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Internal Revenue Service Updates Golden Parachute Payments Audit Technique Guide, Signaling Key Items IRS May Review on Audit

McDermott Will & Emery
Article By
Andrew C. Liazos
Joseph K. Urwitz
Maureen O'Brien
McDermott Will & Emery
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Summary

In early 2017, the IRS updated its Golden Parachute Payments Audit Technique Guide for the first time since its 2005 issuance. While intended as an internal reference for IRS agents conducting golden parachute examinations, the Audit Technique Guide offers valuable insight for both public and private companies, and recipients of golden parachute payments, into how IRS agents are likely to approach golden parachutes when conducting an audit.

In Depth

In January 2017, the Internal Revenue Service (IRS) published its first updated Golden Parachute Payments Audit Technique Guide (Updated Guidelines) since 2005. While intended as an internal reference for IRS agents to consult during the audit process, the Updated Guidelines highlight likely areas for audit. Corporations providing golden parachute payments to their executives and independent contractors—as well as individuals eligible to receive golden parachute payments—can find current, practical compliance tips and insight into IRS thinking in the Updated Guidelines.

Background

The concept of a golden parachute arises from Sections 280G and 4999 of the Internal Revenue Code of 1986, as amended, (Code) and regulations promulgated thereunder (together, the Golden Parachute Rules). The Golden Parachute Rules apply the following tax penalties if certain employees and independent contractors (including directors) of a corporation undergoing a “change in control” receive “parachute payments” in connection with the change in control: (1) the payor of the parachute payments loses the ability to deduct the parachute payments that constitute “excess parachute payments”; and (2) the employee or independent contractor who receives the parachute payments incurs a 20 percent excise tax, in addition to ordinary income tax liability, on the parachute payments that constitute excess parachute payments (collectively, the Golden Parachute Penalties).

What’s New in the Updated Guidelines

The Updated Guidelines include: (1) a review of the golden parachute rules and a discussion of potential audit adjustments; (2) a list of documents to review in connection with a golden parachute examination; and (3) a list of nine steps to perform in a parachute payment examination. New matters covered by the Updated Guidelines include the following:

- Adds the annual proxy statements and information statements filed on Schedules 14A and 14C containing disclosure of potential change in control payments to Named Executive Officers (NEOs) as document containing relevant background information on change in control payments (for public companies, these forms are not applicable to private companies);

- Adds Forms S-4 and F-4 disclosures in registration statements related to mergers, acquisitions or in cases when securities are exchanged between companies as documents containing relevant background information on change in control payments (for public companies, these forms are not applicable to private companies). The Forms S-4 and F-4 contain disclosures of NEO golden parachute payments in a disclosed transaction as required the Dodd-Frank Act; and

- Discusses the technical interplay between Sections 162(m) and 280G. Under Section 162(m) of the Code, the $1 million limitation must be reduced by any amount of excess parachute payment paid. For example, if a NEO receives an excess parachute payment of $300,000 under the Golden Parachute Rules, the company is not only denied a deduction under the Golden Parachute Rules for the $300,000 excess parachute payment, but the company is also limited to a $700,000 deduction under Section 162(m) of the Code.

The Updated Guidelines confirm our experience that the IRS is increasingly looking to securities filings when evaluating tax positions under Section 280G. These filings often include disclosures that could be inconsistent with desired tax positions, such as disclosing payments in a manner that makes them appear to be parachute payments. For example, a company might disclose estimated tax gross-up payments that need not be made or payments that are not linked to a non-compete even though post-termination payments are being treated as reasonable compensation for post-merger service. We have also found that the IRS will evaluate whether tax deductions for executives continuing employment have been properly reduced due to both parachute payment treatment and the $1 million tax deduction limitation.

Regardless of whether a company is public or private, the Updated Guidelines are a good resource to consult when preparing 280G calculations and determining how best to position the company in the event of an audit.