



Federal Tax ADVISORY ■

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General Utilities Repeal and Spins

Notice 2015-59, 2015-40 IRB 459, issued last September, suggests that the IRS has concerns about several aspects of Section 355 tax-deferred spinoffs. One of these is the relevance of the 1986 repeal of the *General Utilities* doctrine and how the government should apply Section 355 in light of that repeal.

The issue is an odd one. Although the Treasury has authority to write regulations to implement *General Utilities* repeal in the nonrecognition rules of Subchapter C, it has not attempted to do so in 30 years. Moreover, Rev. Rul. 2003-110, 2003-2 CB 1083, addressed part of the issue and concluded that if all other Section 355 requirements were satisfied in determining whether a distribution of the stock of a controlled corporation satisfies the business purpose requirement of § 1.355-2(b), that the distribution be motivated, in whole or substantial part, by one or more corporate business purposes, the fact that § 355 permits a distributing corporation to distribute the stock of a controlled corporation without recognition of gain does not present a potential for the avoidance of federal taxes for purposes of § 1.355-2(b).

Section 1.355-2(b)(1) provides that § 355 applies to a transaction only if it is carried out for one or more corporate business purposes. A transaction is carried out for a corporate business purpose if it is motivated, in whole or substantial part, by one or more corporate business purposes. The potential for federal tax avoidance by the distributing or controlled corporations (or a corporation controlled by either) can be relevant in determining the extent to which an existing corporate business purpose motivated the distribution. The sole example of such avoidance identified in the regulation is making an S election.

Some people read Rev. Rul. 2003-110 to imply that avoidance of the corporate-level gain on the spinoff also cannot be evidence of using the spinoff as a prohibited device for the distribution of earnings and profits, to be taxed as a capital gain. But the ruling does not deal with the device issue.

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However, it makes sense that a purpose to avoid Section 311 gain recognition should not be evidence of device. The regulations make clear that a device is using the spinoff to avoid the dividend provisions of the code, at the shareholder level. That cannot include avoiding Section 311 gain. The meaning of a dividend is for the shareholder to get cash out that is taxed as ordinary income and still own stock. That is why a post-spin sale can be evidence of device, when the shareholder reports a capital gain and still owns stock of one of the two corporations.

A second reason why there should be no *General Utilities* repeal question as to device is that the one part of the regulation that evaluates tax avoidance in terms of corporate level tax, cited above, does not apply to Section 311 gain, according to Rev. Rul. 2003-110.

It is odd that the IRS stirred up this concern in Notice 2015-59. Hopefully, a further guidance will defuse the concern.

For additional information, call [Jack Cummings](#) at 919.862.2302.

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