

# Meridian Client Update

## Included in \$1.9 Trillion Covid-19 Relief Bill is a Modification to 162(m) of the Internal Revenue Code

The American Rescue Plan Act of 2021 (“ARP”), the massive \$1.9 trillion relief bill, includes a little noticed modification to section 162(m) of the Internal Revenue Code (“Code”). This modification would extend the \$1 million deduction limit under Code section 162(m) to additional high paid employees.

Although having no direct connection to Covid-19 relief matters, Congress included in ARP a modification of Code section 162(m). This modification will increase the number of employees whose compensation would be subject to the \$1 million deduction cap.

Current law bars a public corporation from taking a federal income tax deduction for compensation paid in excess of \$1 million to its CEO, CFO and three-highest paid executive officers other than the CEO and CFO (i.e., “Covered Employee”). In addition, once an individual is a Covered Employee, they remain a Covered Employee for the duration of their employment (irrespective of whether they remain an executive officer) and into retirement.

The modification to Code section 162(m) expands the definition of Covered Employee to include the five-highest paid employees of a public corporation other than the CEO, CFO and the three-highest paid executive officers. This modification becomes effective for tax years beginning after December 31, 2026 (“Effective Date”). Therefore, after the Effective Date, the term Covered Employee will include the following classes of employees:

- Any employee who served as CEO during the tax year
- Any employee who served as CFO during the tax year
- The three-highest paid executive officers (other than the CEO and CFO)
- The **five-highest paid employees** other than the CEO, CFO and three-highest paid executive officers

Unlike the other Covered Employees, an employee who is identified among the five-highest paid employees is not permanently classified as a Covered Employee. Rather, for each tax year, a public corporation will be required to identify those employees whose compensation places them among the five-highest paid employees of the corporation (other than the CEO, CFO and three-highest paid executive officers).

**Meridian comment.** The modification to Code section 162(m) will have a disparate impact among public corporations. As with other Covered Employees, the deduction cap will solely apply to those employees among the “five-highest paid employees” whose compensation exceeds \$1 million for a given tax year. Therefore, for some public companies, the deduction cap will not apply to any of its five-highest paid employees and, for other public companies, the deduction cap will apply to one or more of its five-highest paid employees.

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