

Will Carrier Stock Repurchases Be Distributions in Liquidation?

by Robert Willens



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In this article, Willens examines Carrier Global Corp.'s plan to distribute the net proceeds from the divestiture of its commercial and residential fire business

in the redemption of a portion of its stock, and he describes the advantages of partial liquidation treatment for a distributing corporation's noncorporate shareholders.

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Carrier Global Corp. has embarked on what it is referring to as a "transformational journey to becoming a focused, agile, higher-growth, pure-play company dedicated to creating a more sustainable world for generations to come."¹ This metamorphosis has been characterized by significant acquisitions and divestitures, undertaken to place Carrier firmly within the HVAC space while terminating its long-standing involvement in the refrigeration and fire and security lines of business.

Carrier announced that it has entered into a definitive agreement to sell its commercial and residential fire business to an affiliate of Lone Star Funds for an "enterprise value of \$3 billion."² This sale "marks a critical milestone in Carrier's

portfolio transformation, following the [\$14.2 billion] acquisition of Viessmann Climate Solutions in January and the successful divestiture of its Industrial Fire and Global Access Solutions businesses. The Commercial Refrigeration sale is on track to close around the end of the third quarter. . . . Carrier expects to deploy the estimated \$2.2 billion in net proceeds from the transaction towards share repurchases."³

Genuine Contraction

For Carrier's shareholders whose stock will be repurchased, the burning question is whether the redemption proceeds will be treated as a distribution in part or full payment in exchange for the redeemed shares or as a distribution of property to which section 301 applies. In general, a redemption will qualify for exchange treatment, rather than relegated to distribution treatment, if the distributee shareholders sustain a "sufficient" reduction of their proportionate interest in the corporation.

Section 302(a) provides that if "a corporation redeems its stock . . . and if paragraph (1), (2), (3), (4), or (5) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock." Paragraphs (1), (2), and (3) are only applicable if the redemption is not essentially equivalent to a dividend (because it has resulted in a meaningful reduction of the shareholder's proportionate interest), the redemption is substantially disproportionate regarding the shareholder, or the redemption is in complete redemption of all the stock owned by the shareholder. In making these determinations, it is abundantly clear that

¹ See Carrier release announcing agreement to sell to Lone Star Funds (Aug. 15, 2024).

² *Id.*

³ *Id.*

the constructive ownership of stock rules must be taken into account.⁴

There is another pathway to exchange treatment, even if the redeeming shareholders do not suffer the requisite reduction of their proportionate interest in the corporation or any reduction at all. Section 302(b)(4) provides that “subsection (a) shall apply to a distribution if such distribution is (A) in redemption of stock held by a shareholder who is not a corporation, and (B) in partial liquidation of the distributing corporation.”

Section 302(e)(1) provides, “For purposes of subsection (b)(4), a distribution shall be treated as in partial liquidation of a corporation if — (A) the distribution is not essentially equivalent to a dividend (determined at the corporate level rather than at the shareholder level), and (B) the distribution is pursuant to a plan and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.” It is well settled that each of these requirements, including the seemingly ministerial timing requirement, must be strictly complied with (substantial compliance will not pass muster) if a distribution is to attain partial liquidation status.⁵ It has also been held that a formal plan of liquidation is not required to qualify under section 302(e). “However, there must be clear evidence of an intention to liquidate if an informal plan is to be effective.”⁶ It is now well established that the redemption requirement does not always necessitate an actual surrender of stock. A deemed surrender will be found to have taken place when an actual surrender is determined to be a “meaningless gesture.” An actual surrender will attain that designation in cases in which the distribution by the corporation is pro rata; the corporation has issued and outstanding only a single class of stock; and there are no other rights, that is, options, warrants, or convertible securities, affecting the stock.⁷

⁴ See section 302(c)(1): “Except as provided in paragraph (2) of this subsection, section 318(a) shall apply in determining the ownership of stock for purposes of this section.” Section 302(c)(2) provides for a waiver of the family attribution rules for purposes of determining whether a redemption qualifies under section 302(b)(3).

⁵ See Rev. Rul. 77-468, 1977-2 C.B. 109.

⁶ See *Blaschka v. United States*, 393 F.2d 983 (Ct. Cl. 1968).

⁷ See Rev. Rul. 90-13, 1990-1 C.B. 65.

That said, the requirement that truly distinguishes a partial liquidation from a run-of-the-mill redemption is the condition that the distribution be “not essentially equivalent to a dividend.”⁸ A distribution is not a dividend equivalent when it results from a “genuine contraction” of the corporate business. For purposes of securing an advance ruling regarding the issue of dividend equivalence, the IRS requires that the distribution reduce the distributing corporation’s gross revenues, net fair value of assets, and employees by at least 20 percent. The law in this area is not expressed in those strict numerical terms, but in all events to secure genuine contraction classification, the distribution must result in a “significant reduction of the level of business activities.”⁹

In Carrier’s case, the soon-to-be divested commercial and residential fire business does not appear to account for at least 20 percent of Carrier’s gross revenues or net fair value of assets. Still, viewed in isolation, it is more than arguable that the termination of that business, qualitatively, will give rise to a significant reduction in the level of Carrier’s business activities. However, when considering that in implementing its makeover, significant additions have been made to Carrier’s stable of businesses, one wonders whether it can be fairly said that Carrier will truly experience a genuine contraction of corporate business.

In Rev. Rul. 67-299, 1967-2 C.B. 138, a corporation sold one of its operating parcels of real estate but used the proceeds to remodel some of its remaining parcels. Later, it adopted a purported plan of partial liquidation and distributed an amount equal to the net proceeds of the sale to its shareholders in the redemption of a portion of their stock. The ruling determined that the sale “was a potential contraction of the corporate business. However, the remodeling . . . was an expansion of the corporation’s business offsetting any possible contraction effected by the sale.” Thus, the distribution was not a distribution in partial liquidation, and the pro rata redemption was denied the protection of pre-Tax Equity and Fiscal Responsibility Act section 346(a)(2), the

⁸ See Rev. Rul. 79-275, 1979-2 C.B. 137.

⁹ See Rev. Rul. 78-55, 1978-1 C.B. 88, and Rev. Rul. 76-526, 1976-2 C.B. 101.

predecessor of section 302(e), and was found to be a distribution of property to which section 301 applied.

Qualified Trade or Business

The vagaries of the contraction route to exchange treatment can be avoided, however, if the distribution can qualify for what amounts to a safe harbor for nondividend equivalence. Thus, section 302(e)(2) provides:

The distributions which meet the requirements of paragraph (1)(A) shall include (but shall not be limited to) a distribution which meets the requirements of subparagraphs (A) and (B) of this paragraph:

(A) The distribution is attributable to the distributing corporation's ceasing to conduct, or consists of the assets of, a *qualified trade or business*.

(B) Immediately after the distribution, the distributing corporation is actively engaged in the conduct of a qualified trade or business. [Emphasis added.]

The concept of qualified trade or business borrows heavily from section 355's definition of an "active trade or business" for its meaning. Thus, a qualified trade or business is one that has been actively conducted throughout the five-year period ending on the date of the redemption and was not acquired by the corporation within that period in a transaction in which gain or loss was recognized in whole or in part.¹⁰ Moreover, the IRS has ruled that "the size of the discontinued trade or business is immaterial for purposes of determining whether a distribution meets the requirements of section 346(b)" (the predecessor of section 302(e)(2)).¹¹

In Carrier's case, it seems clear that its commercial and residential fire business, the net proceeds from the cessation of which the corporation will employ to repurchase stock, constitutes a qualified trade or business.¹² It is

equally apparent that, following the distribution, Carrier will be actively engaged in the conduct of at least one other qualified trade or business. More significantly, Carrier has pledged to redeploy the estimated \$2.2 billion in net proceeds (that is, the gross sale proceeds less the taxes and expenses arising from the sale) toward share repurchases. Section 346(b), properly construed, requires a complete distribution of the (net) proceeds attributable to the business cessation. Section 346(b) contemplates two types of distributions: one attributable to the corporation's ceasing to conduct a trade or business and one that consists of the assets of a trade or business. The first type deals with proceeds, and the second type deals with assets. The second speaks of "the assets," not merely "assets," and the inference is clear that the meaning is "all the assets." Thus, as the court found in *Baan*, "we must conclude that *all* the [net] proceeds [derived from the sale of a qualified trade or business] must be distributed as well" (emphasis in original).¹³

Carrier's commitment to deploying all the net sales proceeds toward share repurchases appears to satisfy this exacting standard. Thus, Carrier's repurchases, toward which the entire net sales proceeds from the disposal of the commercial and residential fire business will be devoted, exhibit the most important earmark of a distribution in partial liquidation, that is, the factor of nondividend equivalence. Will Carrier adopt, formally or otherwise, a plan of partial liquidation, and will it distribute the net proceeds under that plan in a timely fashion? We have seen on several occasions that corporations seemingly eligible to bestow the advantages of section 302(b)(4) on their shareholders studiously avoid that characterization of their distributions. It may be that those corporations are reluctant to attach the portentous word, "liquidation," to their actions.

While Carrier seemingly has the wherewithal to afford its shareholders access to the benefits of section 302(b)(4), whether it chooses to do so remains to be seen. While the concept of corporate contraction is undoubtedly the primary characteristic of a partial liquidation, it is equally

¹⁰ See Rev. Rul. 71-473, 1971-2 C.B. 179.

¹¹ See Rev. Rul. 77-376, 1977-2 C.B. 107.

¹² See Rev. Rul. 56-451, 1956-2 C.B. 208, and LTR 8633018.

¹³ See *Baan v. Commissioner*, 51 T.C. 1032 (1969), aff'd sub nom *Gordon v. Commissioner*, 424 F.2d 378 (2d Cir. 1970).

true that judicial authority indicates that each of the requirements of section 346(a)(2), including the plan and timing requirements, must be met for a distribution to qualify.¹⁴ Thus, despite the fact that the heavy lifting has been done (that is, Carrier's distributions would certainly be not essentially equivalent to a dividend within the meaning of section 302(e)(1)(A)), Carrier must take the further step of ensuring that those distributions are in accordance with a formally or informally adopted plan and occur within the statutory time frame (that is, before the close of the tax year following the tax year in which the plan is adopted) to ensure its shareholders' access to the benefits of section 302(b)(4). ■

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¹⁴ See *McCarthy v. Conley Jr.*, 341 F.2d 948 (2d Cir. 1965), and Rev. Rul. 77-468.