INTERNAL REVENUE SERVICE

Number: **200244006**
Release Date: 11/1/2002
Index No.: 423.00-00

CC:TEGE:EB:EC/PLR-112345-02

July 02, 2002

LEGEND:

Company =

Plan =

Z Corporation =

Plan Z =

This is in reply to a letter dated February 26, 2002, submitted on behalf of Company and Z Corporation by their authorized representative, in which rulings are requested under section 423 of the Internal Revenue Code with respect to the Plan and certain aspects of a proposed merger of Company and Z Corporation .

The facts submitted are that Company's board of directors adopted the Plan on November 18, 1999, that its shareholders approved the Plan on February 29, 2000, effective November 1, 2000, and that it was most recently amended on March 29, 2001. At the times of its adoption and approval, it was intended that the Plan qualify as an "employee stock purchase plan," as defined in section 423(b) of the Code. Under the Plan, options to purchase shares of Company common stock are offered during a 24-month period (the first of which commenced on November 1, , and ends on October 31,), within which there are four Purchase Periods (11/1/ through 4/30/ ; 5/1/ through 10/31/ ; 11/1/ through 4/30/ ; and 5/1/ through 10/31/).

An employee is eligible to participate in the Plan if the employee is regularly employed by Company or by any designated subsidiary corporation of Company on a full-time or part-time (20 hours or more per week on a regular schedule) basis. Thus, there is no minimum-period-of-service requirement that an employee must satisfy in order to participate in the Plan.

Z Corporation's board of directors adopted Plan Z on January 28, , and its shareholders approved Plan Z on April 12, . At the times of its adoption and approval, it was intended that Plan Z qualify as an "employee stock purchase plan." Under Plan Z, options to purchase shares of Corporation Z common stock are offered during successive six-month purchase periods (5/1/ through 10/31/ and 11/1/ through 4/30/).

In September of , the boards of directors of Company and Z Corporation agreed to a plan of merger, under which Z Corporation would merge with a subsidiary corporation of Company, Z Corporation would be the surviving corporation, and Z Corporation would become a wholly owned subsidiary of Company. At the effective time of the merger ("Effective Time"), the employees of Z Corporation will become employees of Company's corporate group. Within six to nine months after the effective time, Z Corporation will be merger into Company.

The Merger Agreement provides that Plan Z will be terminated no later than the Effective Time, and that, in conjunction with that termination, the rights of participants in Plan Z with respect to Plan Z's offering period then underway will be determined by treating the last business day prior to (or, if more administratively feasible, the last payroll date of Corporation Z immediately prior to) the Effective Time as the last day of such offering period. Therefore, on that last business day (or last payroll date) all outstanding options granted under Plan Z will be exercised. Thereafter, the shares so purchased will be converted into shares of the common stock of Company, and such shares will be administered and treated in the same manner as the Z corporation shares purchased under Plan Z would have been administered and treated under Plan Z had there been no merger.

Under the Plan, the current purchase period began on May 1, , and will end on October 31, . If the Effective Time occurs prior to May 1, , Z Corporation employees who participated in Plan Z and who become employees of Company will begin participation in the Plan on May 1, . If the Effective Time occurs on or after May 1, , the former Z Corporation employees will have a special entry date and purchase period under the Plan and begin participation in the Plan on (approximately) June 1, . The former Z Corporation employees will exercise the options to be granted to them under the Plan on the last day of the Plan's purchase period ending on October 31, .

In pertinent portion, section 421(a) of the Code provides that, if a share of stock is transferred to an individual in a transfer in which the requirements of section 423(a) are met, no income results to the individual at the time of the transfer, no deduction under section 162 is allowable at any time to the employer corporation with respect to the share transferred, and no amount other than the price paid under the option is considered as received by the employer corporation for the share transferred.

Under section 421(b), If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 423(a) except that there is a failure to meet any of the holding period requirements of section 423(a)(1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, is treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred.

Section 423(a) of the Code provides that section 421 will apply to the transfer of a share of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan if (1) no disposition of the stock is made by the individual within two years after the date of grant of the option nor within one year after the transfer of such share to him or her, and (2) at all times during the period beginning with the date that the option is granted and ending 3 months before the date of its exercise, the optionee remains an employee of the granting corporation, a parent or subsidiary corporation of such corporation, or a corporation (or parent or subsidiary corporation of such corporation) issuing or assuming a stock option in a transaction to which section 424(a) applies.

For purposes of these determinations, section 424(e) of the Code defines "parent corporation" as any corporation (other than the employer corporation) in an unbroken chain of corporations ending with the employer corporation if, at the time of the granting of the option, each of the corporations (other than the employer corporation) owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain. Section 424(f) defines "subsidiary corporation" as any corporation (other than the employer corporation) in an unbroken chain of corporations beginning with the employer corporation if, at the time of the granting of the option, each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50 percent or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

Section 1.421-7(c)(1) of the Income Tax Regulations provides, in part, that, for purposes of sections 421 and 423 of the Code, the words "the date of the granting of

the option" and "the time such option is granted" (and similar phrases) refer to the date or time when the corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option.

For purposes of determining when an option is granted, a corporation "completes corporate action," within the meaning of section 1.421-7(c)(1) of the regulations, when, pursuant to the terms of its offer, the number of shares of stock that may be purchased is fixed and determinable. If an offer to sell stock does not designate a fixed and determinable maximum number of shares that an employee may purchase, corporate action has not been completed. See Revenue Ruling 68-317, 1968-1 C.B. 186, and Revenue Ruling 70-358, 1970-2 C.B. 96, both of which are clarified by Revenue Ruling 73-223, 1973-1 C.B. 206.

Section 423(b) of the Code defines an "employee stock purchase plan" as a plan that meets the requirements set forth in paragraphs (1) through (9) of that section. Among those requirements, section 423(b)(2) provides that an employee stock purchase plan must be approved by the stockholders of the granting corporation within 12 months before or after the plan is adopted.

In pertinent portion, section 1.423-2(c)(3) of the regulations provides that the plan as adopted and approved must designate the aggregate number of shares that may be issued under the plan and the corporations (or class of corporations) whose employees will be offered options under the plan. Section 1.423-2(c)(4) provides that, after the initial adoption and approval, any increase in the aggregate number of shares that may be issued under the plan (other than an increase merely reflecting a change in capitalization, such as a stock dividend or stock split-up) is treated as the adoption of a new plan requiring the approval of the stockholders within 12 months of such adoption. Similarly, a change in the designation of corporations whose employees may be offered options under the plan is treated as the adoption of a new plan requiring stockholder approval, unless the plan provides that designations may be made from time to time among a group consisting of the grantor corporation and its parent or subsidiary corporations. Any other changes in the terms of the plan may be made without stockholder approval.

Section 423(b)(5) of the Code provides that, under the terms of the plan, all employees granted options under the plan must have the same rights and privileges, except that the amount of stock that may be purchased by any employee under his (or her) option may bear a uniform relationship to the total compensation (or the basic or regular rate of compensation) of employees, and the plan may provide that no employee may purchase more than a maximum amount of stock designated therein.

Section 1.423-2(f)(4)(i) of the regulations provides that section 423(b)(5) does not prohibit the delaying of the grant of an option to any employee who is barred from being granted an option solely by reason of such employee's failing to meet a minimum service requirement until the employee meets the requirement.

Section 423(b)(8) of the Code provides that, under the terms of the plan, no employee may be granted an option which permits his (or her) rights to purchase stock under all employee stock purchase plans of his employer corporation and its parent and subsidiary corporations to accrue at a rate which exceeds $25,000 of fair market value of such stock (determined at the time such option is granted) for each calendar year in which such option is outstanding at any time. For purposes of this limitation, the right to purchase stock under an option accrues when the option (or any portion thereof) first becomes exercisable during the calendar year; the right to purchase stock under an option accrues at the rate provided in the option, but in no case may such rate exceed $25,000 of fair market value of such stock (determined at the time such option is granted) for any one calendar year; and a right to purchase stock which has accrued under one option may not be carried over to any other option. See also section 1.423-2(i) if the regulations.

Applying the above law to the information submitted, we rule as follows:

(1) The designation of Z Corporation by the Plan Committee as the sole corporation (along with any Z subsidiaries do designated) whose employees will be offered the opportunity to commence participation in the Plan on a special entry date, (in early June of) and for a special shortened Purchase Period will not be treated as the adoption of a new plan requiring approval of shareholders under section 423(b)(2), nor violate the "equal rights and privileges" requirement of section 423(b)(5);

(2) The "grant date" of options granted under the Plan, for purposes of section 423(b)(6) is the Entry Date contemplated by section 2(i) of the Plan or the special Entry Date offered to former employees of Z Corporation; and

(3) In calculating calendar year 's $ limitation for former employees of Z Corporation participating in the Plan, both the fair market value of Company stock (determined at the time the option is granted) purchased through the exercise of options granted under the Plan and the fair market value of Z Corporation common stock (determined at the time the option is granted) purchased under options exercised under Plan Z just prior to the Effective Time must be taken into account.

Except as ruled above, no opinion is expressed regarding the federal tax consequences of the transaction described above under any provision of the Internal Revenue Code. In particular, please note that no opinion is expressed regarding

whether the Plan qualifies as an "employee stock purchase plan" under section 423(b) of the Code. Additionally, please note that we express no opinion on requested ruling (4) (which concerned certain determinations to be made by the Plan Administrator), because that ruling presents a question of fact. Finally please note that, if the Plan is amended, the above rulings may not remain in effect.

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

A copy of this letter should be attached to Company's federal income tax return for the year in which the Plan is implemented. A copy is enclosed for that purpose.

Sincerely yours,

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ROBERT B. MISNER
Senior Technician Reviewer
Executive Compensation Branch
Office of the Division Counsel /
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures (2):
Copy of this letter
Copy for 6110 purposes