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IRS Updates its Golden Parachute Audit Techniques Guide



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Although it hasn't made it into the headlines, it's worth a mention that the IRS updated its Audit Techniques Guide (ATG) covering the examination of golden parachute matters under Internal Revenue Code (IRC) Sections 280G and 4999 on January 20, 2017.

IRC Section 280G generally disallows a company's tax deduction for change-in-control (CIC) payments made to executives that are determined to be excessive in amount (the technical term is *"excess parachute payment"*). In turn, the executive receiving an excess parachute payment is subject to a whopping 20 percent excise tax.

While ATGs are generally written to provide guidance to IRS examiners in audits on various industry related and technical topics, they can also be very helpful to businesses since they provide insight into the IRS' examination techniques and focus.

The Golden Parachute Payment ATG was first issued back in 2005 when the IRS issued a series of ATGs on various executive compensation related topics. The guide primarily provides a) an overview of the golden parachute rules and implications of potential audit adjustments, b) a list of the documentation an IRS agent should review as background about a company's golden parachute payments, and c) the nine steps involved in a parachute examination including a helpful *Golden Parachute Payments Examination Flow Chart.*

The 2017 ATG is the first update since the original was issued in 2005. It primarily updates the golden parachute guide for the following discrete issues:

- Adds the following public disclosures as containing relevant background information on CIC payments:
  - Annual proxy statements and information statements filed on Schedules 14A and 14C containing disclosure of potential CIC payments to Named Executive Officers (NEOs); and
  - Forms S-4 and F-4 disclosures in registration statements related to mergers, acquisitions, or in cases when securities are exchanged between companies. These filings contain disclosures of NEO golden parachute payments in a disclosed transaction (commonly referred to as s*ay-on-golden-parachute*

disclosures) as required by the Dodd-Frank Act.

- Outlines the technical interplay between IRC Sections 162(m) and 280G:
  - As the ATG mentions, under IRC Section 162(m) the $1 million limitation must be reduced by any amount of excess parachute payment paid. So, if a CEO receives an excess parachute payment of $300,000, the company is not only denied a deduction under IRC Section 280G for the $300,000 excess parachute payment, but the company is also limited to a $700,000 deduction under IRC Section 162(m) ($1,000,000 - $300,000).
  - This intersection between 162(m) and 280G is not new, so the addition of this technical issue in the guide probably indicates that the IRS will be more likely in the future to cross check for 162(m) deductions when auditing golden parachute matters.

It's uncertain whether the release of these guidelines—which notably occurred on Inauguration Day—provides any forewarning that the IRS intends to focus more attention on 280G matters in the near future. When the executive compensation ATGs were originally issued in 2005, the IRS had announced its intent to make executive compensation issues a routine part of IRS audits of large and mid-size business, but it's impossible to predict what the current administration will really focus on. In any event, the release serves as a great reminder to companies that the IRS routinely audits golden parachute matters and has a planned method to its investigating this very complicated topic. Therefore, companies (including likely acquisition targets and those actually involved in transactions) are well-advised to address and plan for golden parachute matters early on so that the final 280G calculations are done right and can survive an IRS audit.

About the Author

Margaret has 30+ years experience advising on tax, compensation, and benefits matters, with a focus on corporate transactions, change-in-control provisions, and IRC compliance.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.