

Section 162(m) Reminder: Shareholders May Need to Reapprove Certain Compensation Plans Every Five Years

Section 162(m) of the Internal Revenue Code limits to \$1 million the deduction that certain publicly held corporations may claim in any year for compensation to the CEO or any of the three most highly paid named executive officers other than the CEO or the CFO. An important exception makes the deduction limitation inapplicable to “performance-based” compensation under qualifying shareholder-approved plans.

The Section 162(m) regulations require that, where an arrangement depends upon the achievement of specific performance goals set by the compensation committee from among performance criteria approved by the shareholders, the material terms of the arrangement—including the performance criteria—must be disclosed to and reapproved by the corporation’s shareholders not less frequently than every five years.

Corporations should review their plans intended to qualify for the performance-based exception from Section 162(m) to determine if shareholder action needs to be taken in an upcoming proxy season. For companies that had performance-based plans approved in 2005, the disclosure and reapproval would generally need to occur this year (2010).

The rules under Section 162(m) are detailed and complex, and the above reminder relates to only one of the many potentially applicable rules. If you have any questions regarding Section 162(m), please contact any member of the Tax & Benefits Department or your usual Ropes & Gray advisor.

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