Section 162(M): Executive Compensation and the Implications of Revenue Ruling 2008-13

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In early 2008, the Internal Revenue Service issued Private Letter Ruling 200804004 and Revenue Ruling 2008-13. This Article explores these Rulings’ impact on executive bonus plans and employment agreements. It then provides approaches companies can take to comply with the Service’s new position that the accelerated vesting of performance-based compensation upon termination without cause, termination by executive for good reason, or retirement causes the entire plan or agreement to be ineligible for the Section 162(m) performance-based exception. Lastly, it critiques the Revenue Ruling and suggests the IRS focus on the involuntariness of these events in assessing deductibility.

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I. INTRODUCTION

On February 21, 2008 the IRS issued Revenue Ruling 2008-13 holding that provisions in employment agreements providing for the accelerated vesting of performance based awards upon the termination of an executive by the company without cause, termination by the executive for good reason, or voluntary retirement does not meet the performance-based exception of Section 162(m) of the Internal Revenue Code.¹ The impact of this Ruling is that executive bonus plans or agreements containing such provisions are ineligible for the performance-based exception.² Because this Ruling is a reversal of the Service’s previous position, companies will have to alter their executive bonus plans and agreements that contain these provisions.³

³ Id. at 4-6.
This Article explores the impact of Revenue Ruling 2008-13 on executive bonus plans and employment agreements, and provides a critique of the Ruling. Part II discusses the taxation of executive compensation prior to the enactment of Section 162(m) and the reasons for the enactment of this Section. Part III provides an overview of Section 162(m) and discusses three Private Letter Rulings issued in connection with this Section of the Internal Revenue Code. Part IV summarizes Revenue Ruling 2008-13 and discusses the implications of the Ruling, including drafting measures that companies can take to comply with the Ruling. Part V critiques the Ruling and suggests that the IRS should have taken a different position regarding whether termination by the Company without cause, termination by the employee for good reason, or voluntary retirement meets the performance-based exception of Section 162(m). Part VI concludes the Article.
II. BACKGROUND

This section will provide an overview of the taxation of executive compensation prior to the enactment of Section 162(m) and the reasons for the enactment of this Section of the Code.

A. Taxation of Executive Compensation Prior to the Enactment of Section 162(m)

Section 162(a)(1) of the Internal Revenue Code allows a deduction for reasonable compensation paid to employees. As such, a Company may deduct as an ordinary and necessary business expense a reasonable allowance for salaries or other compensation for services rendered. This provision of the Code has its origin in the Revenue Act of

\[\text{\textsuperscript{4}}\text{I.R.C. §162(a)(1) (allowing as a deductible ordinary and necessary business expense for the taxable year a “reasonable allowance for salaries or other compensation for personal services rendered.”).}\]

\[\text{\textsuperscript{5}}\text{Id.}\]
The Act was shortly thereafter interpreted by the Board of Tax Appeals in a way that gives the IRS the authority and duty to inquire into the reasonableness of compensation. In 1925, the United States Supreme Court interpreted the Act in the same manner as the Board.

While Section 162(a)(1) seems to imply that the IRS has the power to police compensation arrangements, such policing is not what occurs in practice. In fact, the reasonableness test is used almost exclusively to deny deductions for payments that are gifts or dividends disguised as compensation. In essence, the reasonableness test prevents closely held businesses from inflating employee

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7 Id.
8 Id. at A-2.
10 Id. at 883.
compensation by distributing profits in a deductible form.\textsuperscript{11} The IRS does not apply the reasonableness test to executive bonus plans,\textsuperscript{12} nor does it police arm’s length negotiations of executive employment agreements\textsuperscript{13} between a public corporation and an employee.\textsuperscript{14} Because the Service’s

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\textsuperscript{11} See KAFKA, supra note 6, at A-3.
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\textsuperscript{12} For purposes of this article an executive bonus plan is an incentive compensation plan designed in a way to obtain the deduction provided by Section 162(m)(4)(C). See generally Mintz Levin, Employee Benefits Advisory: Section 162(m): Where Do We Go from Here? (Mar. 7, 2008), http://www.mintz.com/publications.php?PublicationID=1444.
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\textsuperscript{13} For the purposes of this article employment agreements are defined as employment, retention, separation, or severance agreements containing severance provisions. K&L Gates, IRS Confirms Controversial New Position on Section 162(m) Performance-Based Compensation Deduction, EXECUTIVE COMPENSATION ALERT (Feb. 28, 2008), http://www.klgates.com/newsstand/Detail.aspx?publication=4353.
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application of Section 162(a)(1) has not been used to police executive compensation, Congress enacted Section 162(m).\footnote{id}

\textit{B. Reasons for the Enactment of Section 162(m)}

In the late 1980s and early 1990s politicians, academics, the popular press, and other taxpayers began to view executive compensation as excessive.\footnote{meredith_r_conway} Much of the complaining about these large salaries came from ordinary workers who were not doing well financially.\footnote{id} The public outcry increased when President George H.W. Bush took a trip to Japan with automobile executives from the United States, and the media coverage of the trip compared American executive salaries with significantly lower Japanese executive salaries.\footnote{alison_leigh_cowan}

\footnote{id}{\textit{Id.}}
\footnote{meredith_r_conway}{Meredith R. Conway, \textit{Money for Nothing and the Stocks for Free: Taxing Executive Compensation}, 17 \textit{CORNELL J. L. \\ \\ & PUB. POL’Y} 383, 396 (2008).}
\footnote{id}{\textit{Id.}}
\footnote{alison_leigh_cowan}{See Alison Leigh Cowan, \textit{The High-Energy Board Room}, N.Y. TIMES, Oct. 28, 1992, at D1.}
This populist outrage reached its pinnacle during the 1992 presidential race.\textsuperscript{19} In his campaign, then Governor Bill Clinton stated that “[i]t’s wrong for executives to do what so many did in the 1980s. The biggest companies raised their [executive officers’] pay four times the percentage their workers’ pay went up and three times the percentage their profits went up.”\textsuperscript{20} Also during the race, Mr. Clinton recommended that executive compensation be limited by enacting changes to the tax laws.\textsuperscript{21} When President Clinton took office, Congress passed the Omnibus Budget Reconciliation Act of 1993, which included Section 162(m).\textsuperscript{22} According to the Senate Finance Committee “the

\begin{itemize}
  \item \textsuperscript{19} See Mintz Levin, supra note 12.
  \item \textsuperscript{22} Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §13211(b), 107 Stat. 312, 471.
\end{itemize}
amount of compensation received by corporate executives has been the subject of scrutiny and criticism. The committee believes that [because of this Act] excessive compensation will be reduced. This reduction was intended to occur by the introduction of Section 162(m), which provides that a public corporation is not permitted to deduct an executive’s compensation that exceeds $1 million, absent an exception.

III. SECTION 162(M) AND PRIVATE LETTER RULINGS

This section provides an overview of Section 162(m) and discusses three Private Letter Rulings issued in connection with this portion of the Internal Revenue Code.

A. Overview of the Law

Under Section 162(m)(1), a public corporation cannot deduct compensation paid to the Chief Executive Officer.

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24 See I.R.C. §162(m)(1).
and the four most highly compensated employees if that compensation exceeds $1 million.\(^{25}\) The Regulations define a public corporation to mean any corporation issuing any class of common equity securities required to be registered under Section 12 of the Securities Exchange Act of 1934, as amended.\(^{26}\) There are seven principal exceptions to the rule, the most important of which is the exception for performance-based compensation, which is codified in Section 162(m)(4)(C).\(^{27}\) Under this exception, the $1 million dollar limit does not apply if four requirements are met.\(^{28}\) The requirements are that (1) compensation paid to an executive is paid solely for meeting one or more performance goals;\(^ {29}\) (2) a compensation committee

\(^{25}\) *See id.*

\(^{26}\) *See Treas. Reg. §1.162-27(c)(1) (2007).*

\(^{27}\) *See Miske, supra* note 14, at 372.

\(^{28}\) *See Conway, supra* note 16, at 400.

\(^{29}\) *See I.R.C. §162(m)(4)(c); Treas. Reg. §1.162-27(e)(2)(i) (2007).*
consisting of two or more outside directors approve the performance goals;\textsuperscript{30} (3) the shareholders approve the material terms for which the compensation will be paid, including the performance goals;\textsuperscript{31} and (4) prior to the payment, the committee certifies that the executive met the performance goals.\textsuperscript{32} The first element of this test, which relates to performance goals, is most often at issue as this requirement is substantive rather than procedural.

Treasury Regulation §1.162-27(e) explains the four requirements needed to meet the Section 162(m) requirement.\textsuperscript{30} See 162(m)(4)(c)(i); Treas. Reg. §1.162-27(e)(3) (2007). A director is an outside director if the director (A) is not a current employee of the publicly held corporation; (B) is not a former employee of the publicly held corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year; (C) has not been an officer of the publicly held corporation; and (D) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services. See Treas. Reg. §1.162-27(e)(3) (2007).\textsuperscript{31} See 162(m)(4)(c)(ii); Treas. Reg. §1.162-27(e)(4) (2007).
performance-based exception by specifying when compensation will be considered qualified performance-based.\textsuperscript{33} This discussion includes information regarding when the performance goal requirement is met.\textsuperscript{34} For compensation to meet the performance goal requirement it must be paid solely on account of the attainment of one or more pre-established and objective performance goals.\textsuperscript{35} The Regulations further provide that Compensation does not meet the requirements of qualified performance-based

\textsuperscript{32} See 162(m)(4)(c)(iii); Treas. Reg. §1.162-27(e)(5) (2007).
\textsuperscript{35} \textit{Id.} A performance goal is considered pre-established if it is established in writing by the compensation committee not later than 90 days after the commencement of the period of service to which the performance goal relates, provided that the outcome is substantially uncertain at the time the compensation committee actually establishes the goal. However, in no event will a performance goal be considered to be pre-established if it is established after 25 percent of the period of service (as scheduled in good faith at the time the goal is established) has elapsed. A performance goal is objective if a third party having knowledge of the relevant facts could determine whether the goal is met. \textit{Id.}
compensation if facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained.\(^{36}\) Consequently, if the payment of compensation under a grant or award is only nominally or partially contingent on attaining a performance goal, none of the compensation payable under the grant or award will be considered performance-based.\(^{37}\) Despite this limitation, compensation does not fail to be qualified performance-based merely because the plan or agreement allows the compensation to be payable upon death, disability, or change of ownership or control.\(^{38}\) While compensation actually paid on account of

\(^{36}\) Id. at (e)(5).

\(^{37}\) Id. For example, if an employee is entitled to a bonus under either of two arrangements, where payment under a nonperformance-based arrangement is contingent upon the failure to attain the performance goals under an otherwise performance-based arrangement, then neither arrangement provides for compensation that satisfies the requirements of this paragraph (e)(2). Id.

\(^{38}\) Id.
these events prior to the attainment of the performance goal would not typically meet the definition of qualified performance-based compensation, the Service has carved out an exception for these events.\textsuperscript{39}

The practical implication of this exception is that performance-based compensation that is paid pursuant to plans or agreements containing provisions awarding such compensation upon death, disability, or a change of control, is still deductible because the compensation qualifies for the performance-based exception. While the determination of whether compensation is qualified performance-based is typically made on a grant-by-grant basis,\textsuperscript{40} the determination of whether the performance goal requirement is met is made taking into account all plans, arrangements, and agreements that provide for compensation to the employee.\textsuperscript{41}

\textsuperscript{39} \textit{Id.}

\textsuperscript{40} \textit{See} Treas. Reg. §1.162-27(e)(2) (iv)(2007).

\textsuperscript{41} \textit{See} Treas. Reg. §1.162-27(e)(2) (iv)(2007).
Essentially, compensation paid pursuant to executive bonus plans or agreements that directly or indirectly provide for the payment of performance-based compensation upon death, disability, or a change of control is still deductible notwithstanding the fact that the performance goal may not be attained. This exception to the general rule that performance-based compensation is not deductible if an employee receives such compensation pursuant to a plan or agreement that contains provisions awarding such compensation regardless of whether the performance goal is attained, has been the subject of several Private Letter Rulings\textsuperscript{42} and a Revenue Ruling.\textsuperscript{43}

\textsuperscript{42} See infra, Section III.B.

\textsuperscript{43} See infra, Section IV.A.
B. Private Letter Rulings

1. Private Letter Ruling 199949014

This letter was issued in reply to a request for a ruling concerning whether compensation paid under a restricted stock plan upon the attainment of a performance goal would be considered performance-based compensation under section 162(m)(4)(C) even though the compensation could have been paid upon the executive’s termination by the company without cause or for termination by the executive for good reason.\textsuperscript{45} The restricted stock agreements provided that the shares of restricted stock would immediately

\textsuperscript{44} According to two practitioners “[a]lthough PLRs may generally not be used or cited as precedent for a substantive tax position by taxpayers other than to whom they are written, they are sometimes viewed by practitioners as an indication of the IRS’s current thinking regarding the issues addressed thereby. In addition, in the absence of contrary rulings, PLRs may serve as substantial authority for taxpayers taking return positions which they hope will not result in penalties if the positions eventually fail.” See Oringer & Dewalt, \textit{supra} note 2, at 3.

become fully vested if an executive was terminated by the Company without cause,\textsuperscript{46} or termination occurred by the executive for good reason,\textsuperscript{47} as those terms were defined in

\textsuperscript{46} The plan defined cause as “(i) an act of willful misrepresentation, fraud or willful dishonesty intended to result in substantial personal enrichment at the expense of Company, (ii) willful misconduct with regard to Company that was intended to have a material adverse impact on Company, (iii) material, willful and knowing violation of Company guidelines or the executive’s fiduciary duties which has or was intended to have a material adverse impact on Company, (iv) willful or reckless behavior which has a material adverse impact on Company, (v) willful failure to perform duties or follow written direction of the board of directors, (vi) conviction of, or pleading nolo contendre or guilty to a felony, or (vii) any other material breach that is not cured within 20 days of receipt of written notice. Id. at 2.

\textsuperscript{47} The Plan defined good reason as “the occurrence of any of the following, without the executive’s express written consent: (i) assignment of duties materially inconsistent with the executive’s current authorities, duties, responsibilities, and status, any reduction in the executive’s title, position, or reporting lines, or any material reduction in the executive’s status, authorities, duties, or responsibilities, (ii) relocation of the executive from the principal office of Company or relocation of the principal office of Company, (iii) reduction in the executive’s base salary, (iv) reduction in the executive overall level of participation in Company incentive, benefit, or retirement plans, (v) failure of Company to obtain assumption of the executive’s employment agreement from
the agreement.\textsuperscript{48} The IRS ruled that the restricted share awards were considered performance-based, despite the fact that the compensation could be paid regardless of whether the performance goal had been attained.\textsuperscript{49} The Service reasoned that “[t]ermination by Company without cause and termination by an executive with good reason are both involuntary terminations similar to terminations as a result of death, disability or change in control.”\textsuperscript{50} These terminations are considered involuntary because the termination is contingent on circumstances that are beyond the executive’s control (hereinafter “involuntary terminations”).\textsuperscript{51}

\textsuperscript{48} Id. at 1.
\textsuperscript{49} Id. at 3-4.
\textsuperscript{50} Id. at 3.
\textsuperscript{51} MillerChevalier, \textit{Exec Comp Corner: IRS Reverses Ruling Position for Performance-Based Bonuses}, FOCUS ON EMPLOYEE BENEFITS VOL. 1 ISSUE 3 (Feb. 8, 2008), http://www.millerchevalier.com/files/Publication/648abe71-
2. Private Letter Ruling 200613012

This letter was issued in response to a request for a ruling to consider whether (1) compensation paid under an Annual Plan upon attainment of performance goals would be considered performance-based even though the compensation could be paid upon the executive’s termination by the Company without cause, or by the executive for good reason and (2) whether compensation paid under a Long-Term Plan upon attainment of performance goals would be considered performance-based even though the compensation could be paid upon the executive’s termination by the Company without cause, by the executive for good reason or upon the executive’s retirement. The IRS held that compensation paid under the Annual Plan and the Long Term Plan is considered
performance-based compensation under section
162(m)(4)(C).\textsuperscript{53} Essentially, the IRS upheld its position in
the 1999 PLR regarding involuntary terminations, while
simultaneously holding that compensation payable upon the
executive’s retirement will also be considered performance-
based compensation.\textsuperscript{54} Thus, prior to February 2008, plans
or agreements containing provisions for the accelerated
vesting of performance-based compensation upon an
involuntary termination or retirement were not disqualified
from meeting the performance-based exception, even though
they included provisions for the accelerated payment of
performance-based compensation upon such events.\textsuperscript{55}

3. Private Letter Ruling 200804004

This letter was issued in response to a request for a ruling
on whether compensation paid under an incentive plan that

\textsuperscript{53} Id. at 4.
\textsuperscript{54} See Oringer & DeWalt, supra note 2, at 3.
provided incentive awards, including performance share and performance unit awards, upon attainment of a performance goal is considered performance-based compensation under section 162(m)(4)(C), even though the compensation could have been paid upon the executive’s termination without cause, or termination by the executive for good reason, without attaining the performance goal.\textsuperscript{56} Essentially, the employment agreement between the company and the executive included a provision that upon an involuntary termination any performance goal under any outstanding performance share or performance unit award would be deemed to be achieved at target and the awards would vest at termination.\textsuperscript{57} The IRS held that compensation paid to an executive upon an involuntary termination regardless of whether the performance goal is attained is not considered

\textsuperscript{55} \textit{Id.}


\textsuperscript{57} \textit{Id.} at 1-2.
performance-based compensation. It concluded that “[t]he provision in the Agreement allowing for payment of performance share or performance unit awards under the Plan upon Executive’s termination by Company without cause or by Executive with good reason does not meet the exception in Section 1.162-27(e)(2)(v) of the regulations that allows compensation to be payable upon death, disability or change of ownership or control.” Thus, compensation paid to an executive with respect to performance share or performance unit awards is not payable solely upon attainment of a performance goal, for purposes of section 162(m)(4)(C) of the Code.”

The IRS in so ruling reversed its position from the 1999 PLR where it deemed involuntary terminations as similar to death, disability, or change in ownership or control

58 Id. at 3.
59 Id.
60 Id.
reasoning that all of these events are involuntary.\textsuperscript{61} According to the author of the 2008 PLR, the IRS “viewed those two events [without cause or for good reason] as dissimilar to death, disability and change in control because there’s an opportunity - there’s a possibility that they can occur as a result of poor performance, which isn’t the case with respect to death, disability and chance [sic] of control.\textsuperscript{62}” Mr. Griffin further stated that “there’s a possibility under those two events, without cause and for good reason that the compensation would be paid as a result of poor performance, which is in contrast to what the "solely" requirement of the statute is really targeted at.” After issuing the PLR, the IRS cleared up any doubt about its new position regarding accelerated vesting of

\textsuperscript{61} See \textit{supra} note 45, at 3.

performance-based compensation upon the happening of specified events by issuing Revenue Ruling 2008-13.\textsuperscript{63}

IV. Revenue Ruling 2008-13

This section summarizes Revenue Ruling 2008-13 and discusses the implications of the Ruling, including drafting measures that companies can take to comply with the Ruling.

A. Summary of the Ruling

Revenue Ruling 2008-13 addressed the issue of whether compensation meets the performance-based exception of Section 162(m)(4)(C) if the plan or agreement provides that the compensation will be paid upon attainment of a performance goal, and also provides that the compensation will be paid without regard to whether the performance goal is attained in either of the following situations: (i) the covered employee’s employment is involuntarily terminated by the corporation without cause or the covered employee

\textsuperscript{63} See Oringer & DeWalt, supra note 2, at 4.
terminates his or her employment for good reason, or (ii) the covered employee voluntarily retires. The IRS held that an employee’s termination without cause or for good reason does not meet the performance-based exception of Section 162(m)(4)(c). It reasoned that termination without cause or for good reason is not listed as a permissible payment event under Treasury Regulation §1.162-27(e)(2)(v), which lists death, disability, or change of ownership or control as permissible events. It further stated that “involuntary termination without ‘cause’ may occur or a ‘good reason’ (e.g., a reduction in title or base salary) may arise as a result of covered employee’s poor performance and failure to meet the Performance Goal.” The IRS therefore concluded that the compensation is not “remuneration payable solely on

64 See supra note 1, at 1.
65 Id.
66 Id.
67 Id.
account of the attainment of one or more performance goals,” as required by Section 162(m)(4)(C).68

With respect to voluntary retirement, the IRS held that this event does not meet the performance-based compensation exception of Section 162(m)(4)(c).69 It reasoned that voluntary retirement is not listed as a permissible payment event under Treasury Regulation §1.162-27(e)(2)(v).70 It further stated that “[b]ecause retirement generally is a voluntary action within the control of the covered employee, the compensation is not “remuneration payable solely on account of the attainment of one or more performance goals,” as required by Section 162(m)(4)(C).”

68 Id.
69 Id.
70 Id.
B. Implications of the Ruling

In response to public concern over the 2008 Private Letter Ruling, the IRS provided transition relief in Revenue Ruling 2008-13. The Revenue Ruling will not apply to compensation arrangements where (i) the performance period for such compensation begins on or before January 1, 2009 or (ii) the compensation is paid pursuant to the terms of an employment contract as in effect on February 21, 2008. In preparing to comply with the Ruling, there are three basic approaches that companies can take to assure that their plans and agreements are in compliance with the Revenue Ruling.

One approach a company can take is that it could simply eliminate the provisions from these plans or agreements that relate to termination for good cause, termination by the

\[71\] See Oringer & DeWalt, supra note 2, at 7.
\[72\] Id. at 5.
employee for good reason, or voluntary retirement. This change could be accomplished by eliminating such provisions with respect to performance-based compensation, but providing a payment that occurs upon these events that is measured differently from the performance-based compensation. For example, a separate payment for these events could be based on the prior year’s performance payment or on an average of bonuses made over the previous few years. A second approach that companies could take is to let the performance period expire and then

74 Id.
75 Id. “This approach may be less attractive for a voluntary retirement than for death or disability because an employee could time the retirement and affect the amount of payment. In addition, care should be taken to structure the retirement or involuntary termination payments so that they are separate from and unrelated to the performance-based compensation that is payable under other circumstances so
determine whether the performance goal has been satisfied.\textsuperscript{76} The plan or agreement will still qualify for the performance-based exception because the payment would be contingent on achieving the performance goal after the termination or retirement occurred.\textsuperscript{77} In taking this approach, companies should consider its impact for executives who terminate employment early in the performance period.\textsuperscript{78} For example, companies should consider whether the executive must be employed for a minimum portion of the performance period in order to be eligible for a payment.\textsuperscript{79} A third approach as to avoid “tainting” the compensation that is intended to be performance-based.”

\textsuperscript{76} See Oringer & DeWalt, supra note 2, at 5. “This type of delay may be more acceptable for disability and retirement than for death, particularly for a multi-year performance period.” See McGuireWoods LLP, supra note 73.

\textsuperscript{77} See McGuireWoods LLP, supra note 73.


\textsuperscript{79} Id.
companies could take is to pro-rate the performance awards based on the executive’s actual performance through the termination date.\textsuperscript{80} Such an approach, would amount to making the performance analysis at the point the termination occurred.\textsuperscript{81} If taking this approach, companies must be aware of the regulatory requirement imposed by Treasury Regulation §1.162-27(e)(2)(i) that not more than 25% of the period can have elapsed when the goal is set.\textsuperscript{82} While there are numerous drafting approaches that companies can take to assure that their bonus plans and employment agreements still fall within the Section 162(m)(4)(C) performance-based exception, these solutions do not change the fact that the IRS’s holding in Revenue Ruling 2008-13 was incorrect and its reasoning flawed.

\textsuperscript{80} \textit{Id.}
\textsuperscript{81} See Oringer & DeWalt, \textit{supra} note 2, at 5.
\textsuperscript{82} \textit{Id.}
This section provides a critique of the Revenue Ruling and suggests that the IRS should have taken a different position regarding whether involuntary termination and voluntary retirement meet the performance-based exception of Section 162(m)(4)(C).

A. Involuntary Terminations Satisfy Section 162(m)(4)(C)

In the Service’s 1999 PLR it held that the accelerated vesting of performance awards upon termination by the Company without cause or termination by the executive for good reason satisfied the performance-based exception of Section 162(m)(4)(C). It reasoned that “[t]ermination by Company without cause and termination by an executive with good reason are both involuntary terminations similar to terminations as a result of death, disability or change in control.” This ruling reflects the correct position regarding

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83 See supra note 45, at 3-4.
84 Id. at 3.
these provisions, and indicates sound reasoning by the IRS in reaching its conclusion. Consequently, the Service should not have reversed its position in the 2008 Revenue Ruling where it held that these terminations do not meet the performance-based exception of Section 162(m)(4)(C).

In reaching its conclusion in the Revenue Ruling, the IRS engaged in flawed analysis when it reasoned that because "involuntary termination without ‘cause’ may occur or a ‘good reason’ (e.g., a reduction in title or base salary) may arise as a result of covered employee E’s poor performance and failure to meet the Performance Goal.” Instead of analyzing this issue based on poor performance, the IRS should analyze this issue based on the involuntariness of these events. Such analysis is superior because these two types of terminations are always classified as involuntary, while such terminations can often occur for reasons other

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85 See supra note 1, at 4.
than poor performance. For example, a termination without cause can occur simply because there are new members elected to the board of directors who want to bring in a new Chief Executive Officer. In turn, this CEO will often bring in his or her own management team. In addition, termination by the executive for good reason can often occur for reasons beyond an executive’s control such as the relocation of the executive from the principal office of the Company, or the relocation of the principal office of the Company. While there are situations where poor performance impacts or even causes an involuntary termination, the fact that there are situations where poor performance does not influence these terminations makes this standard inconsistent. On the other hand, a standard based on the involuntariness of these terminations consistently provides that involuntary terminations meet the performance-based exception of Section 162(m)(4)(C). Since these events are always classified as involuntary
because they are contingent on circumstances beyond the executive’s control, analyzing them based on their involuntariness results in a clear cut standard that companies can rely on in drafting their executive bonus plans and employment agreements.

**B. Retirement Does Not Fall Within Section 162(m)(4)(C)**

In its 2006 PLR, the Service held that a bonus plan containing a provision providing for accelerated vesting of a performance award upon retirement satisfies the Section 162(m)(4)(C) performance-based exception.\(^{86}\) This ruling reflects an incorrect position regarding retirement, and also indicates flawed reasoning. It is therefore unsurprising that the result in this PLR is what caused the IRS to re-examine its position regarding involuntary terminations.\(^{87}\) According to the author of the 2008 PLR and 2008 Revenue Ruling “it was that ruling [the 2006 PLR] that surfaced this issue to our

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\(^{86}\) See *supra* note 52, at 4.

\(^{87}\) See Griffin, *supra* note 62.
attention and we looked at that rule and traced it back to the ’99 ruling, and we concluded quickly that retirement being voluntary or typically voluntary really was almost an aberration here and really didn’t fit within the analysis of the ’99 ruling.”

After reviewing the 2006 PLR in drafting the 2008 PLR, the Service corrected its position by holding in the 2008 Revenue Ruling that the accelerated vesting of a performance award upon retirement does not satisfy the performance-based exception of Section 162(m)(4)(C).

The IRS employed sound reasoning stating that “[b]ecause retirement generally is a voluntary action within the control of the covered employee, the compensation is not ‘remuneration payable solely on account of the attainment of one or more performance goals,’ as required by §162(m)(4)(C).”

88 Id.
89 See supra note 1, at 4.
90 Id.
C. Position IRS Should Have Taken in the Revenue Ruling

In Revenue Ruling 2008-13 the IRS should have taken the position that it took in the 1999 PLR regarding involuntary terminations. In this regard, provisions providing for the accelerated vesting of performance awards upon termination by the Company without cause or termination by the executive for good reason should be held to meet the performance-based exception of Section 162(m)(4)(C). Such provisions should be held to meet this exception because they are involuntary events. In addition, the IRS took the correct position in the Revenue Ruling regarding retirement by finding that retirement does not meet the performance-based exception because it is voluntary. The IRS should issue a Revenue Ruling stating that involuntary terminations meet the performance-based exception because they are involuntary, and retirement does not meet the exception because it is voluntary.
VI. CONCLUSION

This Article has explored the impact of Revenue Ruling 2008-13 on executive bonus plans and employment agreements. It has offered drafting approaches that companies can take to comply with the Revenue Ruling. It has also offered a critique of the Revenue Ruling and recommended that the IRS take a different position regarding termination by the company without cause or termination by the executive for good reason by focusing on the involuntariness of these events. While this Article provides drafting approaches to comply with the Revenue Ruling, further research could be conducted on how specific provisions in executive bonus plans and employment agreements could be written to comply with the Ruling.
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