

# Executive Compensation Alert: Action Required for 2010 162(m) Performance Pay

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## Background

Section 162(m) of the Internal Revenue Code (the “Code”) denies a tax deduction to a public company if compensation paid to certain individuals (known as “covered employees”) exceeds one million dollars for the taxable year. However, compensation that is “performance-based” within the meaning of Code Section 162(m) is deductible by the public company for tax purposes. A “covered employee” is defined as a public company’s Chief Executive Officer and its three other most highly compensated officers (excluding the CFO) whose compensation is required by the SEC to be disclosed for a given year.

## New Ruling

On February 21, 2008 the IRS released Revenue Ruling 2008-13 (discussed previously in our earlier alert at [http://www.fenwick.com/docstore/Publications/Corporate/Execu\\_Comp\\_02-22-08.pdf](http://www.fenwick.com/docstore/Publications/Corporate/Execu_Comp_02-22-08.pdf)). Revenue Ruling 2008-13 ruled that compensation paid by a public company that is intended to constitute “performance-based” compensation (such as a covered employee’s bonus) under Code Section 162(m) does not include compensation payable in the event of a covered employee’s: (1) retirement, (2) termination without cause, or (3) termination for good reason, without taking into account whether the relevant performance metrics had been satisfied.

## Transition Period

While Revenue Ruling 2008-13 reversed the IRS’s prior position on these issues, the Ruling nonetheless provides public companies with a transition period. Namely, Ruling 2008-13 does not apply (1) where the performance period in question began on or before January 1, 2009 or (2) the amount intended to qualify as performance-based compensation is paid under an employment contract that was in effect on February 21, 2008.

## What Public Companies Should Do

The performance period for calendar year public companies is coming to a close and public companies that maintain bonus arrangements that are intended to be “performance-based” compensation for Code Section 162(m) purposes need to review such programs to ensure that these bonuses are not paid upon a termination without cause, for good reason or because of retirement, without regard to whether the applicable performance metrics were satisfied. Also, public companies should review current employment agreements in existence on February 21, 2008 that contain automatic renewals or contain an expiration date. There are potential solutions that can be put in place that will result in deductibility, but companies must act before 2010 bonus metrics are formulated and communicated by compensation committees.

For more information, you may contact any attorney in the Executive Compensation and Employee Benefits Group.

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