

(b) An annuity plan described in section 403(a);

(c) A simplified employee pension (as defined in section 408(k)); or

(d) A simple retirement account (as defined in section 408(p)).

Q-9: Which payments of reasonable compensation are exempt from the definition of *parachute payment*?

A-9: Except in the case of securities violation *parachute payments*, the term *parachute payment* does not include any payment (or portion thereof) which the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services to be rendered by the disqualified individual on or after the date of the change in ownership or control. See Q/A-37 of this section for the definition and treatment of securities violation *parachute payments*. See Q/A-40 through Q/A-44 of this section for rules on determining amounts of reasonable compensation.

Payor of Parachute Payments

Q-10: Who may be the payor of parachute payments?

A-10: Parachute payments within the meaning of Q/A-2 of this section may be paid, directly or indirectly, by—

(i) The corporation referred to in paragraph (a)(3) of Q/A-2 of this section;

(ii) A person acquiring ownership or effective control of that corporation or ownership of a substantial portion of that corporation's assets; or

(iii) Any person whose relationship to such corporation or other person is such as to require attribution of stock ownership between the parties under section 318(a).

Payments in the Nature of Compensation

Q-11: What types of payments are in the nature of compensation?

A-11: (a) *General rule.* For purposes of this section, all payments—in whatever form—are payments in the nature of compensation if they arise out of an employment relationship or are associated with the performance of services. For this purpose, the performance of services includes holding oneself out as available to perform services and refraining from performing services (such as under a covenant not to compete or similar arrangement). Payments in the nature of compensation include (but are not limited to) wages and salary, bonuses, severance pay, fringe benefits, life insurance, pension benefits, and other deferred compensation (including any amount characterized by the parties as interest thereon). A payment in the

nature of compensation also includes cash when paid, the value of the right to receive cash, or a transfer of property. However, payments in the nature of compensation do not include attorney's fees or court costs paid or incurred in connection with the payment of any amount described in paragraphs (a)(1), (2), and (3) of Q/A-2 of this section or a reasonable rate of interest accrued on any amount during the period the parties contest whether a payment will be made.

(b) *When payment is considered to be made.* Except as otherwise provided in A-11 through Q/A-13 of this section, a payment in the nature of compensation is considered made (and is subject to the excise tax under section 4999) in the taxable year in which it is includible in the disqualified individual's gross income or, in the case of fringe benefits and other benefits excludible from income, in the taxable year the benefits are received.

(c) *Prepayment rule.* Notwithstanding the general rule described in paragraph (b) of this A-11, a disqualified individual may, in the year of the change in ownership or control, or any later year, prepay the excise tax under section 4999, provided that the payor and disqualified individual treat the payment of the excise tax consistently and the payor satisfies its obligations under section 4999(c) in the year of prepayment. The prepayment of the excise tax for purposes of section 4999 must be based on the present value of the excise tax that would be due in the year the excess parachute payment would actually be paid (calculated using the discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d) and regulations thereunder; see Q/A-32)). For purposes of projecting the future value of a payment that provides for interest to be credited at a variable interest rate, it is permissible to make a reasonable assumption regarding this variable rate. A disqualified individual is not required to adjust the excise tax paid under this paragraph (c) merely because the interest rates in the future are not the same as the rate used for purposes of projecting the future value of the payment. However, a disqualified individual may not apply this paragraph (c) of this A-11 to a payment to be made in cash if the present value of the payment would be considered not reasonably ascertainable under section 3121(v) and § 31.3121(v)(2)-1(e)(4) of this Chapter or to a payment related to health benefits or coverage. The Commissioner may provide additional guidance regarding the applicability of this paragraph (c) to certain payments in

published guidance of general applicability under § 601.601(d)(2) of this Chapter.

(d) *Transfers of property.* Transfers of property are treated as payments for purposes of this A-11. See Q/A-12 of this section for rules on determining when such payments are considered made and the amount of such payments. See Q/A-13 of this section for special rules on transfers of stock options.

(e) The following example illustrates the principles of this A-11:

Example. D is a disqualified individual with respect to Corporation X. D has a base amount of \$100,000 and is entitled to receive two parachute payments, one of \$200,000 and the other of \$400,000. A change in ownership or control of Corporation X occurs on May 1, 2005, and the \$200,000 payment is made to D at the time of the change in ownership or control. The \$400,000 payment is to be made on October 1, 2010. Corporation X and D agree that D will prepay the excise tax and X will satisfy its obligations under section 4999(c) with respect to the \$400,000 payment. Using discount rate determined under Q/A-32, Corporation X and D determine that the present value of the \$400,000 payment is \$300,000 on the date of the change in ownership or control. The portions of the base amount allocated to these payments are \$40,000 $((\$200,000/\$500,000) \times \$100,000)$ and \$60,000 $((\$300,000/\$500,000) \times \$100,000)$, respectively. Thus, the amount of the first excess parachute payment is \$160,000 $(\$200,000 - \$40,000)$ and that of the second excess parachute payment is \$340,000 $(\$400,000 - \$60,000)$. The excise tax on the \$400,000 payment is \$68,000 $(\$340,000 \times 20 \text{ percent})$. Assume the present value (calculated in accordance with paragraph (c) of this A-11) of \$68,000 is \$50,000. To prepay the excise tax due on the \$400,000 payment, Corporation X must satisfy its obligations under section 4999 with respect to the \$50,000, in addition to the \$32,000 withholding required with respect to the \$200,000 payment.

Q-12: If a property transfer to a disqualified individual is a payment in the nature of compensation, when is the payment considered made (or to be made), and how is the amount of the payment determined?

A-12: (a) Except as provided in this A-12 and Q/A-13 of this section, a transfer of property is considered a payment made (or to be made) in the taxable year in which the property transferred is includible in the gross income of the disqualified individual under section 83 and the regulations thereunder. Thus, in general, such a payment is considered made (or to be made) when the property is transferred (as defined in § 1.83-3(a)) to the disqualified individual and becomes substantially vested (as defined in § 1.83-3(b) and (j)) in such individual. The amount of the payment is