

ownership or control. For this purpose, the date of the change in ownership or control is the date the corporation experiences one of the events described in Q/A-27, Q/A-28, or Q/A-29 of this section. However, if the disqualified individual was not an employee or independent contractor of the corporation with respect to which the change in ownership or control occurs (or a predecessor entity or a related entity as defined in Q/A-21 of this section) for this entire 5-year period, the individual's base period is the portion of such 5-year period during which the individual performed personal services for the corporation or predecessor entity or related entity.

(b) The following examples illustrate the principles of Q/A-34 of this section and this Q/A-35:

*Example 1.* A disqualified individual, D, was employed by a corporation for 2 years and 4 months preceding the taxable year in which a change in ownership or control of the corporation occurs. D's includible compensation income from the corporation was \$30,000 for the 4-month period, \$120,000 for the first full year, and \$150,000 for the second full year. D's base amount is \$120,000,  $((3 \times \$30,000) + \$120,000 + \$150,000)/3$ .

*Example 2.* Assume the same facts as in *Example 1*, except that D also received a \$60,000 signing bonus when D's employment with the corporation commenced at the beginning of the 4-month period. D's base amount is \$140,000,  $((\$60,000 + (3 \times \$30,000)) + \$120,000 + \$150,000) / 3$ . Since the bonus will not be paid more often than once per year, the amount of the bonus is not increased in annualizing D's compensation for the 4-month period.

*Example 3.* E is a disqualified individual with respect to Corporation X who was not an employee or independent contractor for the full 5-year base period. In 2004 and 2005, E is a director of X and receives \$30,000 per year for E's services. In 2006, E becomes an officer of X. E's includible compensation from Corporation X is \$250,000 for 2006 and 2007, and \$300,000 for 2008. In 2008, X undergoes a change in ownership or control. E's base amount is \$140,000  $((2 \times \$250,000) + (2 \times \$30,000)/4)$ .

Q-36: How is the base amount determined in the case of a disqualified individual who did not perform services for the corporation (or a predecessor entity or a related entity as defined in Q/A-21 of this section), prior to the individual's taxable year in which the change in ownership or control occurs?

A-36: (a) In such a case, the individual's base amount is the annualized compensation for services performed for the corporation (or a predecessor entity or related entity) which—

(1) Was includible in the individual's gross income for that portion, prior to

such change, of the individual's taxable year in which the change occurred (including amounts that were excluded under section 911), or would have been includible in such gross income if such person had been a United States citizen or resident;

(2) Was not contingent on the change in ownership or control; and

(3) Was not a securities violation parachute payment.

(b) The following examples illustrate the principles of this A-36:

*Example 1.* On January 1, 2006, A, an individual whose taxable year is the calendar year, enters into a 4-year employment contract with Corporation M as an officer of the corporation. A has not previously performed services for Corporation M (or any predecessor entity or related entity as defined in Q/A-21 of this section). Under the employment contract, A is to receive an annual salary of \$120,000 for each of the 4 years that he remains employed by Corporation M with any remaining unpaid balance to be paid immediately in the event that A's employment is terminated without cause. On July 1, 2006, after A has received compensation of \$60,000, a change in the ownership or control of Corporation M occurs. Because of the change, A's employment is terminated without cause, and he receives a payment of \$420,000. It is established by clear and convincing evidence that the \$60,000 in compensation is not contingent on the change in ownership or control, but the presumption that the \$420,000 payment is contingent on the change is not rebutted. Thus, the payment of \$420,000 is treated as contingent on the change in ownership or control of Corporation M. In this case, A's base amount is \$120,000  $(2 \times \$60,000)$ . Since the present value of the payment which is contingent on the change in ownership of Corporation M (\$420,000) is more than 3 times A's base amount of \$120,000  $(3 \times \$120,000 = \$360,000)$ , the payment is a parachute payment.

*Example 2.* Assume the same facts as in *Example 1*, except that A also receives a signing bonus of \$50,000 from Corporation M on January 1, 2006. It is established by clear and convincing evidence that the bonus is not contingent on the change in ownership or control. When the change in ownership or control occurs on July 1, 2006, A has received compensation of \$110,000 (the \$50,000 bonus plus \$60,000 in salary). In this case, A's base amount is \$170,000  $(\$50,000 + (2 \times \$60,000))$ . Because the \$50,000 bonus will not be paid more than once per year, the amount of the bonus is not increased in annualizing A's compensation. The present value of the potential parachute payment (\$420,000) is less than 3 times A's base amount of \$170,000  $(3 \times \$170,000 = \$510,000)$ , and therefore no portion of the payment is a parachute payment.

#### Securities Violation Parachute Payments

Q-37: Must a payment be contingent on a change in ownership or control in order to be a parachute payment?

A-37: (a) No, the term *parachute payment* also includes any payment (other than a payment exempted under Q/A-6 or Q/A-8 of this section) that is in the nature of compensation and is to (or for the benefit of) a disqualified individual, if such payment is a securities violation payment. A securities violation payment is a payment made or to be made—

(1) Pursuant to an agreement that violates any generally enforced Federal or state securities laws or regulations; and

(2) In connection with a potential or actual change in ownership or control.

(b) A violation is not taken into account under paragraph (a)(1) of this A-37 if it is merely technical in character or is not materially prejudicial to shareholders or potential shareholders. Moreover, a violation will be presumed not to exist unless the existence of the violation has been determined or admitted in a civil or criminal action (or an administrative action by a regulatory body charged with enforcing the particular securities law or regulation) which has been resolved by adjudication or consent. Parachute payments described in this A-37 are referred to in this section as securities violation payments.

(c) Securities violation parachute payments that are not contingent on a change in ownership or control within the meaning of Q/A-22 of this section are not taken into account in applying the 3-times-base-amount test of Q/A-30 of this section. Such payments are considered parachute payments regardless of whether such test is met with respect to the disqualified individual (and are included in allocating base amount under Q/A-38 of this section). Moreover, the amount of a securities violation parachute payment treated as an excess parachute payment shall not be reduced by the portion of such payment that is reasonable compensation for personal services actually rendered before the date of a change in ownership or control if such payment is not contingent on such change. Likewise, the amount of a securities violation parachute payment includes the portion of such payment that is reasonable compensation for personal services to be rendered on or after the date of a change in ownership or control if such payment is not contingent on such change.

(d) The rules in paragraph (b) of this A-37 also apply to securities violation parachute payments that are contingent on a change in ownership or control if the application of these rules results in greater total excess parachute payments with respect to the disqualified