

## Part I

### Section 162(m)—Excessive Compensation

26 CFR 1.162-27(e)

Rev. Rul. 2008-13

#### ISSUE

Is compensation payable by a publicly held corporation to a covered employee (within the meaning of § 162(m)(3) of the Internal Revenue Code) considered “remuneration payable solely on account of attainment of one or more performance goals” under § 162(m)(4)(C) if the plan or agreement under which the covered employee is paid provides that the compensation will be paid upon attainment of a performance goal and also provides that the compensation will be paid without regard to whether the performance goal is attained in either of the following situations: (i) the covered employee’s employment is involuntarily terminated by the corporation without cause or the covered employee terminates his or her employment for good reason, or (ii) the covered employee retires.

#### FACTS

Company X is a publicly held corporation within the meaning of § 162(m)(2). X maintains a bonus plan (Plan) that pays a cash award (Award) to covered employee E if X’s earnings per share do not decrease during the calendar year, determined on December 31, 2009 (Performance Goal). In accordance with § 1.162-27(e)(2) of the Income Tax Regulations, X’s compensation committee established the Performance Goal in writing within 90 days after the commencement of the period of service to which the Performance Goal relates, and the Performance Goal satisfies § 1.162-27(e)(2)(ii) and (iii). In 2009, X’s earnings per share increase by seven percent.

#### Situation 1.

The Plan provides that the Award will be paid to covered employee E if the Performance Goal is attained. The Plan also provides that, even if the Performance Goal is not attained, the Award will be paid if covered employee E dies or becomes

disabled, or if X experiences a change of ownership or control. In addition, the Plan provides that the Award will be paid even if the Performance Goal is not attained if covered employee E is terminated by X without “cause” or if covered employee E voluntarily terminates his or her employment with X for “good reason.”

The definition of “cause” in the Plan is (i) an act of willful misrepresentation, fraud or willful dishonesty intended to result in substantial personal enrichment at the expense of X, (ii) willful misconduct with regard to X that was intended to have a material adverse impact on X, (iii) willful or reckless behavior that has a material adverse impact on X, (iv) willful failure to perform duties or follow written direction of the board of directors, or (v) conviction of, or pleading nolo contendere or guilty to a felony. The definition of “cause” does not include poor performance that does not involve one of the events described in the preceding sentence.

The definition of “good reason” under the Plan is the occurrence of any of the following, without the executive’s express written consent: (i) assignment of duties materially inconsistent with the executive’s current authorities, duties, responsibilities, and status, any reduction in the executive’s title, position, or reporting lines, or any material reduction in the executive’s status, authorities, duties, or responsibilities, (ii) relocation of the executive from the principal office of X or relocation of the principal office of X, (iii) reduction in the executive’s base salary, (iv) reduction in the executive’s overall level of participation in X incentive, benefit, or retirement plans, (v) failure of X to obtain assumption of the executive’s employment agreement from a successor of X, or (vi) any other material breach of the executive’s employment by X.

#### Situation 2.

The Plan provides that the Award will be paid to covered employee E if the Performance Goal is attained. The Plan also provides that the Award will be paid to covered employee E, even if the Performance Goal is not attained, if covered employee E dies or becomes disabled or if X experiences a change of ownership or control. In addition, the Plan provides that the Award will be paid to covered employee E even if the Performance Goal is not attained if covered employee E voluntarily retires during the calendar year.

#### LAW

Section 162(a)(1) allows as a deduction all 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 that in the case of any publicly held corporation, no deduction is allowed for applicable employee remuneration with respect to any covered

employee to the extent that the amount of the remuneration for the taxable year exceeds \$1,000,000.

Section 162(m)(3) provides that the term “covered employee” means any employee of the taxpayer if (i) 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 (ii) 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 162(m)(4)(A) defines “applicable employee remuneration,” with respect to any covered employee for any taxable year, generally as the aggregate amount allowable as a deduction for the taxable year (determined without regard to § 162(m)) for remuneration for services performed by the employee (whether or not during the taxable year).

Section 162(m)(4)(C) provides that applicable employee remuneration does not include any remuneration payable solely on account of the attainment of one or more performance goals, but only if (i) the performance goals are determined by a compensation committee of the board of directors of the taxpayer which is comprised solely of 2 or more outside directors, (ii) the material terms under which the remuneration is to be paid, including the performance goals, are disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before payment of such remuneration, and (iii) before any payment of such remuneration, the compensation committee referred to in clause (i) certifies that the performance goals and other material terms were in fact satisfied.

Section 1.162-27(b) provides that § 162(m) precludes a deduction under chapter 1 of the Internal Revenue Code by any publicly held corporation for compensation paid to any covered employee to the extent that the compensation for the taxable year exceeds \$1,000,000. Section 1.162-27(e)(1) provides that the deduction limit in § 1.162-27(b) does not apply to qualified performance-based compensation. Section 1.162-27(e)(1) further provides that qualified performance-based compensation is compensation that meets all of the requirements of § 1.162-27(e)(2) through (5).

Section 1.162-27(e)(2)(i) provides, in part, that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals.

Section 1.162-27(e)(2)(v) provides that compensation does not satisfy the requirements of § 1.162-27(e)(2) if the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained and that, if the payment of compensation under a grant or award is only nominally or partially contingent on attaining a performance goal, none of

the compensation payable under the grant or award will be considered performance-based. Section 1.162-27(e)(2)(v) further provides that compensation does not fail to be qualified performance-based compensation merely because the plan allows the compensation to be payable upon death, disability, or change of ownership or control, although compensation actually paid on account of those events prior to the attainment of the performance goal would not satisfy the requirements of § 1.162-27(e)(2).

The IRS and Treasury have not previously issued any guidance on which taxpayers are entitled to rely that explicitly addresses the situations described in this revenue ruling.

## ANALYSIS

Under § 162(m)(4)(C) and § 1.162-27(e), compensation is not considered applicable employee remuneration, and thus is not subject to the \$1,000,000 limit in § 162(m)(1), if it satisfies the requirements for “qualified performance-based compensation.” Among these requirements is that the compensation is payable “solely” on account of the attainment of one or more performance goals. Under § 1.162-27(e)(2)(v), compensation is not performance-based if the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained. Section 1.162-27(e)(2)(v) provides further that compensation does not fail to be qualified performance-based compensation merely because the plan allows the compensation to be payable upon death, disability, or change of ownership or control.

### Situation 1.

A covered employee’s termination without “cause” or for “good reason” is not listed as a permissible payment event under § 1.162-27(e)(2)(v). As defined in the Plan, involuntary termination without “cause” may occur or a “good reason” (e.g., a reduction in title or base salary) may arise as a result of covered employee E’s poor performance and failure to meet the Performance Goal. Therefore, under the facts and circumstances analysis, the compensation is not “remuneration payable solely on account of the attainment of one or more performance goals,” as required by § 162(m)(4)(C).

### Situation 2.

Voluntary retirement is not listed as a permissible payment event under § 1.162-27(e)(2)(v). Because retirement generally is a voluntary action within the control of the covered employee, the compensation is not “remuneration payable solely on account of the attainment of one or more performance goals,” as required by § 162(m)(4)(C).

## HOLDINGS

### Situation 1.

The Award is not qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e)(2).

### Situation 2.

The Award is not qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e)(2).

## APPLICATION

Pursuant to § 7805(b)(8), the holdings in this revenue ruling will not be applied to disallow a deduction for any compensation that otherwise satisfies the requirements for qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e) and that is paid under a plan, agreement, or contract that has payment terms similar to the terms described in this revenue ruling if either (i) the performance period for such compensation begins on or before January 1, 2009 or (ii) the compensation is paid pursuant to the terms of an employment contract as in effect (without respect to future renewals or extensions, including renewals or extensions that occur automatically absent further action of one or more of the parties to the contract) on February 21, 2008. For purposes of the preceding sentence, the performance period for such compensation is the period of service to which the performance goal applicable to such compensation relates. The relief under this paragraph does not extend to other issues under § 162(m) or to any other provision of the Code.

## DRAFTING INFORMATION

This revenue ruling was prepared by Ken Griffin of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Mr. Griffin at (202) 622-6030 (not a toll-free call).