

Internal Revenue Service

Department of the Treasury
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In Re:

LEGEND

Taxpayer	=
Subsidiary A	=
State A	=
Stock Plan	=
Year 1	=
Year 2	=
Year 3	=
Month 1	=
Date 1	=
Date 2	=
Date 3	=
\$a	=

Dear :

This letter is in response to the letter, dated October 8, 2008 and submitted by your authorized representative, requesting certain rulings under section 424 of the Internal Revenue Code (Code) regarding the adjustment, as the result of a particular transaction, of outstanding options intended to qualify as incentive stock options under section 422 of the Code. The facts, as presented, are as follows.

Taxpayer is a real estate investment trust (REIT) incorporated in State A. Taxpayer has common equity securities that are required to be registered under section 12 of the Securities Exchange Act of 1934. In Year 1, Taxpayer adopted the Stock Plan, which was approved by Taxpayer's stockholders. Under the terms of the Stock Plan, eligible individuals may receive incentive stock options, nonstatutory stock options, stock appreciation rights, and restricted stock. Options intended to qualify as incentive stock options under section 422 of the Code have been granted under the Stock Plan to officers and directors of Taxpayer.

The Stock Plan includes an adjustment provision under which Taxpayer's compensation committee "may make such substitution or adjustment, if any, as it deems to be equitable" with respect to the number or kind of shares or other securities issued or reserved for issuance pursuant to the Stock Plan, as applicable, and to outstanding awards in the event of any change in Taxpayer's outstanding shares by reason of any share dividend or split, recapitalization, merger, consolidation, spinoff, combination or exchange of shares or other corporate change, or any distributions to common stockholders other than regular cash dividends.

The agreement evidencing options granted under the Stock Plan that are intended to qualify as incentive stock options includes an adjustment provision under which Taxpayer's compensation committee "shall make such substitution or adjustment, if any, as it deems to be equitable" with respect to the number or kind of shares or other securities issued or reserved for issuance pursuant to the Stock Plan, as applicable, and to outstanding awards in the event of any change in Taxpayer's outstanding shares by reason of any share dividend or split, recapitalization, merger, consolidation, spinoff, combination or exchange of shares or other corporate change, or any distributions to common stockholders other than regular cash dividends.

Since Taxpayer became a REIT in Year 2, Taxpayer has not paid regular dividends and has not paid any other dividend or made any other distribution to its stockholders. In Month 1 of Year 3, Taxpayer liquidated Subsidiary A. As a result of such liquidation, on Date 1, Taxpayer declared a special distribution of \$a per share payable to its stockholders of record on Date 2.

The special distribution represents a nonrecurring event and not a part of a pattern of dividends or distributions. The special distribution is directly related to a capital transaction (i.e., the liquidation of Subsidiary A) representing a nonrecurring event that is separate and apart from Taxpayer's core business activities. The special distribution is not a payout of normal corporate earnings. Further, the special distribution potentially reduced or diluted the value of the option holders' interests relative to those of the stockholders who received the special distribution.

As a result of the special distribution, on Date 3 Taxpayer made a proportional adjustment of outstanding options, including options intended to qualify as incentive stock options under section 422 of the Code, under the Stock Plan. The adjustment applied to all options that were outstanding when the special distribution was paid. The options cover the same stock before and after the adjustments.

Section 424(a) of the Code provides that the term "issuing or assuming a stock option in a transaction to which section 424(a) applies" means a substitution of a new option for the old option, or an assumption of the old option, by an employer corporation, or a parent or subsidiary of such corporation, by reason of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation, if (1) the excess of the aggregate fair market value of the shares subject to

the option immediately after the substitution or assumption over the aggregate option price of such shares is not more than the excess of the aggregate fair market value of all shares subject to the option immediately before such substitution or assumption over the aggregate option price of such shares, and (2) the new option or the assumption of the old option does not give the employee additional benefits which he did not have under the old option.

Section 1.424-1(a)(4)(i) of the Income Tax Regulations (Regulations) provides that in order for a change in an option or issuance of a new option to qualify as a substitution or assumption, the change must occur by reason of a “corporate transaction” as defined in section 1.424-1(a)(3).

Section 1.424-1(a)(4)(ii) of the Regulations provides that generally a change in an option or issuance of a new option is considered to be by reason of a corporate transaction unless the relevant facts and circumstances demonstrate that such change or issuance is made for reasons unrelated to such corporate transaction. A change in an option or issuance of a new option will be considered to be made for reasons unrelated to a corporate transaction if there is an unreasonable delay between the corporate transaction and such change in the option or issuance of a new option or if the corporate transaction serves no substantial corporate business purpose independent of the change in options.

Section 1.424-1(a)(4)(iii) of the Regulations provides that a change in an option or issuance of a new option is by reason of a distribution or change in the terms or number of the outstanding shares of a corporation only if the option as changed, or the new option issued, is an option on the same stock as under the old option.

Section 1.424-1(a)(3)(ii) of the Regulations provides that the term corporate transaction includes a distribution (excluding an ordinary dividend or a stock split or stock dividend described in section 1.424-1(e)(4)(v)) or change in the terms or number of outstanding shares of a corporation.

Based solely on the facts presented, we rule as follows:

1. The special distribution made on Date 1 was a “corporate transaction” within the meaning of that term as used in section 1.424-1(a)(3) of the Regulations.
2. The Date 3 adjustment of options intended to qualify as incentive stock options that were granted pursuant to the Stock Plan to reflect the special distribution is treated as occurring “by reason of” a “corporate transaction” (within the meaning of those terms as used in section 1.424-1(a)(3) and (4) of the Regulations).

No opinion is expressed or implied regarding whether options granted under the Stock Plan satisfy the requirements of section 422 of the Code. No opinion is expressed or implied concerning the tax consequences of the proposed transactions

under any other provision of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed or implied concerning the application of section 409A of the Code to the proposed transactions.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

THOMAS D. SCHOLZ
Assistant Branch Chief
Executive Compensation Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)