# Practising Law Institute

## Section 355:
## Divisive Strategies
## Discussion Problems*

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# Section 355 Transactions

How many members of the audience have been involved in a distribution intended to qualify under Section 355 where Distributing debt was satisfied in exchange for Controlled securities as part of the plan of reorganization?

# Significant Issue Ruling Program

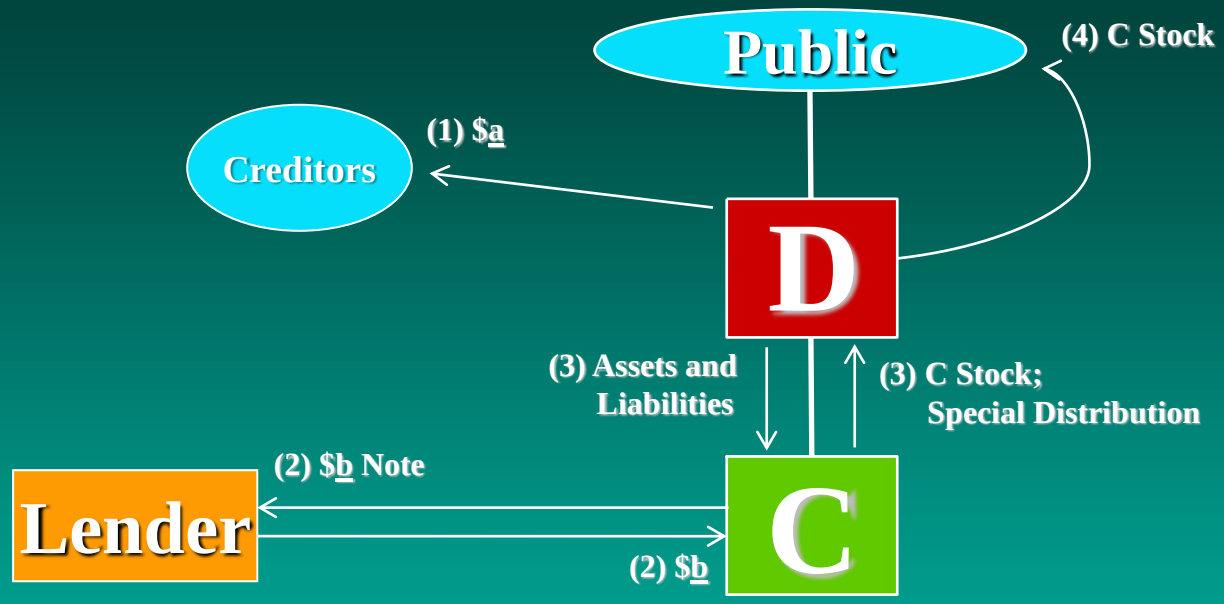
- In Rev. Proc. 2013-32, 2013-2 C.B. 55 the Service announced that it would no longer provide "no gain or loss" rulings with respect to section 355 (or sections 332, 351, 1036 or rulings on whether a transaction constitutes a reorganization within the meaning of section 368). Instead, the Service would rule on significant legal issues under such sections. Currently, as noted below, pursuant to Rev. Proc. 2017-52, the Service will provide no gain or loss and significant issue rulings.
- A significant issue is a germane and specific issue of law, provided that a ruling on the issue would not be a comfort ruling or the conclusion in such a ruling otherwise would not be essentially free from doubt.
- An issue is germane if resolution of the issue is necessary to determine an element of the tax treatment of the transaction. An issue is specific if it is the narrowest articulation of the germane issue. A change of circumstances arising after a transaction ordinarily does not present a significant issue with respect to the transaction
- An issue the resolution of which is not essentially free from doubt under one Code section may nevertheless not be germane to determining the tax consequences of the transaction if, for instance, another Code section provides the same consequences as the first Code section
- Rev. Proc. 2016-45, 2016-37 I.R.B. 344 added the possibility of ruling on significant legal issues relating to business purpose and device provided that the issue is not inherently factual in nature.
- The Service will not issue rulings with respect to significant issues which are the subject of a no-rule position (e.g., whether a distribution and an acquisition are part of a plan under section 355(e) – see Rev. Proc. 2021-3, 2021-1 I.R.B. 140, § 3.01(62)).

# IRS Statement Regarding ATB – September 25, 2018

- Considering ATB guidance with respect to non-incoming producing entrepreneurial activities conducted for the purpose of earning income
  - An ATB "ordinarily must include the collection of income." See Treas. Reg 1.355-3(b)(2)(ii); compare Rev. Rul. 85-122, 1985-2 C.B. 118 (facts indicate ski operations experienced significant losses for several years and company near bankrupt).
  - While the IRS studies the issue, it has suspended two revenue rulings dealing with the income requirement (Rev. Rul. 57-492, 1957-2 C.B. 247, which provided that exploring for oil was not an ATB because no income was produced, and Rev. Rul. 57-464, 1957-2 C.B. 244, which provided that rental operation is not an ATB because, among other reasons, the net rental income is incidental).

- Factors that might be considered include:
  - Regular and continuing research and related activities by significant management and operational employees conducted with the intent to earn income
  - Incurrence of significant and regular expenses
  - Significant progress in research toward a point in time when income would be earned
  - Holding the business out to others as one that will produce income
  - Other businesses similarly situated that have produced income

# Simplified PLR 201524005: Pre-Contribution Boot Purge




**Step 1:** On Date B following the formation of C, D paid pre-existing creditors $a (the "Date B Payment").

**Step 2:** C borrowed $b from unrelated third party lenders.

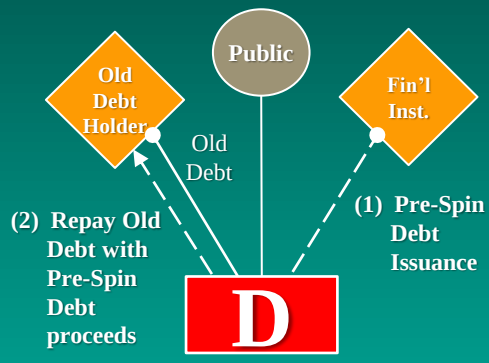
**Step 3:** D transferred assets to C in exchange for C common stock, $c of the $b borrowed in Step (2) (the "Special Distribution"), and the assumption of certain liabilities.

**Step 4:** D distributed all of the stock of C pro rata.

- Provided the Date B Payment otherwise qualified as a distribution in pursuance of the plan of reorganization within the meaning of sections 361(b)(1)(A) and 361(b)(3), the fact that the Date B Payment was made prior to the Special Distribution will not preclude it from being considered a payment to creditors within the meaning of section 361(b)(3). See PLR 201524005 (Feb. 24, 2015) (Ruling (1)); cf. Rev. Rul. 72-343 (pre-merger purge of cash to creditors treated as pursuant to the plan of reorganization).

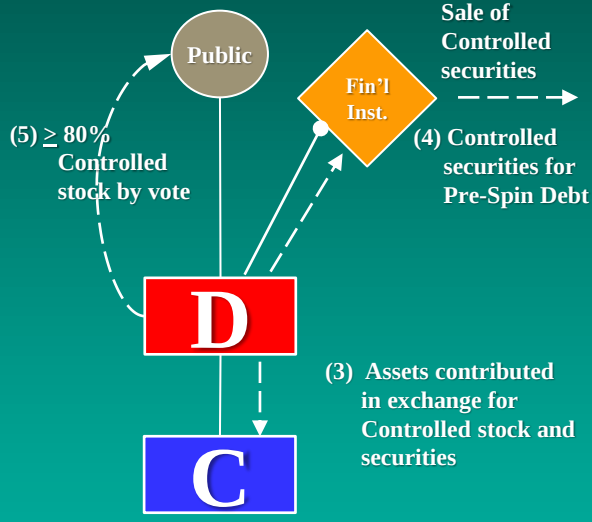
# Rev. Proc. 2018-53: Debt issued in anticipation of, and to be retired in connection with, a spin-off (simplified PLR 201835001)

## Old Debt Repayment



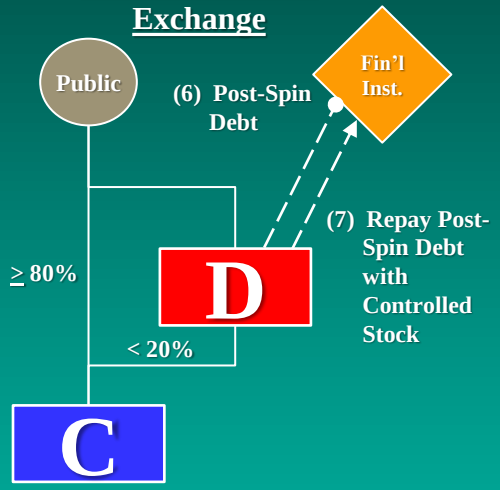

At least [1] day after the Pre-Spin Debt issuance and in anticipation of the spin where the loan proceeds were applied immediately to satisfy Old Distributing debt, Distributing and the Financial Institutions, agree to exchange Controlled securities for the Pre-Spin Debt

## External Distribution & Debt-for-Debt Exchange




At least [2] days after the Pre-Spin Debt issuance, Distributing exchanges Controlled securities for the Pre-Spin Debt and distributes at least 80-percent of Controlled to the Public

## Post-Spin Debt Issuance & Debt-for-Stock Exchange

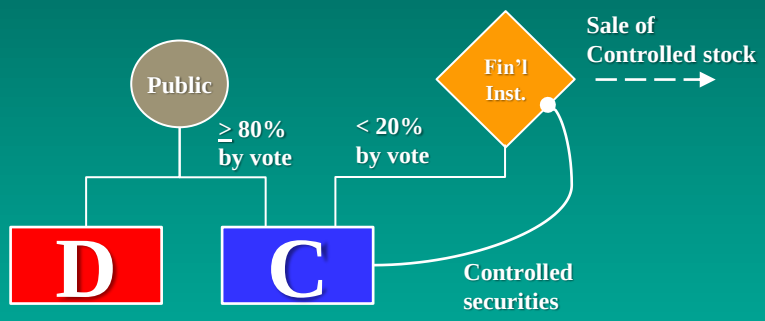



At least [1] day after the Post-Spin Debt issuance, Distributing and the Financial Institutions agree to exchange Controlled stock for the Post-Spin Debt. Post-Spin Debt proceeds used to repay old Distributing debt.

Distributing exchanges Controlled stock for the Post-Spin Debt at least [2] days after the Post-Spin Debt issuance and no later than approximately [12] months after the External Distribution.

# Rev. Proc. 2018-53: Debt issued in anticipation of, and to be retired in connection with, a spin-off (simplified PLR 201835001) (continued)

**Resulting Structure**



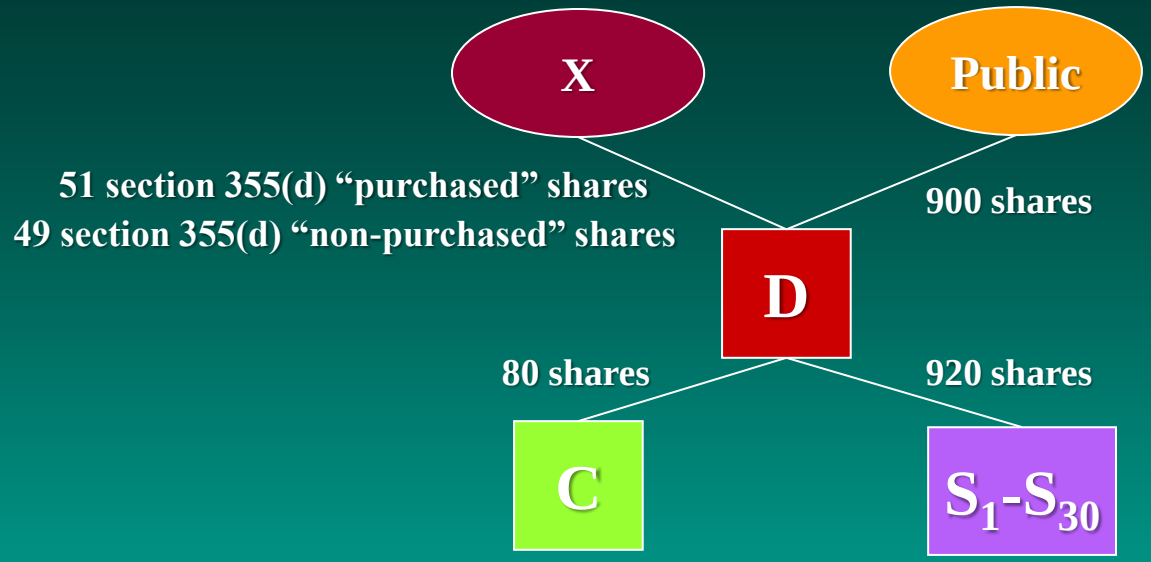

**Representation Supporting Historic Debt Status**

- The sum of Distributing debt that is assumed under section 357 and the Distributing debt satisfied under section 361 does not exceed the historic average of the total debt owed to unrelated persons by Distributing and other members of the Distributing separate affiliated group. The historic average will be computed as of the close of the eight fiscal quarters immediately before the date that is at least 60 days before the transaction or a similar transaction is disclosed or announced to the public or approved by Distributing's board of directors (whichever is earlier).

**Ruling**

- No gain or loss to Distributing in connection with the receipt and transfer by Distributing of the Controlled stock or securities in the External Distribution, the Debt-for-Debt Exchange, and the Debt-for-Equity Exchange. Section 361(c).

# Section 355(d) and Specific Identification

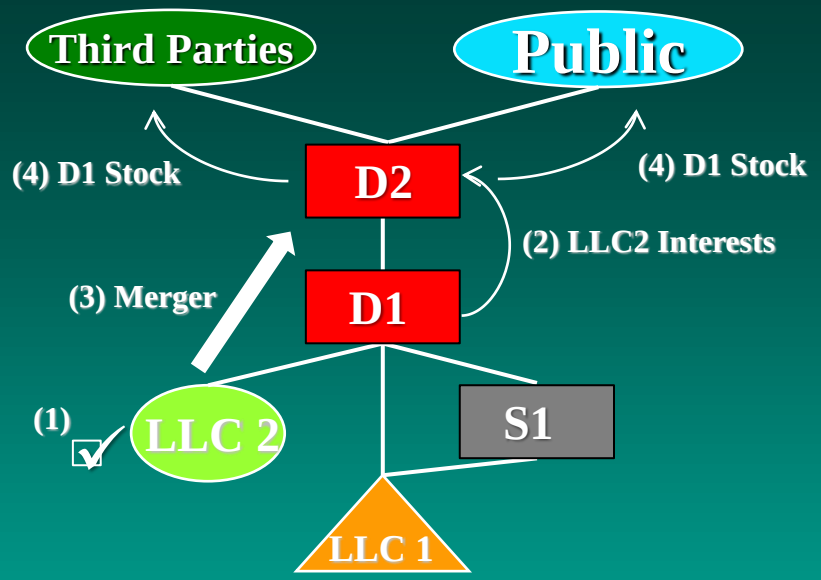



- Each share of each D, C, and all other members of the D group has $1 FMV.
- D proposes to split-off C to Shareholder X in exchange for 80 shares of D stock.
  - Can Shareholder X specifically identify D shares tendered in the exchange for the 80 shares of C stock in accordance with Reg. §1.1012-1(c) and thus avoid application of §355(d), e.g., tendering 41 non-purchased shares and 39 purchased shares?
  - Is the tender exchange instead deemed to be made based upon a convention, e.g., pro rata or taxpayer favorable (adverse) stacking rule?

See PLR 200810024 (Dec. 3, 2007); PLR 200808006 (Nov. 7, 2007) (same), PLR 200810001 (Nov. 7, 2007) (same), PLR 200810018 (Dec. 3, 2007) (same); see also PLR 201512001 (Sept. 30, 2014) (designation of exchanged shares as part of split-off), supplemented by, PLR 201527003 (Dec. 22, 2014); PLR 201001009 (Sept. 30, 2009).

# Simplified PLR 201538015: 355(e) Netting / Born-to-Die

Prior to Step 1 but as part of a plan including the spin-off, D1 and S1 acquired 15% of the interests of LLC 1 held by Third Parties in exchange for D2 stock (the "Exchanges"). D1 also negotiated and evaluated various possible acquisitions (the "Acquisitions") which it is likely to pursue following the spin-off which is, in part, motivated to facilitate the Acquisitions.




Step 1: LLC2 elects to be treated as a corporation (the "LLC 2 Election").

Step 2: D1 distributes LLC2 to D2 (the "LLC2 Distribution") in a transaction intended to qualify under §§368(a)(1)(D) and 355.

Step 3: LLC2 merges with and into D2, with D2 surviving (the "LLC2 Liquidation") in a transaction intended to qualify as a complete liquidation under §332.

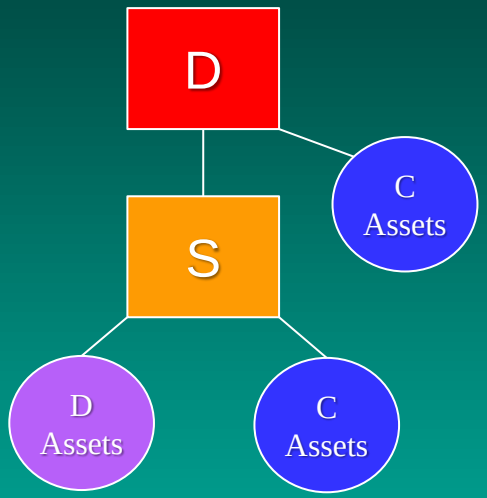
Step 4: D2 will distribute all of the stock of D1 in a transaction intended to qualify under §355.

Ruling 1: Provided the Acquisitions are treated as pursuant to a plan under §355(e)(2)(A)(ii), the increases in the percentage of either voting power or value of the stock of D1 or D2 acquired, directly or indirectly, by Third Parties in the Exchanges will be treated as acquisitions that are taken into account for purposes of §355(e) only after reducing such increases for any dilution, directly or indirectly, in such respective interests resulting from any Acquisition.

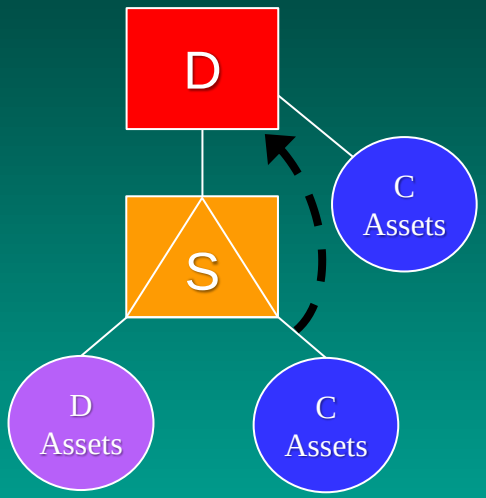
Ruling 2: The LLC2 Election will be respected for purposes of the LLC2 Distribution, notwithstanding the subsequent LLC2 Liquidation. See Rev. Rul. 2003-79, 2003-2 C.B. 80; Rev. Rul. 98-27, 1998-1 C.B. 1159.

# Liquidation-Reincorporation in Connection with a Section 355 Transaction?

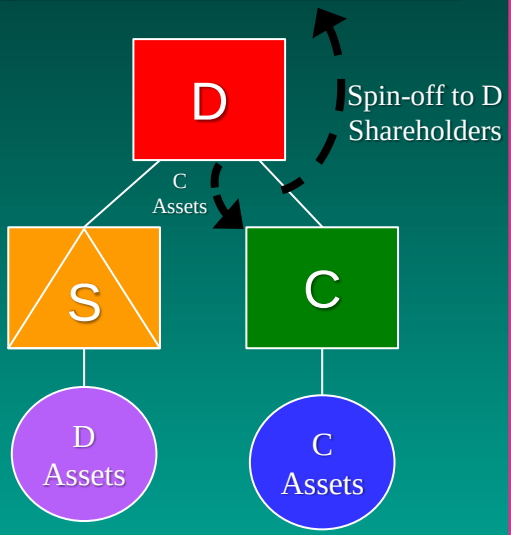
**Beginning Structure**




**S converts to an LLC under state law and thereafter distributes C Assets to D**




**D contributes all C Assets to C and spins off C to D Shareholders**




**Issues**

1. Is conversion a tax-free liquidation under Sections 332 and 337 or does liquidation/re-incorporation doctrine apply?
2. Is conversion an "upstream" C reorganization, subject to Treas. Reg. §1.368-2(k) (COBE is satisfied through D's ownership of S assets)?
3. Could the transaction be viewed as a taxable transfer of the D assets by S/C to D?
4. IRS view appears to be Sections 332 and 337 apply ((e.g.) PLR 200725002 (Mar. 15, 2007))
   a. C is not S's alter-ego
   b. C assets move closer to D shareholders via spin-off.
5. What if all S's assets are reincorporated?
6. Does it matter if C assets are dropped below C?
7. What if D and/or C contributed the liquidated assets received by D to one or more of their subs in an amount:
   a. Less than 30 percent of the FMV of the assets of S?
   b. Greater than 30 percent of the FMV of the assets of S?

# Helpful Recent Private Letter Rulings

- Pension plan as Distributing creditor for purposes of section 361. See e.g., PLR 202051009 (Mar. 17, 2020).
- Purge by Distributing of boot received from Controlled to internal creditor to repay internal debt used to refinance historic commercial paper debt of Distributing. See e.g., PLR 202114017 (Jan. 12, 2021).
- Purge by Distributing of boot received from Controlled to pay regular quarterly dividends of Distributing. PLR 202114017 (Jan. 12, 2021); PLR 201818010 (May 22, 2017).
- Segregation of boot not required. See e.g., PLR 201818010 (May 22, 2017).
- Post-closing adjustment payment from Controlled to Distributing treated as boot received immediately before the Distribution. See e.g., PLR 202051009 (Mar. 17, 2020).
- Affirmative use of inversion rules to avoid Section 367. See e.g., PLR 2012107009 (Nov. 23, 2020).

# Rev. Proc. 2017-52: Full No Gain or Loss Rulings

- In addition to the significant issue ruling regime, the Service will issue "no gain or loss rulings" with respect to transactions intended to qualify under sections 368(a)(1)(D) and 355 or under section 355(a) and 355(c) ("Covered Transactions" and such rulings with respect to them, "Transactional Rulings").
- A Transactional Ruling may include the tax consequences of a D/355 or 355 distribution under sections 312, 355, 357, 358, 361, 362(b), 362(e), 368(a)(1)(D), 368(b), 1032(a), 1223(1) and 1223(2) and relevant consolidated return regulations.
- If a plan includes multiple D/355 transactions or section 355 distributions, a taxpayer may request a Transactional Ruling, significant issue ruling, or no ruling with respect to any of the transactions or distributions.
- A single issue ruling as part of a Transactional Ruling, is also possible with respect to a legal device or business purpose issue. See Rev. Proc. 2017-52, § 3.03(6) (business purpose) and (7) (device). Presumably, other such single issue rulings are possible as part of a Transactional Ruling?
- All outstanding no-rules apply to any request for a Transactional Ruling or a significant issue ruling, e.g., the general issue of whether the distribution constitutes a device or whether the business purpose requirement is satisfied will not be addressed.
- The program was originally set to expire on March 21, 2019, but it has been extended indefinitely. See IRS Statement on Private Letter Ruling Pilot Program Extension (March 12, 2019).

# Rev. Proc. 2017-52: New Section 355 Guidance

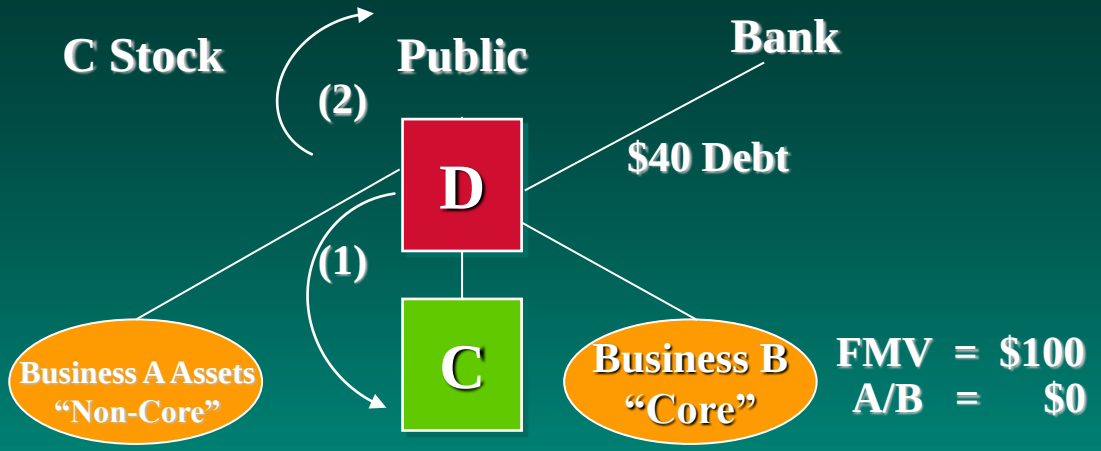
- Rev. Proc. 2017-52 supersedes Rev. Proc. 96-30 and is the current repository of general guidance with respect to seeking rulings for any D/355 transaction or section 355 distribution.
- Any request for a Transactional Ruling must include:
  - a description of any transaction that is part of the same plan or series of related transactions;
  - a description and analysis of all legal issues that may affect the requested rulings (even if arising in a D/355 or section 355 distribution for which no ruling is requested); and
  - a description of the federal income tax consequences of all other material transactions related to the request.
- Supplemental Rulings. A taxpayer may request a supplemental ruling if the facts since the Transactional Ruling have changed in material respects from the controlling facts on which the Transactional Ruling was based.
- Documentation. Only relevant documents should be submitted with the request. If only a portion of a document is relevant, the taxpayer must indicate the relevant portions by highlighting them or underscoring them. In all instances, the taxpayer must summarize the relevant portions and explain their relevance in the body of the request.
  - Revocation. For purposes of determining whether to revoke a ruling, in determining whether there has been a misstatement or omission of controlling facts only those facts in the body of the request (and not any attachments) will be considered.

# Rev. Proc. 2017-52: Required Representations and Information

- A request for a Transactional Ruling is required to provide a specific list of information and confirmation of a list of specific representations (*see* Rev. Proc. 2017-52, Appendix, §3). For example:
  - Loss Recognition: A taxpayer also now must submit a description of any loss that will be recognized in the D/355 transaction or section 355 or any related transaction.
  - Affiliated Group. A taxpayer must represent that with respect to any distribution of stock from one member to another of an Expanded Affiliated Group, the section 358 allocation will not result in Controlled stock having a higher basis than it had immediately prior to the distribution.
- If a taxpayer cannot provide the required representations, the taxpayer must explain the inability to make the respective representation and if appropriate, provide a modified representation that addresses the same issue and explain why it is sufficient to support the ruling as requested.

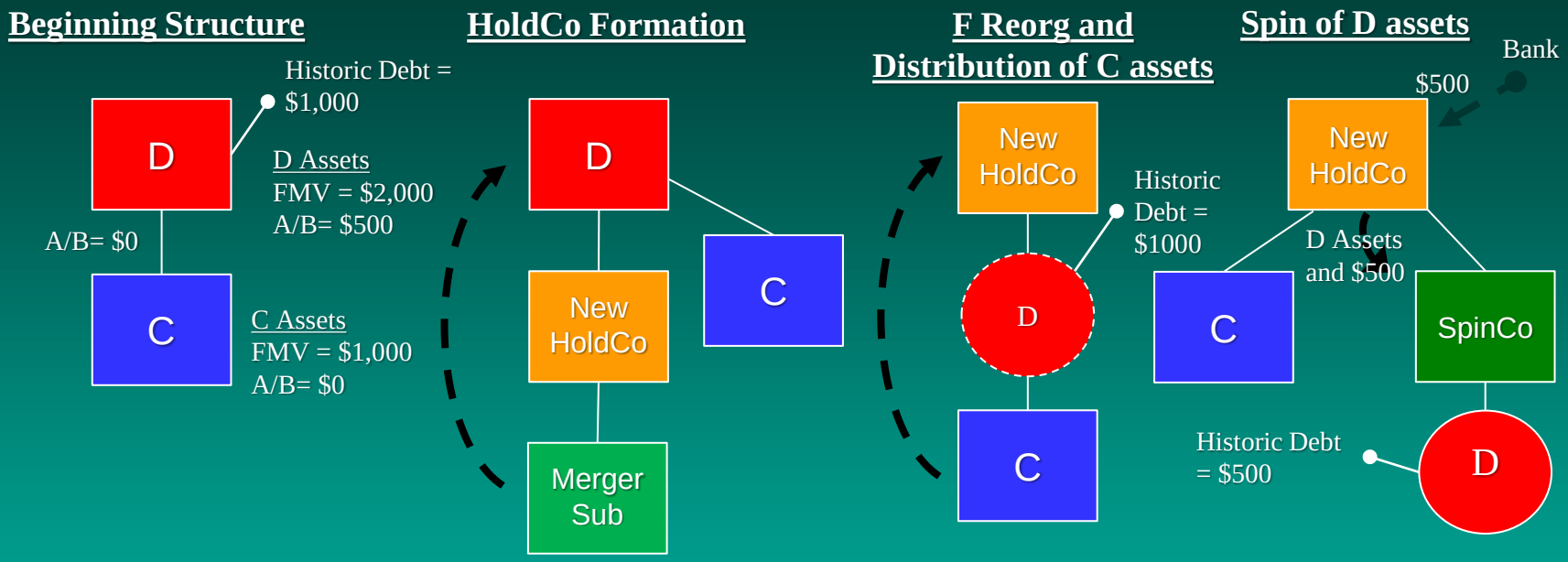
# Divisive Reorganizations — Establishing Capital Structure

**Relevant Authority**
- §§357, 361
- §1.1502-13(g)
- Common Law



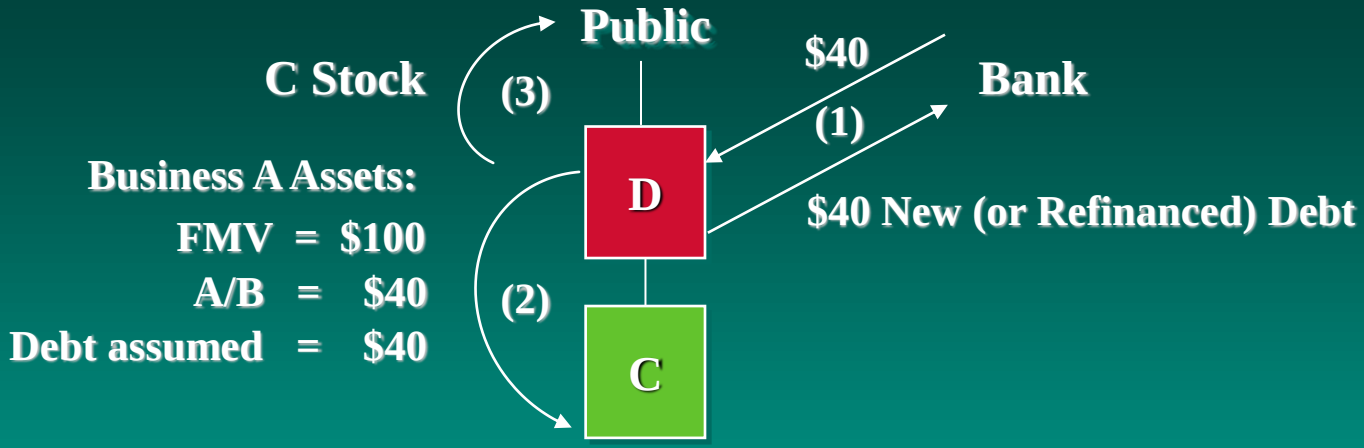

- Base Case:
  - D is engaged in Non-Core Business A ($100 FMV/$20 A/B) and Core Business B ($100 FMV/$0 A/B)
  - D seeks to spin off newly formed C which will own Non-Core Business A
  - D will retain Core Business B
- Objective: $40 Debt Capitalization for Controlled
- Alternatives for Establishing Desired Capital Structure:
  - Assumption of D Debt: C assumes $40 of D's debt in connection with D's contribution of Business A
  - C Borrowing and Distribution of Loan Proceeds: C borrows $40 and distributes the proceeds to D
  - Use of C Securities (or Stock) to repay (or reduce) D Debt: C issues $40 securities to D, which are used to repay D's $40 bank debt.
  - Combinations of the above
  - Reverse the Direction of the Spin: D instead contributes Core Business and cash (financed by Business A) to C which is spun off

# Holding Company Structure in lieu of a Direct Issuance Exchange and use of Controlled Securities: Reverse Direction




1. D assets have $500 basis and C assets have no basis, $500 of the $1,000 D historic debt is attributable to the C business, and C does not want to have a capital structure comprised exclusively of long-term debt precluding the use of C securities as a solution to allocate debt to C on a tax-free basis. D's historic debt is long-term and of a tenor appropriate to D.
2. Pursuant to a plan of reorganization and immediately after the formation of New HoldCo structure and the merger of Merger Sub with and into D, D checks the box to become a disregarded entity completing an F reorganization and thereafter distributes C to New HoldCo.
3. New HoldCo borrows $500, contributes it to D to pay down $500 of D historic debt, thereafter contributes disregarded entity D to SpinCo, and distributes SpinCo. See e.g., PLR 200708016 (Nov. 6, 2006).

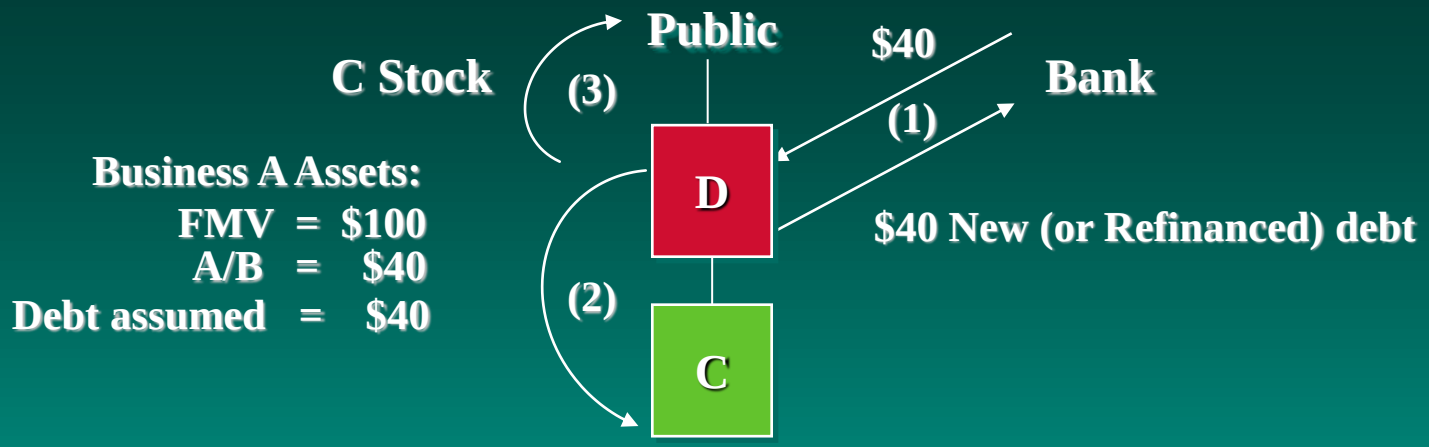
# Debt Allocation/Identity of Debtor - Debt Assumption & Substance Over Form




Identity of tax debtor: If C is the true debtor, D's retention of financed cash will be taxable.

- Rev. Rul. 79-258, 1979-2 C.B. 143 (D respected as borrower of new assumable debt which refinanced pre-existing, non-assumable debt incurred in connection with the business transferred to C; D's debt level not increased by virtue of the refinancing).
- Southwest Consolidated Corp., 315 U.S. 195 (1942) (target newly borrowed funds and acquiring assumed liability pursuant to the overall acquisitive reorganization plan; assumption recast as payment by acquiring of cash boot to target which resulting in failure of the "solely for voting stock" requirement for "C" reorganization).
- See e.g., PLR 9751043 (Sept. 28, 1997) (D refinanced old debt with newly-incurred third-party debt; C assumed new debt; D represented new debt was attributable to business contributed to C).

# Debt Allocation - Liability Assumption Treated as Boot



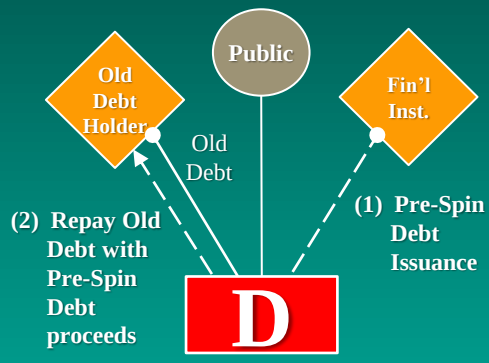

**Business A Assets:**
FMV = $100
A/B = $40
Debt assumed = $40

**Entire liability assumption treated as boot under Section 357(b) if principal purpose (a) was to avoid tax on the exchange, or (b) was not a bona fide business purpose.**

- **Rev. Rul. 79-258:** Assumed liabilities were traceable to the business transferred to C.
- **Rev. Proc. 96-30:** Requesting a representation that often cannot be made: "[the assumed liabilities] were incurred in the ordinary course of business and are associated with the assets being transferred."
- **Private Letter Rulings:** Above representation modified to reflect that the liability assumption was intended to establish an appropriate capital structure. See e.g., PLR 201350007 (May 31, 2013); PLR 200510017 (Nov. 16, 2004); PLR 200217006 (Dec. 21, 2001); PLR 200146019 (July 11, 2001).
- **Rev. Rul. 2003-110:** Consider significance of ruling in analyzing §357(b): avoiding gain on C stock is not tax avoidance in the context of a spin-off.

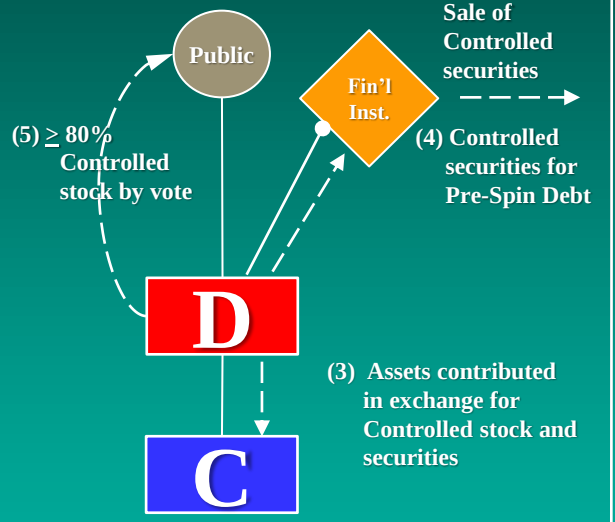
# Rev. Proc. 2018-53: Debt issued in anticipation of, and to be retired in connection with, a spin-off (simplified PLR 201835001)

## Old Debt Repayment



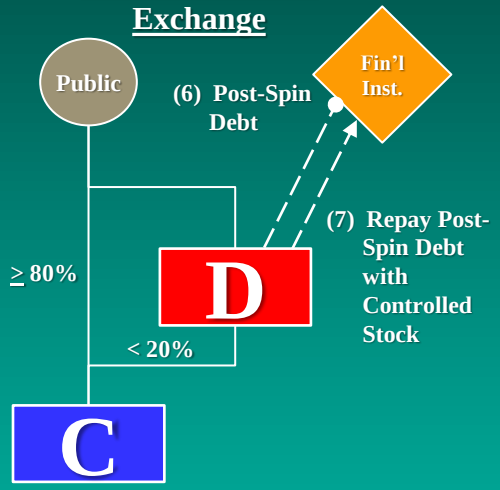

At least [1] day after the Pre-Spin Debt issuance and in anticipation of the spin where the loan proceeds were applied immediately to satisfy Old Distributing debt, Distributing and the Financial Institutions, agree to exchange Controlled securities for the Pre-Spin Debt

## External Distribution & Debt-for-Debt Exchange




At least [2] days after the Pre-Spin Debt issuance, Distributing exchanges Controlled securities for the Pre-Spin Debt and distributes at least 80-percent of Controlled to the Public

## Post-Spin Debt Issuance & Debt-for-Stock Exchange

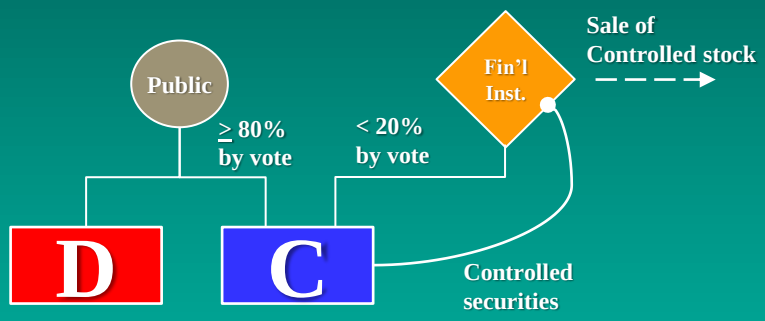



At least [1] day after the Post-Spin Debt issuance, Distributing and the Financial Institutions agree to exchange Controlled stock for the Post-Spin Debt. Post-Spin Debt proceeds used to repay old Distributing debt.

Distributing exchanges Controlled stock for the Post-Spin Debt at least [2] days after the Post-Spin Debt issuance and no later than approximately [12] months after the External Distribution.

# Rev. Proc. 2018-53: Debt issued in anticipation of, and to be retired in connection with, a spin-off (simplified PLR 201835001) (continued)

**Resulting Structure**



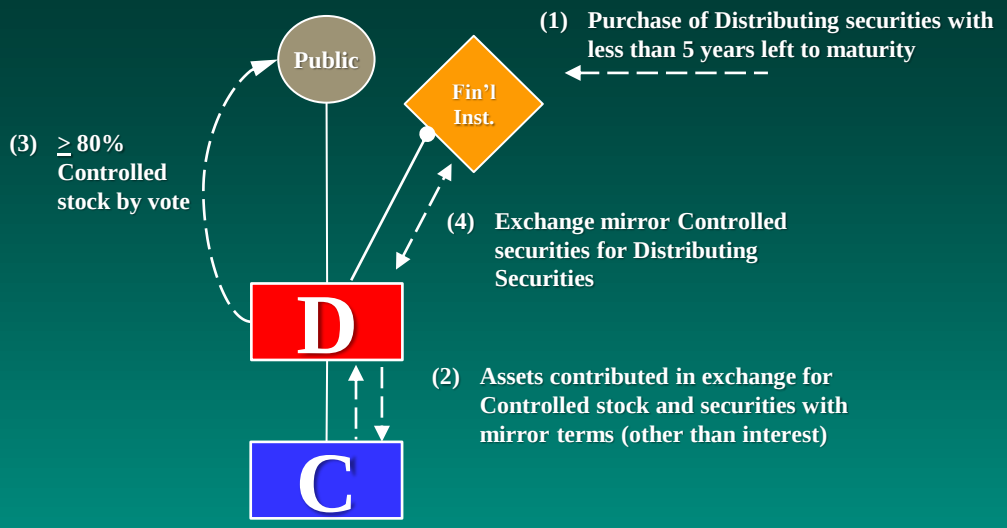

**Representation Supporting Historic Debt Status**

- The sum of Distributing debt that is assumed under section 357 and the Distributing debt satisfied under section 361 does not exceed the historic average of the total debt owed to unrelated persons by Distributing and other members of the Distributing separate affiliated group. The historic average will be computed as of the close of the eight fiscal quarters immediately before the date that is at least 60 days before the transaction or a similar transaction is disclosed or announced to the public or approved by Distributing's board of directors (whichever is earlier).

**Ruling**

- No gain or loss to Distributing in connection with the receipt and transfer by Distributing of the Controlled stock or securities in the External Distribution, the Debt-for-Debt Exchange, and the Debt-for-Equity Exchange. Section 361(c).

# Rev. Rul. 2004-78 and Intermediated Exchanges




- Intermediated exchanges, in which financial institutions purchase existing D debt as principals for their own account to then exchange such debt for C stock or securities, offer an opportunity to issue short-term C securities in retirement of short-term D debt on a tax-free basis.
- Rev. Rul. 2004-78 permits the tax-free receipt of C debt by D without any basis limitation where the C debt is exchanged for outstanding D debt that was a security upon issuance with remaining terms to maturity of any length (e.g., 15 months), where the C debt exchanged therefore has the same maturity date and other terms (other than interest) . See e.g., PLR 201721002 (Feb. 17, 2017) (ruling 2); PLR 201649012 (Jun. 6, 2016) (ruling (4)).

# Adjusted Basis Limitation in Divisive Reorganizations

**Current law**: Section 361 provides that Distributing does not recognize gain on either (i) boot received in the exchange and transferred to creditors to the extent of adjusted bases of contributed assets, reduced by liabilities assumed, or (ii) the transfer of "qualified property" (stock or securities) to its creditors.

**W&M Statutory Language**: Distributing recognizes gain on boot received in the exchange and transferred to creditors to the extent the sum of the (i) liabilities assumed by Controlled, (ii) boot Distributing transfers to creditors, and (iii) principal amount of Controlled debt securities transferred to creditors, exceeds the adjusted bases of contributed assets.

- Effective for reorganizations occurring on or after the date of enactment – no transition relief for transactions in progress prior to publication of Ways & Means proposal.

**JCT Explanation/W&M Committee Report**: Distributing recognizes gain on Controlled securities received in the exchange and transferred to creditors to the extent the amount of such securities exceeds (i) the adjusted bases of contributed assets, reduced by sum of the (ii) (A) liabilities assumed by Controlled, and (B) boot received in the exchange.

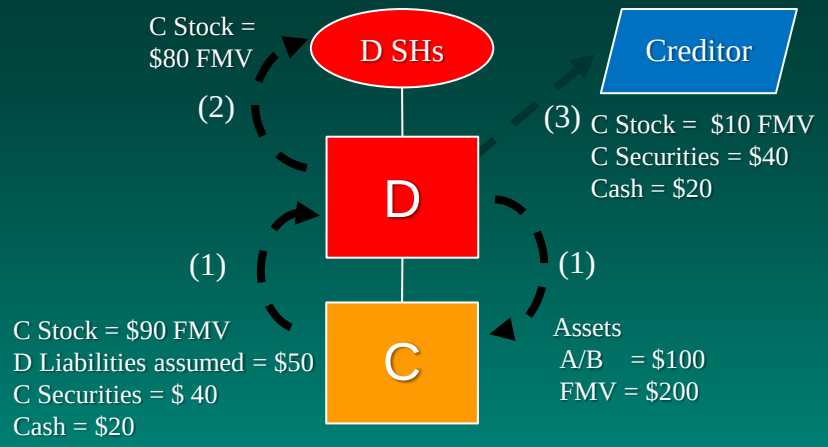
**Differences**: In essence, the Ways & Means statutory language reduces amount of the Section 361(b)(3) basis available to shield boot from gain recognition by the principal amount of Controlled securities received in the exchange and transferred to creditors. In contrast for purposes of Section 361, the JCT Explanation and W&M Committee Report treat Controlled securities received in the exchange and transferred to creditors as boot in addition to money and other property.

**Questions**:

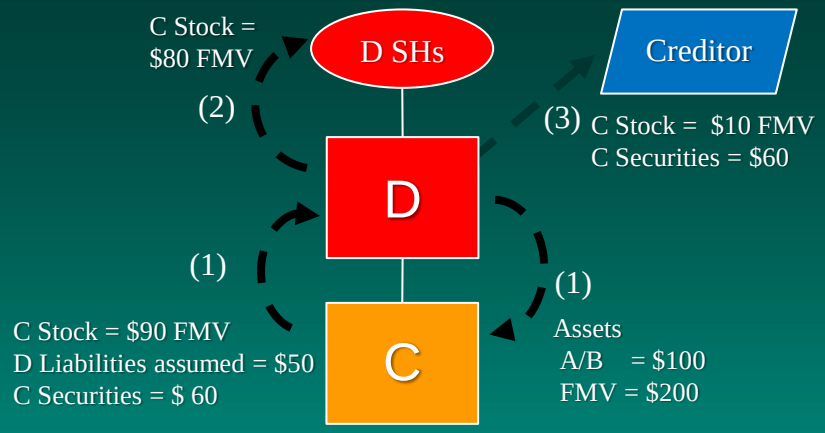
- Does the grant of regulatory authority have any implications for a different approach to the IRS administration of Section 361?

# Adjusted Basis Limitation in Divisive Reorganizations

## Case #1: Current Law




## Case #2: Alternative Transaction




**Case 1**

1. D transfers to C $200 of assets with an adjusted basis (A/B) of $100 in exchange for: (i) $50 liabilities assumed; (ii) $90 C common stock; (iii) $40 C debt securities; and (iv) $20 cash.
2. D distributes $80 in C stock to shareholders.
3. D transfers to Creditor $10 in C stock, $40 in C debt securities, and $20 cash in payment of historic debt.

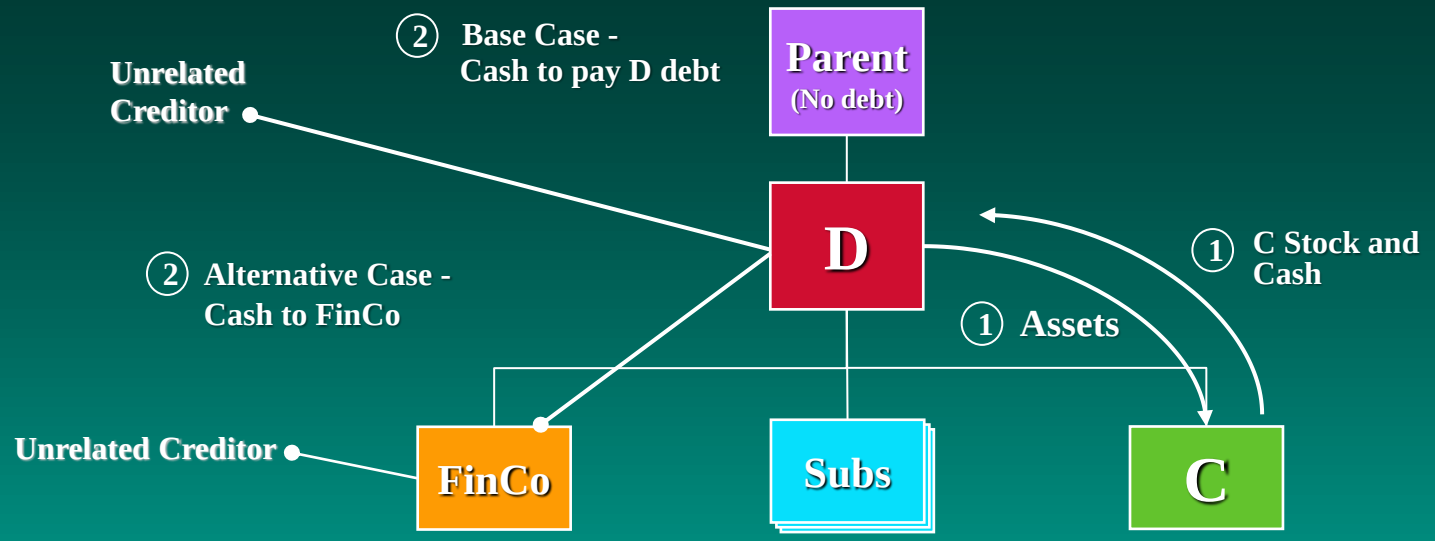
- **Current law**: D recognizes no gain on the boot transferred to Creditor ($100 A/B in assets - $50 liabilities assumed = $50 > $20 boot transferred to Creditor)
- **W&M Statutory Language**: D recognizes $10 gain on the boot transferred to Creditor [($50 liabilities assumed + $20 cash + $40 C securities) - $100 A/B in assets transferred to C = $10 gain]. **Note** – Gain under the W&M statutory language can never exceed the amount of boot transferred to Creditor.
- **JCT Explanation/W&M Committee Report**: D recognizes $10 gain on the boot and securities transferred to Creditor [($50 liabilities assumed + $20 cash + $40 C securities) - $100 A/B in assets transferred to C = $10 gain]. **Note** – Securities are treated as boot under the JCT Explanation and W&M Committee Report.

**Case 2**

In lieu of transferring $20 cash to D, C increases the amount of the debt securities to $60, which D transfers to Creditor.

- **Current law**: D recognizes no gain on the transfer of securities to Creditor (no boot transferred to Creditor)
- **W&M Statutory Language** : D recognizes no gain (no boot transferred to Creditor). **Note** – Gain under the W&M statutory language can never exceed the amount of boot transferred to Creditor.
- **JCT Explanation/W&M Committee Report** : D recognizes $10 gain on securities transferred to Creditor [($50 liabilities assumed + $60 C securities) - $100 A/B in assets transferred to C = $10 gain]. **Note** – Securities are treated as boot under the JCT Explanation and W&M Committee Report.

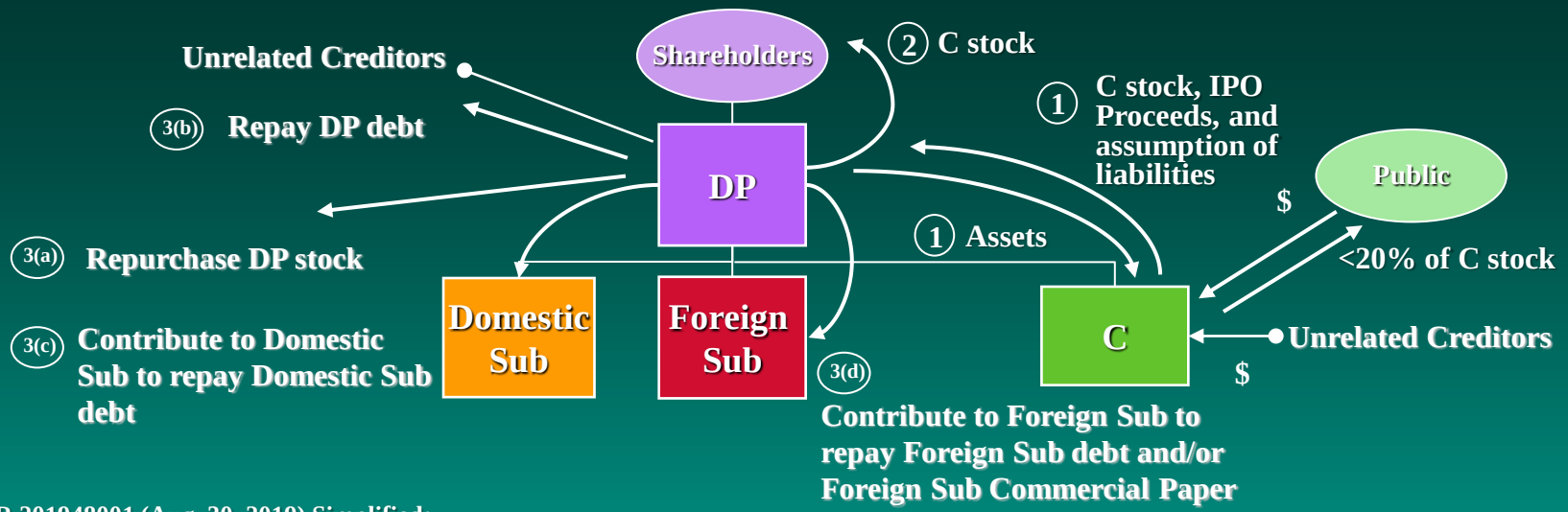
# §361 and Payment of Group Debt




Facts: Parent owns all of the stock of D, which owns all of the stock of FinCo, a financing subsidiary, and various Subs, all of which join in the filing of a consolidated return. D contributes assets to C in exchange for C stock and Cash. D uses the Cash to satisfy its debt to its subsidiary, FinCo, or other group debt.

- The payment in respect of the FinCo debt, by itself, as a statutory matter is sufficient to satisfy section 361. For advance ruling purposes, if D uses the Cash to satisfy its debt to FinCo, and FinCo then uses the Cash to pay off Unrelated Creditors, this 'in form' satisfaction of section 361 should be respected. See Rev. Proc. 2018-53, Section 3.04(2) (boot used to repay debt to related person should establish that such amount is used to satisfy a non-contingent debt obligation to an unrelated person); cf. Reg. §1.1502-13(g)(3)(i)(B)(7) (deemed satisfaction/reissuance inapplicable where controlled securities issued to the distributing corporation in a "D" reorganization are transferred to a nonmember shareholder or nonmember creditor pursuant to a transaction to which section 361(c) applies; treatment does not extend to transfers to member shareholder or member creditor; -13(g)(3)(i)(B)(7) does not address whether consolidated group members similarly should be treated as divisions of a single corporation in applying section 361(b)(3) with respect to "other property").
  - What consequence, if instead, D acquires FinCo note held by Unrelated Creditor with Cash received from C and thereafter contributes such note to FinCo – no 'in form' transfer of Cash to any D creditor, however, the transaction is economically equivalent to the alternative case insofar as FinCo debt to an Unrelated Creditor is reduced?
- What if FinCo is a non-consolidated, wholly-owned subsidiary and the Cash is used to satisfy D's debt to FinCo without any related satisfaction of FinCo's debt to Unrelated Creditor?

# Section 361 and Payment of Group Debt: Simplified PLR 202022005, *partially revoking* PLR 201948001




PLR 201948001 (Aug. 30, 2019) Simplified:

1. Distributing Parent ("DP"), common parent of a consolidated group, contributes assets to Controlled ("C") in exchange for the cash proceeds ("Cash") from a loan and an IPO of C stock, C stock, and the assumption of liabilities (the "Contribution").
2. DP distributes the stock of C to its shareholders in a transaction intended to qualify under section 355.
3. No later than q months after the distribution, DP will use the Cash to (a) repurchase DP stock, (b) repay DP debt, (c) contribute a portion of the Cash to wholly-owned Domestic Sub for the purpose of repaying its debt, or (d) contribute a portion of the Cash to Foreign Sub for the purpose of repaying its debt and/or a portion of the Foreign Sub Commercial Paper, or some combination thereof.

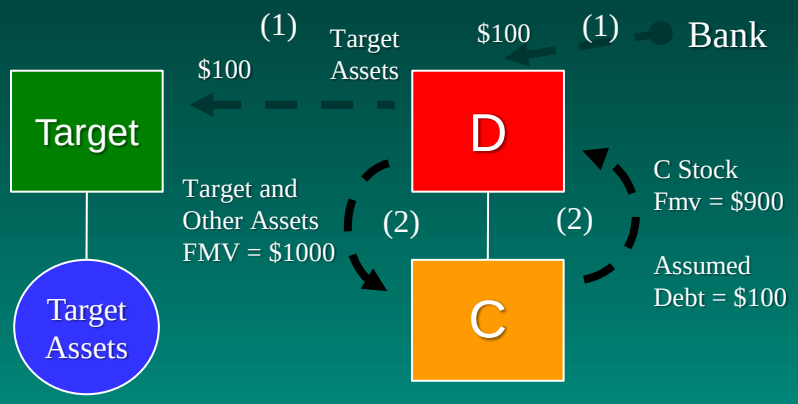
Relevant Ruling: DP recognizes no gain or loss in connection with the receipt of the Cash in step 1. PLR 201948001 (Ruling (3)).

Revocation: Ruling (3) revoked to the extent it applied to the Cash contributed to Domestic Sub and/or Foreign Sub, notwithstanding such Cash would be used to repay Domestic Sub debt, Foreign Sub debt, or Foreign Sub Commercial Paper. The partial revocation of Ruling (3) will not be given retroactive application. See PLR 202022005 (Feb. 25, 2020).

- The absence of an in-form purge of the Cash to DP shareholder(s) and/or DP creditor(s) distinguishes PLR 201948001 from prior rulings approving boot purge where the boot was paid to nonmember shareholders or creditors. See e.g., PLR 201411002 (Dec. 13, 2013) (distribution of cash received by internal distributing to its parent which transferred such cash to repay its outstanding debt or to distribute to its shareholders).
- Assume instead as a first step, Domestic Sub merges with and into DP and the Cash is applied in satisfaction of the Domestic Sub's debt assumed by DP in the merger. Cf. Rev. Rul. 74-79, 1974-1 C.B. 81 (prior to SAG rules, section 332 liquidation of subsidiary conducting an active trade or business to provide distributing corporation with active trade or business to satisfy ATB Requirement).

# Acquisition Debt – Economically Equivalent Alternative Structures

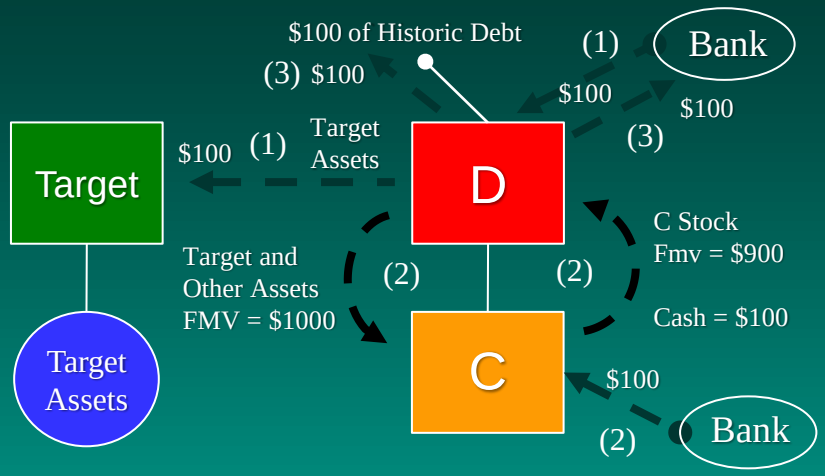
## Case #1: Acquisition Debt Assumed




1. D has no liabilities. Independent of the spin-off in Step 3,* but after its announcement, D borrows $100 from Bank and purchases Target Assets for $100.
2. D contributes to C assets, including Target assets, having a fair market value of $1000 in exchange for C stock and the assumption of the newly-incurred $100 Bank debt.
3. D distributes C to shareholders.

D cannot make the standard Rev. Proc. 2018-53 representations both because the assumed debt is incurred after announcement of the spin-off and it exceeds historic debt levels. The facts and circumstances test of Rev. Proc. 2018-53 would appear to be available because the assumed debt is directly attributable to the contributed assets. Cf. Rev. Proc. 2018-53, Section 3.04(4) (indicating amenability to ruling where debt assumed and its proceeds are contributed to Controlled).

## Case #2: Payment of Acquisition Debt with Boot

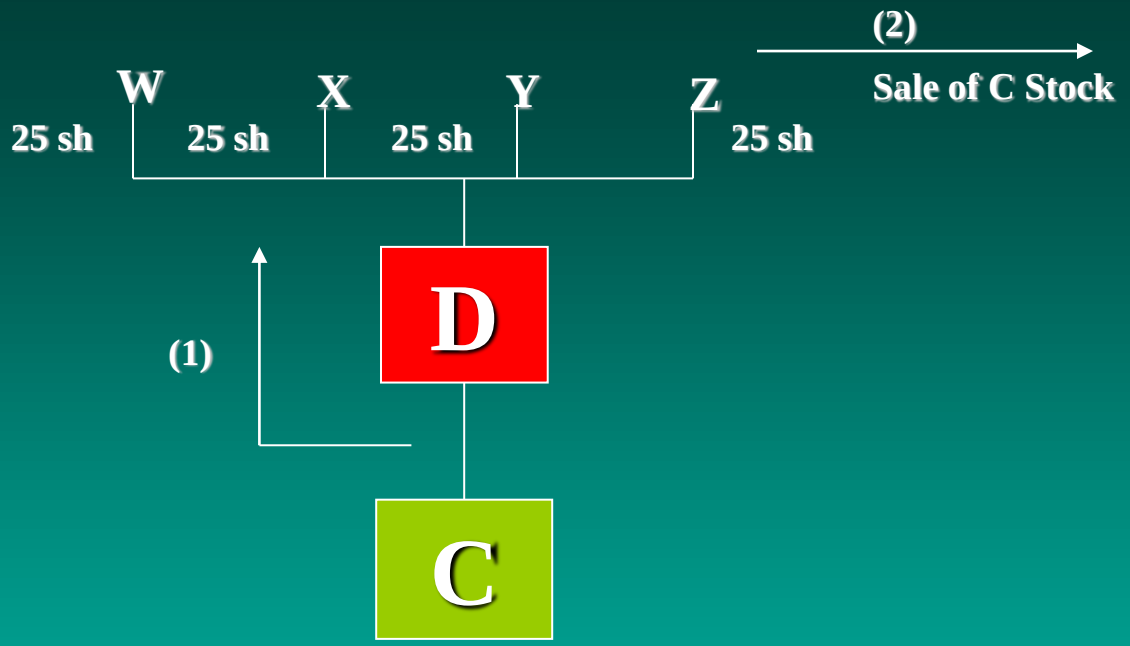



1. D has $100 of historic debt. Independent of the spin-off in Step 4,* but after its announcement, D borrows $100 from Bank, which debt is more expensive than the historic debt, and purchases Target Assets for $100 .
2. D contributes to C assets, including Target assets, having a fair market value of $1000 in exchange for C stock and $100 that C borrows from Bank.
3. D transfers the boot in satisfaction of the $100 Bank debt, or, in the alternative, the $100 historic debt.
4. D distributes C to shareholders.

D cannot make the standard Rev. Proc. 2018-53 representations with respect to the satisfaction of the Bank debt because such debt is incurred after announcement of the spin-off. The facts and circumstances test of Rev. Proc. 2018-53 would appear to be available under the same rationale as Case #1.

* In each case, the debt is not conditioned either on the occurrence of the spin-off or the assumption/boot purge.

# "Device" Prohibition and Continuity of Interest




(1) D distributes the stock of C to its shareholders, pro rata.

(2) In a transaction negotiated and agreed on at the time of the spin-off, Z sells its C stock but retains its D stock

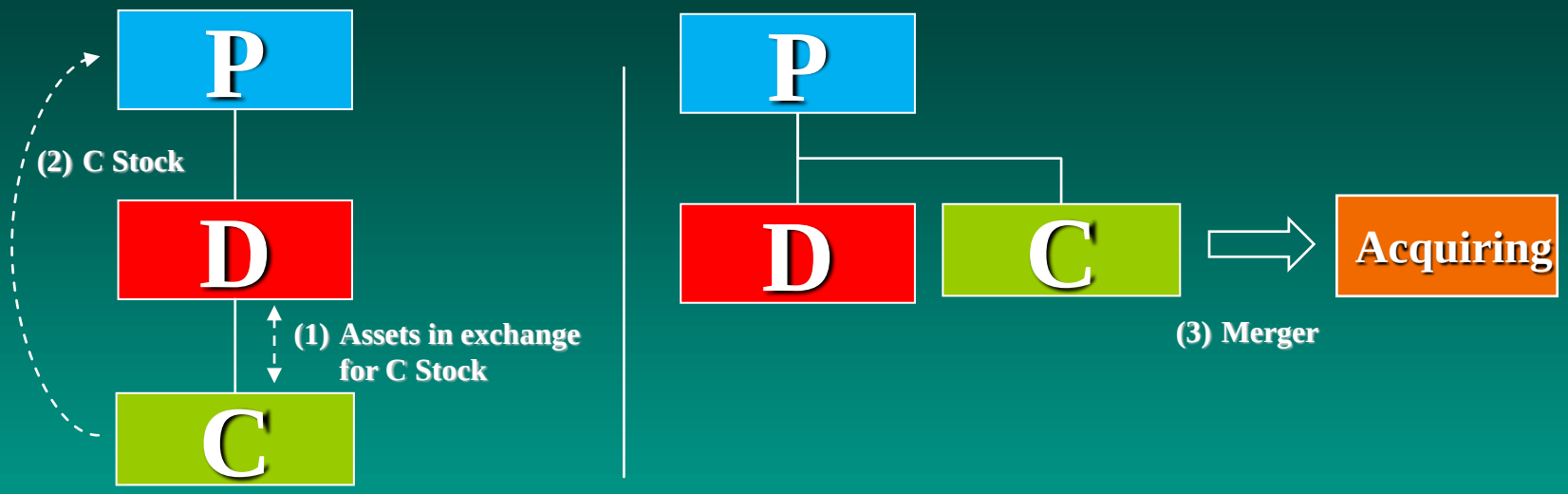
What result if Z sells its D stock and its C stock to the same person? To different persons?

What result if X, Y and Z all sell their D stock and their C stock, in each case, to the same person? To different persons?

Does it make any difference if D stock is publicly-traded; Z is a mutual fund; and Z decides to sell its C stock without consulting or coordinating with D or C?

Reg. §§1.355-2(c) and (d)

# Tax Exempt Distributee: PLR 201734004



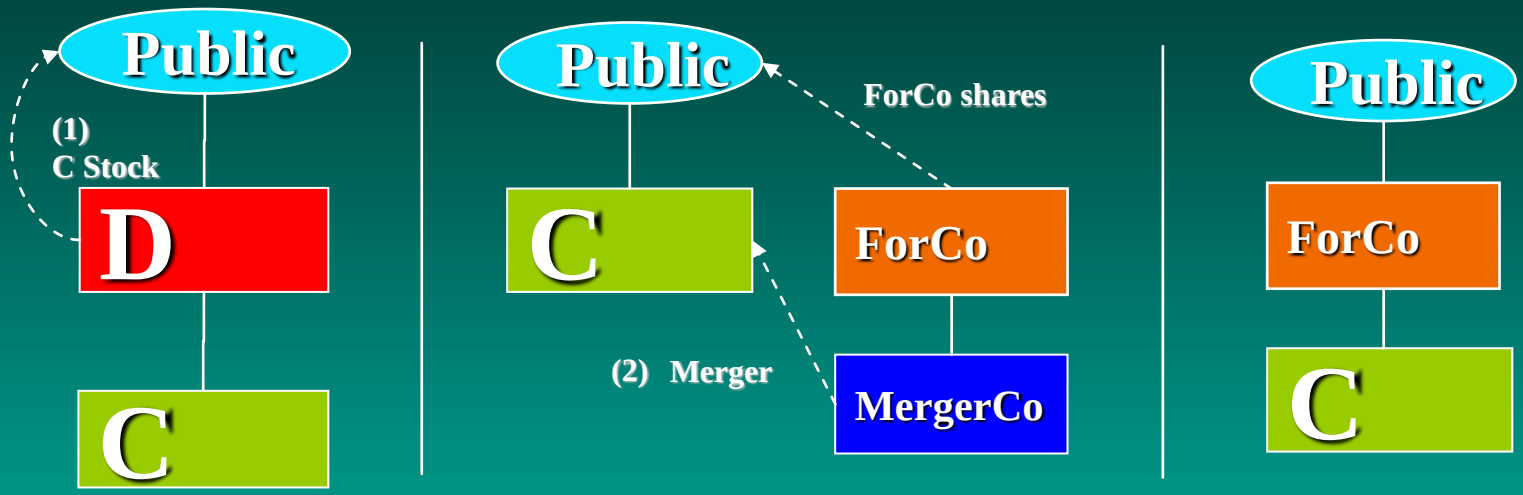

Step 1: D forms C and contributes assets in exchange for all of the stock of C.

Step 2: D distributes C to P, a tax-exempt organization under Section 501(c)(3).

Step 3: C merges with and into Acquiring.

- P represented that there was no plan or intent to cease to be tax-exempt and that absent section 355, the receipt of C stock would not be taxable to P.
- Service ruled that because P is exempt from federal income tax under Section 501(c)(3) and because P is the sole shareholder of D, the distribution does not present evidence of device. Reg. § 1.355-2(d). See PLR 201734004 (May 30, 2017) (Ruling (3)).

# Spin-Off and Expatriation – Slide 1




- D distributes C to Public.
- Prior to the distribution, C or designated incorporators form ForCo, and ForCo forms MergerCo.
- After the distribution, MergerCo merges with and into C, with C's shareholders receiving ForCo shares and ForCo receiving all of C's shares.
- C's shareholders recognize gain under section 367(a) with respect to their exchange of C shares for ForCo shares.
- Does this transaction raise a significant device concern? See PLR 201232014 (Feb. 16, 2012); PLR 20187001 (Jan. 26, 2018); cf. PLR 201923003 (Dec. 20, 2018).

  See also §355(a)(1)(B); Reg. §1.355-2(d)(2)(iii)(E), -2(d)(3)(ii); Pulliam v. Commissioner, T.C. Memo 1997-274 (1997)
- Note the absence of "cashing out" and the presence of basis recovery. Reg. §1.355-2(d)(1).

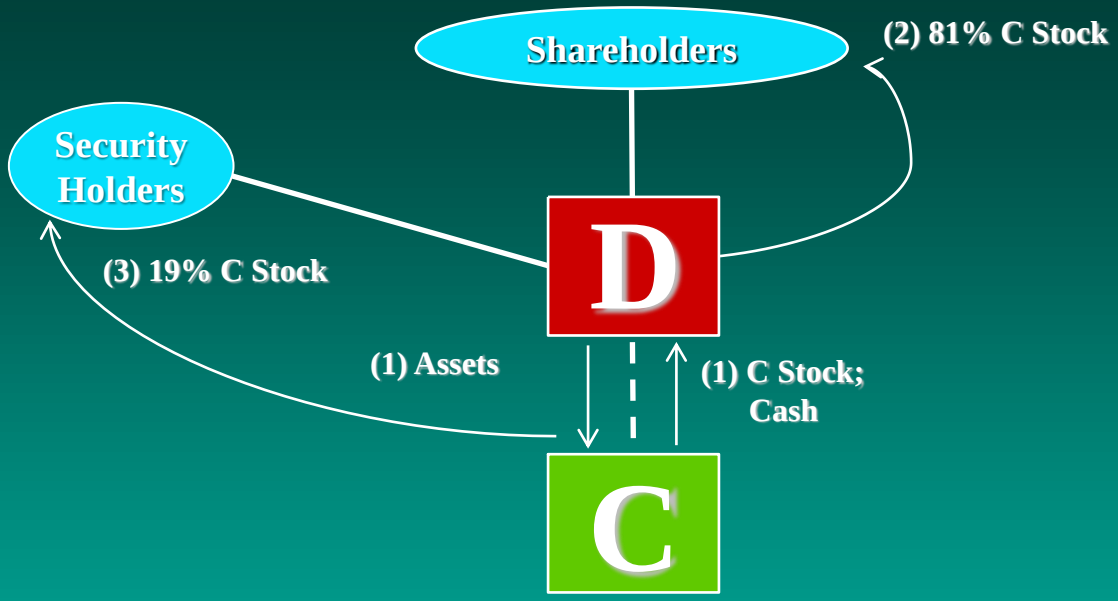
# Spin-Off and Expatriation – Slide 2

- In PLR 201232014 (Feb. 16, 2012) the taxpayer made the following device representations (despite the no-rule on device at the time):
  - Taking into account the exchange of C common stock for ForCo common stock in the exchange (including the resulting section 367(a) gain recognition), the distribution is not being used principally as a device for the distribution of earnings and profits of any of D, ForCo, or C.
  - There is no plan or intention by D, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, except that such repurchases may be effected through open market purchases, block purchases, accelerated share repurchase transactions, Dutch auction tender offers, or some combination thereof.
  - There is no plan or intention by C or ForCo, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the distribution, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. Proc. 96-30, 1996-1 C.B. 696, except that such repurchases may be effected through open market purchases, block purchases, accelerated share repurchase transactions, Dutch auction tender offers, or some combination thereof.
  - D has no knowledge or belief that any shareholder of D will have a plan or intention to sell, exchange, transfer by gift or otherwise dispose of its stock in D or C after the distribution other than in exchange for stock in ForCo in the exchange and in connection with the redemption or sale of any fractional shares, ordinary market trading or readjustments consistent with the relevant indices by shareholders that are index funds.
  - D has no knowledge or belief that any shareholder of D will have a plan or intention to sell, exchange, transfer by gift or otherwise dispose of its stock in ForCo, whether on account of the section 367(a) gain recognition that occurs pursuant to the exchange or otherwise (other than in connection with ordinary market trading or readjustments consistent with the relevant indices by shareholders that are index funds).
  - The distribution and the exchange are not being effected for the purpose of or with a view to facilitating any sales of stock of ForCo by the shareholders after the exchange, including by causing them to recognize gain upon the exchange.

# 2021 ABA Device Report

- On March 19, 2021, the Tax Section of the American Bar Association submitted comments on the proposed regulations relating to device issued in July 2016 (the "Proposed Device Regulations"). The report favored the current regulations (the "1989 Regulations") over the Proposed Regulations, providing:
  - The mechanical approach regarding the allocation of non-business assets adopted by the 2016 Proposed Regulations does not adequately take into account corporate-level business objectives motivating a distribution and the allocation of assets between Distributing and Controlled.
  - The Proposed Regulations would have the effect of disallowing many relatively common, non-abusive transactions, contrary to the intent of Congress in enacting the Device Prohibition which rejected a mechanical test based purely on mathematical formulas.
  - The report recommended keeping the 1989 Regulations in lieu of the 2016 Proposed Regulations and making certain modifications to address the concerns underlying the 2016 Proposed Regulations.
    - For example, to deal with any evidence of device presented by disproportionate allocation of investment assets, the report recommended changing Examples 3 and 4 in Reg. § 1.355-2(d)(4) to provide that such evidence of device might be rebutted either by (i) a corporate business purpose for such allocation, or (ii) in the unlikely event that there is no corporate business purpose for such allocation, other facts and circumstances, including the business purpose for the distribution.

# Retention




**Facts:**

**Step 1:** D owns 100% of C. D transfers property to C in exchange for C stock and cash.

**Step 2:** D distributes 81% of the C stock to the D shareholders and the cash to creditors, but holds back 19% of the C stock.

**Step 3 (intended):** As soon as practicable, and hopefully within a year, D intends to transfer the 19% of C stock to D security holders in exchange for D securities. The reason D is holding back 19% of the C stock is that the delay will permit the market for C stock to settle following the Step 2 distribution allowing D to repay the security holders under normal market conditions.

**Step 3 (modified):** Due to unforeseen circumstances that arise after the Step 2 distribution (e.g., the COVID-19 crisis), the distribution of the 19% of C stock to D security holders will be delayed beyond a year.

# Section 355(a)(1)(D)

- Section 355(a)(1)(D) sets forth one of the requirements for tax-free treatment of a spinoff.
- Section 355(a)(1)(D) requires that "as part of the distribution, the distributing corporation distributes –

  (i) all of the stock and securities in the controlled corporation held by it immediately before the distribution, or

  (ii) an amount of stock in the controlled corporation constituting control within the meaning of section 368(c), and it is established to the satisfaction of the Secretary that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax."

# Analysis of Fact Pattern

- In our fact pattern, assuming that D's distribution of C stock would otherwise qualify as tax-free under section 355, what is the tax significance of D's hold-back of 5% of the C stock?
- If D's later transfer of the 5% of the C stock is included as part of the distribution, then section 355(a)(1)(D)(i) is satisfied and the entire distribution of 100% of the C stock to D shareholders and security holders is tax-free to the D shareholders and security holders under section 355.
  - If D's later transfer of the 5% of the C stock is included as part of the initial distribution, establishing that there is not a principal purpose to avoid tax is unnecessary.
- Alternatively, if D's later transfer of the 5% of C stock to D security holders is treated as a "retention," then there is a question under section 355(a)(1)(D)(ii) whether the retention is "in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax."
  - If there is a principal purpose to avoid tax, then both the distribution of 95% of C stock to the D shareholders and the 5% of C stock to D security holders are taxable for the D shareholders, security holders and D.
  - If there is no tax avoidance purpose and the 5% is treated as a retention because the distribution of such amount is not treated as part of the initial distribution (or, as discussed below, as part of the plan of reorganization if in connection with a D/355 transaction), the distribution of the 5% would be taxable to D and the recipient security holders but the distribution of the 95% would be tax-free to D and the recipients under section 355.

# October 13, 2017 IRS Statement

- **Paragraph #2 of the October 13, 2017 IRS statement about PLRs states that "in determining whether the retention of stock or securities is in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax, within the meaning of section 355(a)(1)(D)(ii), IRS will continue to follow the guidelines in Appendix B of Rev. Proc, 96-30, even though Rev. Proc. 2017-52 has superseded Rev. Proc. 96-30."**
- **Appendix B of Rev. Proc. 96-30 states that the IRS will issue favorable PLRs regarding the application of section 355(a)(1)(D)(ii) to retained C stock in a widely held corporation if four requirements are satisfied, including that the retained stock is disposed of as soon as a disposition is warranted consistent with the business purpose but no later than 5 years after the distribution.**
- **Appendix B also states that in other cases, the IRS may issue favorable PLRs, based upon all relevant facts and circumstances, regarding the application of section 355(a)(1)(D)(ii). For example, the IRS will rule favorably if the transaction is covered by Rev. Rul. 75-321, 1975-2 C.B. 123 (retention of 5 percent interest to serve as collateral for short-term financing for distributing).**
- **There are numerous favorable PLRs with various reasons for retention.**

# COVID-19 Environment

- In our fact pattern, is the eventual transfer of the 19% of the C stock to D security holders included as part of the initial distribution, or is it a "retention" subject to section 355(a)(1)(D)(ii)?
- This issue has particular importance in a COVID-19 environment, where at the time of the initial distribution D intends to transfer the 19% of C stock to D security holders as soon as practicable, hopefully within a year, but it is impossible to know now whether a delay beyond a year will occur and how long that extra delay might be.
- Because of this timing uncertainty, and the tax uncertainty it might cause, taxpayers might decide to avoid this situation altogether and structure their transactions without a hold-back of C stock.
- How would the IRS handle a PLR request in these circumstances?

# Section 361(b)

- Section 361 is relevant for the treatment at the corporate level in a section 368(a)(1)(D)/section 355 transaction.
- Section 361(a) provides the general rule that D will not recognize gain or loss if it exchanges property, in pursuance of the plan of reorganization, solely for stock or securities of C.
- Section 361(b)(1) provides that if D receives other property from C, D will not recognize gain if it distributes the other property to its shareholders in pursuance of the plan of reorganization.
- Section 361(b)(3) provides that D will not recognize gain if it transfers the other property to creditors in connection with the reorganization. The transfer to creditors is treated as a distribution in pursuance of the plan of reorganization.
- In our fact pattern, D's transfer of property to C for C stock and cash is tax-free to D under section 361(b)(1) and (b)(3) because D transfers the cash to D's creditors in connection with the reorganization.

# Section 361(c)

- Section 361(c)(1) and (c)(2) provide that D will not recognize gain or loss on the distribution of C stock to D shareholders in pursuance of the plan of reorganization.
- Section 361(c)(3) provides that a transfer of C stock by D to D creditors in connection with the reorganization is treated as a distribution to D shareholders pursuant to the plan of reorganization.
- In our fact pattern, D's transfer of C stock to D security holders is tax-free to D if the transfer is in connection with the reorganization, which is treated as pursuant to the plan of reorganization.
  - Query whether the standard of whether the stock is transferred pursuant to the plan of reorganization is different from the standard of whether the later distribution is treated as part of the initial distribution for purposes of section 355(a)(1)(A) and section 355(a)(1)(D)(i)?

# October 13, 2017 IRS Statement

- **Paragraph #2 of the October 13, 2017 IRS statement about PLRs states:**

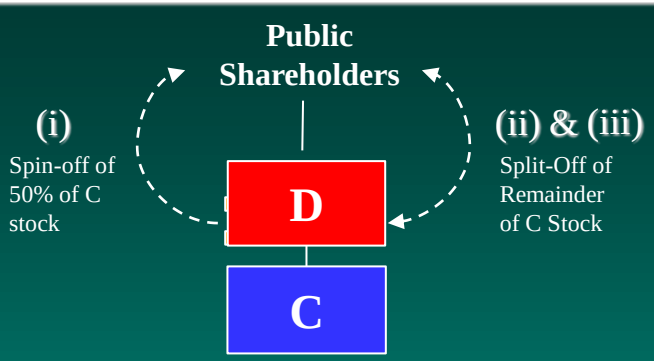
  **"If, in connection with a section 355 distribution, a distribution of stock, securities or other property to the distributing corporation's shareholders or creditors is substantially delayed, IRS will continue to rule on whether the delayed distribution is tax-free under section 355 or section 361. However, rulings on such issues will not be based solely on the length of the delay. Instead, IRS will rule on this issue only based on substantial scrutiny of the facts and circumstances (including the circumstances of the delay) and full consideration of the legal issues and the effects of a ruling on federal tax administration."**

# Rev. Proc. 2018-53

- Rev. Proc. 2018-53 provides procedures for taxpayers requesting PLRs regarding certain issues pertaining to section 368(a)(1)(D)/section 355 transactions.
- Section 3.04(6) of Rev. Proc. 2018-53 deals with delayed satisfaction of D debt:

  "If applicable, submit the following REPRESENTATIONS: There are one or more substantial business reasons for any delay in satisfying Distributing Debt with § 361 Consideration [C stock, money, C debt obligations or other C property] beyond 30 days after the date of the first distribution of Controlled stock to Distributing's shareholders. All the Distributing Debt that will be satisfied with § 361 Consideration will be satisfied no later than 180 days after such distribution. The taxpayer should submit information and analysis to establish the substantial business reasons for any delay in satisfying Distributing Debt after the 30-day period beginning on the date of the first distribution of Controlled stock to Distributing's shareholders. If satisfaction of any Distributing Debt with § 361 Consideration will occur more than 180 days after the date of such first distribution, the taxpayer should submit information and analysis to establish that, based on all the facts and circumstances, the satisfaction will be in connection with the plan of reorganization."
- Practitioners have expressed concern that the wording of section 3.04(6), including the time periods and the inquiry about "substantial business reasons," suggests a high standard for satisfaction of D debt after 30 days after the first distribution of C stock to D shareholders, and an even more rigorous standard for satisfaction of D debt after 180 days after the first distribution of C stock to D shareholders.

# Commissioner v. Gordon: The Distribution Requirement



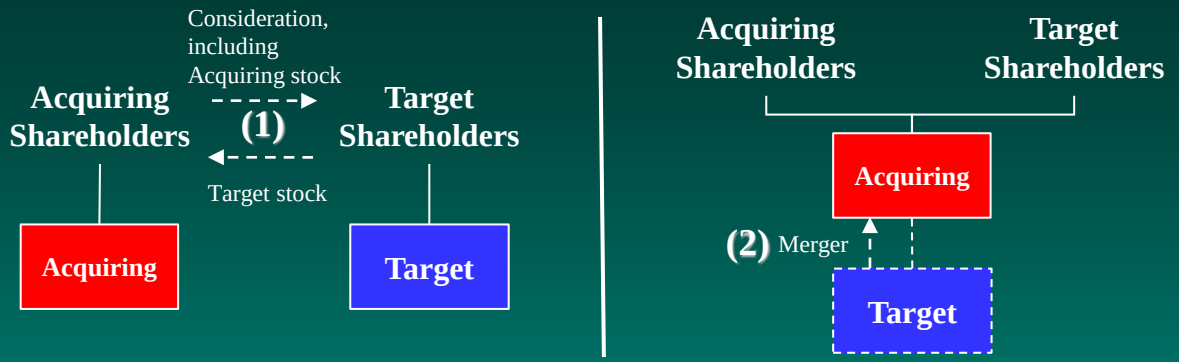

Simplified Facts: D stock is widely held. D owns all of the stock of C. Consistent with its expectation, (i) in Year 1/Month 1, D distributes 50% of the stock of C to its shareholders on a pro-rata basis and thereafter (ii) in Year 1/Month 8 splits-off 25% of the C stock and then (iii) in Year 2/Month 3, approximately 14 months after Step (i), splits-off the remaining 25%. Satisfaction of the Distribution Requirement requires each of the three distributions to be taken into account.

Observations:

- Failure of the Distribution Requirement: "The Commissioner contends that the 1961 distribution of [C] stock failed to qualify under s 355 in several respects. ***We need, however, reach only one. Section 355(a)(1)(D)*** requires that… [describing distribution requirement]." Commissioner v. Gordon, 391 U.S. 83, 94 (1968) (emphasis added and footnotes omitted).
- Prominence of the annual accounting principle: "Absent other specific directions from Congress, Code provisions [here, the distribution requirement,] must be interpreted so as to conform to the basic premise of annual tax accounting. It would be wholly inconsistent with this premise to hold that the essential character of a transaction, and its tax impact, should remain not only undeterminable but unfixed for an indefinite and unlimited period in the future, awaiting events that might or might not happen. This requirement that the character of a transaction be determinable does not mean that the entire divestiture must necessarily occur within a single tax year. It does, however, mean that if one transaction is to be characterized as a 'first step' there must be a binding commitment to take the later steps." 391 U.S. at 96 (footnotes omitted).

What if the distribution of all of the C stock occurs on two dates, first a 75% pro rata distribution and then a 25% split-off within the same taxable year? What if, instead, the amount of the distributions, respectively, are 80.1% and 19.9% in the same or subsequent year?

# King Enterprises, Inc. v. U.S.



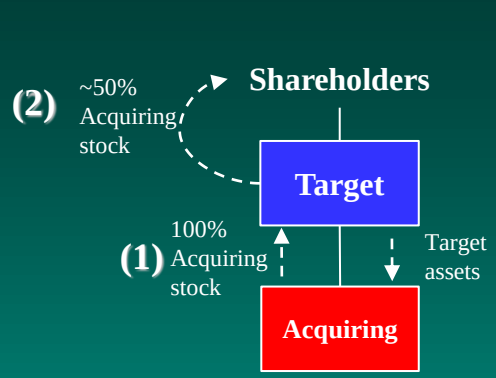

Facts:

- During September 1959, Acquiring acquired all of the stock of Target for a mix of cash, notes and Acquiring voting stock, which constituted more than 50 percent of the consideration. After the stock acquisition, Acquiring's directors approved the merger of Target into Acquiring, which occurred in the subsequent taxable year during April 1960.
- PLR 6002256580A (Feb. 25, 1960)(the "PLR") ruled that the acquisition was a taxable asset purchase under former section 334(b)(2) so that the subsequent merger resulted in the former assets of Target taking a stepped-up basis equal to the basis of the acquired stock.

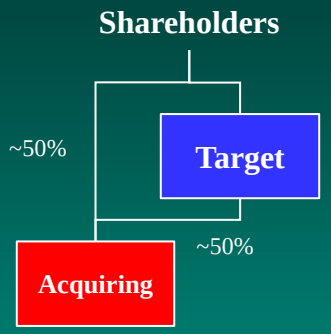
Analysis:

- Rejecting the Service's view in the PLR, King Enterprises, Inc. v. U.S., 418 F.2d 511 (Ct, Cl. 1969) held that the transaction was an "A" reorganization and the receipt of acquiring stock by target shareholders was tax-free pursuant to a "plan of reorganization" including the merger.
- King Enterprises explicitly concluded Gordon was nothing more than a step transaction doctrine inquiry with respect to the specific distribution requirement. *See* 418 F.2d at 517, 519 ("The primary issue in Gordon was whether the 1961 distribution was part of a Type D reorganization…. [T]he opinion addressed a narrow situation (a D reorganization) involving a specific statutory requirement (divestiture of control), and limited the potential for dilution and circumvention of that requirement by prohibiting the indefinite extension of divestiture distributions. Its interpretation should be so limited").
- In determining that the initial exchange and subsequent merger were pursuant to the "plan of reorganization," King Enterprises applied the "end result" test and focused on the intended result. *See* 418 F.2d at 519 ("The operative facts in this case clearly justify the inference that the merger … was the intended result … from the outset, the initial exchange of stock constituting a mere transitory step").
- King Enterprises has been favorably cited by the Service in the analysis of multi-step reorganization rulings. *See e.g.*, Rev. Rul. 2001-26, 2001-1 C.B. 1297 ("The principles of *King Enterprises* support the conclusion that, because the tender offer is integrated with the statutory merger … the tender offer exchange is treated as part of the statutory merger … for purposes of the reorganization provisions") (emphasis added); *see also* Rev. Rul. 2001-46, 2001-2 C.B. 321.

# Fry v. Commissioner: Plan Contingencies/Uncertainties




**Result**



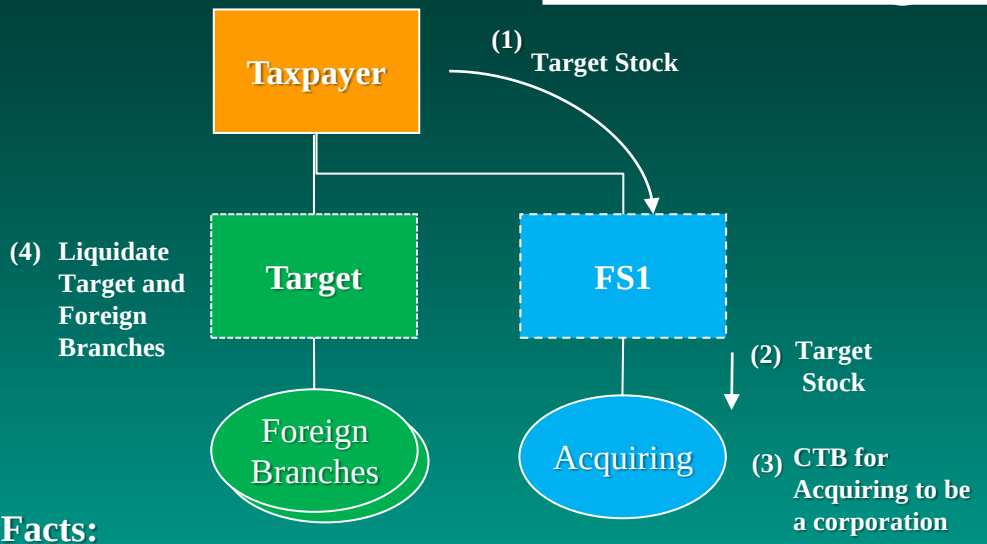

Steps

1. In 1933, the Bank of Commerce & Trust Co. ("Target") transferred its assets to the newly formed National Bank of Commerce in Memphis ("Acquiring"). Acquiring stock issued in the transaction was pledged to secure Target debt. It was the "hope and intention" that such stock could ultimately be distributed to Target shareholders and this was the best chance for salvaging value for them. Such stock, if any, would be distributed only after repaying certain debt.
2. Six years later in 1939, approximately 50% of the stock received by Target in the reorganization was released from the pledge and distributed to the Target shareholders.

Analysis

- Acknowledging the intent of the plan to preserve equity to the greatest extent possible for Target shareholders, the Tax Court concluded that the 1939 distributions were made in "pursuance of the plan of reorganization." Fry v. Comm'r, 5 TC 1058, 1071 (1945).
- The delay in effectuating a transfer, here, due to reasonable cause, involving the resolution of uncertainties or contingencies, including the potential complete failure of the contemplated exchange or distribution, neither precludes the existence of the plan nor the delayed transfer from occurring in pursuance of such plan.

# Simplified PLR 202128001 (April 19, 2021): Plan of Reorganization




**Proposed Transaction Steps:**

1. Taxpayer contributes Target stock to FS1.
2. FS1 contributes Target stock to Acquiring.
3. Acquiring elects to be treated as a corporation.
4. Target and its Foreign Branches liquidate into Acquiring (steps 2-4, the "Target Reorganization")

**Facts:**

- The business of Target and its Foreign Branches are heavily regulated in the various countries in which they are conducted. As such, approvals will be required in various countries to execute the Proposed Transactions. In addition, certain transfers of operations as part of the Proposed Transactions will require contract-by-contract approvals.
- All the necessary approvals for the Proposed Transactions are anticipated to take five years.

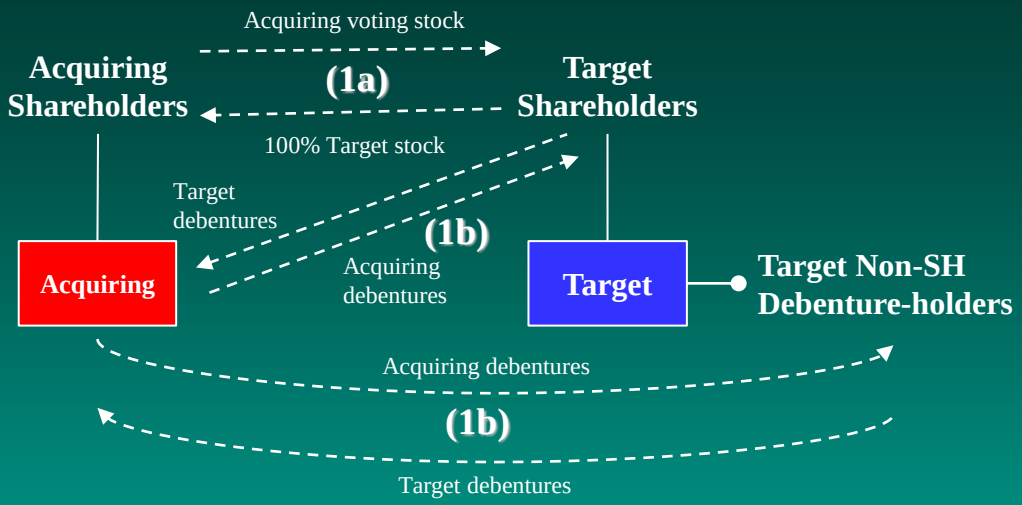
**Representation:**

- Taxpayer represented: Other than with respect to the plan of reorganization requirement, the Target Reorganization will qualify as a reorganization under 368(a).

**Ruling:**

- The steps of the Target Reorganization will each be treated as occurring pursuant to a plan of reorganization as required by Treas. Reg. 1.368-1(c).

# Revenue Ruling 98-10, 1998-1 C.B. 643



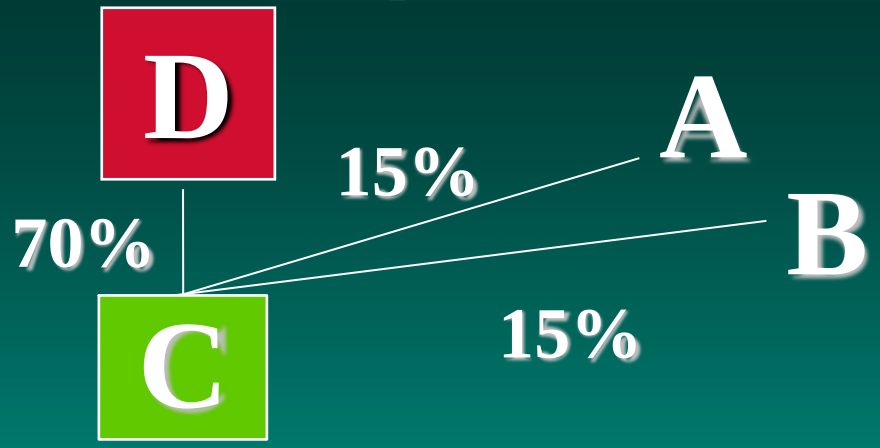

Facts

- Target has outstanding 6% 15-year debentures; some of the debentures are held by its shareholders, but a substantial portion are held by persons who are not.
  - 1(a) Acquiring acquires all of the outstanding capital stock of Target in exchange for Acquiring voting stock.
  - 1(b) Pursuant to the plan of reorganization, Acquiring acquires all of Target's outstanding 6%/15-year debentures in exchange for an equal principal amount of new six percent fifteen-year debentures of Acquiring.

Ruled

- The transaction's form is respected and the transaction qualifies as a "B" reorganization. The acquisition of Target debentures occurs as part of the overall transaction, but was not a part of the stock-for-stock exchange qualifying as a reorganization. Nonetheless, the exchange was in pursuance of the plan of reorganization and, as a result, qualifies under section 354(a)(1).
- The ruling modified and/or superseded Rev. Rul. 69-142, which concluded that section 1001 would apply to the securities exchange. The ruling establishes that (i) transactions not needed to create section 368 reorganizations can be "in pursuance of the plan of reorganization" and (ii) the "in pursuance of" standard may be satisfied if the transaction is considered "part of the overall transaction."

# Recap Into Control & Subsequent Unwind




- **D's 70% recapped into Class B with 80% vote.**
- **A&B's 30% recapped into Class A with 20% vote.**
- **Business Purpose to create stock for key employee and to facilitate transaction**

- Permanent change in capital structure, together with business purpose for recapitalization including a purpose other than merely obtaining control to effect spin-off tax-free. Rev. Rul. 69-407, 1969-2 C.B. 50.
  - •• See GCM 39088 (July 15, 1983) (section 1036 has no business purpose requirement).
- Reverts to 70/30 ratio in 20 years; 10 years; 5 years; 46 days? Rev. Rul. 63-260, 1963-2 C.B. 147 (transitory and illusory changes in capital structure not respected as conferring §368(c) control).
- Rev. Proc. 2016-40, 2016-30 I.R.B. 165, provides two safe harbors with respect to certain issuances of Controlled stock resulting in Distributing's acquisition of control that is subsequently unwound.
- Note the exception for recapitalization in the proposed ATB regulations prohibiting use of Distributing assets to acquire control. Prop. Reg. §1.355-3(b)(4)(ii)(A).

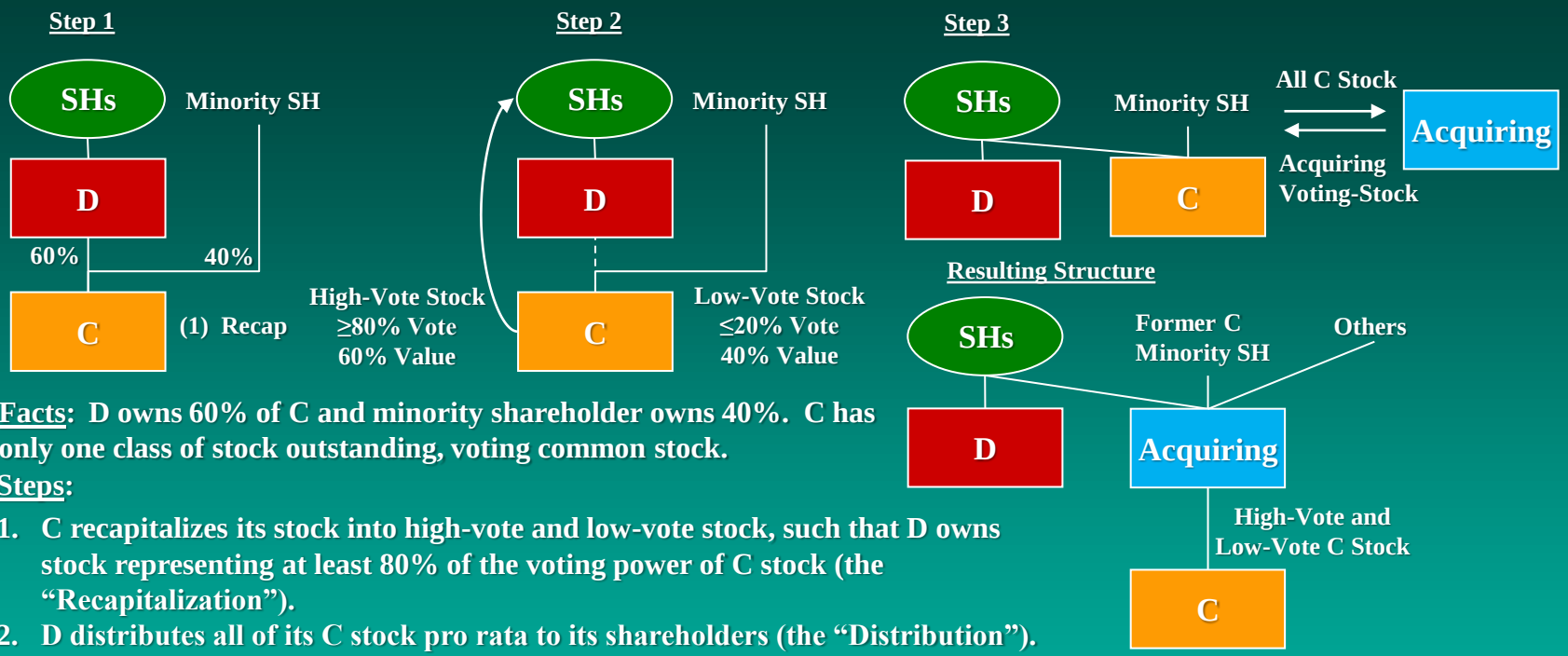
# Rev. Proc. 2016-40: Safe Harbors for Recapitalizations into Control and Subsequent Unwinds

- Rev. Proc. 2016-40, 2016-30 I.R.B. 165, provides two safe harbors with respect to certain issuances of Controlled stock that result in Distributing obtaining control in anticipation of a distribution where such transactions are subsequently unwound, "in actuality or in effect, [where the unwind] substantially restores (a) C[ontrolled]'s shareholders to the relative interests, direct or indirect, they would have held in C[ontrolled] (or a successor to C[ontrolled]) had the issuance not occurred; and/or (b) the relative voting rights and value of the C[ontrolled] classes of stock that were present prior to the issuance (an unwind)."
  - What of low vote stock issued to preserve control?
  - What implications for recapitalizations that are not unwound?
- If either of the two safe harbors apply, the Service will not assert that a transaction described above "lacks substance, and that therefore D[istributing] lacked control of C[ontrolled] immediately before the distribution, within the meaning of [section] 355(a)(1)(A)…." The safe harbors apply solely to determine whether an acquisition of control has substance for purposes of section 355(a)(1)(A).
- No inference should be drawn with respect to the federal income tax treatment of a transaction if it fails to qualify for the safe harbors described in the revenue procedure. See Rev. Proc. 2014-60, §5.02

# Rev. Proc. 2016-40: Safe Harbors

- **Safe Harbor #1 (No Action Taken within 24 Months):** No action is taken (including adoption of any plan or policy), at any time prior to 24 months after the distribution, by C's board of directors, C's management, or any of C's controlling shareholders (as defined in Reg. §1.355-7(h)(3)) that would (if implemented) actually or effectively result in an unwind.
  - What constitutes an "action," e.g., internal discussions of a possible unwind prior to or during the 24 months following the distribution, a question from the CEO to the company tax advisor or investment advisor as to whether and when an unwind is permitted, the mere expectation that an unwind will occur immediately after the 2 year window, a public statement that there is no plan or intent to consider an unwind for the 24-month period following the distribution, etc.?
  - Absent the application of Safe Harbor #2, could the Service sign-off on a structure under audit within 24 months of the distribution (e.g., for a taxpayer in the CAP program with its accelerated audits)?
- **Safe Harbor #2 (Third Party Transaction):** C engages in a transaction with one or more persons (for example, a merger of C with another corporation) that results in an unwind, regardless of when it takes place, provided that: (i) the transaction or similar transaction was not the subject of an "agreement, understanding, arrangement, or substantial negotiations" or "discussions (within the meaning of [Reg.] §1.355-7(h)(6))" at any time during the 24-month period ending on the date of the distribution; and (ii) at any time, including after the 24-month period, one person (treating corporations or investment funds as a person) does not own more than 20 percent (by vote or value) of both C and the third party that engaged in the unwind transaction.
  - Does the safe harbor apply to a "hot market" in which a post-distribution acquisition is anticipated? Cf. Reg. §1.355-7(j) (Ex. 3) (Super Safe Harbor application to hot market).
- Availability of both safe harbors depend upon the date of the distribution – how are they applied when the distribution occurs on more than one date?

# Rev. Proc. 2016-40: What Constitutes an Unwind?



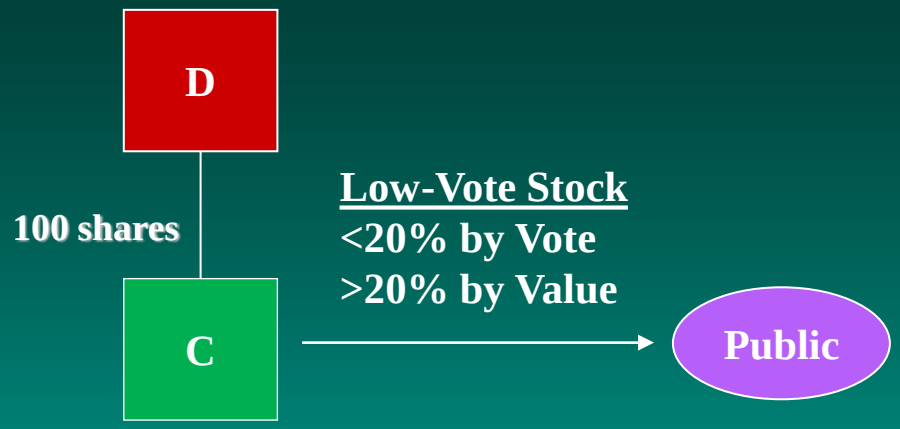

Facts: D owns 60% of C and minority shareholder owns 40%. C has only one class of stock outstanding, voting common stock.

Steps:

1. C recapitalizes its stock into high-vote and low-vote stock, such that D owns stock representing at least 80% of the voting power of C stock (the "Recapitalization").
2. D distributes all of its C stock pro rata to its shareholders (the "Distribution").
3. Three months after the Distribution, Acquiring acquires all of the stock of C in a reorganization qualifying under section 368(a)(1)(B).

- Is the Recapitalization unwound by virtue of the acquisition of all the C stock in the B reorganization? See Rev. Proc. 2016-40, 2016-30 I.R.B. 165, §3 (safe harbors will only apply to transactions where controlled subsequently engages in a transaction that "actually or in effect" restores (a) Controlled's shareholders to the relative interests, direct or indirect, they held in Controlled (or a successor) had the recapitalization not occurred, and/or (b) the relative voting rights and value of Controlled's classes of stock prior to the recapitalization).
- Alternatively, what if there were discussions related to the acquisition before the Distribution? See Rev. Proc. 2016-40 (second safe harbor does not apply if discussions during 24-month period ending on date of distribution).

# Pre-Spin IPO in Dual Class Structure

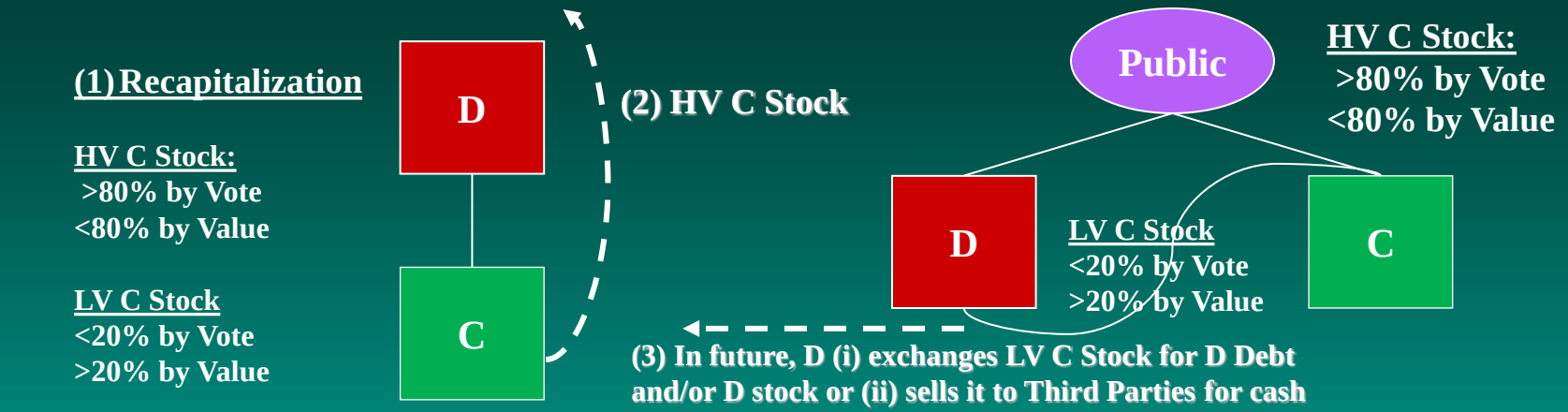



**Facts:** D owns all 100 outstanding shares of C common stock, each with 1 vote per share. C issues 50 shares of a new class of C common stock having 1/10th of a vote per share. The new class of C stock represents 1/3 by value and approximately 4.76% by vote of the C stock.

**Questions:**

- Does Rev. Proc. 2016-40 apply where low vote stock is issued or other corporate mechanics are implemented to maintain control?
- If inapplicable, how might the underlying premises of Rev. Proc. 2016-40 be applied in the context of a private letter ruling application? Cf., PLR 201731004 (Feb. 16, 2017).
  - Presumably the dual class structure would satisfy the underlying principles after the passage of some 24-month period if "no action" is taken.
  - When should the 24-month period commence in the case of a distribution that occurs on multiple dates – the date of the first transfer, the date on which the distribution requirement would be satisfied or the date on which D distributes the last of its remaining C shares?

# Offering of C Stock in Dual Class Structure Following Distribution of Section 368(c) Control




**Facts**: D owns all 100 outstanding shares of C common stock

(1) C recapitalizes its stock into two classes: 100 shares of stock with 1 vote per share ("HV C Stock") and 50 shares of stock with 1/10th of a vote per share ("LV C Stock"). The LV C Stock represents 1/3 by value and approximately 4.76% by vote of the C stock.

(2) D distributes all of the HV C Stock to its shareholders pro rata (the "Distribution").

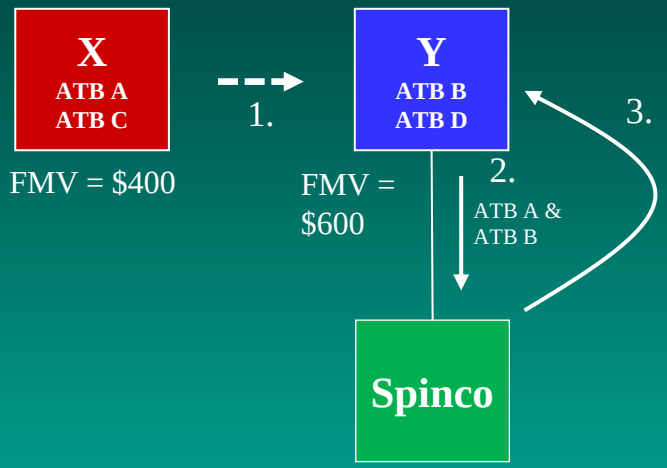
(3) D either (i) exchanges the LV C Stock for D debt and/or D stock within 18 months after the Distribution, or (ii) sells the LV C Stock no later than 5 years after the Distribution.

**Questions**:

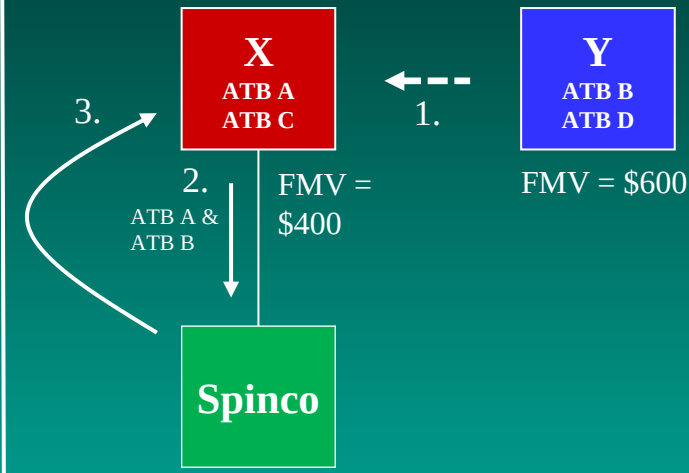
- Does Rev. Proc. 2016-40 apply where low-vote stock is issued to ensure the satisfaction of the distribution of control requirement when control is pre-existing?
- If inapplicable, how might the underlying premises of Rev. Proc. 2016-40 be applied in the context of a private letter ruling application? Cf., PLR 201731004 (Feb. 16, 2017).
  - Presumably the dual class structure would satisfy the underlying principle after the passage of some 24-month period if "no action" is taken.
  - When should the 24-month period commence in the case of a distribution that occurs on multiple dates – the date of the first transfer, the date on which the distribution requirement would be satisfied or the date on which D distributes the last of its remaining C shares?

# Section 355(e) Predecessor Rules—Direction of Pre-spin Merger

## Scenario #1: X Merges Into Y; Y Contributes ATB A & B to Spinco; Y Distributes Spinco




## Scenario #2: Y Merges Into X; X Contributes ATB A & B to Spinco; X Distributes Spinco




**Facts**:

- Unrelated X owns ATB A, FMV = $100, A/B=$0; and ATB C, FMV = $300, A/B=$0; aggregate FMV of $400.
- Unrelated Y owns ATB B, FMV = $200, A/B=$0; and ATB D, FMV = $400, A/B=$0; aggregate FMV of $600.
- Scenario 1. X merges into Y in a Section 368(a)(1)(A) reorganization, after which Y contributes ATB A and ATB B to Spinco and distributes Spinco in a transaction otherwise qualifying as a Section 355 transaction.
- Scenario 2. Y merges into X in a Section 368(a)(1)(A) reorganization, after which X contributes ATB A and ATB B to Spinco and distributes Spinco in a transaction otherwise qualifying as a Section 355 transaction.

**Questions**:

- Does Section 355(e) cause gain recognition under Scenario 1 and/or 2 and in what amount? Is the amount different? See Treas. Reg. § 1.355-8(a)(1), (b)(1) (definition of predecessor of distributing (POD)); 8(e)(2) (gain limitation upon planned 50% acquisition of POD); -8(e)(3) (gain limitation upon planned 50% acquisition of D); see also Treas. Reg. § 1.355-8(h)(Ex. 1) (planned 50% acquisition of POD), (Ex. 2) (planned 50% acquisition of D)

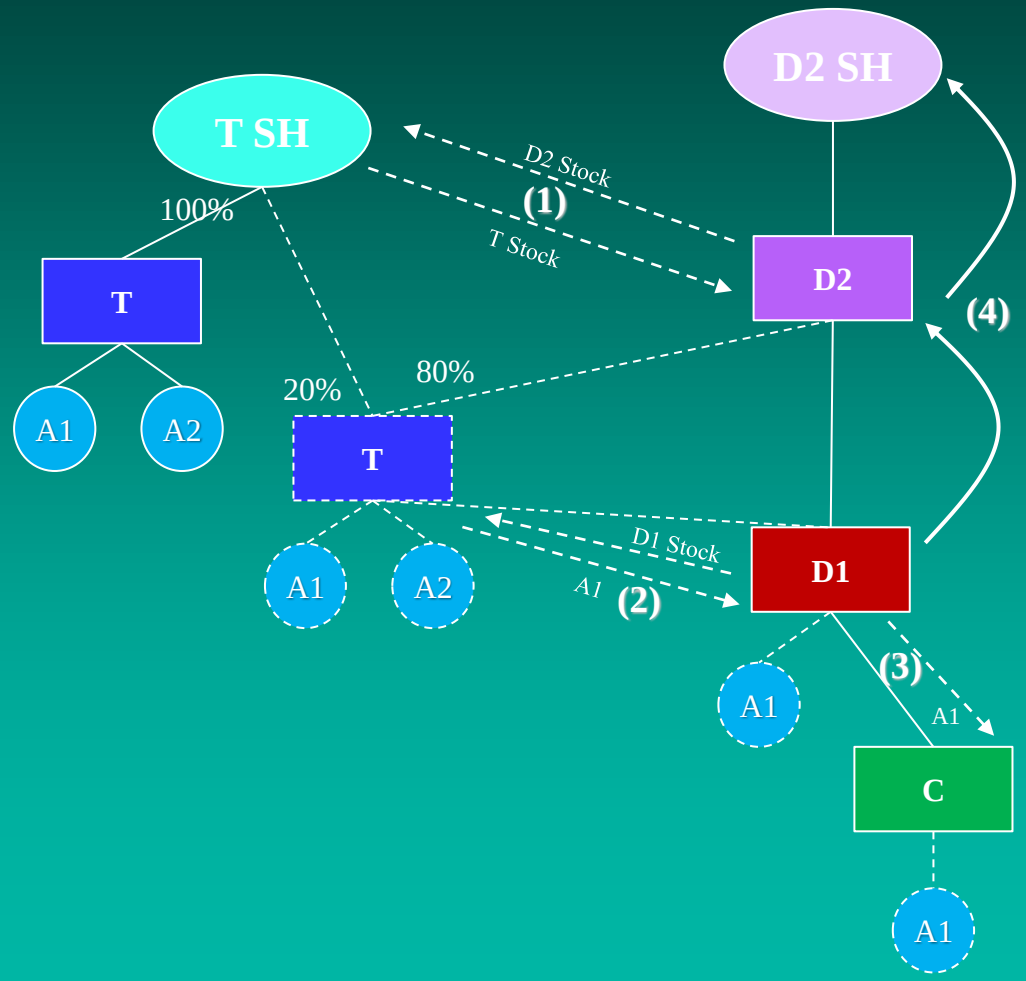
# Non-Section 381 Transfers and Predecessors

**Steps:**

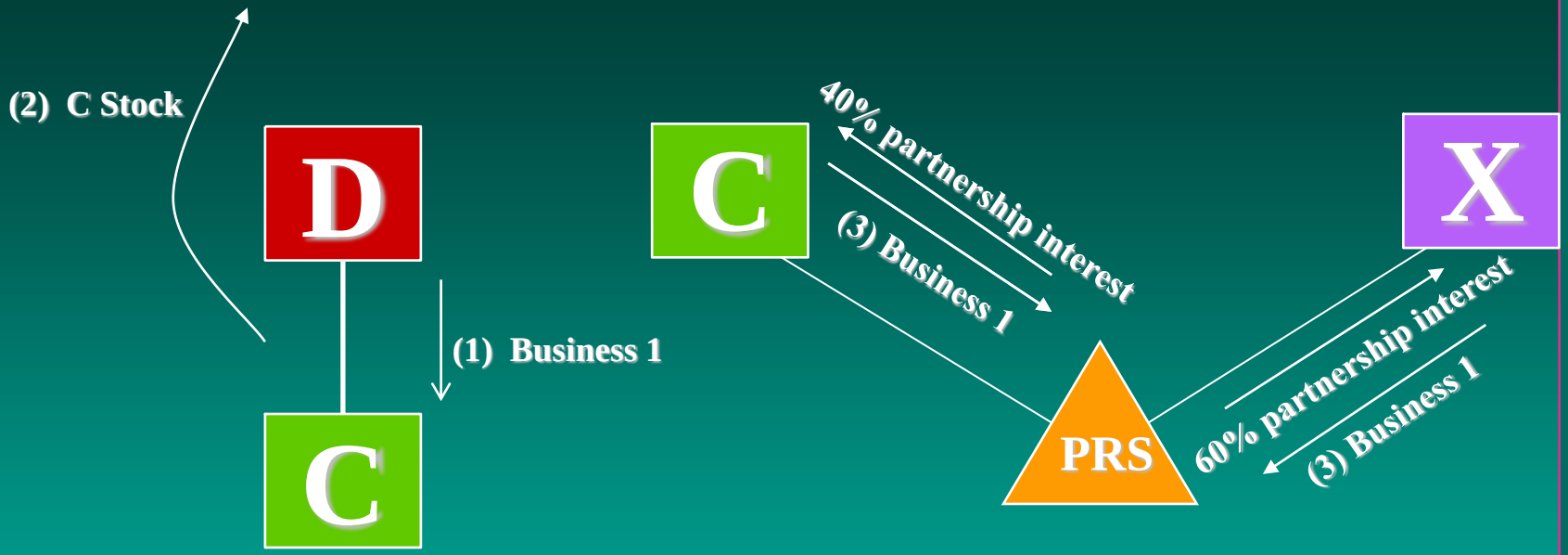
1. D2 acquires 80% of T stock in exchange for D2 stock
2. T transfers asset A1 to D1 in exchange for D1 stock in a §351 transfer (see Treas. Reg. §1.1502-34).
3. D1 contributes Asset A1 to C.
4. D1 and D2 distribute C stock in split-offs otherwise qualifying under Section 355. See e.g., Treas. Reg. § 1.355-8(h) (Ex. 5).

**Questions:**

- Is T a predecessor of D1? See Treas. Reg. § 1.355-8(b)((2)(ii) (potential predecessor includes corporation transfers property to POD, D, or member of same Expanded Affiliated Group in a Section 381 transaction, or immediately after completion of plan corporation is member of same Expanded Affiliated Group of D); 8(b)(2)(v) (stock of Distributing not relevant property if acquired by POD in a section 351 transaction).
- What if, either (a) between steps 3 and 4, D2 sells any amount of T stock to an unrelated third party or (b) D2 had acquired less than 80% of T? Compare Treas. Reg. § 1.355-8(h) Examples 5 and 6.



# Predecessor/Successor and Partnerships: Case 1



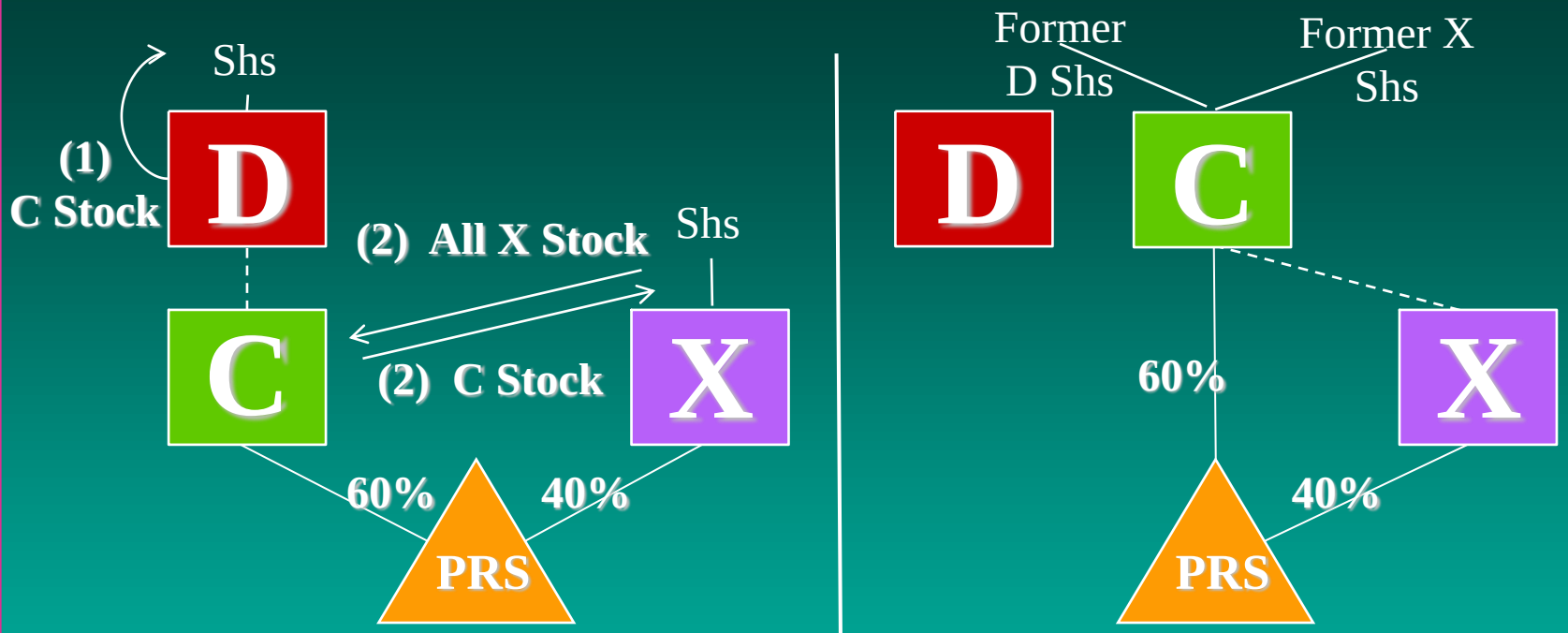

**Step 1:** D contributes Business 1 to newly formed C.

**Step 2:** D distributes the stock of C to its shareholders.

**Step 3:** C contributes Business 1 (i.e., all of its assets) to partnership PRS in exchange for 40% of the interests in PRS and X, an unrelated investor, contributes cash or other assets in exchange for the remaining 60% of the PRS interests; C will manage the day-to-day operations of PRS

- See Section 355(e)(3)(B) and 355(e)(4)(D); Reg. §1.355-8(b)(2)(ii), (c)(2) (applying predecessor and successor rules only to corporations); TD 9888 (Preamble to Reg. §1.355-8; "[a] partnership cannot receive assets in a Section 381 Transaction. Accordingly, a partnership could not have been a Successor under either the 2004 Proposed Regulations or the 2016 Regulations. As noted later in this part V, the final regulations retain this approach").

# Predecessor/Successor and Partnerships: Case 2



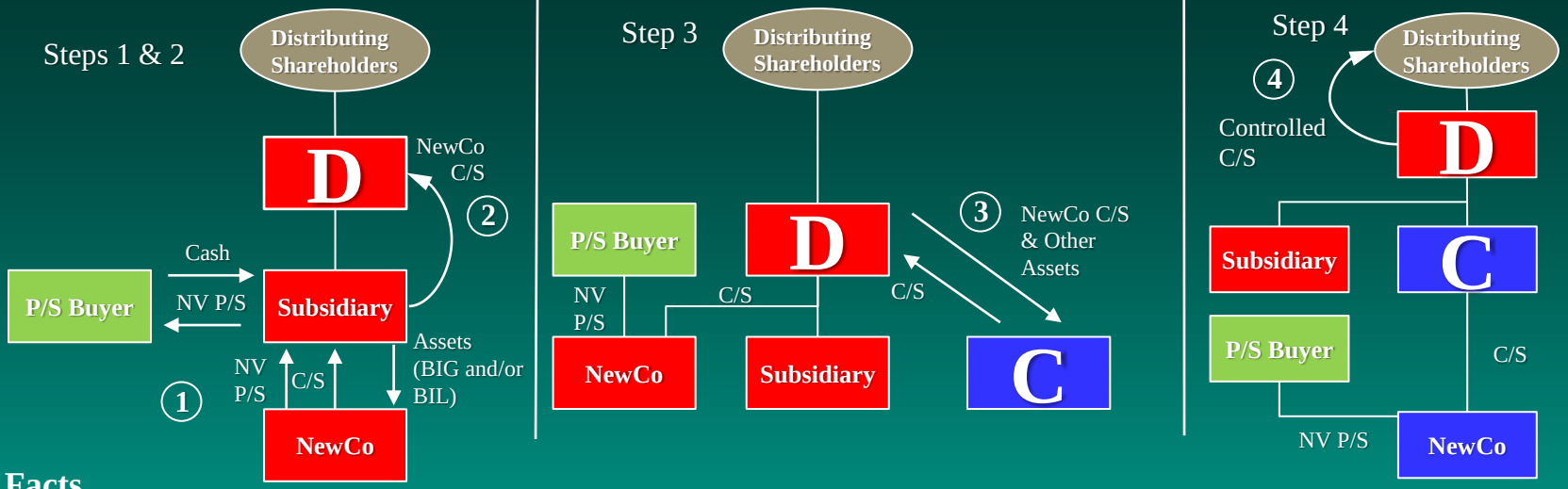

D owns 100% of C, which owns 60% of partnership, PRS. Unrelated investor, X, owns the remaining interest in PRS. These interests in PRS have been owned for the past 5 years. C is a pure holding company owning nothing but the interest in PRS.

Step 1: D distributes the stock of C to its shareholders.

Step 2: C acquires all of the stock of X solely in exchange for C stock.

- Does the overlap rule in section 355(e)(3)(A)(iv) apply to shield the acquisition by X shareholders of the stock of C in step 2? In order for the overlap rule to apply, is it necessary that section 355(e)(4)(D) apply notwithstanding the inapplicability of Reg. §1.355-8?

# "Busted 351" Followed by a Tax-Free Distribution – Slide 1




**Facts**

**Step 1:**

a. **Subsidiary, a member of the D consolidated group, contributes assets with built-in gain and/or loss in exchange for NewCo Common and Nonvoting Preferred Stock, with such preferred stock comprising approximately 5% of the value of Subsidiary stock.**

b. **Pursuant to a pre-contribution binding commitment, Subsidiary sells the NewCo Nonvoting Preferred Stock to P/S Buyer for cash or other property, *e.g.* marketable securities.**

**Step 2:** **Subsidiary immediately distributes the NewCo Common Stock at no further gain or loss to Subsidiary and, assuming tax consolidation, no gain or loss to Distributing.**

**Step 3:** **Distributing contributes all of the NewCo Common Stock and other Distributing Assets to a newly formed Controlled in exchange for Controlled Common Stock.**

**Step 4:** **Distributing distributes all of the Controlled Common Stock to its shareholders, and the distribution occurs:**

- **within 90 days of Step 1b**
- **more than 90 days after Step 1b**

# "Busted 351" Followed by a Tax-Free Distribution – Slide 2

- Several favorable IRS private letter rulings have been issued with respect to "busted 351" transactions in connection with tax-free section 355 distributions. See e.g., PLR 201818010 (May 22, 2017); PLR 201644018 (section 368(a)(1)(G) reorganization); PLR 201333007 (May 20, 2013) (loss recognition); PLR 201203004 (Oct. 19, 2011) (loss recognition); PLR 200611003 (Dec. 1, 2005) (loss recognition); PLR 200422003 (Feb. 13, 2004) (loss recognition).

Considerations: Efficient management of tax attributes

- Implementation of a Tax Receivables Agreement for gain recognition transactions
  - Application of Relation-Back Doctrine under *Arrowsmith v. Comm'r*, 344 U.S. 6 (1952) or Open Transaction Doctrine under *Burnet v. Logan*, 283 U.S. 404 (1931)
  - Application of § 361 with respect to Tax Receivables Agreement payments
- Cherry-picking/selectivity considerations with respect to corporate-level recognition and nonrecognition transactions
- With respect to loss recognition transactions: section 267(f), section 269, and Reg. §1.1502-13(h)
- In this case, is section 168(k) bonus depreciation available notwithstanding that NewCo was a member of the Distributing consolidated group? See Prop. Reg. § 1.168(k)-2(b)(3)(v)(C) (addressing prior use prohibition for series of related transactions where assets leave group).

# Overview - Amended Section 168(k)

**Amended Section 168(k)**

- 100% first-year depreciation deduction for qualified property acquired and placed in service after September 27, 2017 and before 2023.
- The first-year depreciation percentage is phased down from 2023 through 2026.
- Definition of qualified property is modified to include used property acquired by purchase, so long as:
  - The property was not used by the taxpayer prior to the acquisition,
  - The property is not acquired from a person whose relationship would result in the disallowance of losses under sections 267 or 707(b), and
  - The property is not acquired from another component member of the same controlled group

**Implications**

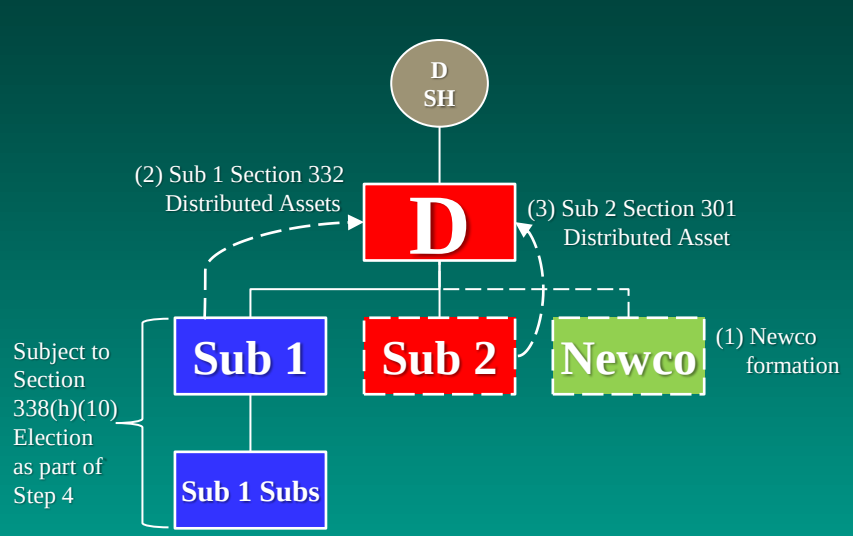
- Results in the aggregate acceleration of deductions in tax system to the extent the seller has basis in the property (i.e., buyer deduction exceeds seller gain).
- Modeling required to determine if 100% depreciation is desirable, i.e., compare the tax benefit to buyer for each dollar of depreciation to the tax cost to seller for each dollar of gain. See e.g., Sections 163(j), 250.

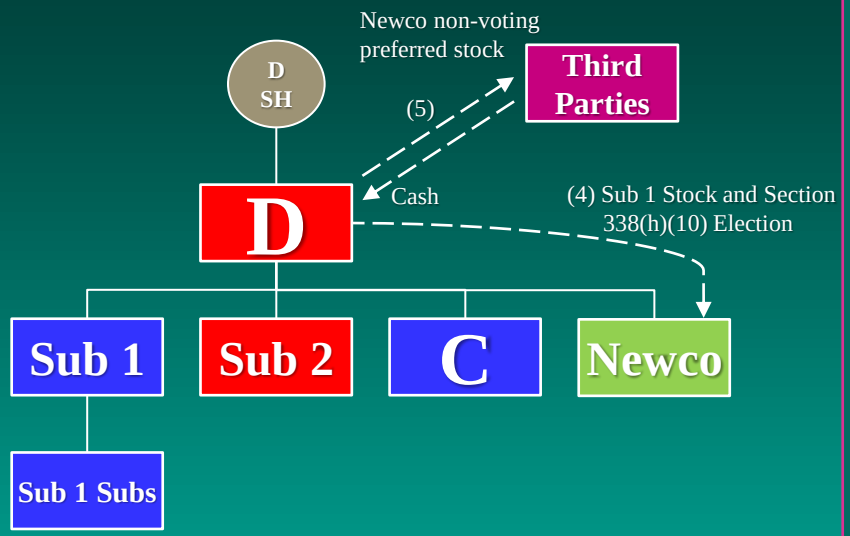
# Background – Used Property Acquisition Requirements

**For an acquisition of "used" depreciable property to qualify for immediate expensing, such property must (inter alia) meet the following requirements (Reg. 1.168(k)-2(b)(3)(iii)(A)):**

- **The property was not used by the taxpayer or a predecessor at any time prior to the acquisition (the "No Prior Use Requirement").**
  - **In general, a consolidated group is treated as having a depreciable interest in property during the time a member of the consolidated group had a depreciable interest. In addition, if a member of a consolidated group purchases property in which the consolidated group has a depreciable interest, such acquirer is treated as having a depreciable interest prior to the acquisition. Prop. Reg. 1.168(k)-2(b)(3)(v)(A).**
  - **An exception is provided for such a sale (or a deemed sale as a result of section 338 or 336 election) if, as part of a series of related transactions, the transferee member leaves the group within 90 days of the acquisition. In that case, the transferor member is treated as disposing of, and the transferee member is treated as acquiring the depreciable property for all Federal income tax purposes one day after the date on which the transferee member ceases to be a member of the consolidated group (the Deconsolidation Date) and transferee member treated as placing the property in service no earlier than day after the Deconsolidation. Prop. Reg. 1.168(k)-2(b)(3)(v)(C), (D) (collectively, the Proposed Consolidated Acquisition Rules).**
- **For all Federal income tax purposes, if the Proposed Consolidated Acquisition Rules apply the acquisition is treated as occurring after the Deconsolidation Date so that the deduction will occur in the acquiring group's consolidated return. See Prop. Reg. 1.168(k)-2(b)(3)(v)(C), (D); REG 106808-19 (Sept. 13, 2019).**
- **The acquisition of such property satisfying the Proposed Consolidated Acquisition Rules meets the section 168(k) requirements for a sale from an unrelated seller (the "Unrelated Seller Requirement"). In general, to satisfy this requirement property must not be acquired (A) from a person whose relationship would result in the disallowance of losses under Sections 267 or 707(b) (with certain modifications), (B) by a component member of a controlled group from another component member of the same controlled group, or (C) in a carryover basis transaction.**
  - **For all Federal income tax purposes, if the Proposed Consolidated Acquisition Rules apply the sale transaction is treated as occurring the day after the Deconsolidated Date so that the acquirer would not be a component member of the controlled group of the seller because it would not have been a member of the controlled group for any portion of its taxable year in which the sale is deemed to occur.**
- **Does Treasury/IRS plan on providing comparable treatment for nonconsolidated, controlled groups for which such treatment is at least, if not more, justified?**

# Gain or Loss Recognition via Section 338(h)(10) in connection with a Tax-Free Distribution – Slide 1




**Transaction Steps: (PLR 201702035 Simplified)**

Step 1: D forms Newco and enters into a binding commitment to sell Newco non-voting preferred stock to third parties.

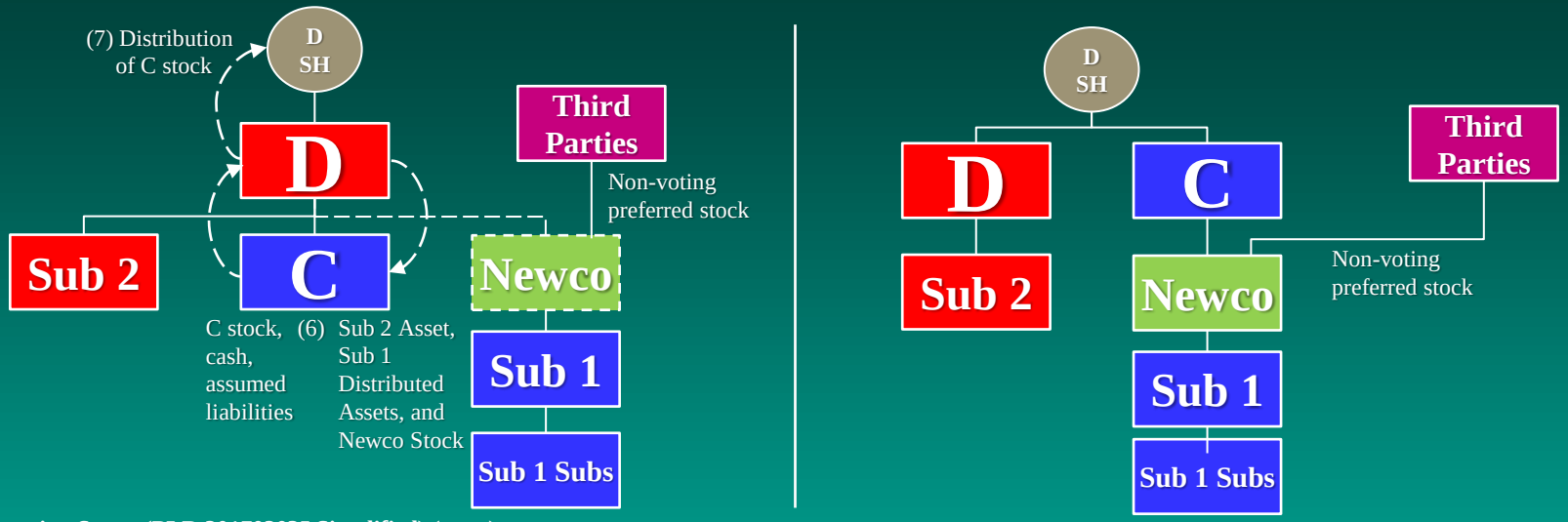
Step 2: Sub 1 distributes assets that are part of the active trade or business to be conducted by C ("Business C" and such distributed assets, the "Sub 1 Distributed Assets") pursuant to resolutions indicating that such distributions are undertaken in connection with the §338(h)(10) election made in Step 5.

Step 3: Sub 2 distributes a Business C asset (the "Sub 2 Asset") to D.

Step 4: D transfers all Sub 1 stock to Newco in exchange for Newco common stock and non-voting preferred stock. D and Newco make a joint section 338(h)(10) election to treat the transaction as (i) sale of "old" Sub 1's assets to "new" Sub 1 and (ii) distribution of proceeds thereof, together with the assets distributed in Step 2, in complete liquidation of "old" Sub 1. If elections are made for the Sub 1 Subsidiaries, the deemed asset sales and liquidations are treated as occurring bottom-up.

Step 5: Pursuant to the binding commitment from Step 1, D sells the Newco non-voting preferred stock to third parties for cash.

# Gain or Loss Recognition via Section 338(h)(10) in connection with a Tax-Free Distribution – Slide 2




**Transaction Steps: (PLR 201702035 Simplified) (cont.)**

Step 6: D contributes the Sub 2 Asset, Sub 1 Distributed Assets, its stock of Newco, and other assets to C in exchange for C stock, assumption of liabilities associated with Business C, and cash from borrowings by C.

Step 7: D distributes all stock of C to D's shareholders and, after 18 months, distributes the cash received from C to its shareholders and creditors.

The Service ruled that:

(1) As a result of the section 338(h)(10) election, the D consolidated group would take into account immediately before the distribution any losses recognized pursuant to the deemed sale. See Ruling 5.

(2) The distributions of the Sub 1 Distributed Assets in Step 2 will be treated as distributions pursuant to the deemed liquidations of Sub 1 and the Sub 1 Subsidiaries (Treas. Reg. §1.338(h)(10)-1(d)(4), and the distribution of the Sub 2 Asset will be treated as a distribution under section 301 and Treas. Reg. §1.1502-13(f)(2). See Ruling 8.

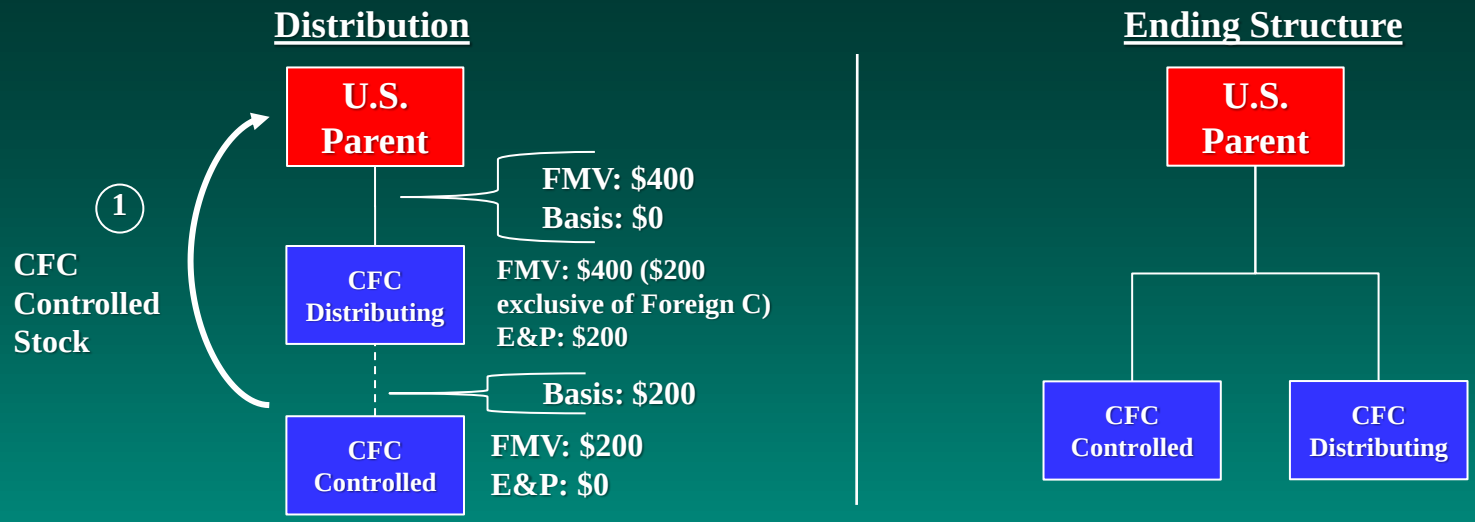
(3) Neither the deemed sales of assets of "old" Sub 1 to "new" Sub 1 and from any "old" Sub 1 Subsidiary to any "new" Sub 1 Subsidiary, nor D's contribution of the Newco common stock and the Sub 1 Distributed Assets to C will preclude the deemed liquidation of "old" Sub 1 or any "old" Sub 1 Subsidiary pursuant to the section 338(h)(10) election from qualifying as a complete liquidation under section 332. See Ruling 9.

(4) Neither the purchase of Sub 1 assets by Newco nor the section 338(h)(10) election will preclude the distribution from satisfying the active trade or business requirement of section 355(b). See Ruling 10.

As a result, in connection with the tax-free separation of C, D was able to recognize loss with respect to certain assets, a portion of the ownership of which was contributed to C.

In addition,, under current regulations, the assets acquired in the section 338(h)(10) election should be eligible for bonus depreciation/immediate expensing. See Treas. Reg. § 1.179-4(c)(2)).

# CFC Distributing and no BIG CFC Controlled: Dividend from CFC




Facts: CFC Distributing distributes stock of CFC Controlled to U.S. Parent.

Overview:

Section 245A allows U.S. Parent a 100-percent DRD with respect to the "foreign source portion" of dividends received from CFC Distributing (see also sections 245(a) and 243(e) providing a similar DRD in the uncommon case of "U.S. source portion" of dividends from CFC Distributing).

Analysis

- If the distribution were to fail section 355 qualification, CFC Distributing would not recognize gain or loss under section 311(b) with respect to the distribution (i.e., no built-in gain or loss in stock of CFC Controlled) and U.S. Parent would recognize a $200 dividend. Assuming the applicable requirements are satisfied, U.S. Parent is allowed a $200 DRD with respect to the $200 dividend.
- While not listed as a section 355 nondevice factor, the availability of a section 245A DRD if the distribution were taxable would seem to mitigate potential device concerns for section 355 qualification. Compare Treas. Reg. § 1.355-2(d)(3)(iv) (nondevice factor if 100% DRD under Sections 243(a)(2) or (3), 65% DRD under Section 243(a)(1) as modified by Section 243(c), or 100% DRD under Section 245(b) would apply).
  - Insufficient CFC Distributing E&P may raise device considerations in respect of basis recovery.

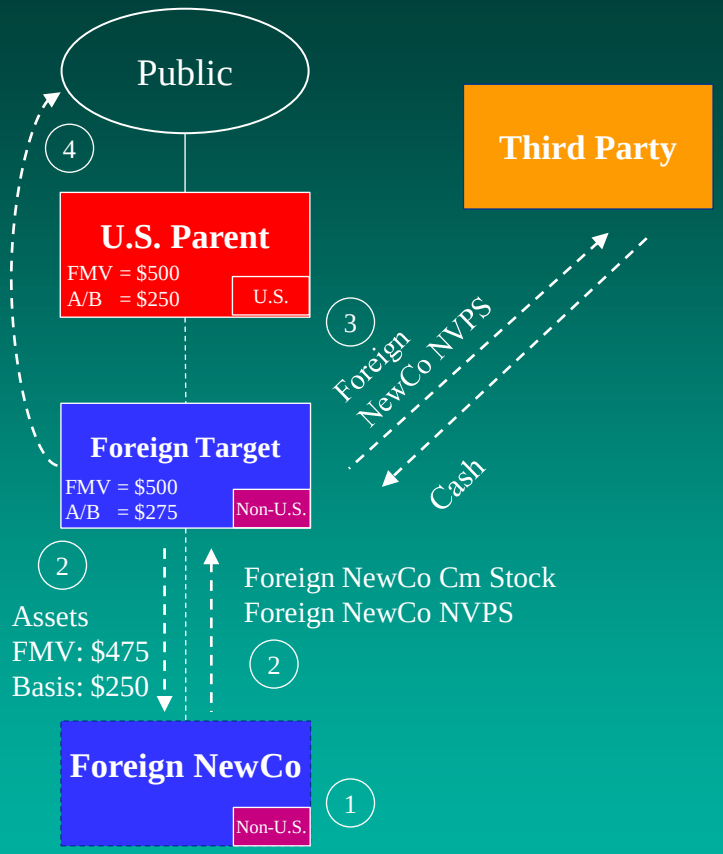
# CFC Distributing and BIG CFC Controlled: CFC Stock Gain Treated as Dividend


Facts and Overview: Same as prior Slide (except for E&P and basis)

Analysis

- The distribution does not reduce U.S. Parent's section 1248 amount with respect to CFC Distributing or CFC Controlled and thus, no basis adjustments or deemed dividends result under Treas. Reg. § 1.367(b)-5(c).
- If the distribution were to fail section 355 qualification, CFC Distributing would recognize $200 gain under section 311(b) with respect to the distribution, which would be recharacterized as a dividend under section 964(e) to the extent of CFC Controlled's $200 of E&P.
  - CFC Distributing's dividend income would be subpart F income.
  - U.S. Parent would include the subpart F income and would be allowed a corresponding 100% DRD under section 245A with respect to such deemed dividend from CFC Distributing.
- While not listed as a section 355 nondevice factor, the availability of a section 245A DRD if the distribution were taxable would seem to mitigate potential device concerns. Compare Treas. Reg. § 1.355-2(d)(3)(iv) (nondevice factor if 100% DRD under Sections 243(a)(2) or (3), 65% DRD under Section 243(a)(1) as modified by Section 243(c), or 100% DRD under Section 245(b) would apply).

# Busted 351/RMT/10.5% Reduction in Gain Toll Charge: Foreign Buyer (no U.S. Subsidiaries) (Slide 1)

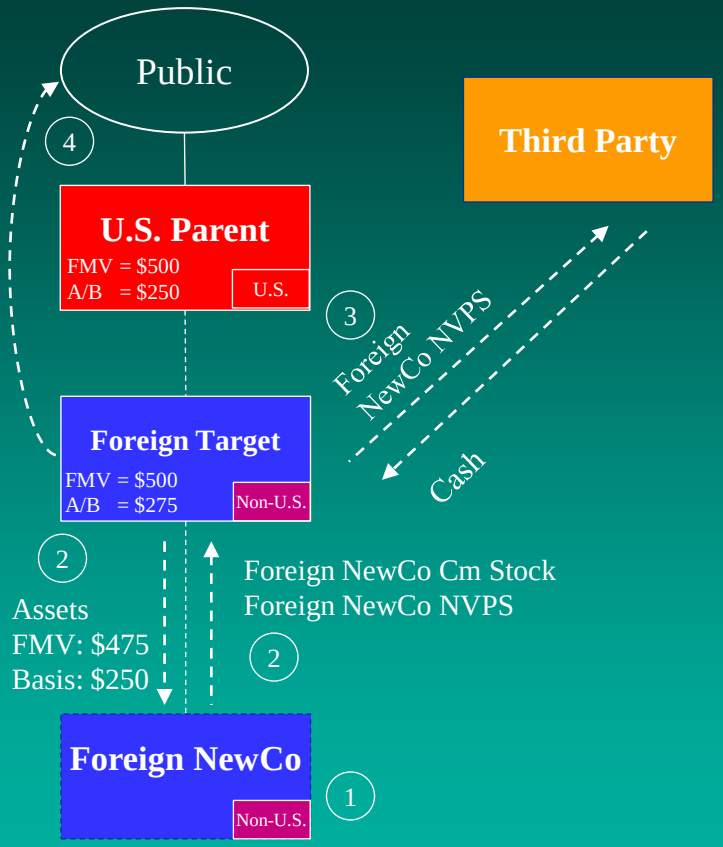



**Transaction Steps***

1. Foreign Target forms Foreign NewCo and enters into binding commitment to sell NewCo's nonvoting Section 1504(a)(4) preferred stock ("NVPS") to an unrelated third party buyer ("Third Party").
2. Foreign Target contributes all of its business assets (fair market value $475 and basis of $250) to NewCo in exchange for NewCo (i) common stock and (ii) a not insignificant amount of Foreign NewCo NVPS.
3. Pursuant to the binding commitment, Foreign Target sells the NVPS to Third Party.
4. On December 30th in the same year as Steps 1-3, U.S. Parent distributes its Foreign Target stock to the Public (the "Distribution") in a transaction that satisfies section 355, although section 355(e) may be implicated due to post-spin merger (see following slide); U.S. Parent and Foreign Target are calendar year taxpayers for U.S. Tax purposes.

* Simplifying assumption is that basis is the same for taxable income and E&P purposes. All of Foreign Target's $25 of accumulated E&P is untaxed and attributable to U.S. Parent under Section 1248.

# Busted 351/RMT/10.5% Reduction in Gain Toll Charge: Foreign Buyer (no U.S. Subsidiaries) (Slide 2)

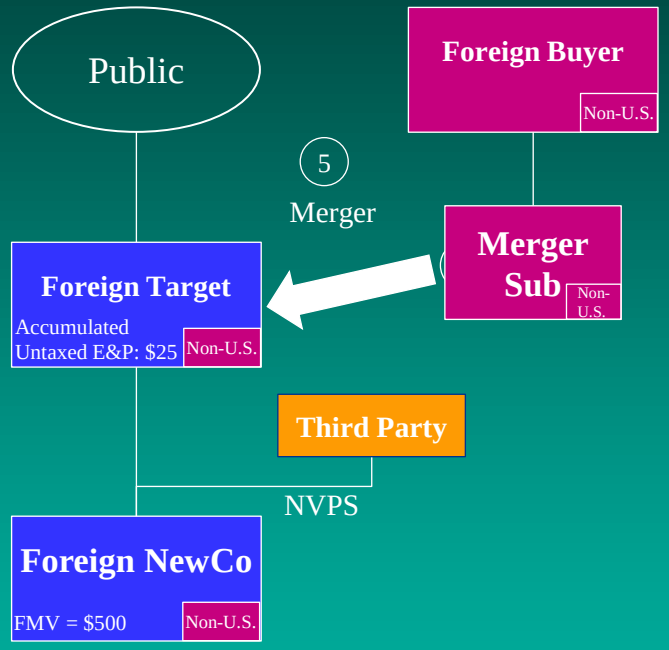



* Simplifying assumption is that basis is the same for taxable income and E&P purposes. All of Foreign Target's $25 of accumulated E&P is untaxed and attributable to U.S. Parent under Section 1248.

**Analysis**

- The contribution does not qualify as a section 351 exchange because the section 368(c) control requirement is not satisfied (assume no portion of Foreign Target's gain is subpart F income).
- Foreign Target recognizes $225 of gain with respect to the contribution ($475-$250)
  - Foreign Target's CFC status ends as a result of the distribution of its stock to the Public; Foreign Target does not regain CFC status as a result of the post-spin merger (see following slide)
  - Foreign Target's gain generates tested income for Foreign Target; U.S. Parent includes its pro rata share of this income as a GILTI inclusion (assume U.S. Parent does not have any other CFCs and Foreign Target does not have QBAI)
  - U.S. Parent increases its Foreign Target stock basis for its GILTI inclusion
- In lieu of the above steps, which results in full gain recognition for Foreign Target on the assets contributed to Foreign NewCo, Foreign Target could contribute its business assets for Foreign NewCo common stock and Foreign NewCo NQPS, in which case Foreign Target recognizes gain only to the extent of the NQPS. No sale to Third Party is required under this alternative and income recognition can be sized to approximate no more than the built-in-gain in the stock of the Foreign Target.

# Busted 351/RMT/10.5% Reduction in Gain Toll Charge: Foreign Buyer (no U.S. Subsidiaries) (Slide 3)




**Facts Post Spin-Off**

5. Pursuant to a binding commitment, immediately after the Distribution in Step 4, Foreign Merger Sub merges into Foreign Target, with the Public receiving Foreign Buyer stock for their Foreign Target Stock; the historic shareholders of Distributing will own less than 50% of Foreign Buyer stock and no such shareholder will own 5% or more of Foreign Buyer, which has no U.S. subsidiaries.

**Analysis**

- U.S. Parent recognizes gain on its distribution of Foreign Target stock to Public under sections 367(e)(1), 367(b), and 355(e), as applicable
- U.S. Parent's GILTI inclusion with respect to Foreign Target effectively reduces the U.S. tax on 364/365$^{th}$ of its Foreign Target stock gain from 21% to 10.5%, assuming the availability of the section 250 deduction and other considerations (i.e., only 1/365$^{th}$ of Foreign Target's income is accounted for after the cessation of its CFC status)
- Gain recognized by U.S. Parent on the distribution of Foreign Target stock is recharacterized as a dividend to the extent of the untaxed E&P of Foreign Target attributable to U.S. Parent's ownership of Foreign Target under section 1248. If certain requirements are satisfied, dividend income qualifies for the 100% DRD under section 245A. *See, e.g.*, Treas. Reg. § 1.245A-5(e)(2)(ii) (reducing USP's pre-reduction pro rata share with respect to FT's tested income for the amount otherwise taken into account by USP).
- No future GILTI inclusion for Foreign Buyer because it is not a United States shareholder with respect to Foreign Target or Foreign NewCo