

IRS Releases Revenue Ruling 2008-13 Adopting Position That Performance Based Compensation Is Non-Excludible Under 162(m) If Also Payable On Termination Without Cause, For Good Reason Or For Voluntary Retirement – But Prospective Application

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Update to our Client Alerts of [February 8, 2008](#) and [February 14, 2008](#)

On February 21, 2008, the IRS released [Revenue Ruling 2008-13](#), confirming the position taken in PLR 200804004 that compensation intended to qualify as deductible performance-based compensation pursuant to Section 162(m) of the Internal Revenue Code of 1986, as amended, will not qualify as such if the recipient's employment agreement provides for payment of the performance compensation upon a termination of employment without cause or for good reason, even if the performance metrics applicable to such compensation are satisfied.

Revenue Ruling 2008-13 provides that if otherwise performance-based compensation is also payable to the executive on a termination of employment (i) without cause, (ii) for "good reason" or (iii) due to voluntary retirement (this is an expansion on PLR 200804004), such compensation is not classifiable as performance-based compensation and will not be deductible under Section 162(m) if compensation exceeds one million dollars in the taxable year.

The good news is that this Revenue Ruling is prospective, it is not retroactive. The IRS's position as announced in the Revenue Ruling will not apply with respect to (i) compensation for performance periods that begin on or before January 1, 2009, or (ii) compensation under an employment contract in effect on February 21, 2008 (without respect to future renewals or extensions, including renewals or extensions that occur automatically absent further action of one or more of the parties to the contract).

What is Section 162(m)?

Section 162(m) denies a tax deduction to a company if compensation paid to certain individuals (known as "covered employees") exceeds one million dollars for the taxable year, but compensation that is "performance-based" within the meaning of Section 162(m) is excepted from this limit. Section 162(m) applies only to public companies. A "covered employee" is defined as the public company's Chief Executive Officer and its 3 other most highly compensated officers (excluding the CFO) whose compensation is required by the SEC to be disclosed for a given year.

What Should Companies Do?

Public company employers need to review their outstanding compensation arrangements, plans and employment contracts that are intended to provide performance-based compensation or that permit the payment of such compensation upon certain events (a common example being the acceleration of performance-based restricted stock units upon a covered employee's termination of employment without cause, even if the performance factors applicable to such restricted stock units is not satisfied) to determine whether such arrangement may require amendment in light of Revenue Ruling 2008-13.

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