

Internal Revenue Service

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Person to Contact:

Telephone Number:

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November 2, 1999

Taxpayer =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

Sub 5 =

Business A =

Business B =

Business C =

a =

b =

c =

d =

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Date 1 =

We respond to your letter dated July 1, 1999, requesting rulings on the federal income tax consequences of completed and proposed transactions. Additional information was submitted in letters dated August 18 and September 21, 1999. The information submitted for consideration is summarized below.

Taxpayer is a closely held, domestic corporation and the parent of a consolidated group of corporations. Taxpayer has three classes of stock, all of which are owned by individuals or trusts. The classes of stock consist of a shares of preferred stock, b shares of voting common stock, and c shares of nonvoting common stock. Sub 1, Sub 2, Sub 3 and Sub 4 are wholly owned subsidiaries of Taxpayer. Sub 5 is a wholly owned subsidiary of Sub 4.

Sub 1 has been engaged in Business A for over five years. Sub 2 has been engaged in Business B and Business C for over five years. Each of the remaining subsidiaries likewise has been engaged in the active conduct of a trade or business for over five years.

Taxpayer has decided to terminate the business of Sub 1. Accordingly, on Date 1, the operating assets of Sub 1 were sold to an unrelated buyer. The proceeds of the sale were set aside in a separate bank account and have not been utilized for any purpose except to be held by the bank to accrue interest pending the determination of this ruling request. The only assets remaining are two parcels of land for which Sub 1 was unable to realize a fair value and, therefore, was unwilling to sell.

Taxpayer wishes to distribute a portion of the proceeds to its shareholders in partial liquidation. Only cash will be distributed, and the distribution will not include any accrued earnings on the bank account. To that end, Taxpayer has represented that Sub 1 will liquidate into Taxpayer, thereby transferring its attributes to the Taxpayer in accordance with § 381 of the Internal Revenue Code. Taxpayer will directly retain ownership of the remaining two parcels of land. Taxpayer will then, pursuant to a plan of partial liquidation, distribute pro rata to its common stock shareholders that amount of the proceeds sufficient to result in at least a 20 percent contraction of Taxpayer. Taxpayer will not require that the distribution be accompanied by a formal surrender and cancellation of a proportionate number of shares of Taxpayer common stock.

Taxpayer has made the following representations in connection with the proposed transaction:

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- (a) All distributions pursuant to the plan of partial liquidation will be made within the taxable year in which the plan is adopted or within the succeeding taxable year.
- (b) The proceeds from the sale of assets to be distributed are not from (1) a reserve for expansion which is no longer needed; (2) a mere decline in, or loss of business; (3) a mere decrease in need for working capital; (4) mere proceeds of a sale which is nominal in relation to the entire business of the Taxpayer; and (5) a mere business operated at a loss which acquired assets from another business of the Taxpayer.
- (c) The proceeds to be received in partial liquidation will be segregated in a special account and will not be used in Taxpayer's continuing business. The proceeds will be temporarily invested in savings accounts, money market certificates, certificates of deposit, mutual fund accounts or other similar liquid short-term investments.
- (d) The assets sold represent assets that were actively used in the business, or were replacements of assets actively used in the business, and were neither passive or investment assets nor substituted assets.
- (e) As a result of the partial liquidation, Taxpayer's gross revenues, number of employees, and net book value of its assets each will be reduced by at least 20 percent. As an appraisal of the net fair market value of all of Taxpayer's assets would be inordinately cumbersome, the Taxpayer asserts that it is unaware of any substantial deviation in the proportion of net fair market value reduction to the book value reduction.
- (f) The business of Sub 1 was continuously and actively conducted for the five-year period immediately preceding the date of the sale of assets of Sub 1, and Taxpayer will continue to be actively operated.
- (g) There is no current plan or intention to completely liquidate Taxpayer, and it will continue to be engaged in business.
- (h) There is no plan or intention to re-enter a terminated business or expand Taxpayer's continuing Business B and Business C (conducted by Sub 2) through other than normal internal growth.
- (i) No assets representing income earned on the short term investment of the proceeds will be distributed pursuant to the plan of partial liquidation.

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- (j) All distributions pursuant to the plan of partial liquidation will be made in cash or its equivalent.
- (k) The cash distributed to each shareholder will be proportionate to the outstanding common stock shares. There will be no redemption of shares as part of this partial liquidation.
- (l) None of the consideration received pursuant to the proposed transaction will be received by any shareholder as a debtor, creditor, employee, or in any capacity other than as a shareholder.
- (m) The maximum amount of the proceeds to be distributed in partial liquidation will equal approximately \$ d, which represents the proceeds from the sale of the assets of Sub 1, less any losses on the temporary investment of the sales proceeds, less any amount allocated to a covenant not to compete with the buyer, less all expenses and taxes incurred on the sale and those incurred in connection with the distribution. The amount of cash distributed will be limited to the net proceeds from the sale of assets of Sub 1 less all liabilities attributable to those assets retained or distributed in kind. No working capital will be distributed in the transaction.
- (n) The amount of the distribution in partial liquidation will not include any portion attributable to Sub 1's indebtedness to Taxpayer that was canceled upon the liquidation.

Based solely on the information submitted and the representations set forth above, we hold as follows:

- (1) The distribution will be treated as a distribution in partial liquidation under § 302(e)(1), provided the distribution is made in the taxable year in which the plan of partial liquidation is adopted or in the next succeeding year (§ 1.346-1(a)(2); Rev. Rul. 75-223, 1975-1 C.B. 109).
- (2) The maximum amount considered distributed in partial liquidation will equal the sales proceeds received from the sale of Sub 1, reduced by all liabilities attributable to Sub 1 (including all taxes and expenses of Taxpayer incurred in connection with the sale of Sub 1 and the proposed transaction). This amount will not include any earned or accrued investment earnings on the sales proceeds.
- (3) Any amount distributed to the shareholders that exceeds the amount specified in ruling (2) above may constitute a distribution in redemption

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under § 302(b)(1), (2), or (3) that will be treated as in full payment for the stock constructively redeemed (§ 302(a)), or, alternatively, depending on the circumstances of the particular shareholder, may be treated as a distribution of property under §§ 301 and 316.

- (4) The distribution will be treated as in full payment in exchange for the stock deemed to have been redeemed (§ 302(a)). Gain or loss will be recognized to Taxpayer's non-corporate shareholders to the extent of the difference between the amount distributed in the partial liquidation and the adjusted basis of the shares deemed surrendered in exchange therefor. Provided that the Taxpayer stock is a capital asset in the hands of the Taxpayer shareholders and that § 341(a) (relating to collapsible corporations) is not applicable, gain or loss, if any, will be considered capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Code.
- (5) No gain or loss will be recognized to Taxpayer on the distribution of the sales proceeds from Sub 1 consisting solely of cash in partial liquidation. (§ 311(a)).
- (6) For purposes of rulings (1) and (4) above, the number of shares that will be considered to be constructively redeemed for the purpose of determining gain or loss will be determined in accordance with the principles set forth in Rev. Rul. 77-245, 1977-2 C.B. 105.

No opinion was requested and none is expressed as to whether, for federal income tax purposes, the granting of a covenant not to compete should be considered a separate transaction from the sale of Sub 1's assets and, if separate, the fair market value of this covenant and the portion of the proceeds properly allocable to this covenant. See §4.02(1) of Rev. Proc. 99-3, 1999-1 I.R.B. 103. The tax treatment of any portion of the proceeds so allocable is not governed by the rulings in this letter, and no opinion is expressed as to the federal tax consequences to Buyer, Taxpayer or Taxpayer's shareholders with regard to any amount allocable to the covenant.

No opinion is expressed about the tax treatment of the partial liquidation 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, these transactions that are not specifically covered by the above rulings.

No opinion is expressed about the tax treatment of the distribution of the assets of Sub 1 to Taxpayer in complete liquidation or the recognition of gain or loss on such liquidation.

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No opinion is expressed about the tax treatment of any distribution of proceeds which is less than the amount necessary to result in at least a 20 percent contraction of Taxpayer. Nor is any opinion expressed regarding the tax effect for federal income tax purposes of the reincorporation of any part of the distributed proceeds.

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.

A copy of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

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,

Assistant Chief Counsel (Corporate)

By: *Filiz A. Serbes*

Filiz A. Serbes

Assistant to the Chief, Branch 5