

# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 25.—Interest on Certain Home Mortgages

A revenue procedure provides issuers of qualified mortgage bonds, as defined in section 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in section 25(c), with (1) the nationwide average purchase price for residences located in the United States, and (2) average area purchase price safe harbors for residences located in statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam. See Rev. Proc. 2008-17, page 549.

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2008. See Rev. Rul. 2008-11, page 541.

## Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

A revenue procedure provides issuers of qualified mortgage bonds, as defined in section 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in section 25(c), with (1) the nationwide average purchase price for residences located in the United States, and (2) average area purchase price safe harbors for residences located in statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam. See Rev. Proc. 2008-17, page 549.

## Section 162.—Trade or Business Expenses

26 CFR 1.162-27(e): Certain employee remuneration in excess of \$1,000,000.

**Performance-based compensation.** This ruling holds that compensation paid to an executive is not qualified performance-based compensation for purposes of section 162(m) of the Code, even if the compensation is paid upon the attainment of the performance goal, if the plan agreement or contract provides for payment of compensation to an executive upon the attainment of a performance goal or for

(1) termination without “cause” or for “good reason” or (2) voluntary retirement.

## Rev. Rul. 2008-13

### ISSUE

Is compensation payable by a publicly held corporation to a covered employee (within the meaning of § 162(m)(3) of the Internal Revenue Code) considered “remuneration payable solely on account of attainment of one or more performance goals” under § 162(m)(4)(C) if the plan or agreement under which the covered employee is paid provides that the compensation will be paid upon attainment of a performance goal and also provides that the compensation will be paid without regard to whether the performance goal is attained in either of the following situations: (i) the covered employee’s employment is involuntarily terminated by the corporation without cause or the covered employee terminates his or her employment for good reason, or (ii) the covered employee retires.

### FACTS

Company X is a publicly held corporation within the meaning of § 162(m)(2). X maintains a bonus plan (Plan) that pays a cash award (Award) to covered employee E if X’s earnings per share do not decrease during the calendar year, determined on December 31, 2009 (Performance Goal). In accordance with § 1.162-27(e)(2) of the Income Tax Regulations, X’s compensation committee established the Performance Goal in writing within 90 days after the commencement of the period of service to which the Performance Goal relates, and the Performance Goal satisfies § 1.162-27(e)(2)(ii) and (iii). In 2009, X’s earnings per share increase by seven percent.

### Situation 1.

The Plan provides that the Award will be paid to covered employee E if the Performance Goal is attained. The Plan also provides that, even if the Performance

Goal is not attained, the Award will be paid if covered employee E dies or becomes disabled, or if X experiences a change of ownership or control. In addition, the Plan provides that the Award will be paid even if the Performance Goal is not attained if covered employee E is terminated by X without “cause” or if covered employee E voluntarily terminates his or her employment with X for “good reason.”

The definition of “cause” in the Plan is (i) an act of willful misrepresentation, fraud or willful dishonesty intended to result in substantial personal enrichment at the expense of X, (ii) willful misconduct with regard to X that was intended to have a material adverse impact on X, (iii) willful or reckless behavior that has a material adverse impact on X, (iv) willful failure to perform duties or follow written direction of the board of directors, or (v) conviction of, or pleading *nolo contendere* or guilty to a felony. The definition of “cause” does not include poor performance that does not involve one of the events described in the preceding sentence.

The definition of “good reason” under the Plan is the occurrence of any of the following, without the executive’s express written consent: (i) assignment of duties materially inconsistent with the executive’s current authorities, duties, responsibilities, and status, any reduction in the executive’s title, position, or reporting lines, or any material reduction in the executive’s status, authorities, duties, or responsibilities, (ii) relocation of the executive from the principal office of X or relocation of the principal office of X, (iii) reduction in the executive’s base salary, (iv) reduction in the executive’s overall level of participation in X incentive, benefit, or retirement plans, (v) failure of X to obtain assumption of the executive’s employment agreement from a successor of X, or (vi) any other material breach of the executive’s employment by X.

### Situation 2.

The Plan provides that the Award will be paid to covered employee E if the Performance Goal is attained. The Plan also provides that the Award will be paid to

covered employee E, even if the Performance Goal is not attained, if covered employee E dies or becomes disabled or if X experiences a change of ownership or control. In addition, the Plan provides that the Award will be paid to covered employee E even if the Performance Goal is not attained if covered employee E voluntarily retires during the calendar year.

## 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)(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(b) provides that § 162(m) precludes a deduction under chapter 1 of the Internal Revenue Code by any publicly held corporation for compensation paid to any covered employee to the extent that the compensation for the taxable year exceeds \$1,000,000. Section 1.162-27(e)(1) provides that the deduction limit in § 1.162-27(b) does not apply to qualified performance-based compensation. Section 1.162-27(e)(1) further provides that qualified performance-based compensation is compensation that meets all of the requirements of § 1.162-27(e)(2) through (5).

Section 1.162-27(e)(2)(i) provides, in part, that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals.

Section 1.162-27(e)(2)(v) provides that compensation does not satisfy the requirements of § 1.162-27(e)(2) if the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained and that, if the payment of compensation under a grant or award is only nominally or partially contingent on attaining a performance goal, none of the compensation payable under the grant or award will be considered performance-based. Section 1.162-27(e)(2)(v) further provides that compensation does not fail to be qualified performance-based compensation merely because the plan allows the compensation to be payable upon death, disability, or change of ownership or control, although compensation actually paid on account of those events prior to the attainment of the performance goal would not satisfy the requirements of § 1.162-27(e)(2).

The IRS and Treasury have not previously issued any guidance on which taxpayers are entitled to rely that explicitly

addresses the situations described in this revenue ruling.

## ANALYSIS

Under § 162(m)(4)(C) and § 1.162-27(e), compensation is not considered applicable employee remuneration, and thus is not subject to the \$1,000,000 limit in § 162(m)(1), if it satisfies the requirements for “qualified performance-based compensation.” Among these requirements is that the compensation is payable “solely” on account of the attainment of one or more performance goals. Under § 1.162-27(e)(2)(v), compensation is not performance-based if the facts and circumstances indicate that the employee would receive all or part of the compensation regardless of whether the performance goal is attained. Section 1.162-27(e)(2)(v) provides further that compensation does not fail to be qualified performance-based compensation merely because the plan allows the compensation to be payable upon death, disability, or change of ownership or control.

### Situation 1.

A covered employee’s termination without “cause” or for “good reason” is not listed as a permissible payment event under § 1.162-27(e)(2)(v). As defined in the Plan, involuntary termination without “cause” may occur or a “good reason” (e.g., a reduction in title or base salary) may arise as a result of covered employee E’s poor performance and failure to meet the Performance Goal. Therefore, under the facts and circumstances analysis, the compensation is not “remuneration payable solely on account of the attainment of one or more performance goals,” as required by § 162(m)(4)(C).

### Situation 2.

Voluntary retirement is not listed as a permissible payment event under § 1.162-27(e)(2)(v). Because retirement generally is a voluntary action within the control of the covered employee, the compensation is not “remuneration payable solely on account of the attainment of one or more performance goals,” as required by § 162(m)(4)(C).

## HOLDINGS

### Situation 1.

The Award is not qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e)(2).

### Situation 2.

The Award is not qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e)(2).

## APPLICATION

Pursuant to § 7805(b)(8), the holdings in this revenue ruling will not be applied to disallow a deduction for any compensation that otherwise satisfies the requirements for qualified performance-based compensation under § 162(m)(4)(C) and § 1.162-27(e) and that is paid under a plan, agreement, or contract that has payment terms similar to the terms described in this revenue ruling if either (i) the performance period for such compensation begins on or before January 1, 2009 or (ii) the compensation is paid pursuant to the terms of an employment contract as in effect (without respect to future renewals or extensions, including renewals or extensions that occur automatically absent further action of one or more of the parties to the contract) on February 21, 2008. For purposes of the preceding sentence, the performance period for such compensation is the period of service to which the performance goal applicable to such compensation relates. The relief under this paragraph does not extend to other issues under § 162(m) or to any other provision of the Code.

## DRAFTING INFORMATION

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

## Section 163.—Interest

(Also: Sections 469, 702, 703.)

**Application of section 163(d) to limited partners in a trader partnership.**

This ruling explains how section 163(d) of the Code applies to a noncorporate limited partner's distributive share of the interest expense allocable to the partnership's trade or business of trading securities, if the limited partner does not materially participate.

## Rev. Rul. 2008-12

### ISSUE

Is a noncorporate limited partner's distributive share of partnership interest expense incurred in the trade or business of trading securities by the partnership subject to the limitation on the deduction of investment interest in § 163(d) of the Internal Revenue Code?

### FACTS

PRS is a partnership that is engaged solely in the trade or business of trading securities for its own account and not for customers. LP is a taxpayer other than a corporation (a noncorporate taxpayer) that owns an interest in PRS as a limited partner. LP does not materially participate (as that term is used in § 469) in the activity in which PRS is engaged.

PRS incurs indebtedness in its trade or business of trading securities. LP's distributive share of the income, gain, loss, deduction, or credit of PRS includes interest expense incurred on this indebtedness.

### LAW AND ANALYSIS

Section 703 provides that the taxable income of a partnership is computed in the same manner as an individual, except that items described in § 702 must be separately stated and certain deductions are not allowed to the partnership.

Section 702(a)(7) provides that each partner in determining its income tax is required to take into account separately its distributive share of the partnership items of income, gain, loss, deductions, and credits to the extent provided by regulations.

Under § 1.702-1(a)(8)(ii) of the Income Tax Regulations, each partner must take into account separately its distributive share of any partnership item that, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that

partner did not take the item into account separately.

Section 1.702-1(b) provides that the character in the hands of a partner of any item of income, gain, loss, deduction or credit is determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

Section 163(a) provides that, in general, a deduction is allowed for all interest paid or accrued within the taxable year on indebtedness. Section 163(h)(1) provides that a noncorporate taxpayer is not entitled to a deduction for personal interest paid or accrued during the taxable year. Section 163(h)(2) provides that personal interest does not include interest paid or accrued on indebtedness properly allocable to a trade or business (other than the trade or business of performing services as an employee) or investment interest, as defined in § 163(d).

Section 163(d)(1) provides that the amount allowed as a deduction for investment interest for any taxable year by a noncorporate taxpayer shall not exceed the amount of the taxpayer's net investment income for the taxable year. Section 163(d)(3)(A) provides that the term "investment interest" means any interest allowable as a deduction that is paid or accrued on indebtedness properly allocable to property held for investment.

Section 163(d)(5)(A)(ii) provides that the term "property held for investment" shall include any interest held by a taxpayer in an activity involving the conduct of a trade or business that is not a passive activity and with respect to which the taxpayer does not materially participate. Under § 163(d)(5)(C), the terms "activity", "passive activity", and "materially participate" have the meanings given such terms by § 469.

Section 1.469-1T(e)(6) provides that an activity of trading personal property for the account of owners of interests in the activity is not a passive activity (without regard to whether such activity is a trade or business activity). The term "personal property" has the meaning provided for such term in § 1092(d) without regard to paragraph (3) thereof.

Section 1.469-4(a) provides that a taxpayer's activity includes an activity conducted through a partnership. Also, un-