



Recent CCM Provides that CFO of Small Reporting Companies May Be Subject to Code Section 162(m), Raises Questions for All Public Companies

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Since 2007, public companies have generally relied on a position taken by the IRS in Notice 2007-49 that a "covered employee" for determining who is subject to the \$1 million deductibility limitations of Code Section 162(m) means the principal executive officer and the three highest compensated officers (other than the principal executive officer (PEO) and principal financial officer (PFO)). Under this approach, public companies have typically determined that chief financial officers are not included in the "covered employee" group for purposes of Code Section 162(m).

The IRS issued Notice 2007-49 to resolve a conflict between the language of Code Section 162(m) and its regulations and a 2006 amendment to the SEC disclosure requirements under Item 402 S-K.

Under Code Section 162(m)(3), a "covered employee" is any employee of the company if (A) as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is an individual acting in such capacity, or (B) the total compensation of such employee for the taxable year is required to be reported to shareholders in the proxy statement because such employee is among the four highest compensated officers for the taxable year (other than the chief executive officer). This approach was consistent with the SEC's pre-2006 disclosure rules. The SEC amendment changed those disclosure rules by adding the "principal financial officer" as a named executive officer for whom compensation disclosure was required solely by reason of being an officer serving in that position. The SEC amendment also reduced from four to three the number of other executives treated as "named executive officers" by reason of compensation. As a result, the SEC requires disclosure of compensation for the PEO (CEO), the PFO (CFO) and the three highest paid executive officers.

This month, in addressing the application of Code Section 162(m) to a "small reporting company", a recently issued Chief Counsel Memorandum (CCM 201543003) expressed the view that the determination of who is a "covered employee" is determined based on reference to the more lenient SEC disclosure rules for "smaller reporting companies" (which generally are defined as having a public float of less than \$75.0 million). Under the "smaller reporting company" rules, disclosure of compensation is not required of an officer solely because of the individual serving as principal financial officer. Instead, the disclosure rules require disclosure of compensation for the chief financial officer of a smaller reporting company only if such officer is one of the two most highly compensated executive officers other than the chief executive officer who were serving as executive officers at the end of the year. Thus, under the facts of the CCM, a chief financial officer who was the second highest paid officer was found to be a covered employee under Section 162(m). For more information click [here](#).

While this result is not surprising and generally represents a consistent application of the IRS' position taken in the Notice, the CCM also expressed an apparent change in the IRS' position regarding the treatment of principal financial officers under Code Section 162(m), or at least articulates a position that is contrary to the most common interpretation of the IRS' Notice, as applicable to public companies generally.



In this regard, it has been generally believed that a chief financial officer would not be a “covered employee” by reason of the Notice’s express carve-out of the PFO from covered employee status. The CCM, however, states that Notice 2007-49 “does not preclude the PFO from qualifying as a covered employee if disclosure relating to the PFO is required by reason of such officer being among the highest compensated officers.” Although practitioners have long recognized a potential caveat where a CFO performs other functions at a publicly traded company, which could include also serving as a chief administrative officer or in some other executive role, and thus could theoretically be swept into “covered employee” status by reason of compensation for those other services, the CCM could be viewed as taking the position that there is no exclusion from “covered employee” status based on service as a public company’s PFO.

At a minimum, the CCM has an impact on the manner that “small reporting companies” comply with Code Section 162(m). Whether the CCM represents a change in the IRS’s position or rather the simple implication that a chief financial officer could, by reason of compensation for other services, become a covered employee for purposes of Code Section 162(m) is unclear. We expect there to be more discourse on this issue, and even though the CCM does not appear to override the Notice, public companies may want to consider addressing this potential issue by structuring CFO compensation in the same manner as compensation of “covered employees” including using “performance-based” compensation which is exempt from the \$1.0 million deduction limit.

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