

# Client Alert

March 1, 2008

## Update to Client Alert on Section 162(m) of the Internal Revenue Code

The IRS has confirmed reversal of its longstanding position regarding the tax treatment of awards that may be accelerated following an involuntary termination. The effect will be to disqualify as "performance-based compensation" such awards, which previously had been treated as tax-deductible under Section 162(m).

PM&P's previous **Client Alert** [<http://pearlmeyer.com/knowledgecenter/alerts/Deductability.pdf>] had described a recent Private Letter Ruling (PLR) that discussed employment agreements that provide for automatic payment of awards at the "target" level when employment is terminated without cause or with good reason. The IRS had stated that such performance awards would *not* qualify as "performance-based compensation" under Section 162(m), regardless of whether the performance goals were attained, because the payouts were not based solely on attainment of one or more performance goals.

The IRS subsequently was pressed by many companies, lawyers, accountants, consultants and other commentators to further clarify and provide guidance as to whether the Service had indeed reversed its historic position. On February 21, 2008, the IRS released Revenue Ruling 2008-13, confirming its new position and clarifying the breadth and transitional impact of the new position.

### Breadth of Coverage:

Under the new Revenue Ruling, compensation will not be treated as performance-based for purposes of the 162(m) exemption from the \$1 million limit if it may be paid, regardless of performance achieved, upon termination of employment:

- By the company without "cause"
- By the executive with "good reason"
- By the executive due to retirement (an added disallowance trigger that was not addressed in the recent PLR)

A plan that contains these accelerated payment triggers will not qualify for the performance-based compensation exception, even if the acceleration never takes place and the award is eventually paid out based on performance. A plan that merely provides for accelerated payment based on death, disability or change-in-control, however, may still qualify for the performance-based compensation exception if the award is ultimately paid out based on performance achieved.

### Transition Rules:

The IRS provides two types of transitional relief for plans and arrangements. A deduction will be allowed for plans and arrangements that otherwise qualify as performance-based compensation under Section 162(m) as long as:

- The performance period for such compensation begins on or before January 1, 2009, or
- The compensation is paid pursuant to an employment agreement as in effect (excluding automatic and intentional renewals) on February 21, 2008.



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