

**Internal Revenue Service**

Department of the Treasury

Index Number: 280G.01-00

Washington, DC 20224

Number: **200041020**  
Release Date: 10/13/2000

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Telephone Number:

Refer Reply To:  
CC:TEGE:EB:EC-PLR-105360-00  
Date:  
July 13, 2000.

LEGEND:

Company =

Corporation X =

Date A =

Date B =

Exchange =

*c* =

*d* =

*e* =

*f*% =

*g* =

Date H =

*i* =

*k* =

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*p* =

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r =s% =t =u =

Business V =

w% =

This letter is in response to your letter dated March 7, 2000, submitted on behalf of Company requesting rulings under section 280G of the Internal Revenue Code. Specifically, the letter requested rulings, under the facts outlined below, that the merger did not cause a change in ownership or effective control of Company; that the merger will not cause a change in a substantial portion of Company's assets; and that the provisions of sections 280G and 4999 of the Internal Revenue Code will not apply to payments made by reason of the merger. The facts, as submitted, are set forth below.

Pursuant to an Agreement and Plan of Merger (Agreement) dated Date A, Company and Corporation X agreed to merge. According to Agreement, a wholly-owned subsidiary of Company, Merger Sub, will merge with and into Corporation X, with Corporation X as the surviving company. As of the effective date of the merger, Merger Sub will cease to have any corporate existence and Corporation X will become a wholly-owned subsidiary of Company.

Company's common stock is widely held and is listed on the Exchange. As of Date B, Company had c outstanding shares of Company common stock. As of that date, Company also had d shares of preferred stock, without par value, none of which was outstanding, and e shares of which have been designated as Series A Junior Participating Preferred Stock and reserved for issuance on the exercise of rights distributed to holders of Company common stock pursuant to a rights agreement in the event that a person or group acquires ownership of, or makes a tender for, f% or more of Company's common stock. The merger will not trigger the exercise of these rights. Additionally, Company has outstanding stock options, granted through employee stock option plans, which represent the right to purchase g shares of Company common stock.

Corporation X's common stock is widely held and listed on Exchange. As of Date H, Corporation X had i shares of common stock outstanding. Additionally, as of that date, Corporation X had k shares of Series A Convertible Perpetual Preferred Stock outstanding and held by Corporation X's employee stock ownership plan. l shares of Corporation X convertible Preferred Stock have been authorized as

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Participating Preferred Stock and reserved for issuance pursuant to a rights agreement in the event that a person or group acquires ownership of, or makes a tender offer for,  $m\%$  or more of Corporation X's common stock. The merger will not trigger the exercise of these rights. Additionally, Corporation X has outstanding stock options, stock appreciation rights, and deferred share awards granted pursuant to stock option plans, which represent the right to purchase  $q$  shares of Corporation X common stock.

As of the effective date of the merger, each issued and outstanding share of Corporation X stock will be converted into the right to receive  $p$  shares of Company common stock (together with cash in lieu of fractional shares). As of the effective date of the merger, each share of issued and outstanding Corporation X Convertible Preferred Stock (other than those with respect to which appraisal rights have been exercised) will be converted into the right to receive one share of a newly created series of Company Convertible Preferred Stock that will have substantially the same terms and conditions as the Corporation X Convertible Preferred Stock. As of the effective date of the merger, each share of Company Convertible Preferred Stock received in exchange for Corporation X Preferred Stock will be convertible into  $r$  shares of Company common stock and will have the same voting rights as  $r$  shares of Company common stock.

Immediately after the merger, the pre-merger Company shareholders will hold approximately  $s\%$  of the total voting power and total value of the post-merger Company's outstanding stock. For purposes of calculating the above percentages, all vested, outstanding options and stock appreciation rights have been treated as outstanding common stock for purposes of section 280G of the Code. Deferred share awards that are paid in the form of common stock in connection with a change in control have also been counted as outstanding common stock. There are no agreements, written or unwritten, express or implied, among Corporation X shareholders to act in a concerted manner to control the management and policies of Company after the merger.

Immediately after the merger, the Board of Directors (Post-Merger Board) of Company will consist of  $t$  members, half of whom will be designed by the Company prior to the merger and half of whom will be designated by Corporation X prior to the merger. The members of the Post-Merger Board will be current directors of Company and Corporation X or such other persons designated by Company or Corporation X who are reasonably acceptable to the other party. Likewise, immediately after the merger, the executive committee, audit committee, compensation committee, and nominating committee (as well as any other committees of the Post-Merger Board) each will consist of an equal number of members who are directors designated by Company prior to the merger and directors designated by Corporation X prior to the merger.

The current chairman and chief executive officer of Company will be appointed nonexecutive chairman of the Post-Merger Board and the current president and chief

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executive officer of Corporation X will be appointed chief executive officer of Company after the merger. The Agreement provides that after a certain number of months after the effective date of the merger, Corporation X's existing chief executive officer will become chairman of the Post-Merger Board and chief executive officer of Company. Additionally, Company and Corporation X have agreed that the u most senior executive positions of Company after the merger (on a combined basis with its subsidiaries), excluding the positions of chairman and chief executive officer, will be held by a combination of half of the executives from Company and half of the executives from Corporation X.

Certain officers and employees of Company are currently covered by various company benefit plans and/or have entered into agreements with Company that provide for the payment of severance benefits, accelerated vesting of stock options, and other types of payments (collectively, Payments) upon the occurrence of a change in control, as defined in such plans and agreements, of Company or in the event of certain qualifying terminations of employment after a change in control. The merger will constitute a "change in control" as defined in such plans and agreements. At least some of the officers and employees who will become entitled to Payments as a result of the merger are "disqualified individuals" within the meaning of section 280G(c) of the Code.

The Agreement also provides that Company and Corporation X intend, as promptly as practicable following the merger, that the Company transfer Business V to a direct or indirect subsidiary and sell up to w% of the subsidiary in an initial public offering (IPO).

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

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parachute payment a tax equal to 20 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), 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) 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 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. 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 50 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 20 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).

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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 50 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).

Viewing the merger from Company's perspective, Company did not surrender potential ownership or control when it issued its common stock to Corporation X's shareholders in consideration for their Corporation X stock. Because Corporation X's shareholders did not acquire a greater than 50% interest (by value or voting power) in Company due to this transaction, Company did not experience a change of ownership under Q&A 27. (Corporation X did, however experience such a change.)

Also, further, viewing the merger from Corporation X's perspective, all of Corporation X's stock was transferred to Company in consideration for the issuance of Company stock to Corporation X shareholders. This will result in Corporation X shareholders acquiring a greater than 20-percent voting interest in Company. In accordance with Q&A 28, it is presumed that Company will experience a change in effective control.

The facts submitted, however, indicate that Corporation X shareholders will not act in a concerted way to control the management and policies of Company after the merger. The facts also indicate that the composition of the post-merger board was agreed upon by both Corporation X and Company pursuant to Agreement and that neither company will appoint a majority of the directors.

Under Q&A 29, the Business V IPO will be a sale of assets of Company's post-merger affiliated group (which is treated as one corporation for purposes of section 280G of the Code), but the percentage of the assets being sold through the IPO (at most  $w\%$  of one subsidiary of Company) is less than one-third of the fair market value of all of the assets of Company's affiliated group. Also, it is expected that shareholders purchasing stock through the IPO will not be acting as a group.

Accordingly, based strictly on the information and representations submitted, we rule as follows:

1. The merger and Business V IPO will not cause a change in the ownership of

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Company within the meaning of section 280G(b)(2)(A)(i)(I);

2. Provided that after the merger the pre-merger shareholders of Corporation X do not act in a concerted way to control the management and policies of Company, the merger and Business V IPO will not cause a change in effective control of Company within the meaning of section 280G(b)(2)(A)(i)(I);
3. The merger and Business V IPO will not change a change in the ownership of a substantial portion of the Company's assets within the meaning of section 280G(b)(2)(A)(i)(II); and
4. The provisions of sections 280G and 4999 will not apply to the Payments by reason of the merger and the Business V IPO.

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

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. 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 not been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations to the extent that the regulations are inconsistent with any conclusion in the ruling. However, when the criteria in section 12.05 of Rev. Proc. 00-4, 2000-1 I.R.B. 4, 47 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

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

Enclosure:

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cc: