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Memorandum

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to:
Senior CEP Team Coordinator

from: Richard S. Bloom
Associate Area Counsel, LM:HMT:CLE:PIT

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subject: CDSOA Rebate

This memorandum responds to your request for assistance dated January 7, 2005. The advice rendered is conditioned on the accuracy of the facts provided by you. This memorandum should not be cited as precedent.

LEGEND

Taxpayer =
Seller =
Buyer =
Specialty business line =
Year 1 =
Year 2 =
Year 3 =
Date A =
Date B =
Date C =
Date D =
Date E =
Date F =
Date G =
X percent =
$ AA =

$BB =

ISSUE

How should the portion of the Continued Dumping and Subsidy Offset Act (”CDSOA”) subsidy received by Taxpayer in Year 2 that was paid to Seller, its former parent, under the circumstances described below, be taxed?

CONCLUSION

In our opinion, the entire Year 2 CDSOA subsidy received by Taxpayer, including the amount remitted to Seller, is includable in Taxpayer’s income. The amount remitted to Seller should be treated as additional consideration paid by Buyer to Seller for the stock of the Taxpayer.

FACTS

Seller sold its Specialty business line to Buyer. The business line consisted of certain operating assets, as well as several subsidiaries, one of which was the Taxpayer. As part of the transaction, Buyer acquired all of the stock of Taxpayer, which became a wholly-owned subsidiary of Buyer.

Pursuant to a Stock and Asset Purchase Agreement, dated Date A, Year 1, Buyer agreed to pay $ AA million for the Specialty business line. The Agreement allocated $BB million of the purchase price to Taxpayer’s stock. This is the same figure reflected on Buyer’s tax return for Taxpayer’s assets per an I.R.C. § 338 election.

In addition to the above, Buyer also agreed under the terms of the Stock and Asset Purchase Agreement to immediately remit to Seller X percent of the CDSOA subsidies received by the Taxpayer for Year 2 and Year 3. It was recited in a WHEREAS clause that prior to closing Taxpayer was to distribute the rights to X percent of the Year 2 and Year 3 CDSOA subsidies to Seller. The Agreement provided that Taxpayer was responsible for prosecuting the claim for the CDSOA subsidies, for preparing all of the necessary documentation, and bearing all costs. Taxpayer was required to pay Seller its X percent share of the CDSOA subsidies in cash within 5 days of receipt.

Buyer and Seller further agreed that all amounts remitted by Taxpayer in respect to the CDSOA subsidies were not additional compensation for the Taxpayer shares, or for any other interests or assets transferred. The full fair market value of all of the stock, interests and/or assets transferred was said to be fully reflected in the stated purchase price. It was further provided that Taxpayer was to act solely as custodian and collection agent for Seller with respect to the latter’s share of the CDSOA subsidies. Taxpayer was allowed to commingle the CDSOA subsidies collected with its own funds, pending remittance to Seller, but could not otherwise exercise any dominion or control over such amounts. Neither could it hold itself out to any third party as owner of such amounts, nor hold such amounts under a claim of right. Finally, consistent with

Taxpayer's stated status as custodian and collection agent, both parties were to report the CDSOA subsidies collected by Taxpayer and paid over to Seller, for both tax and financial reporting purposes, as having been received directly by Seller from the United States.

On Date B, Year 2, just a week or so before closing on the Stock and Asset Purchase Agreement, Taxpayer declared a dividend to Seller in an amount equal to X percent of the CDSOA subsidies to be received by Taxpayer attributable to Year 2 and Year 3. The dividend was to be paid as provided in a Dividend Payment Agreement entered into by the parties on the same day. Pursuant to the Dividend Payment Agreement, Taxpayer transferred all of its beneficial rights and interests in X percent of the CDSOA subsidies for Year 2 and Year 3 to Seller in accordance with the terms of the Stock and Asset Purchase Agreement. Taxpayer was to apply, collect and remit to Seller its share of the CDSOA subsidies solely as custodian and collection agent for Seller, and not as a principal, partner or joint venturer.

Under the CDSOA, duties assessed pursuant to an anti-dumping duty order must be distributed on an annual basis to the affected domestic producers for qualifying expenditures. 19 U.S.C. § 1675c(a). The term "affected domestic producer" is defined to include any manufacturer or producer that (A) was a petitioner, or an interested party in support of the petition, with respect to which an order has been entered and (B) remains in operation. 19 U.S.C. § 1675c(b)(1). "Qualifying expenditures" are very broadly defined and include most production costs incurred by an affected domestic producer incurred after the issuance of an anti-dumping duty order, ranging from the costs of manufacturing facilities to working capital. 19 U.S.C. § 1675c(b)(4). The expenditures, however, must relate to the production of the same product that is the subject of the associated anti-dumping order. 19 C.F.R. §159.61(c)

During its fiscal year, the Bureau of Customs and Border Protection (CBP) deposits the duties assessed in a special account established with respect to each anti-dumping order for eventual distribution to the affected domestic producers. 19 U.S.C. § 1675c(e). With respect to the Year 2 subsidy, this would entail the duties assessed from October 1, Year 1, through September 30, Year 2. Distributions from the special accounts are required to be made not later than 60 days after the close of the fiscal year. 19 U.S.C. § 1675c(c). For Year 2, distribution was required to be made by the end of November.

Prior to the close of the fiscal year, the CBP is also required to publish a notice listing all of the particular anti-dumping orders in effect; the dollar amount contained in each special account as of June 1 of that year; and, the domestic producers potentially eligible for a distribution. 19 C.F.R. § 159.62(b)(2). The requisite notice for Year 2 was published in the Federal Register in July of that year. The notice lists several anti-dumping orders for which Buyer and the Taxpayer are identified as potentially eligible producers. The notice did not include any amounts contained in the special accounts for the listed orders. It was explained that the dollar amounts were not available in time for inclusion in the notice, but that preliminary amounts would be posted shortly on the CBP website, for purposes of enabling affected domestic producers to determine

whether it would be worthwhile to file a certification. The notice cautioned that the final amounts available for disbursement may differ from the preliminary amounts.

To be entitled to a CDSOA subsidy under a given order, an affected domestic producer must submit a certification to CBP establishing its eligibility for a subsidy. 19 C.F.R. § 159.63(a). In compliance with this requirement, the Taxpayer filed separate certifications from the Buyer for Year 2. Taxpayer actually filed two certifications, indicating in both that it was a wholly-owned subsidiary of Buyer. The qualifying expenditures set forth in the first certification, dated Date D, Year 2, relate to expenditures incurred in years prior to the sale of the Taxpayer's stock to Buyer. The qualifying expenditures set forth in the second certification, dated Date E, Year 2, encompass the same expenditures included in the first certification, plus additional qualifying expenditures incurred up through June 30, Year 2.

On Date F, Year 2, Taxpayer received a first distribution under the CDSOA and X percent was remitted to Seller the next day. The qualifying expenditures listed in the first certification, dated Date D, Year 2 exceeded in amount the first distribution under the CDSOA. On Date G, Year 3, the Taxpayer received an additional distribution of CDSOA proceeds relating to its Year 2 certifications and X percent of this distribution was again remitted to Seller the following day. The qualifying expenditures covered in the Taxpayer's first certification were still in excess of the combined total of the two CDSOA distributions received by the Taxpayer.

LAW AND ANALYSIS

You have asked us to consider the tax consequences of the Taxpayer's alleged pre-sale "dividend" to Seller of the rights to 80 percent of the anticipated CDSOA subsidy to be received in the Year 2.

Although a corporation normally makes a § 301 distribution to its shareholders in cash, it can also distribute property. Section 301(b)(1). The term "property" includes a corporation's own obligation. Treas. Reg. § 1.301-1(d)(1)(ii).

When a corporation distributes its own obligation to its shareholders with respect to their stock, the issue is whether the obligation constitutes "property" or whether it constitutes the distribution of a mere promise to pay dividends in the future. Compare Bazley v. Commissioner, 331 U.S. 737 (1947) (shareholders received taxable distribution on receipt of corporate debentures where debentures were worth at least their principal amount and were "virtually cash" because they were callable at the will of the corporation, which was the will of the shareholder taxpayer) with Stephens v. Commissioner, 60 T.C. 1004 (1973), aff'd per curiam, 506 F.2d 1400 (6th Cir. 1974) (contractual obligation to make future payments did not constitute a corporate distribution of its own obligation). In this regard, the Tax Court has stated "... a contractual obligation to pay an amount with respect to corporate stock is not ordinarily a distribution of an obligation of the corporation or other property." Stephens, 60 T.C. at 1016 (citing Vinnell v. Commissioner, 52 T.C. 934, 944 (1969)). "Whether a contractual obligation is to be considered an 'obligation' of the corporation or other property within

the meaning of section 312(a) is a question of fact to be determined from the provisions of the contract and other evidence of record." Stephens, 60 T.C. at 1016.

In Stephens, the court held that a contractual obligation to make future payments did not constitute a corporate distribution of its own obligation. The court relied on the absence of evidence that the parties intended the contractual obligation to represent payment of the obligation. Stephens, 60 T.C. at 1016. The court also relied on the absence of security for the debt and on the corporation's failure to segregate a portion of its earnings "so as to transfer control of the money to the payees." Stephens, 60 T.C. at 1016-1017. Accordingly, the court concluded that the shareholders did not constructively receive payments in the face amount of the obligation and that the shareholders received distributions when payments were actually made to them on the obligation. Stephens, 60 T.C. at 1017.

In Vinnell, the court considered whether a 1959 contractual obligation was properly regarded as a distribution of property in that year so that, if dividend equivalence on the redemption were determined, 1959 would be the year of distribution. Vinnell, 52 T.C. at 944. The court concluded that the contractual obligation in that case did not constitute a distribution of a corporate obligation. Rather, the court found that the corporation had merely promised to pay a specified sum over a term of years. In reaching this conclusion, the court relied on the facts that the contract did not provide for the payment of interest and the shareholder's right to payments was subject to various contingencies. Vinnell, 52 T.C. at 945. Thus, the court concluded that "[u]nder all of the facts and circumstances here present, the contractual obligation created in 1959 cannot properly be regarded as a distribution in that year of money or property within the meaning of section 301(b)(1)(A). Cf. Nina J. Ennis, 17 T.C. 465 (1951); Dudley T. Humphrey, 32 B.T.A. 280 (1935)." Vinnell, 52 T.C. at 945.

In Ennis, the issue was the amount of petitioner's amount realized on the sale of property for cash and the buyer's contractual obligation to pay the balance in deferred payments over a term of years. The court concluded that only the cash received was part of the amount realized in the year of the sale because the contractual obligation to make payments in the future was not a cash equivalent. In reaching this conclusion, the court noted that, in determining what obligations are the "equivalent of cash," the requirement has always been that the obligation be "freely and easily negotiable so that it readily passes from hand to hand in commerce." Ennis, 17 T.C. at 470. In the Ennis case, the promise to pay was merely contractual and was not embodied in a note which possessed the element of negotiability and free transferability.

One way to summarize these factors is whether these rights, when distributed, were unqualifiedly made subject to the shareholder's, i.e., Seller's, demand for payment. See Treas. Reg. §§ 1.301-1(b) and 1.451-1(a). In this case, Taxpayer distributed an obligation to Seller for Buyer to pay Seller an amount equal to X percent of the subsidy payments, when received by Taxpayer. Based on the factors described above, at the time this obligation was distributed, it was not unqualifiedly made subject to the shareholder's, i.e., Seller's, demand for payment.

First, Seller had no right to receive payment on the obligation until Taxpayer filed its claim with the Federal Government and the Government paid the claim. Second, until the claim was paid, Seller had no idea how much it would receive or when. To put it another way, payment of the obligation to Seller was contingent both with respect to the amount of the payment and its timing. This is especially the case where, as here, the amounts paid could be, and in fact were, less than the amounts submitted by Taxpayer in its claims to the Government.

Third, Seller had no recourse against Taxpayer for the money because it was not a party to the sales agreement. Rather, it was Buyer that was obligated to pay to Seller its portion of the subsidy payments. In other words, under the best case argument for these rights to be classified as a distribution of property from Taxpayer to Seller (assuming all other issues were also favorable), the agreement to make such payment would have to have been between Seller and Taxpayer, with Buyer only guaranteeing Taxpayer's compliance with the agreement. That was not the case here. Moreover, as noted above, Seller had no recourse against even Buyer until the Buyer group[1] received the payment from the Federal Government. Therefore, as between Seller and Taxpayer these rights should only be treated as a mere executory promise by Taxpayer to Seller. Consequently, there were no tax consequences to either Taxpayer or Seller upon the distribution of this obligation.

Because the declaration should be disregarded, the transaction cannot be treated according to its form. Rather, in substance, there is only the sale of the Taxpayer stock and the subsequent payment made by Buyer to Seller pursuant to the sales agreement. Thus, the CDSOA subsidies remain the income of the Taxpayer and the payment of X percent upon receipt by Taxpayer to Seller can only be treated as additional consideration for the sale of the Taxpayer stock.

Note that, in our case, characterizing the X percent of the subsidy payment as additional consideration to Seller for the sale of the Taxpayer stock has one collateral consequence to Buyer. Buyer will have additional basis in its Taxpayer stock[2] and, as a result of the § 338 election, Buyer will also have additional basis in Taxpayer's assets.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

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[1] In effect, Taxpayer received the payment from the Government and then distributed it to Buyer, which paid it to Seller.

[2] Of course, under the consolidated return regulations, Buyer would have already reduced its basis in its Taxpayer stock by such amount when it received it from Taxpayer as a dividend (see footnote 1). Treas. Reg. §§ 1.1502-13(f)(2)(iv)(A) and 1.1502-32(b)(2)(iv). Thus, there is no net change in Buyer's basis in Taxpayer's stock as a result of the receipt of and payment made pursuant to the agreement.

If you have any further questions, please call . at .

RICHARD S. BLOOM
Associate Area Counsel (LMSB)

By: ____________________________
MICHAEL A. YOST, JR.
Senior Attorney (LMSB)