Office of Chief Counsel
Internal Revenue Service

Memorandum

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to: Erica Wu
CC:LM:CTM:LN

from: John B. Richards, Acting Senior Technician Reviewer
CC:TEGE:EB:EC

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subject: Covered Employees Under Section 162(m)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Company X =
Company Y =
Date A =
Date B =
Year C =

ISSUE

Whether any of Company X's officers were "covered employees" under I.R.C. § 162(m) for the Year C tax year?

CONCLUSION

Company X had officers who were "covered employees" for the Year C tax year. Company X's chief executive officer and four highest compensated officers (other than the chief executive officer) were "covered employees" because Company X was a publicly held corporation registered under section 12 of the Securities Exchange Act of 1934 (Exchange Act) and was required to disclose compensation of these officers pursuant to the executive compensation disclosure rules under the Exchange Act for the Year C tax year.

FACTS

Company X, a calendar year taxpayer, was a publicly held corporation registered under section 12 of the Exchange Act for the Year C tax year. On Date A, Company X entered into a plan of merger agreement with Company Y, a publicly held corporation. The agreement permitted Company Y to designate a majority of Company X's directors. Because Company Y had the authority to appoint the majority of Company X's directors, Company X was required to file a statement with the Securities and Exchange Commission (SEC) pursuant to Rule 14f-1 of the SEC regulations. Rule 14f-1 required Company X to disclose compensation for its executive officers for Year C pursuant to the executive compensation disclosure rules in item 402 of the SEC regulations ("Compensation Disclosure Rules"). Company X filed the Rule 14f-1 statement on Date B. A few months later, Company Y completed its acquisition of Company X.

LAW AND ANALYSIS

Section 162(m) limits a publicly held corporation's deduction of employee remuneration paid to its covered employees.

Section 162(m)(2) defines a publicly held corporation as a corporation issuing any class of common equity securities required to be registered under section 12 of the Exchange Act. Section 1.162-27(c)(1) adds that whether a corporation is publicly held is determined based solely on whether, as of the last day of its taxable year, the corporation is subject to the reporting obligations of section 12 of the Exchange Act.

Section 162(m)(3) provides that two types of employees of a publicly held corporation are a "covered employee." First, an employee is a "covered employee" if, as of the close of the taxable year, the employee is the chief executive officer of the corporation or is an individual acting in such capacity. Second, an employee is a "covered employee" if the total compensation of such employee for the taxable year is required to be reported to shareholders under the Exchange Act by reason of such employee being among the four highest compensated officers for the taxable year (other than the chief executive officer). Section 1.162-27(c)(2)(ii) interprets the statutory definition by providing that whether an individual is a chief executive officer or among the four highest compensated officers is determined pursuant to the Compensation Disclosure Rules under the Exchange Act.

The Compensation Disclosure Rules under the Exchange Act are contained in Item 402 of the SEC regulations. *See* Item 402 of Regulation S-K, 17 CFR 229.402. For the Year C tax year, the Compensation Disclosure Rules required, in relevant part, executive compensation disclosure for (i) all individuals serving as the registrant's chief executive officer or acting in a similar capacity during the last completed fiscal year ("CEO") regardless of compensation level and (ii) the registrant's four most highly compensated executive officers other than the CEO who were serving as executive officers at the end of the last completed fiscal year. *Id*.

Rule 14f-1 of the SEC regulations requires an issuer to file a Rule 14f-1 Statement with the SEC if the issuer anticipates a change in the majority of its board of directors in connection with a tender offer. 17 CFR 240.14f-1. The Rule 14f-1 Statement must contain information that is substantially equivalent to the information required by Item 8 of Schedule 14A of Regulation 14A. *Id*. Item 8 of Schedule 14A of Regulation 14A requires the issuer to furnish information required by Item 402 of Regulation S-K, which contains the Compensation Disclosure Rules. 17 CFR 240.14a-101.

Company X was a publicly held corporation because on the last day of its taxable year it was subject to the reporting requirements under section 12 of the Exchange Act.

Company X was required to file a Rule 14f-1 Statement and thus report the executive compensation of its officers pursuant to the Compensation Disclosure Rules contained in Item 402 of the Exchange Act. Therefore, Company X's CEO and four highest compensated officers (other than the CEO) are "covered employees" for purposes of § 162(m) for the Year C tax year.

Company X argues that it does not have any "covered employees" for the Year C taxable year for two reasons. First, Company X claims that because filing the Rule 14f-1 Statement was voluntary, any compensation disclosed in the Statement was not "required to be reported" within the meaning of § 162(m). Company X maintains that filing the Rule 14f-1 Statement was voluntary because it voluntarily entered into the plan of merger agreement with Company Y. Second, Company X argues that it is not subject to § 162(m) because it was not required to and did not file a proxy statement containing a summary compensation table when filing the Rule 14f-1 Statement.

Company X's first argument is without merit. Even though Company X voluntarily entered into the plan of merger agreement with Company Y, Company X's filing of the Rule 14f-1 Statement was mandatory. Rule 14f-1 of the SEC regulations requires certain issuers to file Rule 14f-1 Statements, which must include information on the compensation of its officers pursuant to the Compensation Disclosure Rules.

Company X's second argument is based on an incorrect assumption. In arguing that it is not subject to § 162(m) because it was not required to and did not file a proxy statement containing a summary compensation table when filing the Rule 14f-1 Statement, Company X assumes that a publicly held corporation is subject to § 162(m) only when it is required to file a proxy statement containing a summary compensation table. This assumption is incorrect. A publicly held corporation has "covered employees" and is thus subject to § 162(m) when it is required to disclose executive compensation of its chief executive and other officers pursuant to the Compensation

Disclosure Rules. *See* Reg. § 1.162-27(c)(2)(ii). As illustrated by the rules for filing a Rule 14f-1 Statement, required disclosure of executive compensation pursuant to the Compensation Disclosure Rules is not limited to proxy statements that contain summary compensation tables.

Company X cites a number of PLRs in arguing that if an issuer is not required to file a proxy statement containing a summary compensation table, then the issuer does not have any "covered employees" for purposes of § 162(m). Generally these PLRs address whether a Target corporation has "covered employees" for purposes of § 162(m) after being acquired by another corporation, and rule that the Target has no "covered employees" because the Target ceases to exist after the acquisition and is thus not required to file a proxy statement containing a summary compensation table. None of the PLRs hold that an issuer has no "covered employees" because the issuer is not required to file a proxy statement containing a summary compensation table. Instead, the PLR's hold that if an issuer is not required to report executive compensation of its officers pursuant to the Compensation Disclosure Rules, then the issuer does not have any "covered employees" for purposes of § 162(m). The form of disclosure of compensation is irrelevant for § 162(m). If an issuer discloses executive compensation of its officers pursuant to the Compensation Disclosure Rules, then the issuer has "covered employees" subject to § 162(m).

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Please call (202) 622-6030 if you have any further questions.