

Liquidation Fails to Trigger Ownership Change Under Parachute Rules

by Robert W. Wood • San Francisco

One of the topics we address from time to time is the tax treatment of golden parachute payments. Although there is no particular industry standard, what I see frequently is companies understandably wanting to reward executives on a change in ownership or control, but equally understandably, not wanting to run afoul of the onerous golden parachute rules.

No longer controversial, Section 280G of the Code makes payments of so-called "excess parachute payments" nondeductible to the paying corporation. This slap on the wrist from a tax perspective was (and still is) coupled with a nondeductible 20% excise tax on excess parachute payments. The excise tax is embodied in Section 4999(a). Between nondeductibility for the payment itself and a 20% excise tax (the excise tax is also nondeductible), the real economic loss of paying such amounts can be particularly painful. Presumably it is designed to be so.

Much of the golden parachute regime involves line drawing. The harsh regime of nondeductibility plus nondeductible excise tax applies only to parachute payments that are "excess." A parachute payment is

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PARACHUTE RULES

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defined as any compensatory payment to or for the benefit of a disqualified person (officer, shareholder, key employee or highly compensated person performing personal services for the corporation) under the following circumstances:

- The payment is contingent on a change in the ownership or effective control of the corporation or a substantial portion of its assets, and the aggregate present value of the compensatory payments equals or exceeds three times the base amount; or
- The payment is made pursuant to an agreement that violates any generally enforced securities laws or regulations.

Determining whether a payment is a parachute payment is typically rather easy. A payment is generally just that. Yet, normally a parachute payment does not include payments to or from qualified pension and profit sharing plans, annuity plans, and simplified employee pensions. (See I.R.C. §280G(b)(6).)

As it is only "excess" parachute payments that are sanctioned, the definition of "excess" is key. A parachute payment is "excess" if: (1) it is made to a "disqualified individual;" (2) the payment is contingent on a change in the control or ownership 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 for the individual for a five-year period ending before the date of the change in control.

What is a Change in Control?

One of the relatively quiet issues under this statutory scheme has been exactly what constitutes a change of ownership or control. A recent letter ruling, Letter Ruling 9747041 (December 1, 1997), considered whether the liquidation of a bankrupt publicly owned corporation would cause a change of ownership of a substantial portion of the assets, or a change of ownership or effective control under the golden parachute rules.

The situation involved a specialty retail corporation, which was the common parent of an affiliated group. The group filed for bankruptcy protection, and ultimately liquidated all of its assets. A plan of liqui-

ation was later confirmed by the court, under which the remaining assets would be converted to cash and distributed to creditors. As a result of the liquidation, however, executives also were to receive severance pay and other benefits. The IRS concluded that the provisions of Section 280G do not apply to payments made to the executives under the liquidation.

Conclusion

Letter Ruling 9747041 hardly represents the ideal plan for a company to pay healthy departure packages and yet not pay the price of excess golden parachute status. Still, the setting for the ruling is interesting. Perhaps it even could signal more healthy payments for departures in bankruptcy. More conventional planning would involve the use of savings clauses in the parachute compensation documents themselves. (For recent coverage of savings clauses and their uses, see Wood, "Dealing with the Non-Tax Aspects of Golden Parachute Payments," Vol. 5, No. 9, *M&A Tax Report* (April 1997), p. 4.) ■

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