

Proposed Regulations Issued Under Internal Revenue Code § 162(m)

February 12, 2025

Changes effective starting on January 1, 2027

In the last few days preceding President Donald Trump's inauguration, the IRS under the Biden administration proposed regulations to implement amendments to Internal Revenue Code § 162(m) that were enacted in 2021 but will first become effective for taxable years beginning after December 31, 2026. The proposed regulations were published in the Federal Register on January 16, 2025, and any public comments on the proposal are due by March 17, 2025.

In light of the subsequent change in administration (and in the spirit of the regulatory freeze ordered by Trump on his first day in office), it is unclear whether the proposed regulations will progress or be adopted.

Regardless of whether final regulations are finally adopted, however, the changes to 162(m) effected by the 2021 amendments will apply to taxable years beginning after December 31, 2026 (unless those changes are revoked or otherwise modified). Accordingly, companies subject to 162(m) – generally only publicly held corporations and certain of their affiliates – should still understand the effect of those amendments.

Brief history of 162(m) and the 2021 amendments

Section 162(m) was first added to the Internal Revenue Code in 1993 and generally denies publicly held corporations a federal income tax deduction for compensation in excess of \$1 million paid to "covered employees" in any year. Until 2017, covered employees for any taxable year included only the corporation's CEO and certain other of its "named executive officers" for the applicable year for proxy reporting purposes, excluding the chief financial officer (CFO).

In 2017, as discussed in this prior Cooley alert, 162(m) was amended by the Tax Cut and Jobs Act in certain respects, including to expand the group of covered employees to include the CFO, to provide that any individual who was a covered employee in any year would remain a covered employee in all future years, and to eliminate an exception from the deduction limitation for certain performance-based compensation.

Then, in 2021, 162(m) was again amended by the American Rescue Plan Act (ARPA) to add as additional covered employees for any taxable year any employee who is among the five highest compensated employees for that taxable year, other than the CEO or CFO or the three highest compensated executive officers for the taxable year (who already are covered employees under the pre-ARPA language). Notably, those additional five employees are covered employees for the particular tax year only, not also for all future taxable years, as is the case for the other, pre-ARPA covered employees.

Practical significance

The proposed regulations go into considerable detail regarding how to identify the additional ARPA covered employees. Again, however, even if the proposed regulations are not finalized, companies subject to 162(m) will still need to identify those additional five individuals on an annual basis as required by the statutory language, and it is not too soon to start thinking about implementing any necessary procedures. Even in just their proposed form, the regulations could offer some guidance on how to structure those procedures.

Any company concerned about loss of a deduction under 162(m) may want to consider – before 2027 – how to structure pay programs for 2027 and later years in a manner that will minimize the loss of a tax deduction by reason of 162(m), with an eye toward who the company anticipates the additional ARPA covered employees will

be for a particular year.

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as "Cooley"). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction, and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. When advising companies, our attorney-client relationship is with the company, not with any individual. This content may have been generated with the assistance of artificial intelligence (AI) in accordance with our AI Principles, may be considered Attorney Advertising and is subject to our legal notices.

Key Contacts

Alessandra Murata	amurata@cooley.com
Palo Alto	+ 1 650 843 5696
Michael Bergmann	mbergmann@cooley.com
Washington, DC	+1 202 728 7008

This information is a general description of the law; it is not intended to provide specific legal advice nor is it intended to create an attorney-client relationship with Cooley LLP. Before taking any action on this information you should seek professional counsel.

Copyright © 2023 Cooley LLP, 3175 Hanover Street, Palo Alto, CA 94304; Cooley (UK) LLP, 22 Bishopsgate, London, UK EC2N 4BQ. Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Cooley LLP as the author. All other rights reserved.