

# EXECUTIVE COMPENSATION

## Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

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## IRS Releases Shocking 162(m) Private Letter Ruling

February 7, 2008

In Private Letter Ruling 200804004 dated September 21, 2007 (but just released on January 25, 2008), the IRS ruled that employment agreement terms providing for the accelerated vesting of performance-based equity awards upon termination of the executive by the company without cause or termination by the executive for good reason, *would cause the awards to fail to satisfy 162(m)'s performance-based exception, even if the accelerated vesting is never triggered.*

The ruling concluded: “The 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 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.”

**Who this ruling affects:** Companies who make full-value equity-based performance awards intended to qualify under Section 162(m) where those performance awards will accelerate and be paid in full, or “at target,” regardless of the performance actually achieved by the company if the executive is terminated without cause by the company (or terminates for good reason). These accelerated vesting rights may arise either through separate employment agreements or through the award itself; though in our experience, most award agreements themselves do not grant these rights. It may also affect those employees who would stand to receive a full cash bonus in the event of an involuntary or constructive termination. The effect of the ruling is the loss of a federal tax deduction by the company; there is no effect on the executive.

**Is the ruling binding?** Generally, a private letter ruling can only be relied upon by the taxpayer who receives it; however, the ruling reflects the current position of the IRS

regarding these types of arrangements. As a result, the ruling should be considered when drafting new performance-based awards. The ruling also may affect determinations under the “more likely than not” thresholds of the FIN 48 analysis for financial accounting purposes.

If you have any questions about this Executive Compensation Alert, or would like any additional information, please contact any Bass, Berry & Sims attorney in the Executive Compensation Practice.

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