

INTERNAL REVENUE SERVICE

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April 13, 1999

Taxpayer =

Acquiring =

Target =

W =

date a =

date b =

date c =

year d =

year e =

x shares =

Dear

This is in reply to a request for rulings concerning the deduction limitation of section 162(m) of the Internal Revenue Code. The facts, as presented by Taxpayer, are as follows.

Taxpayer is the holding company for the Taxpayer's affiliated group. Target is the holding company for the former Target affiliated group. Acquiring was formed by

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Taxpayer and incorporated on date a for the sole purpose of acquiring the stock of Target. On date b, Taxpayer, Acquiring and Target entered into a merger agreement whereby all parties agreed that Acquiring would merge into Target, with Target being the surviving entity.

Pursuant to the merger agreement, each share of Target common stock was converted into a right to receive x shares of Taxpayer common stock. Shares of Target convertible preferred stock were converted into a right to receive x shares of Taxpayer common stock (rather than one share of Target stock) upon conversion. Shares of Target non-convertible preferred stock were converted into a right to receive an equal amount of newly-created Taxpayer preferred stock.

On date c, Acquiring merged with and into Target, with Target being the surviving entity. As a result of the merger, Target became a wholly-owned subsidiary of Taxpayer. Immediately subsequent to the merger, Acquiring contributed the stock of Target to W.

Taxpayer indicates that the merger transaction was structured to qualify as a reorganization under section 368 of the Code and was treated as a "pooling of interests" for GAAP purposes.

Taxpayer contends that Target will not be required to file any reports or statements with the Securities and Exchange Commission (SEC) for year d that disclose executive compensation, because Target will cease to be a reporting entity as a result of the merger. Hence, there would be no "summary compensation table" (as required by SEC rules) for Target which would disclose the compensation of the CEO and the four highest paid officers.

Taxpayer further contends that none of the former Target employees will be included in the year d "summary compensation table" to be filed with the SEC by Taxpayer for year d, or in the year e "summary compensation table" for year e. None of them will be employees of Taxpayer or any of its subsidiaries during the year d or year e tax years.

Several of Acquiring's corporate officers intend to resign their positions as officers and all of their duties as such in year d, or in a later year. These individuals may continue to perform services as employees of Taxpayer for the remainder of the year of resignation and possibly in future years. Thus, the resignation from their positions as officers does not necessarily equate to separation from service with the Taxpayer. These officers may, however, be listed pursuant to the executive compensation disclosure rules under the Securities Exchange Act as chief executive officer or one of the highest compensated officers of Acquiring for the resignation year.

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Section 162(a)(1) of the Code allows 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 is allowed for applicable employee remuneration with respect to any covered employee to the extent that the amount of the remuneration for the taxable year exceeds \$1,000,000.

Section 162(m)(3) of the Code defines "covered employee" to mean any employee of the taxpayer if as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is an individual acting in such capacity, or the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the 4 highest compensated officers for the taxable year (other than the chief executive officer).

Section 1.162-27(c)(2) of the Income Tax Regulations provides the general rule for who is a covered employee. Under the regulations, a covered employee means any individual who, on the last day of the taxable year, is (A) the chief executive officer of the corporation or is acting in such capacity; or (B) among the four highest compensated officers (other than the chief executive officer). Whether an individual is the chief executive officer or one of the four highest compensated officers is determined pursuant to the executive compensation disclosure rules under the Exchange Act.

In the notice of proposed rulemaking containing the proposed regulations under section 162(m), the preamble contains the following language concerning the identification of "covered employee":

The regulations clarify which employees are "covered employees" for purposes of section 162(m). The legislative history to section 162(m) provides that "covered employees" are defined by reference to the SEC rules governing executive compensation disclosure under the Exchange Act. Under the regulations, an individual generally is a "covered employee" if the individual's compensation is reported on the "summary compensation table" under the SEC's executive compensation disclosure rules, as set forth in Item 402 of Regulation S-K, 17 CFR 229.402, under the Exchange Act. However, the regulations specifically provide that, in order to be a "covered employee" for section 162(m) purposes, an individual must be employed as an executive officer on the last day of the taxable year. Thus, only those employees who appear on

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the "summary compensation table" and who are also employed on the last day of the taxable year are "covered employees."

Therefore, based on the facts as outlined above, we rule as follows:

1. Assuming that no summary compensation table is required to be filed by Target with the SEC for year d, the acquisition year, and Target's officers will not be listed on any summary compensation table filed by Target for year d or for any subsequent year, for purposes of section 162(m) of the Code, Target's officers will not be "covered employees" with respect to the acquisition year.
2. For purposes of section 162(m) of the Code, Taxpayers's officers who resign their positions as officers before the last day of the taxable year with no intent to resume their duties as officers at any time in the foreseeable future will not be "covered employees" with respect to the resignation year. Accordingly, no compensation to these officers with respect to the resignation year will be subject to the section 162(m) deduction limitation.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(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 transaction described above under any other provisions of the Code.

Sincerely yours,

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Enclosure:  
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