



Federal Tax ADVISORY ■

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Predecessor and Successor Regulations

In December, the Treasury published temporary and proposed regulations clarifying the application of Section 355(e) when the distributing (D) corporation or the controlled (C) corporation has a predecessor (P) or successor (S). Section 355(e)(4)(D) states that references to D and C shall include a reference to P and S of such corporations. It purports to be effective without regulations. But practitioners have raised many questions about the meaning of this rule.

The temporary regulation answers the questions about Ps this way:

- Any corporation other than D and C is a “potential predecessor.”
- Except for a special affiliated group rule, a potential predecessor can only be a predecessor of D.
- A potential predecessor becomes a P of D if some but less than all of its property winds up in C in a way that both gives C a transferred basis in the property and gives D an exchanged basis in the C stock.
- After identifying a P, ask whether there has been a “planned 50-percent acquisition” of D or P.
- If yes as to P, the gain that must be recognized under Section 355(e) is limited to the gain with respect to P’s property that was spun off in C (or that was C). In this case P and D need not have engaged in a merger or other Section 381 event. Example: the controlling shareholder of D acquires all of the stock of P and causes P to transfer some property to D, some or all of which is put into C in a Section 351 exchange (or is C).
- If yes as to D but not P, then the gain that must be recognized under Section 355(e) is limited to the gain with respect to D’s property that was spun off in C. In this case P and D must have engaged in a merger or other Section 381 event. Example: P merged into D and control of P did not change, but control of D did change.

Of course you still have to find the planned 50-percent acquisition. If it was a change of ownership of P and

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not D, that change must be found to be part of a plan with the spin. On the other hand, if there was a change of ownership of D and not P, then the regulation imposes an added requirement: that planned change of control plus spin must occur “as the result of a transfer by a P of D to D in a Section 381 transaction.”

The identification of successors is much easier: a Section 381 transferee of D or C.

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

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