

PUBLIC COMPANY EMPLOYMENT AGREEMENTS MAY NEED TO BE AMENDED BEFORE 2010

BACKGROUND

Section 162(m) of the Internal Revenue Code generally prohibits a publicly held corporation from deducting compensation paid to certain highly paid employees to the extent it exceeds \$1 million in one year, unless the compensation constitutes “qualified performance-based compensation” or meets one of the limited number of other exceptions.

Among other requirements, performance-based compensation must be paid solely on account of the attainment of one or more predetermined, objective performance goals. The regulations under Section 162(m) provide that compensation does not fail to be performance-based merely because it can be paid upon the employee's death or disability or a change in ownership or control of the employer before the end of the performance period. However, compensation paid as a result of one of those events before the specified performance goals are met would not qualify for the performance-based exception.

In January 2008 the IRS issued a private letter ruling¹ which stated that a bonus payable under an executive employment agreement did not qualify as performance-based compensation under Section 162(m) because the agreement provided that in the event of the executive's termination of employment without cause, any performance goal would be treated as having been achieved and the awards would vest to the extent such awards would have become vested had the executive's employment continued for two years. The IRS ruled that this "deemed vesting" provision meant that the bonus was not payable solely on account of the attainment of the stated performance goals, and therefore failed to qualify as performance-based compensation, even if the contingency (termination without cause) did not occur.

The 2008 ruling represented a reversal of the IRS' previous position regarding the effect of these types of clauses², and tax professionals urged the IRS to reverse the position taken in the 2008 ruling or, at minimum, to apply it prospectively only. In response the IRS issued Revenue Ruling 2008-13, which affirmed the position taken in the new private ruling, but provided transition relief for any agreements or contracts for which the performance period began on or before January 1, 2009, and for compensation paid pursuant to an employment agreement in effect on February 1, 2008. **In other words, for most public companies operating on a calendar year basis, Revenue Ruling 2008-13 will apply to performance periods beginning on or after January 1, 2010.**

WHAT PUBLIC COMPANIES SHOULD DO

Companies subject to the \$1 million compensation deduction limitation should review all of their employment agreements and bonus plans that may be subject to Section 162(m) before January 1, 2010 to ensure that they comply with Revenue Ruling 2008-13. If you have any questions regarding this Alert or any other executive compensation issues, please contact Robert Patterson at 716.843.3910 / rpatterson@jaeckle.com, or Michele Heffernan at 716.843.3850 / mheffernan@jaeckle.com.

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¹ PLR 200804004 (1/25/2008).

² E.g. PLR 200613012 (3/31/2006).