

Internal Revenue Service

Department of the Treasury

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Refer Reply To:
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Date:
July 20, 2000.

LEGEND:

Parent =
Acquiring =
Target =
Company =
Date A =
Date B =
Year C =

This letter is in response to your letter dated March 21, 2000, submitted on behalf of Parent requesting rulings under section 162(m) of the Internal Revenue Code. Specifically, the letter requests rulings, under the facts outlined below, that Target officers will not be covered employees with respect to the Acquisition Year or the Resignation Year under section 162(m). A ruling under section 280G concerning whether the base period includes any period during which a disqualified individual served as an outside director was withdrawn. The facts, as submitted, are set forth below.

Company was formed for the sole purpose of acquiring the stock of Target. On Date A, Acquiring and Company entered into an acquisition agreement (Merger Agreement) to purchase all of the issued and outstanding stock of Target. Subsequently, Parent commenced an offer to purchase all of the shares of Target. On Date B, Target became a wholly owned subsidiary of Acquiring. The merger was structured to be tax free at the corporate level, however, the purchase of shares was taxable to Target shareholders.

Parent represents that Target will not be required to file any reports or

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statements with the SEC that disclose executive compensation and that would be due after Target ceased to be a reporting entity as a result of the merger. Accordingly, there will be no "Summary Compensation Table" for Target which would disclose the compensation of the chief executive officer and four highest paid officers for Target's year that ended with the merger the day prior to Date B (Acquisition Year).

Parent represents that none of the former Target employees will be included in the Year C Summary Compensation Table to be filed by Parent with the SEC. Many Target executives will continue to be Target employees, but some may become Acquiring employees or employees of other affiliated corporations during Year C or the following year.

Certain corporate officers of Target and Parent resigned in Year C or may resign in a later year as employees; others may resign their positions as officers and all of their duties as officers in a year (Resignation Year). Those individuals who resign their positions as officers may continue to perform services as consultants or as Target or Parent employees or employees of another company in the Parent controlled group for the remainder of the Resignation Year and possibly in future years. Thus, resignation from their positions as officers does not necessarily equate to resignation from service as consultants or employees. These officers may be listed pursuant to the executive compensation disclosure rules under the Exchange Act as chief executive officer or one of the highest compensated officers for the Resignation Year.

Section 162(a)(1) of the Code allows a deduction for all of the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 162(m)(1) of the Code provides that for any publicly held corporation, no deduction shall be allowed for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year exceeds \$1,000,000.

Section 162(m)(3) of the Code defines "covered employee" as any employee of the corporation if, as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is an individual acting in such capacity, or the total compensation of such employee for the taxable year is required to be reported to shareholders under the Exchange Act by reason of such employee being among the four highest compensated officers for the taxable year (other than the chief executive officer).

Section 1.162-27(c)(2) of the Income Tax Regulations provides the general rule describing who is a "covered employee." Under the regulations, a covered employee means any individual who, on the last day of the taxable year, is (A) the chief executive

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officer of the corporation or is acting in such capacity; or (B) among the four highest compensated officers (other than the chief executive officer). Whether an individual is the chief executive officer or one of the four highest compensated officers is determined pursuant to the executive compensation disclosure rules under the Exchange Act.

In the notice of proposed rulemaking containing the proposed regulations under section 162(m) of the Code, the preamble contains the following language concerning the identification of “covered employee”:

The regulations clarify which employees are “covered employees” for purposes of section 162(m). The legislative history to section 162(m) provides that “covered employees” are defined by reference to the SEC rules governing executive compensation disclosure under the Exchange Act. Under the regulations, an individual generally is a “covered employee” if the individual’s compensation is reported on the “summary compensation table” under the SEC’s executive compensation disclosure rules, as set forth in Item 402 of Regulations S-K, 17 C.F.R. 229.402, under the Exchange Act. However, the regulations specifically provide that, in order to be a “covered employee” for section 162(m) purposes, an individual must be employed as an executive officer on the last day of the taxable year. Thus, only those employees who appear on the “summary compensation table” and who are also employed on the last day of the taxable year are “covered employees.”

Accordingly, based on the facts as submitted, we rule as follows:

1. For purposes of section 162(m) of the Code, Target’s officers will not be “covered employees” with respect to the Acquisition Year because no Summary Compensation Table is required to be filed by Target with the SEC for the Acquisition Year and these officers will not be listed on any Summary Compensation Table filed by Parent for the Acquisition Year.
2. For purposes of section 162(m) of the Code, officers of Target and Acquiring will not be “covered employees” with respect to the Resignation Year, if they have resigned their employment or their positions as officers before the last day of the Resignation Year with no intent to resume their duties as officers in the foreseeable future. Accordingly, no compensation paid to these officers with respect to the Resignation Year will be subject to the 162(m) deduction limitation.

Although you requested a ruling concerning whether the base period under section 280G(d)(1) of the Code includes the period during which a disqualified individual served as an outside director, the ruling was withdrawn. Except as specifically ruled on above, no opinion is expressed as to the federal income tax consequences of the above-described transaction under any other provisions of the

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Code.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
Robert Misner
Assistant Chief
Executive Compensation Branch
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)

Enclosure: Copy for 6110