

Internal Revenue Service

Department of the Treasury

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Date:
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Corporation X =

Corporation Y =

Parent =

Date X =

Date Y =

Date Z =

Individual B =

f =

g =

h =

i =

k =

l =

m =

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This is in response to your letter of September 8, 1998, requesting rulings under section 280G of the Internal Revenue Code. Specifically you requested a ruling that, under the facts outlined below, there will not be a change in the ownership or effective control of Corporation X, nor a 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 Merger described below, both Corporation X and Corporation Y were widely-held, publicly traded corporations. As of Date X, Corporation X had f shares of common stock and g shares of Class A stock outstanding. Also as of Date X, Corporation Y had h shares of common stock outstanding.

Corporation X and Corporation Y entered into a Merger Agreement, which was approved by the shareholders of both corporations on Date Y. To effect the Merger, Parent was created to become a holding company for Corporation X and Corporation Y and their respective subsidiaries. Parent formed two wholly owned subsidiaries, Sub X and Sub Y. On Date Z, in accordance with the terms of the Merger Agreement, Sub X merged into Corporation X, with Corporation X surviving. Sub Y merged into Corporation Y, with Corporation Y surviving. Both Corporation X and Corporation Y became wholly owned subsidiaries of Parent with the former Corporation X and Corporation Y shareholders owning stock in Parent.

Pursuant to the Merger Agreement, each share of Corporation Y stock was converted into j shares of Parent stock and each share of Corporation X stock was converted into k shares of Parent stock. The former Corporation X shareholders acquired l percent of the outstanding Parent stock. Following the Merger, Individual B, a former Corporation Y shareholder, holds approximately m percent of the voting power in Parent.

Pursuant to the Merger Agreement, one-half of the members of the Board of Directors of Parent will be designated by Corporation X and one-half will be designated by Corporation Y.

Certain officers of Corporation X and its subsidiaries had employment agreements with Corporation X. It has been represented that each of these officers is a disqualified individual for purposes of sections 280G and 4999 of the Internal Revenue Code. Pursuant to the terms of the Employment Agreements, the consummation of the Mergers entitled the officers to terminate his or her employment and receive certain payments and benefits. Parent terminated the Employment Agreements effective Date Z and made payments to the officers.

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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.

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

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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."

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).

It has been represented that, immediately following the Merger, the former Corporation X shareholders will have acquired more than 50 percent of the value of the outstanding Parent stock.

Viewing the merger from Corporation X's perspective, Corporation X surrendered potential ownership or control when it issued its stock to Parent in consideration for the issuance of Parent stock to the Corporation X shareholders. Since Corporation X's shareholders acquired sufficient stock value and voting power 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 Corporation Y shareholders, which resulted in Corporation Y's shareholders receiving a greater than 20 percent 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.

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The facts submitted, however, indicate that the Corporation Y shareholders will not act in a concerted way to control the management and policies of Corporation X. The facts also indicate that Parent's board of director's was approved by both Corporation X and Corporation Y and that neither corporation appointed a majority of the directors.

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

- 1) Provided that after the Merger the shareholders of Corporation Y do not act in a concerted way to control the management and policies of Corporation X, neither the approval nor the implementation of the Merger will cause a change in the ownership or effective control of Corporation X, nor will it cause a change in the ownership of a substantial portion of Corporation X'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 X and its subsidiaries in connection with the approval and the implementation of 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. Specifically, no opinion was requested and none is expressed on the federal income tax consequences of the Mergers described above.

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.

Sincerely yours,

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ROBERT B. MISNER
Assistant Chief, Branch 4
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(Employee Benefits and
Exempt Organizations)

Enclosure:
Copy for 6110 purposes