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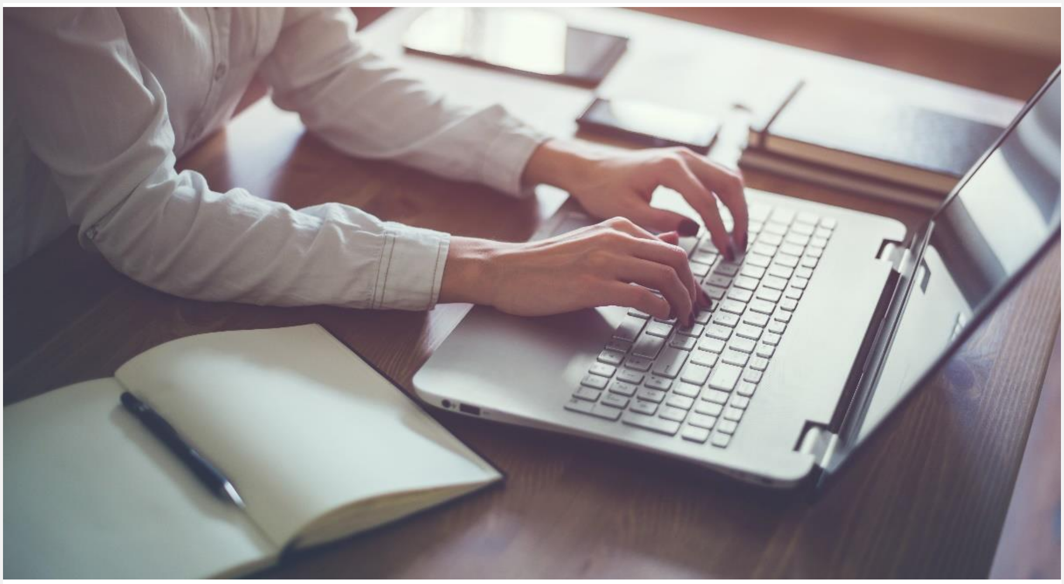

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IRS Issues Proposed Regulations to Implement ARPA Changes to Code Section 162(m) Cap on Deductible Compensation

The IRS has issued proposed regulations to implement changes made by the American Rescue Plan Act ("ARPA") of 2021 to Code Section 162(m), which generally imposes a $1 million limit on deductible compensation for "covered employees" of publicly held corporations.

Background

Briefly, ARPA amended Code Section 162(m) to expand the definition of "covered employee" to include the "5 highest compensated employees for the taxable year." This new category of "covered employee," which is codified at Code Sec. 162(m)(3)(C) and applies to taxable years beginning after December 31, 2026, will be in addition to:

a) anyone who was the principal executive officer (PEO) or principal financial officer (PFO) at any time during the taxable year,
b) the 3 highest compensated officers (other than the PEO or PFO) whose compensation must be reported to shareholders pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), and
c) anyone who was a "covered employee" pursuant to items a) or b) for any preceding taxable year beginning after December 31, 2016.

Summary

For purposes of identifying the "5 highest compensated employees," the proposed regulations would clarify that both common law employees and corporate officers would be taken into account.

In order to address IRS's concerns that publicly traded companies could use subsidiaries or a holding company structure to circumvent Congress's intent to significantly expand the number of "covered employees" for purposes of Code sec. 162(m), the proposed regulations would adopt similar rules to those in the current Code sec. 162(m) regulations relating to affiliated groups of corporations ("affiliated groups").

Specifically, the proposed regulations would provide that any employee of any corporation in an affiliated group may be one of the 5 highest compensated employees of the publicly held corporation even if the individual is otherwise an employee of a different company within the affiliated group.

If an employee of a publicly held corporation receives compensation from more than one affiliated group member, the proposed regulations would provide that compensation paid to the employee by each affiliated group member would be aggregated for purposes of determining if the employee is one of the 5 highest compensated employees.

If an affiliated group includes a foreign corporation, the proposed regulations would confirm that compensation paid by the foreign corporation that would otherwise be allowable as a deduction under the Code would also be taken into account for purposes of determining if an individual is one of the 5 highest compensated employees.

Proposed Effective Date

The proposed effective date would be for taxable years beginning after December 31, 2026, which is the same date Code section 162(m)(3)(C) will begin to apply. But if final regulations are not issued by December 31, 2026, the proposed effective date would be tax years beginning after final regulations are issued.

Comments on the proposed regulations are due by March 17, 2025.

IRS Provides Guidance on Tax Issues Related to State-Mandated Paid Family and Medical Leave Programs, But Not on those of Private Insured Programs

The IRS has published Revenue Ruling [2025-4] to provide guidance on the Federal income and employment tax treatment of contributions to, and benefit payments from, certain state paid family and medical leave ("PFML") programs. Unfortunately, the revenue ruling specifically does not offer any guidance on these issues as they relate to private family and medical leave programs that employers set up as a state-approved alternative to certain states' PFML programs, whether fully-insured or self-insured.

At least 13 states plus the District of Columbia have mandatory PFML programs. Most, but not all, permit employers to set up their own programs in lieu of the state program as long as they satisfy certain minimum requirements. Typically, these private programs can be funded through an insurance product or be self-insured by the employer.

Regardless of how the benefits are provided – i.e., directly through a state program or a private employer program – there are numerous tax-related questions, including:

- Can employers take a Federal deduction for mandatory contributions to the program or, in the case of a private plan, insurance premiums?
- Are mandatory employer contributions treated as taxable income to employees? Are they wages for purposes of employment taxes, like Social Security and Medicare?
- Are mandatory employee contributions, which are withheld from employees' paychecks, included in taxable income? What about wages?
- What happens if the employer pays some or all of employees' contributions on their behalf? Is the employer deduction still available? What are the tax consequences for employees?

- How about benefit payments? Are they taxable income? What about wages for employment tax purposes? If they are wages, who is responsible for the related withholding and reporting obligations?

Obviously, the answers to these questions could have significant tax implications for both employers and employees. Revenue Ruling 2025-4 provides some helpful guidance, but only with respect to state programs.

Key Takeaways from Rev. Rul. 2025-4

- Generally, employer contributions to a state program are deductible by the employer, but employee contributions are not excluded from either gross income or wages (for employment taxes) for the employee.
- Family leave benefits from the state are gross income, but not wages, for the employee.
- If the benefits are for medical leave, a portion will be excluded from gross income. The portion included in gross income is not treated as wages for employment tax purposes.
- The guidance also addresses the impact if the employer "picks up" the employee portion, and generally confirms that these contributions are deductible as ordinary and necessary business expenses.

IRS Delays Proposed Effective Date for Some Rules in Proposed RMD Regulations

The Internal Revenue Service ("IRS") announced that, in response to comments, it anticipates that it will delay until 2026 the effective date of certain provisions in proposed regulations on required minimum distributions ("RMDs") that were published in July 2024. Plans will now have at least a year to implement those specific provisions, and maybe longer depending on when the proposed regulations are issued in final form.

Background

In July 2024, the IRS published the long-awaited final RMD regulations, which reflected amendments to the RMD rules that were enacted as part of the SECURE Act of 2019 and the SECURE 2.0 Act of 2022 (SECURE 2.0). The final regulations went into effect on January 1, 2025. (See Rewards Policy Insider 2024-16 and 2024-18 for in-depth discussions of the final regulations.)

At the same time that it released the final RMD regulations, the IRS also released additional, new proposed regulations, which further update the RMD rules. The proposed regulations were needed because it was not possible to include all the changes from SECURE 2.0 in the 2024 final RMD regulations, since the 2024 final regulations were based on proposed regulations that were issued several months before Congress enacted SECURE 2.0 in late 2022. The additional proposed regulations addressed a wide range of RMD issues, including the provisions in SECURE 2.0 that changed the rules for qualifying longevity annuity contracts and reduced the penalty for failures to take an RMD.

Some, But Not All, Effective Dates Delayed

Initially, the IRS proposed that the effective date of the new proposed regulations would generally be the same as the final RMD regulations – i.e., January 1, 2025. The IRS received pushback on this proposed effective date because it meant that those new rules would go into effect a mere six months after being released. Many stakeholders commented that it would not be realistic for plans and plan administrators to implement the proposed regulations by the first of the year.

In response, on December 18, 2024, the IRS released Announcement 2025-2, which provides that certain provisions of the new proposed RMD regulations will apply no earlier than 2026. Importantly, this delay does not apply to all provisions in the proposed regulations, nor does it apply to any provisions in the 2024 final RMD regulations.

According to the IRS's announcement, the anticipated delay will apply *only* to the sections of the additional proposed RMD regulations that address the following topics:

- The rule addressing the treatment of RMDs by the beneficiary of a surviving spouse after the spouse's death;
- Certain aspects of the new rules permitting a surviving spouse to determine the amount of his or her RMDs using the Uniform Lifetime Table;
- The rule regarding the valuation of an annuity contract under the new partial annuitization option enacted by SECURE 2.0 (which already had a 2026 proposed effective date, so the Announcement actually has no effect here);
- The rule regarding treating distributions from in-plan Roth accounts during the individual's life as not counting towards satisfaction of the individual's lifetime RMD obligations;
- The rules governing the penalty for failing to take an RMD and corrective distributions to remedy such a mistake; and
- The rules addressing when a divorce or separation agreement may be used in lieu of a qualified domestic relations order for purposes of the RMD rules regarding annuity benefits to former spouses.

As a reminder, the IRS has not yet finalized the additional proposed RMD regulations. Thus, there could still be additional changes to those regulations – i.e., substantive changes and/or additional changes to the effective date – whenever they are finalized. The purpose of the Announcement is to inform plans that the above rules will apply, at the very least, no earlier than 2026.

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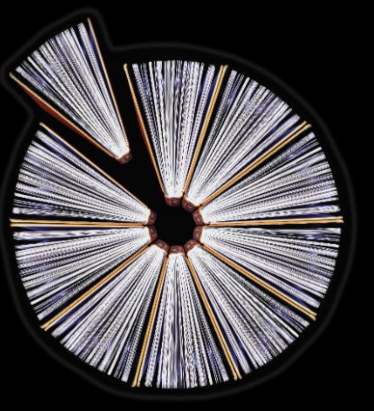

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