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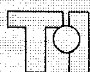

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Chrysler Devises Platinum Parachutes: How Will They Stand Up Under Tax Laws?

by Robert W. Wood • San Francisco

In the typical golden parachute arrangement, executives are given healthy benefits to soften the blow of an acquisition. Because of the purpose of such agreements, they are typically conditioned upon a change in control of the company. This is why, of course, the golden parachute provisions of the Code as enacted target payments triggered by a change in control. Section 280G makes the payments of excess parachute payments themselves nondeductible, while Section 4999(a) imposes a nondeductible 20% excise tax on the excess parachute payments. Thus, the cost to the paying entity of such arrangements can be quite steep indeed.

Now, Chrysler may have upped the ante in its recent move to bolster even further its defenses against takeover maneuvers. Under the new Chrysler plan, its 30 highest ranking officers were given golden parachutes that are triggered if a potential acquirer moves to remove the executives even before a takeover is completed. See "Chrysler has Bold New Ideas—in Parachutes," *Wall Street Journal*, July 13, 1995, p. B1.

"Potential" Change in Control

While golden parachute arrangements are nothing new, what is now sometimes being referred to as a "potential change of control" clause in a parachute agreement is. The theory, according to one commentator, is that there may be no change of control, but the threat of a protracted, hostile takeover fight may leave executives in a quandary about their positions long before the results of the takeover attempt are clear. If the golden parachute arrangement is triggered early enough, the executive is seen as having an incentive to weather the storm, whether they are eventually discharged before or after a takeover.

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Of course, investors and professionals alike are likely to see these provisions as increasing substantially the costs of a takeover attempt—whether or not it is ultimately successful. Such an arrangement may also effectively dampen attempts in a takeover setting to convince the board to dump executives before a takeover is completed.

In a typical "potential change of control" clause, there are still conditions that must be met for the executive to reap the benefits of the parachute agreement. In the Chrysler plan, an executive must remain employed by the company during the period referred to as the "potential change of control" period, plus for a minimum of two months after the change of control. The Chrysler plan defines a "potential change of control" to include tender offers for a minimum of 20% of the shares outstanding, as well as outside solicitation of proxies for the selection of directors.

The Chrysler plan is certainly not the only one of these arrangements that is now in existence. At least ten major U.S. companies now have these potential change of control clauses. According to Judith Fischer, publisher of *Executive Compensation Reports*, they include: Inland Steel Industries, Inc., Maytag Corp. and Upjohn Co., among others. Some plans trigger the parachute payment as long as there is a potential change of control and the executive is fired. Others, like the Chrysler plan, require tenure through the actual change in control. See "Chrysler has Bold New Idea—in Parachutes," *Wall Street Journal*, July 13, 1995, p. B1. The latter would seem on their face to be somewhat less effective from an executive's viewpoint, but presumably less objectionable from an investor's stance.

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Savings Clauses

The triggering event, of course, says little about the amount of the parachute payment, or in other words, whether the parachute is gold, platinum or base metal. Chrysler's arrangement is not atypical, with the top few officers slated to receive parachute payments equal to three times their current base salaries, as well as three times the average of their annual bonuses for the past three years. Most of the other Chrysler executives would get twice their average salaries and bonuses, rather than three times.

These amounts, not surprisingly, are geared to the tax rules that seem now to be relatively well understood. The excise tax of Section 4999(a) is only imposed on "excess" parachute payments. A payment is considered "excess" if: (1) it is made to a "disqualified individual," generally an easy requirement to meet; (2) the payment is contingent on a change in control or ownership of the corporation; and (3) the present value of the payment is at least three times the individual's "base amount." The base amount is essentially annualized compensation for a five-year period ending before the date of change of control.

It has become relatively common for golden parachute arrangements to include a savings clause to specify that the company will have no liability to pay an "excess" parachute payment that would incur the wrath of the nondeductible excise tax. A savings clause can be a good idea, since an excess parachute payment incurs a double whammy: nondeductibility for the excess parachute payment under Section 280G, plus the 20% excise tax (which is *also* nondeductible) under Section 4999(a).

All the fuss over precisely what clauses are put in a golden parachute agreement itself raises some timing issues. Section 280G (which defines excess parachute payments) states that an agreement that is entered into within one year before a change in control, or a substantial amendment to an existing agreement made within one year of the change, will be presumed to be contingent on a change in control unless the contrary is established by clear and convincing evidence. IRC §280G(b)(2)(C). Of course, most energy seems to be focused on making

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sure that the parachute arrangement comes right up to the prohibited line (but does not cross over it) that defines "excess."

Still, whopping payments are occasionally made. (For some staggering figures, see Wood, "More Parachute Payment Rulings," Vol. 3, No. 6 *M&A Tax Report* (January 1995) p. 1. ■