

February 29, 2008

IRS DELAYS APPLICATION OF ITS HOLDING UNDER RECENT SECTION 162(M) EXECUTIVE PERFORMANCE PAY RULING

As discussed in our "Benefits News Alert" dated February 7, 2008, the Internal Revenue Service (IRS) recently released Private Letter Ruling 200804004 (the "PLR"), which denied federal income tax deductibility under section 162(m)(4)(C) of the Internal Revenue Code of 1986, as amended (the "Code") for compensation payable to certain executive officers by a public corporation under an arrangement that provided for accelerated payments in the event of certain types of employment termination.

Concerns arose about the timing for application of the IRS's position, its impact on a company's financial statements, and whether a company can continue to anticipate a tax deduction related to performance-based compensation that provides for the waiver of performance conditions upon certain employment terminations. For financial statement purposes, private letter rulings issued by the Service *can be considered* when evaluating whether a tax position satisfies the "more likely than not" standard required under the Financial Accounting Standard Board's Interpretation No. 48 (FIN 48). If a tax benefit has been previously recognized for a position that no longer meets the "more likely than not" standard, then the prior accounting effect must be reversed in the first subsequent reporting year. In addition, companies may be required to disclose the anticipated reduction in deferred tax assets in their financial statements.

In light of these concerns, the IRS issued Revenue Ruling 2008-13 (the "Revenue Ruling") on February 21, 2008, providing a transition period before application of the principles under the PLR.

Although the Revenue Ruling confirmed the position set forth in the PLR, it provides that the IRS will not apply that position to disallow any deduction under Code section 162(m) for compensation paid pursuant to any plan, agreement or contract that contains payment acceleration provisions in the event of (i) involuntary termination without cause, (ii) voluntary termination with "good reason" and (iii) retirement, provided that either (a) the performance period applicable to such compensation begins prior to January 1, 2009 or (b) the compensation is paid pursuant to an employment agreement in effect as of February 21, 2008. With respect to employment agreements, the exception will continue to apply until the agreement is renewed or extended, including any renewal or extension that arises automatically under the agreement (*i.e.*, an "evergreen provision").

Publicly traded corporations should consider the following actions during the transition period:

- Review any agreement providing performance-based compensation covered by Code section 162(m) (or acceleration of such compensation) to determine if it would permit payment upon the impermissible employment terminations (*i.e.*, terminations other than death, disability and change in control) regardless of the level of performance attained;
- If any agreement subject to Code section 162(m) contains such language, consider amending it, as necessary, so that the performance-based compensation will be paid only if actual performance is achieved or upon death, disability or change in control; and
- Consider the implications for the company's proxy disclosures related to performance-based compensation.

If you have any questions regarding the foregoing, please feel free to contact one of the attorneys listed below.

Charles F. Plenge
214.651.5573

charles.plenge@haynesboone.com

John M. Collins
214.651.5564

john.collins@haynesboone.com

Greta E. Cowart
214.651.5592

greta.cowart@haynesboone.com

Jesse J. Gelsomini
713.547.2233

jesse.gelsomini@haynesboone.com

Susan A. Wetzel
214.651.5389

susan.wetzel@haynesboone.com

Marilyn Doolittle
713.547.2901

marilyn.doolittle@haynesboone.com

Tiffany Walker
214.651.5266

tiffany.walker@haynesboone.com

Kirsten Jensen
214.651.5171

kirsten.jensen@haynesboone.com

Jamison Klang
713.547.2025

jamie.klang@haynesboone.com

Katy Zarolia
214.651.5121

katy.zarolia@haynesboone.com

Chris Kang
214.651.5944

chris.kang@haynesboone.com

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