

ALERT

EXECUTIVE COMPENSATION

February 2008

IRS Changes Position on Performance-Based Compensation for Public Companies

The Internal Revenue Service (IRS) has taken a new position under Section 162(m) of the Internal Revenue Code as it relates to the deductibility by a public company of “qualified performance-based compensation” paid to its highly compensated employees.

Section 162(m) of the Internal Revenue Code limits a public company’s ability to deduct compensation to the company’s Chief Executive Officer and its other four highest-compensated employees. That limit is \$1 million for each such employee per year. A public company can deduct in excess of that \$1 million amount if it pays the compensation to such employee in the form of “qualified performance-based compensation,” as defined under rules set forth in Section 162(m).

This new position by the IRS changes its historical position regarding one of those rules. Compensation will no longer qualify as “qualified performance-based compensation” if the compensation could be paid (without attaining the performance goals) upon the employee’s termination without cause, resignation for good reason or retirement. According to the IRS, having this type of provision disqualifies an arrangement as “qualified performance-based compensation” even if the performance goals are otherwise satisfied.

The IRS indicated that the new ruling will be applied prospectively. In addition, the IRS has granted some transition relief to allow public companies limited time to become compliant with the new rule. The IRS has also grandfathered certain employment agreements.

For more information on how this new rule can affect your current compensation arrangements and how to revise those arrangements to comply with the new rule, please contact **Jeffrey A. Hopper**, Partner, at jhopper@btlaw.com or 317-231-7552; or **Michael G. Paton**, Partner, at mpaton@btlaw.com or 317-231-7201.

This Barnes & Thornburg LLP publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer on any specific legal questions you may have concerning your situation.

Please send address changes or requests to opt in or out of these alerts to jodie.daugherty@btlaw.com.