



## AMERICAN BENEFITS COUNCIL

### **Maintain Link Between 162(m) Four Highest Paid Officers and SEC Rules**

- Among other things, the proposed amendments to Code section 162(m) as previously passed by the Senate would de-link the determination of "covered employees" subject to the \$1 million deduction limit from the SEC proxy rules. This change is unnecessarily broad and would create much ambiguity. Instead, any legislative change to section 162(m) regarding the definition of covered employees should continue to link the definitions of "officer" and "compensation" to the SEC rules.
- Under current law, section 162(m) and IRS regulations generally define a covered employee as a public company's chief executive officer and its four other highest compensated officers as required to be reported in the company's proxy statement. Linking the definition to the SEC proxy rules has had the effect of providing straightforward rules for calculating applicable compensation and targeting the rule at "named executive officers" who have significant policy-making authority.
- Last year, the SEC issued comprehensive new rules on the disclosure of executive compensation that, among other things, changed the composition of the executives covered by the proxy.
  - The amended SEC rules now require disclosure of a public company's principal executive officer, principal financial officer and three other most highly compensated officers.
  - As a result, the definition of covered employee in section 162(m) no longer matches the SEC proxy rules.
- The IRS recently issued Notice 2007-49 to provide guidance on identifying covered employees for purposes of section 162(m) as a result of the changes in the SEC rules.
  - The IRS will now interpret the term "covered employee" for purposes of section 162(m) to mean a company's principal executive officer or an employee who is required to be reported in the company's proxy statement by reason of being one of its three highest compensated officers (other than the principal executive officer or principal financial officer).

- An individual who is required to be disclosed in the proxy on account of the individual being the company's principal financial officer is not a covered employee.
- The alternative definition of covered employee in the Senate-passed legislation is unnecessarily broad and would create ambiguity as to applicable definitions of "compensation" and "officer" to be used for these purposes. It appears the limit could apply even to employees with no policy-making authority who just happen to be highly compensated (e.g., because of receipt of a large performance bonus) and treated as an officer for some purpose in a particular year. As a result, the pool of potential covered employees would be expanded significantly.
- It is unnecessary to completely de-link the definition of covered employee from the SEC proxy rules in order to address the recent changes to the SEC rules. Instead, any legislative "fix" to section 162(m) should maintain a link to the SEC proxy rules by providing that the term covered employee is defined as a company's:
  - primary executive officer within the meaning of the SEC rules, and
  - four highest compensated officers (other than the primary executive officer), with the term "officer" and "compensation" defined by reference to the definitions in the SEC rules.
- Using the SEC definitions of these terms will ensure that section 162(m) applies to that class of officers with significant policy making authority and will avoid the unnecessary ambiguity that would otherwise occur. Such a change should also result in better compliance because affected companies are already required to determine their officers and measure compensation in this manner in order to comply with the SEC proxy rules.