

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

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Date: July 30, 2003

Company =

Plan =

date A

date B

date C

date D

year X

year Y

taxable year Z

Committee

This is in reply to a letter dated March 14, 2003, and subsequent correspondence, submitted on behalf of Company by its duly authorized representative requesting a ruling under section 162(m) of the Internal Revenue Code. Specifically, a ruling is requested that the deduction limitation of section 162(m) of the Code does not apply to awards granted under the Plan before the first meeting of shareholders of Company in the fifth year after the year in which Company's shareholders most recently approved

the performance goals under the Plan, regardless of when Company actually makes payments pursuant to the awards.

The facts as represented by Company are as follows:

On or about date A, year X, Company's board of directors adopted the Plan and Company's shareholders approved the material terms of the Plan on date B, year X.

The Plan provides for awards of incentive bonuses to Company's "covered employees" (as defined in section 1.162(m)-27(c)(2) of the Income Tax Regulations) and other eligible employees of Company ("participants"). Company has represented that, except for the specific issue on which a ruling is requested, all of the requirements of section 162(m) of the Code and section 1.162(m)-27(e) of the regulations relating to qualified performance based compensation have been satisfied, including the requirements that (i) compensation must be paid solely on account of the attainment of one or more pre-established, objective performance goals, (ii) a compensation committee comprised solely of two or more "outside directors" must establish the performance goal and (iii) the compensation committee must certify that all conditions for payment have been satisfied.

For each fiscal year of Company, the Committee adopts a target equal to a desired level of achievement of one or more performance objectives that are set out in the Plan, based on results attained over one or more fiscal years of Company. The Committee assigns to each participant a bonus amount that Company will pay if 100 percent of the specified target is achieved. With respect to each target, the Committee also specifies a separate floor amount based on one or more of the performance objectives that, if not achieved, will result in no bonus being paid to the participant. Finally, the Committee adopts a mathematical formula or matrix for the fiscal year or years for purposes of determining the extent to which a bonus shall be paid to the participant if the applicable floor amount is exceeded, but 100 percent of the specified target is not achieved. The Committee retains the discretion to decrease the bonus payable to any covered employee.

As soon as practicable after the close of the last fiscal year covered by an award, the Committee determines and certifies to the board of directors of Company with respect to each participant whether and the extent to which the floor amount described above has been exceeded and the amount of the bonus payable to the participant, if any. The Committee has discretion to defer payment of an award to the extent that Company would not be entitled to deduct a current payment for Federal income tax purposes as a result of section 162(m) of the Code.

Year Y was the fifth year after year X. On date C, year Y, before the first meeting of shareholders of Company in year Y, the Committee approved the terms of awards under the Plan for taxable year Z. Shareholders of Company met for the first time during year Y on date D. Shareholders of Company took no action with respect to the Plan at that meeting. After date D, year Y, in accordance with the Plan and the terms of the awards made on date C, year Y, the Committee determined the amounts of the bonuses payable to covered employees of Company under the Plan for taxable year Z.

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) of the Code provides that a publicly held corporation shall not be allowed a deduction for remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year exceeds \$1,000,000.

Section 162(m)(4)(C) of the Code excepts from this limitation certain “performance-based compensation” payable solely on account of attaining one or more performance goals, as determined by a compensation committee comprised solely of two or more outside directors, if the material terms under which the compensation is paid, including the performance goals, have been approved by the shareholders of the publicly held corporation.

Section 1.162-27(e)(4)(vi) of the Regulations states that, if 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 and reapproved 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 do not address specifically what happens if the material terms of a performance goal are not reapproved within the required period.

In this case, the Committee made awards pursuant to the Plan before the date of the first meeting of shareholders of Company that occurred in the fifth year following the year in which shareholders most recently approved the material terms of the performance goal under the Plan, but payments pursuant to such awards were not made before that meeting and the Plan was not reapproved by shareholders at that meeting.

Based on the facts submitted, we rule as follows:

Amounts paid by Company to covered employees pursuant to the Plan in accordance with the terms of awards made by the Committee before date D, year Y, will not fail to constitute “qualified performance based compensation” within the meaning of section 1.162-27(e) of the Regulations merely because such amounts are paid after date D, year Y.

Except as expressly provided herein, no opinion is expressed or implied concerning the Federal 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

Sincerely yours,

ROBERT B. MISNER  
Senior Technical Reviewer  
Executive Compensation Branch  
Office of the Division Counsel/Associate  
Chief Counsel  
(Tax Exempt and Government Entities)