Office of Chief Counsel
Internal Revenue Service

memorandum

CC:[redacted] TL-N-3317-99
[redacted]

date: APR 18 2000

to: Examination Division, [redacted]
Attention: [redacted]

from: District Counsel, [redacted] District

ubject: [redacted]
Statute of Limitations/Transferee Liability
UIL 1502.77-00 Regulations Governing Consolidated Returns, Common Parent as Agent for Subsidiaries
6901.03-01 Transferred Assets, Period of Limitations, Extension by Agreement
6901.05-00 Transferred Assets, Definition of Transferee

Years previously examined, pending with Appeals:

Years currently under examination: [redacted]

STATUTE OF LIMITATIONS EXPIRES:
[redacted] (for [redacted] through [redacted])
[redacted] (for [redacted])

DISCLOSURE STATEMENT

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ISSUE: How may the statute of limitations be extended for liabilities due from the above-named taxpayer?

CONCLUSION:

Our recommendations are set forth in detail at the end of this memorandum. The consolidated return years present additional complications, and the proposed recommendations are subject to some discretion and to changes in circumstances. We discuss the alternatives in our memorandum below, but at the present time our preference is as follows:

1. A Form 872 should be obtained from the taxpayer in its individual capacity for the separate return years, and another from [redacted], as successor of the taxpayer in its individual capacity for the separate return years.

2. A Form 872 should be obtained from the "taxpayer and subsidiaries" for the consolidated return years, and from [redacted], as successor of the "taxpayer and subsidiaries" for the consolidated return years.

3. A Form 872 should also be obtained from each of the taxpayer's former subsidiaries for the consolidated return years during which each subsidiary was a member of the consolidated group. Before you can deal separately with the subsidiaries, you must send the taxpayer a letter notifying it that you intend to deal directly with the former subsidiaries with regard to the [redacted] and [redacted] taxable years for the consolidated tax of the taxpayer and subsidiaries group. The form and content of this letter are described in our memorandum below.

4. A Form 977 should be obtained from [redacted]; from [redacted]; from [redacted]; from [redacted] and from [redacted] covering each party's liability as transferee of the taxpayer both for the separate return years, and for the consolidated return years.

5. No Form 2045 should be obtained at the present time from any of the parties listed under item 3.

FACTS

General Background. The tax liabilities in this case were incurred by [redacted], commonly known

as [redacted]. The taxpayer filed separate returns for the taxable years [redacted] through [redacted]. For the taxable years [redacted] and [redacted], the taxpayer filed consolidated returns with its subsidiaries, [redacted] For the taxable years [redacted], and [redacted] and [redacted], the consolidated group also included [redacted], and [redacted]. The taxpayer dissolved on or about [redacted].

Prior to 1987, Blue Cross and Blue Shield organizations generally operated independently in specific geographic jurisdictions under specific legislation that varied from jurisdiction to jurisdiction. Since the principal function of Blue Cross organizations is to provide coverage for health benefits on a not-for-profit basis, the special legislation generally combined elements applicable to insurance companies with elements applicable to charitable organizations. See, for example, [redacted].

In 1986, Congress became concerned that such organizations were in effect engaged in insurance activities whose nature and scope are inherently commercial rather than charitable, and that such organizations' tax exempt status provided an unfair competitive advantage over commercial insurers. Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 584 (1987). Accordingly, I.R.C. §501(m) was enacted as part of the Tax Reform Act of 1986, effectively ending tax exempt treatment for Blue Cross and Blue Shield organizations by allowing tax exemption to an organization "only if no substantial part of its activities consists of providing commercial-type insurance."

Based on excerpts from the taxpayer's financial statements, it appears that since at least [redacted], the taxpayer carried out its operations through [redacted], a corporation jointly-owned by the [redacted] organizations of [redacted]. This subsidiary corporation was sometimes called "[redacted]" and sometimes "[redacted]." As of [redacted], the taxpayer entered into an administrative services agreement with [redacted], in connection with which all but [redacted] employees of the taxpayer were transferred to [redacted]. ([redacted] Financial Statement.) Under the agreement, [redacted] provided all of the necessary services in four primary areas: Marketing, Benefits Administration/ Information Systems, Finance and Administration. ([redacted] Financial Statement.)

At [redacted], the taxpayer owned a [redacted]% interest in [redacted]. During [redacted], the taxpayer's ownership increased to [redacted]%. ([redacted] Financial Statement.)

The [redacted] financial statement indicates that the taxpayer "reorganized substantially," in anticipation of a new administrative contract between the taxpayer and [redacted] "that was on the threshold of being signed [redacted] at year's end." The taxpayer's President reported that "The reorganization also took into consideration that all but a few [redacted] employees would be transferred to [redacted] once the contract was finalized." The new contract was signed [redacted], although Article XXIII states that the term of the agreement shall begin on [redacted].

As noted above, the Tax Reform Act of 1986 effectively ended tax exempt treatment for Blue Cross and Blue Shield organizations. Among other things, section 1012(c)(3)(A)(ii) of the Act included a provision allowing Blue Cross and Blue Shield organizations to adjust the basis of their assets to the fair market value on the first day of the first taxable year beginning after December 31, 1986, so that such organizations would "not be taxed on unrealized appreciation or depreciation that accrued during the period the organization was not generally subject to income taxation." Conf. Rep. No. 99-841 at II-350. In the present case, because of the unusual relationship between the taxpayer and Northeast Consolidated Services, questions arise as to what assets were owned by which entity as of December 31, 1986.

Taxpayer's Claims. The examination in this case covered the taxable years [redacted], [redacted], and [redacted]. At the conclusion of the examination the taxpayer filed a protest with the Appeals Division. While the case was pending with the Appeals Division, the taxpayer for the first time presented informal claims for losses based on the partial abandonment of various assets allegedly held on [redacted], with fair market values on that date as follows:

Customer Relationships	$ [redacted]
Provider Contracts	
Assembled Employees	
Software	
Total	$ [redacted]

An appraisal presented by the taxpayer shows total abandonment losses for these assets from [redacted] through [redacted] of $[redacted].

The abandonment loss claims have been referred to the Examination Division for investigation. While the case was pending with the Appeals Division, the taxpayer sold its health benefits operations. The taxpayer dissolved following the sale.

The statute of limitations for the years [redacted] through [redacted] will expire [redacted].

The issue for the present memorandum is to identify the party or parties that may be liable for any deficiencies in tax that may be proposed, for purposes of extending the statute of limitations.

Asset Purchase Agreement. The terms of the sale of the taxpayer's health benefits operations are set forth in an Asset Purchase Agreement dated [redacted]. Because of the taxpayer's unusual status under [redacted] law, the sale was subject to review by the Insurance Commissioner and by the Director of Charitable Trusts, and was also the subject of hearings before the Probate Court. In an Order dated [redacted] [redacted], the Probate Court approved the dissolution of the taxpayer, effective as of the closing date of the sale. These proceedings are summarized in a memorandum dated [redacted], from [redacted] [redacted], who is identified as the interim Secretary for [redacted]. According to [redacted]'s memorandum, the sale closed [redacted]. Par. 16.

The principal materials for review are the Asset Purchase Agreement, a Findings and Determination by the Director of Charitable Trusts, dated [redacted], a Findings and Final Order by the [redacted] Insurance Commissioner, dated [redacted] [redacted], the Order of the Probate court, dated [redacted] and [redacted]'s memorandum of [redacted]. There are some inconsistencies between these materials which will be noted in the following discussion.

The Asset Purchase Agreement identifies the parties to the sale as:

> [redacted], a [redacted] service corporation (the "Seller"), and

, an mutual insurance company (the "Purchaser").

However, the Findings and Final Order of the Insurance Commissioner indicate that the actual application for acquisition of was submitted by "", a wholly owned subsidiary of , which is a wholly owned subsidiary of .

The total consideration stated in the Asset Purchase Agreement was $. According to , the sales proceeds were distributed as follows:

Purchase Price	$
Satisfaction of Surplus Note Obligations	<$ >
Escrow for Purchase Price Adjustment	<$ >
Transaction Expenses	<$ >
Net Sale proceeds	<$, >

memorandum, par. 6.

The Asset Purchase Agreement refers in several places to "the Seller or the Foundation." The Definitions section of the Agreement states that "'Foundation' means an independent charitable foundation to be established after the date of this Agreement, with oversight by the Attorney General's Office, to receive some or all of Total Consideration at the direction of the Probate Court." The Agreement indirectly recognizes that the Seller has a charitable obligation. In section 5.12 (page 55) the Seller and Purchaser agree that "the Total Consideration will be distributed and used in the manner directed by the Probate Court in its order on the Seller's cy pres petition." One of the Conditions to Closing of the transaction is entitled "Resolution of Charitable Claims, Etc." (page 67) and requires that "The approvals of Governmental Authorities shall (i) clearly discharge all charitable, cy pres or similar claims on the Assets through the establishment and funding of the Foundation or as otherwise directed by the Probate Court." Thus, the Agreement contemplates that at least some of the proceeds payable to the Seller will be used to fund a charitable foundation.

Under section 2.01 of the Asset Purchase Agreement (page 16), the Seller (,) transferred "all the assets" owned by the Seller, other than

certain "Excluded Assets." The assets transferred include "all equity interests in other Persons (including without limitation equity interests in Affiliates and Subsidiaries) held by the Seller." The Excluded Assets include the "Seller's Tax Refund Claims," which are described in Exhibit 1.01(b) of the Agreement as any right or claim for refund or credit, "but only to the extent that such refund, reduction, credit or other application arises in connection with . . . the basis adjustment provisions of Section 1012(c)(3)(A)(ii) of the Tax Reform Act of 1986." Thus, the Seller retains its right to any tax refunds arising from the step-up in basis. However, later in the Agreement section 2.09 (page 24) indicates that any "Excess Tax Refund" shall be split with the Purchaser fifty/fifty.

Section 2.02 of the Agreement (page 18) provides that the Purchaser [redacted] shall assume and pay "all Liabilities of the Seller as at the Closing Date, . . . except for the Excluded Liabilities." These Excluded Liabilities included the "Seller's Aggregate Tax Liability," which is described in Exhibit 1.01(a).

Allocation of Tax Liabilities. Exhibit 1.01(a) sets forth a somewhat complicated formula which distinguishes between the "Pre-Closing Portion" of the Seller's tax liability, and the "Seller's Post-Closing Tax Liabilities." The Seller's Post-Closing Tax Liabilities are defined in the Agreement (page 13) as the liability for taxes imposed on income earned after the Closing Date. Exhibit 1.01(a) indicates that these liabilities shall be calculated using the highest marginal rate applicable in determining the total liability. The Pre-Closing Portion of the total liability is then the difference between the total liability and the Seller's Post-Closing Liability.

The Pre-Closing Portion of the liability is then allocated to the Seller in proportion to the ratio between the income or gain attributable to the consummation of the transaction, and the aggregate income or gain attributable to events occurring prior to the Closing Date. The portion allocated to the Seller constitutes the "Seller's Aggregate Tax Liability." The balance of the liability for taxes would be included in "all Liabilities" assumed by the Purchaser.

[redacted]'s memorandum summarizes the transaction thus far as follows: "At the closing, the Foundation assumed [redacted]'s Tax liabilities, if any, attributable to the sale of [redacted]'s assets to [redacted] (the 'Transactional Tax Liabilities'); and [redacted] assumed all other Tax liabilities of [redacted], if any,

relating to periods through the closing (the 'Operational Tax Liabilities')." Par. 10. The Agreement itself does not use the terms "Transactional Tax Liabilities" or "Operational Tax Liabilities," but [redacted]'s description is consistent with the substance of the Agreement. The Purchaser is assuming all liabilities, which would include "operational" taxes, but does not assume the "Seller's Aggregate Tax Liability," which, as described above, in effect consists of the "transactional" tax liabilities -- the liabilities arising from the consummation of the sale.

The Order of the Probate Court approves "[t]he assumption by the Foundation of certain [redacted]'s contractual obligations." Page [redacted]. This seems to refer to the liabilities retained by the Seller under the Asset Purchase Agreement. Although these obligations are described as "contractual," the Order attaches an Exhibit A containing "supplemental finds of fact," which states "Specifically, the Foundation must expressly assume [redacted]'s obligations pursuant to Article VII and Sections 1.09, 5.09 and 9.01 of the Asset Purchase Agreement, relating to taxes, non-competition and indemnification." Organizational documents for the Foundation indicate that it is called "[redacted]."

Distribution of proceeds. [redacted]'s memorandum states that "The Probate Court directed that the net sale proceeds . . . be paid to a newly-formed charitable healthcare foundation. . ." Paragraph 8. The Order does refer to "[t]he payment of the net proceeds of the Sale and the transfer of [redacted]'s remaining assets to the Foundation" (page [redacted], but the actual terms of the Order are that "[redacted] shall apply the net proceeds of the Sale in the manner set forth in paragraphs [redacted] through [redacted] of the Petition." (Page [redacted]) A copy of the petition is not presently available. For purposes of this memorandum, we assume the net proceeds have in fact been paid to [redacted], or are in the process of being paid to [redacted]

The Asset Purchase Agreement also provides for the disposition of "Tobacco Claims," which are described as claims against tobacco companies for expenditures made by the Seller and its self-funded customers. Such claims were specifically included among the assets transferred to the purchaser. Section 5.14 (page 58) however indicates that the net proceeds will be divided with [redacted] percent to the Foundation, and [redacted] percent to the Purchaser. The Order of the Probate Court indicates that a separate foundation was established for the anticipated tobacco claims recoveries. Organizational documents

for this foundation indicate that it is called "[redacted]."

In summary:

1. With certain exceptions and exclusions, the purchaser received all the assets of the taxpayer and assumed all its liabilities, in exchange for a purchase price of $[redacted]. It appears that the assets received included the subsidiaries of the taxpayer's consolidated group. It is not clear whether the purchaser is [redacted], as stated in the Asset Purchase Agreement, or [redacted], as stated in the Findings and Final Order of the Insurance Commissioner. By the terms of the Asset Purchase Agreement, the purchaser assumed all tax liabilities for activities through the Closing Date, other than taxes arising out of the sale itself.

2. The seller dissolved following the sale. The net sales proceeds of $[redacted] were transferred to [redacted], along with the taxpayer's refund claims based on intangible assets -- the claims which have been referred to the Examination Division for investigation. [redacted], also assumed the taxpayer's liability for taxes arising out of the sale of the taxpayer's assets.

3. A second foundation, [redacted], will receive any net proceeds received from the prosecution of certain claims against tobacco companies.

It is our understanding that no return has yet been filed for the taxpayer's final taxable period. The information available does not indicate that either the taxpayer or the members of the group have designated any other member of the group to act as agent for the group.

DISCUSSION

General Discussion: Transferee Liability

I.R.C. §6901 provides that the liability at law or in equity of a transferee of property may be assessed and collected in the same manner as in the case of the taxes with respect to which the liability was incurred. Section 6901(c) sets forth the period for assessment of transferee liability. With respect to the initial transferee, the liability must be assessed within one

year after the expiration of the period of limitations for assessment against the transferor. For any transferee of a transferee, the liability must be assessed within one year after the expiration of the period of limitations for assessment against the preceding transferee, but not more than three years after the expiration of the period of limitations for assessment against the initial transferor.

For purposes of section 6901, a transferee is a party who receives property under circumstances that subject the transferee to the outstanding liabilities of the transferor. There can be no "transferee" liability without a transfer. However, all recipients of property are not "transferees" for purposes of section 6901, in the sense that all transfers do not necessarily subject the party who receives the property to the liabilities of the party transferring the property.

The liability of a transferee arises in a different manner from the liability of a transferor. The liability of a transferor is a primary liability, based upon a taxable transaction. The liability of a transferee is a secondary liability, based upon the receipt of property under circumstances which subject the party who receives the property to the liabilities of the party transferring the property.

Under the laws of some states, the corporation resulting from a consolidation or merger is liable for the obligations of the predecessor corporations "to the same extent as if said debts, liabilities, and duties had been incurred or contracted by it [the "resulting or surviving corporation]." 4. Del. Code Ann. tit. 8 § 259(a), discussed in Missile Systems Corp. of Texas v. Commissioner, T.C.M. 1964-212. It has been held that under such laws the corporation resulting from the consolidation or merger is primarily liable on the same basis as the original taxpayer, and thus is not secondarily liable as a transferee. Commissioner v. Oswego Falls Corporation, 71 F.2d 673 (2d Cir. 1934); Missile Systems Corp. of Texas v. Commissioner, supra. Compare N.H. Rev. Stat. Ann. ch. 293-A:77 II. (e) (". . . Any claim existing or action or proceeding pending by or against any of the corporations may be prosecuted as if the merger or consolidation had not taken place, and the surviving or new corporation may be substituted in its place.")

However, it has been held that such a corporation may also be secondarily liable as a transferee where it has "contractually obligated itself under the merger agreement to pay the liabilities" of a predecessor corporation. Southern Pacific

Transportation Co. v. Commissioner, 84 T.C. 367 (1985). See also, Turnbull, Inc. v. Commissioner, 42 T.C. 582 (1964), aff'd, 373 F.2d 91 (5th Cir. 1967); Texsun Supply Corporation v. Commissioner, 17 T.C. 433 (1951); Missile Systems Corp. of Texas v. Commissioner, supra.

Section 6901 does not create any separate liability but merely provides a method for enforcing such liability as may be created under other federal or state laws. Phillips v. Commissioner, 283 U.S. 589 (1931). State law may impose liability on transferees in several different ways, any of which may provide the basis for an assessment under section 6901. In any particular case, the type of liability which may be imposed will depend on the facts of that case. Liability which may apply in one case could be inappropriate in another, and more than one type of liability may apply. Note in particular that under I.R.C. §6902, the burden of proof is upon the Government to show that a person is liable as a transferee of property of a taxpayer.

Transferee liability may be imposed either "at law" or "in equity." A recipient of assets can be both a transferee at law, to the extent the recipient has agreed to assume liabilities of the transferor, and a transferee in equity, if the necessary conditions apply. An agreement between the parties may impose an additional liability on a party as a transferee at law, but cannot limit the liability of the party as a transferee in equity. In other words, while the parties to a transfer may agree between themselves how to apportion the transferor's liabilities, their agreement cannot bind the Government or reduce the scope of any equitable liability.

Liability at law arises where the transferee assumes the liability of the transferor directly by contract, or where such liability is imposed by law as a consequence of the transfer. For example, under various state laws, the successor of merged corporations is subject to the liabilities of those corporations.

Liability in equity is generally based on some form of fraudulent conveyance. In order to invoke any kind of equitable remedy, it is generally necessary to show that legal remedies have been exhausted. In other words, before seeking to impose liability on a transferee in equity, the Government must first attempt to recover the liability from the transferor. Wire Wheel Corporation of America v. Commissioner, 16 B.T.A. 737, 742(1929). In a situation such as the present case, the dissolution of the

transferor, [redacted], satisfies this condition.

[redacted]

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

"Claim" is defined as "a right to payment, whether or not the right is reduced to judgement, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured, or unsecured." [redacted]. For purposes of I.R.C. § 6901, a transferee is retroactively liable for the transferor's taxes for prior years and for the year of transfer. Leach v. Commissioner, 21 T.C. 70 (1953). Wyche v. Commissioner, 36 B.T.A. 414 (1937).

In summary, to establish transferee liability at law, the Government must show:

> A transfer of property, by the taxpayer, to the transferee;
>
> That the taxpayer was liable for the tax in issue at the time of the transfer; and
>
> That the transferee agreed by contract to assume the tax liability of the taxpayer.

In establishing transferee liability at law, the Government is not required to show the insolvency of the transferor at the time of the transfer, the exhaustion of remedies against the transferor, or the value of the assets transferred. However, transferee liability at law will be limited by the terms of the agreement. In other words, where the Government relies on the transferee's contractual assumption of the liabilities of the transferor, transferee liability only attaches to the extent of the liabilities assumed. See Reid Ice Cream Corp. v. Commissioner, 59 F.2d 189 (2d Cir. 1932).

To establish transferee liability in equity, the Government must show:

A transfer of property, by the taxpayer, to the transferee;

That the transfer was made during or after the period for which the tax liability of the transferor accrued;

That the transfer was made without consideration or for less than adequate consideration;

That the transferor was insolvent prior to or because of the transfer of property; and

That all reasonable efforts to collect from the transferor have been exhausted.

The Government must also establish the value of the transferred property, since the liability of a transferee in equity is limited to the value of the property received.

Note that transferee liability at law is limited by the terms of the agreement, while transferee liability in equity is limited by the value of the transferred property. As indicated above, while the agreement between the parties establishes the extent of transferee liability at law, it cannot limit any transferee liability in equity. Accordingly, while at law a party may contractually assume some portion of the liabilities of another party, in equity it may be liable for a greater amount of those liabilities.

Application to the present case.

In the present case, the statute of limitations for the taxpayer's [redacted] through [redacted] taxable years will expire [redacted]. As indicated above, the issue for the present memorandum is to identify the party or parties that may be liable for any deficiencies in tax that may be proposed, for purposes of extending the statute of limitations. The determination and assertion of transferee liability raise complicated legal and factual questions, and it is important to fully develop such facts since the Government bears the burden of proof. It is not the purpose of this memorandum to determine that transferee liability should be asserted against any particular party. That determination will require further investigation. However, in view of the imminent expiration of the statute of limitations, it is appropriate to identify the party or parties that may be

liable as transferees, and to solicit consents from those parties to extend the period for assessment of any such liability.

1. Survival of the taxpayer. Obviously, if the taxpayer were still in existence, with sufficient resources to satisfy any proposed liability, there would be no need to consider transferee liability. However, even if a taxpayer is insolvent, it may be useful to solicit an extension of the statute of limitations from the taxpayer, since the period for assessment against transferees is measured by the period for assessment against the transferor. Thus, an extension by an insolvent taxpayer would automatically extend the period for assessment against transferees of that taxpayer.

The taxpayer in this case was a nonprofit health service corporation, organized under [redacted]. See, [redacted]. Such corporations are subject to the provisions of chapter [redacted], [redacted]. Chapter [redacted], provides rules for the dissolution of voluntary corporations. Among other things, section [redacted] provides that:

> Any corporation whose charter is repealed, revoked and annulled pursuant to this subdivision shall, nevertheless, continue as a body corporate for the term of 3 years from the date such charter is repealed, revoked and annulled for the purpose of presenting and defending suits by or against it and of closing and settling its concerns and distributing its assets, including the disposition and transfer of all corporate assets and property. . .

According to [redacted]'s memorandum, "[redacted] was dissolved and liquidated (effective [redacted]." Par. 16. However, under [redacted] law, the taxpayer would continue in existence for three years for the purpose of "settling its concerns," which would include the execution of consents to extend the statute of limitations. Accordingly, while the taxpayer may have dissolved for purposes of its day-to-day operations, it would appear the taxpayer would still have the power to extend the statute of limitations for assessment. See I.R.M. 4582.21(2).

While the taxpayer would continue in existence for three years from its dissolution date, it is not recommended that a consent be solicited which runs for the full three-year period, because after that period there would be no party to whom the notice of deficiency could be sent, or who could file a petition

with the Tax Court. See I.R.M. 4582.21(2). Accordingly, any consent solicited from the taxpayer should not extend the statute of limitations beyond [redacted]. This would allow for the issuance of a notice of deficiency and the filing of a petition with the Tax Court prior to [redacted].

Under [redacted], we believe that the taxpayer retains the power to extend the statute of limitations for the separate return years. We also believe that it retains the power to extend the statute of limitations for the years during which it was the parent of the consolidated group, at least to the extent of its own liability. However, while [redacted] law continues the existence of the taxpayer for [redacted] purposes of "settling its concerns," it could be argued that this does not extend the taxpayer's agency authority for the consolidated group. In other words, an argument might be raised that the phrase "settling its concerns" does not include continuing as the agent of the other members of the group. Accordingly, while we recommend that you obtain Form 872's from the taxpayer for the consolidated return years in order to extend the statute of limitations for the liabilities of the taxpayer itself, we further recommend that you obtain Form 872's from each member of the consolidated group with respect to the liability of that member.

2. <u>Direct solicitation of the members of the consolidated group</u>.

As indicated above, the taxpayer filed separate returns for the taxable years [redacted] through [redacted], and consolidated returns for the taxable years [redacted] through [redacted].

Under Treas. Reg. § 1.1502-6(a), each member of a consolidated group during any part of a consolidated return year is severally liable for the tax for such year. Furthermore, Treas. Reg. § 1.1502-6(c) provides that "No agreement entered into by one or more members of the group with any other member of such group or with any other person shall in any case have the effect of reducing the liability prescribed under this section." Thus, each subsidiary that was a member of the taxpayer's consolidated group for any taxable year remains liable for the full liability of the group for that year, regardless of the terms of the Asset Purchase Agreement between the taxpayer and [redacted], and regardless of any agreements made in the organization of the foundations or in the transfer of the sales proceeds to the foundations. It appears that these subsidiaries were included in the assets transferred

to the purchaser. Thus, regardless of any liability the purchaser may have assumed as a transferee of the taxpayer, it appears that the subsidiaries acquired by the purchaser remain liable for the consolidated liabilities of the taxpayer.

Generally, where a consolidated return has been filed, the common parent is the sole agent for each member of the consolidated group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. The common parent in its name may give waivers which shall be considered as having also been given by each subsidiary. Treas. Reg. § 1.1502-77(a). However, the final sentence of Treas. Reg. § 1.1502-77(a), provides "Notwithstanding the provisions of this paragraph, the district director may, upon notifying the common parent, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself."

Treas. Reg. § 1.1502-77(d) requires that if the common parent corporation contemplates dissolution or is about to be dissolved, it must notify the district director with whom the consolidated return is filed of such fact and designate another member as agent to act in its place. In the present case, no information is available indicating that the taxpayer has designated any member of the group to act as the agent for the group. If the notice is not given, the remaining members can designate another member to act as such agent. Again, no information is available indicating that such designation has been made. Until a notice in writing designating a new agent has been approved by the district director, any notice of deficiency or other communication mailed to the common parent shall be considered as having been properly mailed to the agent of the group. However, Treas. Reg. § 1.1502-77(d) further provides that "if such district director has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member in respect of its liability."

Finally, Treas. Reg. § 1.1502-77T provides alternative agents for purposes of executing waivers in situations where the common parent of the group ceases to be a common parent. These alternative agents include the common parent of the group for all or any part of the year to which the notice or waiver applies, and the agent designated by the group under Treas. Reg. § 1.1502-77(d).

Clearly, in the present case the district director has reason to believe the existence of the common parent has terminated. [redacted] indicates the taxpayer dissolved on [redacted]. As indicated in the previous section, it appears that under [redacted] law, the taxpayer will continue in existence for three years for the purpose of "settling its concerns." While this would give the taxpayer power to extend the statute of limitations on its own behalf, both for the separate return years, and for its own liability for the consolidated return years, it could be argued that the taxpayer no longer has the authority to act as agent of the other members of the group. See I.R.M. 4582.21(2). This is the type of situation covered by Treas. Reg. § 1.1502-77(d), where the district director is authorized to deal directly with any member in respect of its liability.

Accordingly, in order to assure that the statute of limitations is extended with respect to each member of the consolidated group, we recommend that you solicit Form 872's directly from the group members.

3. The purchaser as transferee. In the present case, under the terms of the Asset Purchase Agreement, the parties agreed that the purchaser would assume all liabilities of the seller, with the exception of an item defined as the "Seller's Aggregate Tax Liability." Thus, the total tax liabilities of the seller are accounted for: either they have been assumed by the purchaser, as part of "all Liabilities of the Seller," or they have been retained by the seller as part of the "Seller's Aggregate Tax Liability." The Asset Purchase Agreement thus provides a basis for asserting transferee liability at law.

Based on the information available to this office at the present time, the purchaser in this case may be considered a transferee at law. The only difficulty is determining the precise identity of the purchaser. The Asset Purchase Agreement identifies the purchaser as "[redacted]," while the Findings and Final Order of the Insurance Commissioner identify the purchaser as "[redacted]," a second-tier subsidiary of [redacted]. Also, as indicated above, the purchaser's liability at law would be limited to the portion of the liabilities assumed under the Asset Purchase Agreement.

4. Recipient of the sales proceeds as primary obligor. The remaining portion of the taxpayer's liability for taxes has been retained by the seller. The difficulty with this portion of the

liability is that the seller, [redacted], has dissolved. Assets of the taxpayer have been transferred to two foundations, both of which may be potentially liable as "transferees". In addition, it appears that the first foundation, [redacted], has assumed a portion of the taxpayer's liability for taxes. Thus, [redacted] asserts that "[a]t the closing, the Foundation assumed [redacted]'s tax liabilities, if any, attributable to the sale of [redacted]'s assets to [redacted] (the "Transactional Tax Liabilities") (par. 10), and the Order refers to "[t]he assumption by the Foundation of certain [redacted]'s contractual obligations" [redacted]. However, it does not appear that either foundation was a direct party to the Asset Purchase Agreement. Accordingly, the mechanism by which [redacted], assumed the taxpayer's liabilities is not clear -- whether by some agreement with the taxpayer, or whether the foundation was created by the taxpayer for the purpose of assuming the liabilities. Depending on the precise mechanism by which [redacted], assumed the tax liabilities of the taxpayer, it may be either primarily liable, on the same basis as the taxpayer, or secondarily liable as a transferee.

5. Recipients of the sales proceeds as tranferees. As indicated in the previous section, both foundations are potentially liable as transferees. Since the distribution in dissolution would have left the taxpayer itself insolvent, both foundations may be liable as transferees in equity, in which case the liability would not be limited by the terms of the Asset Purchase Agreement or any allocation of liabilities between the seller and purchaser. Depending on the precise mechanism by which the assets were transferred to the foundations and the manner in which they were organized, it is possible there may be some contractual liability, in which case the foundations may be liable as transferees at law.

RECOMMENDATIONS

In view of the foregoing, we recommend the following:

1. You should solicit a Form 872 (Consent to Extend the Time to Assess Tax) from each of the following parties:

[redacted] [covering the separate return years]

[redacted], as successor of [redacted] [covering the separate return years]

The Form 872 executed by the taxpayer in its individual capacity will extend the statute of limitations for the taxpayer for its separate return years, and will extend the statute of limitations for all transferees of the taxpayer with respect to the separate return years. We also recommend obtaining a Form 872 from [redacted], "as successor" to the taxpayer in its individual capacity in the event that further investigation may disclose that [redacted], in fact is primarily liable, as opposed to being secondarily liable as a transferee.

As explained above, we recommend that the Form 872s executed by the taxpayer should not extend beyond [redacted].

2. For the consolidated return years:

a. You should solicit a Form 872 (Consent to Extend the Time to Assess Tax) from each of the following parties:

[redacted] [covering the consolidated return years]

[redacted], as successor of [redacted] [covering the consolidated return years]

We believe the Form 872 executed by the taxpayer and subsidiaries will extend the statute of limitations for the consolidated return years, and thus will extend the statute of limitations for all transferees of the taxpayer with respect to the consolidated return years. We also recommend obtaining a Form 872 from [redacted], "as successor" to the taxpayer and subsidiaries in the event that further investigation may disclose that [redacted], in fact is primarily liable, as opposed to being secondarily liable as a transferee.

While we believe that under [redacted] the taxpayer retains the power to execute Form 872's on its own behalf for the consolidated return years, it could be argued whether it still has authority to act as agent of the other members of the group for those years.

Accordingly, we recommend that you solicit Form 872's directly from the members of the group, as described below.

As explained above, we recommend that the Form 872s executed by the taxpayer should not extend beyond [redacted].

b. You should solicit a Form 872 from each subsidiary of the taxpayer covering the consolidated return years during which that subsidiary was a member of the group. The information available does not indicate the precise names of the subsidiaries, but it appears for the taxable years [redacted] and [redacted] that [redacted], and [redacted] were members of the consolidated group, and that those subsidiaries were also members for the taxable years [redacted] and [redacted], along with [redacted], [redacted], and [redacted]. You should confirm the correct name of each subsidiary and the years in which it was a member of the consolidated group.

Before dealing separately with the subsidiaries, you must send the taxpayer a letter notifying it that you intend to deal directly with the former subsidiaries with regard to the [redacted] and [redacted] taxable years for the consolidated tax of the taxpayer and subsidiaries group. See the final sentence of Treas. Reg. § 1.1502-77(a). The letter must include the names of the corporations with which the Service intends to deal, and a statement that the Service intends to deal individually with these corporations. Further, the letter must indicate that the Service is breaking agency only with regard to the [redacted] and [redacted] taxable years. The letter should be sent to the taxpayer at its last known address.

Each Form 872 obtained from the former subsidiary members should include an asterisk immediately after the description of the taxpayer on the first page of the Form 872. Another asterisk should be placed at the bottom of the form, followed by the phrase "With respect to the consolidated liabilities of the [redacted] consolidated group for taxable years [redacted] and [redacted]."

3. You should solicit a Form 977 (Consent to Extend the Time to Assess Liability at Law or in Equity for Income, Gift and Estate Tax Against a Transferee or Fiduciary) from each of the following parties:

[redacted], a transferee or fiduciary of [redacted] [covering both the separate return years and the consolidated return years]

[redacted], a transferee or fiduciary of [redacted] [covering both the separate return years and the consolidated return years]

[redacted], a transferee or fiduciary of [redacted] [covering both the separate return years and the consolidated return years]

[redacted], a transferee or fiduciary of [redacted] [covering both the separate return years and the consolidated return years]

[redacted], a transferee or fiduciary of [redacted] [covering both the separate return years and the consolidated return years]

Consents from the first three parties will cover the transferee liability of the "purchaser," whichever of the [redacted] corporations that might be. A consent from [redacted], "as transferee" of the taxpayer will cover its liability as a transferee either at law or in equity. It appears that [redacted] would only be liable as a transferee in equity, and a Form 977 should be solicited to extend the period for assessment of that liability.

We recommend that the dates for the Forms 977s extend one year beyond the dates for the Form 872s that are being solicited from the taxpayer and from [redacted].

4. At the present time we do not recommend soliciting a Form 2045 (Transferee Agreement) from any of the parties listed under item 3. Under the terms of this form, in exchange for the petitioner's agreement that it is a transferee, the Government agrees not to issue a notice of deficiency to the transferor. Since the Government is still developing information on the details of the transaction and the alleged dissolution of the transferor, it would be better at this time not to solicit a Form

2045. This would not preclude the solicitation of such an agreement at some later time.

5. We recommend that you give consideration to obtaining the following additional materials:

1. The Probate Court Order refers to

a. A Petition filed by [redacted]. In various places, the Order refers to or cites the petition. Thus, this document is necessary in order to understand the full effect of the Order.

b. A "closing statement setting forth the application of the Sales proceeds" is described at page 6.

2. The report of the Charitable Trusts Director refers to

a. An Amendment to the Asset Purchase Agreement, dated [redacted]. Paragraph 9.

b. A "fairness opinion" by [redacted]. Paragraph 15.

c. Paragraph 15 of the report also refers to the Attorney General's use of [redacted] as a consultant. You should request any reports that were made by [redacted].

d. Paragraph 15. also refers to [redacted], a division of [redacted] as verifying the processes and analytical methodologies used by [redacted]. You should request any reports that were made by [redacted].

3. The Findings and Final Order of the Insurance Commissioner refer to an "Application" for the acquisition of [redacted], submitted by "[redacted]" The caption of the Findings and Final Order is directed to a "Form A Statement Regarding the Acquisition . . ." Presumably these are the same document, which would be useful in explaining the transfer from the taxpayer to the [redacted] corporations.

4. The Asset Purchase Agreement refers to

a. Exh. 1.01(d), Financial Projections, of net worth, and earnings, which was to be used for purposes of adjusting the consideration.

b. Section 7.04 of the Asset Purchase Agreement requires the seller to prepare a "reasonably-detailed description of the calculation of such Closing Tax Reserve amount (including a breakdown of each Tax to be covered by the Closing Tax Reserve by amount and Tax period)." Section 7.04 also refers to "the workpapers generated by Seller and its tax professionals in performing such calculation," and "any material supporting authority, valuations or opinions upon which the Seller and/or its tax professionals have relied, or which it has employed, in connection with performing such calculation." [redacted] states in paragraph 11. of his memorandum that [redacted] ultimately determined that the Closing Tax Reserve should be zero. But whether [redacted] waived the requirement for a reserve or not, it would seem that the required documents would have been prepared. You should also request these items.

5. You should request a copy of any Order of dissolution of the taxpayer.

6. As indicated above, there is some uncertainly regarding the precise mechanism by which [redacted], assumed the tax liabilities of the taxpayer. You should request copies of all documents by which [redacted], assumed the liabilities of the taxpayer. This would include any assignment or other agreement executed by [redacted]; any court order imposing the liabilities upon [redacted]; and any organizational documents in which [redacted], assumes the liabilities.

If you have any questions, please call [redacted] at [redacted].

[redacted]
Assistant District Counsel

By: [redacted]
[redacted]
Attorney

cc: [redacted]
Appeals Division, [redacted]

4/17/00 MTO 4/17/00