

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

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date: March 3, 2000

to: District Director, Illinois  
[REDACTED]

from: District Counsel, Illinois CC:MS:ILD

subject: IRC § 162(m)

[REDACTED]  
EIN: [REDACTED]

Years: [REDACTED]

You have asked for assistance in determining which amounts should be included in salary in [REDACTED] for purposes of the disallowance under IRC § 162(m).

Section 162(m) (1) limits the deductible compensation of certain employees of a publicly held corporation to one million dollars. The amounts which you propose to disallow were paid to [REDACTED] chief operating officer of the taxpayer and its subsidiary, [REDACTED] since [REDACTED]

In [REDACTED] was paid \$ [REDACTED] in base salary. In addition, he was paid:

1. \$ [REDACTED]
2. [REDACTED]
3. [REDACTED]
4. [REDACTED]
5. [REDACTED]
6. [REDACTED]
7. [REDACTED]
8. [REDACTED]
9. [REDACTED]
10. [REDACTED]

It is our understanding that at this point, the taxpayer only contests the proposed disallowance of items [REDACTED] and [REDACTED]. The taxpayer contends that these amounts are contract payments, rather than payment for services.

Item [REDACTED] is labeled "[REDACTED]" in the Employment Agreement ("Agreement") dated [REDACTED]. Article [REDACTED] itself is entitled "[REDACTED]" Paragraph [REDACTED] states that the amount of \$[REDACTED] is paid as an inducement to enter into the Agreement.

Item [REDACTED] is labeled "[REDACTED]" in the Agreement. It is contained in Article [REDACTED] which is entitled "[REDACTED]" Paragraph [REDACTED] states that the amount of \$[REDACTED] is paid as compensation for actual and expected compensation, benefits and programs which [REDACTED] was entitled to receive, or expected to become entitled to receive, from his previous employer. No breakdown of the amount is contained in the Agreement, and there is no evidence about how the amount was arrived at.

The terms of the Agreement make it clear that the amounts which were paid to [REDACTED] were intended as compensation for his services. Treas. Reg. § 1.162-27 sets out the rules limiting deductions under § 162(m). Section 1.162-27(c)(1) and (2)(i)(A) identifies the chief executive officer of a publicly held corporation as an employee whose compensation is covered by § 162(m). Section 1.162-27(c)(3)(i) defines compensation as amounts paid as remuneration for services performed by a covered employee. Section 1.162-27(c)(3)(ii) sets out two exceptions to the definition of compensation, neither one of which apply in this case. Section 1.162-27(e) provides for another exception concerning performance base compensation, which also does not apply to the two items under consideration.

The taxpayer contends that the amounts involved were contract payments rather than payment for services. This seems to be an argument that the payments were not "compensation," i.e., that the payments are deductible business expenses other than compensation, and hence not subject to the restrictions of § 162(m) in the first place. However, the taxpayer offers no rationale under which the payments can be characterized as anything other than compensation for services to be rendered by [REDACTED].

Assuming for the moment that payments for "contract rights" might not be compensation under some circumstances, no contract rights have been identified as having been acquired by the taxpayer from [REDACTED] nor have any such rights been released by [REDACTED] to the taxpayer.

The \$[REDACTED] payment evidently was made to induce [REDACTED] to become an employee of the taxpayer. There is nothing to suggest that any "contract rights" were involved.

The \$[REDACTED] payment apparently was intended to compensate [REDACTED] for benefits accrued at his former employer, but which he lost when he was hired by the taxpayer. The contract rights, if any, involved were between [REDACTED] and his former employer. As such, the payment made by the taxpayer was not for contract rights, but rather, to replace lost benefits. The taxpayer neither acquired nor was released from any contract. This payment is simply compensation measured by the amount that [REDACTED] stood to gain or retain had he stayed with his former employer.

We have not commented on any of the other payments, since at this point the taxpayer does not seem to be contesting their disallowance and you have not raised any questions concerning them. However, we suggest that you should not agree to allow any of these amounts without asking for our opinion.

Richard A. Witkowski  
District Counsel

By: \_\_\_\_\_  
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