

No Ownership Change Under Golden Parachute Rules

by Robert W. Wood • San Francisco

A recent technical advice memorandum, No. 9719003, confronts the question whether a transaction results in a change of ownership for

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purposes of Section 280G. Section 280G, readers will recall, governs the tax treatment of golden parachute payments. Despite the "golden" moniker, golden parachute payment designation (in the tax world at least) is not a good thing. Section 280G makes payments of "excess parachute payments" non-deductible, and is coupled with a 20% excise tax (also nondeductible) on such excess parachute payments. The latter tax is imposed by Section 4999(a).

This harsh treatment applies only to excess parachute payments, so there is typically great line-drawing in agreements, not only as to what constitutes a change in ownership or effective control that would trigger a parachute payment, but also as to what constitutes the compensation that is payable so one can determine whether the payment is "excess."

Most of the learning in this area in recent years has focused on the question whether or not a payment is "excess." A parachute payment is considered "excess" if: (1) it is made to a "disqualified individual;" (2) the payment is contingent upon a change in the ownership or control of the corporation; and (3) the present value of the payment is at least three times the individual's base amount.

This base amount is essentially annualized compensation of the individual for a five-year period

ending before the date of the change in control. So-called savings clauses are a popular means of attempting to forestall the operation of this provision. (For discussion of a recent case regarding savings clauses, see Wood, "Dealing with the Non-Tax Aspects of Golden Parachute Payments," Vol. 5, No. 9, *M&A Tax Report*, April 1997, p. 4.)

What's a Change in Control?

With all the learning under Section 382 and various other provisions of the Code, one would think that determining whether a company has experienced a change in ownership or control would be relatively easy. Under Section 382, for example, an ownership change is defined as any ownership shift involving a 5% shareholder, or any equity structure shift, in either case, where the percentage of stock of the loss company owned by one or more 5% shareholders increases by more than 50 percentage points over the lowest percentage of stock of the loss corporation owned by those shareholders at any time during the testing period. Shorn of its various details, this is basically a 50 percentage point shift. I.R.C. §382(g).

In the context of Section 280G, the test is a considerably more simple one, merely requiring that there be a change in the ownership or effective control of the corporation. Technical Advice Memorandum 9719003, however, looks at a transaction and determines that there was no change in ownership.

In the tech advice, a company was merged into a first-tier subsidiary of a parent in a statutory A reorganization. The shareholders of the merged company received stock in the parent in the merger, as well as some cash. They wound up with more than a 50% interest in the parent corporation. The executives at the merged company also received substantial payments under their employment contracts as a result of the merger.

The IRS ruled that when the company was merged into the first-tier subsidiary of the parent, it did not experience a change in ownership, or a change of a substantial portion of its assets under Section 280G(b)(2)(i). The Service reasoned that the former shareholders of the merged company had a greater than 50% interest in the parent company following

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the merger. For authority, the Service cited Prop. Reg. §1.280G-1, Q&A 27-29.

Interestingly, the tech advice memo also ruled that when the company merged into the first tier subsidiary, a rebuttable presumption was created that the merged company did not experience a change in effective control under Section 280G(b)(2)(i). Whether this kind of presumption has been rebutted, says the tech advice, is a matter to be determined as a factual question that should be resolved by the IRS District Director. ■

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