Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Mark Hulse, Area Counsel
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from: John Richards, Senior Technical Reviewer
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subject: Allocating Deduction Limitation under § 162(m)(6)

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

ISSUE

Corporation Y is a tax-exempt hospital and is part of an aggregated group with Corporation X, a covered health insurance provider. Both Corporations X and Y paid applicable individual remuneration to Employee A. The regulations under § 162(m)(6) provide that the § 162(m)(6) deduction limitation must be allocated among members of an aggregated group. Is remuneration paid by Corporation Y otherwise deductible and taken into account for purposes of applying the deduction limitation even though Corporation Y is a tax-exempt entity?

CONCLUSION

Yes, remuneration paid by Corporation Y is otherwise deductible and is taken into account in applying the deduction limitation under §162(m)(6).

FACTUAL SCENARIO (for illustrative purposes)

For its 2015 taxable year, Corporation X was a covered health insurance provider as defined in § 162(m)(6)(C)(i)(II). For 2015, Corporation Y was a tax-exempt entity described in § 501(c)(3). Corporations X and Y were treated as a single employer under § 414(b). From January 1 to July 31 of 2015, Employee A was an employee of

Corporation X. For the remainder of 2015, Employee A was an employee of Corporation Y. For 2015, Employee A was an applicable individual within the meaning of § 162(m)(6)(F). For the 2015 taxable year, Corporations X and Y paid applicable individual remuneration (as defined in § 162(m)(6)(D)) to Employee A of $750,000 and $250,000, respectively. Employee A received no other remuneration from Corporations X and Y in 2015.

LAW

Section 162(a)(1) allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 162(m)(6)(A) limits the allowable deduction to $500,000 for applicable individual remuneration and deferred deduction remuneration attributable to services performed by applicable individuals that is otherwise deductible by a covered health insurance provider in taxable years beginning after December 31, 2012.

Section 162(m)(6)(B) provides that the term “disqualified taxable year” means, with respect to any employer, any taxable year for which such employer is a covered health insurance provider.

Section 162(m)(6)(C)(i)(II) provides that, for taxable years beginning after December 31, 2012, a covered health insurance provider is any employer that is a health insurance issuer as defined in §9832(b)(2) and with respect to which not less than 25% of the gross premiums received from providing health insurance coverage (as defined in §9832(b)(1)) are from minimum essential coverage (as defined in §5000A(f)). Section 162(m)(6)(C)(ii) provides that two or more persons who are treated as a single employer under § 414(b), (c), (m), or (o) are treated as a single employer for purposes of §162(m)(6). Section 1.162-31(b)(2) of the regulations defines an “aggregated group” as one or more persons treated as a single employer under §162(m)(6)(C)(ii).

Section 162(m)(6)(D) provides that applicable individual remuneration (AIR) for any disqualified taxable year is the aggregate amount otherwise allowable as a deduction for such taxable year for remuneration for services performed by such individual (whether or not during the taxable year), but does not include any deferred deduction remuneration with respect to services performed during the disqualified taxable year.

Section 162(m)(6)(E) provides that deferred deduction remuneration (DDR) means remuneration which would be applicable individual remuneration for services performed in a disqualified taxable year but for the fact that the deduction for such remuneration is allowable in a subsequent taxable year.

Section 162(m)(6)(F) provides that an applicable individual, with respect to any covered health insurance provider for any disqualified taxable year, is any individual (i) who is an officer, director, or employee in such taxable year, or (ii) who provides services for or on behalf of such covered health insurance provider during such taxable year.

Section 1.162-31(e)(4)(i) of the regulations provides that the total combined deduction for AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year allowed for all members of an aggregated group that are covered health insurance providers for any taxable year is limited to $500,000. Therefore, if two or more members of an aggregated group that are covered health insurance providers may otherwise deduct AIR or DDR attributable to services performed by an applicable individual in a disqualified taxable year, the AIR and DDR otherwise deductible by all members of the aggregated group is combined, and the deduction limitation is applied to the total amount.

Section 1.162-31(e)(4)(ii) of the regulations provides that if the total amount of AIR and DDR attributable to services performed by an applicable individual in a disqualified taxable year that is otherwise deductible by two or more members of an aggregated group in any taxable year exceeds the $500,000 deduction limit (as reduced by previously deductible AIR or DDR, if applicable), the deduction limit is prorated based on the AIR or DDR otherwise deductible by the members of the aggregated group in the taxable year and allocated to each member of the aggregated group. The deduction limit allocated to each member of the aggregated group is determined by multiplying the deduction limit for the disqualified taxable year by a fraction, the numerator of which is the AIR or DDR otherwise deductible by that member in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year, and the denominator of which is the total AIR or DDR otherwise deductible by all members of the aggregated group in that taxable year that is attributable to services performed by the applicable individual in the disqualified taxable year. The amount of AIR or DDR otherwise deductible by a member of the aggregated group in excess of the portion of the deduction limit allocated to that member is not deductible in any taxable year.

ANALYSIS

Corporation X is a covered health insurance provider as defined in § 162(m)(6)(C)(i)(II). Pursuant to § 162(m)(6)(C)(ii), because Corporations X and Y are treated as a single employer under §414(b), the two corporations are also treated as a single employer for purposes of the deduction limitation under § 162(m)(6). Because Corporations X and Y are members of the same aggregated group, the AIR otherwise deductible by them is aggregated for purposes of applying the § 162(m)(6) deduction limitation, thus resulting in a reduced deduction limit for each corporation. *See* §§ 1.162-31(e)(4)(i) and (ii).

Neither § 162(m)(6) nor the regulations thereunder provide an exception for tax-exempt entities that are members of an aggregated group. Remuneration paid by a tax-exempt

entity engaged in a related or unrelated trade or business is considered otherwise deductible regardless of whether the entity may use the deduction (for example, regardless of whether the entity has taxable income, such as unrelated business taxable income, against which the deduction may be taken). Accordingly, pursuant to §1.162-31(e)(4)(ii), because the aggregate $1,000,000 AIR otherwise deductible by Corporations X and Y for 2015 exceeds the $500,000 deduction limitation for Employee A for 2015, the deduction limit is prorated and allocated to Corporations X and Y in proportion to the AIR otherwise deductible by each corporation for 2015. Therefore, the deduction limit that applies to the AIR otherwise deductible by Corporation X is $375,000 ($500,000 x ($750,000 / $1,000,000)) and the deduction limit that applies to the AIR otherwise deductible by Corporation Y is $125,000 ($500,000 x ($250,000 / $1,000,000)). For the 2015 taxable year, with respect to AIR paid to Employee A, Corporation X may not deduct $375,000 of the $750,000 of AIR ($750,000 - $375,000).

Please call Ilya Enkishev at (202) 317-5600 if you have any further questions.