February 24, 2023

Ms. Carol Weiser
Acting Benefits Tax Counsel
Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Ms. Rachel Leiser Levy
Associate Chief Counsel (EEE)
Office of Chief Counsel
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Re: Request for Guidance Related to Changes to Section 162(m) made by the American Rescue Plan Act of 2021

Dear Ms. Weiser and Ms. Levy:

The American Institute of CPAs (AICPA) submits the comments below to the Department of the Treasury ("Treasury") and Internal Revenue Service (IRS) related to changes made to section 162(m)[1] by the American Rescue Plan Act of 2021 (ARPA).[2]

Background

Section 162(m) of the Internal Revenue Code (IRC) places a $1 million limitation on the amount of remuneration with respect to a covered employee that a publicly held corporation may deduct in a taxable year.

Prior to the passage of the Tax Cuts and Jobs Act[3] (TCJA), under section 162(m) and Notice 2007-49 – Covered Employees Under Section 162(m)(3), the term "covered employee" included the principal executive officer (PEO) as of the last day of the taxable year as well as the three highest paid officers, excluding the PEO. The compensation of the principal financial officer (PFO) was not subject to the section 162(m) limitation.

The definition of a "covered employee" under section 162(m), was broadened by the TCJA as follows:

- To include any individual holding the PFO title without regard to compensation;

- The trigger for inclusion of the PEO and PFO changed from an individual holding one of the positions on the last day of the year to an individual holding one of the positions at any time during the year; and

[1] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.
[2] Pub. L. No. 117-2.
[3] Pub. L. No. 115-97.

- Individuals who are covered employees of the employer or any predecessor employer in any tax year beginning after December 31, 2016, are considered covered employees in all future years, including in retirement and after death (collectively, the "Current Law Covered Employees").

The three other most highly compensated officers continued to be included, for a minimum of five covered employees.

The ARPA added section 162(m)(3)(C), a new subsection to section 162(m), which will further limit the deductibility of certain employee remuneration by expanding the definition of a "covered employee" effective for taxable years beginning after December 31, 2026. Beginning in 2027, for calendar year taxpayers, a public company's covered employees will include Current Law Covered Employees as well as the next five highest paid employees (the "ARPA 5"). The employees included in the ARPA 5 are subject to change every year, and they do not remain covered employees in future years unless they meet the criteria in that future year or become a Current Law Covered Employee.

I. Covered Employees as ARPA 5 Employees

Overview

Section 162(m)(3) states that for purposes of this subsection, the term "covered employee" means any employee of the taxpayer if—

> (A) Such employee is the principal executive officer or principal financial officer of the taxpayer at any time during the taxable year, or was an individual acting in such capacity,
>
> (B) The total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the 3 highest compensated officers for the taxable year (other than any individual described in subparagraph (A)),
>
> (C) In the case of taxable years beginning after December 31, 2026, such employee is among the 5 highest compensated employees for the taxable year other than any individual described in subparagraph (A) or (B), or
>
> (D) Was a covered employee described in subparagraph (A) or (B) of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.
>
> Such term shall include any employee who would be described in subparagraph (B) if the reporting described in such subparagraph were required as so described.

Subsections (A) and (B) above identify certain officers as covered employees based on their position at a public corporation during the tax year. Subsection (D) makes permanent the covered employee status of any (A) or (B) covered employee, providing that any individual identified in (A) or (B) for a tax year remains a covered employee for all subsequent taxable years even if no longer serving in the relevant position. Subsection (C) captures the ARPA 5 but, excludes (A) or (B) covered employees from the identification pool. In contrast, subsection (C) does not exclude subsection (D) employees from the identification pool.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance clarifying that a covered employee under section 162(m)(3)(D) may be included as one of the five highest paid employees under section 162(m)(3)(C) for a particular taxable year.

Analysis

Section 162(m)(3)(C), as amended, will add to the pool of covered employees, the five highest compensated employees who are not individuals identified in section 162(m)(3)(A) or section 162(m)(3)(B). There is no other limitation on which employees may be identified as a section 162(m)(3)(C) employee, including individuals who are covered employees solely due to the operation of section 162(m)(3)(D).

> *Example*
>
> Employee A was the principal executive officer (PEO) of a publicly held corporation for a prior tax year but, is no longer the PEO (or any officer) in the current tax year. Employee A is one of the top five highest compensated employees for the current tax year. Employee A is not considered an individual described in section 162(m)(3)(A) or section 162(m)(3)(B) for the tax year but, is an individual described in section 162(m)(3)(D).
>
> Section 162(m)(3)(C) does not exclude an individual described in section 162(m)(3)(D) from consideration therefore, Employee A is considered one of the top five highest compensated employees for the tax year identified in section 162(m)(3)(C), notwithstanding that Employee A is also a covered employee by virtue of section 162(m)(3)(D).
>
> To eliminate Employee A from consideration as a section 162(m)(3)(C) employee, the language of section 162(m)(3)(C) must exclude any individual described in section 162(m)(3)(D), which it currently does not.

We suggest that Treasury and the IRS publish guidance confirming that an employee in the same circumstances as the example, may be treated as one of the five employees identified under section 162(m)(3)(C).

II. Determination of ARPA 5 – Definition of Compensation

Overview

Current Law Covered Employees include current and former officers of public corporations. Treasury Reg. § 1.162-33(c)(2)(i)(B) refers to Securities and Exchange Commission (SEC) rules for use in determining who is considered an "executive officer." Treasury Reg. § 1.162-33(c)(2)(i)(B) also uses the Securities Exchange Act of 1934 executive compensation disclosure rules to determine the amount of compensation for purposes of identifying which officers are the most highly compensated.

The ARPA 5 are included as covered employees under section 162(m)(3)(C) based upon being the five highest compensated employees outside of the Current Law Covered Employees. Since the ARPA 5 are not required to be officers, it is unknown if the determination of which employees are considered the ARPA 5 can or must be determined in the same manner as the Current Law Covered Employees. Therefore, clarity on an appropriate measure of compensation for purposes of identifying the ARPA 5 is needed.

Recommendation

The AICPA recommends that Treasury and the IRS issue guidance related to the determination of which employees are included in the ARPA 5 as follows:

- Define compensation for identifying the ARPA 5 in the same manner that compensation is defined for Current Law Covered Employees (i.e., using the Securities and Exchange Commission (SEC) executive compensation disclosure rules);

- Allow a publicly held corporation to elect to define compensation for purposes of determining the ARPA 5 as the aggregate amount of compensation otherwise deductible by the taxpayer or the amount of compensation that would be deductible if the employer were a taxable U.S. corporation (e.g., by a foreign affiliate corporation as if it was subject to section 162(a) in the taxable year);

- Treat taxpayers as having made the election to define compensation by how they apply the deduction limitation and identify the ARPA 5 in the first year their deduction is limited for compensation paid to the ARPA 5;

- Provide guardrails, such as the following, to prevent manipulation of the rules by taxpayers:

    - require taxpayers to true up prior taxable years to account for any compensation not accounted for or double-counted if the change in election would place amounts in different years (similar to that required due to a change in accounting method);

    - mandate a delay in a taxpayer's ability to change an election once one is made.

- Consider the impact of mergers and acquisitions between taxpayers who have made contrasting elections.

Analysis

The ARPA 5 of some publicly traded corporations will be officers with similar pay structures to their Current Law Covered Employees. These taxpayers will calculate SEC compensation for officers as part of the application of both the SEC rules and the current section 162(m) limitation. Therefore, allowing them to use the same method to calculate compensation as the Current Law Covered Employees is equitable and reasonable as a default rule. However, the SEC rules for determining executive compensation disclosures use different timing for certain compensation items than do tax rules. Without an election to use a tax timing rule, taxpayers whose ARPA 5 contain employees who are not officers, or who have compensation arrangements that vary from the Current Law Covered Employees, would bear the burden of calculating compensation under a different set of rules for a group of employees that they otherwise would not need to consider for SEC purposes (and for which the compensation structures may not be fully addressed by the SEC rules). This will impose a significant burden on these taxpayers and may lead to inadvertent noncompliance.

Permitting taxpayers to compute deductible compensation on an annual basis utilizing the method which they use for purposes of calculating their corporate income taxes removes the additional administrative burden from them. Using deduction timing and computational principles will also inherently identify the employees with the highest disallowed compensation in a tax year, since tax timing rules are more likely to lump compensation into a given year than SEC accrual-based rules.

To ensure that taxpayers do not use an election framework to compare the two compensation alternatives and choose the method resulting in the lowest compensation deduction limitation every tax year, guidance should include guardrails. For example, guidance could contain a true-up to capture any prior year adjustments, similar to adjustments made when changing accounting methods. Guidance could also limit the frequency of which taxpayers are permitted to change their election. Additionally, guidance on the election framework must contain information related to competing elections in cases of mergers and acquisitions.

*****

The AICPA is the world's largest member association representing the accounting profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please feel free to contact Tom Pevarnik, Chair, AICPA Employee Benefits Taxation Technical Resource Panel, at (202) 879-5314, or tpevarnik@deloitte.com; Kristin Esposito, AICPA Director – Tax Policy & Advocacy, at (202) 434-9241, or kristin.esposito@aicpa-cima.com; or me, at (601) 326-7119, or JanLewis@HaddoxReid.com.

Sincerely,

Jan Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Lily Batchelder, Assistant Secretary for Tax Policy, Department of the Treasury
Mr. Douglas O'Donnell, Acting Commissioner, Internal Revenue Service
Ms. Helen Morrison, Deputy, Benefits Tax Counsel, Office of the Benefits Tax Counsel, Department of the Treasury
Mr. Andrew Holubeck, Attorney-Advisor, Office of Tax Policy, Department of the Treasury
Mr. William Paul, Principal Deputy Chief Counsel (Technical) and Deputy Chief Counsel, Internal Revenue Service
Mr. Ilya Enkishev, Attorney, IRS Office of Associate Chief Counsel (EEE), Internal Revenue Service
Ms. Lynne Camillo, Acting Deputy Associate Chief Counsel (EEE), Internal Revenue Service
Ms. Laura Warshawsky, Deputy Associate Chief Counsel, Employee Benefits, Internal Revenue Service