Alternatives to NQDC in Transactions

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STEP 1: Section 409A Change in Control Payment Event?

- ❑ Does the ParentCo's NQDC Plan (the plan) have a Change in Control Payment Event?
- ❑ Does the divestiture (the transaction) of ManufacturingCo (M-Co) represent 40% or more of the gross fair market value of all of ParentCo's assets in satisfaction of the 409A Change in Control definition?
- ❑ Does the divestiture satisfy the Change in Control Payment Event definition under the plan?

YES

ParentCo must pay plan benefits to employees at closing of the transaction.

NO

STEP 2: Section 409A Change in Control-Related Plan Termination?

The divestiture of M-Co will be a Change in Control Event (change of ownership) for M-Co.

Is it also a Change in Control Event for ParentCo (represents 40% or more of the gross fair market value of all of ParentCo's assets)?

ParentCo terminates and cashes out all plan liabilities as to the M-Co employees in connection with the transaction.

Pros

- No ongoing ParentCo administration of the plan as to M-Co employees.
- EngineeringCo employees are unaffected and remain in the plan.
- No purchase price adjustment required.

Cons

- Results in taxation for M-Co employees and loss of deferral.
- Must comply with 409A termination rules, including aggregation of plan and timing rules.

ParentCo terminates and cashes out the plan in its entirety in connection with the transaction.

Pros

- No ongoing ParentCo administration of the plan.
- No purchase price adjustment required.

Cons

- Results in taxation for all employees and loss of deferral.
- Must comply with 409A termination rules, including aggregation of plan and timing rules.

STEP 3: NQDC Plan Spin-Off?

Negotiate with the buyer as part of the transaction agreement to require the buyer to assume the plan liabilities as to the M-Co employees.

The buyer assumes obligations under the plan with respect to M-Co employees, typically by establishing and maintaining a mirror or replacement plan.

Pros

- No ongoing ParentCo administration of Plan as to M-Co employees.
- Preserves tax deferral (no payments under the plan in connection with the transaction) and avoids immediate taxation for M-Co employees.

Cons

- Requires negotiation and purchase price adjustment in exchange for the buyer assuming plan liabilities.
- Some additional coordination and complexity with spinning off the plan.

STEP 4: Ongoing NQDC Administration for Divested Employees

STOCK SALE

Default Rule: No Separation from Service for M-Co employees

ParentCo retains payment obligations to M-Co employees under the plan, which will be payable to M-Co employees upon their separation from service with the buyer.

Pros

- No purchase price adjustment required.
- Preserves tax deferral (no payments under the plan in connection with the transaction) and avoids immediate taxation for M-Co employees.

Cons

- Ongoing ParentCo administration of the plan as to M-Co employees; requires post-closing coordination with the buyer to identify when M-Co employees have had a separation from service.

ASSET SALE

Default Rule: Separation from Service for M-Co employees*

Upon the consummation of the transaction, the M-Co employees will be deemed to have separated from service, triggering plan payments by ParentCo in accordance with plan terms.

Pros

- No purchase price adjustment required.
- Standard plan administration; no special ongoing administration.

Cons

- Results in taxation for M-Co employees and loss of deferral.

** Note: 409A permits an asset sale to be treated the same as a stock sale for purposes of the 409A separation from service determination.*