

**Internal Revenue Service**

Department of the Treasury

Number: **200110025**  
Release Date: 3/9/2001  
Index Numbers: 280G.00-00; 4999.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:  
**CC:TEGE:EB:EC-PLR-114891-00**  
Date:  
December 8, 2000

Parent =  
Sub =  
  
Target =  
Corporation A =  
  
Executive =  
M =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Date 5 =  
x =

This is in response to your letter of July 31, 2000, requesting rulings under section 280G of the Internal Revenue Code. Specifically you requested a ruling whether, under the facts outlined below, the parachute payment made to Executive upon the change of control of Target can be reduced by the application of section

PLR-114891-00

1.280G-1 of the Proposed Income Tax Regulations, Q&As 11 or 24(c). The facts as submitted are set forth below.

On Date 1, Executive, the president of Target, entered into an Employment Agreement with Target, a wholly owned subsidiary of Corporation A. The Employment Agreement which set forth a minimum annual salary plus bonus was to run through Date 5. The Employment Agreement provided, in part, that for the term of the Employment Agreement and for 12 months following the cessation of Executive's employment by Target, Executive would not compete directly or indirectly with Target.

The Employment Agreement also provided that if Target or a majority of its capital were sold, exchanged, or traded to a new owner and Executive's powers, position, compensation, duties or physical location would be changed considerably, Executive could treat this as a termination by Target of the Employment Agreement. In such case, Target would be required to pay Executive for the remainder of the contract term.

On Date 2, Parent made a tender offer to buy all the outstanding shares of Corporation A. Parent was primarily interested in acquiring Target which it viewed as a good strategic fit with the business of its wholly-owned subsidiary, Sub. Parent entered into an agreement with M whereby if Parent was successful in acquiring all the stock of Corporation A, Parent would sell the portion of Corporation A that was not related to the business of Sub to M. On Date 3, Parent acquired the stock of Corporation A.

Following Parent's acquisition of Corporation A, conversations were held between Sub and Executive as to Executive's employment with Sub following the integration of the Target business with Sub. Executive's job duties would change and he would be required to move to a new location. Consequently, on Date 4, Executive elected to invoke the provisions of the Employment Agreement and treat his employment as terminated.

Pursuant to the Employment Agreement, Executive received \$x (an amount equal to his salary and bonus for the current year multiplied by the remaining term of the Employment Agreement).

You requested rulings as to whether Q&As 11 and 24(c) reduce the portion of the payment that is treated as contingent on the change in ownership or control.

Section 280G of the Internal Revenue Code provides that no deduction will be allowed for any excess parachute payment. Section 280G(b)(1) of the Code defines the term "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.

PLR-114891-00

Section 280G(b)(2)(A) of the Code defines the term "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 (I) in the ownership or effective control of the corporation, or (II) 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 or 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 280G(b)(4)(A) provides that in the case of a parachute payment described in section 280G(b)(2)(A), the amount treated as a parachute payment does not include the portion of the payment that the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services to be rendered on or after the date of the change of ownership or control.

Section 1.280G-1, Q&A 11, addresses the types of payments that are deemed to be compensation for the performance of services and therefore can be regarded as parachute payments. Q&A 11 provides that the performance of services includes holding oneself out as available to perform services and refraining from performing services (such as under a covenant not to compete or a similar arrangement).

Consistent with Q&A 11, for purposes of section 280G(b)(4)(A) of the Code, the refraining from the performance of services in compliance with a covenant not to compete should also be considered to be "services." If the taxpayer establishes by clear and convincing evidence that the amounts attributable to such a covenant are reasonable, they will not qualify as parachute payments under section 280G(b)(2)(A).

The amount of the parachute payment, if any, attributable to a covenant not to compete is a question of fact. Section 4.02(1) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 111, provides that the Service will ordinarily not issue ruling letters on any matter in which the determination requested is primarily one of fact.

Q&A 22(c) generally provides that a payment that would have in fact 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. However, the payment that is contingent on the change may be significantly reduced by the rules described in Q&A 24(c), provided that it 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.

PLR-114891-00

Q&A 24(c) was included in the proposed regulations to reduce the contingent portion of a nonvested payment that had been partially earned by the taxpayer with services, but had not been paid. This does not occur with amounts paid under an employment agreement because these amounts are paid as they are earned.

In the case of amounts paid under an employment agreement, the operative Q&A governing these payments is Q&A 42(b). Q&A 42(b) indicates that amounts paid as damages for breach of contract may be reasonable compensation for personal services to be rendered on or after the date of the change in control if certain requirements are met. See section 280G(b)(4)(A) and (B) of the Code which concern the treatment to be afforded amounts the taxpayer establishes with clear and convincing evidence represent reasonable compensation for services rendered before and after the change of control.

Q&A 44 of the proposed regulation also affects the treatment, for purposes of section 280G, of payments for the remaining unearned portions of an employment agreement or amounts paid as severance pay. Q&A 44 provides that severance payments are not treated as reasonable compensation for personal services actually rendered before, or to be rendered on or after, the date of a change of control.

Based on the information submitted we rule as follows:

- 1) For purposes of section 280G(b)(4)(A), the term “services” includes the refraining from the performance of services under a covenant not to compete following a termination of employment. Accordingly, a reasonable value attributable to refraining from performing such services will not be a parachute payment under section 280G(b)(2)(A). No opinion is expressed whether the covenant not to compete has any value or what that value may be.
- 2) The amounts paid under the Employment Agreement that substituted for the compensation that Executive would have earned had he continued to perform services for Sub for the remainder of the contract term do not qualify for the reduction set out in Q&A 24(c).

Except as specifically ruled on above, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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. The Taxpayer should attach a copy of this ruling to any income tax return to which it is relevant.

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

PLR-114891-00

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

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 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