

Internal Revenue Service

Department of the Treasury

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Corporation A =

Sub A =

Corporation B =

Year W =

Dat X =

Date Y =

m =

Shareholder C =

n =

o =

p =

q =

This is in response to your letter of October 7, 1998, requesting rulings under section 280G of the Internal Revenue Code. Specifically you requested a ruling that, under the facts outlined below, neither the approval nor the implementation of the Merger described below constitutes a change in the ownership or effective control of

Corporation B, or in the change in the ownership of a substantial portion of the assets of Corporation B within the meaning of section 280G(b)(2) of the Code. The facts as submitted are set forth below.

Prior to the Merger described below, Corporation A and Corporation B were widely-held, publicly traded corporations. In Year W, a Merger Agreement was entered into between Corporation A, Sub A, a wholly-owned subsidiary of Corporation A, and Corporation B. Pursuant to the Merger Agreement, Corporation B was to be merged into Sub A. The boards of directors of both Corporation A and Corporation B approved the Merger on Date X. On Date Y, Corporation B's shareholders approved the Merger, which was consummated on that day.

Pursuant to the Merger Agreement, each Corporation B shareholder was entitled to receive either Corporation A common stock; cash; or a combination of Corporation A stock and cash in exchange for their Corporation B stock. Following the Merger, the former Corporation B shareholders held m percent of the outstanding Corporation A stock. Shareholder C, a pre-Merger shareholder of both Corporation A and Corporation B, holds approximately n percent of the voting power in Corporation A following the Merger. Shareholder C has no representatives on Corporation A's board of directors or among Corporation A's management.

Following the Merger, the Board of Directors of Corporation A consists of o members from the pre-Merger Corporation A board of directors and p members from the pre-Merger Corporation B board of directors. The Corporation B board of directors approved the composition of the post-Merger Corporation A board of directors.

Corporation B had Employment Agreements with q executives. It has been represented that each of these executives is a disqualified individual for purposes of sections 280G and 4999 of the Internal Revenue Code. Corporation B also had severance policies affecting certain other employees. Pursuant to the terms of the Employment Agreements and the severance policies, the employees are entitled to receive certain payments and benefits if his or her employment is terminated following the Merger.

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 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 pre-Merger Corporation B shareholders will have acquired more than 50 percent of the value of the outstanding Corporation A stock.

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

Viewing the merger from Corporation B's perspective, all of Corporation B's stock was transferred to Corporation A in consideration for the issuance of Corporation A stock to Corporation B's shareholders, which resulted in Corporation A's shareholders receiving a greater than 20 percent indirect voting interest in Corporation B. Accordingly, under Q&A 28, it is presumed that Corporation B experienced a change in effective control.

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

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

- 1) Provided that after the Merger the pre-Merger Corporation A shareholders do not act in a concerted way to control the management and policies of Corporation B, the Merger will not cause a change in the ownership or effective control of Corporation B, nor will it cause a change in the ownership of a substantial portion of Corporation B's assets within the meaning of section 280G of the Code.
- 2) The provisions of section 4999 of the Code do not apply to any payments that are received by employees or former employees of Corporation B 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. 99-1, 1999-1 I.R.B. 6, 47 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.

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