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Date:

July 28,2000.

LEGEND:

Company A =

Date 1 =

Company B =

Executive =

Company C =

Date 2 =

\$d =

Year DD =

Year E =

\$f =

\$g =

\$h =

\$i =

\$j =

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\$k =\$l =

Date 3 =

\$m =

Year N =

Year P =

\$q =\$r =\$s =

Date 4 =

\$t =\$u =

Year V =

Year W =

This letter is in response to the letter dated March 9, 2000, submitted by your authorized representative requesting rulings under section 280G of the Internal Revenue Code. Specifically, rulings were requested concerning whether a portion of the payments related to accelerated vesting of options is treated as contingent on a change in ownership or control; whether certain severance payments are contingent on a change in ownership or control; and the calculation of the base amount. The facts, as submitted, are set forth below.

On Date 1, Company B entered into a "Change in Control Agreement" (Date 1 Agreement) with Executive. The Date 1 Agreement provided that if Executive's employment with Company B terminated, other than by reason of death or disability, during a five-year period beginning on the date a change in control occurred, Company B would pay Executive the following amounts within 10 days after the date of termination: (i) Executive's full base salary and vacation pay (for vacation not taken)

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accrued but unpaid through the date of termination at the rate in effect at the time of termination; (ii) an amount equal to the product of Executive's normative bonus under the applicable bonus plan for the fiscal year including the date of termination and a fraction, the numerator of which is the number of days in such fiscal year through the date of termination and the denominator of which is 365; (iii) the amount in the bonus bank for Executive under all bonus plans in which Executive participated; and (iv) a lump-sum severance payment in an amount equal to 440 percent of Executive's annual compensation, meaning an amount equal to the aggregate of Executive's annual cash compensation (other than bonus) from Company B and its subsidiaries in effect immediately prior to the date of termination or change in control and the highest bonus payable to Executive for any of Company B's three fiscal years preceding the date of termination or change in control, whichever is greater.

Additionally, the Date 1 Agreement provided that on a change in control, all of Executive's benefits accrued under the supplemental retirement plans, excess retirement plans, and deferred compensation plans maintained by Company B or any of its subsidiaries would become immediately vested in full.

On Date 2, a change in control, within the meaning of the Date 1 Agreement and section 280G of the Code, occurred. On the change in control, Executive elected to continue employment with the new company, Company A. At the time the change in control occurred, Executive held unvested, nonstatutory, compensatory options to purchase Company B stock. The options had an ascertainable value at that date. Pursuant to the Date 1 Agreement, the Company B options became immediately vested on the change in control. The value of the acceleration of these options was calculated at \$d. Because all other payments under the Date 1 Agreement were contingent on Executive's termination of employment which did not occur on the change, no other payments were made pursuant to that agreement on or about Date 2. Executive's compensation that was payable by Company B and includible in Executive's gross income for Year DD through Year E was \$f; \$g; \$h; \$i; and \$j, respectively. Thus, Executive's base amount was calculated at \$k [$\$f + \$g + \$h + \$i + \j]/5. Because the value of the accelerated options exceeded three times the base amount, it was determined that Executive had received an excess parachute payment equal to \$l.

On Date 3, Company A was acquired by Company C, resulting in a change in control with respect to Company A within the meaning of section 280G of the Code. At the time of this change in control, Executive held unvested, nonstatutory, compensatory stock options to purchase Company A stock. The options had an ascertainable value on that date. On the change in control, all Company A stock options held by Executive became immediately vested. The value of the acceleration of these options was calculated at \$m. Executive's compensation that was payable by Company A and includible in Executive's gross income for Year N through Year P was \$i; \$j; \$q; \$r; and \$s, respectively.

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On Date 4, Executive terminated employment with Company C. This resulted in Executive receiving lump-sum severance payments of \$t, an amount equal to 440 percent of Executive's annual compensation, under the Date 1 Agreement. Additionally, on the termination of employment Executive received an accelerated payment of a prorated portion of the normative bonus for the year. The value of the acceleration of the normative bonus was calculated at \$u.

Neither the accelerated vesting of Company A options nor the accelerated payment of the normative bonus was provided for under the Date 1 Agreement.

Executive is a disqualified individual within the meaning of section 280G(c) of the Code.

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 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, published in the Federal Register on May 5, 1989 (54 Fed. Reg. 19,390), provides guidance concerning parachute payments.

Q&A 11(a) of the proposed regulations provides that, for purposes of section 280G, all payments, in whatever form, are payments in the nature of compensation if they arise out of an employment relationship or are associated with the performance of services. Payments in the nature of compensation include (but are not limited to) wages and salary, bonuses, severance pay, fringe benefits, and pension benefits and other deferred compensation (including any amount characterized as interest thereon).

Q&A 11(b) provides that transfers of property are treated as payments in the nature of compensation for purposes of Q&A 11.

Under Q&A 12(a), a transfer of property is considered a payment made (or to be

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made) in the taxable year in which the property transferred is includible in the gross income of the disqualified individual under section 83 and the regulations thereunder. In general, such a payment is considered made (or to be made) when the property is transferred (as defined in section 1.83-3(a)) to the disqualified individual and becomes substantially vested (as defined in section 1.83-3(b)) in such individual.

Regarding nonqualified stock options, Q&A 13(a) provides that if an option to which section 421 does not apply has an ascertainable fair market value (whether or not readily ascertainable as defined in section 1.83-7(b)) at the time the option becomes substantially vested (as defined in section 1.83-3(b)), the option shall be treated as property that is transferred not later than the time at which the option becomes substantially vested. Thus, for purposes of this section, the vesting of such option is treated as a payment in the nature of compensation.

Q&A 21(a) defines compensation as the compensation which was payable by the corporation with respect to which the change in ownership or control occurs ("changed corporation"), by a predecessor entity, or by a related entity. Such compensation is determined without regard to sections 125, 402(a)(8), and 402(h)(1)(B), and in the case of employer contributions made pursuant to a salary reduction agreement, without regard to section 403(b). Thus, for example, compensation includes elective or salary reduction contributions to a cafeteria plan, cash or deferred arrangement, or tax-sheltered annuity.

Q&A 21(b) explains that a predecessor entity is any entity which, as a result of a merger, consolidation, purchase or acquisition of property or stock, corporate separation, or other similar business transaction transfers some or all of its employees to the changed corporation or to a related entity or to a predecessor entity of the changed corporation.

Q&A 22(a) provides that a payment is treated as contingent on a change in ownership or control if the payment would not, in fact, have been made had no change in ownership or control occurred. A payment generally is to be treated as one which would not, in fact, have been made in the absence of a change in ownership or control unless it is substantially certain, at the time of the change, that the payment would have been made whether or not the change occurred. Property that becomes substantially vested as a result of a change in ownership or control will not be treated as a payment which was substantially certain to have been made whether or not the change occurred.

A payment is also treated as contingent on the change in ownership or control under Q&A 22(b) if (1) the payment is contingent on an event that is closely associated with a change in ownership or control, (2) a change in ownership or control actually occurs, and (3) the event is materially related to the change in ownership or control. A payment is treated as contingent on a change in ownership or control unless it is substantially certain, at the time of the event, that the payment would have been made

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whether or not the event occurred. An event is considered closely associated with a change in ownership or control if the event is of a type often preliminary or subsequent to, or otherwise closely associated with, a change in ownership or control. An event will be presumed to be materially related to a change in ownership or control if the event occurs within the period beginning one year before and ending one year after the date of change in ownership or control.

Under Q&A 22(c) a payment that would in fact have been made had no change in ownership or control occurred is treated as contingent on a change in ownership or control if the change accelerates the time at which the payment is made. Thus, for example, if a change in ownership or control accelerates the time of payment of vested deferred compensation, the payment may be treated as contingent on the change.

Q&A 24(a) generally provides that the full amount of the payment is treated as contingent on a change in ownership or control. However, in certain circumstances, described in Q&A 24(b) and (c), only a portion of the payment is treated as contingent on the change.

Q&A 24(b) applies if it is substantially certain, at the time of the change, that the payment would have been made whether or not the change occurred, but the payment is treated as contingent on the change solely because the change accelerates the time at which the payment is made. In such a case, the portion of the payment that is treated as contingent on the change in ownership or control is the amount by which the amount of the accelerated payment exceeds the present value of the payment absent the acceleration. If the amount of such a payment absent the acceleration is not reasonably ascertainable, and the acceleration of the payment does not significantly increase the present value of the payment absent the acceleration, the present value of the payment absent the acceleration is treated as equal to the amount of the accelerated payment.

Q&A 24(c)(1) applies in the case of a payment that is accelerated by a change in ownership and control and that was substantially certain, at the time of the change, to have been made without regard to the change if the disqualified individual had continued to perform services for the corporation for a specified period of time. In such a case, the portion of the payment that is treated as contingent on the change in ownership or control is the lesser of (i) the amount of the accelerated payment or (ii) the amount by which the payment exceeds the present value of the payment that was expected to be made absent the acceleration (determined without regard to the risk of forfeiture for failure to continue to perform services), plus an amount, as determined in Q&A 24(c)(2), to reflect the lapse of the obligation to continue to perform services.

Under Q&A 24(c)(2), the amount reflecting the lapse of the obligation to continue to perform services depends on all the facts and circumstances. In no event, however, will such amount be less than 1 percent of the amount of the accelerated payment

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multiplied by the number of full months between the date that the individual's right to receive the payment is not subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture (within the meaning of section 1.83-3(c)) and the date that, absent the acceleration the individual's right to receive the payment would not have been subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture.

Under Q&A 31 the present value of a payment is determined as of the date on which the change in ownership or control occurs, or, if a payment is made prior to such date, the date on which the payment is made.

Under Q&A 33, in certain cases, it may be necessary to apply the 3-times-base-amount test of Q&A 30 or to allocate a portion of the base amount to a payment at a time when the present value of all such payments cannot be determined with certainty because the time, amount, or right to receive one or more such payments is contingent on the occurrence of an uncertain future event or condition. For example, a disqualified individual's right to receive a payment may be contingent on the involuntary termination of such individual's employment with the corporation. In such a case, a reasonable estimate of the time and amount of the future payment shall be made, and the present value of the payment will be determined on the basis of this estimate. For purposes of making this estimate, an uncertain future event or condition that may reduce the present value of a payment will be taken into account only if the possibility of the occurrence of the event or condition can be determined on the basis of generally accepted actuarial principles or can be otherwise estimated with reasonable accuracy.

The base amount of a disqualified individual, as defined in Q&A 34, is the average annual compensation (as defined in Q&A 21) which was includible in the gross income of such individual for the taxable years in the base period.

The base period of a disqualified individual, as explained in Q&A 35, is the most recent 5 taxable years of the individual ending before the date of the change in ownership or control.

According to Q&A 38, the portion of the base amount allocated to any parachute payment is the amount that bears the same ratio to the base amount as the present value of such parachute payment bears to the aggregate present value of all parachute payments made or to be made to (or for the benefit of) the same disqualified individual). Thus, the portion of the base amount allocated to any parachute payment is determined by multiplying the base amount by a fraction, the numerator of which is the present value of such parachute payment and the denominator of which is the aggregate present value of all such payments.

The accelerated vesting of Company B options occurred as a result of the Date 2 change in control. The payment related to the accelerated vesting of the Company B

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options was substantially certain to have been made without regard to the Date 2 change in control if Executive had continued to perform services for Company B. Thus, only part of the payment related to the accelerated vesting of the Company B options is considered contingent on the Date 2 change. The part considered contingent on the change is the lesser of (1) the amount of the accelerated payment, or (2) the amount by which the amount of the accelerated payment exceeds the present value of the payment that was expected to be made absent the acceleration (determined without regard to the risk of forfeiture for failure to continue to perform services), plus an amount to reflect the lapse of the obligation to continue to perform services.

The accelerated vesting of Company A options occurred as a result of the Date 3 change in control. The payment related to the accelerated vesting of the Company A options was substantially certain to have been made without regard to the Date 3 change in control if Executive had continued to perform services for Company A. Thus, only part of the payment related to the accelerated vesting of the Company A options is considered contingent on the Date 3 change. The part considered contingent on the change is the lesser of (1) the amount of the accelerated payment, or (2) the amount by which the amount of the accelerated payment exceeds the present value of the payment that was expected to be made absent the acceleration (determined without regard to the risk of forfeiture for failure to continue to perform services), plus an amount to reflect the lapse of the obligation to continue to perform services.

The lump-sum severance payments made to Executive pursuant to the Date 1 Agreement are contingent on the Date 2 change in control. The lump-sum severance payments are contingent on the Date 2 change because the payment was contingent on an event that was closely associated with a change in ownership or control; a change in ownership or control actually occurred; and the event is materially related to the change in ownership or control.

The portion of the Year V base amount that was allocated to the payments contingent on the Date 2 change of control must be reallocated under Q&As 31, 33, and 38 to reflect the lump-sum severance payments made to Executive due to the Date 4 termination of employment.

For purposes of determining Executive's base amount under Q&A 34, Company B is considered a predecessor entity with respect to Company A for purposes of Q&A 21. Thus, Executive's base amount with respect to the Date 3 change in control is equal to the average annual compensation paid by Company A (the changed corporation) and Company B (the predecessor entity) and that was includible in Executive's gross income for the period of Year N through Year P.

Accordingly, based on the facts submitted, we rule as follows:

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1. The accelerated vesting of Company B options that occurred in Year V pursuant to the Date 1 Agreement as a result of the Date 2 change of control is considered contingent on the Date 2 change of control to the extent of the lesser of (1) the amount of the accelerated payment, or (2) the amount by which the amount of the accelerated payment exceeds the present value of the payment that was expected to be made absent the acceleration, without regard to risk of forfeiture for failure to continue services, plus an amount to reflect the lapse of the obligation to continue to perform services, calculated by multiplying 1 percent of the amount of the accelerated payment by the number of full months between the date that Executive vested in the Company B options because of the change in control, and the date that, absent the acceleration, Executive would have vested in the options;
2. The accelerated vesting of the Company A options that occurred in Year W is considered contingent on the change in control that occurred on Date 3 to the extent of the lesser of (1) the amount of the accelerated payment, or (2) the amount by which the amount of the accelerated payment exceeds the present value of the payment that was expected to be made absent the acceleration, without regard to risk of forfeiture for failure to continue services, plus an amount to reflect the lapse of the obligation to continue to perform services, calculated by multiplying 1 percent of the amount of the accelerated payment by the number of full months between the date that Executive vested in the Company A options because of the change in control, and the date that, absent the acceleration, Executive would have vested in the options;
3. The lump-sum severance payments made to Executive pursuant to the Date 1 Agreement as a result of the termination of Executive's employment on Date 4 is considered contingent on the change of control that occurred on Date 2 and not contingent on the change of control that occurred on Date 3;
4. The portion of the Year V base amount that is allocated to the excess parachute payment attributable to the accelerated vesting on Company B options in Year V may be calculated by determining the ratio of the value of such accelerated vesting to the total present value of the parachute payments contingent on the Date 2 change in control and multiplying that ratio by the Year V base amount. The remaining base amount may then be used to calculate the amount of the excess parachute payment attributable to the lump-sum severance payment made to Executive in Year W by subtracting the remaining base amount from the actual amount of the lump-sum severance payment received in Year W; and
5. Executive's base amount with respect to the change in control that occurred on Date 3 is equal to the average annual compensation that was payable by Company A (the changed corporation) and Company B (the predecessor entity) and that was includible in Executive's gross income for the period Year N through Year P [$\$i + \$j + \$g + \$r + \$s$]/5.

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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 reference above.

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. 00-4, 2000-1 I.R.B. 4, 47 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

This ruling is directed only to the taxpayer(s) 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.

Sincerely,
Robert Misner, Assistant Chief
Executive Compensation Branch
Office of the Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government Entities)

Copy for 6110 purposes