Published on *The National Law Review* https://natlawreview.com

Section 162(m) Final Regulations Clarify Grandfathering Rules to Compensation Payable under Account Balance and Nonaccount Balance Nonqualified Plans

Article By:

Christine M. Kong

Pubic companies that sponsor nonqualified deferred compensation plans with grandfathered benefits will want to be aware of helpful payment guidance in the Internal Revenue Code Section 162(m) final regulations. The final regulations, which were published in the Federal Register on December 30, 2020, implement amendments made to Section 162(m) by the Tax Cuts and Jobs Act (TCJA). The regulations adopt the Section 162(m) proposed regulations issued on December 20, 2019, with certain modifications.

Deferred compensation is typically provided under an account balance arrangement or a nonaccount balance arrangement. For both types of arrangements, deferred compensation is grandfathered (it is not subject to the TCJA amendments made to Section 162(m)) if the deferred compensation is payable under a written binding contract that was in effect on November 2, 2017, and that is not materially modified on or after that date.

To clarify the payment rules for grandfathered benefits under nonqualified plans, the final regulations provide as follows.

1. The grandfathered amount under an account balance plan is the amount that the company is obligated to pay under the terms of the plan as of November 2, 2017. If the company is obligated to pay the employee the account balance credited with earnings and losses and the company has no right to terminate or materially amend the plan, then the grandfathered amount would be the account balance as of November 2, 2017, plus any additional contributions and earnings and losses that the company is required to credit under the plan, through the date of payment. The final regulations contain analogous rules for nonaccount balance plans.

2. If an account balance plan with grandfathered benefits states that the company may terminate the plan and distribute account balances to employees, the grandfathered amount is the account balance determined as if the company had terminated the plan on November 2, 2017 or, if later, the earliest possible date the plan could be terminated (termination date). Whether additional contributions and earnings and losses credited to the account balance after the termination date and through the earliest possible date the account balance could have been

distributed to the employee are grandfathered depends on whether the plan requires the company to make those contributions or credit those earnings and losses. The final regulations contain analogous rules for nonaccount balance plans.

3. If an account balance plan with grandfathered benefits states that the company may not terminate the plan, but may cease future contributions and distribute the account balance, the grandfathered amount is the account balance determined as if the company had exercised its right to cease contributions on November 2, 2017 or, if later, the earliest permissible date the company could exercise that right under the terms of the plan (the freeze date). If the plan requires earnings and losses be credited on the account balance after the freeze date through the payment date, earnings and losses credited to the grandfathered account balance are also grandfathered. The final regulations contain analogous rules for nonaccount balance plans.

4. The final regulations include an alternative payment rule for grandfathered benefits in order to streamline plan administration. Under this alternative rule, the company may choose to treat the employee's account balance as of the termination date (or the freeze date, if applicable) as the grandfathered amount regardless of when the amount is paid and regardless of whether it has been credited with earnings or losses prior to payment. The final regulations contain analogous rules for nonaccount balance plans.

   As noted in the preamble to the final regulations, this alternative rule disregards earnings and losses between the termination date (or the freeze date) and the payment date in order to minimize the administrative burden of tracking earnings, losses and new contributions (if any) on an account balance plan or the increase or decrease in a nonaccount balance benefit after November 2, 2017.

5. The final regulations adopt the ordering rule in the 2019 proposed regulations for identifying grandfathered amounts when payments are made in installments. Under the ordering rule, the grandfathered amount is allocated to the first otherwise deductible amount paid under the plan. If the grandfathered amount exceeds the payment, the excess is allocated to the next otherwise deductible amount paid under the plan and this process is repeated until the entire grandfathered amount has been paid. This ordering rule is required for taxable years ending on or after December 20, 2019 (the publication date of the Section 162(m) proposed regulations). However, for taxable years ending before December 20, 2019, the final regulations allow a grandfathered amount to be allocated to the last otherwise deductible payment or to each payment on a pro rata basis for taxable years ending before December 20, 2019.

National Law Review, Volume XI, Number 14