

MEMORANDUM TO CLIENTS

October 13, 2009

RE: Year-End Deadline for Bonus and Performance-Based Equity Fast Approaching

An important deadline for amending executive bonus and other performance-based compensation arrangements is approaching quickly. Public companies should review performance-based arrangements (e.g., bonus plans and equity awards) now to ensure compliance with changes announced by the IRS under section 162(m) of the Code. **Generally, any necessary amendments to address these changes should be made by December 31, 2009.**

Background

Section 162(m) of the Code generally limits to \$1 million the amount that a public company may deduct for compensation paid to certain top executives each year. However, section 162(m) allows a public company to deduct, in addition to the \$1 million annually, all of an employee's "performance-based compensation." Performance-based compensation is compensation that is payable solely upon achievement of one or more performance goals. The goals must be pre-established and objective, and certain other requirements must be satisfied.

IRS regulations provide that compensation does not fail to be "performance-based" if it could also be paid upon death, disability, or a change in control, regardless of achievement of the performance goals. The IRS recently made a significant change in its position on the performance-based status of compensation which could vest upon other events. Previously, the IRS held in private letter rulings that compensation would not fail to be performance-based solely because the compensation could be paid upon involuntary termination, termination for good reason, or voluntary retirement. In 2008, however, the IRS changed this position with the release of PLR 200804004 and Revenue Ruling 2008-13.

Current IRS Position

As expressed in the 2008 rulings, the current IRS position is that compensation is not performance-based if it could be paid regardless of performance when an employee (1) is involuntarily terminated without cause, (2) voluntarily resigns for good reason, or (3) retires. The mere existence of these potential vesting triggers voids from the outset the performance-based nature of the arrangement.

The recent IRS rulings strongly suggest that the IRS would find that a compensation arrangement allowing an incentive award to vest upon any event not specified in IRS regulations (death, disability, and change in control) was not performance-based. Therefore, termination without cause, termination for good reason, and retirement should not be seen as an exhaustive list of impermissible vesting events.

Arrangements requiring satisfaction of performance criteria for payment to occur, even if an impermissible event has occurred (e.g., retirement), should not be affected by these new rules, since no payment will occur unless the performance criteria are also satisfied.

Transition Relief

Although Revenue Ruling 2008-13 is not welcome news for public companies, the IRS did provide fairly generous transition relief. Specifically, the new rules do not apply retroactively to disallow deductions for amounts that otherwise meet the section 162(m) requirements and that have payment terms similar to those described in the Revenue Ruling if either: (1) the performance period for the compensation begins on or before January 1, 2009, or (2) the compensation is paid according to the terms of an employment contract as generally in effect on February 21, 2008 (disregarding future renewals or extensions, including so-called "evergreen" renewals).

Need For Action

Generally, the new IRS rules will apply to performance periods beginning on January 1, 2010, and thereafter. Therefore, before the end of 2009, companies should review and revise as needed, documents such as:

- annual bonus plans,
- multi-year bonus plans (often referred to as "LTIPs"),
- performance-based restricted stock and restricted stock units ("RSUs"),
- change in control agreements, and
- employment and severance agreements.

It is important to look at all these documents because they are often inter-related. For example, a bonus plan may not provide for vesting upon an executive's involuntary termination, but the executive's employment or severance agreement could.

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Please call one of the following, or the Groom attorney you regularly contact, if you have any questions about this or any other matter.

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