



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

May 1, 2000

UIL: 162.36-04
Number: **INFO 2000-0045**
Release Date: 6/30/2000

CC:EBEO:Br.4EMadden
COR-102156-00



Dear [REDACTED]:

This letter responds to your request dated January 27, 2000, for general information regarding section 162(m) of the Internal Revenue Code. This letter is advisory only and is not to be cited as precedent.

In your request for general information you ask whether, where a corporation subject to section 162(m) of the Code amends its plan to increase or decrease the aggregate limit (but retains the individual limit) on the number of equity-based awards that may be issued under the plan that was previously approved by shareholders, compensation paid under the plan qualifies as performance-based compensation under section 162(m)(4)(C). Your question assumes that the plan contains a provision that allows the board of directors of the corporation, in its discretion, to amend the plan at any time in any manner it deems appropriate subject to shareholder approval only to the extent required by applicable laws, regulations, or rules. You also indicate that shareholder approval of a plan containing an aggregate limit is no longer required under section 16(b) of the Securities Exchange Act of 1934 (Exchange Act).

Section 162(a)(1) of the Code allows as a deduction all 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) of the Code, however, 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 which 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.

Under section 1.162-27(e)(1) of the Income Tax Regulations, the deduction limit does not apply to qualified performance-based compensation. Qualified performance-based compensation is compensation that meets all of the requirements of paragraphs (e)(2) (performance goal requirement); (e)(3) (outside director requirement); (e)(4) (shareholder approval requirement); and (e)(5) (certification requirement).

Section 1.162-27(e)(2) of the regulations provides, in part, that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals.

Section 1.162-27(e)(2)(vi) of the regulations provides that compensation attributable to a stock option or stock appreciation plan is deemed to satisfy the requirements of paragraph (e)(2) if the grant or award is made by the compensation committee; the plan under which the option is granted states the maximum number of shares with respect to which the option or right may be granted during a specified period to any employee; and, under the terms of the option or right, the amount of compensation the employee could receive is based solely on an increase in the value of the stock after the date of the grant or award.

Under section 1.162-27(e)(4)(i) of the regulations the material terms of the performance goal under which the compensation is to be paid must be disclosed to and subsequently approved by the shareholders of the publicly held corporation before the compensation is paid. The requirements of paragraph (e)(4) are not satisfied if the compensation would be paid regardless of whether the material terms are approved by the shareholders. The material terms include the employees eligible to receive compensation; a description of the business criteria on which the performance goal is based; and either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is met (except that, in the case of a formula based, in whole or in part, on a percentage of salary or base pay, the maximum dollar amount of compensation that could be paid to the employee must be disclosed).

Section 1.162-27(e)(4)(iv) of the regulations provides that disclosure as to the compensation payable under a performance goal must be specific enough so that shareholders can determine the maximum amount of compensation that could be paid to any employee during a specified period. If the terms of the performance goal do not provide for a maximum dollar amount, the disclosure must include the formula under which the compensation would be calculated. Thus, for example, if compensation attributable to the exercise of stock options is equal to the difference in the exercise

price and the current value of the stock, disclosure would be required of the maximum number of shares for which grants may be made to any employee and the exercise price of those options (e.g., fair market value on date of grant).

Section 1.162-27(e)(4)(vi) of the regulations provides that once the material terms of a performance goal are disclosed and approved by shareholders, no additional disclosure or approval is required unless the compensation committee changes the material terms of the performance goal. If, however, the compensation committee has the authority to change the targets under a performance goal after shareholder approval of the goal, material terms of the performance goal must be disclosed to and approved by shareholders no later than the first shareholder meeting that occurs in the fifth year following the year in which shareholders previously approved the performance goal. The regulations are silent concerning whether additional disclosure and approval is required in a case such as that present in your letter.

Sections 1.162-27(e)(2) and (4) of the regulations do not indicate that the maximum number of equity-based awards that may be granted under the plan is a material term that must be stated in the plan and disclosed to and approved by the shareholders prior to payment of compensation under the plan. Thus, the amendment of a plan to increase or decrease the maximum number of equity-based awards solely through the action of the board of directors and without shareholder approval does not affect the status of options or rights granted under the plan as qualified performance-based compensation under section 162(m) of the Code, provided no change is made to the individual limit and the specified time.

No opinion is rendered concerning whether or not, for purposes other than the federal tax law, a board of directors has complied with its fiduciary duty to shareholders in cases where a board of directors discloses to shareholders the number of shares that will be issued under a plan and then exceeds that limit.

If you have any questions regarding this letter, please contact my office at 202-622-6060.

Sincerely,

Robert Misner
Robert Misner
Assistant Chief, Branch 4
Office of the Associate Chief Counsel
(Employee Benefits and Exempt
Organizations)