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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Uniform Issue List: 401.00-00

Contact Person:

Telephone Number:

In Reference to: T:EP:RA:T3

Date:

JUN - 6 2001

Att'n:

Legend:

Corporation A =

Corporation B =

Plan X =

Dear

This is in response to your request for a ruling, dated August 18, 1998, and supplemented by additional correspondence dated January 11, 1999, May 17, 2000, June 27, 2000 and December 6, 2000, submitted by your authorized representative. The request concerns the federal excise tax consequences of certain dispositions by an employee stock ownership plan under section 4978 of the Internal Revenue Code ("Code"). The following facts and representations have been submitted by your authorized representative.

Corporation A established Plan X on June 1, 1977. Plan X is qualified under section 401(a) of the Code and is an employee stock ownership plan ("ESOP") as described in section 4975(e)(7) of the Code. Plan X acquired shares of Corporation A stock, some of which was acquired during 1996, 1997, and 1998 (the last three years in sales to which Code section 1042 applied). Plan X owns 65.28% of Corporation A stock.

On May 31, 1998, Corporation A sold substantially all of its operating assets to Corporation B, an unrelated corporation founded in 1990, pursuant to an Asset Purchase Agreement ("Agreement") dated April 9, 1998. Consequently, Corporation A's Board of Directors approved and its shareholders adopted a Plan of Liquidation for Corporation A ("Plan of Liquidation"), which became effective June 1, 1998, and specifically authorized the liquidating trustees to, among other things, make interim distributions to shareholders (including Plan X) in liquidation of Corporation A. Pursuant to the Plan of Liquidation and resolutions adopted by the Board of Directors of Corporation A, certificates of dissolution for Corporation A will be filed with the appropriate authorities to commence the dissolution of Corporation A. A substantial portion of the sales price was paid to Corporation A on June 1, 1998.

Under the Agreement, Corporation B required that all of Corporation A's employees (including Plan X participants) be terminated as a condition to the asset sale. Accordingly, all 373 of Corporation A's employees were terminated effective May 31, 1998, and all incurred a one-year

203

break in service no later than December 31, 1999. Article VI of Plan X requires that distributions be made available to each participant as soon as administratively practicable after the year in which the participant's separation from service occurs. The terms of Plan X require that it must offer each participant who elects an option to take cash in place of Corporation A's stock in his account.

The shareholders of Corporation A adopted a plan of liquidation, in part, to allow Plan X to make cash distributions to the Plan X participants who would become eligible for distributions under the Plan. Corporation A intends to make interim liquidating distributions to Plan X when it has excess cash available, and make its final liquidating distribution and cancel the shareholders' stock certificates on or before May 31, 2000. Corporation A will terminate Plan X as soon as it is administratively practicable to do so.

Based on the foregoing, you request a ruling that the liquidating distributions Corporation A makes to Plan X by reason of its employees separating from service with Corporation A for a period resulting in a one-year break in service as defined in section 411(a)(6)(A) of the Code, are exempt from the Code section 4978 excise tax pursuant to the exceptions prescribed in section sections 4978(d)(1)(D).

Section 4978 of the Code imposes a 10% excise tax on an employer maintaining an employee stock ownership plan if, during the three-year period after the date on which the employee stock ownership plan acquired qualified securities in a sale to which Code section 1042 applied, such plan disposes of any qualified securities and (1) the total number of shares held by such plan after such disposition is less than the total number of employer securities held immediately after the Code section 1042 sale or (2) the value of qualified securities held by such plan after such disposition is less than 30% of the total value of all employer securities as of such disposition.

Section 4978(d)(1)(D) of the Code states, in pertinent part, that the section 4978 tax does not apply with respect to any distribution of qualified securities (or sale of such securities) which is made by reason of the separation of an employee from service for any period which results in a one-year break in service (within the meaning of section 411(a)(6)(A)).

Under former section 402(d)(4), special tax treatment was available for employees who separated from service within the meaning of that section. For tax years beginning prior to January 1, 2000, section 402(d)(4) provided special forward averaging treatment for lump sum distributions from plans qualified under section 401(a). Section 402(d)(4)(A) provided that a lump sum distribution was a distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient upon one of several events, including a separation from service. Special forward averaging treatment of lump sum distributions was generally repealed by sections 1401(a) and (c)(2) (subject to limited grandfather treatment) as part of the Small Business Job Protection Act of 1996, P.L. 104-188, 1996-3 C.B. 155.

Revenue Ruling 79-336, 1979-2 C.B. 187 provides that for purposes of the special forward averaging treatment of lump sum distributions under the former section 402(d)(4), an employee will be considered separated from service within the meaning of section 402(d)(4)(A) (formerly section 402(e)(4)(A)) only upon the employee's death, retirement, resignation, or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, or consolidation, etc. of the former employer (i.e. the "Same Desk Rule).

In this case, Corporation A's asset sale is made to Corporation B, an unrelated corporation established in 1990. The former Corporation A employees now employed by Corporation B are not providing services back to Corporation A. Thus, these employees will not be considered to be employed in a continuation of the same trade or business. Accordingly, we have determined that all of the Corporation A employees terminated effective as of May 31, 1998 as a result of the sale (including those employees hired by Corporation B) have separated from service for purposes of section 4978(d)(1)(D) of the Code.

Based on the facts submitted, we have also determined that the liquidating distributions made by Corporation A to Plan X were made by reason of the employees' separation from service (within the meaning of section 4978(d)(1)(D)) to the extent that such amounts are distributed to the employees in accordance with the terms of Plan X prior to the final dissolution of Corporation A. Consequently, we conclude that such liquidating distributions are excepted from the section 4978 excise tax that would otherwise apply.

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 by others as precedent.

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,

Frances V. Sloan

Frances V. Sloan
Manager, Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose

cc:

205