Uniform Issue List No. 401.29-02

200127053

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Person To Contact

Telephone Number:

Refer Reply To:
T:EP:RA:T4

Date: APR 12 2001

Attention:

Legend:

Corporation A =

Corporation B =

Corporation C =

Program M =

Public Administrator =

Division N =

Plan X =

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Dear :

This is in response to a request for rulings submitted May 25, 2000, in which your authorized representative requests rulings concerning the ability of Plan X to make distributions to former participants of the plan. The request was supplemented by letters dated September 20, 2000, December 8, 2000, and March 29, 2001.

The following facts and representations have been submitted to support your ruling requests:

Corporation A maintains Plan X which received a favorable determination letter from the Service on September 24, 1993, concluding that the plan is qualified under section 401(a) of the Internal Revenue Code ("Code"). Plan X includes a cash or deferred arrangement described in section 401(k) of the Code, and the participants' accounts are not distributable prior to the employee's separation from service, death, or disability. Plan X also provides that the accounts of the participants are distributable upon the sale or disposition by Corporation A to an unrelated corporation of substantially all of the assets used in a trade or business of Corporation A, if Corporation A continues to maintain the plan after the disposition, but only with respect to participants who continue employment with the corporation acquiring such assets.

Since 1966 and until its exit from Program M, Corporation A has maintained an operating division (the "Program M Unit") that was dedicated solely to serving as a Program M Intermediary and a Program M Carrier pursuant to separate contracts with the Public Administrator, the government entity responsible for administering Program M. As an Intermediary and a Carrier, Corporation A's Program M Unit processed Program M claims on behalf of the Public Administrator.

The Program M Unit was the sole division of Corporation A responsible for performing the Program M contracts, and the Program M Unit provided no other services for Corporation A.

The Program M Unit operated in separate facilities that were physically, and in most cases geographically, separated from Corporation A's private sector business operations. The Program M Unit had separate management employees who were responsible for the operations of the Unit. Substantially all accounting and financial activities of the Program M Unit were performed within the Unit and were required by the contract with the Public Administrator to be segregated from Corporation A's private sector business. Also the budget for the Program M Unit, which was funded exclusively by the Public Administrator, was approved by the Public Administrator and was completely segregated from Corporation A's other business. Similarly, the costs associated with funding benefits for the Program M Unit were accounted for separately on Corporation A's books and records, and the Public Administrator reimbursed Corporation A for all allowable costs associated with the funded benefits for Program M Unit employees.

In May 1998, Corporation A notified the Public Administrator that it was terminating its Program M Carrier contract. In response, the Public Administrator sought out and designated Corporation B as a replacement contractor (hereinafter "Carrier Replacement Contractor"). The Carrier Replacement Contractor is not related to, or affiliated with, Corporation A. As part of the Program M Carrier transition, Corporation A transferred all of the equipment used in the performance of the Program M Carrier contract (that was not needed to perform services under the Program M Intermediary contract) to the Carrier Replacement Contractor. The equipment transferred consisted primarily of desk chairs and desk top computers. The Carrier Replacement Contractor paid Corporation A an amount equal to the book value of the equipment transferred.

In connection with the termination of the Program M Carrier contract, Corporation A terminated its Program M Unit employees dedicated to performance of services under the Program M Carrier contract. Corporation A's Program M Carrier employees were terminated on October 31, 1998. By letter dated September 20, 2000, it was stated that the book value of assets transferred to the Carrier Replacement Contractor was approximately $, and that virtually all of the

approximately 75 terminated employees were hired by the Carrier Replacement Contractor.

Corporation A's former Program M Unit employees who now work for the Carrier Replacement Contractor are no longer active participants in Plan X. Corporation A retained no interest in the Program M Carrier contract, the Program M Carrier operations, equipment, or employees, and was directed by the Public Administrator to transfer its program operations to the Carrier Replacement Contractor. Corporation A's former Program M Unit employees hired by the Carrier Replacement Contractor do not provide services associated with the ongoing activities of Corporation A.

On September 24, 1999, Corporation A notified the Public Administrator that it was terminating its Program M Intermediary contract. In response, the Public Administrator sought out and designated Division N, an operating division of Corporation C, as a replacement contractor (hereinafter "Intermediary Replacement Contractor"). The Intermediary Replacement Contractor is not related to, or affiliated with, Corporation A. Also, the Intermediary Replacement Contractor for the Program M Intermediary contract is not the same as, affiliated with, or related to the Carrier Replacement Contractor for the Program M Carrier contract. Corporation A's Program M Intermediary employees were terminated on May 31, 2000. As is typical in this type of situation, the Public Administrator directed that the Intermediary Replacement Contractor hire Corporation A's qualified and interested managers and staff dedicated to the performance of services under the Program M Intermediary contract.

By letter dated September 20, 2000, it was stated that the book value of assets transferred to the Program M Intermediary Replacement Contractor was approximately $, and that of the approximately 370 employees of the Program M Unit dedicated to performance of services under the Program M Intermediary contract who were terminated from employment with Corporation A, most of them were hired by the Intermediary Replacement Contractor.

Corporation A's former Program M Unit employees who now work for the Intermediary Replacement Contractor are no longer active participants in Plan X. The former Program M Unit employees hired by the Intermediary Replacement Contractor do not provide services associated with the ongoing activities of Corporation A.

Following the transfer of assets to the Carrier and Intermediary Replacement Contractors and the termination of all Program M Unit employees by Corporation A, the Program M Unit will be dissolved and Corporation A will no longer be engaged in the business of processing Program M claims.

Corporation A continues to maintain Plan X. There will be no direct transfer of assets from Plan X to another qualified retirement plan maintained by the Carrier or Intermediary Replacement Contractors in a transaction subject to section 414(l) of the Code. It has been represented that neither the Carrier Replacement Contractor nor the Intermediary Replacement Contractor are required to be aggregated with Corporation A (or its affiliates) under sections 414(b),(c),(m) or (o) of the Code.

By letter dated December 8, 2000, Ruling Requests 2 and 3 were withdrawn and Ruling Requests 1 and 4 (renumbered as 1 and 2 respectively) were revised to read as follows:

1. That a distribution can be made from Plan X to each participant who terminated employment with Corporation A as a result of Corporation A terminating its Program M Carrier contract and who became an employee of the Carrier Replacement Contractor on grounds that a separation from service has occurred within the meaning of section 401(k)(2)(B)(i)(I) of the Code.

2. That a distribution can be made from Plan X to each participant who terminated employment with Corporation A as a result of Corporation A terminating its Program M Intermediary contract and who became an employee of the Intermediary Replacement Contractor on grounds that there was a disposition of substantially all of the assets used

in a trade or business within the meaning of section 401(k)(10)(A)(ii) of the Code.

With respect to the first ruling request, section 401(k)(2)(B)(i) of the Code provides, in relevant part, that distributions from a qualified cash or deferred arrangement may not be made earlier than the occurrence of certain stated events. Section 401(k)(2)(B)(i)(I) of the Code further provides that one of these distributable events is the employee's "separation from service."

Rev. Rul. 2000-27, 2000-21 I.R.B. 1016 (May 22, 2000), discusses the sale of less than substantially all (i.e., less than 85%) of the assets of a trade or business between two unrelated employers. Under the facts of the revenue ruling, an employer ("Former Employer") sells less than 85% of the assets used in a trade or business of the Former Employer to another employer ("New Employer"), an entity not required to be aggregated with the Former Employer under sections 414(b), (c), (m) or (o) of the Code. Most of the employees of the Former Employer associated with the transferred assets (the "Transferred Employees") are hired by the New Employer and continue to perform, without interruption and in the same capacity, the same functions for the New Employer that they performed for the Former Employer, and they no longer perform services for the Former Employer. In addition, the New Employer does not assume the assets and liabilities of the applicable portion of the 401(k) plan of the Former Employer. The revenue ruling holds that the Transferred Employees are not employed in a continuation of the same trade or business and that the change in their employment status is sufficient to constitute a "separation from service" within the meaning of section 401(k)(2)(B)(i)(I) of the Code that permits distributions from the 401(k) plan of the Former Employer to the Transferred Employees.

We believe that the Program M Unit is a single trade or business of Corporation A for purposes of section 401(k)(10) of the Code. We also view the facts in this case as presenting a situation in which Corporation A has disposed of its Program M Unit in two stages. The "first stage" of the termination of the Program M Unit occurred upon the termination of the Program

M Carrier contract by Corporation A resulting in the sale of less than 85% of the assets used in the Program M Unit to the Carrier Replacement Contractor. This transaction did not constitute a sale of substantially all the assets used in a trade or business within the meaning of section 401(k)(10)(A)(ii) of the Code. However, under Rev. Rul. 2000-27, Plan X may distribute the accounts of the employees terminated by Corporation A and hired by the Carrier Replacement Contractor if the change in their employment status as a result of the sale to the Carrier Replacement Contractor constitutes a "separation from service" within the meaning of section 401(k)(2)(B)(i)(I) of the Code.

Under the facts in this case, we find that the underlying requirements of Rev. Rul. 2000-27 have been met: namely, that there was a sale of less than 85% of the assets of a trade or business of Corporation A to an unrelated employer; that the terminated employees, who continue to perform the same services for the Carrier Replacement Contractor that they used to perform for Corporation A, no longer perform services for Corporation A; and that no plan maintained by the Carrier Replacement Contractor has assumed any portion of the assets and liabilities of Plan X applicable to the employees terminated by Corporation A. Thus, we find that there has been a sufficient change in the employment status of these terminated employees to constitute a "separation from service" within the meaning of section 401(k)(2)(B)(i)(I) as of the date their employment with Corporation A terminated.

Accordingly, with respect to Ruling Request 1, we conclude that a distribution can be made from Plan X to each participant who terminated employment with Corporation A as a result of Corporation A terminating its Program M Carrier contract and who became an employee of the Carrier Replacement Contractor on grounds that a separation from service has occurred within the meaning of section 401(k)(2)(B)(i)(I) of the Code.

With respect to the second ruling request, section 401(k)(2)(B)(i) of the Code provides, in relevant part, that distributions from a qualified cash or deferred arrangement may not be made earlier than the occurrence of certain stated events. Section 401(k)(2)(B)(i)(II) further provides that one

of these distributable events is a disposition of trade or business assets within the meaning of section 401(k)(10)(A)(ii) of the Code. Section 401(k)(10)(A)(ii) provides for distributions from a qualified cash or deferred arrangement upon the disposition by a corporation of substantially all of the assets (within the meaning of section 409(d)(2)) used by such corporation in a trade or business of such corporation, to an unrelated corporation, but only with respect to employees who continue employment with the corporation acquiring such assets. See section 1.401(k)-1(d)(1)(iv) of the Income Tax Regulations (concerning a disposition by a corporation of substantially all the assets within the meaning of section 409(d)(2) used by the corporation in a trade or business of the corporation to an unrelated corporation).

Section 1.401(k)-1(d)(4) of the regulations provides rules applicable to distributions upon the sale of assets. This regulation requires that (i) the seller must maintain the plan, and the purchaser may not maintain the plan after the disposition; (ii) the employee receiving the distribution must continue employment with the purchaser of the assets; (iii) the distribution must be in connection with the disposition of the assets; and (iv) the sale of substantially all the assets used in a trade or business means the sale of at least 85 percent of the assets, and an unrelated entity is one that is not required to be aggregated with the seller under Code sections 414(b), (c), (m), or (o) after the sale or other disposition. Section 1.401(k)-1(d)(5) of the regulations provides, in pertinent part, that a distribution may be made upon a sale or disposition of assets only if it is a lump sum distribution within the meaning of section 402(d)(4) of the Code.

Section 1.401(k)-1(d)(4)(iii) of the regulations provides, in part, that except in unusual circumstances, a distribution will not be treated as having been made in connection with a disposition of assets unless it is made by the end of the second calendar year after the calendar year in which the disposition occurred.

We believe that the "second stage" of the termination of the Program M Unit occurred upon the termination of the Program M Intermediary contract by Corporation A resulting in the sale

of all the remaining assets of the Program M Unit (i.e., those assets which had been used exclusively by employees dedicated to the performance of services under the Program M Intermediary contract and those assets which had been used by both the employees dedicated to performance of services under the Program M Intermediary contract and the employees dedicated to performance of services under the Program M Carrier contract). This "second stage" transaction falls within the meaning of section 401(k)(10)(A)(ii) of the Code because it constitutes the disposition of substantially all of the assets used in a trade or business of Corporation A to an unrelated corporation (the Intermediary Replacement Contractor).

Accordingly, with respect to Ruling Request 2, we conclude that a distribution can be made from Plan X to each participant who terminated employment with Corporation A as a result of Corporation A terminating its Program M Intermediary contract and who became an employee of the Intermediary Replacement Contractor on grounds that there was a disposition of substantially all of the assets used in a trade or business within the meaning of section 401(k)(10)(A)(ii) of the Code.

This ruling is applicable only if (1) distributions from Plan X to the employees who continued employment with the Intermediary Replacement Contractor are made by the end of the second calendar year after the calendar year in which the disposition was completed, and (2) the distributions are lump sum distributions within the meaning of section 402(d)(4) of the Code (or section 402(e)(4)(D) of the Code for tax years beginning after December 31, 1999).

These rulings are based on the assumption that Plan X has complied at all times relevant to these rulings with the requirements of sections 401(a) and 401(k) of the Code.

This letter ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

The original of this letter ruling has been sent to your authorized representative in accordance with a power of attorney on file with this office.

Sincerely yours,

Alan Pipkin

Alan Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt & Government Entities Division

Enclosures:
Deleted copy of letter ruling
Form 437