



Federal Tax ADVISORY ■

OCTOBER 1, 2015

Qualification of Certain Section 355 Spinoff Transactions Added to No-Rule List

On September 14, 2015, the IRS released Notice 2015-59 and Rev. Proc. 2015-43, both relating to Section 355 spinoffs. They respond to government concerns about spinoff transactions that result in the distributing corporation or the controlled corporation owning a substantial amount of cash, portfolio stock, securities or other investment assets in relation to the value of all of its assets and its qualifying business assets. In the Notice, the IRS states that it has become aware, in part through private letter ruling requests, that these transactions may present evidence of device for distribution of earnings and profits, may lack an adequate business purpose or a qualifying business, or may violate other Section 355 requirements. In response to the government's concerns, Notice 2015-59 explains that the IRS and Treasury are studying issues under Sections 337(d) and 355 regarding certain distributions. In light of the IRS's intent to further study issues pertaining to Section 355, Rev. Proc. 2015-43 amends the no-rule Revenue Procedure, Rev. Proc. 2015-3, to include certain spinoff transactions.

Background

Section 355 allows corporations to distribute the stock of a controlled corporation to shareholders without incurring income, gain or loss on the distribution for tax purposes so long as certain requirements are met. Corporations taking advantage of this provision, which is not applicable if the transaction is primarily intended to distribute the company's or its controlled corporation's earnings and profits, must be actively conducting business immediately following the distribution. Additionally, the transaction must be carried out in order to satisfy a business purpose.

The IRS has indicated uneasiness with granting permission to companies seeking to do spinoffs with significant proportions of cash-like securities. In July 2015, the IRS announced that it was studying possible administrative guidance relating to certain issues under Section 355, including the active trade or business requirement.¹

¹ 2015-2016 Joint Treasury-IRS Priority Guidance Plan (2015).

Of note, the issuance of Notice 2015-59 and Rev. Proc. 2015-43 came less than a week after the IRS declined to rule on a planned spinoff by Yahoo! Inc. of its Alibaba Group Holding Ltd. stock and Yahoo Small Business unit.

Notice 2015-59

The Notice states that the IRS and Treasury are studying issues relating to transactions involving one or more of the following characteristics: (1) ownership by the distributing corporation or the controlled corporation of investment assets having substantial value in relation to the value of all of such corporation's assets and the value of the assets of the active trade or business on which the distributing corporation or the controlled corporation relies to satisfy the requirements of Section 355(b); (2) a significant difference between the distributing corporation's ratio of investment assets to assets other than investment assets and such ratio of the controlled corporation; (3) ownership by the distributing corporation or the controlled corporation of a small amount of qualifying business assets in relation to all of its assets; and (4) an election by the distributing corporation or the controlled corporation (but not both) to be a regulated investment company (RIC) or a real estate investment trust (REIT).

The Notice states that the IRS and Treasury are most concerned about transactions that result in the following: (1) the distributing corporation or the controlled corporation owning a substantial amount of cash, portfolio stock, securities or other investment assets in relation to the value of all of its assets and its qualifying business assets; and (2) one of the corporations having a significantly higher ratio of investment assets to non-investment assets than the other corporation. The Notice also states that there is concern about increasing numbers of REIT spinoffs.

The IRS and Treasury request comments concerning the transactions described in the Notice.

Rev. Proc. 2015-43

Rev. Proc. 2015-43 makes three additions to Rev. Proc. 2015-3, which serves as a list of areas in which the IRS will not issue letter rulings or determination letters. The areas listed in Rev. Proc. 2015-3 are commonly referred to as "no rules." Rev. Proc. 2015-43 will apply to all ruling requests that were postmarked or, if not mailed, received on or after September 14, 2015.

Two no-rules are added to Section 4 of Rev. Proc. 2015-3, which sets forth areas in which the IRS will not ordinarily issue rulings or determination letters barring any unique or compelling reasons to do so: (1) spinoffs enabling a C corporation to transfer its property tax-free to a REIT or RIC unless both the distributing corporation and the controlled corporation will both be RICs or will both be REITs immediately after the redistribution; and (2) spinoffs in which the value of the active trade or business in either the distributing corporation or controlling corporation is less than 5 percent of the total fair market value of the gross assets.

Interestingly, the 5 percent active trade or business requirement is not a novel development. Between 1996 and 2003 there was a requirement that the value of the active trade or business in either the distributing corporation or controlling corporation could not be less than 5 percent of the total fair market value of the gross assets.

One no-rule is added to Section 5 of Rev. Proc. 2015-3, which is reserved for matters under study by the IRS and Treasury. The IRS is prohibited from issuing rulings or determination letters on issues included in Section 5 until the IRS resolves the issue through publication of guidance. The no-rule added to Section 5 relates to the qualification of a distribution where all of the following conditions exist immediately after the distribution: (1) the fair market value of the investment assets of either the controlled corporation or the distributing corporation is two-thirds or more

of the value of its gross assets; (2) the fair market value of the active trade or business assets of either the controlled corporation or distributing corporation is less than 10 percent of the value of its investment assets; and (3) the ratio of the fair market value of the controlled corporation's investment assets to that of its other assets is three or more times greater than the ratio found in the distributing corporation or vice versa.

This no-rule added to Section 5 of Rev. Proc. 2015-3 seems very similar to the language of Section 355(g) of the Code. That section provides that "disqualified investment corporations" are not able to take advantage of the benefits of Section 355. This similarity raises the question of why Section 355(g) was not adequate to stop certain investment corporations from taking advantage of the benefits of Section 355 – why was this no-rule even necessary?

A more careful reading of both Section 355(g) and this particular no-rule shows that the no-rule uses a broader definition of "investment assets," expanding on the definition used in Section 355(g). Rev. Proc. 2015-43 provides that, for purposes of the no-rule, the definition of "investment assets" has the meaning given by Section 355(g)(2)(B), except as follows:

- (i) Publicly traded stock is an investment asset unless the distributing corporation or controlled corporation owns 50 percent (by vote and value) of such stock (increased from the 20 percent threshold in Section 355(g)(2)(B)(iv));
- (ii) Except as provided in clause (iv), an interest in a publicly traded partnership is treated in the same manner as publicly traded stock;
- (iii) Except as provided in clause (iv), an interest in a partnership that is not a publicly traded partnership is treated in the same manner as stock that is not publicly traded stock; and
- (iv) An interest in a partnership (other than a publicly traded partnership treated as a corporation pursuant to Section 7704(a)) is not an investment asset if the active trade or business of such partnership is taken into account by the distributing corporation or the controlled corporation, or would be so taken into account without regard to the five-year requirement of Section 355(b)(2)(B).

What to Expect

It is difficult to predict what these additional no-rules mean for certain Section 355 spinoffs in the future. At the September 19 ABA meeting, Robert Wellen, IRS associate chief counsel (corporate), stated that the content of the Notice "is by no means a description of future guidance.... It's a description of concerns that we hope will lead to future guidance or we think will lead to future guidance in some form. There's nothing in this Notice that would suggest a retroactive effective date to last Monday." However, at the DC Bar Taxation Section meeting on September 29, Wellen was less reassuring that the reasoning in the Notice doesn't reflect a definitive change in the IRS's interpretation of the law.

For additional information, call [Jack Cummings](#) at 919.862.2302 or [Stefanie Kavanagh](#) at 202.239.3914.

If you would like to receive future *Federal Tax Advisories* electronically, please forward your contact information to **FederalTax.Advisory@alston.com**. Be sure to put “**subscribe**” in the subject line.

Click [here](#) for Alston & Bird’s Tax Blog.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481
sam.kaywood@alston.com

Edward Tanenbaum
Co-Chair
212.210.9425
edward.tanenbaum@alston.com

George Abney
404.881.7980
george.abney@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Matthew Moseley
202.239.3828
matthew.moseley@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Stefanie E. Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Danny Reach
704.444.1272
danny.reach@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2015

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333