

# One Minute Memo<sup>®</sup>



## CFOs No Longer Subject to \$1 Million Compensation Deduction Limit

The Internal Revenue Service has issued new guidance (IRS Notice 2007-49) that changes the group of public company officers subject to the compensation deduction limit under Section 162(m) of the Internal Revenue Code. Under the new rules, the company's chief financial officer will never be subject to Section 162(m), even if the CFO is one of the most highly compensated officers. In addition, the total number of officers in addition to the CEO who are subject to Section 162(m) was reduced from four to three. The new rules are effective for company fiscal years ending after December 15, 2006.

Section 162(m) generally provides that annual compensation payable to each "covered employee" of a publicly-held corporation is not deductible to the extent it exceeds \$1 million, unless that compensation is performance-based. "Covered employees" are defined as (i) the company's chief executive officer at the end of the company's taxable year, and (ii) the top four highest-paid officers of the company (other than the CEO) whose compensation is required to be disclosed in proxy statements or annual reports filed under the Securities Exchange Act.

In September 2006, the Securities and Exchange Commission released final rules on executive compensation disclosure that altered the executives

whose compensation is subject to reporting. The amended SEC disclosure rules provide that the CFO, as well as the CEO, is always subject to reporting, and reduce the number of other named executive officers from four to three. The change in the SEC reporting rules created a conflict with the Section 162(m) definition of covered employee. Notice 2007-49 resolves the conflict by providing that, for purposes of the \$1 million deduction limitation, covered employees are only the principal executive officer, and the three most highly compensated officers for the taxable year (other than the principal executive officer or the principal financial officer).

In redefining the group of covered employees under Section 162(m), the IRS has departed from the prior definition in two significant ways:

- Only *four* executives are covered employees, as opposed to five under the previous definition.
- The company's *principal financial officer* (the CFO) will never be a covered employee and, therefore, his or her compensation will never be subject to the \$1 million deductibility limit unless that person is also serving as CEO.

Notice 2007-49 was released on June 4, 2007. The IRS has informally indicated that the notice's effective date

is the same as that of the new SEC disclosure rules, which are effective for all fiscal years ending on or after December 15, 2006. Therefore, calendar year taxpayers will apply the new definition of covered employee retroactive to 2006.

*If you have any questions about the deductibility of compensation under Section 162(m), please contact your Seyfarth Shaw attorney, or any of the attorneys in the Employee Benefits & Executive Compensation Department at [www.seyfarth.com](http://www.seyfarth.com).*

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