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Virtual Coffee Talk

A discussion of the latest tax updates

Special Tax Considerations around Compensation & Benefits

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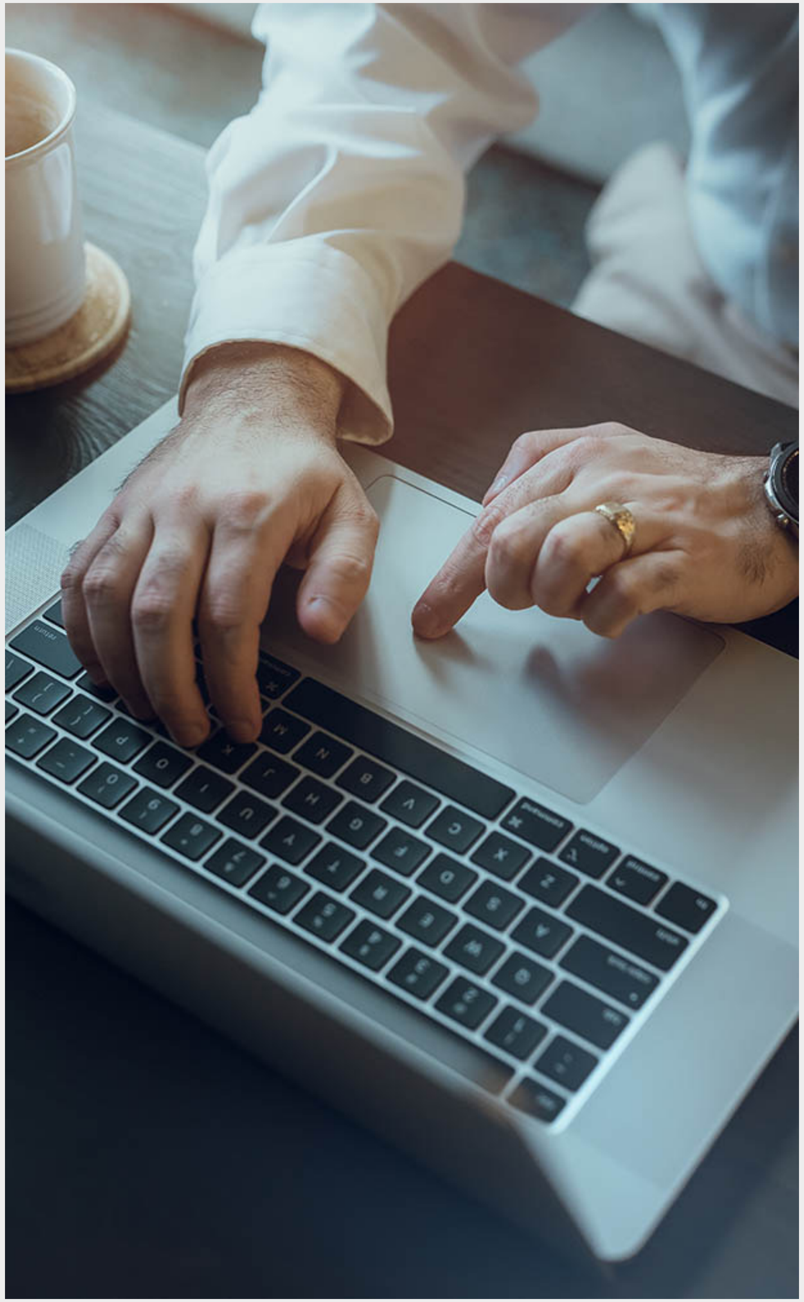

Today’s speakers

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Agenda

- Section 280G
- CIC Benefits Research
- Other M&A Compensation Issues
- Payroll Tax Issues — FICA “Reset”
- SEC Clawback Rules
- Additional Information in CCH® AnswerConnect

Section 280G

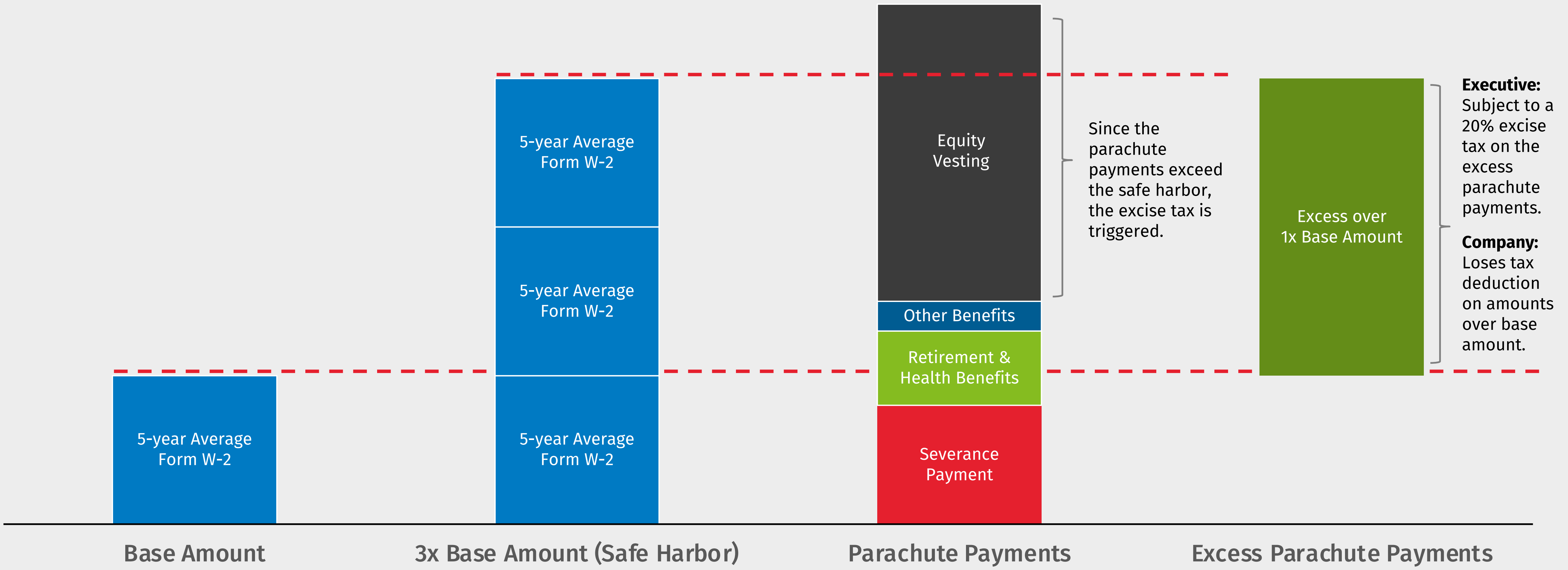
What is Section 280G?

- Section 280G of the Internal Revenue Code is intended to discourage excessive compensation (sometimes referred to as "golden parachute payments") to certain officers, highly compensated individuals, and greater than 1% shareholders (called "disqualified individuals") of a corporation undergoing a change in control. Parachute payments include any compensatory payments or benefits contingent upon a change in control.
- Section 280G was created to protect the interests of shareholders by stopping corporations from making unreasonably large payments to disqualified individuals when control of a corporation changes hands.
- Section 280G applies only to corporations, both public and private. It does not apply to S Corporations, Partnerships or LLCs that are taxed as partnerships.

What is Section 280G? *(cont'd)*

- Golden parachutes are payments or benefits received by an employee (usually executives and upper management) in connection with a change in control.
- Payments/benefits could be made with or without termination of employment. Common golden parachutes include:
  - Severance
  - Prorata bonus
  - Accelerated vesting of equity
  - Continuation of health & welfare benefits
  - Outplacement services
- Excess Parachute Payments made upon a "Change in Control" are subject to:
  - Disallowance of corporate deduction
  - 20% nondeductible excise tax imposed on recipient
- Golden Parachute protections allow management to focus on the best interests of the company rather than be distracted by personal concerns over economic security. This allows the executive to entertain attractive offers of business combination and reject inadequate offers without fear of reprisal.

Golden Parachute Rules — Section 280G



Section 280G Exemptions

1. **Small business corporation**
   - Company could otherwise qualify as an S-Corporation.
2. **Tax exempt entity**
   - Must meet the definition of a tax-exempt organization before and after the CIC.
3. **Non-public corporation with shareholder approval**
   - Executives must put payments "at risk" through a binding vote by the shareholders.
   - If 75% or more of the shareholders of all outstanding stock do not approve, the executives will not get the payments.
     - This voting power test is applied immediately before the ownership change.
     - Individuals who will receive payments that would be parachute payments if the shareholder approval requirements are not met are excluded from the voting process.
     - Persons authorized to vote for entity shareholders are excluded if they will receive payments that would be parachute payments if the shareholder approval requirements are not met. However, entity shareholders are permitted to appoint a replacement equity interest holder to vote on its behalf.
   - There must be adequate disclosure to shareholders of all material facts concerning all payments that would (but for this exception) be parachute payments.
   - Corporations without shareholders cannot use this exception.

Section 280G Mitigation Concepts

Base Amount Planning

- If it is known far enough in advance that a change in control will occur in a future calendar year, there may be an opportunity for Base Amount planning.
- It would be advantageous to include as many parachute payments as possible for a DI in the calendar year prior to the change in control.
  - While the acceleration of these payments may be considered parachute payments, the goal is that the payments will increase the base amount and Section 280G threshold of the DI, which can reduce or completely eliminate any excess parachute payments.

Reasonable Compensation Prior to the CIC

- “Reasonable compensation” for services rendered prior to the change in control
  - Such payments are still considered parachute payments
  - However, in determining the excess parachute payments, the amount of such payment that is for reasonable compensation can be subtracted from the value of the excess parachute payments
  - Services must be actually rendered, and the payment must be reasonable compensation

Reasonable Compensation After the CIC

- Payments can be restructured so that the amount payable may be considered “reasonable compensation” for services actually performed after a change in control.
  - Payments attributable to reasonable compensation after a CIC are not considered parachute payments

Section 280G Mitigation Concepts *(cont'd)*

Reasonable Compensation

Pre-CIC

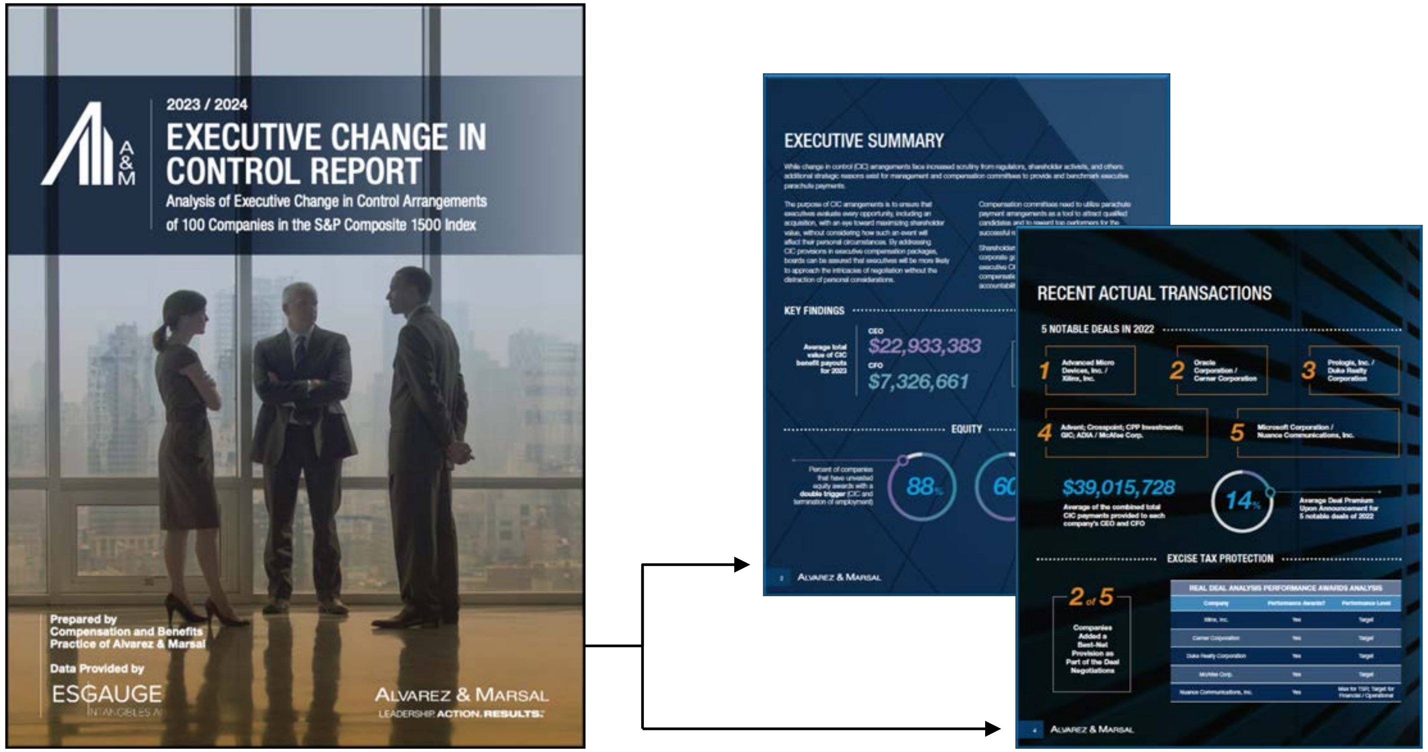
- Pro-Rata Annual Bonuses
- Performance-based stock awards
- Performance-based long-term cash awards

Post-CIC

- Non-Competition Agreements
- Consulting Agreements
- Retention Bonuses

CIC Benefits Research

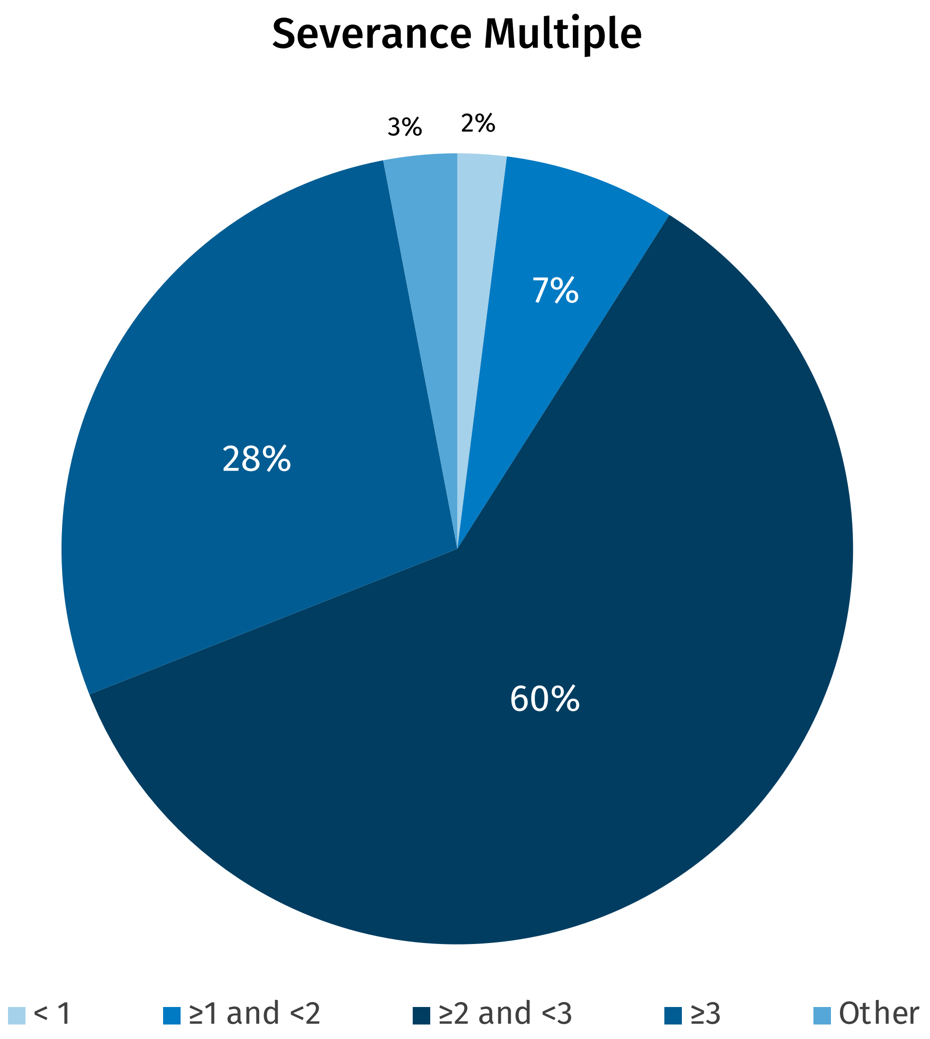
Alvarez & Marsal's Executive Change in Control Report

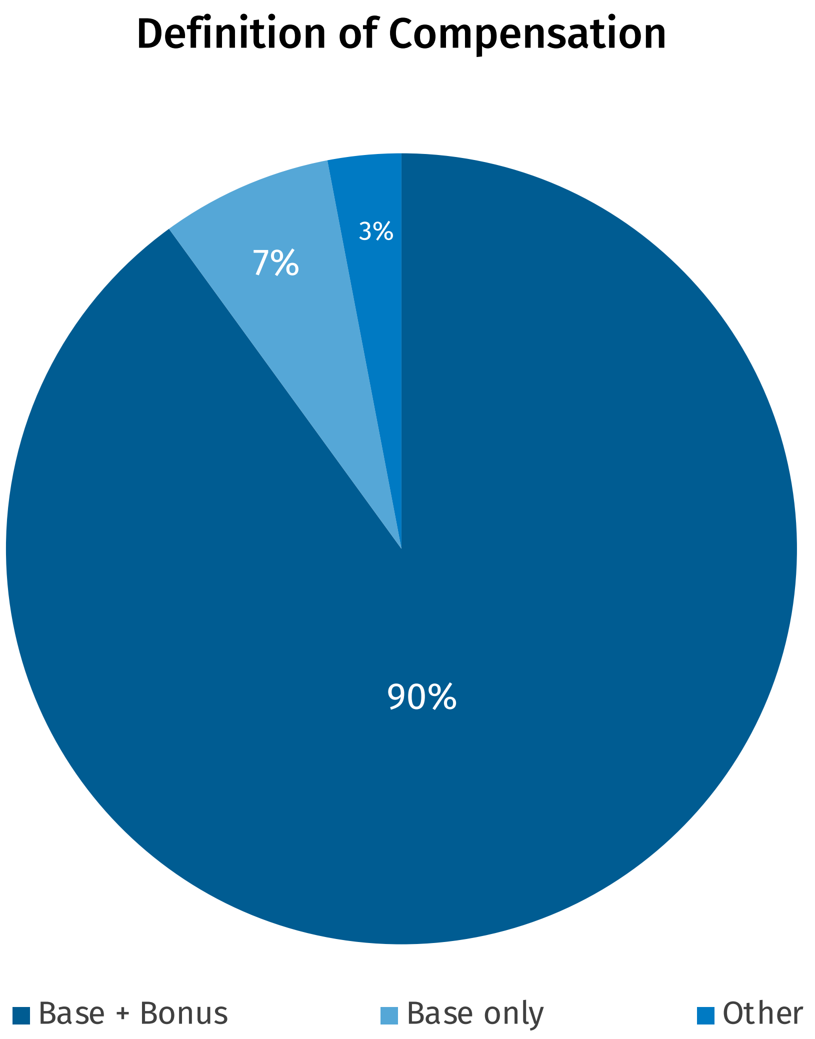


- This is the latest edition of our bi-annual **2023/2024 Executive Change in Control Report**. This report covers 100 U.S. companies across the S&P Composite 1500 Index and provides insights into how companies of different sizes approach CIC benefits. The report also highlights select observations across various sectors.

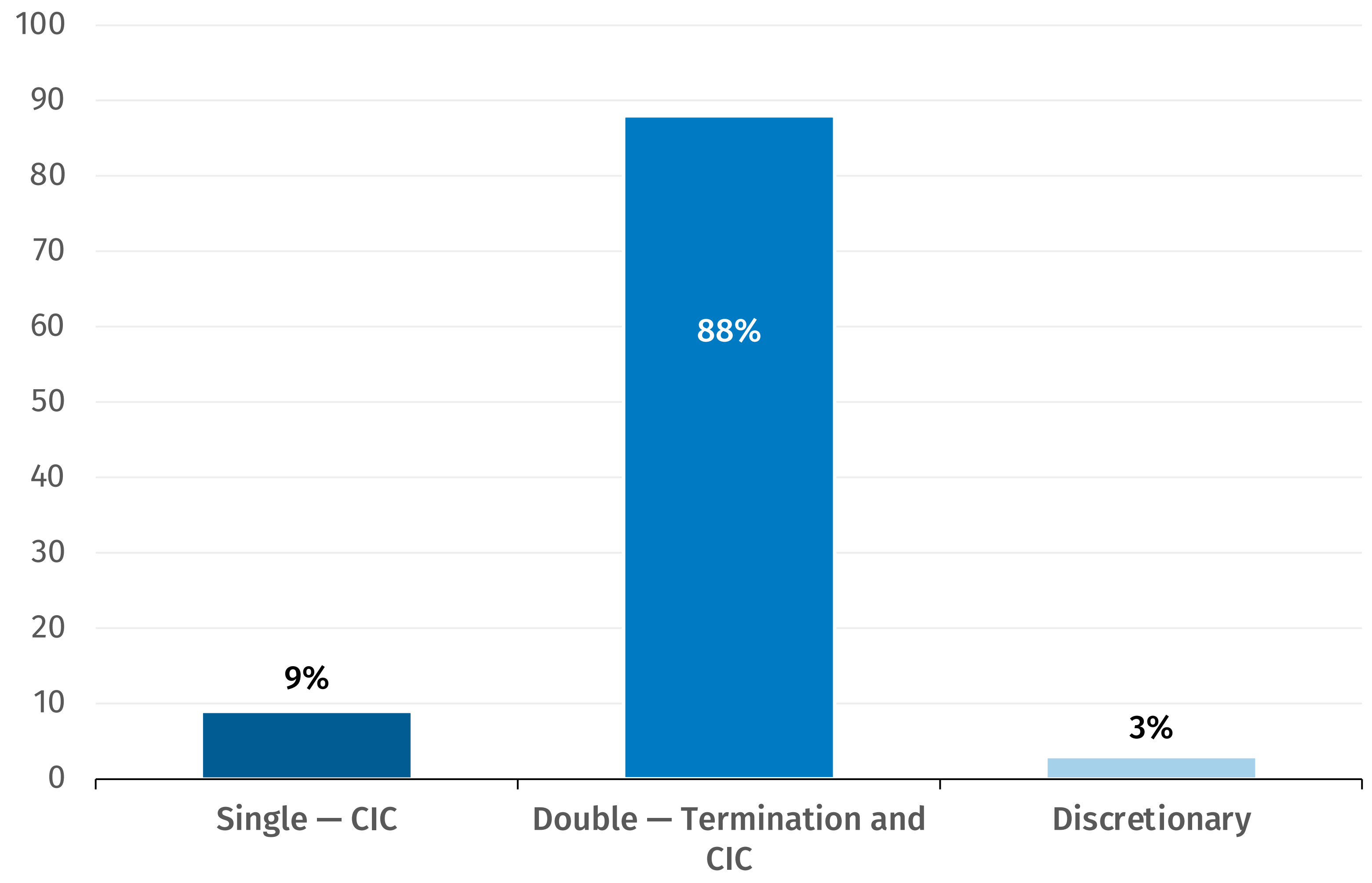
- Click on the link to the full survey results.

CEO Severance

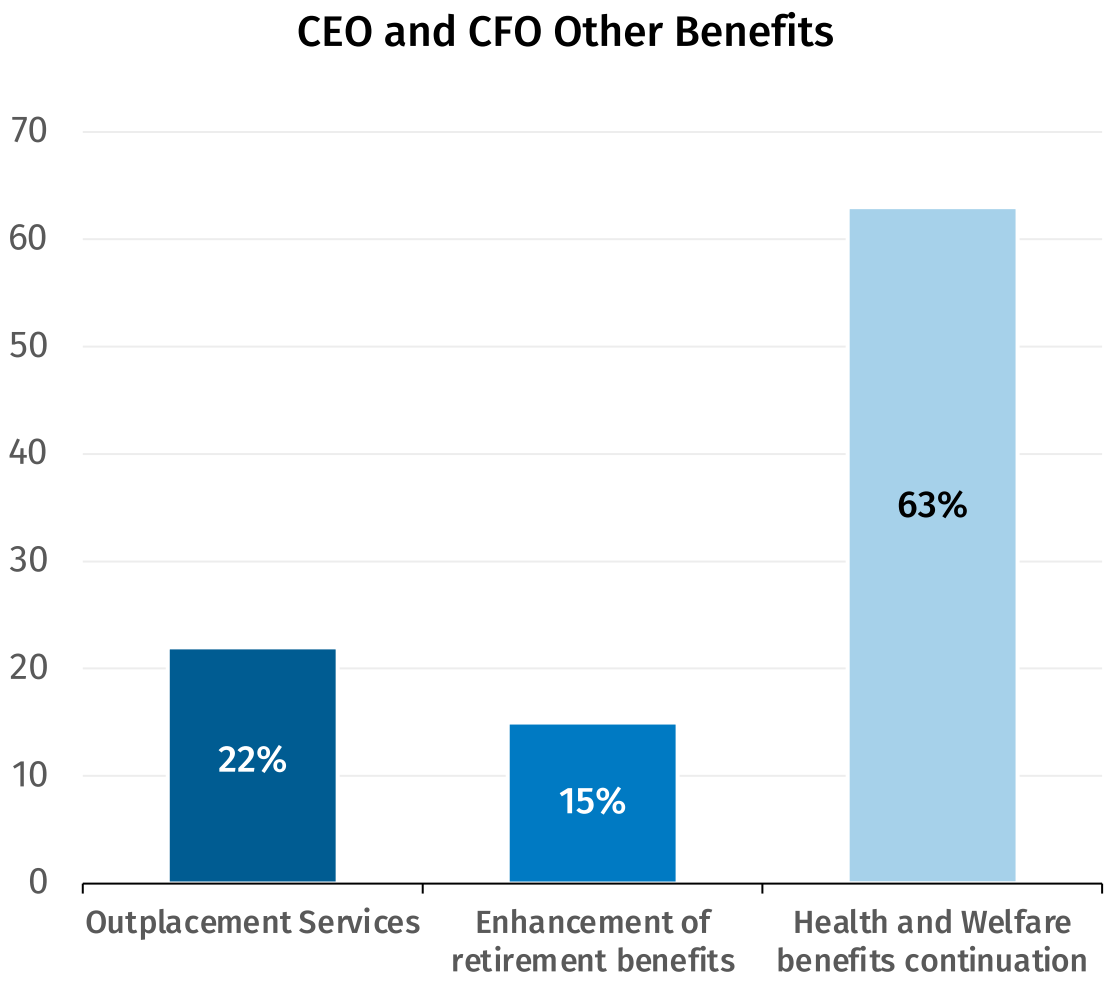


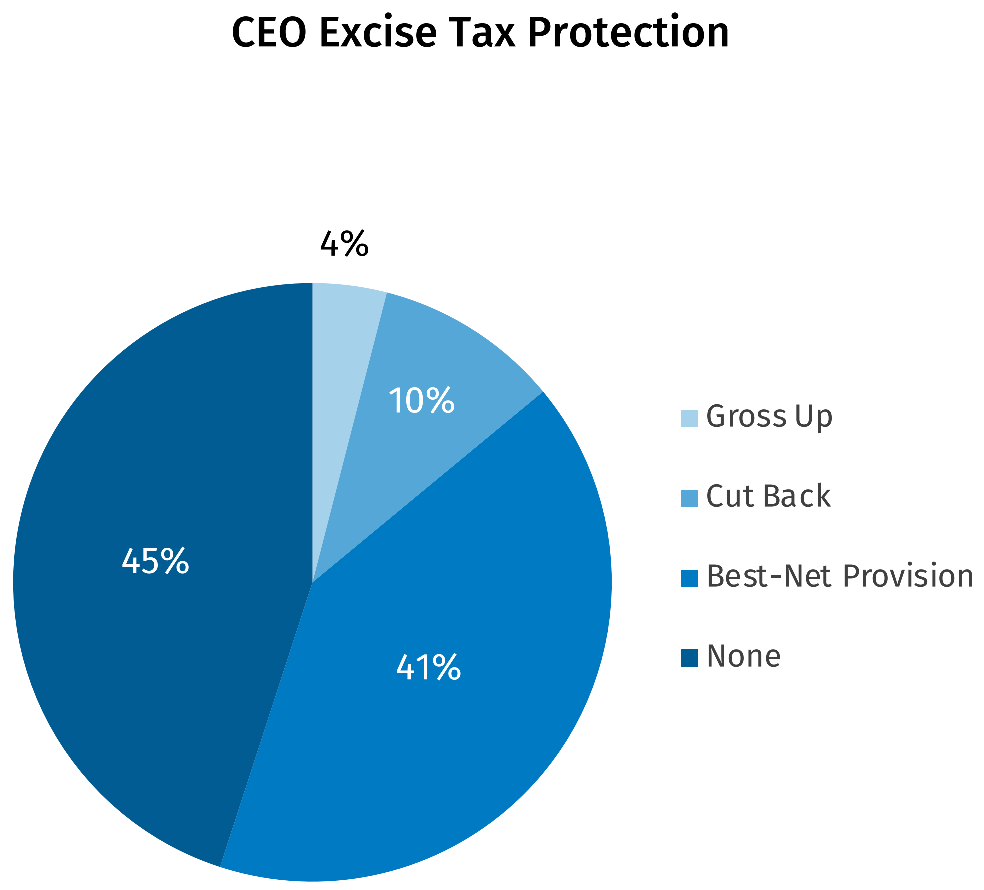


Long-Term Incentive Triggers

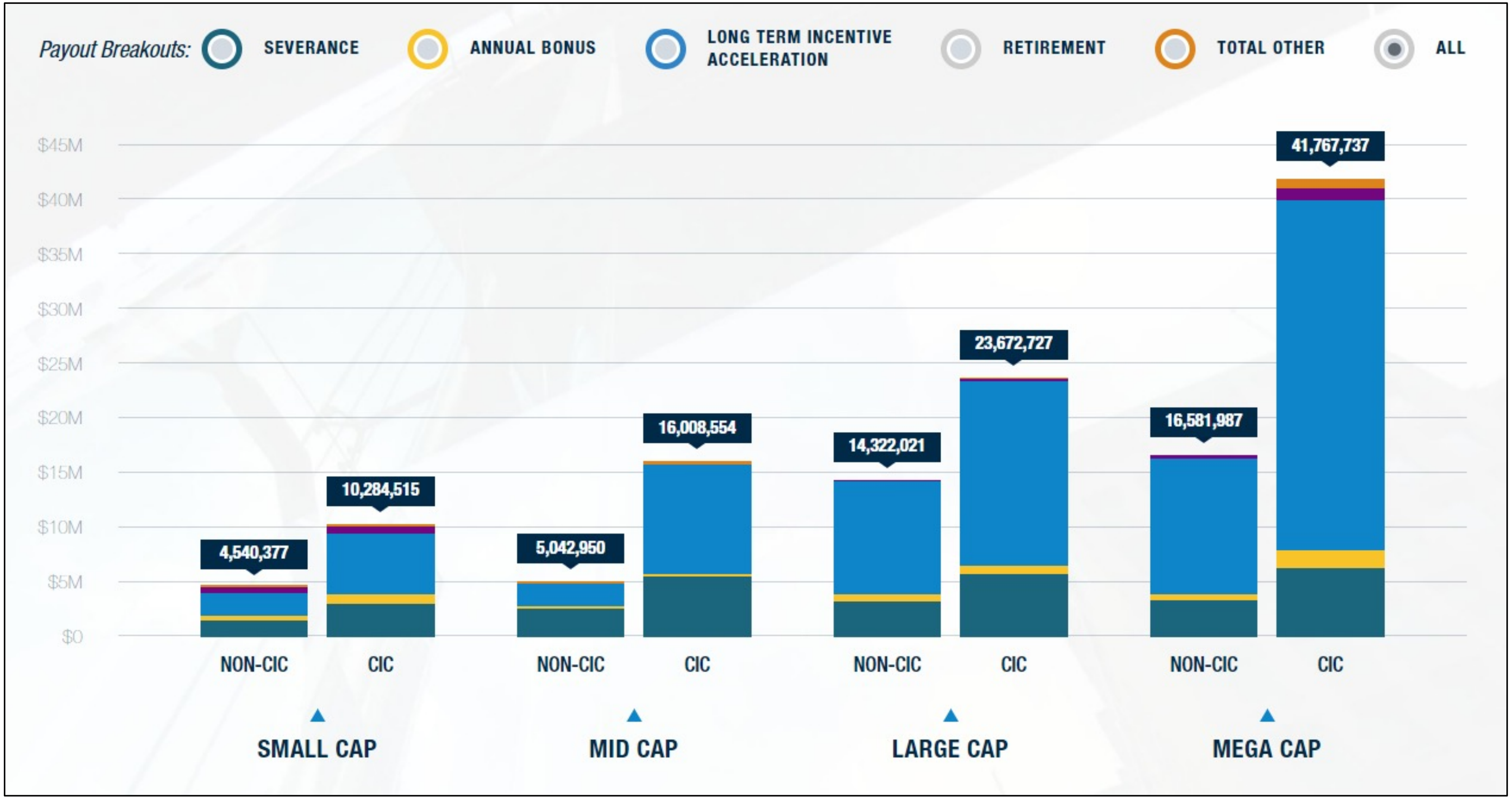


Other Benefits and Excise Tax Protection





CIC vs. Non-CIC Benefits for CEOs

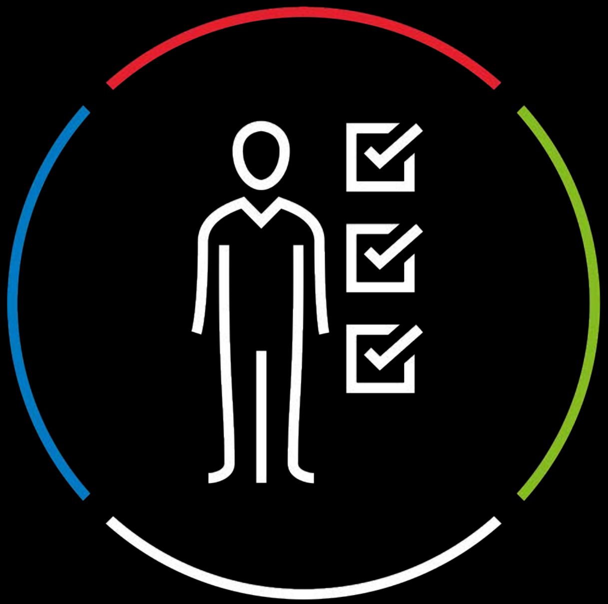


Polling question #1

Have you ever been a part of a change in control transaction?

A. No
B. **Yes, once**
C. **Yes, more than once**

Other M&A Compensation Issues



Earnouts

Whether purported sales proceeds will be reclassified as compensation from services is determined based on all of the relevant facts and circumstances, with no single factor controlling the ultimate outcome in a particular case. The potentially relevant factors include the following:

Indicative of Compensation	Indicative of Sale Proceeds	Indicative of Either
Whether the person was required to be employed by the target as of the date of the transaction, or a subsequent date, to be eligible to receive the payment	Whether the payments are made in proportion to the target shareholders' equity interest in the target	Whether the transactional documents classify the payments as compensation or proceeds of sale
Whether the amount of the payments varies based on length and type of service	Whether the person receiving the payments is otherwise adequately compensated for the services provided after the acquisition	How the parties report the payments to the IRS, and whether the reporting of both parties is consistent
	Whether the overall payments that purport to be for target equity represent a reasonable value of the target business	How the payments are reported for non-tax purposes, including for financial accounting purposes

- The cash-out of equity awards can be paid at the time of the merger or on the same schedule and conditions applicable to the shareholders.
- To comply with section 409A, the earn-out period must not exceed five years for awards subject to section 409A.
- Can use Rev. Rul. 2007-49 to approximate effect of stock earnout treated as sale proceeds.

Adjusting Stock Options Upon a Transaction

Sections 409A and 424

Substitution of a new stock right pursuant to a corporate transaction will not be treated as a new grant if the following two tests are satisfied:

- Spread Test
  - Spread value of new option must be the same as the old option
- Ratio Test
  - On a share-by-share basis, the ratio of the exercise price to fair market value (FMV) of each new option may not be greater than or more favorable than the ratio of the exercise price to FMV of each old option

Example →

	Old Option	New Option
FMV of stock at CIC Date	$10 [A]	$20 [F]
Exercise Price	$5 [B]	$10 [G] = [F] x [E]
# of Options	1,000 [C]	500 [H] = [D] / ([F] - [G])
Total FMV	$5,000 [D] = ([A] - [B]) x [C]	$5,000 [D] = ([F] - [G]) x [H]
Ratio	0.50 [E] = [B] / [A]	0.50 [G] / [F]

Adjusting Stock Options — Impact on Tax Deduction

Whether stock options are properly adjusted in accordance with the applicable rules will impact the tax deduction

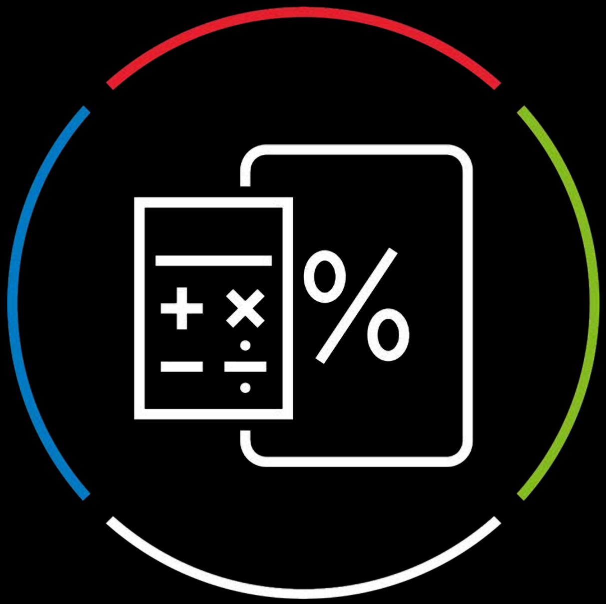
Section 409A (Deferred Compensation)

- If the stock options are not adjusted in a manner that satisfies section 409A, then the awards are subject to section 409A (i.e., not exempt as stock options generally are). Then the options must comply with the permissible distribution dates and other requirements under section 409A. If these complex rules are violated, then the employee will recognize the income upon vesting (rather than exercise) and the deduction will be accelerated for the employer.

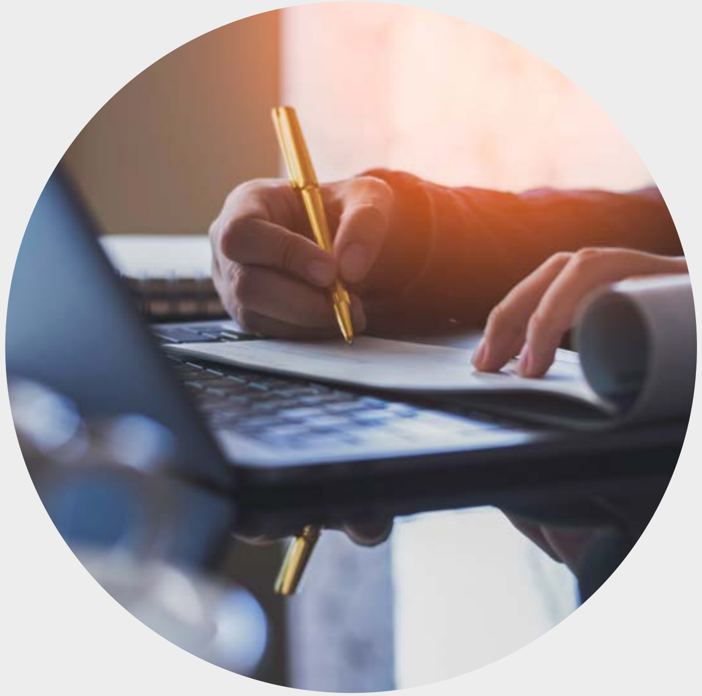
Section 424 (Incentive Stock Options)

- Generally, the employer is not entitled to a tax deduction for incentive stock options ("ISOs"). However, if the ISOs are adjusted in a manner that does not satisfy the rules under section 424, then the ISOs lose their tax qualified status and will be treated like non-qualified stock options. Accordingly, the employer will be entitled to a tax deduction at the time of exercise if the ISOs lose their qualified status due to adjustments upon a corporation transaction. However, the employee will lose its preferential tax treatment if the qualified status is lost.

Payroll Tax Issues – FICA “Reset”



Payroll Tax Issues



General Rules

- Generally, if there is no change of employment status and EIN remains the same, FICA will continue and will not restart. Current employer has the reporting obligation for all periods prior to and after the sale.
  - **Example:** Company A sells Subsidiary B to Buyer Company C. All of B's employees will remain employed in connection with the sale, and prior to the sale, were employed by Company B and paid under Company B's EIN.
    - In this example, FICA will not restart, and Company B will be responsible for reporting all wages, reporting payroll taxes (Forms 941) and for providing all W-2s to employees.
- If there is a change in employment or EIN under which employees are paid, FICA will "restart." Each company involved is responsible for payroll tax and reporting for employees for amounts paid to such employees.
  - **Example:** Company A sells Division B to Buyer Company C. All the employees providing services to Division B are on A's payroll and paid under A's EIN prior to the sale, and after the sale will be employed by Company C.
    - In this example, FICA will restart for all employees who become employed by Company C. Company A is responsible for all payroll taxes and W-2 reporting with respect to all wages paid before the sale, and Company C is responsible for all payroll taxes and W-2 reporting with respect to all wages paid after the sale.
    - This results in additional FICA paid by the employers, because the taxable wage base "restarts."
    - Affected Employees can get a refund on their personal Form 1040 for any excess FICA paid.
  - Same result if Company C absorbs Company A in a statutory merger; because Company C is the surviving corporation and the Company A employees will be paid under Company C's EIN after the merger, under the general rule, FICA will restart. However, under these facts, Company C will provide all W-2's for the affected employees under each EIN separately.
  - Under each example, employees receive multiple W-2s

Payroll Tax Issues *(cont'd)*

Alternative Procedure

- In the preceding example, if the Alternative Procedure were used, FICA would not restart.
- The Alternative Procedure is available applies when an employer (successor) acquires substantially all the property (1) used in a trade or business of another employer (predecessor), or (2) used in a separate unit of a trade or business of a predecessor, and, in connection with or immediately after the acquisition (but during the same calendar year), the successor employs individuals who immediately prior to the acquisition were employed in the trade or business of the predecessor.
  - The problem is that the total wages reported on Forms W-2 and W-3, which are provided by the buyer for all wages, will not balance with the wages reported on the buyer's Forms 941.
  - Additionally, the seller would have filed Forms 941 reporting wages, but will not file corresponding Forms W-2/W-3.
- Each employer files Form 941 relating to wages paid to the employees during the year. Thus, seller files Forms 941 covering wages paid prior to the closing, and the buyer files Forms 941 for post-closing wages.
- Schedule D to Form 941 is used to reconcile these differences.

Payroll Tax Issues *(cont'd)*

Consequences of "Getting it Wrong"

- Seller/merged entity will undoubtedly receive a Penalty Assessment relating to failure to file Forms W-2
  - Penalty notices are typically delayed 2-3 years—this is typical … the IRS moves very slowly.
  - By the time they catch up and assess the penalties, there is substantial increase in the penalty amount due to the delay.
- Buyer will often not receive any notice that it reported too many wages on Forms W-2/W-3.
  - However, if this isn't done correctly and the alternative procedure doesn't apply, the buyer could be hit with an assessment for unpaid FICA taxes … because in this case, the SSTWB should have been reset and FICA restarted.
- In my experience, even when done correctly, the IRS often doesn't always get it right.
  - Often can be cleared up by submitting supplemental information, assuming all was correctly submitted at the time of the transaction.
  - If the buyer and seller neglected to file Schedule Ds, this can be done retroactively.

Polling question #2

How does your company handle payroll?

A. We outsource it

B. We use a PEO

C. In-house

SEC Clawback Rules

Adopting a Clawback Policy

- By December 1, 2023, all companies listed on the NYSE or Nasdaq must adopt clawback policies that comply with listing standards mandated by the SEC.
- Companies must file their policy as an exhibit to their first annual report filed on or after December 1, 2023 (Form 10-K for US domestic issuers).
- Adopting the policy does not trigger a Form 8-K, nor are companies required to post their policy on their website.
- Although unlikely, companies may be subject to potential delisting if they do not adopt a policy by the deadline.
    - If Nasdaq determines that there is a compliance failure, it will immediately notify the company, and the company must issue a press release disclosing the failure within four business days.
    - If the NYSE determines that there is a compliance failure, it will notify the company, and the company must contact the NYSE to discuss the delinquency and issue a press release within five days.
- Many companies have existing clawback policies that are broader in scope than the SEC Clawback Rules that may apply to a larger group of employees beyond current and former executive officers and/or allow for clawback of compensation beyond incentive-based compensation.
    - Compensation committees must decide to retain or modify broader aspects of their clawback policies.
    - Many companies are choosing to retain their broader aspects as a separate policy or integrating existing policies and the SEC Clawback Rules into one policy.

Enforcing a Clawback Policy

(Source: *[SEC Clawback Rules: Practice Considerations and FAQs](#) by Keith Halverstam, Maj Vaseghi, and Jenna Cooper*)

Is the **error** material to prior-period financial statements?

Yes →

"Big R" reissuance

- File item 4.02 Form 8-K
- Restate and reissue financial statements and amend prior periodic reports
- Label prior-period columns "As Restated"
- Include ASC 250 disclosures (1)

No ↓

Is the **error** correction* material to current-period financial statements?

Yes →

"Little r" revision

- Revise prior-period financial statements in next presentation of prior periods
- Do not reissue audit opinion
- Do not label columns "As Restated"
- Do not file item 4.02 Form 8-K
- Do not amend prior periodic reports (2)

Rule 10D-1 Restatement event requires clawback of any erroneous compensation

No ↓

Out-of-Period Adjustment

- Correct error in current-period financial statements
- Correcting adjustment may appear in current period if immaterial to current period (3)

Or

Voluntary Revision

- Revise prior-period financial statements in:
  - next presentation of prior periods, or
  - Single tabular presentation, e.g., quarterly footnote
- Unlike "little r" scenario, error correction does not trigger clawback because error correction is immaterial to current period (4)

Or

Leave Error Uncorrected

- Error remains uncorrected
- This determination may depend on nature and extent of errors
- As with all immaterial errors, GAAP and IFRS provisions need not apply to immaterial items (5)

Immaterial error does not require clawback

Considerations to Mitigate the Impact of a Clawback Policy

- Non-financial reporting measures are not subject to clawback under the SEC Clawback Rules, so companies may consider implementing incentive-based compensation that's less directly tied to financial reporting or TSR and stock price measures.
  - For example, a company may have current incentive plans tied to 40% EBITDA, 30% free cash flow, and 30% strategic milestones. Under the SEC Clawback Rules, the portions of the incentive award that would be subject to clawback are the 40% tied to EBITDA and 30% tied to free cash flow. The company may consider weighting the strategic milestones more to mitigate the impact of future restatements on the payouts under this program.
- The SEC Clawback Rules also do not capture awards vesting solely based on continued service over time or awards that are discretionary.
  - Significant shifts of compensation to solely service-vesting or discretionary may be possible but will be viewed as poor pay practice.
- The requirement for compensation recovery is on a pre-tax basis, so companies may choose to implement deferral arrangements that give executive officers the election to defer payment of incentive-based compensation that is potentially subject to clawback until after the expiration of the recovery period.

Polling question #3

What size is your company ?

A. Less than 100
B. Less than 500
C. 500-1000
D. 1000-5000
E. >5000

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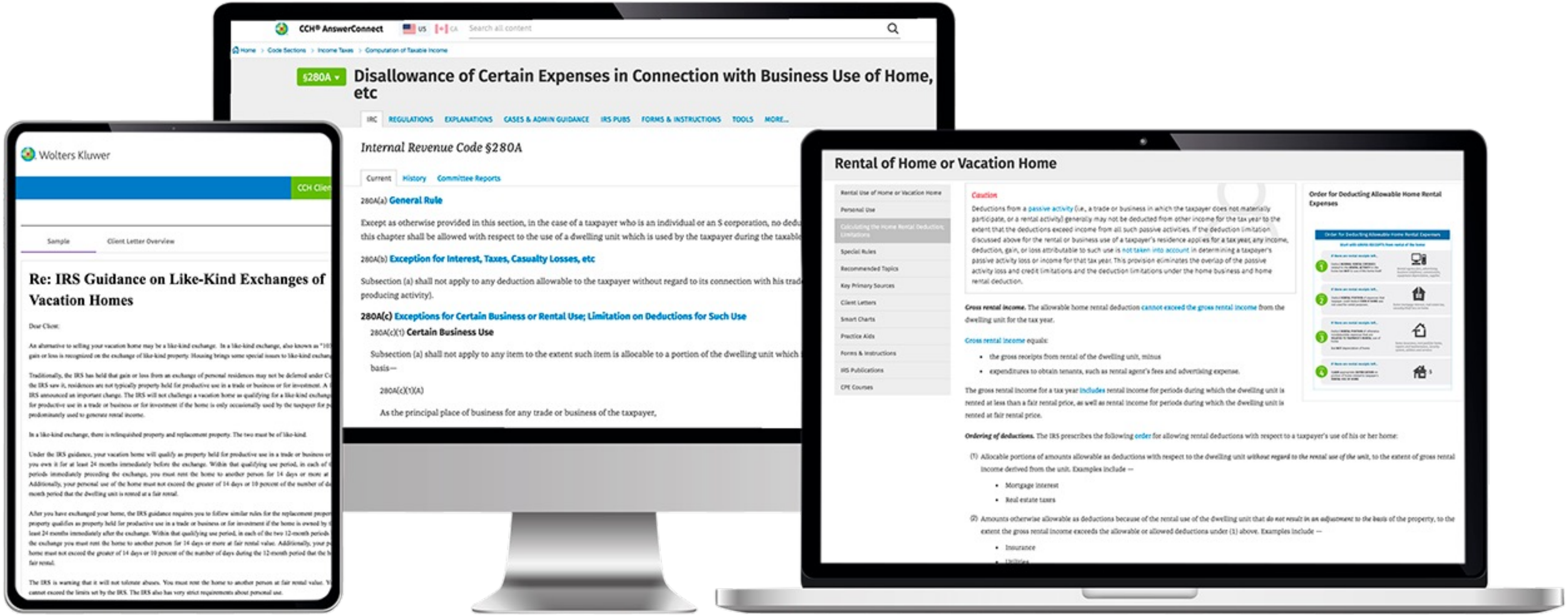

Additional information in CCH® AnswerConnect

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Polling question #4

Would you like a more in-depth demo or further details on the resources and tools available in CCH® AnswerConnect?

A. Yes
B. No

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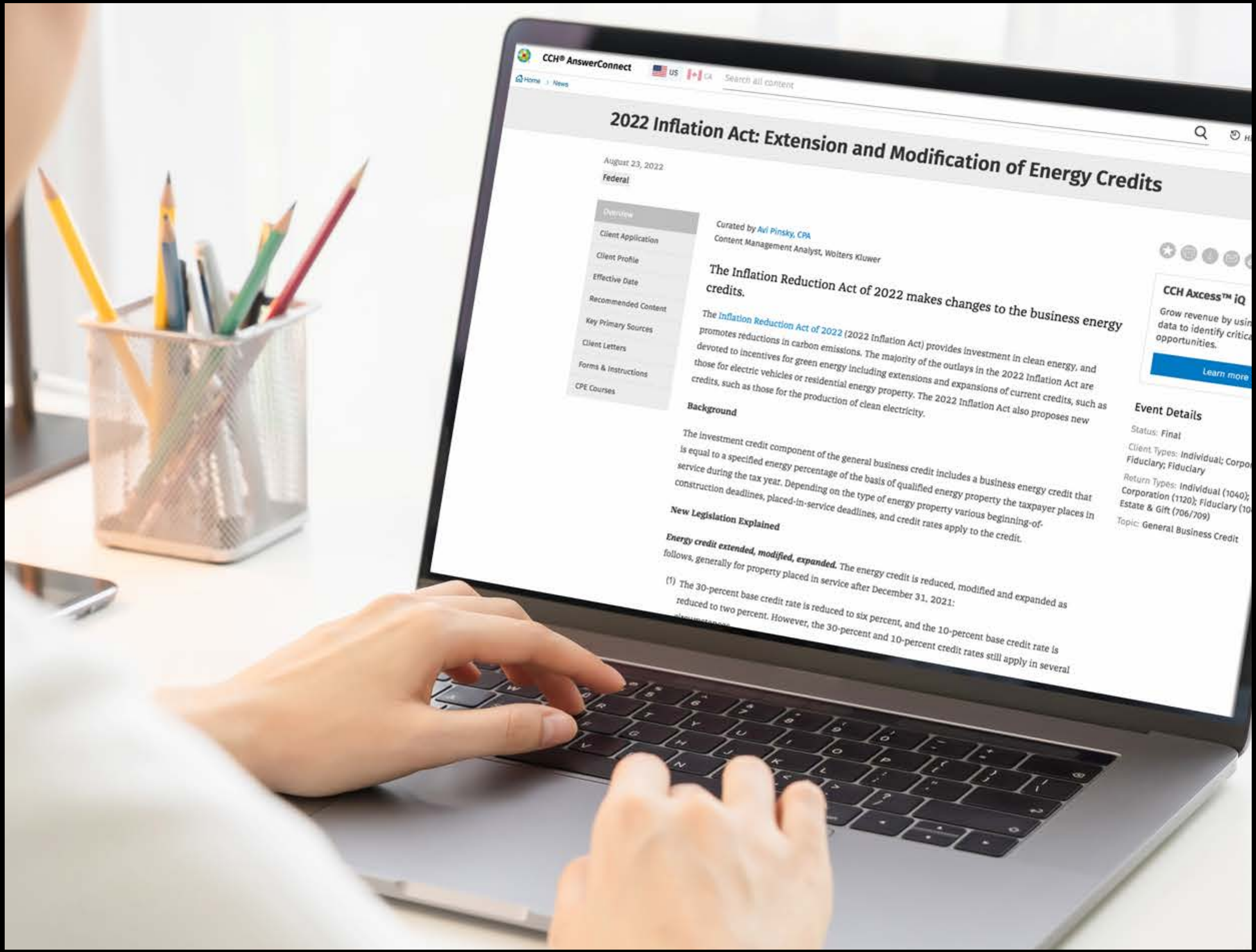
→ [Register to try it for free]()

→ [Learn more about CCH AnswerConnect]()



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Kevin M. Jacobs

Kevin M. Jacobs is a Managing Director with Alvarez & Marsal Tax, LLC in Washington D.C. and the National Tax Office Practice Leader. He brings more than 15 years of experience in tax matters in both the public and the private sectors.

Prior to joining A&M, Mr. Jacobs was a Senior Technician Reviewer (TCJA) with the IRS Office of Associate Chief Counsel (Corporate) for more than six years, where he advised on tax issues such as corporate re-organizations and corporation-shareholder issues, earning and profits, recovery and allocation of stock basis, liquidations, redemptions, bankruptcies, spin-offs and consolidated returns.

Mr. Jacobs was the principal Associate Chief Counsel (Corporate) attorney on several regulatory projects including the proposed section 382(h) regulations on built-in gains and losses, the global intangible low-taxed income regulations, and debt-equity regulations. He provided substantial contributions to numerous other guidance projects, such as the limitation on interest deductions regulations, and assisted in overseeing the Corporate Division's response to TCJA, including the coordination with Treasury's Offices of Tax Legislative Counsel and International Tax Counsel.

Mr. Jacobs earned a bachelor's degree in accounting, a master's degree in accounting (with a concentration in taxation), a J.D. (*magna cum laude*) from the University of Florida and an LL.M. in taxation from New York University. He is admitted to practice before multiple courts and to the District of Columbia and Florida Bars. He is also a licensed Certified Public Accountant (CPA) in Florida and Colorado. Mr. Jacobs is a member of several organizations including the American Bar Association, the American Institute of Certified Public Accountants, the International Fiscal Association, and the New York State Bar Association.

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Allison Hoeinghaus

Allison Hoeinghaus is a Managing Director with Alvarez & Marsal Tax, LLC's Compensation and Benefits practice in Dallas.

Ms. Hoeinghaus helps companies effectively and efficiently tackle paying and incentivizing their employees. She works with companies to design and benchmark annual bonus and long-term incentive compensation programs, while considering the applicable tax, accounting, and other regulatory ramifications.

Ms. Hoeinghaus focuses on mergers and acquisitions, including golden parachute rules and bankruptcy compensation. She also works on executive compensation matters such as equity compensation, the one-million-dollar deduction limitation, qualified and non-qualified retirement plans, and payroll compliance. Ms. Hoeinghaus helps her clients stay
up to speed on emerging compensation trends such as employment-related pandemic relief, gender/racial pay equity, and the impact of environment, social, and governance (ESG) efforts on compensation programs.

Ms. Hoeinghaus earned a bachelor's degree in accounting and a master's degree in professional accounting from the McCombs School of Business at The University of Texas at Austin. She is a Certified Public Accountant and a Certified Executive Compensation Professional (CECP) through the WorldatWork organization.

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James Deets

James A. Deets is a Senior Director at Alvarez & Marsal Tax LLC in Dallas. He specializes in executive compensation, employee benefits and qualified retirement plans and has served as a consulting expert on employee benefits issues within the context of bankruptcy proceedings.

With over 20 years of experience, Mr. Deets' expertise includes qualified plans, such as nondiscrimination and other qualification issues, compliance and correction of plan defects. He has significant experience in health and welfare plans, including PPACA, FMLA, HIPAA and COBRA issues, cafeteria plans, retiree welfare benefits, VEBA trusts, severance plans and multiemployer welfare plans. Mr. Deets advises clients on plans related to executive compensation, nonqualified and stock, employee stock purchase, performance bonus and incentive, split dollar life insurance and top-hat.

He has managed the benefits and executive compensation components of mergers and acquisitions, including the applicability and impact of the golden parachute rules. Mr. Deets has garnered considerable experience in ERISA litigation matters involving benefit claims, fiduciary breaches, subrogation/reimbursement and preemption issues.

Prior to joining A&M, Mr. Deets was Counsel in the Dallas office of Hunton & Williams LLP, where he focused his practice on employee benefits and executive compensation.

Mr. Deets earned a law degree with honors from the Baylor University Law School, where he served as Assistant Managing Editor of the Baylor Law Review. He earned a bachelor's degree in mathematical sciences from Baylor University.

Mr. Deets is a member of the State Bar of Texas. He serves on the Board of Directors of Legal Hospice of Texas and is a member of the National Association of Corporate Directors, Southwestern Benefits Association, DallasHR and the Dallas Bar Association.

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Thank you for joining us today!

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