# Tax Court Rejects Sweep of Golden Parachute Provisions in *Powell*

by Robert W. Wood • Bancroft & McAlister

Section 4999(a) imposes a 20% excise tax on "excess parachute payments." Under Section 280G, an excess parachute payment is a payment in the nature of compensation to a "disqualified individual" if the payment is contingent on a change in the ownership or control of the corporation, and the present value of the payment is at least three times the individual's "base amount."

A "disqualified individual" includes any individual who is an employee, independent contractor, or other person specified in regulations who performs personal services for any corporation, and is an officer, shareholder, or highly compensated individual. The "base amount" is the individual's annualized includible compensation for the base period (generally, the five years ending before the date on which the change in ownership or control occurs).

The excise tax is expensive and nondeductible, and makes the cost of excess parachute payments—golden or otherwise—quite significant. Fortunately, the Tax Court has just decided *Powell*, 100 TC No. 6 (1993), in which it restricts the application of the tax.

## The Story of *Powell*

Virgil Powell was hired by Woods Petroleum in 1966. He was promoted several times, and in 1984, became President and CEO. He received his first written employment contract in 1982, which called for his continued employment through 1987. The contract specified that if the company terminated his employment before the natural end of the contract, he would be paid his base salary of $172,000, plus his normal percs and benefits, through the end of 1987. Powell and the company also executed two stock option agreements in 1982, both of which were amended in 1983.

As an inducement for Powell to remain in the company's employ until the end of 1988, the agreement also stated that if Powell's employment was terminated because of a change in control, he would be entitled to severance pay equal to his annual salary times the greater of five years or the number of years remaining until retirement, plus the amount he would have received under the Woods pension plan. He would also receive various benefits and travel reimbursements through this period. In addition, the company would redeem all unexercised stock options, and would pay Powell an amount equal to the number of shares multiplied by the amount by which the stock purchase price paid by the party acquiring control of the company exceeded the option exercise price.

In November 1984, the company adopted a supplemental pension plan covering various executives, including Powell. The plan was a nonqualified plan, covering only employees whose pension benefits were capped by the $90,000 legal limit.

In February 1985, Sunshine Mining Company agreed to buy 25% of Woods' stock for $25 per share (it actually bought the stock in April). By March 1985, Sunshine had purchased an additional 5.5% of the Woods stock on the open market for $25 per share. On 3/6/85, Woods and Sunshine entered into a merger agreement. Powell was then notified that his employment was terminated.

Powell resigned in May 1985, when his base amount was $309,949. After a dispute over the appropriate amount payable, Woods paid him $3.475 million in cancellation of his employment agreement, plus $1.525 million. The latter represented twice the amount he would have received had his stock options been redeemed under the employment agreement.

The Service determined that Powell had received $4,237,500 in golden parachute payments subject to the excise tax.

## No Tax Due, Says Court

In one of the first cases to flesh out the intricacies of the golden parachute provisions, the Tax Court had to consider whether Powell's employment

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agreement was entered into, renewed, or amended after the effective date of the provisions (6/14/84).

Although Powell's employment agreement was not amended after that date, the Service argued that the agreement was"cancelable at will." Accordingly, argued the Service, it should be treated as a new contract entered into or renewed after that date.

The "cancelable at will" argument had some support in the legislative history to the Deficit Reduction Act of 1984 ("DRA"), which had adopted the parachute payment law. To decide whether Powell's contract was cancelable at will, the Tax Court first looked to Oklahoma law, and concluded that the agreement was not cancelable at will under that state's law. Then, the court examined the DRA's legislative history and the proposed regulations under Section 280, concluding that the contract was not cancelable at will based on these criteria.

While the company could terminate the employment agreement, it would have had to continue paying Powell. The court found that under these circumstances, the contract was not unconditionally terminable, and thus was not cancelable at will.

The court also addressed what constitutes a substantial amendment to a contract, noting that Powell's contract had been substantially amended after 6/14/84 because the supplemental pension plan was adopted after that date. However, the court determined that since Powell was already entitled to pension benefits, the adoption of the supplemental plan did not increase Powell's pension benefits, and so was not a significant amendment to his employment agreement. ■

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