

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:EC-PLR-156482-02

Date:

July 7, 2003

Re:

LEGEND:

Company 1 =
Company 2 =
Company 3 =
Subsidiary 1 =
Subsidiary 2 =
Shareholder 1 =
Shareholder 2 =

Dear _____,

This letter is in response to your request for rulings under sections 280G and 4999 of the Internal Revenue Code. Specifically, the letter requests rulings that the proposed merger does not cause a change in ownership or effective control of, or a change in a substantial portion of assets of Company 1 and that the provisions of sections 280G and 4999 do not apply to payments made contingent on this transaction.

Company 1 and Company 2 were both publicly traded companies. Subsidiary 1 is a subsidiary of Company 2, and Subsidiary 2, a merger subsidiary, was a subsidiary of Subsidiary 1.

Company 1, Company 2, Subsidiary 1 and Subsidiary 2 entered into an agreement wherein it is stated that it is the intent of the parties that Company 1 acquire Company 2. Under the agreement, Company 1 would merge with Subsidiary 2, with Company 1 surviving as a subsidiary of Subsidiary 1, and, indirectly, of Company 2. Company 1 was renamed as Company 3. After the completion of the merger, the former shareholders of Company 1 owned greater than fifty percent of Company 3's stock, and the former shareholders of Company 2 owned less than fifty percent of Company 3's stock.

Shareholder 1 held greater than twenty percent in Company 1. After the merger, Shareholder 1 will own less than twenty percent of Company 3.

Section 280G of the Code provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) defines "excess parachute payment" as an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

Section 280G(b)(2)(A) of the Code defines "parachute payment" as any payment in the nature of compensation to (or for the benefit of) a disqualified individual if (i) such payment is contingent on a change in the ownership or effective control of the corporation or in the ownership of a substantial portion of the assets of the corporation and (ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such change equals or exceeds an amount equal to three times the base amount.

Section 280G(d)(5) of the Code provides that all members of the same affiliated group (as defined in section 1504, determined without regard to section 1504(b)) should be treated as one corporation for purposes of section 280G.

Section 4999(a) of the Code imposes on any person who receives an excess parachute payment a tax equal to twenty percent of the amount of the payment.

Section 1.280G-1 of the Proposed Income Tax Regulations, Q&As 27, 28, and 29, published in the Federal Register on May 5, 1989 (54 Fed. Reg. 19,390) and on February 20, 2002 (67 Fed. Reg. 7,630), provides guidance concerning when a corporation will be considered to have undergone a change in ownership or effective control or a change in the ownership of a substantial portion of its assets.

Q&A 27(a) of the 2002 proposed regulations provides that a change in the ownership or control of a corporation occurs on the date that any one person, or more than one person acting as a group, acquires ownership of stock of the corporation that, together with stock held by such person or group, possesses more than fifty percent of the total fair market value or total voting power of the stock of such corporation. Q&A 27(b) provides that persons will not be considered to be "acting as a group" merely because they happen to purchase or own stock of the same corporation at the same time, or as a result of the same public offering. However, persons will be considered to be "acting as a group" if they are owners of an entity that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the corporation. Q&A 27(c) provides that section 318(a) shall apply in determining stock ownership.

Example (3) of Q&A 27 deals with a corporate merger. There, Corporation P merged into Corporation O and the shareholders of P received O stock in exchange for their P stock. The example concludes that because P shareholders received a greater than fifty percent interest in O, O experienced a change in ownership. By implication, the example concludes that P did not experience such a change.

Q&A 28(a) provides, in part, that a change of effective control of a corporation is presumed to occur on the date that either (1) any one person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of stock of the corporation possessing twenty percent or more of the total voting power of the stock of such corporation; or (2) a majority of the members of the corporation's board of directors is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the corporation's board of directors.

The presumption of Q&A 28(a)(1) and (2) may be rebutted by establishing that the acquisition or acquisitions of the corporation's stock, or the replacement of the majority of the members of the corporation's board of directors, does not transfer the power to control (directly or indirectly) the management and policies of the corporation from any one person (or more than one person acting as a group) to another person (or group). Q&A 28(c) contains the same language as Q&A 27(b) concerning when persons will be considered to be "acting as a group." Q&A 28(d) contains the same language as Q&A 27(c) concerning the application of section 318(a).

Q&A 29 provides that a change in the ownership of a substantial portion of a corporation's assets occurs on the date that any one person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the corporation that have a total fair market value equal to or more than one third of the total fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions. For this purpose, a transfer of assets by a corporation is not treated as a change in the ownership of the assets if the corporation transfers the assets to an entity in which, immediately after the transfer, the shareholders of the corporation own a greater than fifty percent interest (by value or voting power). See Q&A 29(b) and Example (3) of Q&A 29(d). Q&A 29(c) contains the same language as Q&A 27(c) concerning the application of section 318(a).

After the completion of the merger, Company 1 will not undergo a change in ownership under Q&A 27, because no person or group will acquire greater than fifty percent of Company 1's stock. Company 1 will be wholly owned by Company 3, which will hold all of Company 1's stock, but the former shareholders of Company 1 will hold greater than fifty percent of Company 3. Thus, the former shareholders of Company 1 will have control of Company 3, and through it, Company 1. However, because the former shareholders of Company 1 will hold greater than fifty percent of the stock of Company 3, Company 2 will undergo a change in control.

After the completion of the merger, Company 1 will not have undergone an effective change in control as described in Q&A 28. Q&A 28 states that a company will be presumed to have undergone a change of control whenever another company acquires

greater than 20% of its stock. Company 2 has acquired a greater than twenty percent interest in Company 3. However, the presumption of a change in control is one which can

be rebutted, by taking into consideration all facts and circumstances. Based on the facts presented, Company 1 does not appear to have undergone a change in control. Company 1 and Company 2 each designated half of Company 3's board of directors. Six of Company 3's eleven executive officers will be former Company 1 employees, including the Chairman of the Board. (The Chief Executive Officer of Company 3 will be a former Company 2 employee.) The members of Company 3's committees will be split equally between Company 1 and Company 2. Company 2 will nominate three committee chairs, and Company 1 one, while the rest are chosen by Company 1 and Company 2 together. Company 3's offices will be located in the office space previously occupied by Company 1. Company 1 also represents that it knows of no agreement among the former shareholders of Company 2 to attempt to control Company 3.

After the completion of the merger, there will not be a change in a substantial portion of the assets of Company 1, as described in Q&A 29. There is no change if the assets are transferred to a corporation over fifty percent or more of which is owned by the former shareholders of the corporation making the transfer. Such is the case in this transaction. This is further illustrated by Example 3 of Q&A 29.

Based on the foregoing facts and representations, we rule as follows:

1. The merger will not cause a change in ownership, a change in effective control, or a change in the ownership of a substantial portion of the assets of Company 1.
2. The provisions of sections 280G and 4999 will not apply to any payments made contingent upon the merger from Company 1 to, or for the benefit of, the employees, former employees or service providers of Company 1.

Except as specifically ruled on above, no opinion is expressed or implied concerning the tax consequences of any item of any transaction or item discussed above.

This ruling is provided only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be cited as precedent. The taxpayer should attach a copy of

this ruling to any income tax return to which it is relevant.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations to the extent that they are inconsistent with any conclusion in the ruling. However, when the criteria in section 12.05 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 44 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Sincerely,

ROBERT B. MISNER
Senior Technician Reviewer
Executive Compensation Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)

Enclosure:

Copy for 6110 purposes