

Procedure 2005-3, 2005-1 I.R.B. 118, 119. The facts, as represented by Company, are as follows.

Company, a publicly traded corporation, provides executive search services. Upon executing a successful search, Company receives a Cash Fee. Company may also be entitled to an Equity Fee, which generally consists of warrants on the client's stock.

Company's consultants perform the executive search services. The consultants are paid a base salary plus commission. Generally a group of consultants work together as a team (Placement Team). The consultants' share of the Cash Fee, which is based on a set schedule, is paid after Company receives payment for its services.

The Equity Fee is not paid to the consultants until the Equity Fee is converted to cash. Company policy provides that Company will convert the Equity Fee to cash as soon as practical. However, this may occur in a later tax year than the completed search. Company policy provides that x% of the Equity Fee is divided among the Placement Team. The allocation of the Equity Fee to each Team member is determined by the Team members, at the beginning of the search. The allocation is determined pursuant to Company guidelines and is based on the respective duties of the individual Team members. The allocation is subject to approval by the Chief Financial Officer and the Chief Executive Officer.

On Date 1, Company was hired by Client engaged to fill a senior executive position as a direct result of Executive's efforts. In connection with a successful placement on Date 2, Company received a Cash Fee and an Equity Fee consisting of warrants for Client's stock. On Date 3 Company exercised its warrants. Shortly thereafter, Company sold all of the Client stock it acquired on the exercise of the warrants.

Executive was a member of the Placement Team for Client. The Placement Team received x% of the Equity Fee. Executive's pre-determined allocation of the Equity Fee was y%. At the time the Equity Fee was converted to cash and payable to members of the Placement Team, Executive was a covered employee, as defined in section 162(m)(3).

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 shall be 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) defines "covered employee" to mean any employee of the taxpayer if 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 capacity, or 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) provides generally that "applicable employee remuneration" means, with respect to any covered employee for any taxable year, the aggregate amount allowable as a deduction for the taxable year (determined without regard to section 162(m)) for remuneration for services performed by the employee (whether or not during the taxable year).

Section 162(m)(4)(B) excepts from the definition of "applicable employee remuneration" any remuneration payable on a commission basis solely on account of income generated directly by the individual performance of the individual to whom such remuneration is payable.

Section 1.162-27(d) of the Income Tax Regulations provides that compensation is paid on a commission basis if the facts and circumstances show that it is paid solely on account of income generated directly by the individual performance of the individual to whom the compensation is paid. Compensation does not fail to be attributable directly to the individual merely because support services, such as secretarial or research services, are utilized in generating the income. However, if compensation is paid on account of broader performance standards, such as income produced by a business unit of the corporation, the compensation does not qualify for the exception provided under this paragraph (d).

Based on the facts submitted, we rule that the Equity Fee received by Executive for services performed for Client is commission based compensation under section 162(m)(4)(B) and therefore is not subject to the deduction limit of section 162(m).

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Specifically no ruling was requested and none is given regarding the Cash Fee.

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. The taxpayer should attach a copy of this ruling to any income tax return to which it is relevant.

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

Sincerely yours,

WILLIAM C. SCHMIDT
Senior Counsel
Executive Compensation Branch
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)

Enclosure:

Copy for 6110 purposes