

## ***Balch v. Commissioner, 100 T. C. 331 (1993)***

Post-acquisition compensation can be deemed an excess parachute payment if it is contingent on a change in control and not reasonable for services rendered.

### **Summary**

In *Balch v. Commissioner*, the court determined that payments received by Jewel Companies, Inc. 's senior executives post-acquisition by American Stores Company were excess parachute payments subject to excise tax. The executives had amended their severance agreements to avoid golden parachute taxes, but subsequent compensation for their continued service was deemed contingent on the acquisition and not reasonable, thus falling under the purview of sections 280G and 4999 of the Internal Revenue Code. This case underscores the importance of ensuring that post-acquisition compensation arrangements are structured to avoid unintended tax consequences.

### **Facts**

In 1984, Jewel Companies, Inc. (Jewel) was acquired by American Stores Company (American Stores). Before the acquisition, Jewel's senior executives, including the petitioners, signed severance agreements on June 15, 1984. Following the acquisition, on July 12, 1984, these agreements were amended to reduce severance pay to avoid the golden parachute tax under sections 280G and 4999 of the Internal Revenue Code. American Stores then employed the executives and provided additional compensation, which the Commissioner of Internal Revenue deemed to be excess parachute payments.

### **Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax returns due to the classification of their post-acquisition compensation as excess parachute payments. The petitioners contested this determination in the United States Tax Court, which consolidated the cases and ultimately ruled in favor of the Commissioner.

### **Issue(s)**

1. Whether the additional compensation received by the petitioners was contingent on the change in control of Jewel under section 280G(b)(2)(A)(i)?
2. Whether the additional compensation received by the petitioners constituted reasonable compensation for services rendered after the change in control under section 280G(b)(4)(A)?

### **Holding**

1. Yes, because the payments would not have been made had no change in control

occurred, and were part of an oral agreement to compensate for the reduced severance pay.

2. No, because the petitioners failed to establish by clear and convincing evidence that the additional compensation was reasonable under the factors set forth in the General Explanation of the Deficit Reduction Act of 1984.

### **Court's Reasoning**

The court found that the additional compensation was contingent on the change in control because it was part of an oral agreement between American Stores and the petitioners to compensate for the reduced severance pay. The court rejected the petitioners' argument that the payments were not contingent on the change in control, emphasizing that the payments would not have been made without the acquisition. Regarding reasonableness, the court applied a presumption against parachute payments being reasonable compensation, which the petitioners failed to rebut with clear and convincing evidence. The court also noted that the compensation was not based on the time spent performing services or comparable compensation in similar situations, as required by the factors in the General Explanation.

### **Practical Implications**

This decision highlights the importance of structuring post-acquisition compensation arrangements to avoid classification as excess parachute payments. Companies should ensure that any compensation provided to executives post-acquisition is based on clear and objective criteria related to services rendered, rather than as a means to circumvent golden parachute taxes. Legal practitioners should advise clients on the necessity of maintaining detailed records of services performed and ensuring that compensation aligns with industry standards. This case has influenced subsequent decisions involving the application of sections 280G and 4999, emphasizing the strict scrutiny applied to post-acquisition compensation arrangements.