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## CFOs Breathe Sighs of Relief: Notice 2007-49 Addresses Covered Employee Definition under Section 162(m)

2007-06-08

### Overview

Issued by the Internal Revenue Service (IRS) on June 4, 2007, Notice 2007-49 acknowledges the effect the new disclosure rules promulgated last year by the Securities and Exchange Commission (SEC) have on the determination of “covered employees” under Section 162(m) of the Internal Revenue Code (the Code). Rather than align the definition of a covered employee under Section 162(m) with the definition of “named executive officers” under the Securities and Exchange Act of 1934 (the Exchange Act), the IRS interprets covered employees to include a company’s principal executive officer (PEO) (within the meaning of the new disclosure rules) or an individual acting in such capacity, and the three highest-paid officers whose compensation is required to be reported under the Exchange Act (other than the PEO or the principal financial officer (PFO)). As a result, compensation paid to the PFO will not be subject to the deduction limitations under Section 162(m).

### Background

Section 162(m) limits to \$1 million the deduction a public company can take for compensation paid to its covered employees (unless an exception is available). Under Section 162(m), a covered employee is defined as any employee of a company if, (1) as of the close of the taxable year, such employee is the chief executive officer of the company or is an individual acting in such a capacity; or (2) 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 (other than the chief executive officer) for the taxable year. The regulations under Section 162(m) provide that such status will be determined pursuant to the executive compensation disclosure rules under the Exchange Act. Until the SEC amended the disclosure rules related to executive compensation on September 8, 2006, individuals whose compensation was required to be disclosed under the Exchange Act fell under the definition of a covered employee. However, under the final executive compensation disclosure rules, named executive officers include (1) a company’s PEO; (2) a company’s PFO; and (3) a company’s three most highly compensated executive officers other than the PEO and PFO. As a result, the definition of a covered employee includes one officer based on position and four officers based on compensation, while

the definition of a named executive officer now includes two officers based on position and three officers based on compensation.

#### **Notice 2007-49**

Notice 2007-49 was issued in order to address the inconsistency between Section 162(m) and the SEC's new disclosure rules. Effective immediately, for purposes of Section 162(m), the IRS will interpret the term "covered employee" to mean a PEO (within the meaning of the new SEC disclosure rules) or an individual acting in such capacity, or the three highest-paid officers (other than the PEO or PFO) whose compensation is required to be disclosed under the Exchange Act. Those individuals for whom disclosure is required under the new SEC disclosure rules by virtue of the individual's position as the company's PFO will not fall under this definition.

For more information on this or other tax matters, please see our [prior tax publications](#), or contact:

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