

Client Alert

IRS Proposes New Code Section 162(m) Regulations

EXEQUITY

Independent Board and
Management Advisors

The IRS recently released new proposed regulations under Code Section 162(m).¹ Comments are due by September 22, 2011. These proposed regulations clarify:

- What companies must **do** in order to successfully utilize the **performance-based compensation exception** to the Code Section 162(m) limit; and
- What compensation can qualify for the **IPO compensation relief** from Code Section 162(m).

Performance-Based Compensation Exception

The proposed regulations clarify that the plan under which stock options or a stock right is granted must specify the maximum number of shares with respect to which options or rights may be granted to any individual employee during a specified period. In effect, this means that a plan cannot only have an overall maximum number of shares stated and comply with the requirements for the performance-based compensation exception. The plan must also have a per-employee limitation set out.

Additionally, the proposed regulations clarify the shareholder approval requirement for the performance-based compensation exception. Specifically, the requirement for a description of the compensation to be provided to shareholders is satisfied where the maximum number of shares for which grants may be made to each individual employee during a specified period and the exercise price of those options are disclosed to shareholders.

IPO Compensation Relief

The proposed regulations indicate that the companies that become publicly held and can rely on the IPO relief from Code Section 162(m) can only do so for the types of compensation that are specifically listed in the regulations. The regulations specifically provide that the IPO compensation relief applies to any compensation received pursuant to the exercise of a stock option or stock appreciation right, or the substantial vesting of restricted property, granted under a plan or agreement which existed during the period when the company was not publicly held if the grant occurs on or before the earliest of the expiration of the plan, the material modification of the plan, the issuance of all the stock under the plan, or the first shareholder meeting at which directors are elected after the close of the third calendar year following the calendar year in which the IPO occurs.

¹ Published in the *Federal Register*, June 24, 2011, Vol. 76, No. 122, available at <http://www.gpo.gov/fdsys/pkg/FR-2011-06-24/pdf/2011-15653.pdf>

Only compensation attributable to stock options, stock appreciation rights, and restricted property is covered by the IPO compensation relief from Code Section 162(m). Thus, compensation from restricted stock units, performance units, and phantom stock cannot qualify for the IPO compensation relief.

Comment: None of the clarifications included in the proposed regulations are that significant given typical practice. Most companies already include both an overall maximum and a per-employee limitation for equity awards in their plan documents. Additionally, awards of restricted stock units and phantom stock ordinarily would not be exempt from the Code Section 162(m) limit unless they qualified under an exception, e.g., the performance-based compensation exception, to avoid application of the Code Section 162(m) limit to compensation from such awards.



If you have any questions about this **Client Alert**, please contact Ed Hauder ((847) 996-3990 or Edward.Hauder@exqty.com) or any of the following:

Robbi Fox	(847) 948-8655	Robbi.Fox@exqty.com
Mark Gordon	(925) 478-8294	Mark.Gordon@exqty.com
Jeff Hyman	(203) 210-7046	Jeff.Hyman@exqty.com
Lynn Joy	(847) 996-3963	Lynn.Joy@exqty.com
Stacey Joy	(847) 996-3969	Stacey.Joy@exqty.com
Chad Mitchell	(949) 748-6169	Chad.Mitchell@exqty.com
Perry Papantonis	(908) 849-4858	Perry.Papantonis@exqty.com
Jeff Pullen	(847) 996-3967	Jeff.Pullen@exqty.com
Dianna Purcell	(718) 273-7444	Dianna.Purcell@exqty.com
Bob Reilley	(856) 206-9852	Bob.Reilley@exqty.com
Dmitry Shmoys	(949) 748-6132	Dmitry.Shmoys@exqty.com
Mike Sorensen	(847) 996-3996	Mike.Sorensen@exqty.com
Jim Woodrum	(847) 996-3971	Jim.Woodrum@exqty.com
Ross Zimmerman	(847) 996-3999	Ross.Zimmerman@exqty.com

Illinois Office (Headquarters) – 1870 West Winchester Road, Suite 141 • Libertyville, IL 60048

California Offices – 18201 Von Karman, Suite 460 • Irvine, CA 92612

– 2840 Comistas Drive • Walnut Creek, CA 94598

Connecticut Office – 108 Pine Ridge Road • Wilton, CT 06897

New Jersey Office – 3 Werner Way, Suite 300 • Lebanon, NJ 08833

www.exqty.com

You are receiving this **Client Alert** as a client or friend of Exequity LLP. This **Client Alert** provides general information and not legal advice or opinions on specific facts. If you did not receive this directly from us and you would like to be sure you will receive future **Client Alerts** and our other publications, please click on the following link to add yourself to our subscription list: <http://www.exqty.com/References/Subscribe.aspx>. If you want to unsubscribe from our list, please click on “Manage Subscription” at the bottom of the e-mail sent to you.