

IRS grants 162(m) relief

Less than a month after releasing a private letter ruling (PLR 200804004) that questioned the deductions many public corporations have been claiming for “performance-based compensation” (see Ropes & Gray’s [February 8 alert](#)), the IRS, responding to an outcry from the practitioner community and others, has delayed the effective date of its new rule.

PLR 200804004 concluded that an otherwise performance-based executive incentive (e.g., an annual bonus based on company financial results) cannot qualify for the “performance-based compensation” exception to the \$1 million deduction limit under Section 162(m) of the Internal Revenue Code if the executive, on an involuntary termination, would be entitled to a target payment without regard to actual performance results. Based in part on earlier PLRs, many public companies have plans and agreements that provide severance protection of precisely the type challenged in PLR 200804004. Commentators pointed out that the IRS’s new position could have immediate and severe financial statement, public disclosure and plan/award design implications for these companies.

In Rev. Rul. 2008-13, the IRS has reaffirmed its PLR 200804004 analysis and conclusions but has agreed that its new rule will apply only prospectively. The IRS will not apply the new rule to arrangements that otherwise qualify for exemption from the Section 162(m) deduction limitation if either (i) the relevant performance period (that is, the service period to which the performance goal relates) begins on or before January 1, 2009, or (ii) the compensation is paid pursuant to an employment contract as in effect (without regard to future renewals or extensions) on February 21, 2008. The relief thus covers prior awards and gives many employers nearly two years to amend their plans (longer, in some cases where long-term employment contracts are in place).

The relief offered by Rev. Rul. 2008-13 should be an immediate help to companies that are now in the process of drafting proxy statement disclosure, including the “compensation discussion and analysis,” or that are establishing the terms of awards to be made for award periods beginning in 2008.

Contact Information

For more information regarding Rev. Rul. 2008-13, please contact a member of the Tax & Benefits Department.

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