

**Internal Revenue Service**

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Person to Contact:

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Date:

November 15, 2000

Corporation X =

Corporation Y =

Parent =

Date A =

Date B =

Date C =

f =

g =

h =

i =

j =

k =

m =

n =

o =

P =

PLR-113435-00

g =

This is in response to your letter of June 21, 2000, requesting rulings under section 280G of the Internal Revenue Code. Specifically you requested a ruling whether, under the facts outlined below, there will be a change in the ownership or effective control of Corporation X, or in the change in the ownership of a substantial portion of the assets of Corporation X within the meaning of section 280G(b)(2) of the Code. The facts as submitted are set forth below.

Prior to the Mergers described below, Corporation X and Corporation Y were widely-held, publicly traded corporations. As of Date B, immediately prior to the Mergers, there were f shares of Corporation X common stock outstanding and g shares of Corporation Y common stock outstanding. On Date C, the date of the Mergers, Corporation X had outstanding h options to acquire Corporation X stock that were vested and exercisable, and Corporation Y had outstanding i options to acquire Corporation Y stock that were vested and exercisable.

Pursuant to the Merger Agreement dated Date A, Parent, a newly formed corporation, formed two wholly owned subsidiaries, Sub X and Sub Y. On Date C, Sub X merged with and into Corporation X. Corporation X was the surviving corporation and the separate existence of Sub X ceased. Each issued and outstanding share of Corporation X stock was converted into j shares of Parent common stock.

Simultaneously, Sub Y merged with and into Corporation Y. Corporation Y was the surviving corporation and the separate existence of Sub Y ceased. Each issued and outstanding share of Corporation Y stock was converted into k shares of Parent common stock.

As a result of the Mergers, Corporation X and Corporation Y each became a wholly owned subsidiary of Parent. Immediately after the Merger, the pre-Merger Corporation X shareholders held approximately m percent of the outstanding Parent stock when treating the vested options as outstanding stock. The pre-Merger Corporation Y shareholders held approximately n percent of the outstanding Parent stock when treating the vested options as outstanding stock.

The Merger Agreement was approved by the board of directors of both Corporation X and Corporation Y. Following the Mergers, the board of directors of Parent consists of o directors. p of the directors are individuals who either served on the board of directors of Corporation X or were an officer of Corporation X immediately prior to the Merger ("Corporation X nominees"). p of the directors are individuals who

PLR-113435-00

either served on the board of directors of Corporation Y or were an officer of Corporation Y immediately prior to the Merger ("Corporation Y nominees"). The final director will be nominated by the Corporation Y nominees with the consent and approval of the Corporation X nominees.

Following the Mergers, no pre-Merger Corporation Y shareholder will hold more than 9% of the outstanding stock of Parent. It has been represented that to the best knowledge of Corporation X, no pre-Merger Corporation Y shareholder has any agreement, written or unwritten, express or implied, to act in concert to control Parent (and indirectly Corporation X).

Section 280G of the Internal Revenue Code provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) of the Code defines the term "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 the term "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 (I) in the ownership or effective control of the corporation, or (II) 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 4999(a) of the Code imposes on any person who receives an excess 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.

PLR-113435-00

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 the 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 prior to the date of the appointment or election.

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(b) contains the same language as Q&A 27(b) concerning when persons will be considered to be "acting as a group."

It has been represented that, immediately following the Mergers, the pre-Merger Corporation X shareholders will have acquired greater than 50 percent of the value of the outstanding Parent stock. The pre-Merger Corporation Y shareholders will have acquired greater than 20 percent of the value of the outstanding Parent stock.

Viewing the Mergers from Corporation X's perspective, Corporation X surrendered potential ownership or control when it transferred its stock to Parent in consideration for the issuance of Parent stock to the Corporation X shareholders. Since the pre-Merger Corporation X shareholders acquired sufficient stock value and voting power in Parent due to this transaction, Corporation X did not experience a change of ownership under Q&A 27.

As part of the same transaction, all of Corporation Y's stock was transferred to Parent in consideration for the issuance of Parent stock to the Corporation Y shareholders. This resulted in the Corporation Y shareholders receiving a greater than 20% direct voting interest in Parent (and an indirect interest in Corporation X). Accordingly, under Q&A 28, it is presumed that Corporation X experienced a change in effective control.

PLR-113435-00

However, the facts submitted indicate that the pre-Merger Corporation Y shareholders will not act in a concerted way to control the management and policies of Parent and Corporation X. The facts also indicate that the appointment of Parent's board of directors was endorsed by both Corporation X's and Corporation Y's board of directors prior to the date of appointment.

Accordingly, based strictly on the information submitted and Corporation X's representations, we rule as follows:

- 1) Provided that after the Mergers the pre-Merger Corporation Y shareholders do not act in a concerted way to control the management and policies of Parent, the Mergers will not cause a change in the effective control of Corporation X, nor will it cause a change in the ownership of Corporation X or a change the ownership of a substantial portion of Corporation X's assets within the meaning of section 280G(b)(2)(A)(i) of the Code.
- 2) The provisions of section 280G of the Code do not apply to any payments received by employees or former employees of Corporation X and its subsidiaries that are contingent upon the Mergers.
- 3) The provisions of section 4999 of the Code do not apply to any payments that are received by employees or former employees of Corporation X and its subsidiaries that are contingent upon the Mergers.

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 in this letter.

This ruling is directed only to the taxpayer 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 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 46 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

PLR-113435-00

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to the taxpayer and the other authorized representative.

Sincerely yours,

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ROBERT B. MISNER  
Assistant Chief,  
Executive Compensation Branch  
Office of the Division Counsel/Associate  
Chief Counsel (Tax Exempt and  
Government Entities)

Enclosure:  
Copy for 6110 purposes