



IRS Confirms Position That Certain Incentive Awards Are Not Performance-Based

In Revenue Ruling 2008-13, the IRS adopts the position it took in a recent private letter ruling that an incentive agreement providing for payment upon termination without cause or for good reason, or upon retirement, does not provide performance-based compensation for purpose of deductibility under Section 162(m). However, the ruling does provide some relief for awards related to performance periods beginning on or before January 1, 2009 or for compensation paid under an employment contract in effect on February 21, 2008.

Background

Under Section 162(m) of the Internal Revenue Code, companies may only deduct up to \$1,000,000 of compensation to certain high-level employees, unless the compensation is performance-based. In a recent private letter ruling, the IRS reversed the position it took in previous private letter rulings with respect to whether certain incentive arrangements provided performance-based compensation. (See our February 7, 2008 [For Your Information](#).) As this change in position would have a significant effect on many existing executive employment agreements and incentive award plans (e.g., non-deductibility of large amounts of compensation, accounting issues), there was an immediate request for relief from a large number of law firms and other interested parties. The IRS has now issued [Revenue Ruling 2008-13](#), which adopts the position in its recent private letter ruling but provides transition relief for certain existing arrangements.

Revenue Ruling 2008-13

As in the private letter ruling, the IRS addresses a plan that pays an award when certain performance criteria are met, or upon the employee's death or disability, or a change of control or ownership (i.e., permissible events which will not affect a payout's status as performance-based), or upon the employee's termination without cause, voluntary termination with good reason, or retirement. The IRS ruled that because the plan provides for payment upon terminations without cause or for good reason or upon retirement regardless of whether the performance criteria are met, and because these events are not among the permissible payout events, then awards under the plan are not payable "solely" as a result of attaining a performance goal and do not qualify for the performance-based exception.

However, the IRS does provide transition relief for compensation paid under similar plans in either of the following circumstances –

- The performance period for the compensation begins on or before January 1, 2009.
- The compensation is to be provided under an employment contract in effect on February 21, 2008 (but not with respect to any automatic or other renewals or extensions).

Conclusion

The result in the ruling will present difficulties for many employers. Many plans and agreements will have to be reviewed and modified, and shareholder approvals may be required. The transition relief is welcome but limited and, in some cases, more time may be needed to accomplish the necessary changes.

Buck's consultants would be pleased to discuss the effects of this ruling on your incentive plans and arrangements.

This FYI is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic.