

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:

November 4, 1998

Acquiring =

Acquiring Sub =

Target =

Buyer =

Year 1 =

Date W =

Date Y =

Date X =

Group B =

Group C =

Group D =

f =

g =

h =

i =

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i =

m =

This is in response to your letter of June 17, 1998, 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 Target, or in the change in the ownership of a substantial portion of the assets of Target within the meaning of section 280G(b)(2) of the Code. The facts as submitted are set forth below.

Acquiring is a widely-held, publicly traded corporation. As of Date X, immediately prior to the Merger, there were f shares of Acquiring voting stock outstanding, which were held by approximately g persons.

Target, a widely-held, publicly traded corporation had h shares of common stock outstanding as of Date Y, which were held by approximately i persons.

In Year 1, Buyer commenced a tender offer for the stock of Target, which Target's board of directors determined was not in the best interests of Target. Target's board of directors approved certain severance agreements with senior executives and modified an existing employment agreement and existing senior executive severance pay plan. The terms of these agreements were amended later in Year 1 in response to an increased offer from Buyer.

Later in Year 1, Acquiring expressed interest in acquiring Target in a taxable transaction. Acquiring, Acquiring Sub (a subsidiary of Acquiring), and Target entered into a Merger Agreement dated Date W. The Merger Agreement was approved by both the Acquiring and the Target shareholders. On Date X, pursuant to the Merger Agreement, Acquiring Sub merged with and into Target and Target became a wholly owned subsidiary of Acquiring. The directors of Acquiring Sub became the directors of Target.

Pursuant to the Merger Agreement, the former Target shareholders received Acquiring stock and cash. The former Target shareholders acquired m percent of the outstanding Acquiring stock. Following the Merger, Group B, a pre-Merger Acquiring shareholder, holds j percent of the voting power in Acquiring.

Group C, a pre-Merger Acquiring shareholder, has the right to name one nominee on each management slate of nominees to the board of directors of Acquiring.

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There is no agreement binding any Acquiring shareholder to vote for the nominee of Group C. Group C's ownership decreased to less than five percent following the Merger.

Group D held a greater than five percent ownership interest in Acquiring prior to the Merger. Group D's ownership interest decreased to less than five percent following the Merger.

Acquiring represents that neither Group B, Group C, Group D, nor any other shareholder of Acquiring has any agreement, written or unwritten, express or implied, to act in concert to control Acquiring (other than agreements that may exist among members of the same group). Acquiring also represents that the management of Acquiring has no knowledge that any holders of Acquiring stock have any such agreement (other than the agreements that may exist among members of the same group).

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 280G(d)(5) provides that all members of the same affiliated group shall 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), 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

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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.

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 Merger, the Target shareholders will have acquired more than 50 percent of the value of the outstanding Acquiring stock.

Viewing the merger from Acquiring's perspective, Acquiring surrendered potential ownership or control when it issued its stock to Target's shareholders in consideration for Target's stock. Since Target's shareholders acquired sufficient stock value and voting power due to this transaction, Acquiring experienced a change of ownership under Q&A 27.

Viewing the merger from Target's perspective, all of Target's stock was transferred to Acquiring in consideration for the issuance of Acquiring stock to Target

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shareholders, which resulted in Acquiring's shareholders receiving a greater than 20 percent voting interest in Target. Accordingly, under Q&A 28, it is presumed that Target experienced a change in effective control.

However, the facts submitted indicate that the shareholders will not act in a concerted way to control the management and policies of Target. The facts also indicate that Target's board of director's was replaced by directors whose appointment was endorsed by a majority of Target's board of directors prior to the date of appointment.

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

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

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 12.05 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, 48 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

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Sincerely yours,

ROBERT B. MISNER
Assistant Chief, Branch 4
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure:

Copy for 6110 purposes