

SIG # 401.29-02

199920047

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Attn: \*\*\*\*\*

Contact Person:

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Telephone Number:

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In Reference to:

OP:E:EP:T:2/50-06967

Date:

FEB 26 1999

Legend:

Corporation A = \*\*\*\*\*

Division J = \*\*\*\*\*

Division K = \*\*\*\*\*

Division L = \*\*\*\*\*

Unit 1 = \*\*\*\*\*

Unit 2 = \*\*\*\*\*

Plan X = \*\*\*\*\*

Corporation B = \*\*\*\*\*

Corporation C = \*\*\*\*\*

Plan Y = \*\*\*\*\*

Agreement N = \*\*\*\*\*

Location O = \*\*\*\*\*

Dear \*\*\*\*\*:

This is in reply to a ruling request dated October 1, 1998, as supplemented by correspondence dated January 28, 1999, submitted by your authorized representative, regarding the federal income tax consequences of certain distributions from a cash or deferred arrangement described under section 401(k) of the Internal Revenue Code.

Corporation A, as originally incorporated, was established in 1977. It is headquartered in Location O where it maintains a Corporate Division. The various business activities of Corporation A are conducted by Divisions J, K and L. These three Divisions engage in businesses that are each separate and distinct from the other. Division J and Division K have engaged in their businesses since 1977. The business of Unit 1 and the

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business of Unit 2 of Division L were started in 1987 and 1991 respectively.

The business function of Division J is the commercial sale of paper and paper related products used in the food processing, food packaging and food service industries. Distributorships are the selling vehicle. Division J has 10 distributorships in 10 cities spanning 6 states. Each distributor is engaged in the business of buying the described products from manufacturers and then selling such products to end users. Of Division J's 320 employees, 20 work at corporate headquarters and the rest work at the distributorships in sales, delivery, purchasing, accounting and warehousing.

The business function of Division K is to serve its membership. Specifically, when a distributor of paper products (inclusive of but not limited to the types of products described above) has membership in Division K, the Division negotiates on behalf of the member-distributor with paper manufacturers for the purchase of products at preferred prices and then negotiates on behalf of the member-distributor with end users for sale of the products. Division K has a nation-wide membership of 300 distributorships, including the ten distributorships of Division J. Of Division K's 90 employees, approximately 50 work at corporate headquarters; the remainder are spread throughout the United States.

Division L is composed of Units 1 and 2. The business function of Unit 1 is the purchase of copy paper at preferred prices for resale to the membership of Division K and to the distributorships under Division J notwithstanding their membership status. Unit 1 has three employees. The business function of Unit 2 is the sale of janitorial chemical supplies to the membership of Division K and to the distributorships under Division J notwithstanding their membership status. Unit 2 has 7 employees. Division L operates Units 1 and 2 on a combined basis.

Division K, Division L, the corporate office of Division J and each distributorship under Division J each have a separate work force, including managerial employees and sales personnel, where applicable, and are each responsible for the hiring and firing of its employees. In addition, each has its own financial statement and survives as a separate profit center. While all three Divisions conduct some level of their businesses from the same facility in Location O, the respective offices are physically separated.

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On \*\*\*\*\*, 1998, Corporation A entered into Agreement N for the sale of 100 percent of Division K and 100 percent of Division L to Corporation B, an unrelated corporation. The sold assets had an original cost of \$\*\*\*\*\*.\*\* and a book value of \$\*\*\*\*\*.\*\* as of December 31, 1997. Corporation A retained rights to accounts receivable estimated at \$\*\*\*\*\*.\*\*. The sale price under Agreement N was \$\*\*\*\*\*.\*\*. It is represented that the purchase price was largely attributable to intangible assets.

Pursuant to Agreement N, an earn-out agreement effective until the year 2001 entitles Corporation A to stock of Corporation B's parent, Corporation C, however, any resulting ownership interest in the buyer's parent is projected at no more than 4 percent. After the sale, the distributorships under Division J will continue with their memberships under Division K.

Corporation A maintains Plan X, a qualified plan under section 401(a) of the Code, for the benefit of its employees. The majority of employees who became employees of Corporation B as a result of the sale of Divisions K and L have account balances in Plan X attributable to elective deferrals. Corporation B maintains Plan Y, a profit-sharing plan with a cash or deferred arrangement and employee stock ownership plan feature. Plan Y is a qualified plan under section 401(a) of the Code. Corporation A employees who became employees of Corporation B became eligible effective July 1, 1998, to participate in Plan Y.

The purpose of the Corporate Division is to provide services to Divisions J, K and L. The Corporate Division groups its employees to work with a particular noncorporate division. Before the sale, the Corporate Division employed 37 employees: 14 of whom worked solely on behalf of either Division K or L and another 13 of whom worked primarily on behalf of either Division K or L. As a result of the sale, these 27 employees, together with 100 percent of the workforces of Divisions K and L, became employees of Corporation B. Employees transferred from Corporation A will work in the same location and have basically the same job duties and responsibilities as prior to the sale.

It is proposed that Plan X will make lump sum distributions to former employees of Corporation A who became employees of Corporation B on account of Agreement N.

Based on the above facts and representations you have requested a ruling that pursuant to section 401(k)(10)(A)(ii) of the Code, which permits distributions to be made on account of the disposition by a corporation of substantially all of the assets used by such corporation in

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a trade or business of such corporation, distributions attributable to elective deferrals may be made to participants in Plan X who became employees of Corporation B.

Section 401(k)(2)(B)(i) of the Code provides, in pertinent part, that distributions from a CODA of amounts attributable to elective deferrals may not be made earlier than the occurrence of certain stated events. Section 401(k)(2)(B)(i)(II) of the Code, when read together with section 401(k)(10)(A)(ii) of the Code and section 1.401(k)-1(d)(1)(iv) of the Income Tax Regulations, further provides that one of these distributable events is the disposition by a corporation of substantially all of the assets (within the meaning of section 409(d)(2)) used by such corporation in a trade or business of such corporation, but only with respect to an employee who continues employment with the corporation acquiring such assets.

Section 1.401(k)-1(d)(4)(iv) of the Regulations states that for purposes of section 1.401(k)-1(d)(1)(iv), the sale of "substantially all" used by the corporation in a trade or business means the sale of at least 85 percent of the assets.

Section 1.401(k)(d)(4) of the Regulations provides additional rules applicable to distributions upon the sale of assets. Section 1.401(k)(d)(4) of the Regulations provides, in part, that (i) the seller must maintain the plan, and the purchaser may not maintain the plan after the disposition, (ii) the employee must continue employment with the purchaser of the assets; and (iii) distribution must be in connection with the disposition of assets. Section 1.401(k)-1(d)(5) of the Regulations provides that a distribution may be made only if it is a lump sum distribution within the meaning of section 402(d)(4) of the Code.

The facts indicate that Corporation A sold at least 85 percent of the assets used in the business of Division K and at least 85 percent of the assets used in the business of Division L to an unrelated corporation, that employees who become employees of Corporation B as a result of Agreement N were hired to perform the same services they provided to Corporation A, that Corporation A continues to maintain Plan X, that lump sum distributions from Plan X will be made in connection with the disposition that results in the employees' transfer to the purchaser for purposes of section 1.401(k)-1(d)(4)(iii) of the Regulations provided that such distributions are made by December 31, 1999.

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Accordingly, with respect to your ruling request, we conclude that pursuant to section 401(k)(10)(A)(ii) of the Code, which permits distributions to be made on account of the disposition by a corporation of substantially all of the assets used by such corporation in a trade or business of such corporation, distributions attributable to elective deferrals may be made to participants in Plan X who became employees of Corporation B.

This ruling is based on the assumption that Plan X is qualified under sections 401(a) and 401(k) of the Code at the time of the transaction, and that distributions to employees are made in connection with the disposition of assets as described in section 1.401(k)-1(d)(4)(iii) of the Regulations.

A copy of this ruling has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

(signed) JOYCE M. FLOYD

Joyce Floyd  
Chief, Employee Plans  
Technical Branch 2

Enclosures:  
Deleted copy of letter  
Notice of Intention to Disclose

CC:  
EP/EO Division  
\*\*\*\*\* Key District Office  
Attn: District Director

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