

exempt payments are not taken into account in applying the 3-times-base-amount test of Q/A-30 of this section.

Q-6: Which payments with respect to a corporation referred to in paragraph (a)(1), (a)(2), or (a)(4) of Q/A-5 of this section are exempt from the definition of *parachute payment*?

A-6: (a) The term *parachute payment* does not include—

(1) Any payment to a disqualified individual with respect to a corporation which (immediately before the change in ownership or control) would qualify as a small business corporation (as defined in section 1361(b) but without regard to section 1361(b)(1)(C) thereof), without regard to whether the corporation had an election to be treated as a corporation under section 1361 in effect on the date of the change in ownership or control;

(2) Any payment to a disqualified individual with respect to a corporation (other than a small business corporation described in paragraph (a)(1) of this A-6) if—

(i) Immediately before the change in ownership or control, no stock in such corporation was readily tradeable on an established securities market or otherwise; and

(ii) The shareholder approval requirements described in Q/A-7 of this section are met with respect to such payment; or

(3) Any payment to a disqualified individual made by a corporation which is a tax-exempt organization (as defined in paragraph (a)(4) of Q/A-5 of this section), but only if the corporation meets the definition of a tax-exempt organization both immediately before and immediately after the change in ownership or control.

(b) For purposes of paragraph (a)(1) of this A-6, the members of an affiliated group are not treated as one corporation.

(c) The requirements of paragraph (a)(2)(i) of this A-6 are not met with respect to a corporation if a substantial portion of the assets of any entity consists (directly or indirectly) of stock in such corporation and any ownership interest in such entity is readily tradeable on an established securities market or otherwise. For this purpose, such stock constitutes a substantial portion of the assets of an entity if the total fair market value of the stock is equal to or exceeds one third of the total gross fair market value of all of the assets of the entity. For this purpose, *gross fair market value* means the value of the assets of the entity, determined without regard to any liabilities associated with such assets. If a corporation is a member of an affiliated group (which group is treated as one

corporation under A-46 of this section), the requirements of paragraph (a)(2)(i) of this A-6 are not met if any stock in any member of such group is readily tradeable on an established securities market or otherwise.

(d) For purposes of paragraph (a)(2)(i) of this A-6, the term *stock* does not include stock described in section 1504(a)(4) if the payment does not adversely affect the redemption and liquidation rights of any shareholder owning such stock.

(e) For purposes of paragraph (a)(2)(i) of this A-6, stock is treated as readily tradeable if it is regularly quoted by brokers or dealers making a market in such stock.

(f) For purposes of paragraph (a)(2)(i) of this A-6, the term *established securities market* means an established securities market as defined in § 1.897-1(m).

(g) The following examples illustrate the application of this exemption:

*Example 1.* A small business corporation (within the meaning of paragraph (a)(1) of this A-6) operates two businesses. The corporation sells the assets of one of its businesses, and these assets represent a substantial portion of the assets of the corporation. Because of the sale, the corporation terminates its employment relationship with persons employed in the business the assets of which are sold. Several of these employees are highly-compensated individuals to whom the owners of the corporation make severance payments in excess of 3 times each employee's base amount. Since the corporation is a small business corporation immediately before the change in ownership or control, the payments are not parachute payments.

*Example 2.* Assume the same facts as in *Example 1*, except that the corporation is not a small business corporation within the meaning of paragraph (a)(1) of this A-6. If no stock in the corporation is readily tradeable on an established securities market (or otherwise) immediately before the change in ownership or control and the shareholder approval requirements described in Q/A-7 of this section are met, the payments are not parachute payments.

*Example 3.* Stock of Corporation S is owned by Corporation P, stock in which is readily tradeable on an established securities market. The Corporation S stock equals or exceeds one third of the total gross fair market value of the assets of Corporation P, and thus, represents a substantial portion of the assets of Corporation P. Corporation S makes severance payments to several of its highly-compensated individuals that are parachute payments under section 280G and Q/A-2 of this section. Because stock in Corporation P is readily tradeable on an established securities market, the payments are not exempt from the definition of *parachute payments* under this A-6.

*Example 4.* A is a corporation described in section 501(c)(3), and accordingly, its net earnings are prohibited from inuring to the

benefit of any private shareholder or individual. A transfers substantially all of its assets to another corporation resulting in a change in ownership or control. Contingent on the change in ownership or control, A makes a payment that, but for the potential application of the exemption described in A-5(a)(4), would constitute a *parachute payment*. However, one or more aspects of the transaction that constitutes the change in ownership or control causes A to fail to be described in section 501(c)(3). Accordingly, A fails to meet the definition of a *tax-exempt organization* both immediately before and immediately after the change in ownership or control, as required by this A-6. As a result, the payment made by A that was contingent on the change in ownership or control is not exempt from the definition of *parachute payment* under this A-6.

*Example 5.* B is a corporation described in section 501(c)(15). B does not meet the definition of a *tax-exempt organization* because section 501(c)(15) does not expressly prohibit inurement of B's net earnings to the benefit of any private shareholder or individual. Accordingly, if B has a change in ownership or control and makes a payment that would otherwise meet the definition of a *parachute payment*, such payment is not exempt from the definition of the term *parachute payment* for purposes of this A-6.

Q-7: How are the shareholder approval requirements referred to in paragraph (a)(2)(ii) of Q/A-6 of this section met?

A-7: (a) *General rule.* The shareholder approval requirements referred to in paragraph (a)(2)(ii) of Q/A-6 of this section are met with respect to any payment if—

(1) Such payment is approved by more than 75 percent of the voting power of all outstanding stock of the corporation entitled to vote (as described in this A-7) immediately before the change in ownership or control; and

(2) Before the vote, there was adequate disclosure to all persons entitled to vote (as described in this A-7) of all material facts concerning all material payments which (but for Q/A-6 of this section) would be parachute payments with respect to a disqualified individual.

(b) *Voting requirements—(1) General rule.* The vote described in paragraph (a)(1) of this A-7 must determine the right of the disqualified individual to receive the payment, or, in the case of a payment made before the vote, the right of the disqualified individual to retain the payment. Except as otherwise provided in this A-7, the normal voting rules of the corporation are applicable. Thus, for example, an optionholder is generally not permitted to vote for purposes of this A-7. For purposes of this A-7, the vote can be on less than the full amount of the payment(s) to be