INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference:

LEGEND:

Corporation X	=	
Corporation Y	=	
Date 1	=	
A%	=	%
B%	=	%
C%	=	%
D%	=	%
E%	=	%

ISSUE:

When Corporation X merged into Corporation Y, did Corporation X, under section 280G(b)(2)(A)(i) of the Internal Revenue Code and Q/A-29 of the Proposed Income Tax Regulations (published on May 5, 1989 at 54 Fed. Reg. 19,390), experience a change in the ownership of a substantial portion of its assets when, due to the merger, its shareholders received a less than 50-percent ownership interest in Corporation Y? Alternatively, did Corporation X not experience such a change because its shareholders, taking into account stock in Corporation Y certain of its shareholders owned independent of the merger, then owned a greater than 50-percent ownership interest in Corporation Y?

FACTS:

On Date 1, pursuant to a merger agreement, 100 percent of the assets of Corporation X were transferred to Corporation Y, with Y being the surviving corporation. The board of directors of Corporations X and Y unanimously approved the merger. Immediately after the merger, Corporation Y changed its name to X (New X).

Pursuant to the merger, the former shareholders of X received a less than 50-percent interest (approximately A%) in the outstanding stock of Y following the merger. The former shareholders of Y received a greater than 50-percent interest (approximately B%) in the outstanding stock of Y following the merger.

At the time of the merger, certain shareholders of X also held stock of Y. When this stock (an additional C%) is added to the A% received by the X shareholders in the merger, the shareholders of X held a greater than 50-percent interest in Y.

Corporation X contends that it did not experience a change in the ownership of a substantial portion of its assets because its shareholders, after the merger, held a greater than 50-percent ownership interest in Y.

LAW AND ANALYSIS:

Section 280G(a) 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 of exceeds an amount equal to three times the base amount.

Section 4999(a) of the Code imposes on any person who receives an excess parachute payment a nondeductible excise tax equal to 20 percent of the amount of the payment.

According to the Blue Book Report, these above-cited provisions were added to the Code in response to Congressional concern that golden parachute agreements often played too large a role in the decision of corporate management about whether a corporation should, or should not, be taken over by another corporation. This concern was not limited to unfriendly acquisitions because, whether friendly or not, a golden parachute agreement, in the view of Congress, served to unjustifiably reduce the amounts that would otherwise be paid to the shareholders. S. REP. NO. 98-169 at 195 (1984); JOINT COMMITTEE ON TAXATION, 98th CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, 199 (1984).

With the enactment of section 280G, Congress did not define the meaning of a change in ownership or effective control of the corporation or in the ownership of a substantial portion of the assets of the corporation (a change in ownership or control), choosing instead to make that determination dependent on "all the facts and circumstances, giving due regard to the purposes of the provisions." See, H.R. CONF. REP. NO. 98-861, at 851 (1984), 1984-3 C.B. 105; JOINT COMMITTEE ON TAXATION, 98th CONG., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, 203 (1984).

Notwithstanding this legislative history, the Treasury Department and the Service determined that the administration of the provisions would be greatly benefited if the regulations were to prescribe a set of rules that, as objectively as possible, defined a change in ownership or control.

For the years in issue, Q/A-29 of section 1.280G-1 of the proposed regulations, provides guidance concerning when a corporation will be considered to have experienced a change in ownership of a substantial portion of its assets. In the case of a corporate merger, however, Q/A-27 must also be considered as it could apply to the other corporation to determine whether it experienced a change in ownership.

Q/A-27(a) provides that a change in the ownership 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 50 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.

The concept of “acting as a group” is addressed in case law interpreting section 13(d) of the Securities Exchange Act of 1934 on which portions of Q/A-27 through Q/A-29 are based.[1] This case law indicates that the filing requirements of section 13(d) are triggered by an agreement to act in concert to take control. However, a mere relationship (such as a family, personal, or business) does not itself create a group. See, GAF Corp. v. Milstein, 453 F.2d 709 (2d Cir. 1971), cert. denied 406 U.S. 910 (1972).

In Example (2) of Q/A-27(d), all of the corporation’s stock is owned by the founders of the corporation. After a public offering of the stock, the founders of the corporation own 40 percent of the corporation’s stock, and the public owns 60 percent of the corporation’s stock. The example concludes that if no one person (or more than one person acting as a group) owns more than 50 percent of the corporation’s stock (by value or voting power) after the public offering, there is no change in the ownership of the corporation.

Example (3) of Q/A-27(d) 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 50 percent interest in O, O experienced a change in ownership.

Q/A-29(a) 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

[1] Generally, section 13(d) requires any person who, after acquiring directly or indirectly more than 5% of a registered security, to file a statement with the Securities Exchange Commission. When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group is considered a person for purposes of section 13(d).

fair market value of all of the assets of the corporation immediately prior to such acquisition or acquisitions.

Q/A-29(b)(4) provides that a transfer of assets by a corporation is not treated as a change in ownership of such assets if the assets are transferred to an entity, at least 50 percent of the total value or voting power is owned, directly or indirectly, by a person described in Q/A-29(b)(3).

A person described in Q/A-29(b)(3) is a person, or more than one person acting as a group, that owns, directly or indirectly, 50 percent or more of the total value or voting power of all the outstanding stock of the corporation. A person's status is determined immediately after the transfer of the assets.

Example (3) of Q/A-29(d) illustrates an acquisition of assets in the merger context, and thus, mirrors Example (3) of Q/A-27(d). In Example (3) of Q/A-29(d), all of the assets of P are transferred to O (an unrelated entity) in exchange for O stock. Immediately after the transfer, the former shareholders of P own 60 percent of the fair market value of the outstanding stock of O, and the former shareholders of O own 40 percent of the fair market value of the outstanding stock of O. Because O is an entity more than 50 percent of the fair market value of the outstanding stock of which is owned by the former shareholders of P, the transfer of assets is not treated as a change in ownership of a substantial portion of the assets of P. Example (3) of Q/A-27(d) and Example (3) of Q/A-29(d) "mirror" each other because, in the merger, Corporation O is viewed as having transferred its stock to P in exchange for P assets, while P is viewed as having transferred its assets to O in exchange for O stock.

Citing to Q/A-29(b)(4) and the literal language of Example (3) of Q/A-29(d), X argues that it did not experience a change in ownership of its assets because after the transfer of assets, the former shareholders of X owned more than 50 percent of the outstanding stock of Y (if the independently owned shares are considered). X contends that these independently owned shares should be added because the 1989 proposed regulations do not require a corporation's former shareholders to be acting as a group with respect to the previously owned shares to determine post-merger ownership. However, we do not agree that the exception in Q/A-29(b)(4), and, thus, Example (3) of Q/A-29(d), is applicable.

We believe X's argument is misplaced because it is not logical that in a merger, for purposes of Q/A-27 (a), more than 50 percent of Corporation Y's stock would have to be acquired by a person, or persons acting as a group, for Corporation Y to experience a change in ownership, and not have the same acting as a group rule apply to the other corporation in the merger. In this particular case, the shareholders of X that clearly acted as a group only own A% of the stock of Y after the transfer of assets. The

X shareholders, who also owned shares in Y, are considered to be acting as a group with the other shareholders of X only to the extent of their ownership in X prior to the transaction, and not with respect to their independent ownership of Y. Granted, Q/A-29 fails to include a definition of “acting as a group,” however; given the inclusion of the requirement in Q/A-29(b)(3) (cited to in Q/A-29(b)(4)) that, in order for Q/A-29(a) to be avoided, the assets must be transferred to a “person, or more than one person acting as a group, that owns 50 percent or more of the total value or voting power of all the outstanding stock of the corporation”, that failure is merely an oversight in a proposed regulation. Under Q/A-27, a person is not “acting as a group” merely because they happen to purchase or own stock of the same corporation at the same time. It is only logical that, because Q/A-27 and Q/A-29 mirror each other in the merger context, coincidental ownership should also be ignored for purposes of Q/A-29(b)(4).

The facts do not demonstrate that the X shareholders that owned Y were acting, formally or informally with X, to acquire ownership of Y. Instead, the facts demonstrate that these shareholders merely own stock of X and Y coincidentally at the same time. Thus, we conclude that the shareholders of X, acting as a group, acquired less than 50% of Y in the merger.

Although X argues that the 1989 proposed regulations do not require a showing that the X shareholders who also own Y must act in concert to act as a group for purposes of section 280G, X submitted additional documentation to demonstrate that E% of these shareholders were acting as a group with respect to the merger. However, this documentation does not demonstrate any contemporaneous agreement or conscious intention of these shareholders to act, either informally or formally, as a group to acquire the stock of Y. The fact that these shareholders maintained similar positions before and after the transaction or that these shareholders would have voted in favor of the merger does not demonstrate that they were acting as a group to acquire ownership of Y.

CONCLUSION:

Under the facts presented, there was a change in asset ownership of X under section 280G(b)(2)(A)(i) of the Code, and section Q/A-29(a) of the proposed regulations, because its shareholders that acted as a group in the merger did not receive a greater than 50 percent ownership interest in Y.

CAVEATS:

Except as specifically ruled on above, no opinion is expressed or implied concerning the application of any other section of the Code to this transaction.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent..