

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:EBEO:Br.4-PLR-119572-99

Date:

March 31, 2000

Company =

Date A =

Executive =

x =

y =

z =

b% =

Date C =

d% =

Date E =

Date F =

. :

This is in response to the letter dated December 9, 1999, submitted by your authorized representative requesting rulings under section 162(m) of the Internal Revenue Code. Specifically, the rulings requested are that certain nonqualified stock options are "performance-based compensation" under section 162(m)(4)(C) and that the date of the grant of these options for purposes of section 162(m) is the actual date of grant even though the grant is subject to subsequent shareholder approval. The facts, as submitted, are set forth below.

Company adopted and maintains the Company 1995 Incentive Stock Plan

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(Plan). The Plan is intended to provide incentives to attract and retain highly competent persons as officers and key employees of Company and its subsidiaries, as well as independent contractors who provide consulting or advisory services, by providing them the opportunity to acquire Company common stock or to receive monetary payments based on the value of such stock. Plan is administered by the Compensation Committee (Committee) of the Company's Board of Directors. Company represents that members of the Committee are members of the Board who qualify as outside directors under section 167(e)(3) of the Code and section 1.162-27(e)(3) of the Income Tax Regulations.

Awards under Plan may be granted in any one, or a combination, of the following: (i) stock options, (ii) stock appreciation rights, (iii) stock awards, (iv) performance shares, and (v) performance units. Plan provides that stock options may be in the form of either incentive stock options, within the meaning of section 422 of the Code, or nonqualified stock options. Under Plan, the number of shares subject to stock options granted during any calendar year to any one participant cannot exceed 100,000 shares (Annual Grant Limit).

On Date A, Company entered into an employment agreement (Agreement) with Executive. Under the Agreement, Executive's employment with Company commenced on the date of Agreement and anticipates that Executive will become a covered employee for purposes of section 162(m) of the Code. During the period of employment under the Agreement, Executive will receive a base salary, annual bonuses, and nonqualified stock options under Plan.

On Date A, Company granted to Executive (i) a nonqualified stock option under Plan covering x shares of Company common stock at an exercise price equal to the mean between the high and low prices at which the common stock traded on the date of the grant as reported on the NASDAQ, and (ii) a nonqualified stock option (Excess Option) under Plan covering y shares of Company common stock at an exercise price equal to the mean between the high and low prices at which the common stock traded on the date of the grant as reported on the NASDAQ. Because the Excess Option is in excess of Plan's current Annual Grant Limit, the Excess Option will be exercisable only if shareholder approval is obtained of an amendment increasing the Plan's Annual Grant Limit (the Amendment). The nonqualified stock options granted to Executive do not have a readily ascertainable fair market value.

The Board of Directors has adopted the Amendment to increase to z the current Annual Grant Limit. The Amendment to Plan will be submitted to a vote of Company shareholders no later than the 2000 Annual Meeting of Shareholders. If shareholder approval of the Amendment is obtained, the nonqualified stock options granted to Executive pursuant to the Agreement will generally become exercisable with respect to b% of the shares on Date C, and cumulatively, as to an additional d% of the shares subject to the options on each succeeding Date E, so that Executive will be fully vested

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in all nonqualified stock options granted under Agreement as of Date F. There are other acceleration events in the case of a change in control or certain terminations of Executive's employment provided that shareholder approval of the Amendment is obtained.

Section 162(a)(1) of the Code provides that there will be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 162(m)(1) of the Code provides that in the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds \$1,000,000.

Under section 162(m)(4)(C) of the Code, applicable employee remuneration does not include any remuneration payable solely on account of the attainment of one or more performance goals, but only if (i) the performance goals are determined by a compensation committee of the board of directors of the taxpayer which is comprised solely of 2 or more outside directors; (ii) the material terms under the remuneration is to be paid, including the performance goals, are disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before the payment of such remuneration; and (iii) before any payment of such remuneration, the compensation committee referred to in clause (i) certifies that the performance goals and any other material terms were in fact satisfied.

Section 1.162-27(c)(2)(i) of the regulations defines a "covered employee" as any individual who on the last day of the taxable year is (A) the chief executive officer of the corporation or is an individual acting in such capacity, or (B) among the four highest compensated officers (other than the chief executive officer).

Section 1.162-27(c)(2)(ii) of the regulations provides that whether an individual is the chief executive officer described in section 1.162-27(c)(2)(1)(A) or an officer described in section 1.162-27(c)(2)(i)(B) is determined pursuant to the executive compensation disclosure rules under the Exchange Act.

Section 1.162-27(c)(4) of the regulations defines the compensation committee as the committee of directors (including any subcommittee of directors) of the publicly held corporation that has the authority to establish and administer performance goals described in paragraph (e)(2) of this section, and to certify that performance goals are attained, as described in paragraph (e)(5) of this section.

Under section 1.162-27(e)(4) of the regulations the material terms of the

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performance goal under which the compensation is to be paid must be disclosed to and subsequently approved by the shareholders of the publicly held corporation before the compensation is paid. The requirements of paragraph (e)(4) are not satisfied if the compensation would be paid regardless of whether the material terms are approved by the shareholders.

Section 1.162-27(e)(4)(vi) of the regulations provides that once the material terms of a performance goal are disclosed and approved by shareholders, no additional disclosure or approval is required unless the compensation committee changes the material terms of the performance goal. If, however, the compensation committee has the authority to change the targets under a performance goal after shareholder approval of the goal, material terms of the performance goal must be disclosed to and approved by shareholders no later than the first shareholder meeting that occurs in the fifth year following the year in which shareholders previously approved the performance goal.

Section 1.162-27(e)(2) of the regulations provides that qualified performance-based compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals. A performance goal is considered preestablished if it is established in writing by the compensation committee not later than 90 days after the commencement of the period of service to which the performance goal relates, provided that the outcome is substantially uncertain at the time the compensation committee establishes the goal. However, in no event will a performance goal be considered to be preestablished if it is established after 25 percent of the period of service (as scheduled in good faith at the time the goal is established) has elapsed.

Section 1.162-27(e)(2)(vi) of the regulations provides that compensation attributable to a stock option is deemed to satisfy the requirements of paragraph (e)(2) if the grant or award is made by the compensation committee; the plan under which the option is granted states the maximum number of shares with respect to which options may be granted during a specified period to any employee; and, under the terms of the option, the amount of compensation the employee could receive is based solely on an increase in the value of the stock after the date of the grant or award.

Assuming the Amendment to Plan is disclosed to and approved by Company shareholders before any remuneration is paid and, absent their approval, the options will not be exercisable, we rule as follows:

1. The nonqualified stock options granted to Executive pursuant to the Agreement qualify as "performance-based compensation" within the meaning of section 162(m)(4)(C); and
2. The grant date of the Excess Option for purposes of section 162(m) is the actual

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date of grant even though the grant is subject to subsequent shareholder approval of the Amendment.

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. Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the above-described transaction under any other provisions of the Code.

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

Sincerely,

Robert Misner
Robert Misner
Assistant Chief, Branch 4
Office of the Associate Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure: Copy for 6110 purposes