The Golden Parachute Excise Tax: Why it's about to Become More Expensive, Why a Gross-Up May be Necessary and How to Structure it to be Performance-Based

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With the re-emergence of merger and acquisition activity, companies and affected executives will once again be faced with paying out millions of dollars in golden parachute excise tax related costs. Based on the severity of the most recent recession combined with the way Internal Revenue Code ("IRC") Section 280G (i.e., golden parachute rules) functions in general, companies and affected executives are more likely to be in an "excess parachute" situation. In addition, because of actual and/or proposed increases of the highest federal and state marginal income tax rates, gross-up payments made with respect to change-in-control ("CIC") are likely to be higher than at any time since the enactment of IRC Section 280G[1]

The increased likelihood that more executives will be subject to the golden parachute excise tax, which combined with marginal income tax rates may approach (and in some states surpass) 70%, will serve as a disincentive to an executive team, specifically those executives without golden parachute excise tax protection, from exploring mergers or acquisitions that may be in the best interests of their company. Unfortunately, because of the high cost of the golden parachute gross-up, and the general perception that a gross-up on the golden parachute excise tax is an example of the abusive nature of executive compensation, there has been a strong push towards its elimination.

PART I: THE DIFFERENCE BETWEEN TOTAL & TAXABLE COMPENSATION AND WHY THIS IS IMPORTANT WHEN CONSIDERING IRC SECTION 280G CONSEQUENCES.

The Golden Parachute Threshold

In general, the golden parachute excise tax is triggered when an executive receives benefits as a result of a CIC which exceed the "golden parachute threshold amount". The golden parachute threshold amount is the amount of golden parachute benefits which are equal to or greater than three times the executive's "base

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amount." The base amount is the executive's average taxable compensation for the five years preceding the year of the CIC. Once an executive receives parachute payments which are equal to or greater than the golden parachute threshold amount, a 20% excise tax is due with respect to all golden parachute payments or benefits which exceed one times the executive's base amount. Lastly, any golden parachute payment subject to the 20% excise tax is non-deductible to the company for income tax purposes.

Total Versus Taxable Compensation

According to a study prepared for the Wall Street Journal by the management consulting firm Hay Group, total direct compensation dropped 3.4% in 2009. Furthermore, in the *2009 Directors' Compensation and Board Practices Report* (a report released by *The Conference Board* earlier this year), it was reported that in 2009 median total compensation remained flat in 16 industries, declined in two industries, and increased in only four industries.[2] Although recent executive compensation studies and/or press accounts have indicated that executive compensation will be flat or marginally reduced, all these studies include grant date value of plan-based compensation awards (e.g., stock options, restricted stock, or non-equity plan based awards) as part of total (or direct) compensation. The key difference between total compensation and taxable compensation is that total compensation is an estimate of the value of the award at the time of grant (based on various models), whereas taxable compensation is the intrinsic value (i.e., share price — exercise price) of plan-based awards when such awards become,[3] or in the case of stock options, the value when the options are exercised.[4] Lastly, because plan-based awards may account for as much as 50% to 75% of an executive's total compensation, the difference between total compensation and taxable compensation can be significant. For example, assume an executive is awarded 100,000 stock options of XYZ Corporation ("XYZ") with the following terms:

- Strike (or exercise) price of $10 per share (the current share price of XYZ upon grant);
- Option vests immediately; and
- Option expiration date is 10 years from grant date.

If theoretically the executive were to exercise this option upon grant, the option would be worthless to the executive ($10 market value per share less $10 exercise price = $0). Although the point-in-time value of the option is zero at grant date, the option award is not worthless because the executive has ten years to exercise the option.

In order to compute the value of an option, various models such as the Black-Scholes and Binomial models are used. These models utilize several factors such as the company's stock price, expected term or exercise date, historical stock price volatility, dividend rate and risk free rate of return. Unfortunately, these models are not perfect predictors of the ultimate value of the stock option award. For example, if an option holder were to compare the grant date value of his/her option award with the current intrinsic value of the option, because of the general market decline in shareholder value, it is very likely that the grant date value of such option will be significantly higher than the current intrinsic value.

With regard to restricted shares, the difference between grant value and amounts realized by an executive is less pronounced than a stock option because the grant value is based on the company's actual stock price upon grant. In addition, for income tax purposes,

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at the point in time when restricted shares are vested, the value of the shares at time of vesting are recognized as taxable income to the executive. Thus, while a significant decline in the stock price can render a stock option practically worthless, the value of a restricted stock award tracks directly with the change in company stock price.

The key point with respect to stock options and restricted stock awards is that although the grant date value is considered part of an executive's total compensation, for 280G purposes, "taxable income" rather than "total compensation" drives the amount of benefit which may be conveyed to an executive before the golden parachute excise tax is triggered. If there is a decline in shareholder value, the amount of taxable income ultimately recognized by such executives will likely be lower than the annual "total compensation" amounts computed by compensation professionals. Conversely, if shareholder values increase, which is often the case after a steep market decline, the opposite is likely to occur. Thus, because of awards made during the most recent stock market decline, it is likely that executive's taxable income will be higher than the annual "total compensation" computed by compensation professionals.

How Recent Market Conditions Affect IRC Section 280G

The effect of depressed share prices on older equity awards and enhanced share price for recent awards creates double trouble for IRC Section 280G. First, because the executives' older awards are less likely to have been exercised, and restricted shares vested at a relatively low share price, the executive's average taxable income for this period is reduced; thus, the executive's golden parachute threshold amount is lower. Second, with respect to recent awards, it is more likely that these awards will be unvested upon a CIC; therefore, if they receive accelerated vesting (as is often the case), they will be considered parachute payments under IRC Section 280G.[5]

PART II: MARGINAL INCOME TAX — HITTING THE BREAKING POINT

In 2001 President George W. Bush signed the Economic Growth Tax Relief Reconciliation Act ("EGTRRA"). Under EGTRRA, all marginal income tax rates were reduced, including the top marginal income tax rate which was reduced from 39.6% to 35%;[6] however, these reductions are set to expire after 2010. President Obama has indicated that his administration does not support the top marginal income rate remaining at 35%.[7] In addition, Congress missed its self-imposed (non-binding) April 15 budget deadline. What is noteworthy about this missed deadline is that a draft budget has not been formally introduced in either the House or Senate. Some political commentators have speculated that because of the highly charged political environment, Congress will forgo a budget for the first time since 1974.[8] Without any legislative action, in 2011 the top federal marginal income tax rate return will return to 39.6%. Moreover, those executives living in states which have already experienced significant tax increases over the past nine years will be faced with some of the highest combined marginal income tax rates since the enactment of IRC Code Section 280G. Examples of states which have seen significant increases are California, New Jersey, and New York. In 2001, the top marginal income tax brackets for California, New Jersey, and New York were 9.3%, 6.38%, and 6.85% respectively. In 2010, these rates have increased to 10.5%, 8.97%,[9] and 8.97%, respectively. Thus, when an executive combines current federal and state income tax rates with the golden parachute excise tax and applicable deductions,[10] the combined marginal tax rates on parachute pay-

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ments in CA, NJ, and NY are 63% for CA, and 62% for NJ and NY (or for executives who live in New York City, 64.25%). If the top marginal rate under EGTRRA sunsets, these amounts will increase in 2011 to 67% for CA, and 66% for NJ and NY (or 68.4% for executives who live in New York City).

Figure 1: How to Compute the Golden Parachute Marginal Income Tax Rate

*Example Based on Executive Living in the State of NY in 2009.

Federal Income Tax	35.0000%	A
Combined State/Local Income Tax Rate	8.9700%	B
Golden Parachute Excise Tax	20.0000%	C
Medicare Tax	1.4500%	D
Federal Benefit for State Tax Deducion	-3.1395%	E=(B*A)*-1
Phased out of Itemzed Tax Rate	1.0000%	F
Phase out of Itemized Deduction	0.3500%	G=(F*A)
Total Marginal Income Tax Rate	**62.6305%**	H=(A+B+C+D+E+G)

Tax increases will likely not end with the sun setting of the EGTRRA. The 2010 Health Care Act provides that, beginning in 2013, the Medicare tax will increase to 2.35% for incomes greater than $200,000 for a single person and $250,000 for a married couple. This represents an increase of 0.9% over the current 1.45% Medicare tax.[11]

Lastly, among several ideas being considered, the Obama Administration has suggested a tax plan which would limit the tax benefit for itemized deductions to a maximum rate of 28% (as opposed to 35% under EGGTRA and 39.6% post EGGTRA).[12] If this increase were to be passed by Congress, by 2013 the marginal parachute payment tax rate for an executive who lives in New York City would be nearly 72%.

Tax Type	Figure 2: Marginal Tax Rates by Year				
	2001	2009	2010	2011	2013
Federal Income Tax	35.000%	35.000%	39.600%	39.600%	39.600%
Medicare Tax	1.450%	1.450%	1.450%	1.450%	2.350%
Golden Parchute Excise Tax	20.000%	20.000%	20.000%	20.000%	20.000%
California Income Tax	9.300%	10.500%	10.500%	10.500%	10.500%
New Jersey Income Tax	6.370%	10.750%	8.970%	8.970%	8.970%
New York Income Tax	6.850%	8.970%	8.970%	8.970%	8.970%
New York City Resident Income Tax	3.592%	3.648%	3.648%	3.648%	3.648%
Phase out of Itemized Deduction Percentage	3.000%	1.000%	0.000%	3.000%	3.000%

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Tax Type	Figure 2A: Golden Parachute Marginal Tax Rate by Year and Jurisdiction						
	2001	2009	2010	2011	2013	2011 [1]	2013 [1]
California	63.55%	63.63%	63.28%	68.58%	69.48%	69.45%	70.35%
New Jersey	61.64%	63.79%	62.28%	67.66%	68.56%	68.35%	69.25%
New York	61.95%	62.63%	62.28%	67.66%	68.56%	68.35%	69.25%
New York/City	64.29%	65.00%	64.65%	69.86%	70.76%	64.29%	71.87%
States with No Income Tax	56.45%	56.45%	56.45%	61.05%	61.95%	61.05%	61.95%

[1] Assumes itemized deductions limited to 28% marginal income tax bracket

With marginal tax rates approaching 70% on golden parachute payments, there are two key issues company executives, company boards and shareholder advisory groups should consider:

- Will the executive group be dissuaded from entertaining merger talks due to an enormous tax rate?
- Is the company prepared to make a nondeductible payment which could be as high as 333 1/3% of the pre-gross-up golden parachute excise tax?[13]

PART III: IS THE GOLDEN PARACHUTE GROSS-UP A POOR PAY PRACTICE OR A NECESSITY?

With the increased spotlight on executive compensation pay practices, the golden parachute excise tax gross-up payment has been considered by shareholders, the media, and shareholder activist groups as a prime example of an abusive pay practice. RiskMetrics Group's ("RMG") (formerly known as Institutional Shareholder Services ("ISS")), 2010 U.S. Proxy Voting Guidelines Concise Summary provides that the golden parachute excise tax gross-up is "considered among certain adverse practices that are ***particularly contrary*** to a performance-based pay philosophy." Although in practice there are examples where the excise tax gross-up could be viewed as non-performance-based, this is not always the case. Furthermore, if it were in theory applied to all transactions, such a policy could adversely affect shareholder value by decreasing the chance an executive group would pursue a merger which would be in the best interests of shareholders.

As provided in the previous section, the golden parachute excise tax gross-up protects the executive from having the vast majority of his/her CIC benefits being taxed at 70% rather than 50%.[14] Because of the way the golden parachute tax rules function, with the first dollar that an executive's parachute payments exceed the golden parachute threshold amount, it is likely that 2/3 of such payments become subject to a 70% tax rate, and any additional parachute payments will similarly be subject to a 70% marginal rate.[15] This occurs because once an executive exceeds his/her golden parachute threshold amount, the executive will generally be taxed on the amount of parachute payments which exceeds 1/3 of the threshold amount. As a result, if an executive is not entitled to an excise tax gross-up and the total parachute payments only exceed the threshold by a modest amount, the executive is better off reducing his/her total payment to the threshold as opposed to retaining the full amount of the payment and incurring the excise tax. In other words, an executive would be economically better off receiving a benefit equal to the golden parachute threshold amount rather than accept his/her contractual benefit less applicable income and excise taxes. In a

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series of scenarios assuming a 50% tax rate without the excise tax, once the break-even point is reached where an executive is better off receiving his/her contractual benefits versus cutting back to the golden parachute threshold amount, the amount of reduction to his/her benefit after the payment of all taxes including the golden parachute excise tax is 31%. Lastly, as the ratio between excess parachute payments and the executive's base amount increases, this reduction can increase to as much as 40% (See Figures 3 and 3A).

Figure 3: Illustration of How IRC Section 280G affects an Executive who does not have a Gross-Up

A	B	C=(A-(A-B)*70% + (B*50%)	D=A*50%	E=(A-$1,000,000) If C<$500,000, otherwise E=0	F=Max of $500,000 or C	G=E / $1,000,000	H=(D-F)/D
Parachute Payment	Average Taxable Compensation	After Tax ("Net") Benefit to Executive (Assuming 50% Combined Income Tax Rate, and Excise Taxes Paid)	Total Net Benefit to Executive BEFORE Application of 280G Excise Tax	Best Payment Cutback	Net Value of "Best Payment" to Executive	Reduction of Gross Benefits Attributed to IRC Section 280G	Total Reduction of Net Benefits as Compared to an Executive with an Income Tax Gross-Up
$1,000,000	**$333,334**	**$500,000**	**$500,000**	**<--THRESHOLD-->**	**$500,000**	**0.00%**	**0.00%**
$1,200,000	$333,334	$426,667	$600,000	$200,000	$500,000	20.00%	**16.67%**
$1,300,000	$333,334	$456,667	$650,000	$300,000	$500,000	30.00%	**23.08%**
$1,400,000	$333,334	$486,667	$700,000	$400,000	$500,000	40.00%	**28.57%**
$1,444,445	**$333,334**	**$500,000**	**$722,223**	**$444,445**	**$500,000**	**44.44%**	**30.77%**
$1,750,000	$333,334	$591,667	$875,000		$591,667		**32.38%**
$2,000,000	$333,334	$666,667	$1,000,000		$666,667		**33.33%**
$2,500,000	$333,334	$816,667	$1,250,000		$816,667		**34.67%**
$5,000,000	$333,334	$1,566,667	$2,500,000		$1,566,667		**37.33%**
$10,000,000	$333,334	$3,066,667	$5,000,000		$3,066,667		**38.67%**
$30,000,000	$333,334	$9,066,667	$15,000,000		$9,066,667		**39.56%**
$100,000,000	$333,334	$30,066,667	$50,000,000		$30,066,667		**39.87%**
$250,000,000	$333,334	$75,066,667	$125,000,000		$75,066,667		**39.95%**

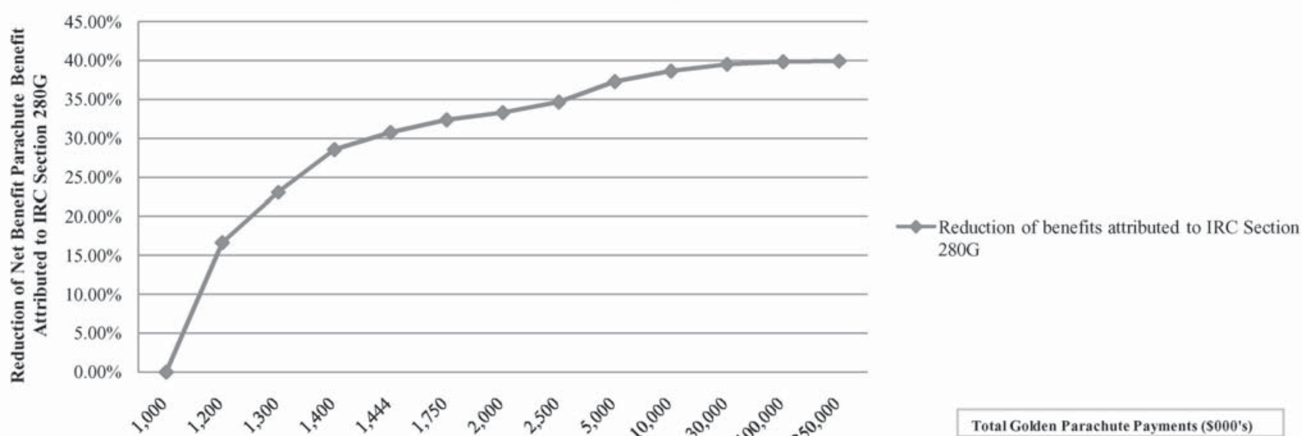

Figure 3A: Reduction of Net Golden Parachutes if Executive Does not have an IRC Section 280G Gross-Up

Although RMG does not consider the gross-up to be an element of performance-based compensation, RMG does not apply the same philosophy towards CIC benefits such as ac-

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celeration of unvested equity or severance payment(s) which is/are less than or equal to three times base salary and target bonus. Essentially RMG's policy statement can be summarized as follows: Although RMG will accept a variety of severance benefits which may exceed the golden parachute threshold amount, and thus be non-deductible to the corporation,[16] regardless of how high an executive's marginal tax rate may be as a result of the golden parachute excise tax, under no circumstances will any gross-up payment on acceptable severance benefits be considered a "performance based compensation element."[17]

Unfortunately, such a narrow approach creates a significant disincentive for executives to enter into transactions which may be in the best interests of shareholders. When a company enters into a CIC, the company's top officers are likely to be terminated within a few months after the transaction. In the case of a CEO or Chairman, it is likely that if they are terminated, neither officer will be able to find a similar position with another public company.[18] The purpose of a CIC severance arrangement is to provide a financial incentive to an executive group to explore such transaction(s), rather than worry that a change-in-control transaction would lead to an executive losing his/her job. Lastly, when a CIC does occur, these arrangements are also valuable in ensuring that the executive team remains in place through the transaction period.

In addition to creating a disincentive in entering into a CIC, the way the golden parachute rules function means that incentive plans which vest based on performance rather than the passage of time are penalized more. In general, the golden parachute regulations provide for two ways in which to value equity that receives accelerated vesting upon a CIC. If the equity vests solely on the performance of services over time, Treasury Regulation Section 1.280G-1 Q/A 24(c) ("Q/A 24(c)") provides that the parachute value of unvested equity is equal to the present value of the unvested equity PLUS the face value of the unvested equity benefit times 1%, which is then multiplied by the number of full months that the vesting is accelerated.[19] However, if the unvested equity is accelerated and the vesting requirement is based upon performance measures, the 280G regulations require that the **entire** value of unvested equity be included as a parachute payment. Furthermore, if the vesting hurdle is based on attaining a certain stock price, and the stock price hurdle is achieved after the announcement of or within a short period prior,[20] Treasury Regulation 1.280G-1 Q/A 22(b)(2) provides that a substantial increase in the market price of a company's stock is an event that would be considered contingent upon a CIC.[21] Unfortunately, this means that executives with long-term incentive structures most closely tied with performance are more likely to see a reduction in benefits conveyed with respect to such incentives if a CIC were to occur.

If an executive is required to forfeit or pay more taxes with regard to unvested equity and/or other long-term incentives, the executive is effectively being punished for entering into a CIC transaction. In general, an executive's total compensation is made up of three major components: base salary, annual incentives, and long-term incentives. When a company implements a compensation program, the company will generally compare the total value of these compensation elements with other executives who have similar responsibilities and who work for companies in similar industries and size. If upon a CIC unvested compensation is not accelerated, or the net payment is reduced because of the golden parachute excise tax, the executive essentially is being asked to forfeit (at least in part) the opportunity to earn a benefit

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which was conveyed to him/her in an earlier year.

PART IV: A BETTER WAY: MAKING THE GOLDEN PARACHUTE EXCISE TAX GROSS-UP PAYMENT PERFORMANCE-BASED

Doctor Phillip McGraw, better known as Dr. Phil, provides in *Life Law #6*: "There is no reality, only perception." This saying can easily be applied to the debate concerning golden parachute payments. Specifically, most of the negative publicity surrounding golden parachute payments has concentrated on those executives receiving severance payments outside of a CIC. Unfortunately, with the recent failure of many reputable financial institutions, and the corresponding exit packages received by the top executives of these organizations, the term golden parachute payment is perceived by many to mean "pay for failure." The truth, however, is that regardless of how large or egregious a "parachute payment" conveyed to an executive may be, if such payment is made in the context of a termination outside of a CIC, the golden parachute excise tax does not apply.

The question that executives, compensation committees, shareholders, and shareholder advisory/advocacy groups should be asking is in what circumstances should an executive receive a golden parachute excise tax gross-up payment? Furthermore, where an excise tax gross-up is appropriate, companies should create a policy so that a gross-up is paid to executives who enter into transactions that increase shareholder value and thus, are in the best interest of shareholders.

Where a company implements an income tax gross-up policy, the following three objectives should be taken into account:

- All CIC arrangements should be structured so that (where possible) the golden parachute excise tax and related gross-up will be minimized or eliminated.
- Where a long standing executive has built up a significant level of company ownership, the company should consider a policy which phases out the golden parachute excise tax gross-up.
- In the case where an excise tax gross-up is provided to an executive, such payment should be made contingent upon pre-established share price goals set annually by the company's compensation committee.

Planning Should Not End With A Golden Parachute Gross-Up

In most situations, structuring a CIC arrangement to mitigate the golden parachute excise tax can reduce, and in many cases eliminate, the need for an income tax gross-up. Unfortunately, in many cases, company boards and executives do not consider planning until merger discussions commence. Three strategies should be considered: 1) Cash severance and related benefits should be paid periodically (not in a lump sum immediately after termination) and be contingent upon an executive's agreement to not compete with the newly merged company; 2) Equity arrangements should be structured to include a CIC pro-rated performance schedule which takes into account actual performance contributed by the executive and the period to which such award was granted so an executive's total compensation level remains within annual market objectives; and 3) A gross-up arrangement should contain a modified gross-up of at least 110%.

With regard to the third strategy, and as alluded to earlier, if an executive were subject to and/or not insulated by the golden parachute excise tax, where an executive exceeds the threshold by only a modest

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amount, he or she would likely be cutback in order to keep the executive in a better financial position. In order to make an executive "whole" for the golden parachute excise tax, a company is obligated to make a payment which depending on the executive's marginal income tax rate could be as high as 333%[22] of the excise tax amount computed. The economic cost to the company, however, is significantly larger than the gross-up payment because the company loses its corporate tax deduction on all parachute payments subject to the golden parachute excise tax. Thus, there should be a company policy requiring an executive to reduce his/her golden parachute benefits to an amount which equals the executive's golden parachute threshold if such payments would have otherwise exceeded the executive's golden parachute threshold amount by up to 10%. Lastly, assuming the amount required to be cutback by an executive would have been taxed at 50% and the combined company Federal, State and Local tax rate is 40%, the company savings based on an after tax comparison would be at least 17 1/2 times (or 1,750%) of the net value of the benefit the executive would otherwise forfeit to remain under the golden parachute threshold amount.[23]

Figure 4: Illustration of the Potential Company Savings if CIC arrangement has a 110% Modified Gross-Up			
Scenario		Without Modified Gross-Up	With Modified Gross-Up
Base Amount	A	$333,334	$333,334
Golden Parachute Threshold Amount	B=(A*3)-1	1,000,001	1,000,001
Total Parachute Payments	C	1,100,000	1,100,000
110% Cutback	D		(100,000)
Total Net Parachute Payments	E	$1,100,000	$1,000,000
Total Excess Paracute Payments	F=C-A (If E>B)	766,666	-
Total Excise Tax	G=F*20%	153,333	-
Total Gross-Up Cost (Assuming 70% Marginal Golden Parachute Income tax Rate)	H=G/(100%-70%)	511,111	-
Total Non Deductible Parachute Payments (Including Gross-up)	I=(H+E)-A	$1,277,777	
Total Deductible Parachute Payments	J=A(If E>B) J=E(If B>E)	333,334	1,000,000
Economic value of Corporate Deduction (Assuming 40% Tax Rate)	K=J*40%	(133,334)	(400,000)
Total After Tax Cost (All Parachute Payments)	L=(I+K)-J	$1,477,777	$600,000
Corporate After Tax Savings of Modified Gross-Up	M=($1,477,777-$600,000)		$877,777
Total Benefit Executive Forfeits	N=D	$100,000	
After Tax benefit (Assumes 50% Marginal Income Tax Rate)	O=D*50%		$50,000
Total Multiple of after Tax Cost Savings	P=M/O		17.56

Taking Into Account Company Shares Held by a Long Standing Executive

A golden parachute excise tax gross-up should not be an eternal benefit conveyed to an executive upon renewal of his/her agreement. Instead, compensation committees should consider phasing out the excise tax gross-up as an executive accumulates a higher percentage of company stock. In the case where an executive is a founder or has accumulated a significant percentage of company stock, the executive would

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financially be motivated to enter into such a transaction regardless of whether the executive has an excise tax gross-up. Furthermore, where an executive receives cash for shares he/she has held long-term, the executive will be subject to long-term capital gains tax treatment rather than ordinary income in the nature of compensation. Based on the number of shares held by the executive and the favorable long-term capital gain tax treatment on such shares, it is likely that the net after tax value conveyed to an executive with respect to such shares will be considerably greater than the net after tax benefits paid with respect to any golden parachute payments.[24]

The Perfomanced-Based Excise Tax Gross-Up

If a company implements a CIC program which minimizes golden parachute excise tax exposure and also considers the stock ownership level of its covered executives, it would not be unreasonable to provide excise tax gross-up protection where a transaction would provide a significant increase in shareholder value. The best way to achieve such an alignment would be for a company's compensation committee to determine on an annual basis a share price in which a full gross-up would be paid, and a minimum share price in which a partial gross-up would be paid. By establishing pre-established stock price levels, the company is conveying a benefit to executives which is aligned with the best interests of shareholders. In addition, by establishing such targets in advance, executives and the board can better understand the consequences of all CIC severance costs including excise tax costs, and thus plan accordingly.

PART V: CONCLUSION

As merger activity picks-up, the golden parachute excise tax is poised to hit companies and executives very hard. In order to deal with this reality, it is important that executives, company boards and shareholder advisory groups understand the impact the golden parachute excise tax and the related effects it may have on an executive team's motivation to enter into merger discussions. Unfortunately, the rigid position taken by shareholder advisory groups, combined with the failure of most companies to implement a comprehensive CIC policy regarding the golden parachute excise tax gross-up does a disservice to the shareholders they represent. It is not in the shareholder's best interest to have a company maintain a CIC severance policy that creates a financial disincentive for its executive team to enter into a successful merger transaction. Nor is it in the best interests of shareholders to have a company maintain a policy in which executive(s) remains eligible for an excise tax gross-up without any consideration of excise tax mitigation strategies, the executive's financial position with respect to ownership levels, or the actual share price negotiated. In summary, if executives, company boards, and shareholder advisory groups take the time to fully examine the relevant factors as they pertain to the golden parachute excise tax gross-up, the interests of shareholders and realistic concerns of executives can be properly aligned.

NOTES:

[1]IRC Code Section 280G was enacted in 1984.

[2]Larkin, Gary, "Studies Show Total CEO Compensation Down; Stock Options Back." Conference Board Governance Center Blog, April 5, 2010, http://tcbblogs.org/governance/2010/04/05/studies-show-total-ceo-compensation-down-stock-options-back/.

[3]Where restricted stock awards are concerned, an executive has the option under IRC Code Section 83(b), to elect to have such awards taxed at the grant date value of the award prior to vesting. Because of the risks associated with making such elections, these elections have been less common over the past decade. For purposes of this discussion we have not factored in the IRC Section 83(b) election.

[4]This is not necessarily the case for statutory or incentive stock options. Because of the effects of FAS 123R, ISO's have become less prevalent.

[5]Where the term parachute or

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golden parachute payment is used, the article refers only to those payments or portion of a payment which is/are subject to IRC Section 280G.

[6]Under EGTRRA the reduction to the four highest marginal rates was initially phased in over a 5 year period. Under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) Congress accelerated this reduction so that the complete reduction would take effect in 2003 rather than 2006.

[7]Furman, Jason and Goolsbee, Austan. "The Obama Tax Plan," The Wall Street Journal Online, August 14, 2008, http://online.wsj.com.

[8]Allen, Jonathan, "Congress Sees No Budget Rush" Politico, April 12, 2010, http://www.politico.com.

[9]In 2009, the top marginal NJ income tax rate was increased to 10.75%. In order to have this increased rate extended into 2010 this would require a new law. The current Governor of New Jersey, Christopher Christie has indicated that he does not support this increase.

[10]This combined rate factors in the federal benefits for state taxes and the phase-out for itemized deductions.

[11]"What's in the Bill," Wall Street Journal/WSJ.com, March 22, 2010, http://online.wsj.com.

[12]Zumbrum, Joshua "How Obama Will Change Your Taxes" Forbes.com. February 27, 2009, http://www.forbes.com.

[13]333%=(1/(1-70%))

[14]For illustrative purposes we assume a post EGTRRA 50% combined marginal tax rate. For most jurisdictions where an income tax exists the post EGTRRA top combined marginal income tax rates will likely fall between 45% and 50%.

[15]In circumstances where an executive receives a golden parachute payment which can be considered "reasonable compensation for pre-CIC services," a portion of such payment would not be subject to the golden parachute excise tax.

[16]Under IRC Code Section 280G(a) excess parachute payments are not deductible for corporate income tax purposes.

[17]"U.S. Proxy Voting Guidelines Concise Summary," Risk Metrics Group, January 22, 2010

[18]Desai, Hemang, Hogan, Chris E. and Wilkins, Michael S., "The Reputational Penalty for Aggressive Accounting: Earnings Restatements and Management Turnover" (August 2004) Available at SSRN: http://ssrn.com/abstract=471842 or DOI: 10.2139/ssrn.471842.

[19]The total value of the equity will be the intrinsic value if, upon a CIC, equity is converted into cash. If equity is converted into Newco options, then an approved GAAP valuation model such as Black-Scholes must be used to determine the value of the equity. For more information regarding accepted valuation methods, see Revenue Procedure 2003-68.

[20]This could occur due to reports of discussion between two companies whether from officials or unofficial sources.

[21]Wagman, Laurence "Structuring Change in Control Arrangements in the Current Financial Environment," Journal of Compensation and Benefits (Sept/Oct 2009): 5-19.

[22]333%=(1/(1-70%))

[23]Where an executive exceeds the golden parachute threshold amount by less than 110% the 17.5 multiple increases. For example, if the required amount of cutback in Figure 4 were $10,000 versus $100,000, the multiple would increase to nearly 146.

[24]Where an executive holds vested stock, if the holding period of such equity units is held one year or more, the effective long-term capital gain tax rate is 15%.

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