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LEGEND:

Company =

Target =

Date B =

Date C =

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Exchange =

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This letter is in response to the letter dated December 22, 1999, submitted by your authorized representative requesting rulings under section 280G of the Internal Revenue Code. Specifically, the letter requests rulings, under the facts outlined below, that the Exchange Value related to vested, nonqualified options does not constitute a parachute payment and that, with regard to the unvested options, the parachute payment is determined under section 1.280G-1, Q&A 24(c), of the proposed regulations, taking into account the Exchange Ratio. The facts, as submitted, are set forth below.

On Date B, Company and Target entered into a Merger Agreement (Agreement) in which Company agreed to acquire Target in a cash and stock transaction. Under Agreement, the acquisition would be accomplished in two steps, a tender offer followed by a merger, or if the tender offer was not successful, a one-step merger.

Shortly thereafter, Company commenced a tender offer to purchase Target g shares for $E per share, representing d% of the outstanding Target shares on Date B, subject to regulatory approvals. During the tender offer period, which was extended pending regulatory approval, the trading price of Target shares rose above the $E per share tender offer price. As a result, fewer than the minium required number of shares were tendered. Consequently, the tender offer expired and was withdrawn by Company.

Under the terms of Agreement, Company and Target took actions to effect the merger subject to shareholder approval of both companies. Similar to the terms of the tender offer, Agreement provided for the consideration to be paid to Target shareholders to be approximately two-thirds cash and one-third Company stock for each Target share.

The total amount of cash that all Target shareholders could receive was fixed at $F, an amount equal to the $E per share offer price multiplied by g shares (i.e., d% of Target outstanding shares at the time of the merger negotiations). The actual amount of cash consideration for each Target share was equal to (i) the ratio of g divided by the number of Target shares outstanding immediately before the merger (ii) multiplied by $E. Accordingly, the negotiated per share cash consideration as of Date B was approximately $H.

The amount of Company shares that Target shareholders could receive is based on the Exchange Ratio. The Exchange Ratio is equal to the number, rounded to the nearest one-millionth, obtained by dividing $E by the average price per share closing price of Company's stock on the Exchange for the twenty trading-day period ending on the second trading day prior to the effective date of the merger (Company Average Price). The Agreement provides that the Exchange Ratio will not be less than j or greater than k. For the calendar year prior to the merger, Company's share price ranged from a low of $L to a high of $M. Until the merger, Company's share price never exceeded $P.

Shareholder approval of the merger was obtained on Date C, which is also the effective date of the merger and the date of the change in control for purposes of section 280G of the Code. The applicable Company Average Price was $Q. Accordingly, the Exchange Ratio of j became operative. Under the Agreement terms, each Target share was converted into the right to receive $R and s shares of Company stock. Based on the average high/low trading price of Company's shares on Date C, the resulting per share value of the merger consideration was approximately $T.

Agreement also provides for the treatment of all outstanding Target stock options granted to employees or directors and any related stock appreciation rights granted under any stock option or stock purchase plan of Target and its subsidiaries. Under Agreement, each Target option, including, if any, related stock appreciation rights (SARs) and limited stock appreciation rights (LSARs), was to be (i) if elected prior to the merger, canceled in exchange for a payment of the intrinsic value based on $E, or (ii) exchanged for an option to purchase a specified number of Company shares (Company option) on the same terms and conditions as were applicable under the Target options. Regarding Target options that were nonqualified stock options, Agreement provided that the exchange was to be made pursuant to the Exchange Ratio as described above. Any Target options qualified under sections 422 through 424 of the Code were either exchanged on a value-for-value basis in accordance with the principles of section 424(a) of the Code or were exercised prior to the merger. Virtually all nonqualified

Target options were exchanged for nonqualified Company options.

With respect to Target's nonqualified options, the number of Company shares that may be acquired through the exercise of a Company option following the exchange is equal to the product of (i) the number of Target shares issuable on exercise of the applicable Target option, and (ii) the Exchange Ratio. The exercise price of each Company option is equal to (i) the applicable exercise price for the Target option divided by (ii) the Exchange Ratio.

As a result of the Exchange Ratio, each nonqualified Target option was converted into the right to receive i Company shares at the original exercise price divided by i. Absent the restrictions placed on the Exchange Ratio in Agreement, the applicable exchange ration would have been u ($E/$Q), and each Target nonqualified option would have been converted into the right to receive u Company shares at the original exercise price divided by u. The differential between the value of the Target nonqualified stock options and the value of the Company options received in the conversion is referred to as the Exchange Value.

Certain Target nonqualified options have LSARs. On a change of control, the holder of a LSAR could elect to exchange the underlying option during a 90-day period for cash consideration equal to the difference between the change of control price and the exercise price of the option. For this purpose, change of control price means the higher of (i) the highest reported sales price of a share of Target common stock during the 60-day period ending on the merger date in any transaction reported on Exchange or (ii) the merger price of $E.

On the merger, Target nonqualified options that included a LSAR were exchanged for Company options, pursuant to the Exchange Ratio previously described, that continued to carry the Target LSARs. These LSARs were exercisable for the remainder of the 90-day period for the same value as before the merger. Accordingly, the change of control price was divided by the Exchange Ratio (i) to reflect, on a per-share basis, the conversion of the underlying Target nonqualified option to Company options pursuant to the Exchange Ratio. These LSARs generally expire on voluntary or involuntary termination of employment.

The determination of the Exchange Ratio was the subject of arm's length negotiations between Company, Target, and their respective advisors. It was intended to reflect the historic price range of a share of Company common stock. Company represents that the Exchange Ratio was not intended to provide any compensatory benefit. Rather, the Exchange Ratio was designed to provide a risk-free exchange of Target shares for Company shares based on the trading information available on Date B and to treat Target option holders essentially the same as Company shareholders. The primary reason for placing a floor and ceiling (collar) on the Exchange Ratio was to limit the dilution that the issuance of new shares would have on Company's existing shareholders and to safeguard Target shareholders, as well as Company shareholders,

from significant fluctuations in share price occurring after entering into Agreement. Recognizing that the merger was conditioned on certain regulatory approvals that could take several months and that the tender offer could close before the merger, the collar was intended to induce Target shareholders to agree to sell their Target shares in the tender offer or to vote favorably for the merger.

Target has a long-established practice of granting options to selected key employees to attract, retain, competitively compensate, and motivate those individuals to promote the long-term financial interest and growth of Target. The nonqualified options that are the subject of this ruling were granted pursuant to the terms of Target's Year V Incentive Plan and Target's Year W Incentive Plan (Plans). Under Plans, Target has granted nonqualifed options to employees who are not disqualified individuals. The typical vesting period for an option grant is one year. Plans provide for all outstanding options to become fully vested on a defined change of control, including the merger.

At the time of the merger, the only outstanding Target options which were not vested were nonqualified options granted on Date X. These options became fully vested on Date C when Target shareholders voted to approve the merger. As of Date C, there were y outstanding options to purchase Target shares, z of which were granted to disqualified individuals. Of the outstanding Target options granted to disqualified individuals, a were not vested as of Date C. Company represents that the Date X option grant was made in the normal course of business, was consistent in timing, amount, and vesting with prior option grants.

Section 280G of the Code provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) defines "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 "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 in the ownership or effective control of the corporation or 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 of 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, published in the Federal Register on May 5, 1989 (54 Fed. Reg. 19,390), provides guidance concerning parachute payments.

Q&A 11(a) provides that, for purposes of section 280G, all payments, in whatever form, are payments in the nature of compensation if they arise out of an employment relationship or are associated with the performance of services. Payments in the nature of compensation include (but are not limited to) wages and salary, bonuses, severance pay, fringe benefits, and pension benefits and other deferred compensation (including any amount characterized as interest thereon).

Q&A 11(b) provides that transfer of property are treated as payments in the nature of compensation for purposes of Q&A11.

Under Q&A 12(a), a transfer of property is considered a payment made (or to be made) in the taxable year in which the property transferred is includible in the gross income of the disqualified individual under section 83 and the regulations thereunder. In general, such a payment is considered made (or to be made) when the property is transferred (as defined in section 1.83-3(a)) to the disqualified individual and becomes substantially vested (as defined in section 1.83-3(b)) in such individual.

Regarding nonqualified stock options, Q&A 13(a) provides that if an option to which section 421 does not apply has an ascertainable fair market value (whether or not readily ascertainable as defined in section 1.83-7(b)) at the time the option becomes substantially vested (as defined in section 1.83-3(b)), the option shall be treated as property that is transferred not later than the time at which the option becomes substantially vested. Thus, for purposes of this section, the vesting of such option is treated as a payment in the nature of compensation.

Under Q&A 13(b) any money or other property transferred to the disqualified individual upon the exercise, or as consideration on the sale or other disposition, of an option described in Q&A13(a) after the time such option vests is not treated as a payment in the nature of compensation to the disqualified individual under Q&A11.

Q&A 22(a) provides that a payment is treated as contingent on a change in ownership or control if the payment would not, in fact, have been made had no change in ownership or control occurred. A payment generally is to be treated as one which would not, in fact, have been made in the absence of a change in ownership or control unless it is substantially certain, at the time of the change, that the payment would have been made whether or not the change occurred. Property that becomes substantially vested as a result of a change in ownership or control will not be treated as a payment which was substantially certain to have been made whether or not the change occurred.

Under Q&A 22(c) a payment that would in fact have been made had no change in ownership or control occurred is treated as contingent on a change in ownership or control if the change accelerates the time at which the payment is made. Thus, for example, if a change in ownership or control accelerates the time of payment of vested deferred compensation, the payment may be treated as contingent on the change.

Q&A 24(a) generally provides that the full amount of the payment is treated as contingent on a change in ownership or control. However, in certain circumstances, described in Q&A24(b) and (c), only a portion of the payment is treated as contingent on the change.

Q&A 24(c)(1) applies in the case of a payment that is accelerated by a change in ownership and control and that was substantially certain, at the time of the change, to have been made without regard to the change if the disqualified individual had continued to perform services for the corporation for a specified period of time. In such a case, the portion of the payment that is treated as contingent on the change in ownership or control is the lesser of (i) the amount of the accelerated payment or (ii) the amount by which the payment exceeds the present value of the payment that was expected to be made absent the acceleration (determined without regard to the risk of forfeiture for failure to continue to perform services), plus an amount, as determined in Q&A24(c)(2), to reflect the lapse of the obligation to continue to perform services.

Under Q&A 24(c)(2), the amount reflecting the lapse of the obligation to continue to perform services depends on all the facts and circumstances. In no event, however, will such amount be less than 1 percent of the amount of the accelerated payment multiplied by the number of full months between the date that the individual's right to receive the payment is not subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture (within the meaning of section 1.83-3(c)) and the date that, absent the acceleration the individual's right to receive the payment would not have been subject to any requirement or condition which would be treated as resulting in a substantial risk of forfeiture.

In this case, the payments made for vested nonqualified Company options were not parachute payments because they were not payments in the nature of compensation under section 280G of the Code. The payments in the nature of compensation related to the vested nonqualified Company options occurred when the options vested (which occurred prior to the merger) and were not contingent on the change.

As to the unvested Company options that became vested as a result of the change of ownership or control of Company, the payments in the nature of compensation related to these shares occurred when they became substantially vested. The payments were contingent on the change because the payments were accelerated, but the contingent portion may be reduced because it was substantially certain, at the time of the change, that the options would have vested if the employees had continued to perform services for a specified period of time.

Accordingly, based on the facts as submitted, we rule as follows:

(1) The Exchange Value relating to the exchange of vested, nonqualified Company stock options for vested Target stock options pursuant to the Exchange Ratio does not

constitute a parachute payment under section 280G of the Code; and

(2) The parachute payment with respect to Company nonqualified stock options that become vested upon shareholder approval of the merger is determined by applying the principles of section 1.280G-1, Q&A24(c), of the proposed regulations to the value (which includes the Exchange Value) of such options at the time of vesting.

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. 00-4, 2000-1 I.R.B. 4, 47 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,
Robert Misner
Assistant Chief
Executive Compensation Branch
Office of the Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for 6110 purposes