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Susan Wetzel Authors Article in Business Law Today About Code Section 280G Issues

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PRACTICES Employee Benefits and Executive Compensation, Executive and Incentive Compensation, ESOPs and Other Stock-Based Plans, Employee Benefits M&A

INTRODUCTION

While employee benefits and executive compensation issues rarely drive a transaction, one issue that should be discussed at the beginning of every deal is whether there are any payments that could trigger taxation under Section 280G.[1] Ignoring this Code section or waiting until a few days before closing to address potential Section 280G issues could result in a large tax bill for impacted individuals, as well as a loss of deduction for the corporations involved and angry clients and executives.

Section 280G and its counterpart, Section 4999, were enacted by Congress in 1984 to address Congressional concerns and the then-common belief that corporate executives were receiving financial windfalls in the deluge of mergers and acquisitions occurring in the '80s, which in turn was impacting shareholder value and potentially could have a cooling effect on M&A activity. As with many provisions of the United States Tax Code, Section 280G and its counterpart Section 4999 attempt to curtail behavior by (i) imposing an excise tax on certain compensation received in connection with the change of control by the executives under Section 4999; and (ii) causing the corporation to lose its deduction under Section 280G for any compensation that subject to such taxation. While the concept of taxation and loss of deduction sounds simple, the application creates a web of complexity that requires someone familiar with these rules to navigate its application in corporation transactions. This article endeavors to assist practitioners unfamiliar with this area in identifying issues in transactions by providing a brief overview of Section 280G and how it can be avoided or if avoidance is impossible, how to offset it or mitigate its impact.

OVERVIEW OF SECTION 280G

Practitioners often refer to the complications caused by Sections 280G and 4999 simply as "280G," but as noted above, these are two distinct Code sections that work in tandem to penalize both the impacted individual and the corporation. Section 4999 imposes a 20% excise tax on the disqualified individual (referred to as "disqualified individuals" and discussed more in depth below) payee of an "excess parachute payment." Section 280G disallows a deduction for the payor of such "excess parachute payment." The 20% excise tax under Section 4999 and the disallowance of deduction under Section 280G only apply if there is an "excess parachute payment," and there can only be an "excess" if there is first a "parachute payment."

Excerpted from *Business Law Today*. To read the full article, click here.