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PLR-115921-04

Date:

July 16, 2004

In re:

LEGEND

Parent =

Sub1 =

Acquiring Parent =

Acquiring =

Founder =

State A =

State B =

a =

b =

Industry A =

Industry B =

IndustryC =

IndustryC1 =

BusinessA =

DateA =

DateB =

DateC =

DateD =

DateE =

DateF =

Manager =

Dear :

This letter responds to a letter dated March 15, 2004, requesting rulings concerning the federal income tax consequences of a proposed transaction. The information provided in that letter and later correspondence is summarized below.

Parent, a State A corporation, is the common parent of an affiliated group of corporations ("Parent Group"). Parent, a diversified company, directly and/or indirectly through its subsidiaries does business in IndustryA, IndustryB, and IndustryC. IndustryC1 (one aspect of IndustryC) is conducted directly and indirectly by Parent. The outstanding stock in Parent is mainly held, directly or indirectly, by descendants of Founder and by current and former employees. The stock in Parent is not publicly traded.

Sub1, a State B corporation, has been directly engaged in IndustryC1 through its operation of BusinessA. Sub1 is a wholly owned subsidiary of Parent.

Acquiring is a State A company. All the stock in Acquiring is held by Acquiring Parent, a State A company.

For several years, Parent has believed that IndustryC1 is not a good strategic fit with Parent Group. Accordingly, Parent Group has been, and continues to be, engaged in the disposition of various IndustryC1 assets. The present transaction is being undertaken in order to dispose of IndustryC1 assets by selling Sub1's BusinessA, and to distribute proceeds from this sale of BusinessA to certain shareholders of Parent. In this regard, the following steps ("Steps") have been taken or are proposed:

- I On DateA an agreement was entered into, and modified on Date B. Pursuant to this modified agreement ("Agreement") between Sub1 and Acquiring and Acquiring Parent, Sub1 agreed to sell its BusinessA to Acquiring in exchange for an immediate cash payment of approximately \$a million ("Sales Proceeds Cash"), plus the right to cash remaining at the termination of a \$b million escrow account ("Escrow Account"), and for the assumption by Acquiring of various BusinessA liabilities.
- II On Date C, in accord with the Agreement, Sub1 sold BusinessA to Acquiring. The BusinessA assets sold included manufacturing assets used exclusively by BusinessA as well as the right to use certain technology, methods, systems, know-how, and/or similar items also used by Parent Group in other businesses ("Transferred Intellectual Property").
- III Shortly after its receipt, the Sales Proceeds Cash was invested by Parent Group, on a temporary basis, in a segregated account ("Segregated Account") in order to preserve the funds received. Subsequently, on termination of the Escrow Account, the cash in the Segregated Account was increased very slightly by the addition to it of the small amount of cash remaining in the Escrow Account. The total amount of cash placed in the Segregated Account (the Sales Proceeds Cash plus the cash from the Escrow Account) was approximately \$a million. (A portion of this cash has now been used to pay expenses and/or taxes related to the sale and a portion has been returned to Acquiring as a purchase price adjustment pursuant to the terms of the Agreement.)
- IV On or before DateD, Parent will liquidate Sub1 in a transaction that (for Federal income tax purposes) will result in Parent acquiring all the assets and liabilities of Sub1. It is anticipated that this liquidation of Sub1 will be accomplished by having Sub1 convert into, or merge into, a limited liability company wholly owned by Parent.
- V On or before DateD, Parent will adopt a plan of partial liquidation ("Plan") calling for Parent to distribute to its shareholders all of the net proceeds from the sale of BusinessA (the "Total Distribution") in redemption of outstanding shares of Parent stock. The amount to be distributed includes all of the cash placed in the Segregated Account, both initially and on

termination of the Escrow Account (less any amount paid for expenses and taxes incurred in the transaction, and less any loss on the temporary investment of the proceeds in the Segregated Account).

- VI Prior to DateE, Parent's shareholders (probably only the common shareholders) will be given an opportunity to choose (the "Election") whether to participate in the distribution.
- VII On DateE, pursuant to the Plan, Parent will distribute the Total Distribution in redemption of shares of its stock to its shareholders in accord with the terms of the Election. It is anticipated that this distribution will be non-pro rata among the shareholders.
- VIII On DateF, it is possible (but not currently planned) that a further distribution may be made from Parent to its shareholders. Such a distribution would be made if it should be concluded by Parent that there were any additional assets properly attributable to BusinessA.

The following representations have been made in connection with the proposed transactions.

- (a) Throughout the period beginning 5-years prior to DateC (the date of the Step II sale of BusinessA to Acquiring) and continuing up until the date of the final distribution in partial liquidation, Parent will have continuously and actively conducted (within the meaning of section 1.351-1(c) of the Income Tax Regulations) various businesses in IndustriesA, B, and C. Throughout this period, Parent will have been directly engaged through its own activities in IndustriesA, B, and C, and Parent will have directly employed over 50 full-time employees in several of these businesses throughout this period. Moreover, at the time of the final distribution in partial liquidation (Steps VII and VIII), there will be no plan or intent for Parent to cease being directly engaged in at least one of these 5-year active businesses with such business employing over 50 full-time employees.
- (b) Parent acquired Sub1, and Sub1 commenced BusinessA, over 10 years ago. Sub1, through its own direct activity, will have continuously and actively conducted BusinessA (within the meaning of section 1.355-1(c)) throughout the 5-year period prior to the Step II sale, and will have directly employed over 50 full-time employees in BusinessA throughout this 5-year period.
- (c) All of the assets of BusinessA sold by Sub1 either: (i) were actively used by BusinessA throughout the 5-year period ending with Date C; or (ii) were replacements of actively used assets. These replacement assets

consisted primarily of fixed assets used in the BusinessA mill to replace similar fixed assets that had worn out or reached the end of their projected or anticipated useful lives. Each of the replacement assets (when considered together with the asset it replaced) was actively used in BusinessA throughout the 5-year period ending with DateC.

- (d) Financial information has been submitted indicating that each of several of Parent's directly operated businesses, as well as BusinessA while operated by Sub1, had income and expenses indicative of business activity in every year in the period beginning 5-years prior to DateC up until the present (or, for BusinessA up until DateC, the date BusinessA was sold).
- (e) Throughout the 5-year period prior to DateC, Sub1 carried on the activities of BusinessA for the purpose of earning income or profit from BusinessA. Sub1's BusinessA activities included every step in the process of earning income or profit.
- (f) Sub1, in large part, operated independently of Parent and the other companies in Parent Group. Only one of Sub1's directors was also a director of Parent. In addition, none of the principal operating officers of Sub1 was either a principal operating officer or director of Parent. BusinessA's operations were managed by Manager whose primary responsibility was the operation of BusinessA. Manager was located on-site at the BusinessA manufacturing facility (which facility is located in a different state than the location of Parent's headquarters). Manager reported to the Parent vice-president in charge of IndustryC1; however, day-to-day management decisions for BusinessA were generally made by Manager independently without consulting anyone at Parent or in Parent Group (other than consulting other employees of BusinessA). The management decisions generally made by Manager alone (or with input only from employees of BusinessA) include determining product mix, overseeing raw material procurement, and all BusinessA personnel matters. All of the BusinessA employees worked solely for BusinessA (except for a few employees involved in back-office support). All (or almost all) of the BusinessA employees represented by a union were represented by a union different than that representing other Parent Group employees in IndustryC1, and there have been no assertions that BusinessA is part of the same enterprise (under section 8(5)(a) of the National Labor Relations Act) as any of Parent Group's other IndustryC1 businesses. BusinessA had different suppliers and customers than other IndustryC1 businesses conducted by Parent Group. The BusinessA product has specifications that make it uniquely suited to the needs of its present customers, and these specifications significantly differentiate the BusinessA product from the product produced by other businesses of the

Parent Group. BusinessA had its own manufacturing facility, plant equipment, trucks, and office equipment. BusinessA was responsible for billing its customers and paying its own expenses. The BusinessA books, records, and accounts (though to some extent maintained on Parent Group's overall record system) were at all times kept as separately identifiable accounts and records.

- (g) The transaction through which Parent receives the proceeds from the Step II sale (the liquidation of Sub1 described in Step IV) will constitute the complete liquidation of a subsidiary within the meaning of section 332 of the Internal Revenue Code. If, as anticipated, this transaction is accomplished by having Sub1 convert into, or merge into, a single member limited liability company with a disregarded entity status, then Parent will take no action that would result in Sub1 losing disregarded entity status.
- (h) Parent has not acquired, and has no plan or intention of acquiring, either directly or indirectly: (i) stock in Acquiring or Acquiring Parent; or (ii) any part of the BusinessA sold to Acquiring.
- (i) Parent has no intention for any member of Parent Group to reenter BusinessA. In addition, it is not anticipated that there would be any expansion of activities in IndustryC1.
- (j) Parent has no plan or intention to completely liquidate.
- (k) Shareholders are receiving nothing in the transaction except cash.
- (l) None of the cash proceeds from the Step II sale has been used in any manner by Parent Group, except for the Step III placement of the Sales Proceeds Cash and the cash left from the Escrow Account into the Segregated Account. The Segregated Account assets at all times will have been invested in nothing other than savings accounts, money market certificates, certificates of deposit, and similar limited-risk short-term investments. Similarly, none of the cash in the Escrow Account was used in any manner except for paying liabilities associated with BusinessA, or for investment in the same type of assets as the Segregated Account.
- (m) The Sales Proceeds Cash and the cash received from the Escrow Account are proceeds from the sale of business assets that were actively used in BusinessA. None of the amount distributed in partial liquidation is, or is attributable to, any of the following: (i) a reserve for expansion; (ii) a mere business decline; (ii) a mere decrease in working capital, or in the need for working capital; (iv) a business operated at a loss; or (v) any member of Parent Group entering into a noncompete agreement with

Acquiring or any related entity. None of the amount being distributed is proceeds from the sale of assets that were idle, passive, or investment assets.

- (n) The Step VII distribution (and any Step VIII distribution) will be consummated during the taxable year in which the plan of partial liquidation is first adopted or in the succeeding taxable year.
- (o) The distribution in partial liquidation will consist of all of the net proceeds from the termination of BusinessA (that is, the entire amount received from Acquiring for BusinessA plus any other assets properly attributable to BusinessA), less: (i) cash used to pay liabilities properly attributable to BusinessA; (ii) taxes and expenses of Parent Group attributable to the sale of BusinessA to Acquiring; (iii) taxes and expenses of Parent Group incident to the proposed distribution in partial liquidation; and (iv) any loss of the proceeds as a result of being temporarily invested while placed in Segregated Account (or while placed in Escrow Account).
- (p) There will have been no unreasonable delay in making the distributions in partial liquidation. The time between the Step II sale and the Step VII distributions (and any Step VIII distributions) represents the period reasonably necessary for Parent Group to make informed decisions, to obtain legal guidance and governmental rulings, to make appraisals and/or cost and liability determinations; and to take other actions such that the transaction proceeds in an orderly and businesslike manner.
- (q) The amount of cash distributed by Parent to each shareholder will in each instance be approximately equal to the fair market value of the stock surrendered by such shareholder in exchange therefor.
- (r) There are no declared but unpaid dividends on the stock being redeemed by Parent.
- (s) None of the shareholders will repay to Parent Group, or reinvest in Parent Group, any of the amount distributed in partial liquidation.
- (t) None of the amounts distributed by Parent to its shareholders in the transactions will be received by a shareholder as a debtor, creditor, employee, or in any capacity other than that of a Parent shareholder.
- (u) The present transactions -- the Step II sale and the Step VII (and possible Step VIII) distributions in partial liquidation -- are not a step in a larger integrated transaction. Other corporate restructuring activities, including other possible sales of IndustryC1 businesses are being conducted independently of the present sale and distributions.

Based solely on the information submitted and on the representations set forth above, and provided that Step IV (the transaction through which assets of Sub1, or the proceeds from the sale of such assets, are transferred to Parent) qualifies as a section 332 liquidation, and provided further that as a result of this liquidation Parent succeeds to the items of Sub1 described in section 381(c), we hold as follows:

- (1) The rulings that follow deal with the question whether distributions of cash by Parent to its shareholders constitute redemptions in partial liquidation treated as exchanges under subsection (4) of section 302(b). These rulings do not deal with the question whether these distributions constitute redemptions under subsections (1), (2), or (3) of section 302(b). Subsections (1), (2), (3), and (4) are not mutually exclusive, so that some distributions may qualify under more than one subsection. Also, any distributions that fail to qualify under subsection (4) may, nonetheless, qualify under one or more of subsections (1), (2), or (3). Moreover, these rulings deal only with BusinessA assets, or the proceeds from the sale of BusinessA assets, and do not deal with any other assets that may have been held by Sub1.
- (2) For purposes of making a section 302(b)(4) partial liquidation determination with regard to the Step VII distributions from Parent to its shareholders (and possible Step VIII distributions), in light of the applicability of sections 332 and 381 to Parent's receipt of Sub1's assets including the proceeds from the sale of BusinessA (see, representation (g), above): (i) the separate corporate existence of Sub1 will be disregarded and the assets and activities of Sub1 will be considered to be those of Parent; and (ii) the acquisition of BusinessA by Acquiring will be viewed as a transfer of the assets and activities of BusinessA from Parent to Acquiring (Rev. Rul. 77-376, 1977-2 C.B. 107, dealing with distributions in partial liquidation under section 346(a)(2) and (b), the predecessor of present section 302(b)(4) and (e)(2)).
- (3) To the extent the \$b million placed in the Escrow Account is working capital of BusinessA, or otherwise properly allocable to BusinessA, it has to be taken into account in determining whether the transaction meets the section 302(e)(2) requirement for termination of a business that the entire business and/or the entire net proceeds from the sale of the business be distributed (section 1.346-1(b)). Thus, this entire amount of \$b million (assuming it is all proceeds from the sale of BusinessA) must be distributed by Parent to its shareholders, except to the extent this Escrow amount has been used to pay: (i) BusinessA liabilities; (ii) expenses from the sale of BusinessA; and (iii) expenses of the distribution. The amount that must be distributed can not be decreased by any liabilities of Sub1 unrelated to BusinessA,

- (4) The placement of Sales Proceeds Cash and the cash from the Escrow Account in Segregated Account in Step III with such cash being invested in limited risk assets, all as described above, will not change the identity or character of the money so invested. For purposes of the distributions in partial liquidation, these temporary investments will not prevent this cash from being considered the proceeds received by Parent from the Step II sale.
- (5) The proposed distributions of the cash in the Segregated Account by Parent to certain of its shareholders in redemption of some or all of the Parent stock held by such shareholders pursuant to the Plan, as described above, will be treated as distributions in partial liquidation under sections 302(b)(4) and 302(e)(2) to the extent provided in rulings (6) and (7) below.
- (6) The distributions from Parent to its shareholders, referred to in ruling (5) above, will be treated as exchanges under section 302(b)(4), provided that each of the three following conditions applies: (i) the redeemed shareholder is not a corporation; (ii) the cash distributed is the proceeds from the sale of operating assets ("Operating Asset Proceeds"); and (iii) the distribution occurs within the taxable year of Parent in which the Plan is adopted, or within the succeeding taxable year. For purposes of this ruling (6) in determining whether the redeemed shareholder is a corporation, any Parent stock held by a trust (or certain other pass-through entities) will be treated as if it were actually held by the beneficiaries of the trust (or other entity). In addition, for purposes of this ruling (6), the term "corporation" does not include individuals but generally does include "C" corporations and similar entities, and the term "Operating Asset Proceeds" includes that portion of the cash that was received with regard to Sub1's BusinessA business operations (including an appropriate amount of working capital), but does not include any amount that was received with regard to a reserve for expansion, investment assets, or working capital in excess of that reasonably needed for business operations. Moreover, the amount received with regard to BusinessA's business operations does not include any amount received with regard to any Transferred Intellectual Property transferred from Sub1 to Acquiring (see Step II), unless the Transferred Intellectual Property was held by Sub1 as a BusinessA asset and was used in BusinessA's business operations. Furthermore, in determining whether the distribution is made within the requisite time period, it should be noted that the date of adoption of a plan of liquidation may, in some circumstances, be the date of a prior informal plan rather than the date of formal plan adoption.
- (7) The maximum amount that will be considered to be distributed in partial liquidation is the amount of Sales Proceeds Cash plus the cash from the

Escrow Account to the extent these items were received with regard to the business operations of Sub1's BusinessA, with this maximum amount being decreased by all properly attributable liabilities and expenses. This maximum amount does not include any amount attributable to activities or assets of Parent Group (such as the Transferred Intellectual Property) if such assets did not belong to BusinessA. Moreover, the partial liquidation does not include any earned or accrued investment earnings or gains resulting from any investment of the Sales Proceeds Cash or the Escrow cash. The properly attributable liabilities and expenses (which must be deducted from the amount that may be distributed in partial liquidation) include all of Parent Group's liabilities and expenses (including taxes) arising from the sale of the BusinessA assets and all of Parent Group's liabilities and expenses (including taxes) arising from the distribution of the proceeds to Parent's shareholders. Furthermore, there also must be deducted from the amount distributable in partial liquidation any expenses with regard to, or any current or accrued losses on, any investment of the Sales Proceeds Cash and the Escrow cash, including the temporary investment in Segregated Account, and any such investment losses may not be offset by investment gains. (See Rev. Rul. 60-262, 1960-2 C.B. 115; Rev. Rul. 71-250, 1971-1 C.B. 112; Rev. Rul. 76-279, 1976-2 C.B. 99; Rev. Rul. 76-289, 1976-2 C.B. 100.)

- (8) Any amount distributed to the shareholders that is not considered to be distributed in partial liquidation in accordance with the above rulings or that otherwise fails to constitute a distribution in partial liquidation under section 302(b)(4) may, nonetheless, constitute a distribution in redemption under section 302(b)(1), (2), or (3) that will be treated as in full payment for the stock redeemed under section 302(a), or, alternatively, depending on the circumstances of the particular shareholder, may be treated as a distribution of property under sections 301 and 316.
- (9) For each of the shareholders, the amount of the distribution received by the shareholder that constitutes a distribution in partial liquidation under section 302(b)(4) will be treated as received by the shareholder as full payment in exchange for the shares of stock redeemed by such shareholder, as provided by section 302(a). Gain or loss will be recognized by the shareholder to the extent of the difference between the amount received in the partial liquidation distribution and the adjusted bases of the shares of stock surrendered in exchange therefor. Provided that the redeemed stock constitutes a capital asset in the hands of the exchanging shareholder, the gain or loss will be considered capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.

- (10) No gain or loss will be recognized to Parent on the distribution to its shareholders of cash.

No opinion is expressed about the tax treatment of the transactions under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not directly covered by the above rulings. In particular, no opinion is expressed as to whether the Transferred Intellectual Property was property of BusinessA, and, if not property of BusinessA, the proper Federal tax treatment of any transfer of this property (or the right to use this property) to Acquiring.

This ruling letter 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 the federal income tax return of the taxpayer involved for the taxable year (or years) in which the transactions covered by this ruling letter are consummated.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for the ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Sincerely,
Marlene Oppenheim
Marlene Oppenheim
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Corporate)

cc :