Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC
PLR-124111-06

Date:
September 11, 2006

Legend

Corporation =

A =

Date X =

Date Y =

Date Z =

$q =

$r =

x =

Dear :

This letter responds to your request, dated April 28, 2006, for a ruling under section 162(m) of the Internal Revenue Code. The facts represented by Corporation are as follows.

Corporation is a publicly-held corporation. In connection with Corporation's initial public offering of stock, Corporation established a stock incentive plan ("Plan"). Pursuant to the Plan, 90x shares of Corporation's common stock initially were authorized for issuance and reserved for purchase upon exercise of options granted, subject to adjustments for changes in capitalization. The Plan provides that no

participant may receive stock options for more than 15x shares of common stock in the aggregate per calendar year, subject to adjustments for changes in capitalization.

On Date X, Corporation hired A as president and chief executive officer. Corporation granted A non-statutory stock options to purchase 6x shares of its common stock at an exercise price of $q per share ("Original Options"). Corporation did not issue the Original Options to A under the Plan. The exercise price of the Original Options was equal to the fair market value of Corporation's stock on Date X. The Original Options were scheduled to vest over 4 to 7 year periods in accordance with a pre-determined vesting schedule, provided A remained employed by Corporation, and were subject to partial or full acceleration of vesting under certain circumstances.

On Date Y, Corporation effected a two for one stock split through a stock dividend. Corporation proportionally adjusted the Original Options pursuant to their terms so that they became options to purchase 12x shares of common stock at an exercise price of $q/2 following the stock split.

On Date Z, Corporation canceled the Original Options and immediately re-granted to A options to purchase 12x shares ("New Options") under the Plan. The New Options had the same exercise price ($q/2), vesting schedule and vesting commencement date as the Original Options. On the date the New Options were granted, Corporation's stock price was $r, which is less than the exercise price of the New Options. The purpose of the cancellation and re-grant was to bring A's options under the terms and conditions of the Plan, including the Plan's individual annual grant limitation, to better align A's compensation with the stockholder approved limitations and to qualify the options as performance-based compensation under section 162(m).

Section 162(a)(1) 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) 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 such remuneration for the taxable year with respect to such employee exceeds $1,000,000.

Under section 1.162-27(e)(1) of the Income Tax Regulations, the $1,000,000 deduction limitation does not apply to qualified performance-based compensation. Section 1.162-27(e)(2)(vi)(A) provides that compensation attributable to a stock option or a stock appreciation right is deemed to satisfy the requirements for qualified performance-based compensation if the grant or award is made by the compensation committee; the plan under which the option or right is granted states the maximum number of shares with respect to which options or rights may be granted during a

specified period to any employee; and, under the terms of the option or right, the amount of compensation the employee could receive is based solely on an increase in the value of the stock after the date of the grant or award.

Section 1.162-27(e)(2)(vi)(B) provides that compensation attributable to a stock option or stock appreciation right does not satisfy the requirements for qualified performance-based compensation to the extent that the number of options granted exceeds the maximum number of shares for which options may be granted to the employees, as specified in the plan. Section 1.162-27(e)(2)(vi)(B) further provides that, if an option is canceled, the canceled option continues to be counted against the maximum number of shares for which options may be granted to the employee under the plan.

Based on the facts represented by Corporation, we rule that:

(i) Because the Original Options were not issued pursuant to the Plan, the Original Options do not count for purposes of determining whether the New Options, which were granted under the Plan, exceed the maximum number of shares that can be granted during a specified period to any employee for purposes of section 1.162-27(e)(2)(vi)(A).

(ii) Because the Original Options were not issued pursuant to the Plan, the Original Options are not treated as “canceled options” for purposes of section 1.162-27(e)(2)(vi)(B) that count against the maximum number of options that can be granted to an employee during a specified period.

Except as specifically ruled on above, no opinion is expressed as to the Federal tax consequences of the transaction described above under any other provision of the Code. 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.

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,

William C. Schmidt
Senior Counsel, Executive Compensation Branch
Office of the Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities)