
Public Companies Face Deadline to Amend Incentive Pay and Preserve Tax Deductions

by Scott E. Landau and Bradley A. Benedict

Section 162(m) of the Internal Revenue Code limits a public company's income tax deduction for compensation paid to the Chief Executive Officer and the three most highly compensated executive officers other than the Chief Executive Officer and the Chief Financial Officer. The annual tax deduction is generally capped at \$1 million per officer, but "performance-based compensation" is exempt from the \$1 million limit. Many public companies structure their incentive bonus plans and arrangements to take advantage of this exemption.

In Revenue Ruling 2008-13, the Internal Revenue Service ruled that an incentive pay arrangement providing payments upon termination of employment without cause or for good reason, or upon voluntary retirement, can lose the "performance-based compensation" exemption if such payments can be made without regard to whether performance goals are actually achieved. For example, if payments to be made on termination of employment are based on the officer's "target" bonus rather than on what he or she would have earned based on actual performance, then the officer's bonus arrangement is not exempt from the \$1 million deduction limit—even if the officer remains employed and is actually paid a bonus based on actual performance results. For a full explanation of these rules, see our March 4, 2008 Client Alert, *IRS 162(m) Ruling Requires Review of Incentive Pay Arrangements*.

As noted in our prior Client Alert, the IRS delayed application of the Revenue Ruling to allow companies relying on its earlier guidance to make appropriate changes to their compensation arrangements. Specifically, no deduction will be disallowed solely because of the payment provisions noted above if (i) the applicable performance period began on or before January 1, 2009 or (ii) the amount is paid under an agreement in effect on February 21, 2008 (excluding renewals or extensions, whether affirmative or automatic).

Many public companies, however, will have to comply with the Revenue Ruling for incentive plans and arrangements having a 2010 performance period. Public companies should review their executive employment agreements and compensation plans and arrangements to determine whether any modifications are needed to ensure the deductibility of incentive pay. **For calendar year plans, action by the board of directors or the appropriate committee may be necessary before January 1, 2010.**

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work or any of the members of the Executive Compensation & Benefits group.

New York

Susan P. Serota (bio)
+1.212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt (bio)
+1.212.858.1139
peter.hunt@pillsburylaw.com

Scott E. Landau (bio)
+1.212.858.1598
scott.landau@pillsburylaw.com

John J. Battaglia (bio)
+1.212.858.1738
john.battaglia@pillsburylaw.com

Mark C. Jones (bio)
+1.212.858.1430
mark.jones@pillsburylaw.com

Kathleen D. Bardunias (bio)
+1.212.858.1905
kathleen.bardunias@pillsburylaw.com

Bradley A. Benedict (bio)
+1.212.858.1523
bradley.benedict@pillsburylaw.com

Washington, DC / Northern Virginia

Howard L. Clemons (bio)
+1.703.770.7997
howard.clemons@pillsburylaw.com

Keith R. Kost (bio)
+1.703.770.7799
keith.kost@pillsburylaw.com

San Diego—North County

Jan H. Webster (bio)
+1.858.509.4012
jan.webster@pillsburylaw.com

Daniel N. Riesenber (bio)
+1.858.847.4130
daniel.riesenber@pillsburylaw.com

Kenneth E. Bonus (bio)
+1.858.847.4206
kenneth.bonus@pillsburylaw.com

San Francisco

Christine L. Richardson (bio)
+1.415.983.1826
crichardson@pillsburylaw.com

Silicon Valley

Cindy V. Schlaefer (bio)
+1.650.233.4023
cindy.schlaefer@pillsburylaw.com

Grace Chen (bio)
+1.650.233.4873
grace.chen@pillsburylaw.com

This material is not intended to constitute a complete analysis of all tax considerations. Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.

This publication is issued periodically to keep Pillsbury Winthrop Shaw Pittman LLP clients and other interested parties informed of current legal developments that may affect or otherwise be of interest to them. The comments contained herein do not constitute legal opinion and should not be regarded as a substitute for legal advice.

© 2009 Pillsbury Winthrop Shaw Pittman LLP. All Rights Reserved.