(Not So) Golden Parachutes

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Golden parachute payment problems come up in many acquisitions, and their application is unlikely to be a stranger to readers of the M&A TAX REPORT. Although there are certainly traps to watch out for here, the vast majority of contracts now contain formula savings clauses designed to dodge the application of the nondeductibility rule of Code Sec. 280G along with the corollary 20-percent excise tax imposed by Code Sec. 4999.

Recently, though, the IRS addressed a fundamental issue: the scope of the "disqualified" person definition. In LTR 200607006 [Nov. 17, 2005], the subject individual was a director of a corporation, and in fact was the former chairman of the board of directors. The company was a bank holding company, and the bank was its subsidiary. There was no question there was

a change of ownership or control (within the meaning of Code Sec. 280G), and there was no question that this individual served as chairman of the board of directors for the 12-month period preceding the merger.

However, the interesting point is that he was neither a shareholder who owned (directly or indirectly) more than one percent of the stock, nor was he one of the top one-percent highest paid employees or consultants of the company. Notwithstanding all of this, he did get certain benefits by virtue of the change of control, and these amounts were significant enough that they exceeded the base amount threshold specified in Code Sec. 280G.

Fortunately for us, the company took the excess amounts (the amount of the benefits that exceeded the director's base amount) and put it in escrow, asking the IRS for a ruling on the applicability of the golden parachute payment tax to the escrowed funds.

I'm in Charge

A few M&A TAX REPORT readers may remember the remark by former Secretary of State Alexander Haig, who uttered the immortal "I'm in charge" phrase after the assassination attempt on President Reagan in 1981. Sometimes, authority is real, and sometimes it's about perception. A disqualified individual is defined in Code Sec. 280G as an individual who:

- is an employee, independent contractor or other person specified in the regulations who performs personal services for any corporation; and
- is an officer, shareholder or other highly compensated individual.

The question in this ruling was whether this particular director (who, after all, was Chairman of the Board) should be considered an officer, since he clearly was not a shareholder or highly compensated individual. This short-but-sweet ruling refers to the regulations under Code Sec. 280G, which say that all of the facts and circumstances are to be considered. Fair enough. That means one looks to the source of the person's authority, the term for which he or she is elected or appointed and the nature and extent of that person's duties.

You evidently mush this all together and determine whether an individual is an officer. Generally, the term "officer" means an administrative executive who is in regular and continued service. It implies continuity of service and excludes those who are employed only for special or single transactions.

As a result (and without a lot of explanation), the IRS ruled that this director was not a disqualified individual. He had no administrative executive authority over the company, the bank (the company was a bank holding company and the bank was its subsidiary), nor over the board of directors. Al Haig, redux. That meant all the monies could be released to him from escrow, and no golden parachute taint would apply.

No Authority Ruling?

Of course, we all know that private letter rulings don't constitute published authority. At the same time, we also know they're worth reading, and as a practical matter, indicate IRS position on taxpayers generally. Still, it's not clear just how far this kind of ruling goes. It's good news, of course, but the "no administrative executive authority" requirement would seem (in most cases anyhow) to be a pretty tough standard to meet.