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Deadline Mounts to Amend Deferred Compensation Plans for Section 162(m) Changes

Certain deferred compensation plans and agreements maintained by publicly held corporations and subject to Section 409A of the Internal Revenue Code may need to be amended before December 31, 2020, to reflect changes in the tax laws effective in 2018 relating to the \$1 million deduction limit under Section 162(m) of the Internal Revenue Code. If action is not taken by December 31, 2020, an employer may be precluded from paying amounts under the deferred compensation arrangement without triggering a 409A tax issue.

Section 162(m) relief in the Section 409A regulations

Regulations under Section 409A allow a deferred compensation arrangement to delay a payment otherwise due if the employer would not be allowed a deduction for the payment because of Section 162(m). Such a delay does not need to be stated in the plan but can be implemented as a matter of administrative practice. However, some companies—in our experience, very few—drafted their deferred compensation plans to require such a delay.

Section 162(m) denies a deduction to a publicly held corporation generally for compensation to a “covered employee” in excess of \$1 million for a year. Prior to 2018, an individual had to be employed on the last day of the year to be a covered employee. For example, a corporation with a calendar year taxable year was able to disregard the \$1 million limit for 2017 if the covered employee retired on or before December 30 of that year.

After 2017, however, Section 162(m) was amended to provide that a covered employee never ceases to be a covered employee. Therefore, depending on the amount of deferred compensation, if a plan is written to require a delay of

payment until the payments are deductible under Section 162(m), full payment could be delayed for many years.

Such delayed payments may not be intended by the parties or acceptable to an executive. Absent relief, an amendment to eliminate the delay would be a prohibited acceleration of payment, which could trigger harsh tax penalties under Section 409A.

A proposed regulation under Section 162(m) provides relief. Under the relief, an amendment of a nonqualified deferred compensation plan or agreement to remove a mandatory delay due to Section 162(m) will not be treated as an impermissible acceleration of payment under Section 409A. To qualify for the relief, the amendment must be made no later than December 31, 2020.

What this means to you

Every publicly held corporation should confirm that none of its plans or arrangements that are subject to Section 409A fall into the trap described above—i.e., require that payment be delayed until the Section 162(m) limit no longer applies. Arrangements that are subject to 409A can include employment agreements and severance agreements, as well as SERPs, RSUs, and other arrangements that are traditionally considered to be deferred compensation. Any plan or agreement that includes a mandatory Section 162(m) deferral should be amended by December 31, 2020, to eliminate the trap.

Contact us

If you have questions about meeting this deadline or how changes to the Internal Revenue Code impact your business, contact Alan Kandel, Craig Kovarik or your Husch Blackwell attorney.