

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
August 20, 2003

LEGEND:

- Corporation 1 =
- Corporation 2 =
- Corporation 3 =
- Corporation 4 =
- Corporation 5 =
- Corporation 6 =
- Corporation 7 =
- Amount 1 =
- Amount 2 =
- Amount 3 =
- Amount 4 =
- Amount 5 =
- Amount 6 =
- Amount 7 =
- Amount 8 =
- Amount 9 =
- Date 1 =
- Date 2 =
- Percentage 1 =
- Percentage 2 =
- Percentage 3 =

Dear

This letter is in response to your request, made through a duly authorize representative and dated Date 1, for rulings under sections 280G and 4999 of the Internal Revenue Code. Specifically, the letter concerns whether the split-off/spin-off transaction and merger transaction, both of which are described below, cause a change in ownership or effective control of, or a change in a substantial portion of assets of, Corporation 1, in the case of the split-off/spin-off transaction, or of Corporation 2 in the case of the merger transaction.

The split-off/spin-off, between Corporation 2 and Corporation 1, will occur first. The merger will take place between Corporation 2, Corporation 3, and Corporation 4. Corporation 2 was incorporated on Date 2 in order to effectuate Transaction 2.

The split off/spin off transaction

This transaction (some of which has occurred) consists generally of a spin-off of Subsidiary Corporations 2, 5 and 6 from an affiliated group of which Corporation 1 is the parent. Corporation 1 has capitalized Corporation 2 with certain assets and liabilities in exchange for Corporation 2 stock, cash, and the assumption of certain liabilities. Additionally, Corporation 1 will exchange a separate class of voting common stock of Corporation 2 in redemption of all outstanding shares of a special class of Corporation 1 stock that, immediately prior to the spin off, will be held solely by those subsidiaries of Corporation 1 that will be transferred to Corporation 2. One of the business purposes for this transaction is to facilitate a subsequent tax-free acquisition by Corporation 3 in the merger described below with Corporation 2, which was incorporated on Date 2. (A supplemental request for rulings pursuant to sections 355 and 368(a)(i)(D) was filed with another office of the Service concerning this merger transaction.)

Also, as part of this split off/spin off transaction, Corporation 1 expects to distribute Corporation 2 common stock to Corporation 7 in exchange for debt security of Corporation 1. This common stock of Corporation 2 will be converted in the merger described below into shares of Corporation 4. Pursuant to the merger agreement, Corporation 7 will receive shares of nonvoting Corporation 4 stock to the extent that the aggregate voting power of Corporation 4 stock held by Corporation 7 and its affiliates immediately after the merger would exceed Percentage 3.

The merger transaction

This transaction, with certain intermediary steps, will result in the merger of Corporations 2 and 3 to form Corporation 4. After the merger, Corporations 2 and 3 will each be a wholly owned subsidiary of Corporation 4.

At the time of the transactions, Corporation 2 will have outstanding shares of common stock equal to Amount 1, as well as outstanding options for a further Amount 2 shares. Corporation 3 will have outstanding shares of common stock equal to Amount 3, as well as outstanding options for a further Amount 4 shares of common stock.

Once the merger is completed, Corporation 2 shareholders will hold approximately Amount 5 shares of common stock in Corporation 4, with a further Amount 6 options, a greater than 50 percent interest in Corporation 4. Corporation 3 shareholders will hold approximately Amount 7 shares in Corporation 4, with a further Amount 8 options, a less than 50 percent interest in Corporation 4.

After the completion of the merger, the board of directors of Corporation 4 will consist of

Amount 9 members. Corporation 1 and Corporation 3 will each designate an equal number of directors, and the remaining directors will be designated by the two companies jointly.

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 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) and again on February 20, 2002 (67 Fed Reg 7,630), which may be relied upon for changes of ownership or control occurring prior to January 1, 2004, 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. (Hereinafter, a reference to these Q&A’s will be to both the Q&A’s published in 1989 and to those in 2002.)

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).

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 split-off/spin-off and the merger as two separate transactions, after the split-off/spin-off, Corporation 1 will have transferred to Corporation 2 certain assets. These assets are assumed to have a value greater than one-third of the value of Corporation 1's assets (including subsidiary corporations that are part of its affiliated group). Corporation 1 will therefore have surrendered ownership of a substantial portion of its assets, as described in Q&A 29(a). However, Corporation 1 shareholders will own over 50% of the stock of the entity to which ownership of those assets has passed, Corporation 2. Thus, according to Q&A 29(b)(3) and (4), and Example 3 of Q&A 29(d), this transfer will not be considered a change in ownership of a substantial portion of the assets of Corporation 1 for purposes of section 280G. Q&A's 27 and 28 will not apply to this transaction because Corporation 1 will not have departed with any of its stock

and because there will be not be a change in the composition of Corporation 1's board of directors as a result of the transaction.

Q&A's 27 and 28 do not apply to the Corporation 1 stock transferred to Corporation 7 because that stock comprises less than 50 percent and less than 20 percent of Corporation 1's outstanding stock by voting power and value in the case of Q&A 27, and by voting power in the case of Q&A 28.

After the merger, Corporation 2 will have surrendered its stock in exchange for Corporation 4 stock. According to Q&A 27, this would result in a change of ownership of Corporation 2. However, the former shareholders of Corporation 2 will own, after the merger, greater than 50% of the stock of Corporation 4. According to Example (3) in Q&A 27, this would imply that Corporation 2 does not undergo a change of control. Corporation 3, however, will experience such a change.

After the merger, the former shareholders of Corporation 2 will hold approximately Percentage 1 of Corporation 4. The former shareholders of Corporation 3 will hold approximately Percentage 2 of the shares of Corporation 4, an amount less than 50% but greater than 20%. For purposes of determining the percentage of Corporation 4 that, after the exchange, will be held by Corporations 2 and 3, the Corporation 3 stock owned by shareholders of Corporation 2 and the Corporation 2 stock held by shareholders of Corporation 3 prior to the transactions is ignored. The merger will result, constructively, in an acquisition of greater than 20% of Corporation 2's stock by more than one person acting as a group, as described by Q&A 28. Under this Q&A, this creates a presumption that there is an effective change of control. However, this presumption may be rebutted by factors which show that the merger will not cause a transfer of the power to control the management of Corporation 2 (directly or indirectly) to another person or group.

After the merger, former shareholders of Corporation 2 will hold greater than 50% of the shares of Corporation 4. The board of directors for Corporation 4 will be chosen jointly by Corporation 1 (whose shareholders are also the shareholders of Company 2) and Corporation 3. Therefore, the merger will not cause a transfer of the power to control the management of Corporation 2 (directly or indirectly) to another person or group, and Corporation 2 will not undergo a change in effective control.

Pursuant to the merger between Corporation 2 and Corporation 4, none of the assets of Corporation 2 will have changed hands. Thus, there will be no change in the ownership of a substantial portion of the assets, as described in Q&A 29.

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

1. The split-off/spin-off 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 Corporation 1.
2. The provisions of sections 280G and 4999 will not apply to any payments

made contingent upon the split-off/spin-off from Corporation 1 or Corporation 2 to, or for the benefit of, the employees, former employees, or service providers of Corporation 1, Corporation 2, or their respective subsidiaries.

3. 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 Corporation 2. Corporation 3, however, will undergo a change in control.

4. The provisions of sections 280G and 4999 will not apply to any payments made contingent upon the merger by Corporation 2 or Corporation 1 to, or for the benefit of, the employees, former employees, or service providers of Corporation 1, Corporation 2, or their respective subsidiaries.

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.

Sincerely,

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

Enclosure:

Copy for 6110 purposes

cc: