New IRS "No Private Letter Ruling" Policy: Sec. 355 Transactions and a Shrinking PLR Safety Net

Avoiding Unanticipated Tax Liabilities in Spin-Offs and Split-Offs Amid Increased Ambiguity and Complexity

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IRC Section 355:
Breaking Up Just Got a Lot Harder

Structuring Spin-Off and Split-Off Transactions
Without the Private Letter Ruling Safety Net

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Introduction

- On June 25, 2013, the IRS expanded its “no-rule” policy with respect to spin-offs and other tax-free corporate separations.
- Effective for letter ruling requests received by the IRS after August 23, 2013, the IRS will no longer rule on an entire transaction under §355 (or, for that matter, §332, §351, §368, or §1036). See Rev. Proc. 2013-32, 2013-28 I.R.B. 1.
- Instead, the IRS will rule only on one or more “significant issues” arising in the context of such a transaction.
Areas of Discussion

- The Basics of §355
- The Evolution of the IRS’s §355 Ruling Policy
- Tax Counsel’s Legal Opinion
The Basics of Section 355
Section 355 – Big Picture

- D distributes C stock (at least 80% “control”) to all or some of the S/Hs of D.
- Distributee S/Hs may or may not surrender shares of D stock.
- D and C each conduct a qualifying “active trade or business” immediately after the distribution.
- Assuming that §355 applies to the distribution:
  - The distribution generally is tax-free to D, absent substantial pre- or post-distribution stock ownership changes in D or C;
  - The distributee S/Hs are not taxed on the receipt of the C stock, but they may be taxed on any “boot” received in the distribution; and
  - The distributee S/Hs take an allocated or substituted basis in the C stock distributed.
Why Do a Section 355 Transaction?

- Accomplish non-tax corporate business purpose(s) that otherwise could not be achieved if the separated businesses were kept under the same corporate umbrella.
- Hoped for financial play: Combined post-spin market value of D and C shares > pre-spin market value of D shares.
- May set the stage for a subsequent tax-free acquisition transaction involving D or C.
- Move value out of D without corporate-level tax, i.e., circumvent repeal of the General Utilities doctrine.
Section 355 Transaction Forms – Spin-Off

Mechanics

- D distributes C stock *pro rata* to all D S/Hs.
- No D stock is surrendered in this transaction.

Post-Transaction Structure

- Absent §355, this transaction would be subject to §§301 and 311, with the potential for both a S/H-level tax and a corporate-level tax upon the occurrence of the distribution.
D distributes C stock to one or more D S/Hs in exchange for all or some of their D stock.

Absent §355, this transaction would be subject to §302 (dividend v. exchange treatment) and §311, with the potential for both a S/H-level tax and a corporate-level tax upon the occurrence of the distribution.
D distributes C1 stock and C2 stock *pro rata* or non-*pro rata* to D S/Hs in complete liquidation in exchange for their D stock.

Absent §355, this transaction would be subject to §331 and §336 (or, alternatively, §332 and §337 if there is an 80% or more corporate S/H of D), with the potential for both a S/H-level tax and a corporate-level tax upon the occurrence of the distributions.
D contributes assets to C prior to the distribution of the C stock to D’s S/Hs.

Such a contribution can occur in connection with a spin-off, split-off, or split-up.

C can be an existing corporation ("Oldco") or newly organized ("Newco").

Corporate-level nonrecognition treatment for both D and C, so long as this transaction constitutes a divisive reorganization under §368(a)(1)(D).
Section 355 Qualification Requirements

- Statutory requirements
  - Stock of C must be distributed to S/Hs of D with respect to their D stock, or stock or securities of C must be distributed to security holders of D in exchange for D securities.
  - D must “control” C “immediately before” the spin and distribute “control” of C in the spin.
  - The spin must not be used principally as a “device” for the distribution of earnings and profits (E&P) of D or C or both.
  - D and C each must conduct an active trade or business “immediately after” the spin (directly or through an affiliated group member).
  - “Immediately after the transaction,” neither D nor C can be a “disqualified investment corporation” in which any person that holds a 50% or greater interest in such corporation held a less than 50% interest in such corporation “immediately before the transaction.”

- Non-statutory requirements
  - Business purpose
  - Continuity of interest
  - “Continued operation of the business or businesses existing prior to the separation”
Distribution Requirement – D Security Holders

- Under §355(a)(1)(A)(ii), holders of D securities may receive either C stock or C securities tax-free under §355 only if they surrender D securities in the exchange.

- Furthermore, holders of D securities may receive C securities tax-free only to the extent that the principal amount of the securities surrendered equals or exceeds the principal amount of the C securities received.

- Exchanged D or C debt instruments that have sufficiently lengthy maturities (at least 5-10 years) generally constitute “securities” for purposes of §355 and other provisions of Subchapter C.
“Control” Requirements

- “Control” is defined by reference to §368(c).
- §368(c) “control” requires the ownership of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the corporation.
  - Only direct (actual) ownership is taken into account, and 80% of each class of non-voting stock must be held. See Rev. Rul. 59-259, 1959-2 C.B. 115; Rev. Rul. 56-613, 1956-2 C.B. 212.
- In limited circumstances, D may be able to retain a relatively minor portion of the C stock for good business reasons, but not indefinitely. See IRC §355(a)(1)(D)(ii); see also Rev. Rul. 75-321, 1975-2 C.B. 123.
Non-Device Requirement

- §355(a)(1)(B) precludes tax-free treatment for transactions used principally as a “device” for the distribution of the E&P of D or C or both.
- The device restriction is intended mainly to prevent S/H “bailouts” of corporate ordinary income through sales or other capital gain dispositions of stock that allow for recovery of tax basis.
  - The statute states that “the mere fact” that stock in either D or C is sold or exchanged by all or some of the distributee S/Hs subsequent to the spin, “other than pursuant to an arrangement negotiated or agreed upon prior to the . . . [spin] shall not be construed to mean that the transaction was used principally as a . . . device.”
  - Treas. Reg. §1.355-2(d)(1) provides that the determination of whether a transaction was used principally as a device generally will be made from all of the facts and circumstances, including, but not limited to, the presence of the device factors specified in Treas. Reg. §1.355-2(d)(2) and the presence of the non-device factors specified in Treas. Reg. §1.355-2(d)(3).
Active Trade or Business Requirement

- Under §§355(a)(1)(C) and 355(b), both D and C must be engaged in a qualifying active trade or business “immediately after” the spin.

- In general, such trade or business:
  - Must have been actively conducted throughout the 5-year pre-spin period;
  - Must not have been acquired during the 5-year pre-spin period in a transaction in which gain or loss was recognized in whole or in part; and
  - Must not have been conducted by another corporation “control” of which was acquired during the 5-year pre-spin period other than via totally tax-free transactions (e.g., a §368(a) reorganization with no boot).

- Under §355(b)(3), which was added to the Code in 2005, a qualifying active trade or business can be conducted directly by D or C or indirectly through a subsidiary that is a member of the D or C “separate affiliated group” (“SAG”).
  - Under this regime, all SAG members (including the “top” corporation, i.e., D or C) are treated as a single corporation for purposes of the active trade or business requirement.
Disqualified Investment Corporation Prohibition

- §355(g)(1) requires that, “immediately after the transaction,” neither D nor C can be a “disqualified investment corporation” in which any person that holds a 50% or greater interest in such corporation held a less than 50% interest in such corporation “immediately before the transaction.”

- A corporation will constitute a “disqualified investment corporation” under §355(g) if the fair market value of its “investment assets” is equal to at least two-thirds of the fair market value of all of its assets.
  - For this purpose, the term “investment assets” generally means cash, any stock or securities in a corporation, any interest in a partnership, any debt instrument or other evidence of indebtedness, any option, forward contract, futures contract, notional principal contract, or derivative, foreign currency, or any “similar asset.”

- For purposes of §355(g), the term “50-percent or greater interest” means stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote or at least 50% of the total value of shares of all classes of stock.
Business Purpose Requirement

- All §355 transactions must be motivated “in whole or substantial part” by one or more non-federal tax corporate business purposes that otherwise could not be feasibly accomplished on a non-taxable basis without separating C as a stand-alone company.


- Although the IRS stopped ruling on the business purpose requirement in 2003, the business purposes described in Appendix A to Rev. Proc. 96-30 generally continue to be considered acceptable by both practitioners and the IRS, and the administrative criteria set forth in Rev. Proc. 96-30 with respect to such business purposes continue to guide practitioners in the planning of §355 transactions.
Continuity of Interest Requirement

- Treas. Reg. §1.355-2(c)(1) provides that “[s]ection 355 applies to a separation that effects only a readjustment of continuing interests in the property of the distributing and controlled corporation.”

- Thus, in order to satisfy the continuity of interest requirement, “one or more persons who, directly or indirectly, were the owners of” D before the spin must “own, in the aggregate, an amount of stock establishing a continuity of interest in each of” D and C after the spin.

  - Examples in the Treasury regulations indicate that 50% continuing stock ownership is acceptable, but that 20% is too low. See Treas. Reg. §1.355-2(c)(2), Exs. 2 and 4.

  - “Indirect” continuity can exist, for example, where an internal spin of a lower-tier subsidiary is followed by another spin of that subsidiary to the distributee corporation’s shareholders. See, e.g., Rev. Rul. 62-138, 1962-2 C.B. 95.
Continued Business Operation Requirement

- Neither the Treasury regulations under §355 nor the ruling guidelines of Rev. Proc. 96-30 expressly state that a continuity of business enterprise requirement applies to spins.

- However, Treas. Reg. §1.355-1(b) states that “[s]ection 355 contemplates the continued operation of the business or businesses existing prior to the separation.”

  - Although practitioners oftentimes assume that satisfaction of the active trade or business requirement necessarily will assure satisfaction of this “continued business operation” requirement, it is by no means clear that those two requirements always operate in tandem.

  - For example, it is plausible that Treas. Reg. §1.355-1(b) contemplates a longer period of post-spin business operation than whatever period may be contemplated by the “immediately after” element of the active trade or business requirement.
Further Considerations – Section 355(e)

- Under §355(e), D may be required to recognize gain on a spin to which §355 otherwise applies if (i) stock representing a 50% or greater interest in D or any C (or any of their respective successors) is acquired (directly or indirectly) by one or more persons pursuant to a plan (or series of related transactions) (a “Plan”) and (ii) the spin is part of the Plan.
  - Gain is recognized by D because the stock of C is not treated as “qualified property” for purposes of §355(c)(2) or §361(c)(2).
  - **Note:** §355(e) does not apply to situations where §355(d), which provides rules with respect to distributions of “disqualified stock,” is applicable.

- Importantly, for purposes of §355(e):
  - It is irrelevant whether the stock acquisition occurs incident to a taxable or tax-free transaction.
  - If the assets of D or any C are acquired by a successor corporation in a transaction described in §368(a)(1)(A) (statutory merger), (C) (assets for stock), or (D) (also assets for stock) (or any other transaction specified in Treasury regulations), the S/Hs (immediately before the acquisition) of the acquiring corporation will be treated as acquiring stock in the corporation from which the assets were acquired, *i.e.*, D or C.
  - Any reference to D or C includes a reference to any predecessor or successor of such corporation.
Further Considerations – Section 355(e) (cont’d)

- For purposes of §355(e), the term “50-percent or greater interest” means stock possessing at least 50% of the total combined voting power of all classes of stock entitled to vote or at least 50% of the total value of shares of all classes of stock.

  – For purposes of determining whether a 50% or greater interest has been acquired, all of the acquisitions of the stock of D or C that are considered to be part of a Plan must be aggregated.

- Pursuant to §355(e)(2)(B), a Plan is presumed to exist if 1 or more persons acquire (directly or indirectly) stock representing a 50% or greater interest in D or any C during the 4-year period beginning on the date that is 2 years before the date of the spin unless it is established that the spin and the acquisition have not occurred pursuant to a proscribed Plan.
§355(e) was enacted in 1997 in order to thwart long-sanctioned transactions patterned after the decision in *Commissioner v. Morris Trust*, 367 F.2d 794 (4th Cir. 1966), which held that a tax-free spin-off could be followed by a planned tax-free merger between D and an unrelated corporation.

In *Rev. Rul. 68-603, 1968-2 C.B. 148*, the IRS announced that it would follow the decision in *Morris Trust* to the extent that it held that (i) the active trade or business requirement of §355(b) was satisfied even though D merged into an unrelated acquiring corporation immediately after the spin, (ii) the control “immediately after” requirement of §368(a)(1)(D) implies no limitation upon a reorganization of the transferor corporation (D) after the distribution of the stock of C, and (iii) there was a business purpose for the spin and the merger. *See also Rev. Rul. 78-251, 1978-1 C.B. 89; Rev. Rul. 70-434, 1970-2 C.B. 83.*
Further Considerations – Section 355(e) (cont’d)

Reverse *Morris Trust* transactions

- In *Rev. Rul. 98-27, 1998-1 C.B. 1159*, the IRS announced that it no longer views pre-arranged post-spin acquisitions or restructurings of C as possibly violating the §355 “distribution of control” requirement.

- Thereafter, in *Rev. Rul. 2003-79, 2003-2 C.B. 80*, the IRS considered a situation in which a newly formed C transferred all of its assets to an unrelated corporation via a reorganization under §368(a)(1)(C) following a §355 distribution.

  - The IRS reasoned that, given the elimination of the “control immediately after” requirement of §351 and §368(a)(1)(D) for §355 transactions, and the addition of §355(e) to the Code, Congress demonstrated its desire that C be respected as a separate corporation for purposes of determining whether:

    - C constitutes a “controlled corporation” immediately before the spin; and

    - A pre-spin transfer of property to C satisfies the requirements of §368(a)(1)(D) or §351, even if a post-spin restructuring causes C to cease to exist.

  - Therefore, the IRS concluded that C should be considered independently from D in determining whether an acquisition of C will qualify as a reorganization under §368(a). *Cf. Rev. Rul. 75-406, 1975-2 C.B. 125* (respects the merger of C with and into an unrelated corporation following a §355 distribution), *declared obsolete on other grounds by Rev. Rul. 98-27.*
IRS National Office policies with respect to the issuance of private letter rulings for §355 transactions have undergone significant evolution since the mid-1990’s.

Under the comprehensive guidance set forth in Rev. Proc. 96-30, 1996-1 C.B. 696, private letter rulings generally were available with respect to all of the statutory and non-statutory qualification requirements of §355.

– Rev. Proc. 96-30 includes specific language for required factual representations and an appendix – Appendix A – that sets forth a non-exclusive list (and detailed description) of several acceptable non-tax corporate business purposes for completing a spin.

– Included in the Appendix A list is the so-called “fit and focus” business purpose, often the main or sole driver of many public company spins.

Under the purview of Rev. Proc. 96-30, advance rulings were routinely sought even in “plain vanilla” situations where little or no doubt existed as to a favorable outcome.

– In the public company context, the comfort of an advance ruling oftentimes was deemed essential by corporate management given the potentially catastrophic double-tax consequences of a failed §355 transaction.

– Moreover, it was not uncommon for taxpayers to seek and receive one or more supplemental rulings after obtaining a favorable §355 ruling.

- In an effort to reduce the demands associated with the high volume of §355 letter ruling requests, the IRS announced in Rev. Proc. 2003-48, 2003-2 C.B. 86, that it would no longer rule upon the business purpose or non-device requirements for §355 qualification or upon any Plan issues under §355(e).

  - Instead, all §355 letter ruling requests were required to include standard representations with respect to these areas, leaving to the audit examination process the ultimate determination of whether they were problematic.

- In addition, Rev. Proc. 2003-48 announced that a request for a supplemental ruling in connection with a §355 transaction would be entertained only if the request presented a “significant issue.”

- Rev. Proc. 2003-48 was effective with respect to §355 letter ruling requests, including supplemental §355 letter ruling requests, received by the IRS after August 8, 2003.
Certain Section 355(e) Issues Still Open for Ruling

- Notwithstanding the IRS’s no-rule policy with respect to Plan issues under §355(e):
  - The IRS may grant a ruling on a non-Plan issue under §355(e) if an adverse ruling on such non-Plan issue would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50% or greater interest in D or C that is part of a Plan under §355(e). See Rev. Proc. 2013-3, §4.01(30).
  - The IRS will entertain ruling requests regarding the effect of a redemption under §355(e) “pending the issuance of temporary or final regulations” if an adverse ruling would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50% or greater interest in D or C that is part of a Plan under §355(e). See Rev. Proc. 2013-3, §3.01(43).

Prior to the effectiveness of Rev. Proc. 2013-32, the term “significant issue” had been defined as an “issue of law” that met three conditions:

– The issue is not clearly and adequately addressed by a statute, regulation, decision of a court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin;

– Resolution of the issue is not essentially free from doubt; and

– The issue is legally significant and germane to determining the major federal tax consequences of the transaction.

Furthermore, for purposes of applying these definitional criteria, an issue was considered not “clearly and adequately addressed” by the listed authorities and not “essentially free from doubt” where, because of concern over a legal – as opposed to a factual – issue, taxpayer’s counsel was unable to render an unqualified (i.e., “will”) opinion on the federal tax consequences of the transaction. See Rev. Proc. 2013-3, §3.01(41).

- Pursuant to Rev. Proc. 2009-25, 2009-24 I.R.B. 1088, the IRS instituted a special pilot program permitting and according expedited processing of letter ruling requests on significant issues arising in the context of a §355 transaction.

  - This pilot program subsequently was incorporated into the annual letter ruling revenue procedure. See Rev. Proc. 2013-1, §6.03, 2013-1 I.R.B. 1.

- Through this program, the IRS offered to issue a letter ruling on part of an integrated transaction without ruling on the larger transaction if the requested ruling addressed one or more issues that:

  - Were under the jurisdiction of the IRS Associate Chief Counsel (Corporate);
  - Were “significant;” and
  - Involved the tax consequences or characterization of a transaction (or part of a transaction) that occurred in the context of a §355 distribution.

In Rev. Proc. 2013-3, the IRS announced that it will not issue rulings in the following areas because they are “under study” and subjects of future guidance:

– Whether a corporation is a “controlled corporation” within the meaning of §355(a)(1)(A) if, in anticipation of a distribution of the stock of the corporation, D acquires putative control of the controlled corporation – directly or through one or more corporations – in any transaction, including a recapitalization, in which stock or securities were exchanged for stock having a greater voting power than the stock or securities relinquished in the exchange, or if, in anticipation of a distribution of the stock of the putative controlled corporation, such corporation issues stock to another person having different voting power per share than the stock held by D. Rev. Proc. 2013-3, §5.01(9).

– Whether either §355 or §361 applies to D’s distribution of the stock or securities of C in exchange for, and in retirement of, any putative debt of D if such D debt is issued in anticipation of the distribution. Rev. Proc. 2013-3, §5.01(10).

– Whether “North-South” transactions should be respected as separate transactions for federal income tax purposes. Rev. Proc. 2013-3, §5.02(2).
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Control
“Control” Requirement

• Section 355(a) defines “control” by reference to section 368(c).
  – Under section 368(c), “the term ‘control’ means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock of the corporation.”

• This requirement raises issues with respect to what steps may be taken immediately prior to a transaction in order to satisfy this “control” requirement.
Recap into Control for 355 Spin-off, followed by Unwind of Recap – PLR 201007050

Step 5: D2 offers to exchange its Class A stock in C for D2 stock owned by the D2 shareholders (“Exchange Offer” resulting in an “External Split-off” to the D2 shareholders).

Step 6: If the conditions to the Exchange Offer are met, then D2 will convert the Class B stock received in the Internal Spin-off to Class A stock (the “Unwind”) prior to consummation of the Exchange Offer/External Split-off.
The IRS ruled that “The Unwind will not cause the Internal Spin-off to fail to satisfy the control immediately before requirement of Section 355(a)(1)(A).”

The taxpayer represented that immediately after the Internal Spin-off, there would be “no legally binding obligation to change the capital structure or the Charter of Controlled” and “no legally binding obligation to proceed with the remainder of the Proposed Transaction.”

- Compare to prior PLRs requiring no plan or intention. See PLRs 200731025 and 200705016.

- Consummation of the Exchange Offer/External Split-off was conditioned upon a minimum level of participation in the Exchange Offer.
  - The exchange ratio for the Exchange Offer was set at a level intended to encourage the D2 shareholders to tender their D2 stock.
Spin-Off of “Born-To-Die” Controlled

D wants to separate Business B from Business A. X wants to acquire D’s Business B.
1) D forms C and transfers Business B to C.
2) D distributes the C stock to Public.
3) C merges into X; in the merger, Public receives >50 percent of the X stock (i.e., a reverse *Morris Trust* transaction).

PLR 201032017 – Born-to-Die Controlled

- PLR 201032017 respects the transaction as a section 368(a)(1)(D)/355 double distribution, followed by a merger of C1 into D5 (and does not recast the transaction as an asset distribution by D1).
- Cf. PLRs re: newly formed Controlled merged into sister after spin-off and PLRs re pre-existing Controlled merged upstream after spin-off.

1) Shareholder contributes 10 percent of the C stock to D, increasing D’s ownership to 80 percent of the C stock (section 368(c) “control”).
2) D distributes all of its C stock (80 percent) to Shareholder.

• IRS rules that D’s “control” of C is “transitory and illusory” so that D’s distribution of its C stock does not qualify under section 355.
Rev. Rul. 71-593 – Divisive “D” Reorganization to Exchange Stock Ownership Between Shareholders

1) X transfers Asset to Y in exchange for 900 shares (90 percent) of Y stock.

2) X distributes its 900 shares of Y stock to A in exchange for A’s 25 shares (25 percent) of the X stock (split-off).

- IRS rules that, because step 1 was value-for-value, X’s resulting section 368(c) “control” of Y is respected, and split-off qualifies under section 355.
D2 wants to separate Business Y from Business X.

1) C1 authorizes new Class A common stock (80-percent vote, 10-percent value); C1 exchanges its Class B C1 stock for Class A C1 stock (20-percent vote, 90-percent value).
2) D1 transfers Asset Y to C1 in exchange for all the Class A C1 stock.
3) D1 distributes the Class A C1 stock to D2.
4) D2 transfers the C1 stock (Class A and Class B) to C2.
5) D2 distributes the C2 stock to Public pro rata.

- IRS rules that the distribution of the C1 stock by D1 (step 3) qualifies under section 355.
Debt Issued “In Anticipation of the Distribution”
Rules for Treatment of Transfers to Creditors in Divisive Reorganizations

• Under section 361(b)(3), the amount of money plus the FMV of other property that a distributing corporation can distribute to its creditors without gain recognition under section 361(b) is limited to the amount of the basis of the assets contributed to the controlled corporation.
  – Such limitation does not apply to securities of a controlled corporation that a distributing corporation receives and distributes to its creditors as part of the reorganization.
• Several recent legislative proposals would have treated securities as “other property” under section 361, so that a distributing corporation would recognize gain to the extent that securities it receives and transfers to creditors exceed the adjusted basis of the assets transferred by the corporation (net of liabilities). See, e.g., Section 302 of the Small Business and Infrastructure Jobs Tax Act of 2010, H.R. 4849.
  – Such proposals were intended to address concerns with respect to the levels of debt incurred in divisive transactions in which one corporation is relieved of debt while the newly-separate corporation is burdened.
  – However, unlike the distribution of cash, a distributing corporation’s creditors have to agree to take the controlled corporation debt securities in satisfaction of the distributing corporation’s debt, which such creditors would be unlikely to do if the controlled corporation were unduly burdened with debt in relation to its assets.
Treatment of Transfers to Creditors in Divisive Reorganizations – Example

Facts: D owns all of the stock of C in which it has a basis of $100. D conducts Businesses A and B, and C conducts Business A. D contributes its Business A assets, which have an aggregate FMV of $500 and an adjusted basis of $250, to C in exchange for $200 worth of C stock and $300. D uses the cash to repay currently outstanding debt. D then distributes all of its C stock to its shareholders.

Analysis: The amount of money and the FMV of other properties that D can receive tax-free under section 361(b) and then distribute to D creditors without gain recognition is limited to the total adjusted basis of the properties transferred by D to C. Therefore, D has $50 of gain ($300 cash distributed to its creditors - $250 aggregate basis in property contributed to C). See section 361(b)(3).

If, instead of cash, D received C securities worth $300 and used such securities to satisfy its debt, D would not recognize any gain, as the limitation in section 361(b)(3) would not apply.
Debt Issued in Anticipation of the Distribution: IRS Rulings

- The IRS has issued private letter rulings approving the use of controlled securities received in a divisive “D” reorganization to satisfy debt of the distributing corporation.
- Formerly, the IRS only approved such exchanges if the distributing corporation debt satisfied by the controlled securities was “old and cold” debt that was not incurred as part of the transaction.
  - More recently, the IRS has approved transactions where the distributing company’s debt is newly issued and short-term, and the exchange between distributing and controlled is facilitated by an intermediary (e.g., an investment bank or an underwriter).
  - In such rulings, the IRS has generally limited the amount of distributing debt that can be retired with controlled securities to historic average outstanding debt levels.
- In a typical transaction, an investment bank purchases distributing debt (on the open market or directly from distributing) and enters into an exchange agreement with the distributing corporation. In connection with the distribution of controlled, distributing transfers controlled securities to the investment bank in exchange for the distributing debt, with the investment bank selling the controlled securities on the open market.
  - The IRS has generally required a “5-14 representation” in connection with such transactions, which is intended to ensure the existence of event risk and credit risk (i.e., that the investment bank was a real creditor and not merely an agent of distributing).
  - Generally, the IRS has defined event risk as the investment bank holding the distributing debt for at least 5 days before entering into the exchange agreement, and credit risk as the investment bank holding the distributing debt for at least 14 days before executing the exchange of distributing for controlled debt.
Facts:  D contributes Business A to newly formed C in exchange for all of C's stock, the assumption of certain D liabilities by C, and C securities.  D distributes the C stock to its shareholders, and D exchanges the C securities for debt of D.  The debt exchange is facilitated by investment banks that will acquire the D debt at least m days (believed to be 14 days) prior to the date of the exchange.  D and the investment banks will enter into exchange agreements no sooner than n days (believed to be 5 days) after the investment banks acquire the D debt.  The investment banks enter into agreements to sell the C securities received in the exchange to unrelated third parties.  The D debt exchanged for the C securities will not exceed the weighted quarterly average of D's third-party debt for the 12-month period ending on the date before the date D's board of directors directed management to pursue actively the distribution transaction.

Rulings:
• The contribution to C and the distribution by D qualify as a reorganization under section 368(a)(1)(D).
• D will generally not recognize any gain or loss with respect to the C securities under section 361(c).
• See also PLRs 200808006, 200802009.
Debt Issued in Anticipation of the Distribution: IRS Rulings

• Taxpayers have also obtained rulings from the IRS in debt-for-debt exchanges where distributing securities are issued directly to third-party creditors/investors without the use of an intermediary.
  – In this type of transaction, involving so-called “traveling debt,” there is no exchange agreement; rather, the terms of such instruments generally permit the distributing corporation to exchange the debt for securities of controlled.

• The IRS has generally required a similar 5-14 representation to ensure sufficient event and credit risk is assumed by the third-party creditors/investors.
Repayment of Distributing Debt in 355 Spin-off – PLR 201029007

1. D issues Debt to unrelated investors

2. D contributes assets to C in exchange for C stock and C Debt

3. D distributes C stock to D’s shareholders and exchanges C Debt for D Debt

• The IRS ruled that D will not recognize gain or loss on the transfer of C Debt under section 361(c) (with certain exceptions).

• The taxpayer represented that D Debt exchanged for C Debt “will not exceed the daily average outstanding third party indebtedness of D for the 365 day period ending” at the close of the last business day before D’s Board directed management to pursue the distribution.

• Compare to prior rulings requiring D Debt to be “old and cold”. See PLRs 200716024, 200345050, and 200137011.
PLR 201029007 (cont’d)

• The ruling provides that D Debt will be issued to investors at least \( g \) days prior to distribution. The ruling does not specify when D and the investors will agree to the exchange of C Debt for D Debt.

• **Compare** PLR 201032017:
  
  • The Investment Banks acquired D debt (either by direct issuance or on secondary markets) at least \( jj \) days prior to date of exchange (assumed to be 14 days based on PLR 200802009).
  
  • An Exchange Agreement was entered into by the Investment Banks and D no sooner than \( jj \) days after the Banks acquired the debt (assumed to be 5 days based on PLR 200802009).
  
  • It was anticipated that the Investment Banks would sell the C debt they received in the debt exchange.
Facts: D is a publicly-traded corporation that operates Businesses A and B. D operates Business A through a disregarded entity, C, which elects to be treated as a corporation. D contributes to C certain Business A assets and interests in exchange for C stock, cash, C securities, and the assumption of certain liabilities by C. D issues new securities to third-party investors at least 5 days prior to the declaration of its distribution of C stock and 14 days before such distribution. D distributes C stock to its shareholders.
Facts (cont’d): Around the same time as the distribution, and at least 14 days after D’s issuance of new securities, D delivers C securities in satisfaction of its recently issued securities and certain other debt related to Business A. D also uses all of the cash received from C to repay outstanding D debt.

Rulings:
• The contribution to C and the distribution by D qualify as a reorganization under section 368(a)(1)(D).
  – D recognizes no gain or loss on the contribution and the distribution, and no gain or loss is recognized by the D shareholders on the receipt of the C stock.
• D will generally not recognize any gain or loss with respect to the C securities under section 361(c).
  – The taxpayer represented that the amount of D debt (including the newly issued D securities) exchanged for the C securities would not exceed the average of D’s outstanding third party indebtedness at the end of each of the four calendar quarters preceding the date on which the distribution was first presented to D’s board of directors.
Rulings (cont’d):

• The ruling required a 5-14 representation, with event risk tied to the distributing corporation’s declaration of the distribution of its C stock instead of the entering into of an exchange agreement (i.e., requiring the third-party investors to hold the distributing securities for at least 5 days before D declared the C stock distribution).
  
  – The risk that the distribution would not be consummated was presumably viewed by the IRS as sufficient event risk, subjecting the bank to the risk that it would be stuck with distributing securities rather than controlled securities.

  – Such terms appear to place greater risk on the investment bank, which would effectively be subject to 14 days of both event and credit risk because it had no rights to effectuate the exchange of D securities for C securities with the distributing corporation.
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North-South Transactions
North-South Transactions

- Transfers of property (e.g., cash, assets) from a shareholder to a corporation that occur near in time to a distribution of property from the corporation to the shareholder.
- Are the contribution and distribution respected as separate transactions or are they treated as an exchange?
- Issue often arises in the context of a spin-off transaction, but can also arise in section 351 transactions or other corporate reorganizations.
North-South Issues – Spin-Off Transactions Transactions Between Shareholder and Distributing

• The IRS has issued non-exchange rulings that effectively treat asset transfers to distributing as separate from the section 355 distribution.
  – See, e.g., PLR 200611006 (shareholder's contribution of property to distributing, followed by distributing’s distribution of controlled to shareholder and shareholder’s distribution of distributing stock to its shareholders); PLR 200411021 (parent contributed property to distributing, followed by distribution of controlled stock), PLR 200215031 (distributing’s parent contributed cash to distributing); PLR 9708012 (parent contributed property to distributing, followed by distribution of controlled stock).
  – These rulings generally contain the representation that no part of the consideration distributed by distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
North-South Issues – Spin-Off Transactions Transactions
Between Shareholder and Distributing

• In more recent rulings, the IRS has required a more specific taxpayer representation to avoid exchange treatment. See, e.g., PLR 201033007.
  – These rulings require the taxpayer to represent that there is no regulatory, legal, or economic compulsion or requirement that the contribution be made as a condition of the distribution of controlled stock.
  – The taxpayer must also represent that the fact that the value of distributing will decrease as a result of the distribution was not a consideration in the decision to contribute property to distributing, and that the distribution is not contingent on there being contributed to distributing assets having a specified (or roughly specified) value.
  – Such rulings appear to reflect a position that North-South transfers should be treated as an exchange if the property transferred by the shareholder/distributee to distributing is required to enable the distribution of controlled.

• However, the IRS required a shorter representation in an even more recent non-exchange ruling. See PLR 201149012 (in ruling that contribution will not be treated as having been received by distributing in exchange for distribution of controlled stock, requiring taxpayer representation that there “is no regulatory, legal, contractual, or economic compulsion or requirement that [shareholder] make part or all of the [shareholder contribution] to [distributing] as a condition to the Distribution”).
PLR 201033007 –
North-South Transactions Between Shareholder and Distributing

(1) P contributes ATB1 to D
(2) D spins C to P

- **Facts:** P contributes ATB1 (active business relied on by D in spin-off) to D. D distributes the stock of C to P. Taxpayer made the following representation: “There is no regulatory, legal, or economic compulsion or requirement that the [contribution by P] be made as a condition of the [internal distribution of C]. The fact that the value of [D] will decrease as a result of the [internal distribution] was not a consideration in the decision to contribute property to [D]. The [internal distribution] is not contingent on there being contributed to [D] assets having a specified (or roughly specified) value.”

- **Result:** The ruling held that the contribution by P will not be treated as having been received by D in exchange for the C stock distributed by D. What if D’s distribution to P was a split-off? Does it matter if the shares redeemed include the D shares issued (or deemed issued) in the contribution by P?

- **Other recent North-South rulings have required a similar representation.** See, e.g., PLRs 201034005, 201030005, and 201007050; see also PLR 201202007 (non-exchange ruling involving north-south transfers between shareholder and distributing, where distributing made both a distribution of stock under section 355 and a separate distribution of assets under section 301); PLR 201047016 (cash investment by significant D shareholder into D, followed by D’s distribution of C and cash to public shareholders in a split-off, not treated as purchase of D shares by significant D shareholder; transaction was respected as cash investment into D followed by split-off with boot).

- **Cf.** PLR 201149012 (in ruling that contribution will not be treated as having been received by distributing in exchange for distribution of controlled stock, requiring taxpayer representation that there “is no regulatory, legal, contractual, or economic compulsion or requirement that [shareholder] make part or all of the [shareholder contribution] to [distributing] as a condition to the Distribution”).
**PLR 201136009 – North-South Transactions Between Distributing and Controlled**

- **Facts:** C distributes cash to D, and D contributes assets to C. D distributes the stock of C to its shareholder.
  - If the cash distribution and asset contribution are integrated and treated as an exchange, the cash distribution would be treated as boot received by D.
  - If the cash distribution and asset contribution are respected as separate, the cash distribution would be treated as a dividend separate from the “D” reorganization.
- The taxpayer made the following representation: “There is no regulatory, legal, contractual, or economic compulsion or requirement that [D] make part or all of the [D] Contribution as a condition to the distribution by [C] of the Cash Distribution.”
- **Result:** The IRS ruled that the cash distribution was a section 301(a) distribution (i.e., not “boot” in a divisive “D” reorganization).
- As with North-South transactions between shareholder and distributing, earlier rulings involving north-south transactions between distributing and controlled required a more significant taxpayer representation. See, e.g., PLR 201106004 (taxpayer represented that there “is no regulatory, legal, contractual, or economic compulsion or requirement that the [controlled distribution] be made as a condition to the distribution of [controlled] by [distributing]. The fact that the value of [distributing] will decrease as a result of the distribution of [controlled] by [distributing] was not a consideration in the decision to make the [controlled distribution]. The distribution of [controlled] by [distributing] is not contingent on there being distributed to [distributing] assets having a specified (or roughly specified) value.”).
- **Query:** What if C is a Newco and the distribution is supported by an equity infusion?


  - Per Rev. Proc. 2013-32, the IRS will no longer rule, even on a caveated basis, on whether a transaction qualifies as tax-free under §355.

  - Instead, the IRS will rule only on one or more “significant issues” arising in the context of such a transaction.


- Rev. Proc. 2013-32 is effective with respect to §355 letter ruling requests, including supplemental §355 letter ruling requests, received by the IRS after August 23, 2013.

- The “significant issue” concept has been re-defined in Rev. Proc. 2013-32 to encompass issues of law that:
  - Are “not essentially free from doubt;” and
  - Are “germane to determining the tax consequences of the transaction.”

- Notably, the prior requirement that the issue not be “clearly and adequately addressed” by the Code, Treasury regulations, or other published authority has been dropped from the definition, and the “legally significant” and “major tax consequences” elements have been removed from the earlier “germaneness” requirement.

- In making these changes, the IRS potentially broadened the range of issues that may qualify as “significant” for letter ruling purposes.

- However, it should be noted that the “clearly and adequately addressed” notion has been added to §4.02(9) of Rev. Proc. 2013-3 by Rev. Proc. 2013-32.

  - Specifically, as modified, that section now generally provides that the IRS will not issue a “Comfort Ruling,” i.e., a letter ruling with respect to an issue that is “clearly and adequately addressed by statute, regulations, decision of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin.”

- Rev. Proc. 2013-32 also provides that the IRS will apply the same no-rule policy to supplemental letter ruling requests.

- Furthermore, as relevant to supplemental letter ruling requests:
  - A change of circumstances arising after a transaction has been completed ordinarily will **not** present a significant issue with respect to the transaction;
  - An issue of fact will **not** present a significant issue; and
  - All pertinent no-rule policies described in Rev. Proc. 2013-3 will govern such requests.
Rev. Proc. 2013-32 – Additional Aspects

- Rev. Proc. 2013-32 does not impact:
  - The provisions of Rev. Proc. 2013-3 pursuant to which the IRS announced that it will not issue rulings concerning recapitalizations into control, debt issued “in anticipation of the distribution,” and “North-South” transactions because those areas are under study; or
  - A taxpayer’s ability to receive rulings with respect to the §355(e) issues that are described on p. 32.

  - Rev. Proc. 2013-32 effectively adopts the approach of the pilot program, thereby eliminating the need for it.
The IRS’s decision to expand its §355 no-ruling policy likely will have the most significant impact on spins involving public companies.

Historically, many such transactions had been contingent upon the receipt of a letter ruling from the IRS addressing the transaction’s qualification under §355 and the ancillary tax consequences following from that determination.

Going forward, these types of transactions will have to proceed on the basis of an opinion of counsel, coupled with the possibility of receiving a “significant issue” letter ruling from the IRS.
Obtaining a “Significant Issue”
“ Significant Issue” Letter Ruling Requests

  
  - For example, the no-ruling policy regarding business purpose and device issues and Plan issues under §355(e) continues in effect.
  
  - The same goes for the provisions of Rev. Proc. 2013-3 pursuant to which the IRS announced that it will not issue rulings concerning recapitalizations into control, debt issued “in anticipation of the distribution,” and “North-South” transactions because those areas are under study.

- It is advisable for a taxpayer’s representative to call IRS Associate Chief Counsel (Corporate) and discuss whether the IRS will entertain the letter ruling request.
“Significant Issue” Letter Ruling Requests (cont’d)

- Taxpayers should continue to consult Rev. Proc. 96-30 when drafting a §355 letter ruling request and include in such request the information and representations described in that revenue procedure, but only to the extent that such information and/or representations relate to the significant issue(s) described in the letter ruling request.
  
  – In addition, the taxpayer should be prepared to submit a representation to the effect that, assuming that the IRS issues the requested rulings, to the taxpayer’s best knowledge and belief, the spin should constitute a distribution of stock of a controlled corporation that qualifies as tax-free under §355.

- Rev. Proc. 2013-32 does not limit the number of significant issues that may be the subject of a single letter ruling request.

- Be aware that the IRS has reserved the right to rule on any other issue in, or that is a part of, a transaction described in a letter ruling request submitted under Rev. Proc. 2013-32 – including ruling adversely – if the IRS believes that so doing is in “the best interests of tax administration.”
### Section 355 Qualification Requirement

<table>
<thead>
<tr>
<th>Distribution Requirement: Stock of C must be distributed to S/Hs of D with respect to their D stock, or stock or securities of C must be distributed to security holders of D in exchange for D securities.</th>
<th>Yes, but <strong>not</strong> with respect to D debt issued “in anticipation of the distribution.” <em>See, e.g.</em>, Priv. Ltr. Rul. 201312020 (discussed below).</th>
</tr>
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<tbody>
<tr>
<td>“Control” Requirements: D must “control” C “immediately before” the spin and distribute “control” of C in the spin.</td>
<td>Yes, but <strong>not</strong> with respect to recapitalizations into control. <em>See, e.g.</em>, Priv. Ltr. Rul. 201005022 (discussed below).</td>
</tr>
<tr>
<td>Non-Device Requirement: The spin must not be used principally as a “device” for the distribution of the E&amp;P of D or C or both.</td>
<td><strong>No</strong>, continues to be a no-rule area.</td>
</tr>
<tr>
<td>Active Trade or Business Requirement: D and C each must conduct an active trade or business “immediately after” the spin (directly or through an affiliated group member).</td>
<td>Yes. <em>See, e.g.</em>, Priv. Ltr. Rul. 201333003 (discussed below).</td>
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## Potential “Significant Issues” Under §355 (cont’d)

<table>
<thead>
<tr>
<th>Section 355 Qualification Requirement</th>
<th>Potentially a Significant Issue?</th>
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<tr>
<td><strong>Disqualified Investment Corporation Prohibition:</strong> “Immediately after the transaction,” neither D nor C can be a “disqualified investment corporation” in which any person that holds a 50% or greater interest in such corporation held a less than 50% interest in such corporation “immediately before the transaction.”</td>
<td>Yes. <em>Cf. Priv. Ltr. Rul. 201337007</em> (Ruling 24 provides that certain “post-distribution payments” from D to C (or vice versa) will not be treated as made prior to the spin (under <em>Arrowsmith</em> doctrine) for purposes of §355(g)).</td>
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<td><strong>Business Purpose Requirement:</strong> All §355 transactions must be motivated “in whole or substantial part” by one or more non-federal tax corporate business purposes that otherwise could not be feasibly accomplished on a non-taxable basis without separating C as a stand-alone company.</td>
<td>No, continues to be a no-rule area.</td>
</tr>
<tr>
<td><strong>Continuity of Interest Requirement:</strong> “One or more persons who, directly or indirectly, were the owners of” D before the spin must “own, in the aggregate, an amount of stock establishing a continuity of interest in each of” D and C after the spin.</td>
<td>Yes. <em>Cf. Rev. Proc. 2013-1, §6.03</em> (providing that the IRS may rule on significant issues under Treas. Reg. §1.368-1(e) (reorganization continuity of interest requirement), as modified by Rev. Proc. 2013-32.).</td>
</tr>
<tr>
<td><strong>Continued Business Operation Requirement:</strong> “Section 355 contemplates the continued operation of the business or businesses existing prior to the separation.”</td>
<td>Yes. <em>Cf. Rev. Proc. 2013-1, §6.03</em> (providing that the IRS may rule on significant issues under Treas. Reg. §1.368-1(d) (reorganization continuity of business enterprise requirement), as modified by Rev. Proc. 2013-32.).</td>
</tr>
</tbody>
</table>
Potential “Significant Issues” Under §355 (cont’d)

- Rev. Proc. 2013-32 does not impact a taxpayer’s ability to receive rulings with respect to the following issues under §355(e):
  - A non-Plan issue if an adverse ruling on such non-Plan issue would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50% or greater interest in D or C that is part of a Plan under §355(e). See Rev. Proc. 2013-3, §4.01(30).
  - The effect of a redemption “pending the issuance of temporary or final regulations” if an adverse ruling would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50% or greater interest in D or C that is part of a Plan under §355(e). See Rev. Proc. 2013-3, §3.01(43).
“Significant Issue” Private Letter Rulings


- A review of the §355 letter rulings that have been released since the IRS instituted the pilot program reveals that at least four private letter rulings were issued under that program.
  - Priv. Ltr. Rul. 201005022
  - Priv. Ltr. Rul. 201007050
  - Priv. Ltr. Rul. 201312020
  - Priv. Ltr. Rul. 201333003

  • **Note**: This letter ruling offers rulings as to (i) a recapitalization into control and (ii) a “North-South” transaction.
  - Priv. Ltr. Rul. 201312020
  - Priv. Ltr. Rul. 201333003
Distributing plans to distribute all of the outstanding stock of each of Controlled 1 and Controlled 2 to U.S. Parent in transactions intended to qualify as tax-free under §355.

Controlled 1’s active trade or business requires security clearances from the federal government to operate.

- In order to create a security measure designed to insulate Controlled 1 from any foreign control or influence, Foreign Parent, U.S. Parent, Distributing, and Controlled 1 have entered into a proxy agreement.

- The proxy agreement grants to certain proxy holders – individuals that have the requisite qualifications and national security clearance – voting rights with respect to the stock of Controlled 1.

- However, Distributing’s economic interest in Controlled 1 remains paramount under the terms of the proxy agreement, which limits the actions that the proxy holders may take with respect to Controlled 1 and its stock.
IRS ruled that, notwithstanding the proxy agreement, the stock of Controlled 1 owned by Distributing possesses:

- At least 80% of the total combined voting power of all classes of Controlled 1 stock entitled to vote for purposes of §368(c); and
- At least 80% of the total voting power of the stock of Controlled 1 for purposes of §1504(a).
Priv. Ltr. Rul. 201312020

Beginning Structure

- **Parent**
  - Tax-exempt, non-profit corporation
  - Membership interest (no stock)

- **Distributing**
  - Taxable, non-profit corporation

- **Controlled**
  - Membership interest (no stock)

- **Sub 2**
  - Membership interest (no stock)

- **Sub 3**
  - Membership interest (no stock)

- **Sub 2** will liquidate into **Controlled** or convert into a disregarded entity.
- **Controlled** will distribute the **Sub 3** stock to Distributing or transfer **Sub 3** to another Distributing subsidiary.

Interim Structure 1

- **Parent**
  - Membership interest

- **Distributing**
  - Membership interest

- **Sub 3**

- **Controlled**

- **Sub 2**

- **Distributing** then will distribute the stock of **Controlled** to its sole member, **Parent**, in a transaction intended to qualify as tax-free under §355 (the “Distribution”).
Thereafter, Controlled will liquidate into Parent or convert into a disregarded entity (the “Controlled Liquidation”).

Parent represented that: “To the best knowledge and belief of Parent, the Distribution qualifies under section 355(a) of the Code.”
Priv. Ltr. Rul. 201312020 (cont’d)

- IRS ruled as follows:
  - The Distribution will satisfy the requirement of §355(a)(1)(A) that the stock of Controlled be distributed with respect to the stock of Distributing, notwithstanding that Parent holds a membership interest, rather than a formal stock ownership interest, in Distributing.
  - The Distribution will be respected for federal income tax purposes, notwithstanding the Controlled Liquidation.
Distributing formed Controlled as a wholly owned subsidiary.

- Sub formed LLC5, and Sub and/or LLC4 transferred the assets and liabilities associated with Business B to LLC5.
- LLC1 distributed all of its interests in LLC2 and LLC3 to Distributing.

Priv. Ltr. Rul. 201333003
Distributing will contribute all of its interests in LLC2 and LLC3 and cash to Controlled in exchange for Controlled stock of equal value (the “Contribution”).

Controlled will use the cash received in the Contribution to purchase all of the interests in LLC5 from Sub in a value-for-value exchange.

Thereafter, Distributing will distribute all of the stock of Controlled to S/H in a transaction intended to qualify as tax-free under §355 (the “Distribution”).
After the Distribution, the Distributing SAG will continue to operate a portion of Business B for a period “of approximately a months” before transitioning fully to Controlled.

In addition, Distributing and Controlled will enter into an agreement pursuant to which Controlled will provide Business B products and services to the Distributing SAG on market-based terms.

Distributing and Controlled also may enter into certain agreements providing for transitional services for a period of no longer than 2 years after the Distribution (collectively, the “Continuing Arrangements”).
Priv. Ltr. Rul. 201333003 (cont’d)

Representations

a) In applying §355(b)(2)(A) regarding the active conduct of a trade or business, Distributing will treat all members of its separate affiliated group (the “Distributing SAG”), as defined in §355(b)(3)(B), as one corporation.

b) The five years of financial information submitted on behalf of Business A conducted by the Distributing SAG are representative of its present operations, and, with regard to such operations, there have been no substantial changes since the date of the last financial statements submitted.

c) In applying §355(b)(2)(A), Controlled will treat all members of its separate affiliated group (the “Controlled SAG”), as defined in §355(b)(3)(B), as one corporation.

d) The five years of financial information submitted on behalf of Business B conducted by the Distributing SAG before the Distribution – and to be operated by the Controlled SAG after the Distribution – are representative of its present operations, and with regard to such operations, there have been no substantial changes since the date of the last financial statements submitted.

e) The Distributing SAG neither acquired Business A nor acquired control of an entity conducting Business A during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or was treated as recognized) in whole or in part.

f) The Distributing SAG neither acquired Business B nor acquired control of an entity conducting Business B during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or was treated as recognized) in whole or in part.

g) Following the Distribution, the Distributing SAG will continue the active conduct of Business A and the Controlled SAG will continue the active conduct of Business B independently and with their separate employees (except as provided pursuant to the Continuing Arrangements).

h) Assuming that the IRS issues the requested rulings, to the best knowledge and belief of Distributing, the Distribution should constitute a distribution of stock of a controlled corporation that qualifies as tax-free under §355.
Priv. Ltr. Rul. 201333003 (cont’d)

- IRS ruled as follows:
  - Distributing will satisfy the active trade or business requirement with respect to the Distribution.
  - Controlled will satisfy the active trade or business requirement with respect to the Distribution.
Tax Counsel’s Legal Opinion
Pre-2013-3 and -32 Practice

- Obtain rulings on spin-off qualification from IRS, with “back-up” opinions from counsel regarding business purpose, “device,” and/or 355(e) “Plan”

- Prohibit post-spin-off actions potentially implicating continuity of business, continuity of interest, business purpose, “device” or 355(e) without supplemental IRS rulings or opinion of counsel.
  - Since IRS generally will not supplementally rule on “changed circumstances” or circumstances known but not disclosed at time of original request, generally required opinion.
Practice Under Rev. Proc. 2013-3 and -32

• Obtain opinion on spin-off from counsel, with back-up rulings from IRS on any “significant issues” that are not in “no-rule” area.

• Examples:
  -- “active business” issues, such as restructurings/acquisitions

  -- 355(e) non-“Plan” issues, such as redemptions/buyback programs, options/exercises

  -- distributions of less than all C stock/securities

• Tax counsel will “step into the shoes” of IRS with respect to information and representations required

• Most taxpayers (especially public companies) will require a “will” opinion
  -- Counsel may not be able to give a “will” with respect to IRS no-rule issues
Practice Under Rev. Proc. 2013-3 and -32 (cont'd)

• Circular 230 Considerations

  -- If opinion is a “covered opinion,” counsel must address facts/law and provide conclusions as to each “significant federal tax issue” as well as overall conclusion.

  -- “Covered opinion” includes “reliance opinion” (obtained by taxpayer to protect from penalties), and “marketed opinion” (obtained by taxpayer in furtherance of promotion/recommendation of the transaction -- i.e., to shareholders).

    * Exclusions: opinions filed as part of SEC filings for transaction (i.e., public company spin-off); reliance/marketed opinions with disclaimers.

  -- “Significant federal tax issue” is an issue with respect to which the IRS has reasonable basis for successful challenge and resolution of the issue could have a significant impact on the overall federal tax treatment of the transaction.

    * Thus, opinions on spin-offs including no-rule aspects, especially recaps into control, debt in anticipation, and north-south, will probably have to separately address each such aspect and reach a conclusion on it, as well as on the overall transaction. Inability to reach “will” on each such aspect will likely result in inability to deliver “will” opinion.