Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC
PLR-145389-05
Date:
December 21, 2005

Company =

Dear :

This is in response to your letter dated August 31, 2005, submitted by your authorized representative, requesting a ruling under section 162(m) of the Internal Revenue Code. Specifically, you requested a ruling that the adoption of a policy allowing the Company to pay certain non-performance-based compensation will not prevent bonuses paid under the Company's plan from being qualified performance-based compensation under section 162(m)(4)(C) of the Code. The facts, as represented, are as follows.

Company's Performance Compensation Plan (Performance Plan) is intended to be a qualified performance-based compensation plan under section 162(m)(4)(C) and section 1.162-27(e) of the Income Tax Regulations. The Performance Plan was adopted to compensate senior managing directors of the Company and its subsidiaries for significant contributions to the Company.

Section 5 of the Performance Plan provides that a bonus payable under the plan is the sole bonus payable with respect to a fiscal year to each participant who was a senior managing director for the fiscal year. Section 7 of the Performance Plan provides that the compensation committee has the sole discretion to interpret the terms of the Performance Plan. Under section 9, the compensation committee may amend the Performance Plan as long as the amendment does not impair the rights of a participant to an accrued benefit.

To clarify the types of payments that may be made outside of the Performance Plan during the course of any year to Performance Plan participants, the Compensation Committee intends to adopt a definition of “bonus” for purposes of administration of the plan. Under this definition, “bonus” is defined as a non-periodic payment made at the discretion of the Company in recognition of the performance of the individual or Company (or affiliate, subsidiary, unit, division, or any combination). Among other items, the term “bonus” does not include regular wage payments made for overtime pay, sick pay, back pay, holiday pay, vacation pay, commissions, pension or retirement costs or distributions, severance or termination payments, loans or loan forgiveness, amounts paid under reimbursement or other expense allowances (including non-taxable and taxable expense reimbursements), the provision of non-cash benefits, or income recognized on the exercise of a nonstatutory stock option. The term “bonus” does not include the reimbursement of taxes incurred by an individual with respect to any payment. Any item that is excluded from the definition of bonus will still be treated as a bonus if it is paid in lieu of or in substitution of an otherwise payable bonus.

The Company represents that the non-bonus payments will not, in operation, violate the requirement that the payments of performance bonuses under the Performance Plan are only paid on the satisfaction of the performance goals. For example, the Company will not make payments outside the Performance Plan to an employee to make up for any loss of that employee’s targeted performance bonus compensation resulting from any failure to meet performance goals under the Performance Plan.

Section 162(a)(1) of the Code allows a deduction for all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 162(m)(1) provides that for any publicly held corporation, no deduction shall be allowed for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year exceeds $1,000,000.

Under section 162(m)(4)(C) of the Code, applicable employee remuneration does not include any remuneration payable solely on account of the attainment of one or more performance goals, but only if (i) the performance goals are determined by a compensation committee of the board of directors of the taxpayer which is comprised solely of 2 or more outside directors; (ii) the material terms under the remuneration is to be paid, including the performance goals, are disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before the payment of such remuneration; and (iii) before any payment of such remuneration, the compensation committee referred to in clause (i) certifies that the performance goals and any other material terms were in fact satisfied.

Section 1.162-27(e)(2)(i) of the regulations provides that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals. A performance goal is considered preestablished 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 establishes the goal. However, in no event will a performance goal be considered to be preestablished 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.

Under section 1.162-27(e)(2)(iii)(A) of the regulations, the terms of an objective formula or standard must preclude discretion to increase the amount of compensation payable that would otherwise be due on attainment of a goal.

Section 1.162-27(e)(2)(iv) of the regulations provides that the determination of whether compensation satisfies the requirements of 1.162-27(e)(2) generally is made on a grant-by-grant basis. Thus, for example, whether compensation attributable to a stock option grant satisfies the requirements of 1.162-27(e)(2) generally is determined on the basis of the particular grant made and without regard to the terms of any other option grant, or other grant of compensation, to the same or another employee.

Under section 1.162-27(e)(2)(v) of the regulations, compensation does not satisfy the requirements of paragraph (e) if the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained. Thus, 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 payment under the grant or award will be considered performance-based. 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 paragraph (e)(2).

In 1993, proposed regulations were issued to explain the operation of section 162(m) of the Code. See 58 F.R. 66310 (December 20, 1993). The preamble to these regulations explains that for the exception for performance-based compensation to be meaningful, the determination of whether compensation meets those requirements must be made with regard to all of the compensation that is payable to an employee under a single transaction or on the occurrence of single set of events. However, this rule should not be read so broadly as to preclude compensation from being performance-based merely because the employee may receive other performance-based compensation that is not related to the same transaction or set of events, such as salary. See F.R. 66310, 66312.

In 1994, regulations under section 162(m) of the Code were re-proposed. See F.R. 61844 (December 2, 1994). In discussing changes to the rules concerning the aggregation of plans and agreements, the preamble indicates that changes were made to the provisions to clarify that the grant-by-grant rule is the general rule under which compensation arrangements are tested for purposes of determining whether they are performance based. Thus, whether a compensation arrangement is performance-based is generally determined without regard to other compensation arrangements. Further, the changes make clear that the aggregation rule is a limited exception to the grant-by-grant rule, and applies only for the purpose of determining whether the employee would receive, regardless of whether the performance goal is attained, compensation that purports to be performance based. Thus, for example, if payment under a nonperformance-based compensation arrangement is contingent upon the failure to attain a performance goal under an otherwise performance-based arrangement, neither arrangement provides for compensation that is performance based.

Based on the facts submitted, we rule that the Compensation Committee's adoption of an administrative policy under the Performance Plan excluding from the definition of "bonuses" payable under the Performance Plan various types of non-Performance Plan related compensation, does not prevent the Performance Plan from qualifying as a qualified performance-based compensation plan under section 162(m)(4)(C) and section 1.162-27(e).

The question of whether, in operation, the non-bonus compensation causes the performance-based compensation to be paid other than solely on account of the attainment of one or more pre-established, objective performance goals is a question of fact. Questions of fact are best resolved in this area upon examination of several or more filed income tax returns. Thus, no opinion is expressed concerning whether the payments under the administrative policy will prevent the Performance Plan from qualifying as qualified performance-based compensation.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on

examination. A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Robert Misner
Senior Technician Reviewer, Executive Compensation Branch
(Tax Exempt & Government Entities)

cc: