Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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CC:TEGE:EB:EC/PLR-125485-01
Date:
February 5,2002

Target =

Acquiring =

Date A =

Date B =

Date C =

Year 1 =

Executive =

Dear

This is in reply to a letter dated May 3, 2001, from your authorized representative requesting rulings concerning the deduction limitation of section 162(m) of the Internal Revenue Code. The facts, as represented by Acquiring, are as follows.

Pursuant to an Amended and Restated Agreement and Plan of Exchange dated as of Date A, amended and restated as of Date B, Acquiring acquired all the common stock of Target and Target became a wholly-owned subsidiary of Acquiring (the "Acquisition"). The Acquisition occurred on Date C and Target's final separate consolidated tax year ended on that date.

Acquiring is the sole shareholder of Target. Acquiring has represented that Target is not required to file any proxy statements containing a summary compensation table that disclose executive compensation under Item 402 of Regulation S-K for its short year that ends with the Acquisition. However, Target and its wholly-owned subsidiary continue to be reporting companies for purposes of the Securities Exchange Act of 1934 (Exchange Act). As a result, Target will continue to be required to file Form 10-K with the Securities and Exchange Commission (SEC).

Executive resigned in Year 1 (the year of the Acquisition). Acquiring has represented that none of the Target executives who continue to perform services after the Acquisition will be included in the Summary Compensation Table for Year 1 to be filed by Acquiring. Thus, the compensation paid and deducted by Target in its short taxable year ending with the Acquisition will never be reported on a "Summary Compensation Table" filed by either Acquiring or Target.

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 shall be 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 Exchange Act 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 submitted, we rule as follows:

1. For purposes of section 162(m) of the Code, Target's officers will not be "covered employees" with respect to Year 1 provided that no Summary Compensation Table listing Target officers is included in any Target proxy statement that is sent to shareholders and filed by Target with the SEC for Year 1.

2. For purposes of section 162(m) of the Code, Executive will not be a "covered employee" with respect to Year 1. Accordingly, no compensation paid to Executive with respect to Year 1 will be subject to the section 162(m) deduction limitation.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, no ruling was requested and none is given regarding the federal tax consequences of the acquisition of Target. 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, a copy of this letter is 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