

INTERNAL REVENUE SERVICE

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June 29, 2000.

Target =

Acquiring =

Sub =

date a =

year b =

year c =

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 Target, are as follows.

On date a, Target and Acquiring announced a merger whereby a wholly-owned subsidiary of Acquiring will merge with and into Target, so that immediately after the merger Target will be a wholly-owned subsidiary of Acquiring. Target shareholders will become shareholders of Acquiring at the completion of the merger. Target represents that the merger is structured to qualify as a reorganization pursuant to section 368(a)(1)(A) of the Internal Revenue Code. It is further represented that the transaction will be treated as a "pooling of interest" for GAAP purposes.

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All of the companies involved are on the accrual method of accounting. Target's taxable year is the calendar year and its final separate consolidated tax year will end on the date of the merger. Acquiring's taxable year is the calendar year also.

Sub is a direct, wholly-owned subsidiary of Acquiring which was incorporated for the sole purpose of effecting the merger with and into Target. It engages in no other business.

According to Target, it will not be required to file any reports or statements with the Securities Exchange Commission (SEC) that disclose executive compensation for Target's short year that ends with the merger. Target further contends that for the year of the merger, because it will not have publicly-traded equity securities after the merger, it will not file a "Summary Compensation Table" disclosing the compensation of Target's CEO and Target's four highest paid officers for the short year ending with the merger.

Target contends that there are Target executives who are expected to continue to serve as executives of the post-merger combined company and who may be included in the year b "Summary Compensation Table" to be filed by Acquiring. The compensation paid by Target to these executives will not be counted or reported in the filing by Acquiring. The compensation paid and deducted by Target in its short year ending with the merger will never be reported on a "Summary Compensation Table" filed either by Acquiring or Target.

Certain of the corporate officers of Target have resigned in year c, or may resign in a later year as employees; others may resign their positions as officers and all of their duties as officers in a later year. Those individuals who resign their positions as officers may continue to perform services as consultants to Target, or as employees of Acquiring or another company in the Acquiring controlled group for the remainder of the year of resignation and possibly in future years. Resignation from their positions as officers does not necessarily equate to separation from service as consultants or employees. These officers may, in addition, be listed pursuant to the executive compensation disclosure rules under the Securities Exchange Act of 1934 as chief executive officer or one of the highest compensated officers for the year of resignation.

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.

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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 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 the merger year, for purposes of section 162(m) of the Code, Target's officers will not be "covered employees" with respect to the merger year.
2. For purposes of section 162(m) of the Code, officers of Target and Acquiring will not be "covered employees" with respect to any year of

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resignation if they have resigned their employment or positions as officers before the last day of that year with no intent to resume their duties as officers at any time in the foreseeable future. Accordingly, no compensation paid to these officers with respect to the year of resignation 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,

ROBERT B. MISNER
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Compensation Branch
Office of Division Counsel/
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Enclosure:
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