



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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July 28, 2000

INTERNAL REVENUE SERVICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR DISTRICT DIRECTOR,
Attn: Chief, Examination Division

FROM: Assistant Chief, Executive Compensation Branch
Office of the Division Counsel/Associate Chief Counsel (Tax
Exempt and Government Entities), CC:TEBE:EB:EC

SUBJECT: Withdrawal of Section 280G Private Letter Ruling Request

In accordance with section 8.07(2)(b) of Rev. Proc. 2000-1, 2000-1 I.R.B., 4, 33, we are notifying you that a March 9, 2000, ruling request that was submitted to our office for a ruling under section 280G of the Internal Revenue Code, was withdrawn in anticipation of an adverse ruling. It is our understanding that your office has audit jurisdiction over this Taxpayer.

DISCLOSURE STATEMENT

This memorandum is Chief Counsel Advice and is open to public inspection pursuant to the provisions of section 6110(i). The provisions of section 6110 require the Service to remove taxpayer identifying information and provide the taxpayer with notice of intention to disclose before it is made available for public inspection. Sec. 6110(c) and (i). Section 6110(i)(3)(B) also authorizes the Service to delete information from Chief Counsel Advice that is protected from disclosure under 5 U.S.C. § 552 (b) and (c) before the document is provided to the taxpayer with notice of intention to disclose. Only the National Office function issuing the Chief Counsel Advice is authorized to make such deletions and to make the redacted document available for public inspection. **Accordingly, the Examination, Appeals, or Counsel recipient of this document may not provide a copy of this unredacted document to the taxpayer or their representative.** The recipient of this document may share this unredacted document only with those persons whose official tax administration duties with respect to the case and the issues discussed

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in the document require inspection or disclosure of the Chief Counsel Advice. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Taxpayer =

Date 1 =

Date 2 =

Date 3 =

Executives =

Company B =

Year C =

Company D =

ISSUE:

Taxpayer requested that we rule as follows:

The acceleration of the normative bonus (for Executives) that occurred in Year C is considered contingent on the change in control that occurred on Date 3 to the extent the amount by which the amount of the accelerated payment exceeds the present value absent acceleration.

CONCLUSION:

Prior to Taxpayer's withdrawal of the above-listed ruling request, we were prepared to rule adversely as follows:

The full amount of the payments made to Executives that occurred in Year C is treated as contingent on the change in control that occurred on Date 3 because it was not substantially certain at the time of the change that the payments would have been made absent the change if Executives had continued to perform services. The amount of the payment may not be reduced using Q&A 24(b) or Q&A 24(c) of section 1.280G of the proposed regulations. To the extent, however, the payments are established to be reasonable compensation for services rendered for

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personal services actually rendered before the change, the excess parachute payment may be reduced under Q&A 39.

FACTS:

On Date 1, Company B entered into a "Change in Control Agreement" with Executive (Date 1 Agreement). The Date 1 Agreement provided that if the employment of Executives with Company B terminated, other than by reason of death or disability, during a five-year period beginning on the date a change in control occurred, Company B would pay the following amounts to each of the Executives within 10 days after the date of termination: (i) the full base salary and vacation pay (for vacation not taken) accrued but unpaid through the date of termination at the rate in effect at the time of termination; (ii) an amount equal to the product of the normative bonus under the applicable bonus plan for the fiscal year including the date of termination and a fraction, the numerator of which is the number of days in such fiscal year through the date of termination and the denominator of which is 365; (iii) the amount in the bonus bank under all bonus plans in which each of the Executives participated; and (iv) a lump-sum severance payment in an amount equal to 335 percent of annual compensation, meaning an amount equal to the aggregate of annual cash compensation (other than bonus) from Company B and its subsidiaries in effect immediately prior to the date of termination or change in control, whichever is greater, and the highest bonus payable to each of the Executives for any of Company B's three fiscal years preceding the date of termination or change in control, whichever is greater.

Additionally, the Date 1 Agreement provided that on a change in control, all benefits accrued under the supplemental retirement plans, excess retirement plans, and deferred compensation plans maintained by Company B or any of its subsidiaries would become immediately vested in full.

On Date 2, a change in control, within the meaning of the Date 1 Agreement and section 280G of the Code, occurred. On the change in control, each of the Executives elected to continue their employment with the new company, Taxpayer.

On Date 3, Taxpayer was acquired by Company D, resulting in a change in control with respect to Taxpayer within the meaning of section 280G of the Code. On Date 4, each of the Executives terminated employment with Company D. Additionally, on the termination of employment each of the Executives received an accelerated payment of a prorated portion of the normative bonus for the year. The accelerated payment of the normative bonus was not provided for under the Date 1 Agreement; rather, these amounts are related solely to the Year C change in control.

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Under each of the Executives' employment agreements with Taxpayer, each Executive was eligible to receive an annual bonus. The annual bonus was based on the attainment of appropriate performance targets previously established by the Compensation Committee. The normative annual bonus (payable on attainment of 100% of the performance target) was a percentage of base salary for each Executive at the end of the relevant fiscal year of Taxpayer.

LAW AND ANALYSIS:

Section 280G of the Code provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) defines "excess parachute payment" as an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

Section 280G(b)(2)(A) of the Code defines "parachute payment" as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership or effective control of the corporation or in the ownership of a substantial portion of the assets of the corporation and (ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such change equals or exceeds an amount equal to three times the base amount.

Section 4999(a) of the Code imposes on any person who receives an excess parachute payment a tax equal to 20 percent of the amount of the payment.

Section 1.280G-1 of the Proposed Income Tax Regulations, published in the Federal Register on May 5, 1989 (54 Fed. Reg. 19,390), provides guidance concerning parachute payments.

Q&A 11(a) of the proposed regulations provides that, for purposes of section 280G, all payments, in whatever form, are payments in the nature of compensation if they arise out of an employment relationship or are associated with the performance of services. Payments in the nature of compensation include (but are not limited to) wages and salary, bonuses, severance pay, fringe benefits, and pension benefits and other deferred compensation (including any amount characterized as interest thereon).

Q&A 22(a) provides that a payment is treated as contingent on a change in ownership or control if the payment would not, in fact, have been made had no change in ownership or control occurred. A payment generally is to be treated as one which would not, in fact, have been made in the absence of a change in ownership or control unless it is substantially certain, at the time of the change, that the payment would have been made whether or not the change occurred. Property

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that becomes substantially vested as a result of a change in ownership or control will not be treated as a payment which was substantially certain to have been made whether or not the change occurred.

A payment is also treated as contingent on the change in ownership or control under Q&A 22(b) if (1) the payment is contingent on an event that is closely associated with a change in ownership or control, (2) a change in ownership or control actually occurs, and (3) the event is materially related to the change in ownership or control. A payment is treated as contingent on a change in ownership or control unless it is substantially certain, at the time of the event, that the payment would have been made whether or not the event occurred. An event is considered closely associated with a change in ownership or control if the event is of a type often preliminary or subsequent to, or otherwise closely associated with, a change in ownership or control. An event will be presumed to be materially related to a change in ownership or control if the event occurs within the period beginning one year before and ending one year after the date of change in ownership or control.

Under Q&A 22(c) a payment that would in fact have been made had no change in ownership or control occurred is treated as contingent on a change in ownership or control if the change accelerates the time at which the payment is made. Thus, for example, if a change in ownership or control accelerates the time of payment of vested deferred compensation, the payment may be treated as contingent on the change.

Q&A 24(a) generally provides that the full amount of the payment is treated as contingent on a change in ownership or control. However, in certain circumstances, described in Q&A 24(b) and (c), only a portion of the payment is treated as contingent on the change.

Q&A 24(b) applies if it is substantially certain, at the time of the change, that the payment would have been made whether or not the change occurred, but the payment is treated as contingent on the change solely because the change accelerates the time at which the payment is made. In such a case, the portion of the payment that is treated as contingent on the change in ownership or control is the amount by which the amount of the accelerated payment exceeds the present value of the payment absent the acceleration. If the amount of such a payment absent the acceleration is not reasonably ascertainable, and the acceleration of the payment does not significantly increase the present value of the payment absent the acceleration, the present value of the payment absent the acceleration is treated as equal to the amount of the accelerated payment.

Q&A 24(c)(1) applies in the case of a payment that is accelerated by a change in ownership and control and that was substantially certain, at the time of the change, to have been made without regard to the change if the disqualified

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individual had continued to perform services for the corporation for a specified period of time. In such a case, the portion of the payment that is treated as contingent on the change in ownership or control is the lesser of (i) the amount of the accelerated payment or (ii) the amount by which the payment exceeds the present value of the payment that was expected to be made absent the acceleration (determined without regard to the risk of forfeiture for failure to continue to perform services), plus an amount, as determined in Q&A 24(c)(2), to reflect the lapse of the obligation to continue to perform services.

Under Q&A 24(c)(2), the amount reflecting the lapse of the obligation to continue to perform services depends on all the facts and circumstances. In no event, however, will such amount be less than 1 percent of the amount of the accelerated payment multiplied by the number of full months between the date that the individual's right to receive the payment is not subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture (within the meaning of section 1.83-3(c)) and the date that, absent the acceleration the individual's right to receive the payment would not have been subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture.

Ruling Request

Consistent with the legislative history, Q&A 22(c) of the proposed regulations generally provides that, if, in fact, a payment would have been made had no change in control occurred, it is treated as contingent on the change if the change accelerates the time at which the payment is made. However, the payment that is contingent on the change may be significantly reduced by the rules described in Q&A 24, if the payment was vested or, if nonvested, provided that it was substantially certain, at the time of the change, to have been made without regard to the change if the disqualified individual had continued to perform services for the corporation for a specified period of time. If the property may have become, but for the change, substantially vested upon the occurrence of a vesting event other than services, neither Q&A 24(b) nor (c) applies and the full amount of the payment is contingent on the change. See Q&A 24(e), Example 9.

Prior to the withdrawal of the ruling request, we advised Taxpayer's representatives that we were prepared to rule that the requirement that each Executive attain certain performance targets to receive the normative bonus caused the normative bonus to be nonvested prior to the change so that Q&A 24(b) did not apply to the bonus; that the payment in the nature of compensation for purposes of section 280G of the Code occurred when the normative bonus received accelerated vesting as a result of the change of control; and that, because vesting was dependent upon an event other than just services, Q&A 24(c) of the proposed regulations did not apply to reduce the contingent portion of the payment related to

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the normative bonus. Thus, the full amount of the payments for the normative bonus is treated as contingent on the Date 3 change in control.¹

We bring this matter to your attention so that you may take whatever action, if any, you deem appropriate. If you have any questions about this matter, please contact us at (202) 622-6030.

Sincerely,

Robert Misner
Robert Misner
Assistant Chief
Executive Compensation Branch
Office of the Division Counsel/
Associate Chief Counsel (Tax
Exempt and Government Entities)

¹ Note that while this ruling would have required that the full value of the normative bonus be included for purposes of determining the “three-times-base-amount test” of section 280G(b)(2)(A)(ii), it does not preclude a reduction in an excess parachute payment as provided in section 280G(b)(4)(B) if the Taxpayer can prove by clear and convincing evidence that all or a part of the payment represented reasonable compensation for services actually rendered before the change of ownership or control.