## Covered Employees Under Section 162(m)(3)

## Notice 2007–49

PURPOSE

This notice provides guidance on identifying covered employees for purposes of § 162(m)(3) of the Internal Revenue Code.

BACKGROUND

Section 162(a)(1) allows as a deduction all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 162(m)(1) provides, in general, that in the case of any publicly held corporation, no deduction shall be allowed for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000.

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 Securities Exchange Act of 1934 by reason of such employee being among the 4 highest compensated officers for the taxable year (other than the chief executive officer).

Section 1.162–27(c)(2)(ii) of the Income Tax Regulations provides that whether an individual is the chief executive officer or among the four highest compensated officers (other than the chief executive officer) is determined pursuant to the executive compensation disclosure rules under the Exchange Act.

The Securities and Exchange Commission's ("SEC") rules relating to executive compensation disclosure under the Exchange Act are contained in Item 402 of Regulation S-K, 17 CFR 229.402. A final rule amending the SEC executive compensation disclosure rules was published in the Federal Register on September 8, 2006 (71 FR 53158) ("amended disclosure rules"). Among other things, the amended disclosure rules altered the composition of the group of executives that are covered by the disclosure rules. Like the pre-amendment disclosure rules ("old disclosure rules"), the amended disclosure rules refer to these executives as "named executive officers." Companies must comply with the amended disclosure rules for fiscal years ending on or after December 15, 2006.

Under the amended disclosure rules, named executive officers consist of, in relevant part, (i) all individuals serving as the registrant's principal executive officer or acting in a similar capacity during the last completed fiscal year ("PEO"), regardless of compensation level; (ii) all individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year ("PFO"), regardless of compensation level; and (iii) the registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year. Under the old disclosure rules, named executive officers consisted of, in relevant part, (i) all individuals serving as the registrant's chief executive officer or acting in a similar capacity during the last completed fiscal year ("CEO"), regardless of compensation level; and (ii) the registrant's four most highly compensated executive officers other than the CEO who were serving as executive officers at the end of the last completed fiscal year.

The definition of covered employee in § 162(m)(3) mirrored the definition of named executive officers under the old disclosure rules, but it is not the same as that definition under the amended disclosure rules. This is because the amended disclosure rules increase the number of executives who are named executive officers by virtue of their position from one to two, and reduce the number of executives who are named executive officers based on their compensation level from four to three. Thus, while the amended disclosure rules continue to require disclosure for five executive officers, two executives are now covered by the rules based on their positions, and three are covered by the rules based on their level of compensation. In contrast, a covered employee for purposes of § 162(m)(3) consists of only one executive officer based on his or her position and four officers based on their level of compensation.

Under § 162(m)(3) and § 1.162–27(c)(2)(ii), covered employees are determined by looking to the Exchange Act. Thus, guidance clarifying the meaning of covered employees is necessary because the definition in § 162(m)(3) does not track the definition of named executive officers in the amended disclosure rules. In particular, guidance is necessary because the amended disclosure rules (1) require disclosure for the principal executive officer, while the definition of covered employee in § 162(m)(3)(A) uses the term chief executive officer; (2) require disclosure based on compensation level for three executive officers, while the definition of covered employee in § 162(m)(3)(B) applies the deduction limitation by reason of compensation level to four officers; and (3) require disclosure with respect to the principal financial officer by reason of that officer's position (and not by reason of such officer being among the taxpayer's highest compensated officers), while the only officer within the scope of § 162(m) based on a specific position is the chief executive officer.

Accordingly, based upon the statutory language of § 162(m)(3), which has not been amended since the amended disclosure rules were promulgated, the following guidance is provided. The IRS will interpret 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 amended 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 3 highest compensated officers for the taxable year (other than the principal executive officer or the principal financial officer). Accordingly, the term covered employee for purposes of § 162(m) does not include those individuals for whom disclosure is required under the Exchange Act on account of the individual being the taxpayer's principal financial officer (within the meaning of the amended disclosure rules) or an individual acting in such a capacity.

The principal author of this notice is Jean Casey of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this notice, contact Jean Casey at (202) 622–6030 (not a toll-free call).

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## Guidance Regarding Deductions by Individuals for Qualified Conservation Contributions

## Notice 2007–50

PURPOSE

This notice provides guidance relating to the percentage limitations imposed by § 170(b)(1)(E) of the Internal Revenue Code (Code) on "qualified conservation contributions" made by individuals. Section 170(b)(1)(E) was added to the Code by section 1206(a)(1) of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (PPA), and is effective for contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008.

BACKGROUND

*A. Percentage limitations and carryover rules under § 170(b)(1) and § 170(d)(1) of the Code: General rules*

Section 170(a) of the Code generally allows a deduction, subject to certain limitations, for any charitable contribution (as defined in § 170(c)), payment of which is made during the taxable year. Section 1.170A–1(c)(1) of the Income Tax Regulations provides that the amount of a contribution of property is generally the fair market value of the property at the time of the contribution, subject to certain limitations in § 170(e).

The amount of charitable contributions that an individual may deduct in a taxable year is limited to the applicable percentage of the individual's contribution base, pursuant to § 170(b)(1). Section 170(b)(1)(G) provides that the term "contribution base" means the individual's adjusted gross income, computed without regard to any net operating loss carryback.

The applicable percentage of an individual's contribution base varies, depending on the donee organization and the property contributed. For example, for cash contributions made to organizations described in § 170(b)(1)(A), the applicable percentage is 50 percent. For cash contributions to organizations described in § 170(b)(1)(B), and contributions of capital gain property to organizations described in § 170(b)(1)(A), the applicable percentage is generally 30 percent. The term "capital gain property" is defined in § 170(b)(1)(C)(iv) as any capital asset or property which is property used in the trade or business (as defined in § 1231(b)) the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain.

Under § 170(b)(1) and (d)(1), any charitable contribution made during the taxable year in excess of the applicable contribution base generally is carried forward for up to 5 succeeding taxable years (after the contribution year) in order of time.

The total of all charitable contributions deducted in a taxable year may not exceed 50 percent of the individual's contribution base. The contributions that are deducted against the contribution base must follow the order of priority set forth in § 170(b)(1) and (d)(1). For example, if during a taxable year an individual makes a cash contribution and a capital gain property contribution to one or more organizations described in § 170(b)(1)(A), generally the cash contribution is taken into account before the capital gain property contribution in determining the allowable deduction for the year and any carryovers to future years. If the cash contribution equals 50 percent of the contribution base, the entire amount of the capital gain property contribution is carried forward for up to 5 succeeding taxable years (after the contribution year) in order of time. Furthermore, the capital gain property contribution carryover retains its character in the carryover years as a capital gain property contribution to which the 30 percent limitation applies. For additional details about the percentage limitations and carryover rules, see § 1.170A–8 and § 1.170A–10.

Different percentage limitations and carryover rules, which are not relevant here, apply to C corporations. See § 170(b)(2) and (d)(2).

*B. Changes to § 170(b)(1) made by § 1206(a)(1) of the PPA, applicable to qualified conservation contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008*

I. *General rule: 50 percent limitation*

Section 1206(a)(1) of the PPA added § 170(b)(1)(E) to the Code to increase the percentage limitations and carryover period applicable to qualified conservation contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008. Under § 170(b)(1)(E)(i), an individual may be allowed a deduction for any qualified conservation contribution to an organization described in § 170(b)(1)(A) to the extent the aggregate of such contributions does not exceed the excess of 50 percent of the individual's contribution base over the amount of all other charitable contributions allowed under § 170(b)(1) (the 50 percent limitation). Thus, the 30 percent limitation applicable to contributions of capital gain property under § 170(b)(1)(C) does not apply to qualified conservation contributions. If the aggregate amount of qualified conservation contributions exceeds the 50 percent limitation, § 170(b)(1)(E)(ii) provides that the excess will be treated (consistent with § 170(d)(1)) as a charitable contribution to which § 170(b)(1)(E)(i) applies in each of the 15 succeeding years in order of time.

II. *100 percent limitation applicable to certain qualified conservation contributions taken into account by individuals who are qualified farmers or ranchers*

Section 170(b)(1)(E)(iv) provides a special rule for a qualified conservation contribution taken into account by an individual who in the taxable year of the contribution is a qualified farmer or rancher, defined in § 170(b)(1)(E)(v) as a taxpayer whose gross income from the trade or business of farming (within the meaning of § 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year. For such an individual, § 170(b)(1)(E)(iv)(I) provides a general rule that the 50 percent limitation described above is increased to 100 percent (the 100 percent limitation).