

INTERNAL REVENUE SERVICE

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Company =

Plan =

x years =

y months =

Dear

This is in reply to the ruling request you submitted on behalf of Company concerning a proposed amendment to the Plan. The issue presented is whether, under section 162(m) of the Internal Revenue Code, the proposed amendment will adversely effect the performance-based compensation paid under the Plan.

Company's Plan allows directors and officers to defer a defined minimum percentage of their total annual compensation (including performance-based compensation) earned during each year. The Plan's deferral period is generally a minimum of x years after the year for which the compensation was otherwise payable, although the period may be extended or reduced under certain circumstances, including the election at the time of the deferral election of a shorter deferral period by participants over age 55. All deferrals are credited to participants' deferred compensation accounts in the form of units. The number of units credited is determined by dividing the amount of each participant's compensation deferred for a year by the average cost per share of Company's common stock acquired by the Company on the open market on behalf of the Plan.

Each unit is credited with a return as calculated under the Plan. This amount is credited to each participant's account in the form of additional units, subject to certain limitations as described in the Plan. Upon completion of each deferral period,

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participants are entitled to receive shares of common stock equal to the number of units then credited to their respective deferred compensation accounts.

The Plan permits Company to purchase shares of Company common stock for issuance under the Plan either in the open market or in private transactions, which may include the repurchase from participants of the common stock that is distributed upon the expiration of a deferral period. In order to satisfy future Plan distribution requirements, Company has determined that there would be advantages to both Company and Plan participants if Company were authorized to enter into agreements with Plan participants, to be selected by the compensation committee of Company's board of directors, that would allow for the future purchase of shares directly from employees. The agreements, which would be entered into not more than y months prior to the expiration of any deferral period, would entitle participants to receive an amount of cash for their Plan common stock distributions equal to the average trading price of Company's common stock on the New York Stock Exchange during the term of the agreement.

The Company indicates that the advantages of this proposed amendment would be to provide an additional source of available shares for the Plan, while providing participants with the ability to engage in an orderly disposition of their shares at prices designed to afford protection against undue volatility in the trading price of Company's common stock at the time of Plan distributions. As a result of the locked-in price under each agreement, should the trading price of Company's common stock on the date of repurchase under the agreement be higher than the average price over the term of the agreement, Company would pay less for the repurchase than it otherwise would have paid were it to have purchased shares in the open market on such repurchase date. If the market trading price on the date of repurchase is lower than the average price over the term of the agreement, Company would pay more for the repurchase than it otherwise would have paid on the open market.

Because the ultimate repurchase price under the agreements will not be based on a predetermined actual investment as required by the regulations in cases when the payment of performance-based compensation is deferred, the proposed amendment to the Plan is drafted and will be administered so that the agreements to repurchase will meet the requirements of section 1.162-27(e)(2) of the Income Tax Regulations. Accordingly, payment under the agreements will be made only upon the attainment of a preestablished performance goal.

Section 162(a)(1) of the Code provides that there shall be allowed 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.

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Section 162(m)(1) of the Code generally provides that in the case of any publicly held corporation, no deduction is allowed for applicable employee remuneration with respect to any covered employee to the extent that the amount of the remuneration for the taxable year for such employee exceeds \$1 million.

Section 162(m)(4) of the Code defines "applicable employee remuneration", with respect to any covered employee for any taxable year, generally as the aggregate amount allowable as a deduction for the taxable year (determined without regard to section 162(m)) for remuneration for services performed by the employee (whether or not during the taxable year). However, pursuant to section 162(m)(4)(C), the term does not include 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 the 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) 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. 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 actually establishes the goal. A performance goal is objective if a third party having knowledge of the relevant facts could determine whether the goal is met. Performance goals can be based on one or more business criteria that apply to the individual, a business unit, or the corporation as a whole. A preestablished performance goal must state, in terms of an objective formula or standard, the method for computing the amount of compensation payable to the employee if the goal is attained.

The terms of an objective formula or standard must preclude discretion to increase the amount of the compensation payable that would otherwise be due upon attainment of the goal. However, if compensation is payable on or after the attainment

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of a performance goal, and a change is made to defer the payment of compensation to a later date, any amount paid in excess of the amount that was originally owed to the employee will not be treated as an increase in the amount of compensation if the additional amount is based either on a reasonable rate of interest or on one or more predetermined actual investments (whether or not assets associated with the amount originally owed are actually invested therein) such that the amount payable by the employer at the later date will be based on the actual rate of return of a specific investment (including any decrease as well as any increase in the value of the investment).

The determination of whether compensation satisfies the requirements of paragraph (e)(2) above generally will be made on a grant-by-grant basis. As an example given in the regulations, whether compensation attributable to a stock option grant satisfies the requirements of paragraph (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. Further, whether a grant of restricted stock or other stock-based compensation satisfies the requirements of paragraph (e)(2) is determined without regard to whether dividends, dividend equivalents, or other similar distributions with respect to stock, on such stock-based compensation are payable prior to the attainment of the performance goal. These types of distributions with respect to stock that are treated as separate grants are not performance-based compensation unless they separately satisfy the requirements of paragraph (e)(2). Section 1.162-27(e)(2)(iv) of the regulations.

Based on the facts submitted, we rule that any performance-based income payable under participants' Plan accounts at the end of a deferral period will not fail to satisfy section 162(m) of the Code as a result of the proposed amendment of the Plan authorizing distributions to be made pursuant to new performance-based agreements that may increase (or decrease) the participant's compensation income. Furthermore, additional compensation (if any) payable under the agreements will be treated for corporate deduction purposes as a separate grant for purpose of section 162(m). Thus, assuming that the other procedural requirements of section 162(m) are satisfied, the Company's deduction will be based on the amounts ultimately paid (and which amounts are taxed as compensation to the participants) under the agreements (based on the average daily closing price of the Company's common stock acquired by the Company under the agreements).

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This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provisions of the Code. In addition, we express no opinion with regard to the Plan or any original performance-based compensation awards.

Sincerely yours,

ROBERT B. MISNER
Assistant Chief, Branch 4
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure:

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