

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Nina Choi  
CC:TEGE:FS:NELI

from: John B. Richards, 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 =

Date C =

Year D =

ISSUE

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

CONCLUSION

Company X had officers who were "covered employees" for the Year D taxable year. Company X's chief executive officer ("CEO") and three highest compensated officers (other than the CEO and the principal financial 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 D taxable year.

### FACTS

Company X, a calendar year taxpayer, was a publicly held corporation registered under section 12 of the Exchange Act for the Year D taxable year. On Date A, Company X entered into a plan of merger agreement with Company Y. On Date B, Company X filed a Form 10-K, Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, with the Securities and Exchange Commission (“SEC”). On Date C, the merger was completed. Company X never filed a proxy statement or a summary compensation table with the SEC for the Year D taxable year.

### 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) of the Income Tax Regulations 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) defines a “covered employee” as any employee of the taxpayer 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 a capacity, or (B) 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) provides that whether an individual is the 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, 17 CFR 229.402. Pursuant to Notice 2007-49, 2007-25 I.R.B. 1429, effective for taxable years ending on or after December 15, 2006, the IRS interprets the term “covered employee” for purposes of § 162(m) to mean any employee of the taxpayer if, as of the close of the taxable year, such employee is the principal executive officer (within the meaning of the disclosure rules) of the taxpayer or an individual acting in such a capacity, or if the total compensation of such employee for that taxable year is required to be reported to shareholders under the Exchange Act by reason of such employee being among the

three highest compensated officers for the taxable year (other than the principal executive officer or the principal financial officer).

Notice 2007-49 applies to the Year D taxable year. Therefore, Corporation X's covered employees included any employee of Corporation X, who, as of the close of the Year D taxable year, was the principal executive officer of Corporation X or an individual acting in such a capacity, or any employee whose total compensation for that taxable year was required to be reported to shareholders under the Exchange Act by reason of such employee being among the three highest compensated officers for the taxable year (other than the principal executive officer or the principal financial officer).

A publicly held corporation is required to file Form 10-K, and include therein the information required by Item 402 of Regulation S-K. Section G(3) of General Instructions for Form 10-K, permits a corporation to satisfy the executive compensation disclosure requirements by incorporating the required information by reference from the proxy statement, provided the proxy statement is filed with the SEC not later than 120 days after the end of the fiscal year covered by the Form 10-K. The instructions also provide that if the proxy statement is not filed with the SEC within the 120-day period, the required information must be filed as part of the Form 10-K, or as an amendment to the Form 10-K, not later than the end of the 120-day period.

The SEC's Division of Corporate Finance issues Compliance and Disclosure Interpretations (C&DI's) providing interpretations of Exchange Act forms commonly used by corporations. With respect to Form 10-K, Question 104.10 of the C&DI's provides:

**Question:** A company omits the Part III information [disclosure of executive compensation] in its annual report on Form 10-K because it intends to incorporate this information by reference from its proxy statement to be filed within 120 days, pursuant to General Instruction G(3) to Form 10-K. If the company is acquired between the due date of its Form 10-K and the 120th day after the end of its fiscal year, and will not file a proxy statement after the acquisition closes, must the company still amend its Form 10-K to include the Part III information?

**Answer:** Yes. [September 30, 2008]

This C&DI is consistent with the Form 10-K instructions, which provide that if executive compensation is not disclosed on Form 10-K and a proxy statement is not filed with the SEC, then the executive compensation must be disclosed as an amendment to the Form 10-K.

Company X was a publicly held corporation for the Year D taxable year because on the last day of Year D it was subject to the reporting requirements under section 12 of the Exchange Act. Company X was required to file Form 10-K and report therein on a

summary compensation table the compensation of its officers pursuant to the compensation disclosure rules contained in Item 402 of the SEC regulations. Even though Company X neither reported the executive compensation of its officers on Form 10-K nor filed a proxy statement, Company X was required to report the executive compensation of its officers as an amendment to the Form 10-K. Therefore, Company X's principal executive officer (or person acting in that capacity) and three highest compensated officers (other than the principal executive officer and principal financial officer) are "covered employees" for purposes of § 162(m) for the Year D taxable year.

Company X argues that it does not have any "covered employees" for the Year D taxable year because it never disclosed the executive compensation of its officers on a summary compensation table with Form 10-K and did not file a proxy statement. Company X maintains that officers are not "covered employees" if for any reason they are not reported on a summary compensation table. Company X maintains that a number of PLRs support its position.

Company X's position is incorrect. Even though Company X neither reported the executive compensation of its officers on Form 10-K nor filed a proxy statement, Company X was required to report the executive compensation of its officers as an amendment to the Form 10-K. Section 1.162-27(c)(2)(ii) provides that whether an individual is a covered employee is determined pursuant to the compensation disclosure rules under the Exchange Act. Thus, whether an employee is a covered employee is determined based on the requirements of the compensation disclosure rules under the SEC regulations. Failure to comply with the executive compensation disclosure rules pursuant to the Exchange Act does not justify failure to comply with § 162(m).

Company X asserts that the following language from the preamble to the notice of proposed rulemaking for the § 162(m) regulations supports its view:

The regulations clarify which employees are 'covered employees' for purposes of section 162(m). The legislative history to section 162(m) provides that 'covered employees' are defined by reference to the SEC rules governing executive compensation disclosure under the Exchange Act. Under the regulations, an individual generally is a 'covered employee' if the individual's compensation is reported on the 'summary compensation table' under the SEC's executive compensation disclosure rules, as set forth in Item 402 of Regulation S-K, 17 CFR 229.402, under the Exchange Act. However, the regulations specifically provide that, in order to be a 'covered employee' for section 162(m) purposes, an individual must be employed as an executive officer on the last day of the taxable year. Thus, only those employees who appear on the 'summary compensation table' and who are also employed on the last day of the taxable year are 'covered employees.'

Company X's reliance on the preamble is inappropriate. Generally, preambles are not intended to be authoritative, but may be helpful in interpreting ambiguities in regulations. *Armco, Inc. v. Commissioner*, 87 T.C. 865, 868 (T.C. 1986). The § 162(m) regulations defining a "covered employee" are unambiguous regarding the present issue. Section 1.162-27(c)(2)(ii) provides that whether an employee is a covered employee is "determined pursuant to the executive compensation disclosure rules under the

Exchange Act.” Therefore, a publicly held corporation has “covered employees” if it is required to disclose the executive compensation of its officers on a summary compensation table, regardless of whether it actually makes the required disclosure.

Company X’s interpretation of the preamble is inaccurate and inconsistent with the plain language of the regulations. The preamble states that “[a]n individual *generally* is a ‘covered employee’ if the individual’s compensation is reported on the ‘summary compensation table’ ” (emphasis added). The term “generally” means “usually” or “commonly”—the term connotes exceptions. “Generally” does not mean “only.” The above language from the preamble explains § 1.162-27(c)(2)(ii), which provides that “covered employees” are “determined pursuant to the executive compensation disclosure rules under the Exchange Act.” The preamble illustrates this section by providing that the CEO and the three highest compensated officers may be determined from the information disclosed by the publicly held corporation on the summary compensation table. The preamble does not limit the definition of “covered employees” to individuals only disclosed on summary compensation tables that accompany proxy statements. Publicly held corporations always have “covered employees” when they are required to disclose the executive compensation of their officers on a summary compensation table (ex. upon filing a Form 10-K), regardless of whether they make the required disclosure.

Company X cites a number of PLRs in arguing that if an issuer does not file a summary compensation table, then the issuer does not have any “covered employees” for purposes of § 162(m). Company X’s reliance on the PLRs is inappropriate. Section 6110(k)(3) provides that PLRs may not be used or cited as precedent by any taxpayer other than the recipient of the ruling. See also Rev. Proc. 2008-1, § 11.02, 2008-1 IRB 50 (stating that taxpayers may not rely upon a PLR issued to another taxpayer).

Moreover, the PLRs reflect a view that is consistent with our position. 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. Company X misinterprets these PLRs to mean that if an issuer is not required to file a proxy statement, then the issuer does not have any “covered employees” for purposes of § 162(m). These PLR’s do not stand for the proposition that the proxy statement is the sole form of disclosure under the compensation disclosure rules that triggers covered employee status. The PLRs hold that if an issuer is required to report executive compensation of its officers pursuant to the compensation disclosure rules, then the issuer has covered employees for purposes of § 162(m). The form of the required disclosure of compensation is irrelevant. If a corporation is required to disclose the executive compensation of its officers pursuant to the compensation disclosure rules under the SEC regulations, then the issuer has covered employees for purposes of § 162(m).

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