binding contract that permitted the exercise of the negative discretion after the amendments to section 162(m) or rather obligated the employer to pay the compensation because the section 162(m) amendments negated the employer's ability to exercise the negative discretion must be determined based on applicable law. Accordingly, these final regulations do not provide a separate standard for purposes of applying the grandfather rule to compensation agreements that include this type of negative discretion provision (or any other type of negative discretion provision).

C. Recovery of Compensation

The proposed regulations provide that, if the corporation is obligated or has discretion to recover compensation

paid in a taxable year only upon the future occurrence of a condition that is objectively outside of the corporation's control, then the corporation's right to recovery is disregarded for purposes of determining the grandfathered amount for the taxable year. The proposed regulations also provide that, if the condition occurs, then only the amount the corporation is obligated to pay under applicable law remains grandfathered, taking into account the occurrence of the condition. After further consideration, the Treasury Department and the IRS recognize that the corporation's right to recover compensation is a contractual right that is separate from the corporation's binding obligation under the contract (as of November 2, 2017) to pay the compensation. Accordingly, these final regulations provide that the corporation's right to recover compensation does not affect the determination of the amount of compensation the corporation has a written binding contract to pay under applicable law as of November 2, 2017, whether or not the corporation exercises its discretion to recover any compensation in the event the condition arises in the future.

D. Account and Nonaccount Balance Plans

The proposed regulations include examples illustrating the application of the grandfather rule to account and nonaccount balance nonqualified deferred compensation (NQDC) plans. In response to comments, these final regulations clarify the application of the grandfather rule to compensation payable under these plans by providing detailed rules and thus eliminate the need to retain certain examples in these final regulations. Specifically, with respect to an account balance plan, these final regulations provide that the grandfathered amount under an account balance plan is the amount that the corporation is obligated to pay pursuant to the terms of the plan as of November 2, 2017, as determined under applicable law. If the corporation is obligated to pay the employee the account balance that is credited with earnings and losses and has no right to terminate or materially amend the contract, then the grandfathered amount would be the account balance as of November 2, 2017, plus any additional contributions and earnings and losses that the corporation is obligated to credit under the plan, through the date of payment. These final regulations provide an analogous rule for nonaccount balance plans.

If the terms of the account balance plan that is a written binding contract

as of November 2, 2017, provide that the corporation may terminate the plan and distribute the account balance to the employee, then the grandfathered amount is the account balance determined as if the corporation had terminated the plan on November 2, 2017, or, if later, the earliest possible date the plan could be terminated (termination date). Furthermore, whether additional contributions and earnings and losses credited to the account balance after the termination date, through the earliest possible date the account balance could have been distributed to the employee, are grandfathered depends on whether the terms of the plan require the corporation to make those contributions or credit those earnings and losses through the earliest possible date the account balance could be distributed if it were terminated as of the termination date. These final regulations provide an analogous rule for nonaccount balance plans.

If the terms of the account balance plan provide that the corporation may not terminate the contract, but may discontinue future contributions to the account balance and distribute the account balance in accordance with the terms of the plan, then the grandfathered amount is the account balance determined as if the corporation had exercised the right to discontinue contributions on November 2, 2017 or, if later, the earliest permissible date the corporation could exercise that right in accordance with the terms of the plan (the freeze date). Furthermore, if the plan required the crediting of earnings and losses on the account balance after the freeze date through the payment date, then those earnings and losses credited to the grandfathered account balance are also grandfathered. These final regulations provide an analogous rule for nonaccount balance plans.

Alternatively, whether the terms of the account balance plan provide that the corporation may terminate the plan or, instead, may discontinue future contributions, the corporation may elect to treat the account balance as of the termination date (or freeze date, if applicable) as the grandfathered amount regardless of when the amount is paid and regardless of whether it has been credited with earnings or losses prior to payment. These final regulations provide an analogous rule for nonaccount balance plans. These final regulations adopt this alternative grandfather rule that disregards earnings and losses in order to minimize the administrative burden of tracking the earnings, losses and new contributions (if made) on an account balance plan or

the increase or decrease in a nonaccount balance benefit after November 2, 2017. With respect to an account balance plan, the Treasury Department and IRS understand that this grandfather rule may result in contributions made after November 2, 2017, not being subject to the section 162(m) limitation if the contributions offset losses; however, the Treasury Department and IRS concluded that under many common arrangements the continuous separate tracking of earnings, losses, and contributions on the November 2, 2017, account balance through the payment date would be burdensome to administer while having a limited, if any, impact on the available deduction.

E. Ordering Rule for Payments Consisting of Grandfathered and Non-Grandfathered Amounts Deductible for Taxable Years Ending Prior to December 20, 2019

These final regulations adopt the ordering rule set forth in the proposed regulations for identifying the grandfathered amount when payment under a grandfathered arrangement is made in a series of payments. Pursuant to the ordering rule, the grandfathered amount is allocated to the first otherwise deductible payment paid under the arrangement. If the grandfathered amount exceeds the payment, then the excess is allocated to the next otherwise deductible payment paid under the arrangement. This process is repeated until the entire grandfathered amount has been paid.

For example, assume an employer maintains a nonaccount balance NQDC plan (payable as an annuity) as of November 2, 2017, and that the grandfathered amount is \$2,000,000. Further assume that additional benefits accrue under the plan after November 2, 2017, with the result that the employee's benefit is payable as an annual annuity of \$1,500,000 commencing at the employee's retirement for the employee's life. Under these final regulations, the entire \$1,500,000 paid in the first year is grandfathered. In the second year, only \$500,000 of the \$1,500,000 payment is grandfathered; the remaining \$1,000,000 paid in the second year is not grandfathered. For subsequent taxable years, none of the \$1,500,000 payments are grandfathered.

A commenter suggested that for payments otherwise deductible for taxable years ending prior to the date the proposed regulations were published (December 20, 2019), it would be a reasonable good faith interpretation of the statute if the grandfathered amount were allocated to

the last otherwise deductible payment or to each payment on a pro rata basis. The Treasury Department and the IRS agree and these final regulations permit the grandfathered amount to be allocated to the last otherwise deductible payment or to each payment on a pro rata basis for taxable years ending before December 20, 2019. However, these final regulations provide that the ordering rule requiring the grandfathered amount to be allocated to the first otherwise deductible payment paid under the arrangement must be used for taxable years ending on or after December 20, 2019, regardless of the method used to allocate the grandfathered amount for taxable years ending prior to that date.

F. Grandfathered Amount Limited to a Particular Plan or Arrangement

These final regulations provide that the grandfathered amount payable under a plan or arrangement applies solely to the amounts paid under that plan or arrangement. Regardless of whether all of the grandfathered amount is paid to the employee, no portion of that grandfathered amount may be treated as a grandfathered amount under any other separate plan or arrangement in which the employee is a participant. If, for example, all or a portion of a grandfathered amount is forfeited because the employee died before being paid the entire amount, then any unpaid portion of the grandfathered amount may not be applied as a grandfathered amount to payments under any other separate plan or arrangement in which the employee participated.

G. Material Modification

1. In General

These final regulations adopt the rules set forth in the proposed regulations related to material modifications. A material modification occurs when a contract is amended to increase the amount of compensation payable to the employee. 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. Accordingly, if a contract is materially modified, amounts received by an employee under the contract before the material modification are not affected, but amounts received after the material modification are treated as paid pursuant to a new contract, rather than as grandfathered. The adoption of a supplemental contract or agreement that provides for increased compensation, or the payment of additional compensation, results in a material modification if the facts and

circumstances demonstrate that the compensation under the supplement is paid on the basis of substantially the same elements or conditions as the compensation that is otherwise paid pursuant to the written binding contract.

If a written binding contract in effect on November 2, 2017, is subsequently 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 either a reasonable rate of interest or a predetermined actual investment (whether or not assets associated with the original amount are actually invested therein) such that the amount payable by the employer at the later date will be based on the rate of interest or the actual rate of return on the investment (including any decrease, as well as any increase, in the value of the investment). However, the additional amount paid will not be treated as a grandfathered amount. Additionally, a modification of the contract after November 2, 2017, to offer an additional or substitute a predetermined actual investment as an investment alternative under the arrangement is not a material modification.

A commenter suggested that these final regulations provide that the deferral of a grandfathered amount after November 2, 2017, but prior to September 10, 2018 (the publication date of Notice 2018–68), is not a material modification even if the earnings on the deferred amount are not based on either a reasonable rate of interest or a predetermined actual investment because taxpayers were not aware prior to the publication of the notice that this deferral would constitute a material modification. The grandfather rule described in section 13601(e) of TCJA and its legislative history, including the definition and the resulting impact of a material modification, is almost identical to the statutory language and legislative history to the grandfather rule provided when section 162(m) was enacted in 1993. The 1995 final regulations interpreting the original grandfather rule in the 1993 legislation provided that a deferral of payment of compensation will not be treated as a material modification if any additional amount paid were determined based on a reasonable rate of interest or one or more predetermined actual investments, and there is no indication in the grandfather rule in section 13601 of

TCJA or its legislative history of an intent to adopt a different grandfather rule.¹⁷ Therefore, these final regulations do not adopt the commenter's suggestion.

2. Extension of an Exercise Period for a Non-Statutory Stock Option

Commenters asked if extending the exercise period for a non-statutory stock option¹⁸ is a material modification. The grandfather rule in the proposed regulations provides that compensation attributable to the exercise of an option is grandfathered only if, as of November 2, 2017, pursuant to terms of the option and under applicable law, the employer is obligated to transfer the option's underlying shares of stock to the employee upon exercise of the option.

The Treasury Department and the IRS recognize that, for bona fide business reasons, an employer may want to extend an exercise period of a stock option or a stock appreciation right (SAR). This often occurs when a stock option or SAR grant agreement provides that the exercise period will terminate immediately or within a short period following the employee's separation from service, but the employer later decides to waive that termination or otherwise extend the exercise period for some period of time upon the employee's separation from service. These concerns led to treating certain extensions of stock options or SARs as not being material modifications in the regulations under section 409A. For the same reasons, these final regulations incorporate the section 409A regulatory provisions and provide that, if compensation attributable to the exercise of a non-statutory stock option or a SAR is grandfathered and the exercise period of the option or SAR is extended, then all compensation attributable to the exercise of the option or the SAR is grandfathered if the extension complies with § 1.409A–1(b)(5)(v)(C)(1).¹⁹

¹⁷ Section 1.162–27(h)(iii)(B) provides that if the contract is modified to defer the payment of compensation, any compensation paid in excess of the amount that was originally payable to the employee under the contract will not be treated as a material modification if the additional amount is based on either a reasonable rate of interest or one or more predetermined actual investments (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 actual rate of return of the specific investment (including any decrease as well as any increase in the value of the investment).

¹⁸ A non-statutory stock option is an option other than an incentive stock option described in section 422 or a stock option granted under an employee stock purchase plan described in section 423.

¹⁹ Section 1.409A–1(b)(5)(v)(C)(1) describes the following requirements for an extension: (1) At the

VII. Coordination With Section 409A

Section 409A addresses NQDC arrangements and sets forth certain requirements that must be met to avoid current income inclusion, a 20% additional income tax on the amount includible in income per section 409A(a)(1)(B)(i)(II), and a second additional income tax based on the tax benefit received due to the deferral per section 409A(a)(1)(B)(i)(I). Recognizing that the TCJA amendments to section 162(m) required coordination with the section 409A rules in certain circumstances, the preamble to the proposed regulations provided that certain modifications would be made to the regulations under section 409A and that taxpayers may rely on the preamble until this guidance is issued. Commenters suggested additional modifications to the rules and regulations under section 409A to provide further coordination between sections 162(m) and 409A. Until guidance under section 409A is issued, taxpayers may continue to rely on the preamble to the proposed regulations. The Treasury Department and the IRS will continue to consider whether additional guidance under section 409A is appropriate.

VIII. Applicability Dates

A. General Applicability Date

Generally, these final regulations apply to taxable years beginning on or after December 30, 2020. However, taxpayers may choose to apply these final regulations to a taxable year beginning after December 31, 2017, provided the taxpayer applies these final regulations in their entirety and in a consistent manner to that taxable year and all subsequent taxable years. See section 7805(b)(7). Like the proposed regulations, these final regulations generally do not expand the definition of “covered employee” as provided in Notice 2018–68 and do not narrow the application of the definition of “written binding contract” as provided in Notice 2018–68. With respect to the limited number of changes that do affect these definitions, a special applicability date has been provided as described in section VIII.B of this preamble. Accordingly, taxpayers may not rely on Notice 2018–68 for taxable years ending on or after December 20, 2019, the publication date of the proposed regulations.

time of the extension, the exercise price is greater than the underlying stock's fair market value and (2) the exercise period is extended to a date no later than the earlier of the latest date upon which the stock right could have expired by its original terms or the 10th anniversary of the original date of grant.

B. Special Applicability Dates

These final regulations include special applicability dates covering certain aspects of the following provisions of these final regulations:

1. Definition of covered employee.
2. Definition of predecessor of a publicly held corporation.
3. Definition of compensation.
4. Application of section 162(m) to a deduction for compensation otherwise deductible for a taxable year ending on or after a privately held corporation becomes a publicly held corporation.
5. Definitions of written binding contract and material modification.

First, the definition of covered employee applies to taxable years ending on or after September 10, 2018, the publication date of Notice 2018–68, which provided guidance on the definition of covered employee. Notice 2018–68 also provided that the Treasury Department and the IRS anticipate that the guidance in the notice will be incorporated into future regulations that, with respect to the issues addressed in the notice, will apply to any taxable year ending on or after September 10, 2018. These final regulations adopt the definition of covered employee in Notice 2018–68 as anticipated, and accordingly the definition of covered employee in these final regulations applies to taxable years ending on or after September 10, 2018. The Treasury Department and the IRS recognize, however, that the rules under § 1.162–33(c)(2)(i)(B), related to a corporation whose fiscal year and taxable year do not end on the same date, were not addressed in Notice 2018–68 but were discussed initially in the proposed regulations. Accordingly, these final regulations provide that, for a corporation the fiscal and taxable years of which do not end on the same date, the rule requiring the determination of the three most highly compensated executive officers to be made pursuant to the rules under the Exchange Act applies to taxable years ending on or after December 20, 2019.

Second, the provisions defining a predecessor corporation of a publicly held corporation apply to corporate transactions that occur on or after December 30, 2020. These final regulations also include a special applicability date for corporations that change from being a publicly held corporation to a privately held corporation, and, later, back to a publicly held corporation on or after December 30, 2020.

If a corporate transaction occurs before December 30, 2020, then taxpayers may apply either the

definition of predecessor of a publicly held corporation in § 1.162–33(c)(2)(ii) of these final regulations or a reasonable good faith interpretation of the term “predecessor” in section 162(m)(3)(C) with respect to such transaction. However, with respect to any of the following corporate transactions occurring after December 20, 2019, and before December 30, 2020, excluding target corporations from the definition of the term “predecessor” is not a reasonable good faith interpretation of the statute: (1) A publicly held target corporation the stock or assets of which are acquired by another publicly held corporation in a transaction to which section 381(a) applies, and (2) a publicly held target corporation, at least 80% of the total voting power of the stock of which, and at least 80% of the total value of the stock of which, are acquired by a publicly held acquiring corporation (including an affiliated group). No inference is intended regarding whether the treatment of a target corporation as other than a “predecessor” in any other situation is a reasonable good faith interpretation of the statute.

Third, as discussed in section IV.B. of this preamble, these final regulations modify the proposed applicability date for the definition of compensation under § 1.162–33(c)(3)(ii). Under these final regulations, the definition of compensation under § 1.162–33(c)(3)(ii) includes an amount equal to the publicly held corporation’s distributive share of a partnership’s deduction for compensation expense only if the deduction is attributable to compensation paid by the partnership after December 18, 2020 (the date that these final regulations were made publicly available on the IRS website at <http://www.irs.gov>). However, these final regulations continue to provide a transition rule so that this aspect of the definition of compensation related to the distributive share of a partnership’s deduction for compensation expense does not apply to compensation paid after December 30, 2020 if the compensation is paid pursuant to a written binding contract that is in effect on December 20, 2019, and that is not materially modified after that date.

Fourth, the guidance on the applicability of section 162(m)(1) to the deduction for any compensation otherwise deductible for a taxable year ending on or after the date when a corporation becomes a publicly held corporation applies to corporations that become publicly held after December 20, 2019. A corporation that was not a publicly held corporation and then becomes a publicly held corporation on or before December 20, 2019, may rely

on the transition relief provided in § 1.162–27(f)(1) until the earliest of the events provided in § 1.162–27(f)(2). Furthermore, a subsidiary corporation that is a member of an affiliated group (as defined in § 1.162–27(c)(1)(ii)) may rely on the transition relief provided in § 1.162–27(f)(4) if it becomes a separate publicly held corporation (whether in a spin-off transaction or otherwise) on or before December 20, 2019.

Fifth, the definitions of written binding contract and material modification in these final regulations apply to taxable years ending on or after September 10, 2018, the publication date of Notice 2018–68, which provided guidance defining these terms. Notice 2018–68 also provided that the Treasury Department and IRS anticipated that the guidance in the notice would be incorporated into future regulations that, with respect to the issues addressed in the notice, would apply to any taxable year ending on or after September 10, 2018. Because these final regulations adopt the definitions of the terms “written binding contract” and “material modification” that were included in Notice 2018–68, the guidance on these definitions in these final regulations applies to taxable years ending on or after September 10, 2018.

Effect on Other Documents

Section 4.01(13) of Revenue Procedure 2020–3, 2020–1 I.R.B. 131 (providing that “[w]hether the deduction limit under § 162(m) applies to compensation attributable to services performed for a related partnership” is an area in which rulings or determination letters will not ordinarily be issued) is obsolete as of December 30, 2020.

Statement of Availability of IRS Documents

The IRS Notices, Revenue Rulings, and Revenue Procedures cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

Special Analyses

I. Regulatory Planning and Review

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations.

II. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that these final regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that section 162(m)(1) applies only to publicly held corporations (for example, corporations that list securities on a national securities exchange and are rarely small entities) and only impacts those publicly held corporations that compensate certain executive officers in excess of \$1 million in a taxable year. Pursuant to section 7805(f), the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

III. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private section, of \$100 million in 1995 dollars, update annually for inflation. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private section in excess of that threshold.

IV. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Drafting Information

The principal author of these regulations is Ilya Enkishev, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in the development of these regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.162–27 is amended by revising the section heading and paragraphs (a) and (j)(1) to read as follows:

§ 1.162–27 Certain employee remuneration in excess of \$1,000,000 not deductible for taxable years beginning on or after January 1, 1994, and for taxable years beginning prior to January 1, 2018.

(a) *Scope.* This section provides rules for the application of the \$1 million deduction limitation under section 162(m)(1) for taxable years beginning on or after January 1, 1994, and beginning prior to January 1, 2018, and, as provided in paragraph (j) of this section, for taxable years beginning after December 31, 2017. For rules concerning the applicability of section 162(m)(1) to taxable years beginning after December 31, 2017, see § 1.162–33. Paragraph (b) of this section provides the general rule limiting deductions under section 162(m)(1). Paragraph (c) of this section provides definitions of generally applicable terms. Paragraph (d) of this section provides an exception from the deduction limitation for compensation payable on a commission basis. Paragraph (e) of this section provides an exception for qualified performance-based compensation. Paragraphs (f) and (g) of this section provide special rules for corporations that become publicly held corporations and payments that are subject to section 280G, respectively. Paragraph (h) of this section provides transition rules, including the rules for contracts that are grandfathered and not subject to section 162(m)(1). Paragraph (j) of this section contains the effective date provisions, which also specify when these rules apply to the deduction for compensation otherwise deductible in a taxable year beginning after December 31, 2017. For rules concerning the deductibility of compensation for services that are not covered by section 162(m)(1) and this section, see section 162(a)(1) and § 1.162–7. This section is not determinative as to whether compensation meets the requirements of

section 162(a)(1). For rules concerning the deduction limitation under section 162(m)(6) applicable to certain health insurance providers, see § 1.162–31.

* * * * *

(j) * * *

(1) *In general.* Section 162(m) and this section apply to the deduction for compensation that is otherwise deductible by the corporation in taxable years beginning on or after January 1, 1994, and beginning prior to January 1, 2018. Section 162(m) and this section also apply to compensation that is a grandfathered amount (as defined in § 1.162–33(g)) at the time it is paid to the covered employee or otherwise deductible. For examples of the application of the rules of this section to grandfathered amounts paid during or otherwise deductible for taxable years beginning after December 31, 2017, see § 1.162–33(g).

* * * * *

■ **Par. 3.** Section 1.162–33 is added to read as follows:

§ 1.162–33 Certain employee remuneration in excess of \$1,000,000 not deductible for taxable years beginning after December 31, 2017.

(a) *Scope.* This section provides rules for the application of the \$1 million deduction limitation under section 162(m)(1) for taxable years beginning after December 31, 2017. For rules concerning the applicability of section 162(m)(1) to taxable years beginning on or after January 1, 1994, and prior to January 1, 2018, see § 1.162–27. Paragraph (b) of this section provides the general rule limiting deductions under section 162(m)(1). Paragraph (c) of this section provides definitions of generally applicable terms. Paragraph (d) of this section provides rules for determining when a corporation becomes a publicly held corporation. Paragraph (e) of this section provides rules for payments that are subject to section 280G (golden parachute payments). Paragraph (f) of this section provides a special rule for coordination with section 4985 (stock compensation of insiders in expatriated corporations). Paragraph (g) of this section provides transition rules addressing the amendments made by Public Law 115–97, including the rules for contracts that are grandfathered. Paragraph (h) of this section sets forth the effective date provisions. For rules concerning the deductibility of compensation for services that are not covered by section 162(m)(1) and this section, see section 162(a)(1) and § 1.162–7. This section is not determinative as to whether compensation meets the requirements of section 162(a)(1). For rules concerning

the deduction limitation under section 162(m)(6) applicable to certain health insurance providers, see § 1.162–31. For purposes of this section, references to an amount being paid to an employee refer to the event that otherwise would result in the availability of a deduction to the employer with respect to such amount, whether that results from an actual payment in cash, transfer of property, or other event.

(b) *Limitation on deduction.* Section 162(m)(1) precludes a deduction under chapter 1 of the Internal Revenue Code by any publicly held corporation for compensation paid to any covered employee to the extent that the compensation for the taxable year exceeds \$1,000,000.

(c) *Definitions*—(1) *Publicly held corporation*—(i) *General rule.* A publicly held corporation means any corporation that issues securities required to be registered under section 12 of the Exchange Act or that is required to file reports under section 15(d) of the Exchange Act. In addition, a publicly held corporation means any S corporation (as defined in section 1361(a)(1)) that issues securities that are required to be registered under section 12(b) of the Exchange Act, or that is required to file reports under section 15(d) of the Exchange Act. For purposes of this section, whether a corporation is publicly held is determined based solely on whether, as of the last day of its taxable year, the securities issued by the corporation are required to be registered under section 12 of the Exchange Act or the corporation is required to file reports under section 15(d) of the Exchange Act. Whether registration under the Exchange Act is required by rules other than those of the Exchange Act is irrelevant to this determination. A publicly traded partnership that is treated as a corporation under section 7704 (or otherwise) is a publicly held corporation if, as of the last day of its taxable year, its securities are required to be registered under section 12 of the Exchange Act or it is required to file reports under section 15(d) of the Exchange Act.

(ii) *Affiliated groups*—(A) *In general.* A publicly held corporation includes an affiliated group of corporations (affiliated group), as defined in section 1504 (determined without regard to section 1504(b)), that includes one or more publicly held corporations (as defined in paragraph (c)(1)(i) of this section). In the case of an affiliated group that includes two or more publicly held corporations as defined in paragraph (c)(1)(i) of this section, each member of the affiliated group that is a publicly held corporation as defined in

paragraph (c)(1)(i) of this section is separately subject to this section, and, due to having at least one member that is a publicly held corporation, the affiliated group as a whole is subject to this section. Thus, for example, assume that a publicly held corporation (as defined in paragraph (c)(1)(i) of this section) is a wholly-owned subsidiary of another publicly held corporation (as defined in paragraph (c)(1)(i) of this section), which is a wholly-owned subsidiary of a privately held corporation. In this case, the two subsidiaries are separately subject to this section, and all three corporations are members of an affiliated group that is subject to this section. If an individual is a covered employee of both subsidiaries, each subsidiary has its own \$1 million deduction limitation with respect to that covered employee. Furthermore, each subsidiary has its own set of covered employees as defined in paragraphs (c)(2)(i) through (iv) of this section (although the same individual may be a covered employee of both subsidiaries).

(B) *Proration of amount disallowed as a deduction.* If, in a taxable year, a covered employee (as defined in paragraphs (c)(2)(i) through (v) of this section) of one member of an affiliated group is paid compensation by more than one member of the affiliated group, compensation paid by each member of the affiliated group is aggregated with compensation paid to the covered employee by all other members of the affiliated group (excluding compensation paid by any other publicly held corporation in the affiliated group, as defined in paragraph (c)(1)(i) of this section, of which the individual is also a covered employee as defined in paragraphs (c)(2)(i) through (v) of this section). In the event that, in a taxable year, a covered employee (as defined in paragraphs (c)(2)(i) through (v) of this section) is paid compensation by more than one publicly held corporation in an affiliated group and is also a covered employee of more than one publicly held payor corporation (as defined in paragraph (c)(1)(i) of this section) in the affiliated group, the amount disallowed as a deduction is determined separately with respect to each publicly held corporation of which the individual is a covered employee. Any amount disallowed as a deduction by this section must be prorated among the payor corporations (excluding any other publicly held payor corporation of which the individual is also a covered employee) in proportion to the amount of compensation paid to the covered employee (as defined in paragraphs

(c)(2)(i) through (v) of this section) by each such corporation in the taxable year. For purposes of this paragraph (c)(1)(ii)(B), the amount of compensation treated as paid by a payor corporation that is not a publicly held corporation (as defined in paragraph (c)(1)(i) of this section) is determined by prorating the amount actually paid by that payor corporation in proportion to the total amount paid by all of the publicly held corporations of which the individual is a covered employee (as defined in paragraph (c)(2)(i) through (v) of this section). This process is repeated for each publicly held payor corporation of which the individual is a covered employee.

(iii) *Disregarded entities.* For purposes of paragraph (c)(1) of this section, a publicly held corporation includes a corporation that owns an entity that is disregarded as an entity separate from its owner within the meaning of § 301.7701–2(c)(2)(i) of this chapter if the disregarded entity issues securities required to be registered under section 12(b) of the Exchange Act, or is required to file reports under section 15(d) of the Exchange Act.

(iv) *Qualified subchapter S subsidiaries.* For purposes of paragraph (c)(1) of this section, a publicly held corporation includes an S corporation that owns a qualified subchapter S subsidiary as defined in section 1361(b)(3)(B) (QSub) if the QSub issues securities required to be registered under section 12(b) of the Exchange Act, or is required to file reports under section 15(d) of the Exchange Act.

(v) *Qualified real estate investment trust subsidiaries.* For purposes of paragraph (c)(1) of this section, a publicly held corporation includes a real estate investment trust as defined in section 856(a) that owns a qualified real estate investment trust subsidiary as defined in section 856(i)(2) (QRS), if the QRS issues securities required to be registered under section 12(b) of the Exchange Act or is required to file reports under section 15(d) of the Exchange Act.

(vi) *Examples.* The following examples illustrate the provisions of this paragraph (c)(1). For each example, assume that no corporation is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii) of this section. Furthermore, for each example, unless provided otherwise, a reference to a publicly held corporation means a publicly held corporation as defined in paragraph (c)(1)(i) of this section. Additionally, for each example, assume that the corporation is a calendar-year taxpayer and has a fiscal year ending

December 31 for reporting purposes under the Exchange Act. The examples in this paragraph (c)(1)(vi) are not intended to provide guidance on the legal requirements of the Securities Act and Exchange Act and the rules thereunder (17 CFR part 240).

(A) *Example 1 (Corporation required to file reports under section 15(d) of the Exchange Act)*—(1) *Facts.* Corporation Z plans to issue debt securities in a public offering registered under the Securities Act. Corporation Z is not required to file reports under section 15(d) of the Exchange Act for any other class of securities and does not have another class of securities required to be registered under section 12 of the Exchange Act. On April 1, 2021, the SEC declares effective the Securities Act registration statement for Corporation Z's debt securities. As a result, Corporation Z is required to file reports under section 15(d) of the Exchange Act, and this requirement continues to apply as of December 31, 2021.

(2) *Conclusion.* Corporation Z is a publicly held corporation for its 2021 taxable year because it is required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year.

(B) *Example 2 (Corporation not required to file reports under section 15(d) of the Exchange Act)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(A) of this section (*Example 1*), except that, on January 1, 2022, pursuant to section 15(d) of the Exchange Act, Corporation Z's obligation to file reports under section 15(d) is automatically suspended for the fiscal year ending December 31, 2022, because Corporation Z meets the statutory requirements for an automatic suspension. As of December 31, 2022, Corporation Z is not required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporation Z is not a publicly held corporation for its 2022 taxable year because it is not required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year.

(C) *Example 3 (Corporation not required to file reports under section 15(d) of the Exchange Act)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(B) of this section (*Example 2*), except that, on January 1, 2022, pursuant to section 15(d) of the Exchange Act, Corporation Z's obligation to file reports under section 15(d) is not automatically suspended for the fiscal year ending December 31, 2022. Instead, on May 2, 2022, Corporation Z is eligible to suspend its section 15(d) reporting obligation under 17 CFR 240.12h-3 (Rule 12h-3 under the Exchange Act) and files Form 15, Certification and Notice of Termination of Registration under Section 12(g) of the Securities Exchange Act of 1934 or Suspension of Duty to File Reports under Sections 13 and 15(d) of the Securities Exchange Act of 1934, (or its successor) to suspend its section 15(d) reporting obligation for its fiscal year ending December 31, 2022. As of December 31, 2022, Corporation Z is not required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporation Z is not a publicly held corporation for its 2022 taxable

year because it is not required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year. If Corporation Z had not utilized Rule 12h-3 to suspend its section 15(d) reporting obligation, Corporation Z would be a publicly held corporation for its 2022 taxable year because it would have been required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year.

(D) *Example 4 (Corporation required to file reports under section 15(d) of the Exchange Act)*—(1) *Facts.* Corporation Y is a wholly-owned subsidiary of Corporation X, which is required to file reports under the Exchange Act. Corporation Y issued a class of debt securities in a public offering registered under the Securities Act, and therefore is required to file reports under section 15(d) of the Exchange Act for its fiscal year ending December 31, 2020. Corporation Y has no other class of securities registered under the Exchange Act. In its Form 10-K, Annual Report Pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934, (or its successor) for the 2020 fiscal year, Corporation Y may omit Item 11, Executive Compensation (required by Part III of Form 10-K), which requires disclosure of compensation of certain executive officers, because it is wholly-owned by Corporation X and the other conditions of General Instruction I to Form 10-K are satisfied.

(2) *Conclusion.* Corporation Y is a publicly held corporation for its 2020 taxable year because it is required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year.

(E) *Example 5 (Corporation not required to file reports under section 15(d) of the Exchange Act and not required to register securities under section 12 of the Exchange Act)*—(1) *Facts.* Corporation A has a class of securities registered under section 12(g) of the Exchange Act. For its 2020 taxable year, Corporation A is a publicly held corporation. On September 30, 2021, Corporation A is eligible to terminate the registration of its securities under section 12(g) of the Exchange Act pursuant to 17 CFR 240.12g-4(a)(2) (Rule 12g-4(a)(2) under the Exchange Act), but does not terminate the registration of its securities prior to December 31, 2021. Because Corporation A did not issue securities in a public offering registered under the Securities Act, Corporation A is not required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporation A is not a publicly held corporation for its 2021 taxable year because, as of the last day of its taxable year, the securities issued by Corporation A are not required to be registered under section 12 of the Exchange Act and Corporation A is not required to file reports under section 15(d) of the Exchange Act.

(F) *Example 6 (Corporation required to file reports under section 15(d) of the Exchange Act)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(E) of this section (*Example 5*), except that Corporation A previously issued a class of securities in a public offering registered under the Securities Act. Furthermore, on October 1, 2021, Corporation A terminates the

registration of its securities under section 12(g) of the Exchange Act. Because Corporation A issued a class of securities in a public offering registered under the Securities Act and is not eligible to suspend its reporting obligation under section 15(d) of the Exchange Act, as of December 31, 2021, Corporation A is required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporation A is a publicly held corporation for its 2021 taxable year because it is required to file reports under section 15(d) of the Exchange Act as of the last day of its taxable year.

(G) *Example 7 (Corporation not required to file reports under section 15(d) of the Exchange Act and not required to register securities under section 12 of the Exchange Act)*—(1) *Facts.* On November 1, 2021, Corporation B is an issuer with only one class of equity securities. On November 5, 2021, Corporation B files a registration statement for its equity securities under section 12(g) of the Exchange Act. Corporation B's filing of its registration statement is voluntary because the Exchange Act does not require Corporation B to register its class of securities under section 12(g) of the Exchange Act based on the number and composition of its record holders. On December 1, 2021, the SEC declares effective the Exchange Act registration statement for Corporation B's securities. As of December 31, 2021, Corporation B continues to have its class of equity securities registered voluntarily under section 12 of the Exchange Act. Corporation B is not required to file reports under section 15(d) of the Exchange Act because it did not register any class of securities in a public offering under the Securities Act.

(2) *Conclusion.* Corporation B is not a publicly held corporation for its 2021 taxable year because, as of the last day of that taxable year, the securities issued by Corporation B are not required to be registered under section 12 of the Exchange Act and Corporation B is not required to file reports under section 15(d) of the Exchange Act.

(H) *Example 8 (Corporation not required to file reports under section 15(d) of the Exchange Act and not required to register securities under section 12 of the Exchange Act)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(G) of this section (*Example 7*), except that, on December 31, 2022, because of a change in circumstances, Corporation B must register its class of equity securities under section 12(g) of the Exchange Act within 120 days of December 31, 2022. On February 1, 2023, the SEC declares effective the Exchange Act registration statement for Corporation B's securities.

(2) *Conclusion.* Corporation B is not a publicly held corporation for its 2022 taxable year because, as of the last day of that taxable year, Corporation B is not required to file reports under section 15(d) of the Exchange Act and the class of equity securities issued by Corporation B is not yet required to be registered under section 12 of the Exchange Act.

(I) *Example 9 (Securities of foreign private issuer in the form of ADRs traded in the over-the-counter market)*—(1) *Facts.* For its fiscal

and taxable years ending December 31, 2021, Corporation W is a foreign private issuer. Because Corporation W has not registered an offer or sale of securities under the Securities Act, it is not required to file reports under section 15(d) of the Exchange Act.

Corporation W qualifies for an exemption from registration of its securities under section 12(g) of the Exchange Act pursuant to 17 CFR 240.12g3-2(b) (Rule 12g3-2(b) under the Exchange Act). Corporation W wishes to have its securities traded in the U.S. in the over-the-counter market in the form of ADRs. Because Corporation W qualifies for an exemption pursuant to Rule 12g3-2(b), Corporation W is not required to register its securities underlying the ADRs under section 12 of the Exchange Act; however, the depository bank is required to register the ADRs under the Securities Act. Even though the depository bank is required to register the ADRs under the Securities Act, the registration of the ADRs does not result in either the depository bank or Corporation W being required to file reports under section 15(d) of the Exchange Act. On February 3, 2021, the SEC declares effective the Securities Act registration statement for the ADRs. On February 4, 2021, Corporation W's ADRs begin trading in the over-the-counter market. On December 31, 2021, the securities of Corporation W are not required to be registered under section 12 of the Exchange Act because Corporation W qualifies for an exemption pursuant to Rule 240.12g3-2(b). Furthermore, on December 31, 2021, Corporation W is not required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporation W is not a publicly held corporation for its 2021 taxable year because, as of the last day of that taxable year, the securities underlying the ADRs are not required to be registered under section 12 of the Exchange Act and Corporation W is not required to file reports under section 15(d) of the Exchange Act. The result would be the same if Corporation W had its securities traded in the over-the-counter market other than in the form of ADRs.

(J) *Example 10 (Securities of foreign private issuer in the form of ADRs quoted on Over the Counter Bulletin Board)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(I) of this section (*Example 9*), except that Corporation W has its securities quoted on the Over the Counter Bulletin Board (OTCBB) in the form of ADRs. Because Corporation W qualifies for an exemption pursuant to 17 CFR 240.12g3-2(b) (Rule 12g3-2(b) under the Exchange Act), Corporation W is not required to register its securities underlying the ADRs under section 12 of the Exchange Act. However, the depository bank is required to register the ADRs under the Securities Act. In addition, section 6530(b)(1) of the OTCBB Rules requires that a foreign equity security may be quoted on the OTCBB only if the security is registered with the SEC pursuant to section 12 of the Exchange Act and the issuer of the security is current in its reporting obligations. To comply with the OTCBB Rules, on February 5, 2021, Corporation W files a registration statement for its class of securities underlying the ADRs under section 12(g) of the Exchange Act. On February 26, 2021, the SEC declares effective

the Exchange Act registration statement for Corporation W's securities. As of December 31, 2021, Corporation W is subject to the reporting obligations under section 12 of the Exchange Act as a result of the section 12 registration.

(2) *Conclusion.* Corporation W is not a publicly held corporation for its 2021 taxable year because, as of the last day of that taxable year, its ADRs and the securities underlying the ADRs are not required by the Exchange Act to be registered under section 12 and Corporation W is not required to file reports under section 15(d) of the Exchange Act. The Securities Act requirement applicable to the bank pursuant to the OTCBB rules is irrelevant. The result would be the same if Corporation W had its securities traded on the OTCBB other than in the form of ADRs.

(K) *Example 11 (Securities of foreign private issuer in the form of ADRs listed on a national securities exchange without a capital raising transaction)*—(1) *Facts.* For its fiscal and taxable years ending December 31, 2021, Corporation V is a foreign private issuer. Corporation V wishes to list its securities on the New York Stock Exchange (NYSE) in the form of ADRs without a capital raising transaction. Under the Exchange Act, Corporation V is required to register its securities underlying the ADRs under section 12(b) of the Exchange Act. Because the ADRs and the deposited securities are separate securities, the depository bank is required to register the ADRs under the Securities Act. On February 2, 2021, the SEC declares effective Corporation V's registration statement under section 12(b) of the Exchange Act in connection with the underlying securities, and the depository bank's registration statement under the Securities Act in connection with the ADRs. On March 1, 2021, Corporation V's securities begin trading on the NYSE in the form of ADRs. As of December 31, 2021, Corporation V is not required to file reports under section 15(d) of the Exchange Act; however, the securities underlying the ADRs are required to be registered under section 12(b) of the Exchange Act.

(2) *Conclusion.* Corporation V is a publicly held corporation for its 2021 taxable year because, as of the last day of that taxable year, the securities underlying the ADRs are required to be registered under section 12 of the Exchange Act. The result would be the same if Corporation V had its securities listed on the NYSE other than in the form of ADRs. The result also would be the same if Corporation V had wished to raise capital during its 2021 taxable year and been required to register the offer of securities underlying the ADRs under the Securities Act and to register the class of those securities under section 12(b) of the Exchange Act, and the depository bank was required to register the ADRs under the Securities Act.

(L) *Example 12 (Foreign private issuer incorporates subsidiary in the United States to issue debt securities and subsequently issues a guarantee)*—(1) *Facts.* For its fiscal and taxable years ending December 31, 2021, Corporation T is a foreign private issuer. Corporation T wishes to access the U.S. capital markets. Corporation T incorporates

Corporation U, a wholly-owned subsidiary, in the U.S. to issue debt securities. On January 15, 2021, the SEC declares effective Corporation U's Securities Act registration statement. To enhance Corporation U's credit and the marketability of Corporation U's debt securities, Corporation T issues a guarantee of Corporation U's securities and, as required, registers the guarantee under the Securities Act on Corporation U's registration statement. On December 31, 2021, Corporations T and U are required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Corporations T and U are publicly held corporations for their 2021 taxable years because they are required to file reports under section 15(d) of the Exchange Act as of the last day of their taxable years.

(M) *Example 13 (Affiliated group comprised of two corporations, one of which is a publicly held corporation)*—(1) *Facts.* Employee D, a covered employee of Corporation N, receives compensation from, Corporations N and O, members of an affiliated group. Corporation N, the parent corporation, is a publicly held corporation. Corporation O is a direct subsidiary of Corporation N and is a privately held corporation. The total compensation paid to Employee D from the affiliated group members is \$3,000,000 for the taxable year, of which Corporation N pays \$2,100,000 and Corporation O pays \$900,000.

(2) *Conclusion.* Because the compensation paid by all affiliated group members is aggregated for purposes of section 162(m)(1), \$2,000,000 of the aggregate compensation paid is nondeductible. Corporations N and O each are treated as paying a ratable portion of the nondeductible compensation. Thus, two thirds of each corporation's payment will be nondeductible. Corporation N has a nondeductible compensation expense of \$1,400,000 ($\$2,100,000 \times \frac{2,000,000}{3,000,000}$). Corporation O has a nondeductible compensation expense of \$600,000 ($\$900,000 \times \frac{2,000,000}{3,000,000}$).

(N) *Example 14 (Affiliated group comprised of two corporations, one of which is a publicly held corporation)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(M) of this section (*Example 13*), except that Corporation O is a publicly held corporation, Corporation N is a privately held corporation, and Employee D is a covered employee of Corporation O (instead of Corporation N).

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(M) of this section (*Example 13*). Even though subsidiary Corporation O is the publicly held corporation, Corporations N and O still comprise an affiliated group. Accordingly, \$2,000,000 of the aggregate compensation paid is nondeductible, and Corporations N and O each are treated as paying a ratable portion of the nondeductible compensation.

(O) *Example 15 (Affiliated group comprised of two publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(M) of this section (*Example 13*), except that Corporation O is a publicly held corporation. As in paragraph (c)(1)(vi)(M) of this section

(*Example 13*), Employee D is not a covered employee of Corporation O.

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(M) of this section (*Example 13*). Even though Corporations N and O each are publicly held corporations, Corporations N and O comprise an affiliated group for purposes of prorating the amount disallowed as a deduction. Accordingly, \$2,000,000 of the aggregate compensation paid is nondeductible, and Corporations N and O each are treated as paying a ratable portion of the nondeductible compensation.

(P) *Example 16 (Affiliated group comprised of two publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(O) of this section (*Example 15*), except that Employee D also is a covered employee of Corporation O.

(2) *Conclusion.* Corporations N and O each are publicly held corporations and separately subject to this section, but also comprise an affiliated group. Because Employee D is a covered employee of both Corporations N and O, each of which is a separate publicly held corporation, the determination of the amount disallowed as a deduction is made separately for each publicly held corporation. Corporation N has a nondeductible compensation expense of \$1,100,000 (the excess of \$2,100,000 over \$1,000,000), and Corporation O has no nondeductible compensation expense because the amount it paid to Employee D did not exceed \$1,000,000.

(Q) *Example 17 (Affiliated group comprised of three corporations, one of which is a publicly held corporation)*—(1) *Facts.* Employee C, a covered employee of publicly held parent Corporation P, receives compensation from Corporations P, Q, and R, members of an affiliated group. Corporation Q is a direct subsidiary of Corporation P, and Corporation R is a direct subsidiary of Corporation Q. Corporations Q and R both are privately held. The total compensation paid to Employee C from the affiliated group members is \$3,000,000 for the taxable year, of which Corporation P pays \$1,500,000, Corporation Q pays \$900,000, and Corporation R pays \$600,000.

(2) *Conclusion.* Because the compensation paid by affiliated group members is aggregated for purposes of section 162(m)(1), \$2,000,000 of the aggregate compensation paid is nondeductible. Corporations P, Q, and R each are treated as paying a ratable portion of the nondeductible compensation. Thus, two thirds of each corporation's payment will be nondeductible. The nondeductible compensation expense for Corporation P is \$1,000,000 ($\$1,500,000 \times \$2,000,000 / \$3,000,000$); for Corporation Q is \$600,000 ($\$900,000 \times \$2,000,000 / \$3,000,000$); and for Corporation R is \$400,000 ($\$600,000 \times \$2,000,000 / \$3,000,000$).

(R) *Example 18 (Affiliated group comprised of three corporations, one of which is a publicly held corporation)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(Q) of this section (*Example 17*), except that Corporation Q is a publicly held corporation and Corporation P is a privately held corporation, and Employee C is a covered employee of Corporation Q (instead of Corporation P).

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(Q) of this section (*Example 17*). Even though Corporation Q, the subsidiary, is the publicly held corporation, Corporations P, Q, and R comprise an affiliated group. Accordingly, \$2,000,000 of the aggregate compensation paid is nondeductible, and Corporations P, Q, and R each are treated as paying a ratable portion of the nondeductible compensation.

(S) *Example 19 (Affiliated group comprised of three corporations, two of which are publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(R) of this section (*Example 18*), except that Corporation R also is a publicly held corporation. As in paragraph (c)(1)(vi)(R) of this section (*Example 18*), Corporation Q is a publicly held corporation, Corporation P is a privately held corporation, and Employee C is a covered employee of Corporation Q but not a covered employee of Corporation R.

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(R) of this section (*Example 18*). Even though Corporation R also is a publicly held corporation, Corporations P, Q, and R comprise an affiliated group. Accordingly, \$2,000,000 of the aggregate compensation paid is nondeductible, and Corporations P, Q, and R each are treated as paying a ratable portion of the nondeductible compensation.

(T) *Example 20 (Affiliated group comprised of three publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(Q) of this section (*Example 17*), except that Corporations Q and R also are publicly held corporations, and Employee C is a covered employee of both Corporations P and Q but is not a covered employee of Corporation R.

(2) *Conclusion.* Even though Corporations P, Q, and R each are publicly held corporations, they comprise an affiliated group. Because Employee C is a covered employee of both Corporations P and Q, the determination of the amount disallowed as a deduction is separately prorated among Corporations P and R and among Corporations Q and R. For each separate calculation of the total amount of the disallowed deduction and the proration of the disallowed deduction, the amount paid by Corporation R is taken into account in proportion to the total compensation paid by Corporations P and Q. With respect to Corporations P and R, \$875,000 of the aggregate compensation is nondeductible (the excess of \$1,875,000 (the sum of the compensation paid by Corporation P (\$1,500,000) and the portion of compensation paid by Corporation R that is treated as allocable to Employee C being a covered employee of Corporation P ($\$600,000 \times \$1,500,000 / (\$1,500,000 + \$900,000) = \$375,000$) over the \$1,000,000 deduction limitation). Corporations P and R each are treated as paying a ratable portion of the nondeductible compensation. Corporation P has a nondeductible compensation expense of \$700,000 ($\$1,500,000 \times \$875,000 / \$1,875,000$), and Corporation R has a nondeductible compensation expense of \$175,000 ($\$375,000 \times \$875,000 / \$1,875,000$). For Corporations Q and R, \$125,000 of the aggregate compensation is nondeductible (the

excess of \$1,125,000 (the sum of the compensation paid by Corporation Q (\$900,000) and the portion of compensation paid by Corporation R that is treated as allocable to Employee C being a covered employee of Corporation Q ($\$600,000 \times \$900,000 / (\$1,500,000 + \$900,000) = \$225,000$) over the \$1,000,000 deduction limitation). Corporation Q has a nondeductible compensation expense of \$100,000 ($\$900,000 \times \$125,000 / \$1,125,000$), and Corporation R has a nondeductible compensation expense of \$25,000 ($\$225,000 \times \$125,000 / \$1,125,000$). The total nondeductible compensation expense for Corporation R is \$200,000.

(U) *Example 21 (Affiliated group comprised of three publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(T) of this section (*Example 20*), except that Employee C does not receive any compensation from Corporation R.

(2) *Conclusion.* Even though Corporations P, Q, and R each are publicly held corporations and separately subject to this section, they comprise an affiliated group. Because Employee C is a covered employee of, and receives compensation from, both Corporations P and Q, each of which is a separate publicly held corporation, the determination of the amount disallowed as a deduction is made separately for Corporations P and Q. Corporation P has a nondeductible compensation expense of \$500,000 (the excess of \$1,500,000 over \$1,000,000), and Corporation Q has no nondeductible compensation expense because the amount it paid to Employee C was below \$1,000,000.

(V) *Example 22 (Affiliated group comprised of three corporations, one of which is a publicly held corporation)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(Q) of this section (*Example 17*), except that Corporation R is a direct subsidiary of Corporation P (and not a direct subsidiary of Corporation Q).

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(Q) of this section (*Example 17*). Corporations P, Q, and R comprise an affiliated group. Accordingly, \$2,000,000 of the aggregate compensation paid is nondeductible, and Corporations P, Q, and R each are treated as paying a ratable portion of the nondeductible compensation.

(W) *Example 23 (Affiliated group comprised of three publicly held corporations)*—(1) *Facts.* The facts are the same as in paragraph (c)(1)(vi)(V) of this section (*Example 22*), except that Corporations Q and R also are publicly held corporations, and Employee C is a covered employee of both Corporations P and Q but not of Corporation R.

(2) *Conclusion.* The result is the same as in paragraph (c)(1)(vi)(V) of this section (*Example 22*). Even though Corporations P, Q, and R each are publicly held corporations, they comprise an affiliated group. Because Employee C is a covered employee of both Corporations P and Q, the amount disallowed as a deduction is prorated separately among Corporations P and R and among Corporations Q and R.

(X) *Example 24 (Disregarded entity)*—(1) *Facts.* Corporation G is privately held for its

2020 taxable year. Entity H, a limited liability company, is wholly-owned by Corporation G and is disregarded as an entity separate from its owner under § 301.7701-2(c)(2)(i) of this chapter. As of December 31, 2020, Entity H is required to file reports under section 15(d) of the Exchange Act.

(2) *Conclusion.* Because Entity H is required to file reports under section 15(d) of the Exchange Act and is disregarded as an entity separate from its owner, Corporation G is a publicly held corporation for its 2020 taxable year. The result would be the same if Corporation G was a REIT under section 856(a) and Entity H was a QRS under section 856(i)(2).

(2) *Covered employee—(i) General rule.* Except as provided in paragraph (c)(2)(vi) of this section, with respect to a publicly held corporation as defined in paragraph (c)(1) of this section (without regard to paragraph (c)(1)(ii) of this section), for the publicly held corporation's taxable year, a covered employee means any of the following—

(A) The principal executive officer (PEO) or principal financial officer (PFO) of the publicly held corporation serving at any time during the taxable year, including individuals acting in either such capacity.

(B) The three highest compensated executive officers of the publicly held corporation for the taxable year (other than the principal executive officer or principal financial officer, or an individual acting in such capacity), regardless of whether the executive officer is serving at the end of the publicly held corporation's taxable year, and regardless of whether the executive officer's compensation is subject to disclosure for the last completed fiscal year under the executive compensation disclosure rules under the Exchange Act. For purposes of this paragraph (c)(2)(i)(B), the term "executive officer" means an executive officer as defined in 17 CFR 240.3b-7. The amount of compensation used to identify the three most highly compensated executive officers for the taxable year is determined pursuant to the executive compensation disclosure rules under the Exchange Act (using the taxable year as the fiscal year for purposes of making the determination), regardless of whether the corporation's fiscal year and taxable year end on the same date.

(C) Any individual who was a covered employee of the publicly held corporation (or any predecessor of a publicly held corporation, within the meaning of paragraph (c)(2)(ii) of this section) for any preceding taxable year beginning after December 31, 2016. For taxable years beginning prior to January 1, 2018, covered employees are identified in accordance with the rules in § 1.162-27(c)(2).

(ii) *Predecessor of a publicly held corporation—(A) Publicly held corporations that become privately held.* For purposes of this paragraph (c)(2)(ii), a predecessor of a publicly held corporation includes a publicly held corporation that, after becoming a privately held corporation, again becomes a publicly held corporation for a taxable year ending before the 36-month anniversary of the due date for the corporation's U.S. Federal income tax return (disregarding any extensions) for the last taxable year for which the corporation was previously publicly held.

(B) *Corporate reorganizations.* A predecessor of a publicly held corporation includes a publicly held corporation the stock or assets of which are acquired in a corporate reorganization (as defined in section 368(a)(1)).

(C) *Corporate divisions.* A predecessor of a publicly held corporation includes a publicly held corporation that is a distributing corporation (within the meaning of section 355(a)(1)(A)) that distributes the stock of a controlled corporation (within the meaning of section 355(a)(1)(A)) to its shareholders in a distribution or exchange qualifying under section 355(a)(1) (corporate division). The rule of this paragraph (c)(2)(ii)(C) applies only with respect to covered employees of the distributing corporation who begin performing services for the controlled corporation (or for a corporation affiliated with the controlled corporation that receives stock of the controlled corporation in the corporate division) within the period beginning 12 months before and ending 12 months after the distribution.

(D) *Affiliated groups.* A predecessor of a publicly held corporation includes any other publicly held corporation that becomes a member of its affiliated group (as defined in paragraph (c)(1)(ii) of this section).

(E) *Asset acquisitions.* If a publicly held corporation, including one or more members of an affiliated group as defined in paragraph (c)(1)(ii) of this section (acquiror), acquires at least 80% of the gross operating assets (determined by fair market value on the date of acquisition) of another publicly held corporation (target), then the target is a predecessor of the acquiror. For an acquisition of assets that occurs over time, only assets acquired within a 12-month period are taken into account to determine whether at least 80% of the target's gross operating assets were acquired. However, this 12-month period is extended to include any continuous period that ends on, or begins on, any day during which the

acquiror has an arrangement to purchase, directly or indirectly, assets of the target. A shareholder's additions to the assets of target made as part of a plan or arrangement to avoid the application of this subsection to acquiror's purchase of target's assets are disregarded in applying this paragraph (c)(2)(ii)(E). This paragraph (c)(2)(ii)(E) applies only with respect to the target's covered employees who begin performing services for the acquiror (or a corporation affiliated with the acquiror) within the period beginning 12 months before and ending 12 months after the date of the transaction as defined in paragraph (c)(2)(ii)(I) of this section (incorporating any extensions to the 12-month period made pursuant to this paragraph).

(F) *Predecessor of a predecessor.* For purposes of this paragraph (c)(2)(ii), a predecessor of a corporation includes each predecessor of the corporation and the predecessor or predecessors of any prior predecessor or predecessors.

(G) *Corporations that are not publicly held at the time of the transaction and sequential transactions—(1) Predecessor corporation is not publicly held at the time of the transaction.* This paragraph (c)(2)(ii)(G)(1) applies if a corporation that was previously publicly held (the first corporation) would be a predecessor to another corporation (the second corporation) under the rules of this paragraph (c)(2)(ii) but for the fact that the first corporation is not a publicly held corporation at the time of the relevant transaction (or transactions). If this paragraph (c)(2)(ii)(G)(1) applies, the first corporation is a predecessor of a publicly held corporation if the second corporation is a publicly held corporation at the time of the relevant transaction (or transactions) and the relevant transaction (or transactions) take place during a taxable year ending before the 36-month anniversary of the due date for the first corporation's U.S. Federal income tax return (excluding any extensions) for the last taxable year for which the first corporation was previously publicly held.

(2) *Second corporation is not publicly held at the time of the transaction.* This paragraph (c)(2)(ii)(G)(2) applies if a corporation that is publicly held (the first corporation) at the time of the relevant transaction (or transactions) would be a predecessor to another corporation (the second corporation) under the rules of this paragraph (c)(2)(ii) but for the fact that the second corporation is not a publicly held corporation at the time of the relevant transaction (or transactions). If this paragraph (c)(2)(ii)(G)(2) applies, the

first corporation is a predecessor of a publicly held corporation if the second corporation becomes a publicly held corporation for a taxable year ending before the 36-month anniversary of the due date for the first corporation's U.S. Federal income tax return (excluding any extensions) for the first corporation's last taxable year in which the transaction is taken into account.

(3) *Neither corporation is publicly held at the time of the transaction.* This paragraph (c)(2)(ii)(G)(3) applies if a corporation that was previously publicly held (the first corporation) would be a predecessor to another corporation (the second corporation) under the rules of this paragraph (c)(2)(ii) but for the fact that neither the first corporation nor the second corporation is a publicly held corporation at the time of the relevant transaction (or transactions). If this paragraph (c)(2)(ii)(G)(3) applies, the first corporation is a predecessor of a publicly held corporation if the second corporation becomes a publicly held corporation for a taxable year ending before the 36-month anniversary of the due date for the first corporation's U.S. Federal income tax return (excluding any extensions) for the last taxable year for which the first corporation was previously publicly held.

(4) *Sequential transactions.* If a corporation that was previously publicly held (the first corporation) would be a predecessor to another corporation (the second corporation) under the rules of this paragraph (c)(2)(ii) but for the fact that the first corporation is (or its assets are) transferred to one or more intervening corporations prior to being transferred to the second corporation, and if each intervening corporation would be a predecessor of a publicly held corporation with respect to the second corporation if the intervening corporation or corporations were publicly held corporations, then paragraphs (c)(2)(ii)(G)(1) through (3) of this section also apply without regard to the intervening corporations.

(H) *Elections under sections 336(e) and 338.* For purposes of this paragraph (c)(2), if a corporation makes an election to treat as an asset purchase either the sale, exchange, or distribution of stock pursuant to regulations under section 336(e) (§§ 1.336-1 through 1.336-5) or the purchase of stock pursuant to regulations under section 338 (§§ 1.338-1 through 1.338-11, 1.338(h)(10)-1, and 1.338(i)-1), the corporation that issued the stock is treated as the same corporation both before and after such transaction.

(I) *Date of transaction.* For purposes of this paragraph (c)(2)(ii), the date that a transaction is treated as having occurred is the date on which all events necessary for the transaction to be described in the relevant provision in this paragraph (c)(2)(ii) have occurred.

(J) *Publicly traded partnership.* For purposes of applying this paragraph (c)(2)(ii), a publicly traded partnership is a predecessor of a publicly held corporation if under the same facts and circumstances a corporation substituted for the publicly traded partnership would be a predecessor of the publicly held corporation, and at the time of the transaction the publicly traded partnership is treated as a publicly held corporation as defined in paragraph (c)(1)(i) of this section. In making this determination, the rules in paragraphs (c)(2)(ii)(A) through (I) of this section apply by analogy to publicly traded partnerships.

(iii) *Disregarded entities.* If a publicly held corporation under paragraph (c)(1) of this section owns an entity that is disregarded as an entity separate from its owner under § 301.7701-2(c)(2)(i) of this chapter, then the covered employees of the publicly held corporation are determined pursuant to paragraphs (c)(2)(i) and (ii) of this section. The executive officers of the entity that is disregarded as an entity separate from its corporate owner under § 301.7701-2(c)(2)(i) of this chapter are neither covered employees of the entity nor of the publicly held corporation unless they meet the definition of covered employee in paragraphs (c)(2)(i) and (ii) of this section with respect to the publicly held corporation, in which case they are covered employees for its taxable year.

(iv) *Qualified subchapter S subsidiaries.* If a publicly held corporation under paragraph (c)(1) of this section owns an entity that is a QSub under section 1361(b)(3)(B), then the covered employees of the publicly held corporation are determined pursuant to paragraphs (c)(2)(i) and (ii) of this section. The executive officers of the QSub are neither covered employees of the QSub nor of the publicly held corporation unless they meet the definition of covered employee in paragraphs (c)(2)(i) and (ii) of this section with respect to the publicly held corporation, in which case they are covered employees for the taxable year of the publicly held corporation.

(v) *Qualified real estate investment trust subsidiaries.* If a publicly held corporation under paragraph (c)(1) of this section owns an entity that is a QRS under section 856(i)(2), then the covered employees of the publicly held

corporation are determined pursuant to paragraphs (c)(2)(i) and (ii) of this section. The executive officers of the QRS are neither covered employees of the QRS nor of the publicly held corporation unless they meet the definition of covered employee in paragraphs (c)(2)(i) and (ii) of this section with respect to the publicly held corporation, in which case they are covered employees for the taxable year of the publicly held corporation.

(vi) *Covered employee of an affiliated group.* A person who is identified as a covered employee in paragraphs (c)(2)(i) through (v) of this section for a publicly held corporation's taxable year is also a covered employee for the taxable year of an affiliated group treated as a publicly held corporation pursuant to paragraph (c)(1)(ii) of this section (treatment of an affiliated group).

(vii) *Examples.* The following examples illustrate the provisions of this paragraph (c)(2). For each example, assume that the corporation has a taxable year that is a calendar year and has a fiscal year ending December 31 for reporting purposes under the Exchange Act. Also, for each example, unless provided otherwise, assume that none of the employees were covered employees for any taxable year preceding the first taxable year set forth in that example (since being a covered employee for a preceding taxable year would provide a separate, independent basis for classifying that employee as a covered employee for a subsequent taxable year).

(A) *Example 1 (Covered employees of members of an affiliated group)—(1) Facts.* Corporations A, B, and C are direct wholly-owned subsidiaries of Corporation D. Corporations D and A are each publicly held corporations as of December 31, 2020. Corporations B and C are not publicly held corporations for their 2020 taxable years. Employee E served as the PEO of Corporation D from January 1, 2020, to March 31, 2020. Employee F served as the PEO of Corporation D from April 1, 2020, to December 31, 2020. Employee G served as the PEO of Corporation A for its entire 2020 taxable year. Employee H served as the PEO of Corporation B for its entire 2020 taxable year. Employee I served as the PEO of Corporation C for its entire 2020 taxable year. From April 1, 2020, through September 30, 2020, Employee E served as an advisor (not as a PEO) to Employee I and received compensation from Corporation C for these services. In 2020, all four corporations paid compensation to their respective PEOs.

(2) *Conclusion (Employees E and F).* Because both Employees E and F served as the PEO of Corporation D during its 2020 taxable year, both Employees E and F are covered employees of Corporation D for its 2020 and subsequent taxable years.

(3) *Conclusion (Employee G).* Because Employee G served as the PEO of Corporation

A, Employee G is a covered employee of Corporation A for its 2020 and subsequent taxable years.

(4) *Conclusion (Employee H)*. Even though Employee H served as the PEO of Corporation B, Employee H is not a covered employee of Corporation B for its 2020 taxable year, because Corporation B is considered a publicly held corporation solely by reason of being a member of an affiliated group as defined in paragraph (c)(1)(ii) of this section.

(5) *Conclusion (Employee I)*. Even though Employee I served as the PEO of Corporation C, Employee I is not a covered employee of Corporation C for its 2020 taxable year, because Corporation C is considered a publicly held corporation solely by reason of being a member of an affiliated group as defined in paragraph (c)(1)(ii) of this section.

(B) *Example 2 (Covered employees of a publicly held corporation)*—(1) *Facts*. Corporation J is a publicly held corporation. Corporation J is not a smaller reporting company or emerging growth company for purposes of reporting under the Exchange Act. For 2020, Employee K served as the sole PEO of Corporation J and Employees L and M both served as the PFO of Corporation J at separate times during the year. Employees N, O, and P were, respectively, the first, second, and third highest compensated executive officers of Corporation J for 2020 other than the PEO and PFO, and all three retired before December 31, 2020. Employees Q, R, and S were, respectively, Corporation J's fourth, fifth, and sixth highest compensated executive officers other than the PEO and PFO for 2020, and all three were serving as of December 31, 2020. On March 1, 2021, Corporation J filed its Form 10-K, Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 with the SEC. With respect to Item 11, Executive Compensation (as required by Part III of Form 10-K, or its successor), Corporation J disclosed the compensation of Employee K for serving as the PEO, Employees L and M for serving as the PFO, and Employees Q, R, and S pursuant to 17 CFR 229.402(a)(3)(iii) (Item 402 of Regulation S-K). Corporation J also disclosed the compensation of Employees N and O pursuant to 17 CFR 229.402(a)(3)(iv) (Item 402 of Regulation S-K).

(2) *Conclusion (Employee K)*. Because Employee K served as the PEO during 2020, Employee K is a covered employee for Corporation J's 2020 taxable year.

(3) *Conclusion (Employees L and M)*. Because Employees L and M served as the PFO during 2020, Employees L and M are covered employees for Corporation J's 2020 taxable year.

(4) *Conclusion (Employees N, O, P, Q, R, and S)*. Even though the executive compensation disclosure rules under the Exchange Act require Corporation J to disclose the compensation of Employees N, O, Q, R, and S for 2020, Corporation J's three highest compensated executive officers who are covered employees for its 2020 taxable year are Employees N, O, and P, because these are the three highest compensated executive officers other than the PEO and PFO for 2020.

(C) *Example 3 (Covered employees of a smaller reporting company)*—(1) *Facts*. The facts are the same as in paragraph (c)(2)(vii)(B) of this section (*Example 2*), except that Corporation J is a smaller reporting company or emerging growth company for purposes of reporting under the Exchange Act. With respect to Item 11, Executive Compensation, Corporation J disclosed the compensation of Employee K for serving as the PEO, Employees Q and R pursuant to 17 CFR 229.402(m)(2)(ii) (Item 402(m) of Regulation S-K), and Employees N and O pursuant to 17 CFR 229.402(m)(2)(iii) (Item 402(m) of Regulation S-K).

(2) *Conclusion*. The result is the same as in paragraph (c)(2)(vii)(L) of this section (*Example 2*). For purposes of identifying a corporation's covered employees, it is irrelevant whether the reporting obligation under the Exchange Act for smaller reporting companies and emerging growth companies apply to the corporation, and it is irrelevant whether the specific executive officers' compensation must be disclosed pursuant to the disclosure rules under the Exchange Act applicable to the corporation.

(D) *Example 4 (Covered employees of a publicly held corporation that is not required to file a Form 10-K)*—(1) *Facts*. The facts are the same as in paragraph (c)(2)(vii)(B) of this section (*Example 2*), except that on February 4, 2021, Corporation J files Form 15, Certification and Notice of Termination of Registration under Section 12(g) of the Securities Exchange Act of 1934 or Suspension of Duty to File Reports under Sections 13 and 15(d) of the Securities Exchange Act of 1934, (or its successor) to terminate the registration of its securities. Corporation J's duty to file reports under Section 13(a) of the Exchange Act is suspended upon the filing of the Form 15 and, as a result, Corporation J is not required to file a Form 10-K and disclose the compensation of its executive officers for 2020.

(2) *Conclusion*. The result is the same as in paragraph (c)(2)(vii)(B) of this section (*Example 2*). Covered employees include executive officers of a publicly held corporation even if the corporation is not required to disclose the compensation of its executive officers under the Exchange Act. Therefore, Employees K, L, M, N, O, and P are covered employees for 2020. The result would be different if Corporation J filed Form 15 to terminate the registration of its securities prior to December 31, 2020. In that case, Corporation J would not be a publicly held corporation for its 2020 taxable year, and, therefore, Employees K, L, M, N, O, and P would not be covered employees for Corporation J's 2020 taxable year.

(E) *Example 5 (Covered employees of two publicly held corporations after a corporate transaction)*—(1) *Facts*. Corporation T is a publicly held corporation for its 2019 taxable year. Corporation U is a privately held corporation for its 2019 and 2020 taxable years. On July 31, 2020, Corporation U acquires for cash 80% of the only class of outstanding stock of Corporation T. The affiliated group (comprised of Corporations U and T) elects to file a consolidated Federal income tax return. As a result of this election,

Corporation T has a short taxable year ending on July 31, 2020. Corporation T does not change its fiscal year for reporting purposes under the Exchange Act to correspond to the short taxable year. Corporation T remains a publicly held corporation for its short taxable year ending on July 31, 2020, and its subsequent taxable year ending on December 31, 2020, for which it files a consolidated Federal income tax return with Corporation U. For Corporation T's taxable year ending July 31, 2020, Employee V serves as the only PEO, and Employee W serves as the only PFO. Employees X, Y, and Z are the three most highly compensated executive officers of Corporation T for the taxable year ending July 31, 2020, other than the PEO and PFO. As a result of the acquisition, effective July 31, 2020, Employee V ceases to serve as the PEO of Corporation T. Instead, Employee AA starts serving as the PEO of Corporation T on August 1, 2020. Employee V continues to provide services for Corporation T but never serves as PEO again (or as an individual acting in such capacity). For Corporation T's taxable year ending December 31, 2020, Employee AA serves as the only PEO, and Employee W serves as the only PFO. Employees X, Y, and Z continue to serve as executive officers of Corporation T during the taxable year ending December 31, 2020. Employees BB, CC, and DD are the three most highly compensated executive officers of Corporation T, other than the PEO and PFO, for the taxable year ending December 31, 2020.

(2) *Conclusion (Employee V)*. Because Employee V served as the PEO during Corporation T's short taxable year ending July 31, 2020, Employee V is a covered employee for Corporation T's short taxable year ending July 31, 2020, even though Employee V's compensation is required to be disclosed pursuant to the executive compensation disclosure rules under the Exchange Act only for the fiscal year ending December 31, 2020. Because Employee V was a covered employee for Corporation T's short taxable year ending July 31, 2020, Employee V is also a covered employee for Corporation T's short taxable year ending December 31, 2020.

(3) *Conclusion (Employee W)*. Because Employee W served as the PFO during Corporation T's short taxable years ending July 31, 2020, and December 31, 2020, Employee W is a covered employee for both taxable years, even though Employee W's compensation is required to be disclosed pursuant to the executive compensation disclosure rules under the Exchange Act only for the fiscal year ending December 31, 2020. Because Employee W was a covered employee for Corporation T's short taxable year ending July 31, 2020, Employee W would be a covered employee for Corporation T's short taxable year ending December 31, 2020, even if Employee W did not serve as the PFO during this taxable year.

(4) *Conclusion (Employee AA)*. Because Employee AA served as the PEO during Corporation T's short taxable year ending December 31, 2020, Employee AA is a covered employee for that short taxable year.

(5) *Conclusion (Employees X, Y, and Z)*. Employees X, Y, and Z are covered

employees for Corporation T's short taxable years ending July 31, 2020, and December 31, 2020. Employees X, Y, and Z are covered employees for Corporation T's short taxable year ending July 31, 2020, because those employees are the three highest compensated executive officers for that short taxable year. Because they were covered employees for Corporation T's short taxable year ending July 31, 2020, Employees X, Y, and Z are covered employees for Corporation T's short taxable year ending December 31, 2020 and would be covered employees for that later short taxable year even if their compensation would not be required to be disclosed pursuant to the executive compensation disclosure rules under the Exchange Act.

(6) *Conclusion (Employees BB, CC, and DD).* Employees BB, CC, and DD are covered employees for Corporation T's short taxable year ending December 31, 2020, because those employees are the three highest compensated executive officers for that short taxable year.

(F) *Example 6 (Predecessor of a publicly held corporation)—(1) Facts.* Corporation EE is a publicly held corporation for its 2021 taxable year. Corporation EE is a privately held corporation for its 2022 and 2023 taxable years. For its 2024 taxable year, Corporation EE is a publicly held corporation.

(2) *Conclusion.* For its 2024 taxable year, Corporation EE is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(A) of this section because, after ceasing to be a publicly held corporation, it again became a publicly held corporation for a taxable year ending prior to April 15, 2025. Therefore, for Corporation EE's 2024 taxable year, the covered employees of Corporation EE include the covered employees of Corporation EE for its 2021 taxable year and any additional covered employees determined pursuant to this paragraph (c)(2).

(G) *Example 7 (Predecessor of a publicly held corporation)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(F) of this section (*Example 6*), except that Corporation EE remains a privately held corporation until it becomes a publicly held corporation for its 2027 taxable year.

(2) *Conclusion.* Corporation EE is not a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(A) of this section because it became a publicly held corporation for a taxable year ending after April 15, 2025. Therefore, any covered employee of Corporation EE for its 2021 taxable year is not a covered employee of Corporation EE for its 2027 taxable year due to that individual's status as a covered employee of Corporation EE for a preceding taxable year (beginning after December 31, 2016) but may be a covered employee due to that individual's status during the 2027 taxable year.

(H) *Example 8 (Predecessor of a publicly held corporation that is party to a merger)—(1) Facts.* On June 30, 2021, Corporation FF (a publicly held corporation) merged into Corporation GG (a publicly held corporation) in a transaction that qualifies as a reorganization under section 368(a)(1)(A), with Corporation GG as the surviving

corporation. As a result of the merger, Corporation FF has a short taxable year ending June 30, 2021. Corporation FF is a publicly held corporation for this short taxable year. Corporation GG does not have a short taxable year and is a publicly held corporation for its 2021 taxable year.

(2) *Conclusion.* Corporation FF is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(B) of this section. Therefore, any covered employee of Corporation FF for its short taxable year ending June 30, 2021, is a covered employee of Corporation GG for its 2021 taxable year. For Corporation GG's 2021 and subsequent taxable years, the covered employees of Corporation GG include the covered employees of Corporation FF (for a preceding taxable year beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(I) *Example 9 (Predecessor of a publicly held corporation that is party to a merger)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(H) of this section (*Example 8*), except that, after the merger, Corporation GG is a privately held corporation for its 2021 taxable year.

(2) *Conclusion.* Because Corporation GG is a privately held corporation for its 2021 taxable year, it is not subject to section 162(m)(1) for this taxable year.

(J) *Example 10 (Predecessor of a publicly held corporation that is party to a merger)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(I) of this section (*Example 9*), except that Corporation GG, becomes a publicly held corporation (as defined in paragraph (c)(1)(i) of this section) on June 30, 2023, and is a publicly held corporation for its 2023 taxable year.

(2) *Conclusion.* Because Corporation GG became a publicly held corporation for a taxable year ending prior to April 15, 2025, Corporation FF is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(G) of this section. For Corporation GG's 2023 and subsequent taxable years, the covered employees of Corporation GG include the covered employees of Corporation FF (for a preceding taxable year beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(K) *Example 11 (Predecessor of a publicly held corporation that is party to a merger)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(J) of this section (*Example 10*), except that Corporation FF is a privately held corporation for its taxable year ending June 30, 2021, but was a publicly held corporation for its 2020 taxable year.

(2) *Conclusion.* Even though Corporation FF was a privately held corporation when it merged with Corporation GG on June 30, 2021, Corporation FF will be a predecessor corporation if Corporation GG becomes a publicly held corporation within a taxable year ending prior to April 15, 2024. Because Corporation GG became a publicly held corporation for its taxable year ending December 31, 2023, Corporation FF is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(G) of this section. For Corporation GG's 2023

and subsequent taxable years, the covered employees of Corporation GG include the covered employees of Corporation FF (for a preceding taxable year beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(L) *Example 12 (Predecessor of a publicly held corporation that is party to a merger and subsequently becomes member of an affiliated group)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(J) of this section (*Example 10*), except that, on June 30, 2022, Corporation GG becomes a publicly held corporation by becoming a member of an affiliated group (as defined in paragraph (c)(1)(ii) of this section). Corporation II is the parent corporation of the group and is a publicly held corporation. Employee HH was a covered employee of Corporation FF for its taxable year ending June 30, 2021. On July 1, 2022, Employee HH becomes an employee of Corporation II.

(2) *Conclusion.* By becoming a member of an affiliated group (as defined in paragraph (c)(1)(ii) of this section) on June 30, 2022, Corporation GG became a publicly held corporation for a taxable year ending prior to April 15, 2025. Therefore, Corporation FF is a predecessor of a publicly held corporation (Corporation GG) within the meaning of paragraph (c)(2)(ii)(G) of this section. Furthermore, Corporation FF is also a predecessor of Corporation II, a publicly held corporation within the meaning of paragraph (c)(2)(ii)(G) of this section. For Corporation II's 2022 and subsequent taxable years, Employee HH is a covered employee of the affiliated group that includes Corporation II because Employee HH was a covered employee of Corporation FF for its taxable year ending June 30, 2021.

(M) *Example 13 (Predecessor of a publicly held corporation that is party to a merger and subsequently becomes member of an affiliated group)—(1) Facts.* The facts are the same as in paragraph (c)(2)(vii)(L) of this section (*Example 12*), except that Corporation FF was a privately held corporation for its taxable year ending June 30, 2021, and Employee HH was a covered employee of Corporation FF for its taxable year ending December 31, 2020.

(2) *Conclusion.* Even though Corporation FF was a privately held corporation when it merged with Corporation GG on June 30, 2021, Corporation FF will be a predecessor corporation if Corporation GG becomes a publicly held corporation for a taxable year ending prior to April 15, 2024. Because Corporation GG became a publicly held corporation for its 2022 taxable year by becoming a member of an affiliated group (as defined in paragraph (c)(1)(ii) of this section), Corporation FF is a predecessor of a publicly held corporation (Corporation GG) within the meaning of paragraph (c)(2)(ii)(G) of this section. Furthermore, Corporation FF is also a predecessor of Corporation II, a publicly held corporation within the meaning of paragraph (c)(2)(ii)(G) of this section. Therefore, any covered employee of Corporation FF for its 2020 taxable year is a covered employee of the affiliated group that includes Corporation II for its 2022 and subsequent taxable years. For Corporation II's

2022 taxable year, Employee HH is a covered employee of the affiliated group that includes Corporation II because Employee HH was a covered employee of Corporation FF for its 2020 taxable year.

(N) *Example 14 (Predecessor of a publicly held corporation that is a party to a merger)*—(1) *Facts.* Corporation JJ is a publicly held corporation for its 2019 taxable year and is incorporated in State KK. On June 1, 2019, Corporation JJ formed a wholly-owned subsidiary, Corporation LL. Corporation LL is a publicly held corporation incorporated in State MM. On June 30, 2021, Corporation JJ merged into Corporation LL under State MM law in a transaction that qualifies as a reorganization under section 368(a)(1)(A), with Corporation LL as the surviving corporation. As a result of the merger, Corporation JJ has a short taxable year ending June 30, 2021. Corporation JJ is a publicly held corporation for this short taxable year.

(2) *Conclusion.* Corporation JJ is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(B) of this section. For Corporation LL's taxable years ending after June 30, 2021, the covered employees of Corporation LL include the covered employees of Corporation JJ for its short taxable year ending June 30, 2021 (as well as preceding taxable years beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(O) *Example 15 (Predecessor of a publicly held corporation becomes member of an affiliated group)*—(1) *Facts.* On June 30, 2021, Corporation OO acquires for cash 100% of the only class of outstanding stock of Corporation NN. The affiliated group (comprised of Corporations NN and OO) elects to file a consolidated Federal income tax return. As a result of this election, Corporation NN has a short taxable year ending on June 30, 2021. Corporation NN is a publicly held corporation for its taxable year ending June 30, 2021, and a privately held corporation for subsequent taxable years. On June 30, 2022, Corporation OO completely liquidates Corporation NN. Corporation OO is a publicly held corporation for its 2021 and 2022 taxable years.

(2) *Conclusion.* After Corporation OO acquired Corporation NN, Corporations NN and OO comprise an affiliated group as defined in paragraph (c)(1)(ii) of this section. Thus, Corporation NN is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(D) of this section. For Corporation OO's taxable years ending after June 30, 2021, the covered employees of Corporation OO include the covered employees of Corporation NN for its short taxable year ending June 30, 2021 (as well as preceding taxable years beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(P) *Example 16 (Predecessor of a publicly held corporation becomes member of an affiliated group)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(O) of this section (Example 15), except that Corporation OO is a privately held

corporation on June 30, 2021, and for its 2021 and 2022 taxable years.

(2) *Conclusion.* Because Corporation OO is a privately held corporation for its 2021 and 2022 taxable years, it is not subject to section 162(m)(1) for these taxable years.

(Q) *Example 17 (Predecessor of a publicly held corporation becomes member of an affiliated group)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(P) of this section (Example 16), except that, on October 1, 2022, the SEC declares effective Corporation OO's Securities Act registration statement in connection with its initial public offering, and Corporation OO is a publicly held corporation for its 2022 taxable year.

(2) *Conclusion (Taxable Year Ending December 31, 2021).* Because Corporation OO is a privately held corporation for its 2021 taxable year, it is not subject to section 162(m)(1) for this taxable year.

(3) *Conclusion (Taxable Year Ending December 31, 2022).* For the 2022 taxable year, Corporations NN and OO comprise an affiliated group as defined in paragraph (c)(1)(ii) of this section. Corporation NN is a predecessor of a publicly held corporation within the meaning of paragraph (c)(2)(ii)(D) and (G) of this section because Corporation OO became a publicly held corporation for a taxable year ending prior to April 15, 2025. For Corporation OO's 2022 and subsequent taxable years, the covered employees of Corporation OO include the covered employees of Corporation NN for its short taxable year ending June 30, 2021 (as well as preceding taxable years beginning after December 31, 2016) and any additional covered employees determined pursuant to this paragraph (c)(2).

(R) *Example 18 (Predecessor of a publicly held corporation and asset acquisition)*—(1) *Facts.* Corporations VV, WW, and XX are publicly held corporations for their 2020 and 2021 taxable years. Corporations VV and WW are members of an affiliated group. Corporation WW is a direct subsidiary of Corporation VV. On June 30, 2021, Corporation VV acquires for cash 40% of the gross operating assets (determined by fair market value as of January 31, 2022) of Corporation XX. On January 31, 2022, Corporation WW acquires an additional 40% of the gross operating assets (determined by fair market value as of January 31, 2022) of Corporation XX. Employees EB, EC, and EA are covered employees for Corporation XX's 2020 taxable year. Employees ED and EF are also covered employees for Corporation XX's 2021 taxable year. On January 15, 2021, Employee EA started performing services as an employee of Corporation WW. On July 1, 2021, Employee EB started performing services as an employee of Corporation WW. On February 1, 2022, Employees EC and ED started performing services as employees of Corporation WW. On June 30, 2023, Employee EF started performing services as an employee of Corporation WW.

(2) *Conclusion.* Because an affiliated group, comprised of Corporations VV and WW, acquired 80% of Corporation XX's gross operating assets (determined by fair market value) within a twelve-month period, Corporation XX is a predecessor of a publicly

held corporation within the meaning of paragraph (c)(2)(ii)(E) of this section. Therefore, any covered employee of Corporation XX for its 2020 and 2021 taxable years (who started performing services as an employee of Corporation WW within the period beginning 12 months before and ending 12 months after the date of the January 31, 2022, acquisition (determined under paragraph (c)(2)(ii)(I) of this section) is a covered employee of Corporation WW for its 2021, 2022, and subsequent taxable years. For Corporation WW's 2021 and subsequent taxable years, the covered employees of Corporation WW include Employee EB and any additional covered employees determined pursuant to paragraph (c)(2)(i) of this section. For Corporation WW's 2022 and subsequent taxable years, the covered employees of Corporation WW include Employees EB, EC, and ED, and any additional covered employees determined pursuant to this paragraph (c)(2). Because Employee EA started performing services as an employee of Corporation WW before January 31, 2021, Employee EA is not a covered employee of Corporation WW for its 2021 taxable year and subsequent taxable years by reason of paragraph (c)(2)(ii)(E) of this section, but may be a covered employee of Corporation WW by application of other rules in this paragraph (c)(2). Because Employee EF started performing services as an employee of Corporation WW after January 31, 2023, Employee EF is not a covered employee of Corporation WW for its 2023 taxable year by reason of paragraph (c)(2)(ii)(E) of this section, but may be a covered employee of Corporation WW by application of other rules in this paragraph (c)(2).

(S) *Example 19 (Predecessor of a publicly held corporation and asset acquisition)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(R) of this section (Example 18), except that Corporations VV and WW are not publicly held corporations on June 30, 2021, or for their 2021 taxable years.

(2) *Conclusion.* Because Corporations VV and WW are not publicly held corporations for their 2021 taxable years, they are not subject to section 162(m)(1) for their 2021 taxable years.

(T) *Example 20 (Predecessor of a publicly held corporation and asset acquisition)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(R) of this section (Example 18), except that, on October 1, 2022, the SEC declares effective Corporation VV's Securities Act registration statement in connection with its initial public offering, and Corporation VV is a publicly held corporation for its 2022 taxable year.

(2) *Conclusion (2021 taxable year).* Because Corporations VV and WW are not publicly held corporations for their 2021 taxable years, they are not subject to section 162(m)(1) for their 2021 taxable years.

(3) *Conclusion (2022 taxable year).* Corporation XX is a predecessor of a publicly held corporation within the meaning of paragraphs (c)(2)(ii)(E) and (G) of this section because a member of the affiliated group comprised of Corporations VV and WW acquired 80% of Corporation XX's gross operating assets (determined by fair market

value) within a twelve-month period ending on January 31, 2022, and the parent of the affiliated group, Corporation VV, subsequently became a publicly held corporation for a taxable year ending prior to April 15, 2024. Therefore, any covered employee of Corporation XX for its 2020 and 2021 taxable years (who started performing services as an employee of Corporation WW within the period beginning 12 months before and ending 12 months after the acquisition) is a covered employee of the affiliated group comprised of Corporations VV and WW for its 2022 and subsequent taxable years. For Corporation WW's 2022 and subsequent taxable years, the covered employees of Corporation WW include Employees EB, EC, and ED, and any additional covered employees determined pursuant to this paragraph (c)(2).

(U) *Example 21 (Predecessor of a publicly held corporation and a division)*—(1) *Facts.* Corporation CA is a publicly held corporation for its 2021 and 2022 taxable years. On March 2, 2021, Corporation DDD forms a wholly-owned subsidiary, Corporation CB, and transfers assets to it. On April 1, 2022, Corporation CA distributes all shares of Corporation CB to its shareholders in a transaction described in section 355(a)(1). On April 1, 2022, the SEC declares effective Corporation CB's Securities Act registration statement in connection with its initial public offering. Corporation CB is a publicly held corporation for its 2022 taxable year. Employee EG serves as the PFO of Corporation CA from January 1, 2022, to March 31, 2022. On April 2, 2022, Employee EG starts performing services as an employee of Corporation CB advising the PFO of Corporation CB. After March 31, 2022, Employee EG ceases to provide services for Corporation CA.

(2) *Conclusion.* Because the distribution of the stock of Corporation CB is a transaction described under section 355(a)(1), Corporation CA is a predecessor of Corporation CB within the meaning of paragraph (c)(2)(ii)(C) of this section. Because Employee EG was a covered employee of Corporation CA for its 2022 taxable year, Employee ED is a covered employee of Corporation CB for its 2022 taxable year. The result is the same whether Employee EG performs services as an advisor for Corporation CB as an employee or an independent contractor.

(V) *Example 22 (Predecessor of a publicly held corporation and a division)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(U) of this section (*Example 21*), except that Corporation CA distributes 100% of the shares of Corporation CB to Corporation CD in exchange for all of Corporation CD's stock in Corporation CA in a transaction described in section 355(a)(1) and Corporation CB does not register any class of securities with the SEC. Also, Employee EG performs services as an employee of Corporation CD instead of as an employee of Corporation CB. Corporation CD is a privately held corporation for its 2022 taxable year. On October 1, 2023, the SEC declares effective Corporation CD's Securities Act registration statement in connection with its initial public offering. Corporation CD is

a publicly held corporation for its 2023 taxable year. On January 1, 2028, Employee EG starts performing services as an employee of Corporation CA. Corporation CA is a publicly held corporation for its 2028 taxable year.

(2) *Conclusion (2022 taxable year).* Because Corporation CD is a privately held corporation for its 2022 taxable year, it is not subject to section 162(m)(1) for this taxable year.

(3) *Conclusion (2023 taxable year).* Because the exchange of the stock of Corporation CB for the stock of Corporation CA is a transaction described in section 355(a)(1), Corporations CB and CD are an affiliated group, and Corporation CD became a publicly held corporation for a taxable year ending prior to April 15, 2026, Corporation CA is a predecessor of Corporation CD within the meaning of paragraphs (c)(2)(ii)(D) and (G) of this section. Employee EG was a covered employee of Corporation CA for its 2022 taxable year, and started performing services as an employee of Corporation CD following April 1, 2021, and before April 1, 2023. Therefore, Employee ED is a covered employee of Corporation CD for its 2023 taxable year.

(4) *Conclusion (2028 taxable year).* Because Employee EG served as the PFO of Corporation CA from January 1, 2022, to March 31, 2022, Employee EG was a covered employee of Corporation CA for its 2022 taxable year. Because an individual who is a covered employee for a taxable year remains a covered employee for all subsequent taxable years (even after the individual has separated from service), Employee EG is a covered employee of Corporation CA for its 2028 taxable year.

(W) *Example 23 (Predecessor of a publicly held corporation and a division)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(V) of this section (*Example 22*), except that Employee EG starts performing services as an employee of Corporation CD on June 30, 2023, instead of on April 2, 2022, and never performs services for Corporation CA after June 30, 2023. Furthermore, on June 30, 2023, Employee EH, a covered employee of Corporation CB for all of its taxable years, starts performing services for Corporation EF as an independent contractor advising its PEO but not serving as a PEO.

(2) *Conclusion (2023 taxable year).* Because the exchange of the stock of Corporation CB for the stock of Corporation CA is a transaction described in section 355(a)(1) and Corporation CD became a publicly held corporation for a taxable year ending before April 15, 2026, Corporation CA is a predecessor of Corporation CD within the meaning of paragraphs (c)(2)(ii)(D) and (G) of this section. Even though Employee EG was a covered employee of Corporation CA for its 2022 taxable year, because Employee EG started performing services as an employee of Corporation CD after April 1, 2023, Employee EG is not a covered employee of Corporation CD for its 2023 taxable year under paragraph (c)(2)(ii)(C) of this section. However, Employee EG may be a covered employee of Corporation CD by application of other rules in this paragraph (c)(2). Because Employee EH was a covered employee of Corporation

CB for its 2022 taxable year, Employee EH is a covered employee of Corporation CD for its 2023 taxable year.

(X) *Example 24 (Predecessor of a publicly held corporation and election under section 338(h)(10))*—(1) *Facts.* Corporation CE is the common parent of a group of corporations filing consolidated returns that includes Corporation CF as a member. Corporation CE wholly-owns Corporation CF, a publicly held corporation within the meaning of paragraph (c)(1)(i) of this section. On June 30, 2021, Corporation CG purchases Corporation CF from Corporation CE. Corporation CE and Corporation CG make a timely election under section 338(h)(10) with respect to the purchase of Corporation CF stock. For its taxable year ending December 31, 2021, Corporation CF continues to be a publicly held corporation within the meaning of paragraph (c)(1)(i) of this section.

(2) *Conclusion.* As provided in paragraph (c)(2)(ii)(H) of this section, Corporation CF is treated as the same corporation after the section 338(h)(10) transaction as before the transaction for purposes of this paragraph (c)(2). Any covered employee of Corporation CF for its short taxable year ending June 30, 2021, is a covered employee of Corporation CF for its short taxable year ending on December 31, 2021, and subsequent taxable years.

(Y) *Example 25 (Disregarded entity)*—(1) *Facts.* Corporation CH is a privately held corporation for its 2020 taxable year. Entity CI is a wholly-owned limited liability company and is disregarded as an entity separate from its owner, Corporation CH, under § 301.7701-2(c)(2)(i) of this chapter. As of December 31, 2020, Entity CI is required to file reports under section 15(d) of the Exchange Act. For the 2020 taxable year, Employee EI is the PEO and Employee EJ is the PFO of Corporation CH. Employees EK, EL, and EM, are the three most highly compensated executive officers of Corporation CH (other than Employees EI and EJ). Employee EN is the PFO of Entity CI and does not perform any policy making functions for Corporation CH. Entity CI has no other executive officers.

(2) *Conclusion.* Because Entity CI is disregarded as an entity separate from its owner, Corporation CH, and is required to file reports under section 15(d) of the Exchange Act, Corporation CH is a publicly held corporation under paragraph (c)(1)(iii) of this section for its 2020 taxable year. Even though Employee EN is a PFO of Entity CI, Employee EN is not considered a PFO of Corporation CH under paragraph (c)(2)(iii) of this section. As PEO and PFO, Employees EI and EJ are covered employees of Corporation CH under paragraph (c)(2)(i) of this section. Additionally, as the three most highly compensated executive officers of Corporation CH (other than Employees EI and EJ), Employees EK, EL, and EM also are covered employees of Corporation CH under paragraph (c)(2)(i) of this section for Corporation CH's 2020 taxable year. The result would be the same if Entity CI was not required to file reports under section 15(d) of the Exchange Act and Corporation CH was a publicly held corporation pursuant to paragraph (c)(1)(i) instead of paragraph (c)(1)(iii) of this section.

(Z) *Example 26 (Disregarded entity)*—(1) *Facts.* The facts are the same as in paragraph (c)(2)(vii)(Y) of this section (*Example 25*), except that Employee EN performs a policy making function for Corporation CH. If Corporation CH were subject to the SEC executive compensation disclosure rules, then Employee EN would be treated as an executive officer of Corporation CH pursuant to 17 CFR 240.3b–7 for purposes of determining the three highest compensated executive officers for Corporation CH's 2020 taxable year. Employee EN is compensated more than Employee EK, but less than Employees EL and EM.

(2) *Conclusion.* Because Entity CI is disregarded as an entity separate from its owner, Corporation CH, and is required to file reports under section 15(d) of the Exchange Act, Corporation CH is a publicly held corporation under paragraph (c)(1)(iii) of this section for its 2020 taxable year. As PEO and PFO, Employees EI and EJ are covered employees of Corporation CH under paragraph (c)(2)(i) of this section. Employee EN is one of the three highest compensated executive officers for Corporation CH's taxable year. Because Employees EN, EL, and EM are the three most highly compensated executive officers of Corporation CH (other than Employees EI and EJ), they are covered employees of Corporation CH under paragraph (c)(2)(i) of this section for Corporation CH's 2020 taxable year. The result would be the same if Entity CI was not required to file reports under section 15(d) of the Exchange Act and Corporation CH was a publicly held corporation pursuant to paragraph (c)(1)(i) instead of paragraph (c)(1)(iii) of this section.

(AA) *Example 27 (Individual as covered employee of a publicly held corporation that includes the affiliated group)*—(1) *Facts.* Corporations CJ and CK are publicly held corporations for their 2020, 2021, and 2022 taxable years. Corporation CK is a direct subsidiary of Corporation CJ. Employee EO is an employee, but not a covered employee (as defined in paragraph (c)(2)(i) of this section), of Corporation CJ for its 2020, 2021, and 2022 taxable years. From April 1, 2020, to September 30, 2020, Employee EO serves as the PFO of Corporation CK. Employee EO does not perform any services for Corporation CK for its 2021 and 2022 taxable years, however, employee EO is a covered employee (as defined in paragraph (c)(2)(i) of this section) of Corporation CK for its 2020, 2021, and 2022 taxable years. For the 2020 taxable year, Employee EO receives compensation of \$1,500,000 for services provided to Corporations CJ and CK. Employee EO receives \$2,000,000 from Corporation CJ for performing services for Corporation CJ during each of its 2021 and 2022 taxable years. On June 30, 2022, Corporation CK pays \$500,000 to Employee EO from a nonqualified deferred compensation plan that complies with section 409A.

(2) *Conclusion (2020 taxable year).* Because Employee EO is a covered employee of Corporation CK and because the affiliated group (comprised of Corporations CJ and CK) is a publicly held corporation, Employee EO is a covered employee of the publicly held

corporation that is the affiliated group pursuant to paragraph (c)(2)(vi) of this section. Compensation paid by Corporations CJ and CK is aggregated for purposes of section 162(m)(1) and, as a result, \$500,000 of the aggregate compensation paid is nondeductible. The result would be the same if Corporation CJ was a privately held corporation for its 2020 taxable year.

(3) *Conclusion (2021 taxable year).* Because Employee EO is a covered employee of Corporation CK pursuant to paragraph (c)(2)(i)(C) of this section and because the affiliated group (comprised of Corporations CJ and CK) is a publicly held corporation, Employee EO is a covered employee of the publicly held corporation that is the affiliated group pursuant to paragraph (c)(2)(vi) of this section. Compensation paid by Corporations CJ and CK is aggregated for purposes of section 162(m)(1) and, as a result, \$1,000,000 of the aggregate compensation paid is nondeductible. The result would be the same if Corporation CJ was a privately held corporation for its 2021 taxable year.

(4) *Conclusion (2022 taxable year).* Because Employee EO is a covered employee of Corporation CK pursuant to paragraph (c)(2)(i)(C) of this section and because the affiliated group (comprised of Corporations CJ and CK) is a publicly held corporation, Employee EO is a covered employee of the publicly held corporation that is the affiliated group pursuant to paragraph (c)(2)(vi) of this section. Compensation paid by Corporations CJ and CK is aggregated for purposes of section 162(m)(1) and, as a result, \$1,500,000 of the aggregate compensation paid is nondeductible. The result would be the same if Corporation CJ was a privately held corporation for its 2022 taxable year.

(BB) *Example 28 (Individual as covered employee of a publicly held corporation that includes the affiliated group)*—(1) *Facts.* Corporation CL is a publicly held corporation for its 2020 through 2023 taxable years. Corporations CM and CN are direct subsidiaries of Corporation CL and are privately held corporations for their 2020 through 2022 taxable years. Employee EP serves as the PFO of Corporation CL from January 1, 2020 to December 31, 2020, when Employee EP terminates employment from Corporation CL. On January 1, 2021, Employee EP starts performing services as an employee of Corporation CM. In 2021, Employee EP receives compensation from Corporation CM in excess of \$1,000,000. On April 1, 2022, Employee EP starts performing services as an employee of Corporation CN. On September 30, 2022, Employee EP terminates employment from Corporations CM and CN. In 2022, Employee EP receives compensation from Corporations CM and CN in excess of \$1,000,000. For the 2021 and 2022 taxable years, Employee EP does not serve as either the PEO or PFO of Corporations CM and CN, and is not one of the three highest compensated executive officers (other than the PEO or PFO) of Corporations CM and CN. On April 1, 2023, Corporation CL distributes all the shares of Corporation CM to its shareholders in a transaction described in section 355(a)(1). On April 1, 2023, the SEC declares effective Corporation CM's Securities Act registration

statement in connection with its initial public offering. Corporation CM is a publicly held corporation for its 2023 taxable year. On April 2, 2023, Employee EP starts performing services as an employee of Corporation CM but is not an executive officer of Corporation CM.

(2) *Conclusion (2021 taxable year).* Employee EP is a covered employee of Corporation CL for the 2020 and subsequent taxable years. Because Employee EP is a covered employee of Corporation CL and because the affiliated group (comprised of Corporations CL, CM, and CN) is a publicly held corporation, Employee EP is a covered employee of the publicly held corporation that is the affiliated group pursuant to paragraph (c)(2)(vi) of this section for the 2020 and subsequent taxable years. Therefore, Corporation CM's deduction for compensation paid to Employee EP for the 2021 taxable year is subject to section 162(m)(1). The result would be the same if Corporation CM was a publicly held corporation as defined in paragraph (c)(1)(i) of this section.

(3) *Conclusion (2022 taxable year).* Because Employee EP is a covered employee of Corporation CL and because the affiliated group (comprised of Corporations CL, CM, and CN) is a publicly held corporation, Employee EP is a covered employee of the publicly held corporation that is the affiliated group pursuant to paragraph (c)(2)(vi) of this section. Therefore, Corporation CM's and CN's deduction for compensation paid to Employee EP for the 2022 taxable year is subject to section 162(m)(1). Because the compensation paid by all affiliated group members is aggregated for purposes of section 162(m)(1), \$1,000,000 of the aggregate compensation paid is nondeductible. Corporations CM and CN are each treated as paying a ratable portion of the nondeductible compensation. The result would be the same if either Corporation CM or CN (or both) was a publicly held corporation as defined in paragraph (c)(1)(i) of this section.

(4) *Conclusion (2023 taxable year).* Because the distribution of the stock of Corporation CM is a transaction described in section 355(a)(1), Corporation CL is a predecessor of Corporation CM within the meaning of paragraph (c)(2)(ii)(C) of this section. However, because Employee EP started performing services as an employee of Corporation CM on January 1, 2021, and the distribution of stock of Corporation CM did not occur until April 1, 2023, Employee EP is not a covered employee of Corporation CM for its 2023 taxable year.

(3) *Compensation—(i) In general.* For purposes of the deduction limitation described in paragraph (b) of this section, compensation means the aggregate amount allowable as a deduction to the publicly held corporation under chapter 1 of the Internal Revenue Code for the taxable year (determined without regard to section 162(m)(1)) for remuneration for services performed by a covered employee in any capacity, whether or not the services were performed during

the taxable year. Compensation includes an amount that is includible in the income of, or paid to, a person other than the covered employee (including a beneficiary after the death of the covered employee) for services performed by the covered employee.

(ii) *Compensation paid by a partnership.* For purposes of paragraph (c)(3)(i) of this section, compensation includes an amount equal to a publicly held corporation's distributive share of a partnership's deduction for compensation expense attributable to the remuneration paid by the partnership to a covered employee of the publicly held corporation for services performed by the covered employee, including a payment for services under section 707(a) or under section 707(c).

(iii) *Exceptions.* Compensation does not include—

(A) Remuneration covered in section 3121(a)(5)(A) through (D) (concerning remuneration that is not treated as wages for purposes of the Federal Insurance Contributions Act);

(B) Remuneration consisting of any benefit provided to or on behalf of an employee if, at the time the benefit is provided, it is reasonable to believe that the employee will be able to exclude it from gross income; or

(C) Salary reduction contributions described in section 3121(v)(1).

(iv) *Examples.* The following examples illustrate the provisions of this paragraph (c)(3). For each example, assume that the corporation is a calendar year taxpayer.

(A) *Example 1—(1) Facts.* Corporation Z is a publicly held corporation for its 2020 taxable year, during which Employee A serves as the PEO of Corporation Z and also serves on the board of directors of Corporation Z. In 2020, Corporation Z paid \$1,200,000 to Employee A plus a \$50,000 fee for serving as a director of Corporation Z. These amounts are otherwise deductible for Corporation Z's 2020 taxable year.

(2) *Conclusion.* The \$1,200,000 paid to Employee A in 2020 plus the \$50,000 director's fee paid to Employee A in 2020 are compensation within the meaning of this paragraph (c)(3). Therefore, Corporation Z's \$1,250,000 deduction for the 2020 taxable year is subject to the section 162(m)(1) limit.

(B) *Example 2—(1) Facts.* Corporation X is a publicly held corporation for its 2020 and all subsequent taxable years. Employee B serves as the PEO of Corporation X for its 2020 taxable year and is a participant in the Corporation X nonqualified retirement plan that meets the requirements of section 409A. The plan provides for the distribution of benefits over a three-year period beginning after a participant separates from service. Employee B terminates employment in 2021. In 2022, Employee B receives a \$75,000 fee for services as a director and \$1,500,000 as

the first payment under the retirement plan. Employee B continues to serve on the board of directors until 2023 when Employee B dies before receiving the retirement benefit for 2023 and before becoming entitled to any director's fees for 2023. In 2023 and 2024, Corporation X pays the \$1,500,000 annual retirement benefits to Person C, a beneficiary of Employee B.

(2) *Conclusion (2022 Taxable Year).* In 2022, Corporation X paid Employee B \$1,575,000, including \$1,500,000 under the retirement plan and \$75,000 in director's fees. The retirement benefit and the director's fees are compensation within the meaning of this paragraph (c)(3). Therefore, Corporation X's \$1,575,000 deduction for the 2022 taxable year is subject to the section 162(m)(1) limit.

(3) *Conclusion (2023 and 2024 Taxable Years).* In 2023 and 2024, Corporation X made payments to Person C of \$1,500,000 under the retirement plan. The retirement benefits are compensation within the meaning of this paragraph (c)(3). Therefore, Corporation X's deduction for each annual payment of \$1,500,000 for the 2023 and 2024 taxable years is subject to the section 162(m)(1) limit.

(C) *Example 3—(1) Facts.* Corporation T is a publicly held corporation for its 2021 taxable year. Corporation S is a privately held corporation for its 2021 taxable year. On January 2, 2021, Corporations S and T form a general partnership. Under the partnership agreement, Corporations S and T each have a 50% distributive share of the partnership's income, gain, loss, and deductions. For the taxable year ending December 31, 2021, Employee D, a covered employee of Corporation T, performs services for the partnership, and the partnership pays \$800,000 to Employee D for these services, the deduction of \$400,000 of which is allocated to Corporation T. Corporation T's \$400,000 distributive share of the partnership's deduction is reported separately to Corporation T pursuant to § 1.702-1(a)(8)(iii).

(2) *Conclusion.* Because Corporation T's \$400,000 distributive share of the partnership's deduction is attributable to the compensation paid by the partnership for services performed by Employee D, a covered employee of Corporation T, the \$400,000 is compensation within the meaning of this paragraph (c)(3) and Corporation T's deduction for this expense for its 2021 taxable year is subject to the section 162(m)(1) limit. Corporation T's \$400,000 allocation of the partnership's deduction is aggregated with Corporation T's deduction for compensation paid to Employee D, if any, in determining the amount allowable as a deduction to Corporation T for compensation paid to Employee D for Corporation T's 2021 taxable year. The result is the same whether Employee D performs services for the partnership as a common law employee, an independent contractor, or a partner, and whether the payment to Employee D is a payment under section 707(a) or section 707(c).

(4) *Securities Act.* The Securities Act means the Securities Act of 1933.

(5) *Exchange Act.* The Exchange Act means the Securities Exchange Act of 1934.

(6) *SEC.* The SEC means the United States Securities and Exchange Commission.

(7) *Foreign Private Issuer.* A foreign private issuer means an issuer as defined in 17 CFR 240.3b-4(c).

(8) *American Depositary Receipt (ADR).* An American Depositary Receipt or ADR means a negotiable certificate that evidences ownership of a specified number (or fraction) of a foreign private issuer's securities held by a depository (typically, a U.S. bank).

(9) *Privately held corporation.* A privately held corporation is a corporation that is not a publicly held corporation as defined in paragraph (c)(1) of this section (without regard to paragraph (c)(1)(ii) of this section).

(d) *Corporations that become publicly held—(1) In general.* In the case of a corporation that was a privately held corporation and then becomes a publicly held corporation, the deduction limitation of paragraph (b) of this section applies to any compensation that is otherwise deductible for the taxable year ending on or after the date that the corporation becomes a publicly held corporation. A corporation is considered to become publicly held on the date that its registration statement becomes effective either under the Securities Act or the Exchange Act. The rules in this section apply to a partnership that becomes a publicly traded partnership that is a publicly held corporation within the meaning of paragraph (c)(1)(i) of this section.

(2) *Example.* The following example illustrates the provision of this paragraph (d).

(i) *Facts.* In 2021, Corporation E plans to issue debt securities in a public offering registered under the Securities Act. Corporation E is not required to file reports under section 15(d) of the Exchange Act with respect to any other class of securities and does not have another class of securities required to be registered under section 12 of the Exchange Act. On December 18, 2021, the SEC declares effective the Securities Act registration statement for Corporation E's debt securities.

(ii) *Conclusion.* Corporation E becomes a publicly held corporation on December 18, 2021 because it is then required to file reports under section 15(d) of the Exchange Act. The deduction limitation of paragraph (b) of this section applies to any compensation that is otherwise deductible for Corporation E's taxable year ending on or after December 18, 2021.

(e) *Coordination with disallowed excess parachute payments under section 280G.* The \$1,000,000 limitation

in paragraph (b) of this section is reduced (but not below zero) by the amount (if any) that would have been included in the compensation of the covered employee for the taxable year but for being disallowed by reason of section 280G. For example, assume that during a taxable year a corporation pays \$1,500,000 to a covered employee, of which \$600,000 is an excess parachute payment, as defined in section 280G(b)(1), and a deduction for that excess parachute payment is disallowed by reason of section 280G(a). Because the \$1,000,000 limitation in paragraph (b) of this section is reduced by the amount of the excess parachute payment, the corporation may deduct \$400,000 (\$1,000,000 – \$600,000), and \$500,000 of the otherwise deductible amount is nondeductible by reason of section 162(m)(1). Thus \$1,100,000 (of the total \$1,500,000 payment) is nondeductible, reflecting the disallowance related to the excess parachute payment under section 280G and the application of section 162(m)(1).

(f) *Coordination with excise tax on specified stock compensation.* The \$1,000,000 limitation in paragraph (b) of this section is reduced (but not below zero) by the amount (if any) of any payment (with respect to such employee) of the tax imposed by section 4985 directly or indirectly by the expatriated corporation (as defined in section 4985(e)(2)) or by any member of the expanded affiliated group (as defined in section 4985(e)(4)) that includes such corporation.

(g) *Transition rules—(1) Amount of compensation payable under a written binding contract that was in effect on November 2, 2017—(i) General rule.* This section does not apply to the deduction for compensation 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 that date (a grandfathered amount). Instead, section 162(m), as in effect prior to its amendment by Public Law 115–97, applies to limit the deduction for that compensation. Because § 1.162–27 implemented section 162(m) as in effect prior to its amendment by Public Law 115–97, the rules of § 1.162–27 determine the applicability of the deduction limitation under section 162(m) with respect to the payment of a grandfathered amount (including the potential application of the separate grandfathering rules contained in § 1.162–27(h)). Compensation is a grandfathered amount only to the extent that as of November 2, 2017, the corporation was and remains obligated under applicable law (for example, state

contract law) to pay the compensation under the contract if the employee performs services or satisfies the applicable vesting conditions. This section applies to the deduction for any amount of compensation that exceeds the grandfathered amount. If a grandfathered amount and non-grandfathered amount are otherwise deductible for the same taxable year and, under the rules of § 1.162–27, the deduction of some or all of the grandfathered amount may be limited (for example, the grandfathered amount does not satisfy the requirements of § 1.162–27(e)(2) through (5) as qualified performance-based compensation), then the grandfathered amount is aggregated with the non-grandfathered amount to determine the deduction disallowance for the taxable year under section 162(m)(1) (so that the deduction limit applies to the excess of the aggregated amount over \$1 million).

(ii) *Contracts that are terminable or cancelable.* If a written binding contract is renewed after November 2, 2017, this section (and not § 1.162–27) applies to any payments made after the renewal. A written binding contract that is terminable or cancelable by the corporation without the employee's consent after November 2, 2017, is treated as renewed as of the earliest date that any such termination or cancellation, if made, would be effective. Thus, for example, if the terms of a contract provide that it will be automatically renewed or extended as of a certain date unless either the corporation or the employee provides notice of termination of the contract at least 30 days before that date, the contract is treated as renewed as of the date that termination would be effective if that notice were given. Similarly, for example, if the terms of a contract provide that the contract will be terminated or canceled as of a certain date unless either the corporation or the employee elects to renew within 30 days of that date, the contract is treated as renewed by the corporation as of that date (unless the contract is renewed before that date, in which case, it is treated as renewed on the earlier date). Alternatively, if the corporation will remain legally obligated by the terms of a contract beyond a certain date at the sole discretion of the employee, the contract will not be treated as renewed as of that date if the employee exercises the discretion to keep the corporation bound to the contract. A contract is not treated as terminable or cancelable if it can be terminated or canceled only by terminating the employment relationship of the employee. A contract

is not treated as renewed if upon termination or cancellation of the contract the employment relationship continues but would no longer be covered by the contract. However, if the employment continues after the termination or cancellation, payments with respect to the post-termination or post-cancellation employment are not made pursuant to the contract (and, therefore, are not grandfathered amounts).

(iii) *Compensation payable under a plan or arrangement.* If a compensation plan or arrangement is a written binding contract in effect on November 2, 2017, the deduction for the amount that the corporation is obligated to pay to an employee pursuant to the plan or arrangement is not subject to this section solely because the employee was not eligible to participate in the plan or arrangement as of November 2, 2017, provided the employee was employed on November 2, 2017, by the corporation that maintained the plan or arrangement, or the employee had the right to participate in the plan or arrangement under a written binding contract as of that date.

(iv) *Compensation subject to recovery by corporation.* If the corporation is obligated or has discretion to recover compensation paid in a taxable year only upon the future occurrence of a condition that is objectively outside of the corporation's control, then the corporation's right to recovery is disregarded for purposes of determining the grandfathered amount for the taxable year. Whether or not the corporation exercises its discretion to recover any compensation does not affect the amount of compensation that the corporation remains obligated to pay under applicable law.

(v) *Compensation payable from an account balance plan—(A) In general.* Except as otherwise provided in this paragraph (g), the grandfathered amount of payments from an account balance plan (as defined in § 1.409A–1(c)(2)(i)(A)) that is a written binding contract in effect as of November 2, 2017, is the amount that the corporation is obligated to pay pursuant to the terms of the account balance plan in effect as of that date, as determined under applicable law. If under the terms of the plan, the corporation is obligated to pay the employee the account balance that is credited with earnings and losses and has no right to terminate or materially amend the plan, then the grandfathered amount would be the account balance as of November 2, 2017, plus any additional contributions and earnings and losses that the corporation is obligated to credit to the account

balance in accordance with the terms of the plan as of November 2, 2017, through the date of payment.

(B) *Account balance plan providing right to terminate.* If under the terms of the account balance plan in effect as of November 2, 2017, the corporation may terminate the contract and distribute the account balance to the employee, then the grandfathered amount would be the account balance determined as if the corporation had terminated the plan on November 2, 2017 or, if later, the earliest possible date the plan could be terminated in accordance with the terms of the plan (termination date). Whether additional contributions and earnings and losses credited to the account balance after the termination date, through the earliest possible date the account balance could have been distributed to the employee in accordance with the terms of the plan, are grandfathered depends on whether the terms of the plan require the corporation to make those contributions or credit those earnings and losses through that distribution date. Notwithstanding the foregoing, the corporation may treat the account balance as of the termination date as the grandfathered amount regardless of when the amount is paid and regardless of whether it has been credited with additional contributions or earnings or losses prior to payment.

(C) *Account balance plan providing right to discontinue future contributions.* If under the terms of the account balance plan in effect as of November 2, 2017, the corporation has no right to terminate the plan, but may discontinue future contributions and distribute the account balance in accordance with the terms of the plan, then the grandfathered amount would be the account balance determined as if the corporation had exercised the right to discontinue contributions on November 2, 2017, or, if later, the earliest permissible date the corporation could exercise that right in accordance with the terms of the plan (the freeze date). If, after the freeze date, the plan requires the crediting of earnings and losses on the account balance through the payment date, then the earnings and losses credited to the grandfathered account balance would also be grandfathered. Notwithstanding the foregoing, the corporation may treat the account balance as of the freeze date as the grandfathered amount regardless of when the amount is paid and regardless of whether it has been credited with earnings or losses prior to payment.

(vi) *Compensation payable from a nonaccount balance plan—(A) In general.* Except as otherwise provided

in this paragraph (g), the grandfathered amount of payments from a nonaccount balance plan (as defined in § 1.409A–1(c)(2)(i)(C)) that is a written binding contract in effect as of November 2, 2017, is the amount that the corporation is obligated to pay pursuant to the terms of the nonaccount balance plan in effect as of that date, as determined under applicable law. If under the terms of the plan, the corporation is obligated to pay the employee the benefit under the plan and has no right to terminate or materially amend the plan, then the grandfathered amount would be the benefit under the plan as of November 2, 2017, plus any additional accrued benefits that the corporation is obligated to pay in accordance with the terms of the plan as of November 2, 2017, through the date of payment.

(B) *Nonaccount balance plan providing right to terminate.* If under the terms of the nonaccount balance plan in effect as of November 2, 2017, the corporation may terminate the plan and distribute the total benefit to the employee, then the grandfathered amount would be the present value of the total benefit (lump sum value) determined as if the corporation had terminated the plan on November 2, 2017 or, if later, the earliest possible date the plan could be terminated in accordance with the terms of the plan (termination date). Whether an increase or decrease in the lump sum value after the termination date, through the earliest possible date the lump sum value could have been distributed to the employee, is grandfathered depends on whether the terms of the plan require the corporation to increase or decrease the lump sum value through the distribution date. For example, if the plan did not require the corporation to make further service or compensation credits, then any increase in the lump sum value for these credits after the termination date is not grandfathered. Notwithstanding the foregoing, the corporation may treat the lump sum value as of the termination date as the grandfathered amount regardless of when the amount is paid and regardless of whether it has increased or decreased prior to payment. For purposes of this paragraph (g)(1)(vi)(B), the lump sum value is determined based on the actuarial methods and assumptions provided in the plan in effect on November 2, 2017, if the assumptions are reasonable, or any reasonable actuarial assumptions if the plan does not provide for applicable actuarial methods and assumptions or the terms of the plan were not reasonable. The determination of the lump sum value

may not take into account the likelihood that payments will not be made (or will be reduced) because of the unfunded status of the plan, the risk that the employer, the trustee, or another party will be unwilling or unable to pay, the possibility of future plan amendments, the possibility of a future change in the law, or similar risks or contingencies. If the benefit provided under the plan in effect on November 2, 2017, is paid as a life annuity or other form of benefit that is not a single lump sum payment, the application of the grandfathered amount to the payments of the benefit is determined in accordance with the ordering rule of paragraph (g)(1)(viii) of this section.

(C) *Nonaccount balance plan providing right to discontinue future accrual of benefits.* If under the terms of the nonaccount balance plan in effect as of November 2, 2017, the corporation has no right to terminate the plan, but may discontinue future accruals of benefits and distribute the benefit in accordance with the terms of the plan, then the grandfathered amount would be the lump sum value of the total benefit (lump sum value) determined as if the corporation had exercised the right to discontinue the future accrual of benefits on November 2, 2017, or, if later, the earliest permissible date the corporation could exercise such right in accordance with the terms of the plan (the freeze date). If, after the freeze date, the plan required the corporation to increase or decrease the lump sum value through the payment date, then any increase to the grandfathered lump sum would also be grandfathered. Notwithstanding the foregoing, the corporation may treat the lump sum value determined as of the freeze date as the grandfathered amount regardless of when the amount is paid and regardless of whether it has been increased or decreased prior to payment. For purposes of this paragraph (g)(1)(vi)(C), the lump sum value is determined based on the actuarial methods and assumptions provided in the plan in effect on November 2, 2017, if the assumptions are reasonable, or any reasonable actuarial assumptions if the plan does not provide for applicable actuarial methods and assumptions or the terms of the plan were not reasonable. The determination of the lump sum value may not take into account the likelihood that payments will not be made (or will be reduced) because of the unfunded status of the plan, the risk that the employer, the trustee, or another party will be unwilling or unable to pay, the possibility of future plan amendments,

the possibility of a future change in the law, or similar risks or contingencies. If the benefit paid under the plan in effect on November 2, 2017, is paid as a life annuity or other form of benefit that is not a single lump sum payment, the application of the grandfathered amount to the payments of the benefit is determined in accordance with the ordering rule of paragraph (g)(1)(viii) of this section.

(vii) *Grandfathered amount limited to a particular plan or arrangement.* The grandfathered amount under a plan or arrangement applies solely to the amounts paid under that plan or arrangement, so that regardless of whether all of the grandfathered amount is paid to the participant (for example, regardless of whether some or all of the grandfathered amount under the plan is forfeited under the terms of the plan), no portion of that grandfathered amount may be treated as a grandfathered amount under any other separate plan or arrangement in which the employee is a participant.

(viii) *Ordering rule.* If a portion of the amount payable under a plan or arrangement is a grandfathered amount and a portion is subject to this section, and payment under the plan or arrangement is made in a series of payments (including payments as a life annuity), the grandfathered amount is allocated to the first payment of an amount under the plan or arrangement that is otherwise deductible. If the grandfathered amount exceeds the initial payment, the excess is allocated to the next payment of an amount under the plan or arrangement that is otherwise deductible, and this process is repeated until the entire grandfathered amount has been paid. Notwithstanding the foregoing, for amounts otherwise deductible for taxable years ending before December 20, 2019, the grandfathered amount may be allocated to each payment on a pro rata basis or to the last otherwise deductible payment. If one of these two methods was used for taxable years ending before December 20, 2019, then, for taxable years ending on or after December 20, 2019, the method must be changed to allocate any remaining grandfathered amount to the first payment for the remaining payments (treating as the first payment the first otherwise deductible amount for taxable years ending on or after December 20, 2019).

(2) *Material modifications.* (i) If a written binding contract is modified on or after November 2, 2017, this section (and not § 1.162–27) applies to any payments made after the modification. A material modification occurs when

the contract is amended to increase the amount of compensation payable to the employee. 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 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.

(ii) 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 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). For an arrangement under which the grandfathered amounts are subject to increase or decrease based on the performance of a predetermined actual investment, the addition or substitution of a predetermined actual investment or reasonable interest rate as an investment alternative for amounts deferred is not treated as a material modification. However, a modification of a contract to defer payment of a grandfathered amount that results in payment of additional amounts (such as additional earnings) does not necessarily mean that the additional amounts are grandfathered amounts; for rules concerning the determination of grandfathered amounts see paragraph (g) of this section. Notwithstanding the foregoing, if compensation attributable to an option to purchase stock (other than an incentive stock option described in section 422 or a stock option granted under an employee stock purchase plan described in section 423) or a stock appreciation right is grandfathered, an

extension of the exercise period that is extended in compliance with § 1.409A–1(b)(5)(v)(C)(1) will not be treated as a material modification and the amount of compensation paid upon the exercise of the stock option or stock appreciation right will be grandfathered.

(iii) The adoption of a supplemental contract or agreement that provides for increased compensation, or the payment of additional compensation, is a material modification of a written binding contract if the facts and circumstances demonstrate that the additional compensation to be paid is based on substantially the same elements or conditions as the compensation that is otherwise paid pursuant to the written binding contract. However, a material modification of a written binding contract does not include a supplemental payment that is equal to or less than a reasonable cost-of-living increase over the payment made in the preceding year under that written binding contract. In addition, the failure, in whole or in part, to exercise negative discretion under a contract does not result in the material modification of that contract (although the existence of the negative discretion under the contract may impact the initial determination of whether amounts under the contract are grandfathered amounts).

(iv) If a grandfathered amount is subject to a substantial risk of forfeiture (as defined in § 1.409A–1(d)), then a modification of the contract that results in a lapse of the substantial risk of forfeiture is not considered a material modification. Furthermore, for compensation received pursuant to the substantial vesting of restricted property, or the exercise of a stock option or stock appreciation right that does not provide for a deferral of compensation (as defined in § 1.409A–1(b)(5)(i) and (ii)), a modification of a written binding contract in effect on November 2, 2017, that results in a lapse of the substantial risk of forfeiture (as defined § 1.83–3(c)) is not considered a material modification.

(3) *Examples.* The following examples illustrate the provisions of this paragraph (g). For each example, assume for all relevant years that the corporation is a publicly held corporation within the meaning of paragraph (c)(1) of this section and is a calendar year taxpayer, and is not a “smaller reporting company” or “emerging growth company” for purposes of reporting under the Exchange Act. Furthermore, assume that, for each example, if any arrangement is subject to section 409A,

then the arrangement complies with section 409A, and that no arrangement is subject to section 457A.

(i) *Example 1 (Multi-year agreement for annual salary)*—(A) *Facts*. On October 2, 2017, Corporation X executed a three-year employment agreement with Employee A for an annual salary of \$2,000,000 beginning on January 1, 2018. Employee A serves as the PFO of Corporation X for the 2017 through 2020 taxable years. The agreement provides for automatic extensions after the three-year term for additional one-year periods, unless the corporation exercises its option to terminate the agreement within 30 days before the end of the three-year term or, thereafter, within 30 days before each anniversary date. Termination of the employment agreement does not require the termination of Employee A's employment with Corporation X. Under applicable law, the agreement for annual salary constitutes a written binding contract in effect on November 2, 2017, to pay \$2,000,000 of annual salary to Employee A for three years through December 31, 2020.

(B) *Conclusion*. If this section applies, Employee A is a covered employee for Corporation X's 2018 through 2020 taxable years. Because the October 2, 2017, employment agreement is a written binding contract to pay Employee A an annual salary of \$2,000,000, this section does not apply (and § 1.162–27 does apply) to the deduction for Employee A's annual salary. Pursuant to § 1.162–27(c)(2), Employee A is not a covered employee for Corporation X's 2018 through 2020 taxable years. The deduction for Employee A's annual salary for the 2018 through 2020 taxable years is not subject to section 162(m)(1). However, the employment agreement is treated as renewed on January 1, 2021, unless it is previously terminated, and the deduction limit of this § 1.162–33 (and not § 1.162–27) will apply to the deduction for any payments made under the employment agreement on or after that date.

(ii) *Example 2 (Agreement for severance based on annual salary and discretionary bonus)*—(A) *Facts*. The facts are the same as in paragraph (g)(3)(i) of this section (*Example 1*), except that the employment agreement also requires Corporation X to pay Employee A severance if Corporation X terminates the employment relationship without cause during the term of the agreement. The amount of severance is equal to the sum of two times Employee A's annual salary plus two times Employee A's discretionary bonus (if any) paid within 24 months preceding termination. Under applicable law, the agreement for severance constitutes a written binding contract in effect on November 2, 2017, to pay \$4,000,000 (two times Employee A's \$2,000,000 annual salary) if Corporation X terminates Employee A's employment without cause during the term of the agreement.

(B) *Conclusion*. If this section applies, Employee A is a covered employee for Corporation X's 2018 through 2020 taxable years. Because the October 2, 2017, employment agreement is a written binding contract to pay Employee A \$4,000,000 if Employee A is terminated without cause

prior to December 31, 2020, this section does not apply (and § 1.162–27 does apply) to the deduction for \$4,000,000 of Employee A's severance. Pursuant to § 1.162–27(c)(2), Employee A is not a covered employee for Corporation X's 2018 through 2020 taxable years. The deduction for \$4,000,000 of Employee A's severance is not subject to section 162(m)(1). However, the employment agreement is treated as renewed on January 1, 2021, unless it is previously terminated, and this § 1.162–33 (and not § 1.162–27) will apply to the deduction for any payments made under the employment agreement, including for severance, on or after that date.

(iii) *Example 3 (Effect of discretionary bonus payment on agreement for severance based on annual salary and discretionary bonus)*—(A) *Facts*. The facts are the same as in paragraph (g)(3)(ii) of this section (*Example 2*), except that, on October 31, 2017, Corporation X paid Employee A a discretionary bonus of \$100,000, on May 14, 2018, Corporation X paid Employee A a discretionary bonus of \$600,000, and on April 30, 2019, terminated Employee A's employment without cause. Pursuant to the terms of the employment agreement for severance, on May 1, 2019, Corporation X paid to Employee A a \$5,400,000 severance payment (the sum of two times the \$2,000,000 annual salary, two times the \$100,000 discretionary bonus, and two times the \$600,000 discretionary bonus).

(B) *Conclusion*. If this section applies, Employee A is a covered employee for Corporation X's 2019 taxable year. Because the October 2, 2017, agreement is a written binding contract to pay Employee A \$4,000,000 if Employee A is terminated without cause prior to December 31, 2020, and \$200,000 if Corporation X terminates Employee A's employment without cause prior to October 31, 2019, this section does not apply (and § 1.162–27 does apply) to the deduction for \$4,200,000 of Employee A's severance payment. The deduction for \$4,200,000 of Employee A's severance payment is not subject to section 162(m)(1). Because the October 2, 2017, agreement is not a written binding contract to pay Employee A's \$600,000 discretionary bonus (since, as of November 2, 2017, Corporation X was not obligated under applicable law to make the bonus payment), the deduction for \$1,200,000 of the \$5,400,000 payment is subject to this section (and not § 1.162–27).

(iv) *Example 4 (Effect of adjustment to annual salary on severance)*—(A) *Facts*. The facts are the same as in paragraph (g)(3)(ii) of this section (*Example 2*), except that the employment agreement provides for discretionary increases in salary and, on January 1, 2019, Corporation X increased Employee A's annual salary from \$2,000,000 to \$2,050,000, an increase that was less than a reasonable, cost-of-living adjustment.

(B) *Conclusion (Annual salary)*. If this section applies, Employee A is a covered employee for Corporation X's 2018 through 2020 taxable years. Because the October 2, 2017, agreement is a written binding contract to pay Employee A an annual salary of \$2,000,000, this section does not apply (and § 1.162–27 does apply) to the deduction for Employee A's annual salary unless the

change in the salary is a material modification. Even though the \$50,000 increase is paid on the basis of substantially the same elements or conditions as the salary that is otherwise paid under the contract, the \$50,000 increase does not constitute a material modification because it is less than or equal to a reasonable cost-of-living increase to the \$2,000,000 annual salary Corporation X is required to pay under applicable law as of November 2, 2017. However, the deduction for the \$50,000 increase is subject to this section (and not § 1.162–27).

(C) *Conclusion (Severance payment)*. Because the October 2, 2017, agreement is a written binding contract to pay Employee A severance of \$4,000,000, this section would not apply (and § 1.162–27 would apply) to the deduction for this amount of severance unless the change in the employment agreement is a material modification. Even though the \$100,000 increase in severance (two times the \$50,000 increase in salary) would be paid on the basis of substantially the same elements or conditions as the severance that would otherwise be paid pursuant to the written binding contract, the \$50,000 increase in salary on which it is based does not constitute a material modification of the written binding contract since it is less than or equal to a reasonable cost-of-living increase. However, the deduction for the \$100,000 increase in severance is subject to this section (and not § 1.162–27).

(v) *Example 5 (Effect of adjustment to annual salary on severance)*—(A) *Facts*. The facts are the same as in paragraph (g)(3)(iv) of this section (*Example 4*), except that, on January 1, 2019, Corporation X increased Employee A's annual salary from \$2,000,000 to \$3,000,000, an increase that exceeds a reasonable, cost-of-living adjustment.

(B) *Conclusion (Annual salary)*. If this section applies, Employee A is a covered employee for Corporation X's 2018 through 2020 taxable years. Because the October 2, 2017, agreement is a written binding contract to pay Employee A an annual salary of \$2,000,000, this section does not apply (and § 1.162–27 does apply) to the deduction for Employee A's annual salary unless the change in the employment agreement is a material modification. The \$1,000,000 increase is a material modification of the written binding contract because the additional compensation is paid on the basis of substantially the same elements or conditions as the compensation that is otherwise paid pursuant to the written binding contract, and it exceeds a reasonable, annual cost-of-living increase from the \$2,000,000 annual salary for 2018 that Corporation X is required to pay under applicable law as of November 2, 2017. Because the written binding contract is materially modified as of January 1, 2019, the deduction for all annual salary paid to Employee A in 2019 and thereafter is subject to this section (and not § 1.162–27).

(C) *Conclusion (Severance payment)*. Because the October 2, 2017, agreement is a written binding contract to pay Employee A severance of \$4,000,000, this section would not apply (and § 1.162–27 would apply) to

the deduction for this amount of severance unless the change in the employment agreement is a material modification. The additional \$2,000,000 severance payment (two times the \$1,000,000 increase in annual salary) constitutes a material modification of the written binding contract because the \$1,000,000 increase in salary on which it is based constitutes a material modification of the written binding contract since it exceeds a reasonable cost-of-living increase from the \$2,000,000 annual salary for 2018 that Corporation X is required to pay under applicable law as of November 2, 2017. Because the agreement is materially modified as of January 1, 2019, the deduction for any amount of severance paid to Employee A under the agreement is subject to this section (and not § 1.162–27).

(vi) *Example 6 (Elective deferral of an amount that corporation was obligated to pay under applicable law)*—(A) *Facts.* The facts are the same as in paragraph (g)(3)(i) of this section (*Example 1*), except that, on December 15, 2018, Employee A makes a deferral election under a nonqualified deferred compensation (NQDC) plan to defer \$200,000 of annual salary earned and payable in 2019. Pursuant to the NQDC plan, the \$200,000, including earnings, is to be paid in a lump sum on the date six months following Employee A's separation from service. The earnings are based on the Standard & Poor's 500 Index. Under applicable law, pursuant to the written binding contract in effect on November 2, 2017, (and absent the deferral agreement) Corporation X would have been obligated to pay \$200,000 to Employee A in 2019, but is not obligated to pay any earnings on the \$200,000 deferred pursuant to the deferral election Employee A makes on December 15, 2018. Employee A separates from service on December 15, 2020. On June 15, 2021, Corporation X pays \$250,000 (the deferred \$200,000 of salary plus \$50,000 in earnings).

(B) *Conclusion.* If this section applies, Employee A is a covered employee for Corporation X's 2021 taxable year. Employee A's NQDC plan is not a material modification of the written binding contract in effect on November 2, 2017, because the earnings to be paid under the NQDC plan are based on a predetermined actual investment (as defined in § 31.3121(v)(2)–1(d)(2)(i)(B) of this chapter). The deduction for the \$50,000 of earnings to be paid that exceed the amount originally payable to Employee A under the written binding contract (\$200,000 of salary) are subject to this section (and not § 1.162–27). This section does not apply (and § 1.162–27 does apply) to the deduction for the \$200,000 portion of the \$250,000 payment that Corporation X was obligated under applicable law to pay as of November 2, 2017. Pursuant to § 1.162–27(c)(2), Employee A is not a covered employee for Corporation X's 2021 taxable year; thus, the deduction for the \$200,000 payment is not subject to section 162(m)(1).

(vii) *Example 7 (Compensation subject to discretionary recovery by corporation)*—(A) *Facts.* Employee B serves as the PFO of Corporation Z for its 2017 through 2019 taxable years. On October 2, 2017, Corporation Z executed a bonus agreement

with Employee B that requires Corporation Z to pay Employee B a performance bonus of \$3,000,000 on May 1, 2019, if Corporation Z's net earnings increase by at least 10% for its 2018 taxable year based on the financial statements filed with the SEC. The agreement does not permit Corporation Z to reduce the amount of the bonus payment for any reason if the Corporation Z attains the net earnings performance target. However, the agreement provides that, if the bonus is paid and subsequently the financial statements are restated to show that the net earnings did not increase by at least 10%, then Corporation Z may, in its discretion, recover the \$3,000,000 from Employee B within six months of the restatement. Under applicable law, the agreement for the performance bonus constitutes a written binding contract in effect on November 2, 2017, to pay \$3,000,000 to Employee B if Corporation Z's net earnings increase by at least 10% for its 2018 taxable year based on the financial statements filed with the SEC. On May 1, 2019, Corporation Z pays \$3,000,000 to Employee B because its net earnings increased by at least 10% of its 2018 taxable year.

(B) *Conclusion.* If this section applies, Employee B is a covered employee for Corporation Z's 2019 taxable year. Because the October 2, 2017, agreement is a written binding contract to pay Employee B \$3,000,000 if the applicable conditions are met, this section does not apply (and § 1.162–27 does apply) to the deduction for the \$3,000,000 regardless of whether Corporation Z's financial statements are restated to show that its net earnings did not increase by at least 10%, and regardless of whether Corporation Z exercises its discretion to recover the bonus if Corporation Z's financial statements are restated to show that its net earnings did not increase by at least 10%.

(viii) *Example 8 (Performance bonus plan with negative discretion)*—(A) *Facts.* Employee E serves as the PEO of Corporation V for the 2017 and 2018 taxable years. On February 1, 2017, Corporation V establishes a bonus plan, under which Employee E will receive a cash bonus of \$1,500,000 if a specified performance goal is satisfied. The compensation committee retains the right, if the performance goal is met, to reduce the bonus payment to no less than \$400,000 if, in its judgment, other subjective factors warrant a reduction. On November 2, 2017, under applicable law, which takes into account the employer's ability to exercise negative discretion, the bonus plan established on February 1, 2017, constitutes a written binding contract to pay \$400,000. On March 1, 2018, the compensation committee certifies that the performance goal was satisfied, but exercises its discretion to reduce the award to \$500,000. On April 1, 2018, Corporation V pays \$500,000 to Employee E. The payment satisfies the requirements of § 1.162–27(e)(2) through (5) as qualified performance-based compensation.

(B) *Conclusion.* If this section applies, Employee E is a covered employee for Corporation V's 2018 taxable year. Because the February 1, 2017, plan is a written binding contract to pay Employee E \$400,000

if the performance goal is satisfied, this section does not apply (and § 1.162–27 does apply) to the deduction for the \$400,000 portion of the \$500,000 payment. Furthermore, pursuant to paragraph (g)(2)(iii) of this section, the failure of the compensation committee to exercise its discretion to reduce the award further to \$400,000, instead of \$500,000, does not result in a material modification of the contract. Pursuant to § 1.162–27(e)(1), the deduction for the \$400,000 payment is not subject to section 162(m)(1) because the payment satisfies the requirements of § 1.162–27(e)(2) through (5) as qualified performance-based compensation. The deduction for the remaining \$100,000 of the \$500,000 payment is subject to this section (and not § 1.162–27) and therefore the status as qualified performance-based compensation is irrelevant to the application of section 162(m)(1) to this remaining amount.

(ix) *Example 9 (Equity-based compensation with underlying grants made prior to November 2, 2017)*—(A) *Facts.* On January 2, 2017, Corporation T executed a 4-year employment agreement with Employee G to serve as its PEO, and Employee G serves as the PEO for the four-year term. Pursuant to the employment agreement, on January 2, 2017, Corporation T executed a grant agreement and granted to Employee G nonqualified stock options to purchase 1,000 shares of Corporation T stock, stock appreciation rights (SARs) on 1,000 shares, and 1,000 shares of Corporation T restricted stock. On the date of grant, the stock options had no readily ascertainable fair market value as defined in § 1.83–7(b), and neither the stock options nor the SARs provided for a deferral of compensation under § 1.409A–1(b)(5)(i)(A) and (B). The stock options, SARs, and shares of restricted stock are subject to a substantial risk of forfeiture and all substantially vest on January 2, 2020. Employee G may exercise the stock options and the SARs at any time from January 2, 2020, through January 2, 2027. On January 2, 2020, Employee G exercises the stock options and the SARs, and the 1,000 shares of restricted stock become substantially vested (as defined in § 1.83–3(b)). The grant agreement pursuant to which grants of the stock options, SARs, and shares of restricted stock are made constitutes a written binding contract under applicable law. The compensation attributable to the stock options and the SARs satisfy the requirements of § 1.162–27(e)(2) through (5) as qualified performance-based compensation.

(B) *Conclusion.* If this section applies, Employee G is a covered employee for Corporation T's 2020 taxable year. Because the January 2, 2017, grant agreement constitutes a written binding contract, this section does not apply (and § 1.162–27 does apply) to the deduction for compensation received pursuant to the exercise of the stock options and the SARs, or the restricted stock becoming substantially vested (as defined in § 1.83–3(b)). Pursuant to § 1.162–27(e)(1), the deduction attributable to the stock options and the SARs is not subject to section 162(m)(1) because the compensation satisfies the requirements of § 1.162–27(e)(2) through

(5) as qualified performance-based compensation. However, the deduction attributable to the restricted stock is subject to section 162(m)(1) because the compensation does not satisfy the requirements of § 1.162–27(e)(2) through (5) as qualified performance-based compensation.

(x) *Example 10 (Plan in which an employee is not a participant on November 2, 2017)*—(A) *Facts.* On October 2, 2017, Employee H executes an employment agreement with Corporation Y to serve as its PFO, and begins employment with Corporation Y. The employment agreement, which is a written binding contract under applicable law, provides that if Employee H continues in his position through April 1, 2018, Employee H will become a participant in the NQDC plan of Corporation Y and that Employee H's benefit accumulated on that date will be \$3,000,000. On April 1, 2021, Employee H receives a payment of \$4,500,000 (the increase from \$3,000,000 to \$4,500,000 is not a result of a material modification as defined in paragraph (g)(2) of this section), which is the entire benefit accumulated under the plan through the date of payment.

(B) *Conclusion.* If this section applies, Employee H is a covered employee for Corporation Y's 2021 taxable year. Even though Employee H was not eligible to participate in the NQDC plan on November 2, 2017, Employee H had the right to participate in the plan under a written binding contract as of that date. Because the amount required to be paid pursuant to the written binding contract is \$3,000,000, this section does not apply (and § 1.162–27 does apply) to the deduction for the \$3,000,000 portion of the \$4,500,000. Pursuant to § 1.162–27(c)(2), Employee H is not a covered employee of Corporation Y for the 2021 taxable year. The deduction for the \$3,000,000 portion of the \$4,500,000 is not subject to section 162(m)(1). The deduction for the remaining \$1,500,000 portion of the payment is subject to this section (and not § 1.162–27).

(xi) *Example 11 (Material modification of annual salary)*—(A) *Facts.* On January 2, 2017, Corporation R executed a 5-year employment agreement with Employee I to serve as Corporation R's PFO, providing for an annual salary of \$1,800,000. The agreement constitutes a written binding contract under applicable law. In 2017 and 2018, Employee I receives the salary of \$1,800,000 per year. In 2019, Corporation R increases Employee I's salary by \$40,000, which is less than a reasonable cost-of-living increase from \$1,800,000. On January 1, 2020, Corporation R increases Employee I's salary to \$2,400,000. The \$560,000 increase exceeds a reasonable, annual cost-of-living increase from \$1,840,000.

(B) *Conclusion (\$1,840,000 Payment in 2019).* If this section applies, Employee I is a covered employee for Corporation R's 2018 through 2020 taxable years. Because the January 1, 2017, agreement is a written binding contract to pay Employee I an annual salary of \$1,800,000, this section does not apply (and § 1.162–27 does apply) to the deduction for Employee I's annual salary unless the change in the employment

agreement is a material modification. Pursuant to § 1.162–27(c)(2), Employee I is not a covered employee of Corporation R for the 2019 taxable year, so the deduction for the \$1,800,000 salary is not subject to section 162(m)(1). Even though the \$40,000 increase is made on the basis of substantially the same elements or conditions as the salary, the \$40,000 increase does not constitute a material modification of the written binding contract because the \$40,000 is less than or equal to a reasonable cost-of-living increase. However, the deduction for the \$40,000 increase is subject to this section (and not § 1.162–27).

(C) *Conclusion (Salary increase to \$2,400,000 in 2020).* The \$560,000 increase in salary in 2020 is a material modification of the written binding contract because the additional compensation is paid on the basis of substantially the same elements or conditions as the salary, and it exceeds a reasonable, annual cost-of-living increase from \$1,840,000. Because the written binding contract is materially modified as of January 1, 2020, the deduction for all salary paid to Employee I on and after January 1, 2020, is subject to this section (and not § 1.162–27).

(xii) *Example 12 (Additional payment not considered a material modification)*—(A) *Facts.* The facts are the same as in paragraph (g)(3)(xi) of this section (*Example 11*), except that instead of an increase in salary, in 2020 Employee I receives a restricted stock grant subject to Employee I's continued employment for the balance of the contract.

(B) *Conclusion.* The restricted stock grant is not a material modification of the written binding contract because any additional compensation paid to Employee I under the grant is not paid on the basis of substantially the same elements and conditions as Employee I's salary. However, the deduction attributable to the restricted stock grant is subject to this section (and not § 1.162–27).

(h) *Effective/Applicability dates*—(1) *Effective date.* This section is effective on December 30, 2020.

(2) *Applicability dates*—(i) *General applicability date.* Except as otherwise provided in paragraph (h)(2)(ii) of this section, this section applies to taxable years beginning on or after December 30, 2020. Taxpayers may choose to apply this section for taxable years beginning after December 31, 2017, and before December 30, 2020 provided the taxpayer applies this section in its entirety and in a consistent manner.

(ii) *Special applicability dates*—(A) *Definition of covered employee.* The definition of covered employee in paragraph (c)(2)(i) of this section applies to taxable years ending on or after September 10, 2018. However, for a corporation whose fiscal year and taxable year do not end on the same date, the rule in paragraph (c)(2)(i)(B) of this section requiring the determination of the three most highly compensated executive officers to be made pursuant to the rules under the Exchange Act

applies to taxable years ending on or after December 20, 2019.

(B) *Definition of predecessor of a publicly held corporation*—(1) *Publicly held corporations that become privately held.* The definition of predecessor of a publicly held corporation in paragraph (c)(2)(ii)(A) of this section applies to any publicly held corporation that becomes a privately held corporation for a taxable year beginning after December 31, 2017, and, subsequently, again becomes a publicly held corporation on or after December 30, 2020. The definition of predecessor of a publicly held corporation in paragraph (c)(2)(ii)(A) of this section does not apply to any publicly held corporation that became a privately held corporation for a taxable year beginning before January 1, 2018, with respect to the earlier period as a publicly held corporation; or a publicly held corporation that becomes a privately held corporation for a taxable year beginning after December 31, 2017, and, subsequently, again becomes a publicly held corporation before December 30, 2020.

(2) *Corporate transactions.* The definition of predecessor of a publicly held corporation in paragraphs (c)(2)(ii)(B) through (H) of this section applies to corporate transactions that occur (as provided in the transaction timing rule of paragraph (c)(2)(ii)(I) of this section) on or after December 30, 2020. With respect to any of the following corporate transactions occurring after December 20, 2019, and before December 30, 2020, excluding target corporations from the definition of the term “predecessor” is not a reasonable good faith interpretation of the statute:

(i) A publicly held target corporation the stock or assets of which are acquired by another publicly held corporation in a transaction to which section 381(a) applies.

(ii) A publicly held target corporation, at least 80% of the total voting power of the stock of which, and at least 80% of the total value of the stock of which, are acquired by a publicly held acquiring corporation (including an affiliated group).

(C) *Definition of compensation.* The definition of compensation provided in paragraph (c)(3)(ii) of this section (relating to distributive share of partnership deductions for compensation paid) applies to any deduction for compensation that is paid after December 18, 2020. The definition of compensation in paragraph (c)(3)(ii) does not apply to compensation paid pursuant to a written binding contract that is in effect on December 20, 2019,

and that is not materially modified after that date. For purposes of this paragraph (h)(3), written binding contract and material modification have the same meanings as provided in paragraphs (g)(1) and (2) of this section.

(D) *Corporations that become publicly held.* The rule in paragraph (d) of this section (providing that the deduction limitation of paragraph (b) of this section applies to a deduction for any compensation that is otherwise deductible for the taxable year ending on or after the date that a privately held corporation becomes a publicly held corporation) applies to corporations that become publicly held after December 20, 2019. A privately held corporation that becomes a publicly held corporation on or before December 20, 2019, may rely on the transition rules provided in § 1.162-27(f)(1) until the earliest of the events provided in § 1.162-27(f)(2). A subsidiary that is a member of an affiliated group (as defined in § 1.162-27(c)(1)(ii)) may rely on transition relief provided in § 1.162-27(f)(4) if it becomes a separate publicly held corporation (whether in a spin-off transaction or otherwise) on or before December 20, 2019.

(E) *Transition rules.* Except for the transition rules in paragraphs (g)(1)(v) through (vii) of this section, the transition rules in paragraphs (g)(1) and (2) of this section (providing that this section does not apply to compensation payable under a written binding contract which was in effect on November 2, 2017, and which is not modified in any material respect on or after such date) apply to taxable years ending on or after September 10, 2018.

■ **Par. 4.** Section 1.338-1 is amended by revising paragraph (b)(2)(i) to read as follows:

§ 1.338-1 General principles; status of old target and new target.

* * * * *

- (b) * * *
- (2) * * *

(i) The rules applicable to employee benefit plans (including those plans described in sections 79, 104, 105, 106, 125, 127, 129, 132, 137, and 220), qualified pension, profit-sharing, stock bonus and annuity plans (sections 401(a) and 403(a)), simplified employee pensions (section 408(k)), tax qualified stock option plans (sections 422 and 423), welfare benefit funds (sections 419, 419A, 512(a)(3), and 4976), voluntary employee benefit associations (section 501(c)(9)) and the regulations thereunder (§§ 1.501(c)(9)-1 through 1.501(c)(9)-8) and certain excessive employee remuneration (section 162(m)

and the regulations thereunder (§§ 1.162-27, 1.162-31, and 1.162-33));

* * * * *

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

Approved: December 11, 2020.

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2020-28484 Filed 12-28-20; 8:45 am]

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DEPARTMENT OF TREASURY

31 CFR Part 1

RIN 1505-AC66

Privacy Act of 1974; Exemption

AGENCY: Departmental Offices, Department of the Treasury.

ACTION: Final rule.

SUMMARY: In accordance with the requirements of the Privacy Act of 1974, the Department of the Treasury, Departmental Offices (DO) gives notice of a final rule exemption for a new system of records entitled “Department of the Treasury, Departmental Offices .227—Committee on Foreign Investment in the United States (CFIUS) Case Management System,” maintained by the Committee on Foreign Investment in the United States from certain provisions of the Privacy Act. The exemption is intended to comply with the legal prohibitions against the disclosure of certain kinds of information and to protect certain information maintained in this system of records.

DATES: Effective December 30, 2020.

FOR FURTHER INFORMATION CONTACT: Ryan Law, Deputy Assistant Secretary for Management, Office of Privacy, Transparency, and Records, 1750 Pennsylvania Avenue NW, 8th Floor, Washington, DC 20220. Mr. Law may be reached via telephone at (202) 622- 5710 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

The Department of the Treasury (Treasury) published a notice of proposed rulemaking in the **Federal Register**, 85 FR 58308, September 18, 2020, proposing to exempt portions of the system of records from one or more provisions of the Privacy Act. As background, in 2018, the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), Subtitle A of Title XVII of Public Law 115-232, 132

Stat. 2173, was enacted. FIRRMA amends section 721 of the Defense Production Act of 1950, as amended (Section 721), which delineates the authorities and jurisdiction of the Committee on Foreign Investment in the United States (CFIUS). FIRRMA maintains CFIUS’s jurisdiction over any transaction that could result in foreign control of any U.S. business, and broadens the authorities of the President and CFIUS under Section 721 to review and take action to address any national security concerns arising from certain non-controlling investments and certain real estate transactions involving foreign persons.

Executive Order 13456, 73 FR 4677 (January 23, 2008), directs the Secretary of the Treasury to issue regulations implementing Section 721. On January 17, 2020, Treasury published two rules broadly implementing FIRRMA, and those rules took effect on February 13, 2020. 85 FR 3112 and 85 FR 3158. Subsequent amendments were made to the regulations in 2020. 85 FR 8747, 85 FR 45311, and 85 FR 57124.

In addition to the exemptions below, pursuant to section 721(c) of the Defense Production Act of 1950, as amended, 50 U.S.C. 4565(c) and subject to certain exceptions provided therein, any information or documentary material filed with the President or CFIUS under Section 721 is exempt from disclosure under the Freedom of Information Act, as amended (FOIA), 5 U.S.C. 552, and no such information or documentary material may be made public.

Treasury published separately the notice of the new system of records maintained by CFIUS. 85 FR 55534, as amended.

Under 5 U.S.C. 552a(k)(1), the head of a Federal agency may promulgate rules to exempt a system of records from certain provisions of 5 U.S.C. 552a if the system of records is subject to the exemption contained in section 552(b)(1) of title 5. (FOIA exemption (b)(1) protects from disclosure information that is “specifically authorized under criteria established by an Executive order to be kept secret in the interest of national defense or foreign policy” and is “in fact properly classified pursuant to such Executive order.”)

Under 5 U.S.C. 552a(k)(2), the head of a Federal agency may promulgate rules to exempt a system of records from certain provisions of 5 U.S.C. 552a if the system of records contains investigatory materials compiled for law enforcement purposes that are not within the scope of subsection (j)(2) of the Privacy Act (which applies to agencies and