

Disqualified Individuals

The 2002 proposed regulations provide that an individual is a disqualified individual if, at any time during the disqualified individual determination period, the individual is an employee or independent contractor of the corporation and is, with respect to the corporation, a shareholder (*see* Q/A-17), an officer (*see* Q/A-18), or (3) a highly-compensated individual (*see* Q/A-19). The 2002 proposed regulations provide that whether an individual is an officer with respect to a corporation is determined based on all the facts and circumstances in the particular case (such as the source of the individual's authority, the term for which the individual is elected or appointed, and the nature and extent of the individual's duties).

These regulations retain this rule concerning officers. However, under Q/A-18 of these regulations any individual who has the title of officer is presumed to be an officer unless the facts and circumstances demonstrate that the individual does not have the authority of an officer. However, an individual who does not have the title of officer may nevertheless be considered an officer if the facts and circumstances demonstrate that the individual should be considered to be an officer.

Nonvested Payments Under Q/A-24

Under Q/A-24(c) of the 2002 proposed regulations, only a portion of certain nonvested payments is treated as contingent on a change in ownership or control. Specifically, Q/A-24(c) applies to a payment that becomes vested as a result of a change in ownership or control to the extent that (i) without regard to the change in ownership or control, the payment was contingent only on the continued performance of services for the corporation for a specified period of time; and (ii) the payment is attributable, at least in part, to the performance of services before the date the payment is made or becomes certain to be made.

These regulations retain these rules regarding the calculation of the amount of the payment that is considered contingent on a change in ownership or control, with one revision. Under the 2002 proposed regulations, the payment calculation under Q/A-24(c) could not exceed the amount of the accelerated payment. A portion of a payment is contingent on a change in ownership or control if there is accelerated vesting, even if there is no accelerated payment. In that case, the amount attributable to the lapse of the obligation to perform

services is 1 percent of the present value of the future payment multiplied by the number of full months between the date that the individual's right to receive the payment is vested and the date that, absent the acceleration, the payment would have been vested. Under these final regulations, the total portion of such payment treated as contingent on the change in ownership or control cannot exceed the present value of the accelerated payment.

Change in Ownership or Control

A change in ownership or control is defined in Q/A-27, 28, and 29 of the 2002 proposed regulations. Under Q/A-27 of the 2002 proposed regulations, a change in control of a corporation occurs on the date that any one person (or persons acting as a group) acquires ownership or stock of the corporation that, together with stock held by such person or group, has more than 50 percent of the total fair market value or total voting power of the corporation.

Under Q/A-28 of the 2002 proposed regulations, a change in the effective control of a corporation is presumed to occur on the date that either (1) any one person (or more than one person acting as a group) acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing 20 percent or more of the total voting power of the stock of such corporation, or (2) a majority of members of the corporation's board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation's board of directors prior to the date of the appointment or election.

Under Q/A-29 of the 2002 proposed regulations, a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person (or more than one person acting as a group) acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person) assets from the corporation that have a total gross fair market value equal to or more than one third of the total gross fair market value of all of the assets of the corporation immediately prior to such acquisition.

These regulations generally follow the same approach as the 2002 proposed regulations. Some commenters suggested that these three provisions explicitly address whether more than one change in ownership or control can occur in a single transaction. In response to these comments, these

regulations explicitly adopt the "one change" rule that historically has been applied by the IRS. These regulations provide that if a corporation undergoes a change in ownership or control as described in either Q/A-27 or Q/A-29, the other corporation involved in the transaction does not undergo a change in ownership or control.¹ As these regulations apply, in any transaction involving two corporations, if one has a change in ownership or control under Q/A-27 or 29, the other corporation does not also have a change in ownership or control, under either Q/A-27 or 29. Under these regulations, Q/A-28, which relates to effective control, provides that there is no change in effective control of a corporation in a transaction in which the other corporation has a change of control under Q/A-27 or 29.

Commentators also requested that the final regulations define gross fair market value for purposes of Q/A-29. Under Q/A-29 of these regulations, *gross fair market value* is defined as the value of the assets of the corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets. This definition is used throughout these regulations.

For purposes of determining whether there is a change in ownership or control under Q/A-27 through Q/A-29 of the 2002 proposed regulations, two or more persons may be considered as acting as a group. The 2002 proposed regulations provide that, for purposes of determining whether two or more persons are acting as a group, a person who owns stock in both corporations involved in a transaction (an overlapping shareholder) is treated as acting as a group with respect to the other shareholders in a corporation only to the extent of such person's ownership of stock in that corporation prior to the transaction, and not with respect to his or her ownership in the other corporation. This rule is consistent with the interpretation of the 1989 proposed regulations by the IRS.

Commentators suggested different alternatives to the overlapping shareholder rule of Q/A-27 through Q/A-29 of the 2002 proposed regulations. One commentator suggested eliminating the overlapping shareholder rule and instead relying on the presumption of Q/A-28 for all transactions. Under this approach it would be possible for a transaction to result in one, two, or no

¹ Because Q/A-46 provides that all members of an affiliated group are treated as one corporation, even transactions involving multiple entities generally are treated as only two corporations for purposes of section 280G.