Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200104022**
Release Date: 1/26/2000
Index Number: 162.36-04

Person to Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC-PLR-113496-00
Date:
October 25, 2000.

Taxpayer =

Parent =
Target =
Merger Agreement =

Plan =
Year A =
Date B =
Date C =
Date D =
x =
y =
z =

This is in response to your June 29, 2000, letter from your authorized representative requesting rulings on the application of section 162(m)(4) of the Internal Revenue Code, and the regulations thereunder, to the assumption of Taxpayer's incentive compensation plan (Plan) by Parent in the transaction described below. Specifically, you requested rulings that following the transaction the Plan will continue to meet the shareholder approval requirement based on the approval of the Plan by the Taxpayer's shareholders and that the eligibility criteria of the Plan will not be considered to have been modified and therefore no additional shareholder approval will be required. The facts, as represented by Taxpayer, are as follows.

Pursuant to the Merger Agreement, Taxpayer will form a holding company (Parent). The shareholders of Taxpayer will exchange their Taxpayer common stock for Parent common stock. Taxpayer will become a wholly owned subsidiary of Parent.

Target will merge into Parent with the Target shareholders receiving x shares of Parent common stock and $y cash for each share of Target common stock. After the

Merger, Parent will remain the parent of Taxpayer and its subsidiaries and will become the parent of Target's subsidiaries.

In connection with the Merger, Taxpayer will restructure its corporate organization. This restructuring is the subject of a separate letter to be issued by the Office of the Associate Chief Counsel (Corporate). All of the corporations involved will remain within Taxpayer's affiliated group, under Parent as the new common parent.

Taxpayer's Plan, which was adopted by Taxpayer in Year A, authorizes a variety of stock-based awards. These awards include: 1) options; 2) stock awards consisting of one or more share of common stock granted to eligible participants; 3) stock appreciation rights; 4) performance shares; 5) phantom stock; and 6) dividend equivalents. The most recent approval of the Plan by Taxpayer's shareholders was on Date B.

The Plan was amended by Taxpayer's Board of Directors effective Date C to clarify the Plan's definition of "Subsidiary" and to modify the Plan's tax withholding rules. As of Date D, all awards under the Plan have consisted of stock options and restricted stock grants.

After the Merger Agreement is approved by the shareholders of Taxpayer and Target, the Board of Directors will approve the following administrative changes to the Plan: 1) references to Taxpayer will be changed to references to Parent; 2) references to Taxpayer's common stock will be changed to references to Parent's common stock; 3) the number of shares reserved for issuance under the Plan, and the maximum number of shares or maximum compensation that may be delivered or paid to a Plan participant in a fiscal year will be adjusted by multiplying such number by an exchange ratio equal to z. These adjustments will be the only adjustments made to the Plan in connection with the Merger and will have the effect of increasing the number of employees eligible for awards under the Plan.

Section 162(m) of the Code generally provides a limit of $1 million on the deduction for "applicable employee remuneration" paid during any taxable year for the chief executive officer and the other four highest compensated officers of any publicly held corporation.

Section 162(m)(4)(C) of the Code excepts from this limitation "performance-based compensation" that, in relevant part, is payable solely on account of attaining one or more performance goals determined by a compensation committee of the board of directors that is comprised solely of two or more outside directors and if the material terms under which the remuneration is to be paid are approved by a majority of the shareholders.

Section 1.162-27(e)(2) of the Income Tax Regulations provides that qualified performance-based compensation must be based 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. A performance goal does not include the mere continued employment of the covered employee. Thus, a vesting provision based solely on continued employment would not constitute a performance goal.

Under section 1.162-27(e)(2)(vi) of the regulations, grants of stock options and stock appreciation rights will satisfy the performance goal requirement in section 1.162-27(e)(2) if (i) the grant or award is made by the compensation committee; (ii) the plan under which the option or right is granted states the maximum number of shares for which options or rights may be granted to any employee during a specific period; and (iii) under the terms of the option or right, the amount of compensation an employee could receive is based solely upon an increase in the value of the stock after the date of the grant or award.

Under section 1.162-27(e)(4)(i) of the regulations, "material terms" include (i) the employees eligible to receive compensation; (ii) a description of the business criteria on which the performance goal is based; and (iii) either the maximum amount of compensation that could be paid to any employee or the formula used to calculate the amount of compensation to be paid to the employee if the performance goal is attained.

Section 1.162-27(e)(4)(ii) of the regulations provides that in describing the eligible employees, a general description of the class of eligible employees by title or class is sufficient, such as the chief executive officer and vice presidents, or all salaried employees, all executive officers, or all key employees.

Section 1.162-27(e)(4)(vi) of the regulations provides that once the material terms of a performance goal are disclosed to and approved by the 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 authority to change targets under a performance goal after shareholder approval of the goal, material terms of the performance goal must be disclosed and reapproved 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.

The regulations underlying section 162(m)(4)(C) of the Code contain no provision requiring that, in a case such as this, a performance based plan adopted by a corporation that subsequently merges with another corporation must be resubmitted to

the shareholders of the surviving corporation after the merger at anytime prior to the time the original corporation would have been required to resubmit the plan under section 1.162-27(e)(4)(vi) of the regulations. In this regard, compare regulation section 1.162-27(f)(4)(ii).

Based on the information submitted and Taxpayer's representations referred to above, we rule as follows:

1) Following the creation of Parent, the Merger of Parent and Target, and the assumption of the Plan by Parent, the Plan will continue to meet the shareholder approval requirement set forth in section 1.162-27(e)(4)(i) of the regulations based on approval of Taxpayer's shareholders at their annual meeting. Accordingly, approval of the Plan by the shareholders of Parent will not be required by virtue of the merger.

2) The eligibility criteria of the Plan will not be considered to have been modified and consequently no additional shareholder approval will be required under section 1.162-27(e)(4)(vi) of the regulations, if following assumption of the Plan, awards are made to employees of Parent's subsidiaries which, prior to the merger, were subsidiaries of Taxpayer or Target.

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(j)(3) of the Code provides that it may not be used or cited as precedent. Taxpayer should attach a copy of this ruling to any income tax return to which it is relevant.

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
Executive Compensation Branch
Office of the Division Counsel
/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for 6110 purposes