

Part III - Administrative, Procedural, and Miscellaneous

Section 162(m)—Excessive Compensation

Section 280G—Golden Parachute Payments

Notice 2008-94

I. PURPOSE

This notice provides guidance on certain executive compensation provisions of the Emergency Economic Stabilization Act of 2008, Div. A of Pub. Law No. 110-343 (EESA), which was enacted on October 3, 2008. Section 302 of EESA added new §§ 162(m)(5) and 280G(e) to the Internal Revenue Code. Section 162(m) generally limits the deductibility of compensation paid to certain corporate executives and § 280G provides that a corporate executive's excess parachute payments are not deductible and imposes (under § 4999) an excise tax on the executive for those amounts.

New §§ 162(m)(5) and 280G(e) provide additional limitations on the deductibility of compensation paid to certain executives by employers who sell "troubled assets" in the "troubled assets relief program" included in EESA.

Section 162(m)(5) generally reduces the \$1 million deduction limitation to \$500,000 for certain taxable years and provides that certain exceptions to the deduction limitation, including the exception for performance-based compensation, are not applicable. Section 280G(e) generally expands the definition of a parachute payment to include certain payments made contingent on severance from employment.

II. BACKGROUND RELATING TO EESA EXECUTIVE COMPENSATION PROVISIONS

Section 101(a) of EESA authorizes the Secretary of the Treasury to establish a Troubled Assets Relief Program (TARP) to "purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and policies and procedures developed and published by the Secretary." Section 120 of EESA provides that the TARP authorities terminate on December 31, 2009, unless extended upon certification by the Secretary of the Treasury to Congress, but in no event later than two years from the date of enactment (October 3, 2008) (the TARP authorities period). Thus, the TARP authorities period is the period from October 3, 2008 to December 31, 2009 or, if extended, the period from October 3, 2008 to the date so extended, but no later than October 3, 2010.

EESA includes two sections that directly address executive compensation. Section 302 of EESA enacted tax provisions as amendments to §§ 162(m) and 280G that address

compensation paid to certain executive officers employed by financial institutions that sell assets under TARP. This notice addresses these tax provisions.

Section 111 of EESA subjects certain financial institutions that sell assets to the Treasury Department to specified executive compensation standards. In the case of a direct purchase the standards under section 111(b) of EESA include: (a) limits on compensation that exclude incentives on senior executive officers of financial institutions to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Treasury Department holds an equity or debt position, (b) recovery of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate, and (c) a prohibition on making any golden parachute payment to any of its senior executive officers during the period that the Treasury Department holds an equity or debt position. In the case of a financial institution that has sold assets under TARP in sales that are not solely direct purchases and the amount sold (including direct purchases) exceeds \$300 million in the aggregate, the financial institution is prohibited under section 111(c) during the TARP authorities period from entering into any new employment contract with a senior executive officer that provides a golden parachute in the event of involuntary termination from employment, bankruptcy filing, insolvency, or receivership. See Interim final regulations issued by the Treasury under section 111(b) of EESA at 31 CFR part 30, Notice 2008-PSSF1 under section 111(b) of EESA, and Notice 2008-TAAP under section 111(c) of EESA.

III. SECTION 302(a) OF EESA ADDING NEW § 162(m)(5)

A. Section 162(m) Background

Section 162(m) generally limits the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation to no more than \$1 million per year.¹ Section 162(m)(3) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year, or (2) one of the four most highly compensated officers for the taxable year (other than the chief executive officer) required to be reported to the shareholders under the Securities Exchange Act of 1934 (the Exchange Act).

In 2006, the Securities and Exchange Commission amended the rules related to executive compensation disclosure. In response to the 2006 amendment, the Treasury Department and the Service issued Notice 2007-49, 2007-1 C.B. 1429, which provides that “covered employee” means any employee who is (1) the principal executive officer (or an individual acting in such capacity) defined by reference to the Exchange Act or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer or the principal financial officer), again defined by reference to the Exchange Act. Section 1.162-27(c)(2) of the Treasury Regulations provides that

¹ A corporation is treated as publicly held if it has a class of equity securities that is required to be registered under section 12 of Securities Exchange Act of 1934.

the individual must meet the criteria of chief executive officer or be among the highest compensated officers as of the last day of the taxable year in order to be a covered employee.

If an individual is a covered employee for a taxable year, then a deduction limit applies to all compensation not explicitly excluded from the deduction limit, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The \$1 million limit is reduced by excess parachute payments (as defined in § 280G) that are not deductible by the corporation. Under § 162(m) as in effect prior to the amendment included in EESA, the following types of compensation generally are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds \$1 million: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met (“performance-based compensation”); (3) payments to a tax-qualified retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive’s gross income; and (5) any remuneration payable under a written binding contract that was in effect on February 17, 1993 and that was not materially modified thereafter. Because remuneration generally does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee, the deduction limit does not apply to compensation that is deferred until after termination of employment.

B. Section 302(a) of EESA: Amendment adding § 162(m)(5)

Section 302(a) of EESA amended § 162(m) to add § 162(m)(5), which reduces the deduction limit to \$500,000 in the case of “executive remuneration” and “deferred deduction executive remuneration.” This limit applies only to certain employers (an “applicable employer”) for remuneration paid to certain executives (“covered executives”) during certain taxable years (an “applicable taxable year”). Employers covered under § 162(m)(5) are not limited to publicly held corporations (nor even to corporations). The exception for performance based compensation and certain other exceptions do not apply in the case of executive compensation covered under § 162(m)(5).

Q&A-1 and Q&A-2 of this notice provide guidance on when an employer is an applicable employer, Q&A-3 provides guidance on when a taxable year is an applicable taxable year, Q&A-4 provides guidance on the determination of who is a covered executive, Q&A-5 provides guidance on mergers and acquisitions, Q&A-6 provides guidance on executive remuneration, and Q&A-7 through Q&A-10 provide guidance on deferred deduction executive remuneration.

Q-1: What is an applicable employer under § 162(m)(5)?

A-1: (a) General definition. An “applicable employer” is any financial institution that is an employer from whom one or more troubled assets are acquired under TARP, but only if the aggregate amount of the assets acquired exceeds \$300 million. The assets that are counted for the \$300 million threshold include assets that are acquired under TARP in

accordance with section 101(a) of EESA. However, if the only such acquisitions from a financial institution are through a direct purchase, the financial institution is not an applicable employer. (For special rules with respect to employers that sell assets through a direct purchase, see section 111(b) of EESA, Interim final regulations issued by the Treasury under section 111(b) of EESA at 31 CFR part 30, and Notice 2008-PSSFI under section 111(b) of EESA.)

(b) Controlled group rules. For purposes of § 162(m)(5), including the determination of whether the aggregate amount of assets acquired from an employer exceeds \$300 million, two or more persons who are treated as a single employer under § 414(b) (employees of a controlled group of corporations) and § 414(c) (employees of partnerships, proprietorships, etc., that are under common control) are treated as a single employer. However, for purposes of applying the aggregation rules to determine an applicable employer, the rules for brother-sister controlled groups and combined groups are disregarded (including disregarding the rules in § 1563(a)(2) and (a)(3) with respect to corporations and the parallel rules that are in § 1.414(c)-2(c) of the Treasury Regulations with respect to other organizations conducting trades or businesses). See Q&A-4 of this notice regarding the determination of a covered executive in a controlled group, and see Q&A-5 of this notice for special rules where a financial institution has acquired another financial institution through an acquisition.

(c) Example. Bank holding company X is the sole owner of banks A, B, and C. In December of 2008, bank A sells \$150 million of assets under a TARP auction purchase. In February of 2009, bank B sells \$100 million of assets under a TARP auction purchase. On August 14, 2009, bank C sells \$100 million of assets under a TARP auction purchase. Bank holding company X, along with banks A, B, and C, plus any other entity that is treated as the same employer under the rules described in paragraph (b) of this Q&A-1, constitute a single applicable employer that has sold in excess of \$300 million of assets under a TARP auction purchase. As provided in Q&A-4 of this notice, the chief executive officer and chief financial officer of bank holding company X and the three other most highly compensated officers of the bank holding company X controlled group are “covered executives.”

Q-2: Can a corporation that is not publicly traded, or an entity that is not a corporation, be an “applicable employer”?

A-2: (a) General rule. Yes. An applicable employer for purposes of § 162(m)(5) is not limited to a publicly traded corporation or even to the corporate business form. Thus, an entity, whether or not publicly traded, is an applicable employer if the entity is described in Q&A-1 of this notice regardless of whether the entity is a corporation, a partnership (or taxed as a partnership for federal tax purposes), or a trust.

(b) Special rule for partnerships, grantor trusts, and similar entities. In the case of a partnership, grantor trust, or similar entity, the determination of whether more than \$300 million of assets has been sold is generally made at the level of the selling entity (taking into account all entities that are treated as the same employer under the controlled group rules described in Q&A-1(b) of this notice).

However, if the selling entity has no employees who are officers (or acting in the capacity of an officer), then the owner of the entity that manages the selling entity's assets is the entity that may be the applicable employer (along with all entities that are treated as the same employer as the selling entity under the controlled group rules described in Q&A-1(b) of this notice).

Q-3: What is an applicable taxable year to which the \$500,000 deduction limit imposed by § 162(m)(5) applies?

A-3: Section 162(m)(5) does not apply to an employer unless, during a taxable year of the employer that includes any portion of the TARP authorities period, the aggregate amount of the troubled assets acquired under TARP from the employer in that taxable year, when added to the amount acquired from the employer under TARP for all preceding taxable years, exceeds \$300 million (unless all such acquisitions are through a direct purchase. If the condition in the preceding sentence is satisfied, then § 162(m)(5) applies to that taxable year and to any subsequent taxable year of the employer that includes any portion of the TARP authorities period. (See Q&A-10 regarding the applicability of § 162(m)(5) to deferred deduction executive compensation after the TARP authorities period.) If the entities that are treated as a single applicable employer under the controlled group rules described in Q&A-1(b) of this notice do not have the same taxable year, the relevant taxable year is the taxable year of the parent entity in the controlled group.

Q-4: Who is a covered executive under § 162(m)(5)?

A-4: (a) General definition. A "covered executive" means an individual described in the following sentence who is employed by a financial institution that is an applicable employer at any time during an applicable taxable year. Covered executives are limited to: (i) the chief executive officer (CEO) and the chief financial officer (CFO) (or an individual acting in either of those capacities) of the applicable employer during the taxable year that includes any portion of the TARP authorities period, and (ii) the three highest compensated officers of the applicable employer (including the entire controlled group) other than the CEO or CFO, taking into account only employees employed during the taxable year that includes any portion of the TARP authorities period (the high three officers).

(b) Determination of high three officers. For corporations that are subject to the Exchange Act (as defined in section III.A. of this notice), the high three officers are determined on the basis of the shareholder disclosure rules under the Exchange Act with one difference. In accordance with the Exchange Act disclosure rules, the term "officer" means those "executive officers" whose compensation is subject to reporting under the Exchange Act. For the purpose of determining the high three officers, compensation is defined as it is in the Exchange Act disclosure rules to include total compensation without regard to whether the compensation is includible in an executive officer's gross income. However, unlike the Exchange Act disclosure rules that determine the high three officers by reference to total compensation for the last completed fiscal year, the measurement period for purposes of determining the high three officers for an applicable taxable year is that taxable year.

(c) Application to private employers and noncorporate entities. Rules analogous to the rules in paragraphs (a) and (b) of this Q&A-4 apply to employers that are not subject to the Exchange Act disclosure rules, including employers whose stock is not publicly traded and employers that are not corporations.

(d) Time period as a covered executive. If an employee is a covered executive with respect to an applicable employer for any applicable taxable year, the executive is a covered executive for any subsequent applicable taxable year, including being a covered executive in any later taxable year for purposes of the special rule for deferred deduction executive remuneration (described in Q&A-10 of this notice). (See Q&A-5 of this notice for special rules that apply in connection with an acquisition.)

Q-5: How do the rules apply in connection with an acquisition, merger, or reorganization?

A-5: (a) Special rules for acquisitions, mergers, or reorganizations. In the event that a financial institution (target) that sold troubled assets under TARP is acquired by an entity that is not related to target (acquirer) in an acquisition of any form, the troubled assets sold under TARP by target prior to the acquisition are not aggregated with any assets sold by acquirer prior to or after the acquisition. For this purpose, acquirer is related to target if stock or other interests of target are treated (under § 318(a) other than paragraph (4) thereof) as owned by acquirer.

If, after an acquisition, troubled assets of target are sold by acquirer's controlled group (including target in the case of a stock acquisition), those assets must be aggregated with any assets sold by acquirer, whether prior to or after the acquisition, for purposes of determining whether acquirer is an applicable employer.

If target was an applicable employer at the time of the acquisition, acquirer will not become an applicable employer merely as a result of the acquisition. Further, if target was an applicable employer at the time of the acquisition, a covered executive of target will continue to be a covered executive during the TARP authorities period if he or she is employed by the controlled group of which target is a member, regardless of whether acquirer is an applicable employer and regardless of whether the target covered executive is a covered executive of the acquirer. However, if, after an acquisition, a target covered executive ceases employment with the controlled group of which target is a member, no new executive of target will be a covered executive merely because of such termination, unless such executive is a covered executive of acquirer.

(b) Example. In 2008, financial institution A sells \$100 million of troubled assets under TARP and financial institution B sells \$350 million of troubled assets under TARP. In January 2009, financial institution A acquires financial institution B in a stock purchase transaction, with the result that financial institution B becomes a wholly-owned subsidiary of financial institution A. In February 2009, financial institution A sells an additional \$100 million of its troubled assets under TARP, and in March 2009 financial institution B (when it is a wholly owned subsidiary of A) sells an additional \$150 million

of troubled assets. Neither the sale of troubled assets by financial institution A nor the sale of troubled assets by financial institution B are solely through direct purchases.

Based on the rules in paragraph (a) of this Q&A-5, financial institution A is not an applicable employer as a result of the acquisition of B, or as a result of the assets sold in February 2009, because the \$350 million of troubled assets sold by financial institution B prior to the acquisition are not aggregated with the troubled assets sold by financial institution A's controlled group prior to and after the acquisition of financial institution B. However, financial institution A becomes an applicable employer in March 2009 when the amount of troubled assets sold by financial institution A's controlled group (without regard to the sales by financial institution B prior to the acquisition of B by A) total \$350 million. Further, because 2009 is an applicable taxable year with respect to financial institution B, the officers of financial institution B who are covered executives on the date financial institution B was acquired continue to be covered executives during any subsequent applicable taxable year that includes any portion of the TARP authorities period, as long as they are employed by financial institution A's controlled group. Similarly, the CEO, CFO, and high three officers of financial institution A become covered executives in 2009 when financial institution A becomes an applicable employer.

Q-6: What constitutes executive remuneration to which the \$500,000 limit imposed by § 162(m)(5) applies?

A-6: (a) General definition. For the purposes of the § 162(m)(5) \$500,000 deduction limit, except as provided in paragraph (b) of this Q&A-6, executive remuneration means applicable employee remuneration, as determined under § 162(m)(4), but without regard to the following subparagraphs of § 162(m)(4): (B) (remuneration payable on a commission basis), (C) (performance-based compensation), or (D) (exception for existing binding contracts). Under § 162(m)(4), applicable employee remuneration for a year is based on the year in which the remuneration is deductible (whether or not the remuneration is paid in that year or is includible in the employee's income in that year). For example, payments that are deductible by the employer in an applicable taxable year, but are paid to the covered executive by the 15th day of the third month after the end of that year (as described in § 1.404(b)-1T, Q&A-2(b)(1) of the Treasury Regulations), are executive remuneration for that applicable taxable year.

(b) Remuneration only for the applicable taxable year. The \$500,000 deduction limit in § 162(m)(5)(A) applies to executive remuneration and deferred deduction executive remuneration attributable to services performed by a covered executive during an applicable taxable year. Under this rule, payments of remuneration that are deductible in an applicable taxable year for services performed by the covered executive in a prior taxable year are not treated as executive remuneration for purposes of § 162(m)(5). (See Q&A-7 through Q&A-10 of this notice for rules related to deferred deduction executive remuneration.)

Q-7: How does the \$500,000 deduction limitation imposed by § 162(m)(5) apply with respect to deferred deduction executive remuneration?

A-7: (a) General rule. No deduction is allowed for any taxable year for deferred deduction executive remuneration for services performed during any applicable taxable year by a covered executive, to the extent that the amount of the deferred deduction executive remuneration exceeds \$500,000, minus the sum of: (i) the executive remuneration for that applicable taxable year, plus (ii) the portion of the deferred deduction executive remuneration for such services taken into account in a preceding taxable year. Under this rule, the unused portion (if any) of the \$500,000 limit for the applicable taxable year that has not been taken into account (and so is unused) is carried forward until the year in which the deferred deduction executive remuneration allocable to that applicable taxable year is otherwise deductible, and the remaining unused limit is then applied to the payment of the deferred deduction executive remuneration.

(b) Examples. (1) Covered executive A is paid \$400,000 in salary by an applicable employer in 2009 (an applicable taxable year) and A obtains a legally binding right attributable to services performed in 2009 to receive a payment of \$250,000 in 2015. The full \$400,000 in cash salary is deductible under the \$500,000 limit in 2009. In 2015, the employer's deduction with respect to the \$250,000 is limited to \$100,000, which represents the unused portion of the \$500,000 limit from 2009 (and no deduction will be allowed for the remaining \$150,000).

(2) Covered executive B is paid \$400,000 salary by an applicable employer in 2009 (an applicable taxable year) and B obtains a legally binding right attributable to services performed in 2009 to be paid \$250,000 in 2010 (which is also an applicable taxable year), and B is paid \$500,000 in salary in 2010. Accordingly, the employer's deduction in 2010 for the \$250,000 payment made in 2010 (attributable to services performed in 2009) is limited to \$100,000. The entire \$500,000 of salary earned in 2010 is deductible in 2010 (assuming other deduction requirements are satisfied).

Q-8: What is "deferred deduction executive remuneration" for purposes of § 162(m)(5)?

A-8: Deferred deduction executive remuneration means remuneration that would be executive remuneration for services performed by a covered executive in an applicable taxable year but for the fact that the deduction is allowable in a subsequent taxable year (determined without regard to § 162(m)(5)). The amount paid as deferred deduction executive remuneration is taken into account, without distinction between the amount deferred in the taxable year in which the services were performed and earnings thereon.

Q-9: How are the services to which deferred deduction executive remuneration is allocable determined?

A-9: (a) Period during which services are performed. For purposes of the \$500,000 limit on the deductibility of deferred deduction executive remuneration under § 162(m)(5)(A), the period during which the services are performed by a covered executive to which the remuneration is allocable is determined in accordance with this Q&A-9. (See Q&A-7 of this notice regarding the application of the deduction limits to deferred deduction executive remuneration.)

(b) Services to which deferred deduction executive remuneration is allocable. (1) General rule: Remuneration allocable to a service period based on plan formula. If an employee obtains a legally binding right to remuneration under a plan, agreement, or arrangement (plan) and that plan provides for benefit payments under a formula that relates to a specific period of service in a year (such as relating to compensation paid during that period), the deferred deduction executive remuneration is generally allocable to that specific period. To the extent that, based on the terms of the plan, deferred deduction executive remuneration is not allocable to services performed in a particular taxable year, then the remuneration generally is for services performed during the taxable year in which the employee obtains the legally binding right to the remuneration.

(2) Legally binding right. Deferred deduction executive remuneration is not allocable to a period prior to the date the employee is employed by the employer and obtains a legally binding right to the remuneration. An employee does not have a legally binding right to remuneration to the extent that compensation may be reduced unilaterally or eliminated by the employer or other person after the services creating the right to the remuneration have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the remuneration is available or exercisable only upon a condition, or the discretion to reduce or eliminate the compensation lacks substantive significance, then the employee has a legally binding right to the remuneration. For this purpose, remuneration is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of a nondiscretionary, objective provision creating a substantial risk of forfeiture. (See §§ 1.409A-1(b)(1) and 31.3121(v)(2)-1(b)(3)(i) of the Treasury Regulations for additional rules regarding when an employee obtains a legally binding right to remuneration.)

(3) Substantial risk of forfeiture. To the extent that an employee's right to remuneration is subject to a substantial risk of forfeiture (as determined in accordance with the rules under § 1.409A-1(d) of the Treasury Regulations) in the form of a requirement to continue to perform substantial future services for the employer, the remuneration generally is for services performed over the period of time that the employee is required to continue to perform substantial future services for the employer and is allocated to that period on a pro rata basis, unless the remuneration is allocable to a different period under the rule in paragraph (b)(1) of this Q&A-9. If the substantial risk of forfeiture lapses early (such as due to death or disability), then the allocation is prorated over the period from when the employee obtained the legally binding right to the payment to the date that the substantial risk of forfeiture lapses. The only substantial risk of forfeiture taken into account for purposes of this paragraph (b)(3) is a requirement that the employee perform substantial future services. Any other condition related to the purpose of the remuneration that may constitute a substantial risk of forfeiture is disregarded.

(c) Examples. (1) Employee A obtains on January 1, 2006 a legally binding right to be paid \$400,000 at the end of December, 2010, but only if A continues to be employed on the date of payment. In this case, a pro rata portion of the remuneration is for services performed during 2006, 2007, 2008, 2009, and 2010 (\$80,000 per year). If 2009 and 2010

are applicable taxable years for A's employer and A is a covered executive in those years, then, for purposes of the \$500,000 deductible limitation for 2009 and 2010, \$80,000 of the \$400,000 paid in 2010 would be deferred deduction executive remuneration allocable to services rendered in 2009 and \$80,000 of the \$400,000 paid in 2010 would be allocable to services rendered in 2010.

(2) Employee B obtains a legally binding right in 2008 to receive a payment of \$100,000 in 2012 (without regard to continued employment) in the event that an asset is sold by that date for a price at or above a specified dollar amount, which, under the circumstances is a substantial risk of forfeiture. The risk of forfeiture is disregarded and the \$100,000 payment is for services performed in 2008. The \$100,000 payment made in 2012 is deferred deduction executive remuneration allocable to 2008 and is subject to the 2008 \$500,000 deduction limitation.

(3) Employee C obtains on December 31, 2008 a legally binding right to be paid on February 1, 2011 an amount equal to 10 percent of employee C's salary during the period from January 1, 2009 through December 31, 2010, and employee C's salary is \$400,000 for each of 2009 and 2010. Under the terms of the plan in this case, the remuneration is allocable pro rata to services performed in 2009 and 2010, so that half of the \$80,000 payment made on February 1, 2011 is for services performed in 2009 and the other half is for services performed in 2010.

(4) Employee D obtains on December 31, 2008 a legally binding right to be paid on January 1, 2015 an amount equal to 20 percent of D's highest annual salary times the number of years of service completed by D before January 1, 2011, but only if D remains employed through December 31, 2010. Employee D remains employed through December 31, 2010 and has an annual salary of \$400,000 in 2009 and \$450,000 in 2010. Accordingly, Employee D receives a payment of \$180,000 on January 1, 2015 (20 percent times 2 years of service times \$450,000, D's highest annual salary). Under the terms of the plan in this case, under the rule in paragraph (b)(1) of this Q&A-9, the remuneration allocable to services performed in 2009 is \$80,000 (20 percent of Employee D's annual salary in 2009 times 1 year of service). The remuneration allocable to services performed in 2010 is \$100,000 (20 percent of \$450,000, times 2 years of service, reduced by the remuneration allocable to services performed in 2009).

(5) Employee E obtains on December 31, 2008 a legally binding right to be paid \$400,000 on February 1, 2011 (without any requirement of continued employment). Under these facts and circumstances, the remuneration is not allocable to services performed in a period of time after December 31, 2008, so that the \$400,000 paid on February 1, 2011 is for services performed during the taxable year that includes December 31, 2008.

(6) Employee F obtains on December 31, 2008 a legally binding right to acquire stock (a stock option) with an exercise price equal to the fair market value of the stock on December 31, 2008 (without any requirement of continued employment in order to be able to exercise the right and retain the shares). The remuneration is not allocable to

services performed in a period of time after December 31, 2008, so that the remuneration resulting from exercise of the stock option is for services performed in the taxable year that includes December 31, 2008.

(7) Employee G obtains on January 1, 2009 a legally binding right to acquire stock (a stock option) over the next 10 years with an exercise price equal to the fair market value of the stock on January 1, 2009, but the stock option can be exercised only after the employee has continued his or her employment for three more years (through December 31, 2011). The employee exercises the right in 2014 resulting in income of \$210,000. In this case, the payment of \$210,000 is allocable to services performed from January 1, 2009 through December 31, 2011, of which \$70,000 is allocable to services rendered in 2009, \$70,000 is allocable to services rendered in 2010, and \$70,000 is allocable to services performed in 2011.

Q-10: How long does the limit imposed by § 162(m)(5) apply?

A-10: While the limit imposed by § 162(m)(5) only applies to remuneration for services performed in an applicable taxable year, the limit with respect to deferred deduction executive remuneration for services performed in an applicable taxable year applies for deductions in all subsequent taxable years (until the deferred deduction executive remuneration for services performed in that applicable taxable year is completely paid).

IV. SECTION 302(b) OF EESA ADDING NEW § 280G(e)

A. Section 280G Background

Section 280G, as in effect prior to the addition of § 280G(e) made by section 302(b) of EESA, provides that certain payments in excess of certain limits, referred to as “excess parachute payments,” are not deductible by a corporation. In addition, § 4999 imposes an excise tax on the recipient of any excess parachute payment equal to 20 percent of the amount of such payment.

Subject to certain exceptions, § 280G(b)(2) defines a “parachute payment” as any payment in the nature of compensation to (or for the benefit of) a disqualified individual that is contingent on a change in the ownership or effective control of a corporation or on a change in the ownership of a substantial portion of the assets of a corporation (“acquired corporation”) if the aggregate present value of all such payments made or to be made to the disqualified individual equals or exceeds three times the individual’s “base amount.” Section 280G(b)(3) defines the individual’s base amount as the average annual compensation payable by the acquired corporation and includible in the individual’s gross income over the five taxable years of such individual preceding the individual’s taxable year in which the change in ownership or control occurs.

A disqualified individual is any individual who is an employee, independent contractor, or other person specified in Treasury regulations who performs personal services for the corporation and who is an officer, shareholder, or highly compensated individual of the corporation.

B. Section 302(b) OF EESA: Amendment of § 280G

Section 302(b) of EESA amended § 280G by expanding the definition of a parachute payment to include certain severance payments made to a covered executive of an applicable employer participating in TARP. As defined in § 280G(e)(2)(B), an applicable severance from employment is any severance from employment of a covered executive: (1) by reason of an involuntary termination of the executive by the employer or (2) in connection with a bankruptcy, liquidation, or receivership of the employer.

New § 280G(e) is effective for payments made during an applicable taxable year with respect to severances occurring during the TARP authorities period.

Q-11: Who is subject to the special rules in § 280G(e)?

A-11: The special rules in § 280G(e) apply to any covered executive of an applicable employer who has a severance from employment during an applicable taxable year that is treated as an “applicable severance from employment,” as defined in Q&A-12 of this notice. For purposes of § 280G(e), the terms “applicable employer,” “applicable taxable year,” and “covered executive” have the same meaning as under § 162(m)(5) (as those terms are described in Q&A-1 through Q&A-4 of this notice, and taking into account the special rule in Q&A-5 of this notice). However, § 280G(d)(5) (treatment of affiliated groups) and other provisions do not apply.

Q-12: What is an applicable severance from employment of a covered executive for purposes of § 280G(e)?

A-12: (a) Applicable severance from employment defined. An applicable severance from employment means any covered executive’s severance from employment with the applicable employer: (1) by reason of involuntary termination of employment with an entity that is an applicable employer or (2) in connection with any bankruptcy, liquidation, or receivership of an entity that is an applicable employer.

(b) Involuntary termination. (i) An involuntary termination from employment means a severance from employment due to the independent exercise of the unilateral authority of the applicable employer to terminate the covered executive’s services, other than due to the covered executive’s implicit or explicit request, where the covered executive was willing and able to continue performing services. An involuntary termination from employment may include the applicable employer’s failure to renew a contract at the time such contract expires, provided that the covered executive was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and able to continue providing such services. In addition, a covered executive’s voluntary termination from employment constitutes an involuntary termination from employment if the termination from employment constitutes a termination for good reason due to a material negative change in the covered executive’s employment relationship. See § 1.409A-1(n)(2) of the Treasury Regulations.

(ii) A severance from employment by a covered executive is by reason of involuntary termination even if the covered executive has voluntarily terminated employment in any

case where the facts and circumstances indicate that absent such voluntary termination the applicable employer would have terminated the covered executive's employment and the covered executive had knowledge that he or she would be so terminated. (See § 280G(e)(2)(C)(ii)(III).)

Q-13: What is a "parachute payment" for purposes of § 280G(e)?

A-13: (a) General definition. For purposes of § 280G(e), a "parachute payment" means any payment in the nature of compensation to (or for the benefit of) a covered executive made during an applicable taxable year on account of an applicable severance from employment during the TARP authorities period if the aggregate present value of such payments equals or exceeds an amount equal to three times the covered executive's base amount. (See Q&A-14 of this notice for a definition of an excess parachute payment.)

(b) Payment on account of an applicable severance from employment. A payment on account of an applicable severance from employment means a payment that would not have been payable if no applicable severance from employment had occurred (including amounts that would otherwise have been forfeited due to severance from employment) and amounts that are accelerated on account of the applicable severance from employment. (See § 1.280G-1, Q&A-24(b) of the Treasury Regulations for rules regarding the determination of the amount that is on account of an acceleration.) Further, for purposes of § 280G(e), the exclusions under § 280G(b)(2)(C) (payments under certain contracts entered into within 1 year of the change); § 280G(b)(4) (payment of amount determined to be reasonable compensation); § 280G (b)(5) (exceptions for small business corporations); and § 280G(d)(5) (treatment of affiliated groups) do not apply.

(c) Excluded amounts. Payments on account of an applicable severance from employment do not include amounts paid to a covered executive under a tax-qualified retirement plan.

(d) Base amount defined. For purposes of § 280G(e), the "base amount" for a covered executive has the meaning set forth in § 280G(b)(3) and § 1.280G-1, Q&A-34, of the Treasury Regulations, except that references to "change in ownership or control" are treated as referring to an "applicable severance from employment."

Q- 14: What is an "excess parachute payment" for purposes of § 280G(e)?

A-14: For purposes of § 280G(e), an excess parachute payment is any parachute payment (as defined in Q&A-13 of this notice) in excess of the base amount allocated to the payment.

Q-15: What are the consequences of an excess parachute payment?

A-15: (a) General rule. No deduction is allowed for an excess parachute payment. Further, a tax equal to 20 percent of the excess parachute payment is imposed on a covered executive who receives an excess parachute payment.

(b) Example. In 2008, which is an applicable taxable year for the employer, a covered executive has an applicable severance from employment. The covered executive's base

amount is \$1 million and the covered executive receives a lump sum payment of \$5 million on account of an involuntary termination of employment. The lump sum payment qualifies as a parachute payment since the amount of the lump sum payment (\$5 million) is not less than three times the covered executive's base amount (3 times \$1 million equals \$3 million). The amount of the excess parachute payment is equal to \$4 million (\$5 million payment less the covered executive's \$1 million base amount). Thus, under § 280G(e), the \$4 million excess parachute payment is not deductible by the applicable employer. Further, the \$4 million excess parachute payment is subject to a 20 percent tax payable by the covered executive.

Q-16: What if a payment treated as a parachute payment under § 280G(e) is also determined to be a parachute payment under § 280G without regard to § 280G(e)?

A-16: If a payment treated as a parachute payment under § 280G(e) is a parachute payment under § 280G on account of a change in control without regard to § 280G(e), then § 280G(e) does not apply to the payment.

Q-17: To which years does the deduction limit imposed by § 280G(e) apply?

A-17: The limit imposed by § 280G(e) applies to remuneration paid in an applicable taxable year. (See Q&A-3 of this notice for additional information, including the definition of an applicable taxable year.)

REQUEST FOR COMMENTS

The Treasury Department and the Service anticipate issuing additional guidance with respect to §§ 162(m)(5) and 280G(e). The Treasury Department and the Service request comments on the topics addressed in this notice. All materials submitted will be available for public inspection and copying.

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2008-94), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Couriers Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn:CC:PA:LPD:PR (Notice 2008-94), Room 5203. Submissions may also be sent electronically via the internet to the following email address:

Notice.comments@irscounsel.treas.gov. Include the notice number (Notice 2008-94) in the subject line.

EFFECTIVE DATE

Until further guidance is issued, taxpayers may rely on the rules in this notice for purposes of §§ 162(m)(5) and 280G(e) effective from October 3, 2008 (the date of enactment of EESA). Further guidance will be prospective to the extent that it is more restrictive.

CONTACT INFORMATION

For further information regarding this notice, contact Ilya Enkishev of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities) at (202) 622-6030 (not a toll-free call).

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