Part I

Section 162(m)—Excessive Compensation

26 CFR 1.162-27(e)

Rev. Rul. 2008-32

ISSUE

Whether a member of a corporation's board of directors qualifies as an "outside director" under § 162(m)(4)(C)(i) after serving as an interim chief executive officer?

FACTS

Company X, a calendar year taxpayer, is a publicly held corporation within the meaning of § 162(m)(2). Director A is a member of Company X's board of directors. Director A is not a member of the compensation committee of Company X's board of directors. Company X's chief executive officer (CEO), Employee E, unexpectedly resigned on January 7, 2008. In response to Employee E's resignation, the board of directors of Company X appointed Director A to serve as interim CEO while the board of directors conducts a search for a permanent replacement CEO. The service agreement between Company X and Director A does not limit Director A's authority as interim CEO and provides for termination of service upon selection of a permanent CEO. Company X filed Form 8-K (dated January 7, 2008) with the United States Securities and Exchange Commission (SEC) to report Employee E's retirement and Director A's appointment as interim CEO, and to explain that Company X has initiated a search for a permanent replacement CEO. On February 1, 2008, the compensation committee of Company X's board of directors approved, and the board of directors ratified, a compensation plan for the period Director A serves as interim CEO. The plan provides for a base salary of $1,000,000, as well as participation in Company X's executive bonus plan, which pays a percentage of base salary. The plan provides that Director A's compensation will be prorated based on the length of Director A's service as interim CEO.

On December 11, 2008, Company X announced that Employee F was selected as Company X's new CEO. Company X filed Form 8-K (dated December 11, 2008)

with the SEC to report Director A's resignation as interim CEO, effective immediately, and Employee F's appointment as CEO of Company X.

Other than service as interim CEO, Director A has not been employed by Company X (or any member of its affiliated group of corporations). Director A received final, prorated compensation for services as interim CEO on December 29, 2008. Following December 29, 2008, Director A does not receive compensation from Company X, directly or indirectly, in any capacity other than as a director. In January 2009, Director A joined the compensation committee on Company X's board of directors.

LAW

Section 162(a)(1) 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) 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)(2) provides that the term "publicly held corporation" means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934.

Section 162(m)(3) provides that the term "covered employee" means any employee of the taxpayer if (i) as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is an individual acting in such a capacity, or (ii) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the 4 highest compensated officers for the taxable year (other than the chief executive officer).

Section 162(m)(4)(A) 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 § 162(m)) for remuneration for services performed by the employee (whether or not during the taxable year).

Section 162(m)(4)(C) provides that applicable employee remuneration does not include any 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

solely 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 in a separate shareholder vote before payment of such remuneration, and (iii) before any payment of such remuneration, the compensation committee referred to in clause (i) certifies that the performance goals and other material terms were in fact satisfied.

Section 1.162-27(e)(3)(i) of the Regulations provides that a director is an "outside director" if the director (A) is not a current employee of the publicly held corporation; (B) is not a former employee of the publicly held corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year; (C) has not been an officer of the publicly held corporation; and (D) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services.

Section 1.162-27(e)(3)(vi) provides that whether a director is an employee or a former officer is determined on the basis of the facts at the time that the individual is serving as a director on the compensation committee. Thus, a director is not precluded from being an outside director solely because the director is a former officer of a corporation that previously was an affiliated corporation of the publicly held corporation. For example, a director of a parent corporation of an affiliated group is not precluded from being an outside director solely because that director is a former officer of an affiliated subsidiary that was spun off or liquidated. However, an outside director would no longer be an outside director if a corporation in which the director was previously an officer became an affiliated corporation of the publicly held corporation.

Section 1.162-27(e)(3)(vii) provides that, solely for this purpose, "officer" means an administrative executive who is or was in regular and continued service. The regulations state that the term implies continuity of service and excludes those employed for a special and single transaction. An individual who merely has (or had) the title of officer, but not the authority of an officer, is not considered an officer. The regulations further state that determination of whether an individual is or was an officer is based on all of the facts and circumstances in the particular case, including without limitation the source of the individual's authority, the term for which the individual is elected or appointed, and the nature and extent of the individual's duties.

ANALYSIS

The determination of whether an individual is or was an officer is based on all of the facts and circumstances in the particular case, including without limitation the source of the individual's authority, the term for which the individual is elected or appointed, and the nature and extent of the individual's duties. Director A was in regular and continued service from January 7, 2008 through December 11, 2008.

Company X did not employ Director A for a special and single transaction and Director A did not merely have the title of officer. Instead, Company X employed Director A for an indefinite period to serve as interim CEO with the full authority vested in that office. Accordingly, under the facts and circumstances analysis, Director A was an officer of Company X.

HOLDING

Under the facts provided in this revenue ruling, a member of the board of directors who serves as interim chief executive officer is not an “outside director” for purposes of § 162(m)(4)(C) and § 1.162-27(e)(3).

DRAFTING INFORMATION

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