

INTERNAL REVENUE SERVICE

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January 13, 1999

Corporation X =

Corporation X Sub =

Corporation Y =

Corporation Y Sub =

Date A =

Date B =

Date C =

State Y =

d =

e =

f =

g =

h =

i =

m =

n =

This is in response to your letter of July 14, 1998, requesting rulings under section 280G of the Internal Revenue Code. Specifically, you requested rulings that under the facts outlined below, the merger of Corporation Y with and into Corporation X will constitute a change of control of Corporation X; and will not constitute a change in the ownership or effective control of Corporation Y, or a change in the ownership of a substantial portion of the assets of Corporation Y within the meaning of section 280G(b)(2) of the Code.

Corporation X and Corporation Y entered into an Agreement and Plan of Merger on Date A ("Merger Agreement"). The Merger Agreement has been approved by the Boards of Directors of both Corporation X and Corporation Y. The Merger will be effected in accordance with State Y law. The Merger is expected to close on Date C.

As of Date B, Corporation X had d shares of common stock outstanding, each of which includes an attached right to purchase Series A Preferred stock. Rights to purchase Series A Preferred stock are exercisable only in limited circumstances and any Series A Preferred stock would vote together with Corporation X common stock. Corporation X also has outstanding Series B Preferred Stock which does not currently possess any voting rights. Corporation X's outstanding common stock represents 100 percent of Corporation X's current voting power.

Corporation X owns 100 percent of the outstanding stock of Corporation X Sub.

Corporation X also had outstanding options to purchase e shares of Corporation X stock. These options have been granted to employees and directors of Corporation X and Corporation X Sub. A portion of these options are currently exercisable or will become vested at or prior to the closing of the Merger. Corporation X options to purchase f shares of Corporation X are not currently exercisable and will not be exercisable at the time of the consummation of the Merger.

As of Date B, Corporation Y had g shares of common stock outstanding, each of which includes an attached right to purchase Series A Preferred stock. Rights to purchase Series A Preferred stock are exercisable only in limited circumstances and any Series A Preferred stock would vote together with Corporation Y common stock. Corporation Y's outstanding common stock represents 100 percent of Corporation Y's current voting power.

Corporation Y owns all the outstanding stock of Corporation Y Sub.

Corporation Y also had outstanding options to purchase h shares of Corporation Y stock. All of the Corporation Y options are currently exercisable or will become exercisable upon consummation of the Merger.

In connection with the Merger, Corporation X has granted an option to purchase j percent of its stock to Corporation Y. Corporation Y has also granted an option to purchase j percent of its stock to Corporation X. As set forth in the respective Option Agreements, the options are only exercisable upon the occurrence of events outside the control of the option holder. The options expire upon consummation of the Merger.

Pursuant to the Merger Agreement, Corporation Y will merge with and into Corporation X with Corporation X being the surviving entity. Each issued and outstanding share of Corporation Y common stock will automatically be exchanged for m shares of Corporation X common stock, plus cash in lieu of fractional shares. Options to purchase Corporation Y stock will be converted into options to purchase Corporation X stock as set forth in the Merger Agreement. Corporation Y shareholders will acquire n percent of the outstanding Corporation X stock.

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

The Chief Executive Officer, the President, and each of the Executive Vice Presidents of Corporation Y and Corporation Y Sub have entered into Employment Agreements with Corporation Y and Corporation Y Sub which provide for cash payments and other benefits in the event of actual or constructive discharge. Pursuant to the Merger Agreement, Corporation X has agreed to assume these Employment Agreements and perform them as though the consummation of the Merger constitutes a constructive discharge of each of these individuals. Thus, at the time of, or immediately following the Merger, Corporation X will pay a cash amount to each individual and will provide certain additional benefits.

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. Q&A 27(c) provides that section 318(a) shall apply in determining stock ownership.

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 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. This presumption 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(c) contains the same language as Q&A 27(b) concerning when persons will be considered to be "acting as a group." Q&A 28(d) contains the same language as Q&A 27(c) concerning the application of section 318(a).

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).

In determining which of the outstanding stock options are considered to be stock for purposes of Q&A 27, 28 and 29, options which, at the time of the Merger, are exercisable, or are exercisable upon the occurrence of an insubstantial condition precedent are considered outstanding stock. See Rev. Rul. 89-64, 1989-1 C.B. 91. Conversely, options which, at the time of the Merger are not currently exercisable and are only exercisable upon the occurrence of a substantial condition precedent are not outstanding stock for purposes of Q&A 27, 28 and 29. The facts indicate that only the options exercisable at the time of the Merger are stock for purposes of section 280G.

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

Viewing the merger from Corporation Y's perspective, all of Corporation Y's assets were transferred to Corporation X in consideration for the issuance of Corporation X stock to Corporation Y shareholders. Thus, Q&A 29 applies to Corporation Y for purposes of determining whether it has undergone a change in ownership of a substantial portion of its assets. In accordance with Q&A 29(b), because the Corporation X stock that Corporation Y shareholders received in the merger represents a greater than 50 percent interest in Corporation X immediately after the merger in terms of total value, the ownership of Corporation Y assets will not be considered to have changed. In addition, since neither of the events discussed in Q&A 28 occurred in this case relative to Corporation Y, no presumption was created that Corporation Y experienced an effective change of control.

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

- 1) The merger of Corporation Y with and into Corporation X constitutes a change in the ownership of Corporation X within the meaning of section 280G.

2) The merger of Corporation Y with and into Corporation X will not constitute a change in the ownership or effective control of Corporation Y, nor will it cause a change in the ownership of a substantial portion of the assets of Corporation Y within the meaning of section 280G of the Code.

3) The payments made by Corporation X to former officers of Corporation Y as a result of the Merger and attributable to such former officer's employment with Corporation Y will not be subject to the excise tax under section 4999.

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. No ruling was requested and none is given regarding the federal income tax consequences of the merger 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 the 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