



REJECT EXPANSION OF CODE SECTION 162(M)

A proposal passed by the Senate would expand the \$1 million deduction limit in Code section 162(m) to deny employer deductions for certain compensation payments to both current *and former* top officers of publicly-held companies, including payments already scheduled to be made under legally binding contracts. The proposal would also delink the determination of “covered employees” subject to the Code section 162(m) limit from the SEC proxy rules, which would create much ambiguity and result in serious unintended consequences. This proposal is significantly flawed and should be rejected.

Dollar caps in the tax laws create arbitrary results and skews behavior. Experience shows that imposing dollar limits under the tax laws skews behavior. Code sections 162(m) and 280G, which each impose tax penalties for exceeding certain compensation dollar limits, have been uniformly criticized as causing greater harm than benefit. Employers should be designing compensation systems to further their business goals rather than avoiding disincentives created by the tax laws.

Concerns about the size of compensation packages paid by corporations to top executives should not be addressed through the tax laws. At a Finance Committee hearing last fall, virtually all of the government and other witnesses who testified noted the negative effects caused by the \$1 million deduction limit in Code section 162(m). In fact, the Joint Committee on Taxation in its report on Enron recommended that section 162(m) be *repealed*. The Senate-passed proposal instead expands section 162(m) to apply to more individuals and for a longer period.

The proposed changes would apply retroactively. The proposed expansion of Code section 162(m) would apply even to amounts accrued before 2007 and payments that a company is already contractually obligated to make. Unlike the legislation in which the \$1 million deduction limit was originally enacted in 1993, there is no exception in the proposal for legally binding contracts under which a company is already obligated to pay compensation to an executive. Retroactively applying the expansion of the \$1 million limit will not affect the payment of amounts that a company is legally bound to make; instead, it will simply harm shareholders by raising taxes on corporate employers.

Delinking the limit from the SEC rules creates ambiguity and is bad policy. Under current law, the definition of covered employees subject to the \$1 million limit is linked to the SEC proxy rules. This has the effect of providing straightforward rules for calculating applicable compensation and targeting the rule at “executive officers” under the SEC rules who have significant policymaking authority. The Senate proposal would delink the definition of covered employees from the SEC rules, apparently because of changes in the comprehensive new SEC rules on executive compensation disclosures. This change is unnecessary and would create ambiguity as to the applicable definitions of “compensation” and “officer” to be used for these purposes. As a result, the number of covered employees could expand dramatically because the limit apparently would apply even to employees with no policymaking authority who just happen to be highly compensated (e.g., because of receipt of a large performance bonus) in a particular year.