DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR Associate Area Counsel
Washington, DC (LMSB)
Attention: Cheryl Rees, Senior Attorney

FROM: ALFRED C. BISHOP, JR.
Chief, CC:CORP:6

SUBJECT: Acquisition of a corporation followed by its liquidation into the acquiring corporation

LEGEND

Corporation 1 =

Corporation 2 =

Corporation 3 =

Subsidiary =

New Subsidiary =

Business A =

Business B =

Business C =

Company =

Government =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

$A =

$B =

$C =

$D =

$E =

$F =

$G =

$H =

i% =

This Chief Counsel Advice responds to your request for our opinion on the characterization of certain transactions in the above-referenced case. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent. We assume your response to the Field will contain a more comprehensive recitation of the facts. Briefly, our understanding of the facts is as follows:

On Date 1, Corporation 1 acquired i% of the shares of Corporation 2. Shortly thereafter, Corporation 1 made an offer, accepted on Date 2, to acquire the remaining Corporation 2 stock. While awaiting Government's approval of the acquisition of Corporation 2, the Corporation 2 stock was placed in trust. During this time, negotiations took place for Corporation 1 to sell the Business A assets of Corporation 2's wholly-owned subsidiary, Subsidiary, and its subsidiaries.

On Date 3, Corporation 1 and an unrelated third party, Corporation 3, reached an agreement, pursuant to which Corporation 1 was to sell its stock in Subsidiary to Corporation 3. The parties agreed that, at the time of the acquisition, Subsidiary and its subsidiaries were to hold only the assets wanted by Corporation 3 -- i.e., the Business A assets of Subsidiary and its subsidiaries. The sale (i.e., of the Subsidiary stock to Corporation 3) was contingent on Government's approval of the sale of the Corporation 2 stock to Corporation 1.

On Date 4, Government approved the sale of the Corporation 2 stock to Corporation 1. Corporation 1 paid consideration of approximately $A for the Corporation 2 stock: $B in cash, $C in convertible preferred shares, and $D from borrowed funds (i.e., $E from bridge loans and $F from a revolving credit facility).

On Date 5, Corporation 2 liquidated, distributing to Corporation 1 all its assets, including the Subsidiary stock owned by Corporation 2.

On Date 6, Subsidiary redeemed a portion of the stock that Corporation 1 owned in Subsidiary in exchange for Subsidiary's stock in certain subsidiaries.[1] On that same date, Subsidiary sold its Business B assets to a newly-formed subsidiary of Corporation 1, New Subsidiary, in exchange for a note in the amount of $G. Also on Date 6, Corporation 1 sold the remaining shares of Subsidiary (that were not redeemed) to Corporation 3 for nonstock consideration of approximately $H. This consideration included, in part, a note for $G. At the time of Corporation 1's sale of the Subsidiary stock, Subsidiary and its subsidiaries owned Business A, the $G note, cash, short-term investments and tax receivables. Corporation 1 tendered to Subsidiary the $G note received from Corporation 3, in full payment of the note in the amount of $G owed by New Subsidiary to Subsidiary. Additionally, Corporation 1 applied the sales proceeds from the sale of Business A to pay off the bridge loan.

Within months and years of the Corporation 1 sale of the Subsidiary stock to Corporation 3, Corporation 1 sold various assets previously owned by Subsidiary and the subsidiaries to certain Corporation 1 subsidiaries, as well as unrelated third parties. As of Date 7, the only business previously owned by Subsidiary that Corporation 1 still owned and operated was Business C, operated as Company.

The Field is considering arguing that the Date 5 transaction in which Corporation 2 liquidated into Corporation 1 triggered deemed liquidations of Subsidiary and the corporations that were subsidiaries of Subsidiary at the time Corporation 1 sold the

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[1]The Field's memorandum indicates Subsidiary reported capital gain on the excess of the fair market value of the stock of the subsidiaries over the tax basis of the shares, but does not indicate if Corporation 1 also realized, and was required to report, any gain in the redemption transaction.

Subsidiary stock to Corporation 3. The Field asserts that these deemed liquidations trigger deemed dividends and capital gains under section 331 (and also states that the transaction does not qualify for the general nonrecognition rule of section 355 as it was principally a device for the distribution of earnings and profits of Subsidiary).

We believe the Date 5 transaction in which Corporation 2 liquidated into Corporation 1 cannot be viewed as triggering deemed or constructive liquidations of Subsidiary and the subsidiaries. Corporation 2 liquidated at this time, but we see no facts that would support a position that Subsidiary and its subsidiaries also liquidated at this time. We observe that, at or about this time, Subsidiary and its subsidiaries disposed of a significant amount of assets that Corporation 3 did not want; however, Subsidiary and the subsidiaries also appear to have retained significant assets. The facts indicate Corporation 1 bought the Corporation 2 stock for approximately $A and that Corporation 1 sold the Subsidiary stock to Corporation 3 for approximately $H. The IE examiners confirmed, through discussions with our office, that Subsidiary and the subsidiaries retained significant assets. Overall, we believe no facts support an argument that Subsidiary and the subsidiaries liquidated at or about the time Corporation 2 liquidated.

The Field is also considering arguing that Corporation 1's sale of the stock of Subsidiary on Date 6, to Corporation 3 represents a sale of assets, rather than a sale of stock. We assume no section 338 election was made with respect to this sale.

We believe the Field should not argue that Subsidiary sold assets, rather than that Corporation 1 sold the Subsidiary stock. We believe the form of the transaction should be respected-- i.e., as a sale of the Subsidiary stock by Corporation 1 to Corporation 3. Our understanding is that the sales agreement between Corporation 1 and Corporation 3 provides that Corporation 1 is to sell Subsidiary stock, and we are unaware of sufficient facts (e.g., agreements or evidence of negotiations) to support the argument that Subsidiary instead sold assets. Furthermore, we believe the argument (i.e., that Subsidiary sold assets, rather than Corporation 1 sold Subsidiary stock) may be inconsistent with Rev. Rul. 90-95, 1990-2 C.B. 67. Briefly, in Rev. Rul. 90-95, a section 338 qualified stock purchase, immediately followed by a liquidation of the target, was respected as a stock purchase, rather than treated as an asset purchase.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call if you have any further questions.