

From: [Lutrin, Jessica](#)
To: [Rhode, Lynne C. \(City of Jacksonville\)](#)
Cc: [Hunt, Peter J.](#)
Subject: RE: Tax memo
Date: Friday, October 25, 2019 5:28:26 PM
Attachments: [JEA - Tax and Securities Considerations Memo \(Privileged and Confidential\).pdf](#)

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PRIVILEGED & CONFIDENTIAL

Hi Lynne,

Attached please find the PUP tax and securities memo. As you'll see, we have flagged a couple of open items for your confirmation. Once these items are closed out, we can finalize the memo.

Please let us know if you have any questions or would like to discuss.

Best,
Jessica

From: Rhode, Lynne C. (City of Jacksonville) <rhodlc@jea.com>
Sent: Tuesday, October 22, 2019 6:01 PM
To: Lutrin, Jessica <jessica.lutrin@pillsburylaw.com>
Cc: Hunt, Peter J. <peter.hunt@pillsburylaw.com>
Subject: RE: Tax memo

Thank you

Lynne C. Rhode
Vice President and Chief Legal Officer
21 West Church Street Jacksonville, FL 32202
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From: Lutrin, Jessica <jessica.lutrin@pillsburylaw.com>
Sent: Tuesday, October 22, 2019 5:34 PM

To: Rhode, Lynne C. (City of Jacksonville) <rhodlc@jea.com>
Cc: Hunt, Peter J. <peter.hunt@pillsburylaw.com>
Subject: RE: Tax memo

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Hi Lynne,

With apologies for the delay, we will get you the memo this week.

Best,
Jessica

Jessica Lutrin | Partner

Pillsbury Winthrop Shaw Pittman LLP
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From: Rhode, Lynne C. (City of Jacksonville) <rhodlc@jea.com>
Sent: Tuesday, October 22, 2019 4:14 PM
To: Lutrin, Jessica <jessica.lutrin@pillsburylaw.com>
Cc: Hunt, Peter J. <peter.hunt@pillsburylaw.com>
Subject: Tax memo

*** EXTERNAL EMAIL ***

Hi Jessica,
Not sure if you're back in the office, so I'm copying Peter. Do you have an ETA on the PUP tax memo?
Thanks,
Lynne

Lynne C. Rhode
Vice President and Chief Legal Officer
21 West Church Street Jacksonville, FL 32202
Office: (904) 665-4115
Email: rhodlc@jea.com



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31 West 52nd Street | New York, NY 10019-6131 | tel 212.858.1000 | fax 212.858.1500

PRIVILEGED & CONFIDENTIAL

To: Office of the General Counsel of the City of Jacksonville, Florida¹
From: Pillsbury Winthrop Shaw Pittman LLP
Date: October __, 2019
Re: Tax and Securities Considerations Applicable to JEA Long-Term Performance Unit Plan

A. Background

JEA, a body politic and corporate under the laws of the State of Florida and an independent agency of the Consolidated City of Jacksonville (“JEA”), sponsors the JEA Long-Term Performance Unit Plan, effective July 23, 2019 (the “Plan”). As requested by [the Office of the General Counsel of the City of Jacksonville],² this memorandum summarizes the basic terms, vesting conditions, and payment provisions applicable to performance units available for allocation to eligible employees under the Plan, and summarizes the relevant federal tax consequences of the Plan under the Internal Revenue Code of 1986, as amended (the “Code”), and related guidance as well as the relevant federal and state securities consequences of the Plan.

B. Plan Summary

1. Basic Plan Terms

Under the Plan, (i) employees of JEA and its affiliates, assigns, subsidiaries and successors (the “JEA Group”) who have been employed by the JEA Group for at least three months prior to the Purchase Date (as defined below) and (ii) full-time attorneys of the Office of the General Counsel of the City of Jacksonville who are dedicated exclusively to JEA for at least three months prior to the Purchase Date are eligible to be allocated a number of Performance Units (as defined below) by JEA for purchase at a price of \$10 per Performance Unit. The Plan is administered by

¹ Lynne to confirm.

² Lynne to confirm.

the Chairperson of the Compensation Committee of the Board of Directors of JEA (the “Administrator”).³

Each performance unit is a bookkeeping entry that represents a potential right to receive a cash payment in the future based on attainment of specified performance metrics (the “Performance Units”). The aggregate number of Performance Units that may be purchased by eligible employees under the Plan is 100,000 Performance Units. Participation in the Plan is not mandatory and eligible employees who purchase Performance Units under the Plan are referred to in this memorandum as “Participants.”

To purchase Performance Units, an eligible employee must pay the purchase price for the Performance Units the employee wishes to purchase by electing to defer a portion of his or her pay equal to the aggregate purchase price of the Performance Units the employee wishes to purchase. To defer a portion of his or her pay, the employee must complete an election notice (a “Deferral Election”) and file it with the Administrator by no later than December 31st of the calendar year immediately preceding the calendar year to which the Deferral Election relates. Eligible employees may elect to defer their pay earned in the calendar year after the Deferral Election is made over one or two payroll periods.

In [November][December]⁴ 2019, eligible employees will be allocated up to 35,000 Performance Units for purchase under the Plan. An eligible employee who wishes to purchase all or some of the Performance Units allocated to him or her must complete the Deferral Election by December 31, 2019 and elect to defer pay earned in 2020. The purchase date of the Performance Units will be [February 28],⁵ 2020.

2. Vesting of Performance Units

Under the Plan, the Performance Units are subject to a time-based vesting component and a performance-based vesting component, in each case measured over a three-year performance period (the “Performance Period”) that ends on the earlier to occur of (i) the third anniversary of the Purchase Date⁶ (which is [February 28], 2023 with respect to Performance Units purchased on [February 28], 2020) and (ii) the date on which a Recapitalization Event⁷ occurs.

The time-based vesting component is satisfied if a Participant remains employed with any member of the JEA Group through the end of the applicable Performance Period. However, the

³ Following a Recapitalization Event (as defined below), the Administrator may be such other entity designated in the definitive agreement providing for such Recapitalization Event.

⁴ Lynne to confirm.

⁵ Lynne to confirm.

⁶ The “Purchase Date” for Performance Units under the Plan is each [February 28th] of the calendar year following the calendar year in which JEA’s annual financial statements audit is completed, beginning with [February 28], 2020.

⁷ The Plan defines a “Recapitalization Event” as the closing and funding of a transaction or a series of related transactions in accordance with Article 21 of the Charter of the City of Jacksonville and any other applicable law that results in either (i) unencumbered cash proceeds to the City of Jacksonville of at least \$3,000,000,000 or (ii) at least 50% of the net depreciated property, plant and equipment value of either JEA’s electric system or JEA’s water and wastewater system being transferred, assigned, sold or otherwise disposed of.

time-based vesting component is deemed to be satisfied if, prior to the end of the applicable Performance Period, the Participant's employment is terminated due to an involuntary termination or due to the Participant's retirement after the Participant attains one of the retirement milestones described in JEA's General Employees Retirement Plan. An involuntary termination of employment occurs if the Participant's employment is terminated (i) by any member of the JEA Group without "cause" (as defined in the Plan) or (ii) due to the Participant's death or "disability" (as defined in the Plan).

If a Participant's employment is terminated prior to the end of the applicable Performance Period for any reason other than due to an involuntary termination or retirement, the Participant forfeits his or her Performance Units. In such a case, the applicable purchase price paid by the Participant in respect of the forfeited Performance Units is refunded to the Participant, provided that, if the Participant's employment is terminated by any member of the JEA Group for cause or the Participant voluntarily resigns from employment with the JEA Group for any reason (other than due to retirement), the applicable purchase price is not refunded to the Participant. As such, there exists the possibility for a Participant to forfeit completely the amount of pay deferred by the Participant under the Plan for failure to satisfy the time-based vesting component.⁸

The performance-based vesting component is satisfied if, as of the end of the applicable Performance Period, JEA realizes a percentage increase in its enterprise value (taking into account its net position reflected on its financial statements, the aggregate consideration paid by JEA to the City of Jacksonville during the 12-month period prior to the end of the applicable Performance Period and the aggregate consideration paid by JEA to its customers during the 12-month period prior to the end of the applicable Performance Period) as compared to its enterprise value at the beginning of the applicable Performance Period, as more fully described on Schedule A to the Plan (the "Redemption Price Schedule"). If JEA realizes a percentage increase in its enterprise value and the Participant has satisfied the time-based vesting component, the Participant is eligible to receive a cash payment in respect of his or her vested Performance Units. If, however, the change in value percentage does not meet or exceed a specific threshold value percentage, the Redemption Price (including the purchase price paid for the Performance Units) may potentially be reduced to \$0, as more fully described on the Redemption Price Schedule, and the Participant may receive no cash payment in respect of his or her Performance Units (this is true even if the Participant satisfies the time-based vesting component). As such, there exists the possibility for a Participant to forfeit completely the amount of pay deferred by the Participant under the Plan for failure to satisfy the performance-based vesting component.

3. Payment for Vested Performance Units

Assuming satisfaction of both the time-based vesting component and the performance-based vesting component, on the applicable payment date, each Participant will receive an amount equal to the number of his or her vested Performance Units as of the end of the applicable

⁸ Participants may also forfeit all or a portion of their allocated or purchased Performance Units (with the applicable purchase price refunded to them) if they incur a change in their civil service status during the applicable Performance Period, as more fully described in the Plan.

Performance Period multiplied by the “Redemption Price”⁹ per Performance Unit. The Administrator will certify performance within 30 days following the completion of the applicable Performance Period (or, in the case of a Recapitalization Event, within 30 days following the occurrence of such Recapitalization Event) and payment will be made to the Participants no later than 30 days following the date on which performance for the applicable Performance Period is certified by the Administrator. In other words, Participants will be paid the Redemption Price in respect of their vested Performance Units under the Plan no later than 60 days following the end of the applicable Performance Period.

The Plan provides that, in the event of a Recapitalization Event, the Plan and any Award Agreements thereunder will be assumed by any successor of JEA (including any organization(s) that succeeds to a substantial portion of the assets and business of JEA), and that, upon such assumption, the rights and obligations of JEA under the Plan and any applicable Award Agreements will become the rights and obligations of such successor. This means that payment of the Redemption Price under the Plan will be made by JEA’s successor in a Recapitalization Event.

Payment is further conditioned on the Participant (i) executing and not revoking a general release of claims in favor of the JEA Group prior to the applicable payment date, and (ii) complying with the restrictive covenants set forth in the Participant’s award agreement under the Plan (the “Award Agreement”), and satisfaction of the conditions set forth in Section 215.425(3), Florida Statutes.

4. Tax Reimbursement Payment

The Plan provides that, in the event any payments under the Plan and/or any Award Agreement to any Participant are subject to any excise tax, interest or penalties under the Code (the “Penalties”), a member of the JEA Group will pay to such Participant an amount equal to the full amount of the Penalties so that such Participant is in the same economic position the Participant would have been if the Penalties did not apply. However, the JEA Group is under no obligation to make a Participant whole for the Penalties if they relate to the Participant’s breach of the Plan or any Award Agreement or such Participant’s failure to comply with his or her legal obligations.

C. Summary of Federal Tax Consequences

1. Code Section 457

Code Section 457 governs deferred compensation plans of “eligible employers” (i.e., state and local governments and tax-exempt organizations)¹⁰ such as JEA. As described above, the Plan

⁹ The “Redemption Price” means a price per Performance Unit payable by JEA to each Participant calculated in accordance with the Redemption Price Schedule. As described more fully on the Redemption Price Schedule, the Redemption Price will increase by \$100.00 per Performance Unit for each “value change percentage” increase of 1.00% in excess of the “challenge value target” and will decrease by \$0.50 per Performance Unit for each “value change percentage” decrease of 1.00% below the “threshold value target” (as such terms are defined in the Plan), but in no event will the Redemption Price per Performance Unit be less than \$0.

¹⁰ See Code §457(e)(1).

is a deferred compensation plan as Participants may elect to defer a portion of their compensation as payment for the Performance Units. Under Code Section 457, a deferred compensation plan of an eligible employer is either an “eligible deferred compensation plan”¹¹ or a plan that is not an eligible deferred compensation plan (referred to as an “ineligible deferred compensation plan”).¹² A plan is an eligible deferred compensation plan if the amount that can be deferred under the plan for the applicable taxable year is limited to the lesser of (i) \$19,000 (indexed for inflation) and (ii) 100% of the participant’s includible compensation.¹³ As Participants in the Plan are not limited to a maximum deferral of \$19,000 per year, the Plan would not be treated as an eligible deferred compensation plan under Code Section 457(b) and, instead, it would be treated as an ineligible deferred compensation plan under Code Section 457(f).

Amounts (and earnings thereon) deferred under an ineligible deferred compensation plan are includable in the gross income of a plan participant for the first taxable year in which the compensation is not subject to a substantial risk of forfeiture, unless an exemption applies.¹⁴ In other words, amounts payable under an ineligible deferred compensation plan are taxable when they become vested, even if not actually paid until a later date. However, in 2016 the Internal Revenue Service (the “IRS”) published proposed regulations under Code Section 457(f) (the “Proposed 457(f) Regulations”)¹⁵ which provide that deferred compensation plans that satisfy the short-term deferral exemption (the “STD Exemption”) under Code Section 409A¹⁶ are generally not considered ineligible deferred compensation plans under Code Section 457(f).¹⁷

Code Section 409A contains a comprehensive set of rules regarding the taxation of nonqualified deferred compensation plans, but it does not regulate the payment of compensation where there is no delay, or only a minimal delay, between the time an amount is vested and the time the compensation is paid. Under Code Section 409A, the delay is considered minimal if a service provider actually or constructively receives payment of an amount during the first taxable year in which the amount is no longer subject to a substantial risk of forfeiture (“SROF”) or on or before the 15th day of the third month following the end of the taxable year in which the payment is no longer subject to a SROF (i.e., the short-term deferral period). Therefore, a payment is excluded from the application of Code Section 409A and Code Section 457(f) under the STD Exemption if (i) the right to the payment is subject to a condition constituting a SROF and (ii) the payment is paid within the short-term deferral period following the lapse of the SROF.¹⁸ A SROF exists if the entitlement to the compensation is conditioned on the performance of substantial future services or the occurrence of a condition related to the purpose of the compensation and the

¹¹ See Code §457(b).

¹² See Code §457(f).

¹³ See Code §457(b)(2)(A).

¹⁴ See Code §457(f).

¹⁵ See Section V, “Proposed Applicability Dates,” in the preamble to the Proposed 457(f) Regulations, which provides that, until the IRS adopts the Proposed 457(f) Regulations as final, taxpayers may rely on the Proposed 457(f) Regulations.

¹⁶ See Treas. Reg. §1.409A-1(b)(4)(i)(A).

¹⁷ See Prop. Treas. Reg. §1.457-12(d)(2).

¹⁸ Treas. Reg. §1.409A-1(b)(4).

possibility of forfeiture is substantial. Where there are two conditions that would constitute a SROF, the SROF lapses on the satisfaction of the later of the two conditions.

In the case of the Plan, there are two conditions that would constitute a SROF:¹⁹ (i) the time-based vesting component (i.e., the performance of substantial future services) and (ii) the performance-based vesting component (i.e., the occurrence of a condition related to a purpose of the compensation), with vesting of the Performance Units occurring on the satisfaction of the performance-based vesting component as the later of the two conditions that will be satisfied. While there exists the possibility under the Plan for a Participant to retain his or her Performance Units if he or she experiences an involuntary termination of employment or retires from employment prior to the end of the applicable Performance Period, the deferred purchase price and the Performance Units are still subject to a SROF due to the fact that the Performance Units could ultimately be redeemed for \$0 if the threshold value percentage is not attained during the applicable Performance Period.

Additionally, because payments in respect of vested Performance Units under the Plan will be made in all events within 60 days following the date on which the SROF has lapsed (as described under “Payment for Vested Performance Units” above), payment of the Redemption Price will be made within the short-term deferral period.

Accordingly, the Plan satisfies the requirements of the STD Exemption under Code Section 409A and the Proposed 457(f) Regulations and, therefore, it should not constitute an ineligible deferred compensation plan under Code Section 457(f) and payment of the deferred purchase price and the Redemption Price should be taxable to Participants only when paid to them.

2. Code Section 409A

In addition to being subject to Code Section 457(f), ineligible deferred compensation plans are subject to the requirements of Code Section 409A²⁰ governing the taxation of nonqualified deferred compensation plans, unless an exemption applies. The tax rules define a nonqualified deferred compensation plan broadly as any plan that provides for the deferral of compensation.²¹ A “deferral of compensation” occurs where a service provider has a legally binding right during a taxable year to compensation that, under the terms of the plan and the relevant facts and circumstances, is or may be payable to the service provider in a later taxable year.²²

If compensation is not exempt from, and does not comply with, the requirements of Code Section 409A, all compensation deferred under the applicable plan for the taxable year and all preceding taxable years is includable in the gross income of the service provider for the taxable year in which the compensation is no longer subject to a SROF (as described above). In addition,

¹⁹ See Prop. Treas. Reg. §1.457-12(e)(1).

²⁰ See Prop. Treas. Reg. §1.457-12(d)(5)(i).

²¹ See Treas. Reg. §1.409A-1(a)(1); Treas. Reg. §1.409A-1(c)(1).

²² See Treas. Reg. §1.409A-1(b).

the service provider has to pay an additional 20% tax plus a potential premium interest tax on the compensation amount.²³

However, compensation that satisfies the STD Exemption is not considered nonqualified deferred compensation subject to Code Section 409A. As discussed above, payments under the Plan are structured to comply with the STD Exemption under Code Section 409A and, therefore, should not be subject to the requirements of Code Section 409A.

3. Code Section 4960

Code Section 4960 imposes on an employer an excise tax equal to the corporate tax rate (currently 21%) on the sum of (i) remuneration²⁴ in excess of \$1 million paid by an applicable tax-exempt organization (an “ATEO”) or a related organization²⁵ for the taxable year with respect to the employment of a covered employee²⁶ and (ii) any excess parachute payments²⁷ paid by an ATEO or a related organization to a covered employee. Under Code Section 4960, the employer is the common law employer (as generally determined for federal tax purposes).²⁸

²³ See Code §409A(a)(1).

²⁴ See Code §4960(c)(3) and Section D. of IRS Notice 2019-9, which provide that “remuneration” is generally defined as wages under Code §3401(a) (i.e., wages subject to federal income tax withholding), but excluding (i) any excess parachute payment under Code §4960 (parachute payments that are not excess parachute payments are not excluded), (ii) designated Roth contributions under Code §402A(c), (iii) certain retirement benefits (see Code §3401(a)(12)) or certain directors’ fees (see IRS Rev. Rul. 57-246), and (iv) certain remuneration for medical services (see Code §4960(c)(3)(B)), but including amounts required to be included in gross income under Code §457(f).

²⁵ See Code §4960(c)(4)(B), which provides that, a person or governmental entity will be treated as related to an ATEO if such person or governmental entity: (i) controls, or is controlled by, the organization, (ii) is controlled by one or more persons which control the organization, (iii) is a supported organization (as defined in Code §509(f)(3)) during the taxable year with respect to the organization, (iv) is a supporting organization described in Code §509(a)(3) during the taxable year with respect to the organization, or (v) in the case of an organization which is a voluntary employees’ beneficiary association described in Code §501(c)(9), establishes, maintains, or makes contributions to such voluntary employees’ beneficiary association.

²⁶ See Code §4960(c)(2), which provides that a “covered employee” means an employee (including any former employee) of an ATEO if the employee (i) is one of the five highest compensated employees of the organization for the taxable year, or (ii) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016. There is no minimum compensation threshold for an employee to be treated as a covered employee.

²⁷ See Code §4960(c)(5), which provides that an “excess parachute payment” means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment. For these purposes, “parachute payment” means a compensatory payment to a covered employee that is contingent on such employee’s separation from employment, and the aggregate present value of the compensatory payments to such employee which are contingent on his or her separation equals or exceeds three times the base amount. The “base amount” means the employee’s average annual compensation paid or treated as paid by the organization during the five taxable years immediately preceding the year in which the separation occurs (or the average annual compensation over the actual number of years of service with the organization, if fewer than five).

²⁸ See IRS Notice 2019-9, which provides interim guidance under Code §4960; however, until the Department of the Treasury and the IRS issue final guidance, taxpayers may rely on good faith, reasonable interpretations of Code §4960.

Code Section 4960 applies to payments made by ATEOs, which, in relevant part, are defined to include any organization which, for the taxable year, has income excluded from tax under Code Section 115(1).²⁹ We understand from JEA that JEA is exempt from taxation under Code Section 115(1), although we have not independently verified this. As such, assuming that JEA is indeed exempt from taxation under Code Section 115(1), JEA would likely be considered an ATEO that is subject to Code Section 4960. In this respect, payments under the Plan to covered employees that exceed \$1 million or that constitute excess parachute payments may be subject to the 21% excise tax under Code Section 4960.

One possibility for excluding the application of Code Section 4960 may be to assert that JEA is exempt from tax under the doctrine of implied statutory immunity.³⁰ Under this doctrine, the income of a State, a political subdivision of a State or an integral part of a State or political subdivision (often referred to as a “governmental unit”) is generally not taxable unless there is a specific statutory authorization for taxing the income. However, at least in the context of a governmental entity that is exempt from tax under Code Section 501(c)(3), it appears that such entity would first need to relinquish its Code Section 501(c)(3) status for Code Section 4960 not to apply on the basis of the doctrine of implied statutory immunity, and in such a case, such entity may still be liable for the excise tax under Code Section 4960 as a “related organization” under Code Section 4960(c)(4)(B).³¹ As such, if JEA were to assert that it was not subject to Code Section 4960 on the basis of the doctrine of implied statutory immunity, it may be the case that JEA would first have to relinquish its tax-exempt status under Code Section 115(1), although this is not clear from the relevant guidance. The only way to gain certainty on this issue would be for JEA to apply for a private letter ruling (“PLR”) with the IRS.

Another possibility for excluding the application of Code Section 4960 in the context of a Recapitalization Event may be to demonstrate that the payments are not made by an ATEO or a related organization. If the Recapitalization Event is structured as a sale of JEA’s assets and payments under the Plan are made by the purchaser of the assets following the consummation of the Recapitalization Event, then the payments would be made at a time when JEA is no longer an ATEO. This approach may prove unsuccessful, however, on account of the successor employer rules. Under these rules, any purchaser of JEA may be treated as a successor common-law employer and, therefore, subject to Code Section 4960. Moreover, payments under the Plan may need to be included in the pre-closing tax period (i.e., when JEA is an ATEO) because the payments are based on the sale of JEA. Further research (and possibly an IRS PLR) may be needed to gain greater certainty on this issue, but that is beyond the scope of this memorandum.

4. Code Section 280G

Under the golden parachute tax rules of Code Section 280G, a corporation may lose the right to take an income tax deduction with respect to certain compensatory payments made to a disqualified individual that are contingent upon a change in control of the corporation (these

²⁹ See Code §4960(c)(1).

³⁰ Case law has established that JEA is entitled to sovereign immunity treatment. See *Fluid Dynamics Holdings, LLC v. Jacksonville Electric Authority*, No. 18-11082 (11th Cir. 2018).

³¹ See IRS Notice 2019-9, Q&A-5 and Q&A-6.

payments are referred to as “parachute payments”³²). JEA qualifies as a corporation for these purposes.³³ A “disqualified individual” is any officer or top 1% employee when ranked by pay.³⁴ Code Section 4999 imposes on the recipient of a parachute payment a non-deductible 20% excise tax, which excise tax is in addition to the payment of any regular income and employment tax that may apply to the payment. A payment is generally treated as contingent on a change in control if the payment would not, in fact, have been made had no change in control occurred.³⁵ A payment made pursuant to an agreement entered into within one year before the date of a change in control is presumed to be contingent on the change in control, unless the contrary is established by clear and convincing evidence. This memorandum assumes that, for purposes of Code Section 280G, a Recapitalization Event would constitute a change in control and the payment of the Redemption Price in respect of the Performance Units under the Plan would be a payment contingent on a change in control.

Under Code Section 280G, a payment is a “parachute payment” only if the total amount of the contingent compensatory payments made to the service provider in connection with the change in control equals or exceeds three times the disqualified individual’s base amount.³⁶ For these purposes, the “base amount” is the average annual compensation paid or treated as paid by the corporation during the five taxable years immediately preceding the year in which the change in control occurs (or the average annual compensation over the actual number of years of service with the corporation undergoing a change of control, if fewer than five).³⁷ If the total payments to a disqualified individual are less than three times the individual’s base amount (his or her “parachute threshold”), the payments to that disqualified individual are not subject to the loss of tax deduction under Code Section 280G or the excise tax under Code Section 4999. In contrast, if a disqualified individual’s total parachute payments equal or exceed his or her parachute threshold, then both the loss of the tax deduction and the excise tax apply to the extent such parachute payments exceed the disqualified individual’s base amount. In other words, if the parachute threshold is equaled or exceeded, then the loss of tax deduction and the excise tax apply to all parachute payments to the extent they exceed the base amount, and not just to the extent they exceed the parachute threshold.

Unless an exception applies, JEA may be subject to Code Section 280G, which could result in JEA (or its successor in a Recapitalization Event) losing its tax deduction on payments made under the Plan (to the extent a tax deduction would otherwise have been available to JEA or its

³² The definition of “parachute payments” for purposes of Code §280G differs from that of Code §4960, which defines parachute payments as compensatory payments that are contingent on a separation from employment.

³³ See Treas. Reg. Section 301.7701-2(b)(1) defines a “corporation” as “[a] business entity organized under a Federal or State statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic”. JEA was created pursuant to Article 21 of the Charter of the City of Jacksonville, Florida, which would be a “State statute” because the Charter is pursuant to the Laws of Florida. JEA’s charter notes that it is a “body politic.”

³⁴ See Treas. Reg. §1.280G-1 Q/A 15. A disqualified individual also includes a 1% stockholder, which does not apply in JEA’s case unless JEA is reorganized to have stockholders.

³⁵ See Treas. Reg. §1.280G-1 Q/A 22.

³⁶ See Treas. Reg. §1.280G-1 Q/A 2.

³⁷ See Treas. Reg. §1.280G-1 Q/A 34.

successor) and being obligated under the Plan to gross up Participants for excise taxes incurred by them as a result of the application of Code Sections 280G and 4999. In general, the following payments are not treated as parachute payments for purposes of Code Section 280G:³⁸

- Payments made by a corporation that would qualify as a “small business corporation” immediately before the change in control (even if no election is in effect on the date of the change in control). To qualify as a small business corporation, a corporation must have fewer than 100 shareholders, no entity shareholders, and only one class of stock.³⁹
- Payments made by non-publicly traded corporations where the payments are approved by more than 75% of the voting power of the corporation (in accordance with the relevant shareholder approval requirements under Code Section 280G⁴⁰).
- Payments made by a corporation which is exempt from tax under Code Section 501(c)(3), provided that such corporation is exempt from tax under that section immediately before and immediately after the change in control.
- Payments made by a corporation that a taxpayer demonstrates by clear and convincing evidence based on all the facts and circumstances are reasonable compensation for services rendered after a change in control.⁴¹ Whether compensation is reasonable depends on, among other factors, the nature of the services rendered, the disqualified individual’s historical compensation and the compensation of individuals who perform similar services outside of the change in control context.⁴²

Since JEA does not have shareholders (and we understand it is not possible under Florida law to reorganize JEA so that it has shareholders), JEA would likely not be able to utilize the shareholder approval exception described in the second bullet above. However, in an IRS PLR,⁴³ the IRS held that the approval of parachute payments by a bankruptcy court’s order could satisfy the Code Section 280G shareholder approval requirements because the creditors’ committee and the bankruptcy judge represented the shareholders’ interests and the shareholders were not otherwise eligible to approve the payments. Whether some other non-shareholder approval mechanism (e.g., approval by the citizens of the City of Jacksonville) might be available to JEA would likely require a PLR from the IRS. Also, as we understand that JEA is not exempt from tax under Code Section 501(c)(3) (rather, as discussed, JEA is exempt under Code Section 115(1)), JEA would not be able to qualify for the exception described in the third bullet above. However, to the extent that JEA can qualify as a small business corporation, JEA should be able to rely on the exemption under the first bullet above. Again, to gain greater certainty as to whether JEA is exempt from the application of Code Section 280G, JEA would need to seek a PLR from the IRS

³⁸ See Treas. Reg. §1.280G-1 Q/A 5(a)(1), (2), (4) and (5), respectively.

³⁹ See Code §1361(b)(1). Note, for purposes of Code §280G, the term “small business corporation” is determined without regard to Code §1361(b)(1)(C).

⁴⁰ See Treas. Reg. §1.280G-1 Q/A 7.

⁴¹ See Treas. Reg. §1.280G-1 Q/A 9.

⁴² See Treas. Reg. §1.280G-1 Q/A 40.

⁴³ See PLR 200212013. Note, a PLR can only be relied on by the taxpayer to whom it is issued, but it can be indicative of the IRS’s position as to the subject matter of the PLR.

or, in the case of reasonable compensation analysis under the fourth bullet above, commission a study by a third-party valuation firm (such as an accounting firm) to evaluate whether some or all of the compensation is reasonable.

D. Summary of Federal and State Securities Laws

Because JEA is not a publicly traded entity and because the Performance Units are not securities (rather, as discussed above, they are contractual rights to receive cash payments), there should be no consequences for the Plan under applicable federal or state securities laws.