

## *Client Alert*

# Transition Relief Issued for the Deductibility of Your Company's Performance-Based Compensation

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*The IRS Offers Companies Some Time to Get Their Plans and Agreements in Order to Preserve Deductibility under Section 162(m).*

On February 21<sup>st</sup>, in response to a large outcry over the potential implications of a recent Private Letter Ruling (PLR 200804004) for existing compensation arrangements (see our *Client Alert – Your Company's Performance-Based Compensation Might Not Be Deductible\**, February 14, 2008<sup>1</sup>) the IRS issued Revenue Ruling 2008-13 (RR 2008-13) that softens the potential impact on outstanding compensation from PLR 200804004. RR 2008-13 indicates that, in general, the principles of PLR 200804004 will be applied on a prospective basis.

In RR 2008-13, the IRS reaffirms the conclusions reached in PLR 200804004:

- 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**.
- Compensation would fail to be “qualified performance-based compensation” if it **could be payable**:
  - Upon the employee’s termination without “cause” or for “good reason”, or
  - Upon the employee’s voluntary retirement.

However, RR 2008-13 does provide transition relief which will cause these positions to be applied on a prospective basis. Specifically, the revenue ruling’s holdings will not be applied to disallow a deduction for compensation that otherwise qualifies as “qualified performance-based compensation” if either:

- The **performance period** for such compensation **begins on or before January 1, 2009**, or
- The compensation is **paid pursuant to the terms of an employment agreement as in effect** (without respect to future renewals or extensions, including automatic renewals and extensions without any further action of the executive or company) **on February 21, 2008**.

### *Implications*

Revenue Rulings have broad application, unlike private letter rulings which generally only can be relied on and apply to the taxpayers who requested them. Consequently, the fact that RR 2008-13 affirms the conclusions reached in PLR 200804004 means that they will definitely apply to more than just the taxpayer who requested PLR 200804004. The one silver lining to be found in all of

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<sup>1</sup> [http://www.exqty.com/Media/Publications/Exequity%20Client%20Alert\\_162m%20and%20Emp%20Agmts\\_2008-02-14.pdf](http://www.exqty.com/Media/Publications/Exequity%20Client%20Alert_162m%20and%20Emp%20Agmts_2008-02-14.pdf)

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this is that the IRS is allowing for the prospective application of the holdings in RR 2008-13. For calendar year taxpayers running annual bonus plans that are qualified under Section 162(m), the Revenue Ruling generally will give them until their 2010 annual bonus year before they will need to be in full compliance with these requirements. Companies could possibly even have a longer period depending on the provisions of their executives' employment agreements as existed on February 21, 2008.

Left unclear by the Revenue Ruling are the implications for "performance based compensation" under Code Section 409A. The underlying theory which disqualifies the bonus compensation as "performance-based compensation" for purposes of Section 162(m), could ostensibly be applied to "performance-based compensation" in the context of Section 409A. A close reading of the Revenue Ruling finds no reference to Section 409A. We hope the IRS extends the transition rule which is offered for Section 162(m) purposes to performance based compensation for purposes of Section 409A. However, without further guidance, this will remain a gray area which companies should review to determine if they need to take any immediate action for purposes of Section 409A prior to the end of the transition period offered for purposes of Section 162(m).

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