

## IRS Clarifies That Dividends and Dividend Equivalents Must Separately Satisfy Section 162(m) as Performance-Based Compensation

10 July 2012

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The Internal Revenue Service recently released Revenue Ruling 2012-19 to clarify that dividends and dividend equivalents granted in connection with restricted stock or restricted stock units (“RSUs”) that are considered performance-based compensation for purposes of Code Section 162(m) must also separately satisfy the requirements under Code Section 162(m) to be treated as performance-based compensation excludible from the deduction limitation set forth in Code Section 162(m).

Under Code Section 162(m)(1), publicly held corporations cannot deduct the remuneration of a “covered employee” in excess of \$1 million. A “covered employee” for this purpose is generally the chief executive officer, and the three most highly paid officers other than the chief executive officer or chief financial officer. However, performance-based compensation is excluded from this deduction limit if certain requirements under Treas. Reg. § 1.162-27(e) are met.

Under the Revenue Ruling, dividend and dividend equivalents are considered to be qualified performance-based compensation under Code Section 162(m) if the participant’s rights to these amounts vest and become payable only upon satisfaction of established performance goals that meet Code Section 162(m)’s requirements. In this situation, the dividends and dividend equivalents are *excluded* from the \$1 million deduction limitation under Code Section 162(m)(1). However, the performance goals applicable to the dividend or dividend equivalents do not have to be the same as the performance goals for the related restricted stock or RSUs.

In contrast, dividends and dividend equivalents that do not vest and become payable solely on account of the attainment of established performance goals that meet Code Section 162(m)’s requirements are not considered to be qualified performance-based compensation and, accordingly, are counted toward the \$1 million deduction limitation.



Companies should consider the structure of their dividend and dividend equivalent payments in relation to restricted stock and RSU grants in order to maximize their tax deduction.

If you have any questions regarding this Revenue Ruling, Code Section 162(m), or any other executive compensation-related questions, please contact one of the authors listed, or the Reed Smith attorney with whom you usually work.

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