

INTERNAL REVENUE SERVICE

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September 9, 1999

Company =

Plan =

year a =

date b =

Dear

This is in reply to a request for a ruling concerning whether compensation paid under the Plan upon the attainment of a performance goal will be considered performance-based compensation under section 162(m)(4)(C) of the Internal Revenue Code even though the compensation could have been paid upon the executive's termination without cause or for "good reason".

Executives of Company, including executives who will be covered employees for purposes of section 162(m) of the Code, will be granted awards of restricted stock under Company's Plan. The awards of restricted stock will be evidenced by a restricted stock agreement that will specify the number of shares granted, the period of the restriction, and any other conditions of vesting in the award. Awards of restricted stock will vest only if the employee is still employed as of a specified date and if performance targets such as earnings per share, net operating profit, after-tax profit, return on equity, or return on invested capital, are met. For awards granted in year a, the awards will vest if the employee is still employed on date b, and if earnings per share increase at a specified rate over the vesting period. In the event of a change of control of Company, the restricted shares shall immediately vest. In the event an executive terminates as a result of death or disability, the shares will immediately become fully vested. The restricted stock agreements will provide that shares also will immediately become fully vested if an executive is terminated by Company without cause, or on termination by the executive for good reason.

For purposes of determining whether a termination by Company is with or without cause, Company defines "cause" to mean (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 contendere* or guilty to a felony, or (vii) any other material breach that is not cured within 20 days of receipt of written notice.

For purposes of determining whether a termination is for good reason, Company defines "good reason" to mean 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 a successor of Company, or (vi) any other material breach of the executive's employment by Company.

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 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 exceeds \$1,000,000.

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), 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 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 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)(i) of the Income Tax 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.

According to section 1.162-27(e)(2)(ii) of the regulations, 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. A formula or standard is objective if a third party having knowledge of the relevant performance results could calculate the amount to be paid to the employee. A formula or standard must specify the individual employees or class of employees to which it applies.

Section 1.162-27(e)(2)(iii) of the regulations provides that the terms of an objective formula or standard must preclude discretion to increase the amount of compensation payable that would otherwise be due upon attainment of the goal.

Section 1.162-27(e)(2)(v) of the regulations provides that the facts and circumstances cannot 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 payable under the grant or award will be considered performance-based. However, this section also provides that compensation does not fail to be qualified performance-based compensation merely because the plan allows the compensation to be payable upon death, disability, or change of ownership or control, although compensation actually paid on account of those events prior to the attainment of the performance goal would not satisfy the requirements of paragraph (e)(2).

Termination 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. Therefore, based on the facts submitted, we rule that restricted share awards under the Plan will be considered performance-based,

assuming they meet the requirements of section 162(m)(4)(C) of the Code, even though the compensation could be paid upon termination of the executive by Company without cause or termination by the executive for good reason.

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.

Sincerely yours,

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

Enclosure:  
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