Corporate Tax
Current Developments

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Agenda

- Withdrawal of Proposed No Net Value Regulations
- Rev. Proc. 2017-45
- Developments Regarding Final Section 385 Regulations
- Recent Private Letter Rulings

Withdrawal of Proposed No Net Value Regulations

Background

- On March 10, 2005, the IRS issued proposed regulations imposing a requirement that there be an exchange of net value in order to qualify as a reorganization (other than a reorganization described in sections 368(a)(1)(E) or (F)). REG-163314-03
- In general, these regulations would have required that:
  - In an asset reorganization, (i) the target corporation surrender assets with a positive net value and (ii) the acquiring corporation receive assets with a positive net value; and
  - In a stock reorganization, (i) the target corporation have assets with a fair market value in excess of the sum of (a) its liabilities and (b) the consideration received by target shareholders in the exchange and (ii) the acquiring corporation have assets in excess of liabilities immediately after the exchange.
- On July 13, 2017, the proposed regulations were withdrawn. REG-139633-08.

Rev. Proc. 2017-45

Background

- Rev. Proc. 2017-45, issued August 11, 2017, provides a safe harbor whereby certain RICs and REITs can ensure that a distribution of both cash and stock will be treated as a dividend under section 305(b) for purposes of the minimum distribution rules applicable to RICs and REITs where the shareholders can elect to choose stock or cash.

Background: Section 305

- Section 305(b)(1) provides that a distribution by a corporation is subject to section 301 if the distribution is, at the election of any of the shareholders, payable either in stock or property.
- Section 305(b)(2) provides that a distribution by a corporation is subject to section 301 if the distribution has the result of the receipt of property by some shareholders and an increase in the proportionate interests of other shareholders.
- Treas. Reg. section 1.305-2(a) provides that, if any shareholder can elect to receive stock or property in a distribution, then, with respect to all shareholders, the distribution of stock is subject to section 301 regardless of:
  - Whether the distribution is actually made in whole or in part in stock;
  - Whether the election is exercised or exercisable before or after the declaration of the distribution;
  - Whether the distribution is made in one medium unless the shareholder specifically requests payment in the other;
  - The manner in which the election is provided (e.g., corporate charter or declaration); or
  - Whether all or part of the shareholders have the election.

Background: Minimum Distribution Requirements

- Section 852(a) generally provides that in order to qualify as a RIC, the organization must pay dividends every year that equal or exceed a calculated minimum amount.

- Section 857(a) generally provides a similar rule for REITs.

Limitation to Public RICs and REITs

- The safe harbor provided in Rev. Proc. 2017-45 is only available to publicly offered RICs and REITs.
- What is the rationale for limiting this safe harbor to those categories of RICs and REITs?
- Are the policy considerations under section 305 different in the context of closely held RICs and REITs?

Scope of Ruling

- The safe harbor applies to a distribution if:
  - Pursuant to the declaration of the distribution, each shareholder has an election to receive cash or stock with respect to all or a portion of the distribution;
  - The maximum aggregate cash to be distributed to all shareholders is at least 20% of the total distribution;
  - Shareholders that elect to receive an amount of cash less than their proportionate share of all of the cash offered receive the amount of cash they elect to receive;
  - If the cash is not oversubscribed, each shareholder receives the amount of cash they elect to receive;
  - If the cash is oversubscribed, shareholders that elect to receive an amount of cash greater than their proportionate share of all of the cash offered receive a proportionate amount of the cash offered; and
  - The number of shares received is based on a formula that meets certain criteria (described below).

Valuation Formula

- The number of shares received must be calculated based on a formula that:
  - Is based on market prices;
  - Is designed so that the value of the shares offered corresponds to the amount of cash offered; and
  - Uses data from a period of no more than two weeks ending as close as practicable to the payment date.

- What is the policy behind use of the two-week period for the valuation formula? Is this policy consistent with the signing date rule under Treas. Reg. section 1.368-1(e)(2)?

Signing Date Rule Revisited

Reason for Signing Date Rule

- Prior to the Signing Date Rule, T stock surrendered for P stock and P stock received by T shareholders was valued on the closing date for continuity of interest ("COI") purposes.

- If P stock was publicly traded and declined in value between the signing date and the closing date, there was no guarantee that COI was satisfied (absent protective closing date adjustments).

Signing Date Rule History

- Final regulations relating to the Signing Date Rule were initially published on September 16, 2005 (the "Old Regulations").
- Temporary and proposed regulations modifying the Signing Date Rule were published on March 20, 2007 (the "Temporary Regulations").
- Notice 2010-25 allowing taxpayers to rely on the Temporary Regulations if certain requirements are satisfied.
- Final regulations relating to the Signing Date Rule were published on December 19, 2011 (the "Final Regulations").

The Proposed Regulations

- Proposed Regulations provide for "special rules" to determine, under certain circumstances, the appropriate value of P stock when the Signing Date Rule does not apply.

- These special rules include, among other rules, rules when T shareholder consideration is determined based upon a multi-day average price of P stock ("Average Price Rule").

Average Price Rule

- Prop. Treas. Reg. section 1.368-1(e)(2)(vi)(C) provides that for purposes of determining whether COI is preserved, an average of prices *may* be used in lieu of the Closing Date price if—
  - The average price is based upon prices of P stock occurring after the Signing Date and before the Closing Date, and
  - The binding contract utilizes the average price, so computed, in determining the number of shares of each class of P stock and the boot to be exchanged for all the T stock, or to be exchanged for each share of T stock.
- Is the Average Price Rule elective?
  - Average Price Rule uses "may" while collar-related rules provide that such rule "applies if…."
- Should the Closing Date and dates on or before the Signing Date be included in the definition?

Expansion of Signing Date Rule?

- Time for valuation is relevant to more than COI determinations.
  - Section 368(a)(2)(E)
  - Section 368(a)(1)(C)/(a)(2)(B)
  - Section 382
  - Section 355(g)
  - Treas. Reg. section 1.367(a)-3(c)(3)(iii) (substantiality test)
- Are statutory changes necessary to expand Signing Date principles in some cases?

Section 368(a)(2)(E) Example

- Facts
  - P and T sign a binding contract on January 3, Year 1, in which a subsidiary of P (Merger Sub) will merge with and into T with T surviving.
  - In the merger, each T shareholder will receive 8 shares of P stock and $2 of cash for each T share outstanding.
  - On January 2, Year 1, each P share is worth $1.
  - On the Closing Date, each P share is worth $0.80.
- Conclusion: The transaction would not satisfy the section 368(a)(2)(E) requirement that P acquire stock in T representing section 368(c) control in exchange for P voting stock.
  - The control requirement would have been satisfied if the P stock were permitted to be valued on the Pre-Signing Date.
  - Note that COI would be satisfied regardless of the magnitude of the drop in the value of P stock under the Signing Date Rule.

Developments Regarding Final Section 385 Regulations

Background: Section 385

- Section 385(a) provides Treasury with the authority to issue regulations as may be necessary or appropriate to:
  - Determine whether an instrument is debt or equity for U.S. tax purposes, and
  - Bifurcate an instrument as part debt and part equity.
- Section 385(b) includes the following non-exhaustive list of factors that may be taken into account in determining whether an instrument is debt or equity for U.S. tax purposes:
  - Whether the instrument includes a written unconditional promise to pay a sum certain and fixed interest rate;
  - Whether the instrument is subordinated to, or given preference over, other indebtedness;
  - The issuer's debt-to-equity ratio;
  - Whether the instrument is convertible into the issuer's stock;
  - The relationship between holding stock of the issuer and holding the instrument.
- Section 385(c) states that the issuer's characterization of an instrument at the time of issuance is binding on the holder, but not the Service, unless the holder discloses the inconsistent treatment, and provides Treasury with authority to require information necessary to carry out the provisions of the subsection.

Background: Section 385

- Before 2016, the only regulations previously issued under section 385 were widely criticized and withdrawn in 1983.
- Debt/equity determinations under case law look to a dozen+ factors and generally are "all or nothing," not part debt/part equity bifurcation.
- Debt-equity factors can be divided into four categories: (1) economic terms of the debt, (2) legal terms of the debt, (3) intent and conduct of the parties, and (4) the creditworthiness of the borrower.

Economic Terms	Legal Terms
• Right to receive a sum certain • Principal payable on demand or on a fixed maturity date, not unreasonably far into the future • Interest at a fixed or a floating rate, payable without regard to profits of the issuer	• Creditor's rights upon default • Debt in form • Degree of subordination (if any) • Participation in management (or lack thereof)
Intent and Conduct of the Parties	**Creditworthiness of the Borrower**
• Intention to create a bona fide debt • Paying interest and principal when due	• Cash-flow analysis • Ratio of debt to equity or to projected earnings (thin capitalization)

Debt or Equity: Why it Matters

- Interest expense is generally deductible, dividends are not.
- Debt principal can be repaid without tax consequences, dividends generally are taxable income.
- Different withholding tax consequences for interest, principal and dividends.
- Different foreign tax credit consequences because dividends attract FTCs in underlying earnings.
- Debt recharacterized as equity may have implications under other rules including:
  - Control requirements in section 368 reorg;
  - Consolidation;
  - FIRPTA;
  - Section 382.

Proposed Regulations under Section 385

- Proposed section 385 regulations (REG-108060-15) issued in April 2016 ("Proposed Regulations") included rules:
  - Providing the Service with the ability to bifurcate an instrument as part debt and part stock;
  - Setting forth documentation and maintenance requirements that must be satisfied for a related-party instrument to be characterized as debt for U.S. tax purposes;
  - Subject to certain exceptions, re-characterizing related-party debt instruments as stock for all U.S. tax purposes when issued: (i) as a distribution, (ii) in exchange for related-party stock (*e.g.*, section 304 sale), (iii) as consideration in an internal asset reorganization (*e.g.*, a boot D reorganization), or (iv) to fund a distribution, acquisition of related-party stock, or boot in an internal asset reorganization;
  - Providing treatment for when related-party debt comes into or leaves a U.S. consolidated group.

Proposed Regulations under Section 385

- Proposed Regulations would have applied without regard to whether (i) the parties are domestic or foreign, (ii) the parties are S corporations, partnerships, disregarded entities, RICs, REITs or other regulated entities, or (iii) the corporate group effected an inversion.
- Members of a U.S. consolidated group treated as a single entity, so the Proposed Regulations would not apply to debt between consolidated group members.
- The proposed section 385 regulations caused considerable concern among taxpayers and practitioners and were criticized as overbroad by many in the business community and on Capitol Hill.
    - Treasury received 29,600 comments in response to the proposed regulations, 145 of which were unique and commented on substantive aspects of the proposed rules.
    - At a public hearing, 16 speakers testified on the proposed regulations.

Final Regulations: Significant Changes

- Final and temporary section 385 regulations ("Final Regulations") released in October 2016 largely retain the basic structure of Proposed Regulations, but with significantly reduced scope.
- Generally limited ONLY to domestic corporations (reserved on foreign entities).
- No application to S corps and non-controlled RICs and REITs.
- Limited downward attribution.
- Reserved on bifurcation rule.
- Reserved on affirmative use rules.
- Documentation rules (-2):
  - Apply to intercompany obligations issued on or after January 1, 2018;
  - Extension of time for documentation until due date (with extensions) of federal tax return for taxable year including the "relevant date" (usually issue date);
  - Application to controlled partnerships;
  - More detailed rules around cash pooling, intercompany payables, etc.
- Transactional rules (-3):
  - E&P exception;
  - Short-term debt exception;
  - $50M threshold;
  - Netting of distributions/contributions;
  - Application to controlled partnerships;
  - Reduced application to certain regulated entities.

Executive Order 13789

- On April 21, 2017, President Trump issued Executive Order 13789 instructing Secretary of Treasury to review all significant tax regulations issued on or after January 1, 2016 with purpose of identifying and reducing tax regulatory burdens.
- Within 60 days, delivery of interim report identifying all such regulations that:
  - (i) impose undue financial burden on US taxpayers;
  - (ii) add undue complexity to federal tax laws; or
  - (iii) exceed statutory authority of Service.
- Within 150 days, delivery of report recommending specific actions to mitigate burden imposed by regulations identified in interim report.
  - Effective date of such regulations to be delayed or suspended, to extent permitted by law, and modified or rescinded, as appropriate and consistent with law, including, if necessary, through notice and comment rulemaking.
  - Summary of each action taken in response to report no later than 10 days following finalization of such action.
  - Summary of all actions taken within 180 days after submission of report.

Notice 2017-38

- From January 1, 2016 through April 21, 2107, 105 temporary, proposed and final regulations were issued.
- 52 were treated as potentially significant and reexamined for purposes of preparing 60-day interim report.
- To assess undue financial burden, Treasury considered degree to which regulations imposed compliance costs or resulted in tax liabilities exceeding minimum required to achieve relevant statutory objectives.
- To assess undue complexity, Treasury considered extent to which regulations imposed new substantive, computational or other requirements not required to achieve relevant statutory objectives, or introduced rules that added uncertainty for taxpayers.
- Identified 8 regulations meeting at least one of the first two criteria of EO 13789 (undue financial burden or undue complexity), including section 385 regulations.
- No regulations identified as exceeding statutory authority of Service.

Notice 2017-38

- Notice noted that commentators (i) criticized financial burdens of compliance with documentation rules, particularly with respect to ordinary course transactions, (ii) requested longer delay in effective date of documentation rules, (iii) criticized complexity associated with tracking multiple transactions through group of companies, and (iv) criticized increased tax burden on inbound investments.
- Requested comments on whether regulations should be rescinded or modified to reduce burdens and complexity and, if so, how?

Responses to EO 13789 and Notice 2017-38

- ABA (primary author Bill Alexander), NYSBA, SIFMA, AICPA, US Chamber of Commerce, KPMG, Deloitte, PwC, TEI and others submitted comments in response to EO 13789 and/or Notice 2017-38.
- Recommendations to withdraw section 385 regulations entirely, suspend them indefinitely (with prospective effective date after amendments), delay effective date and narrow application of documentation rules, change approach on transactional rules to focus on debt/equity characteristics, clarify reserved rules (e.g., bifurcation, foreign issuers), and generally give further consideration to prior comments on proposed and final regulations.
- Focus on compliance burdens of documentation rules and complexity of and systems/monitoring required by transactional rules, particularly in order to utilize exceptions (e.g., expanded group earnings exception and qualified short-term debt exception).

ABA Comments on Notice 2017-38

- Requested that final regulations be reconsidered.
- Documentation Rules:
  - Noted that, for domestic parented expanded groups, documentation rules primarily apply to obligations of domestic corporations to their CFCs and controlled partnerships, where recharacterization of debt as stock would be least intuitive and least appropriate as matter of tax policy, creating hook stock.
  - Reiterated recommendation that failure of documentation rules not result in automatic equity recharacterization, and that recharacterization not be into hook stock.
  - Reiterated recommendation of relief for ordinary course transactions.
  - Noted that any domestic group member that purchases on credit from group's CFC will be subject to at least annual credit review under final regulations, which will cover all of its obligations, not just those to group's CFCs and controlled partnerships.
  - Transactional documents generally will be prepared by CFCs and controlled partnerships, making it difficult to achieve high level of compliance necessary for relief from automatic recharactization under highly compliant exception.
  - Noted that market standard safe harbor is uncertain where businesses have only related customers, such as CFC that manufactures or purchases only for related parties.
  - State income tax conformity issues.

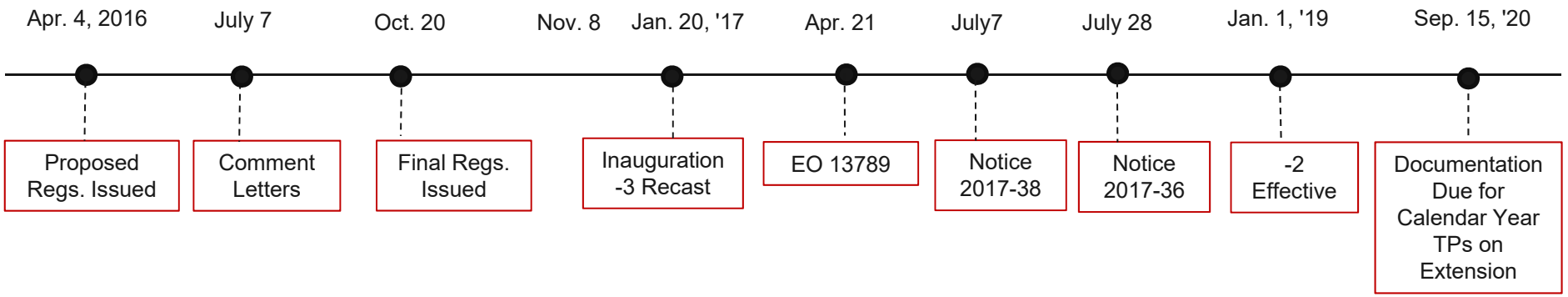
ABA Comments on Notice 2017-38

- Transactional Rules:
  - Acknowledged that section 385 can provide Treasury with a powerful tool that can be legitimately used against earnings stripping through excessive related party debt.
  - But premise of Transactional Rules, that debt can be identified by the context in which it is created and used, raises serious concerns as to whether Transactional Rules are valid exercise of Treasury's authority under section 385.
  - Urged reconsideration of this approach in favor of one based on normative reasons why related party debt might not qualify as debt.
  - Reiterated that the Transactional Rules remain intricate, despite the final regulations' significantly narrower practical application.
  - Some relief provided in final regulations is specific to expanded group parent, putting a premium on US tax planning in transactions that are not really about domestic businesses, such as acquisition of one foreign company by another, or formation of holding company for foreign parented group.

Notice 2017-36

- Delays application of documentation rules by 12 months; regulations to be amended to apply to interests issued or deemed issued on or after January 1, 2019.
- Responsive to concerns that taxpayers continued to raise with timing of application of documentation rules, and in light of further actions concerning the regulations in connection with review pursuant to EO 13789 and Notice 2017-38.
- Requests comments as to whether proposed amendment and delayed application of documentation rules affords adequate time for taxpayers to develop necessary systems or processes to comply.
- Buying time to make additional changes to the regulations?

Section 385 Timeline



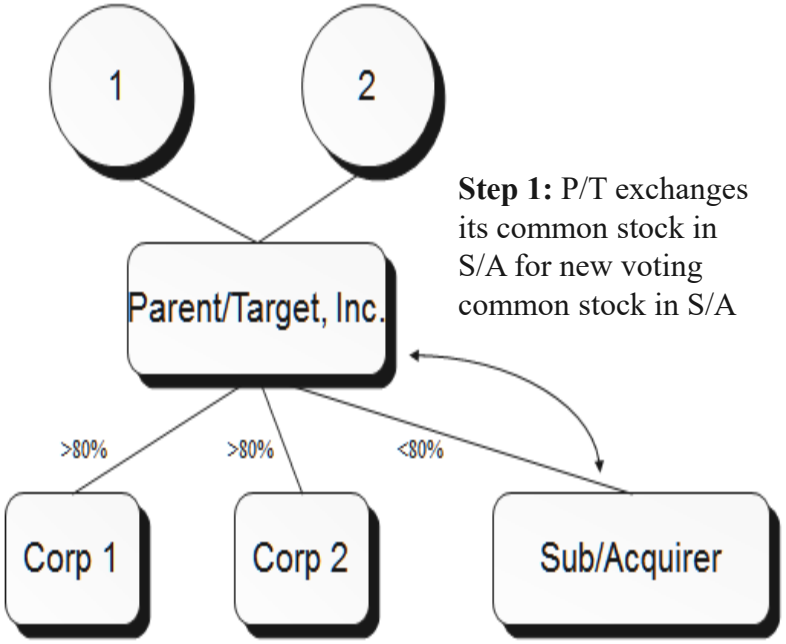
Recent Private Letter Rulings

PLR 201721014

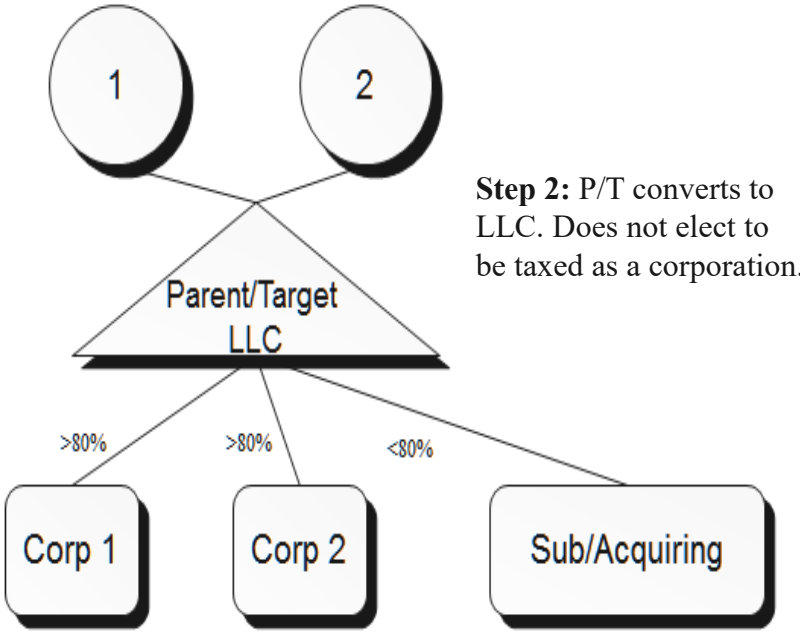
PLR 201721014: Facts

- Released May 26, 2017.
- U.S. corporation ("Parent/Target") is owned by two individuals, who are married (presumably to each other).
  - Parent/Target owns >80% of two corporate subsidiaries ("Corp 1" and "Corp 2"), which are members of Parent/Target's US consolidated group.
  - Parent/Target owns <80% of third corporate subsidiary ("Sub/Acquirer").
  - Parent/Target will exchange all of its currently held common stock in Sub/Acquirer for new voting common stock in Sub/Acquirer.
  - Sub/Acquirer will not assume any liabilities of Parent/Target, nor take any Parent/Target assets subject to liabilities. One shareholder may contribute cash to Parent/Target capital to enable it to pay off liabilities.
  - Parent/Target will convert to LLC and no election will be made to treat LLC as corporation.
  - Shareholders may transfer some of their Sub/Acquirer stock to tax exempt orgs, but there is no present plan to do so.

PLR 201721014: Facts



Step 1: P/T exchanges its common stock in S/A for new voting common stock in S/A



Step 2: P/T converts to LLC. Does not elect to be taxed as a corporation.

PLR 201721014: Significant Rulings

- Provided steps 1 and 2 qualify as a reorganization under section 368(a)(1), distribution of Corp 1 and Corp 2 stock ("Boot") will constitute a distribution of property with respect to stock of Parent/Target to which section 301 applies, citing to section 356(a) and Treas. Reg. section 1.356-1(a).
  - Boot within gain rule.
  - Presumably FMV of boot here is less than total gain.
  - Was there sufficient E&P such that all boot is a dividend?
- Excess, if any, of amount of Boot distributed with respect to share of Parent/Target stock over amount of such distribution treated as a dividend *will be applied against and reduce adjusted basis in share, and any remaining excess* will be treated as gain from sale or exchange of property, citing to sections 301(c)(2) and (c)(3).
- Provided steps 1 and 2 qualify as a reorganization, gain will be recognized to Parent/Target as if it sold the Boot to its shareholders at FMV, citing to section 361(c)(2).
- No reorg ruling, citing to §6.11 of Rev. Proc. 2017-1 (no "comfort" rulings).
  - *See*, *Estate of Gilmore,* 130 F.2d 791 (3d Cir. 1942); Rev. Rul. 78-47.
  - C reorg if Sub/Acquirer stock is substantially all Parent/Target's assets.
  - D reorg if control test is met.

PLR 201731008

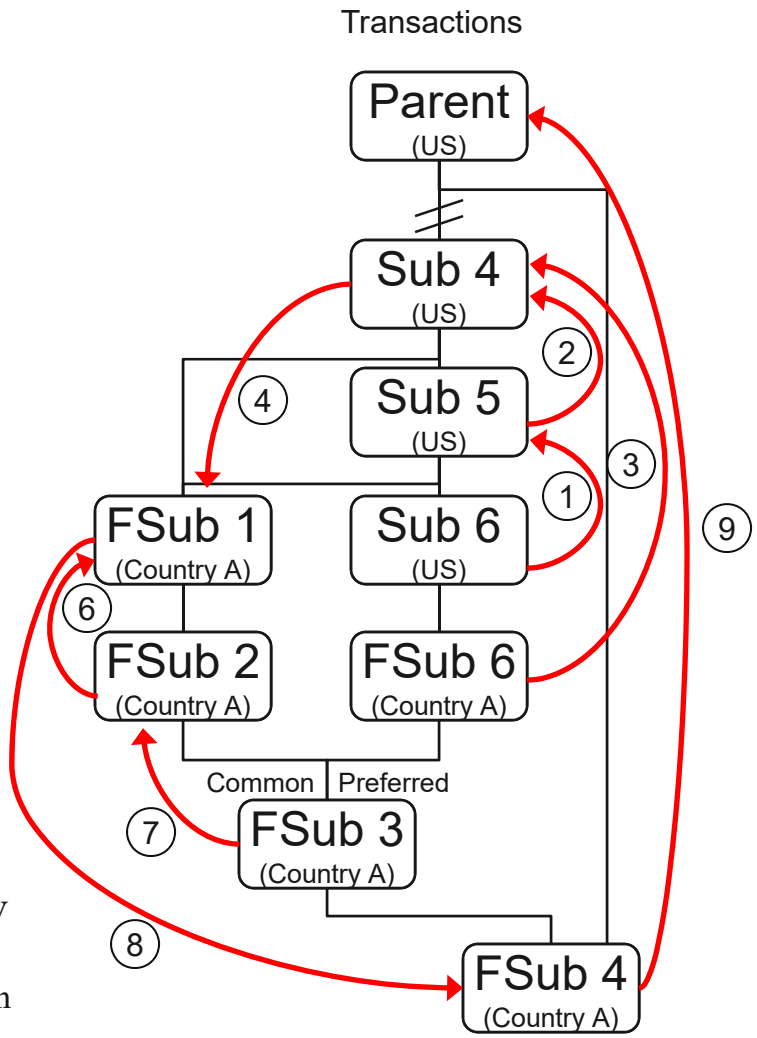
PLR 201731008 – Foreign Restructuring

Steps

1. Sub 6 liquidates in a transaction intended to qualify under sections 332 and 337.
2. At least one day after step 1, Sub 5 liquidates in a transaction intended to qualify under sections 332 and 337.
3. At least two days after step 2, FSub 6 liquidates in a transaction intended to qualify under section 368(a)(1)(C).
4. Sub 4 contributes the FSub 3 preferred stock to FSub 1.
5. At least two days after step 4, Parent gives approval for the remaining steps.
6. On the same day as step 5, FSub 2 liquidates in a transaction intended to qualify under sections 332 and 337.
7. On the same day as step 5, FSub 3 liquidates in a transaction intended to qualify under sections 332 and 337.
8. At least one day after step 7, FSub 1 transfers business assets received in step 6 to FSub 4 subject to certain liabilities.
9. FSub 4 redeems its shares held by Parent.

Representations

1. FSub 3 preferred stock is less than 30% of the gross FMV of the combines assets of (a) Sub 5, Sub 6, and FSub 6 and (b) Sub 6 and FSub 6.
2. The assets transferred in step 8 are less than 30% of the gross FMV of the assets of FSub 2.
3. Before the date of step 7, the legal requirements for adopting a plan of liquidation of FSub 3 will not be satisfied and neither the shareholders nor directors of FSub 3 will adopt a resolution authorizing FSub 3 to liquidate.

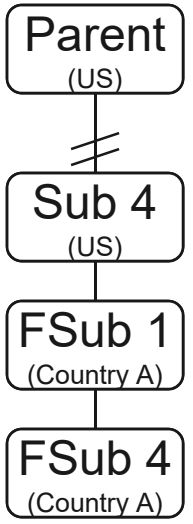


PLR 201731008 – Foreign Restructuring (cont'd)

Rulings

1. FSub 3 will not be treated as having adopted a formal plan of liquidation within the meaning of § 301.7701-3(g)(2)(ii) before it is deemed to become a wholly owned subsidiary of FSub 1 following the FSub 2 liquidation. *See Va. Ice & Freezing Corp. v. Comm'r*, 30. T.C. 1251, 1256-57 (1958); *George L. Riggs*, *Inc. v. Comm'r*, 64 T.C. 474, 487 (1975).
2. The successive liquidations of FSub 2 and FSub 3 in steps 6 and 7, respectively, will not preclude either of the FSub 2 liquidation or the FSub 3 liquidation from qualifying under §§ 332 and 337.
3. The successive liquidations of Sub 6 and Sub 5 in steps 1 and 2, respectively, will not preclude either of the Sub 6 liquidation or the Sub 5 liquidation from qualifying under §§ 332 and 337.
4. The fact that the FSub 6 reorganization and the contribution in step 4 are made in contemplation of the FSub 3 liquidation will not preclude the contribution from qualifying under § 351(a). No gain realized by FSub 1 on the FSub 3 liquidation will be reallocated.
5. The contribution in step 4, together with certain ongoing asset sales by Sub 6 to Sub 1 (a US subsidiary of Parent) and FSub 4, will not preclude either of the Sub 6 liquidation or the Sub 5 liquidation from qualifying under §§ 332 and 337.
6. The transfer of business assets in step 8 will not preclude the FSub 2 liquidation from qualifying under §§ 332 and 337.
7. The Sub 6 liquidation and the Sub 5 liquidation will not preclude the assets of FSub 6 from being treated as acquired solely for voting stock of Sub 4 (within the meaning of § 368(a)(1)(C)) in the FSub 6 reorganization. § 1.368-2(d)(4)(i).
8. The FSub 3 liquidation will not preclude Sub 4 from being treated as acquiring substantially all of the properties (within the meaning of § 368(a)(1)(C)) of FSub 6 in the FSub 6 reorganization. *See George v. Comm'r*, 26 T.C. 396 (1956), acq. 1956-2 C.B. 5.

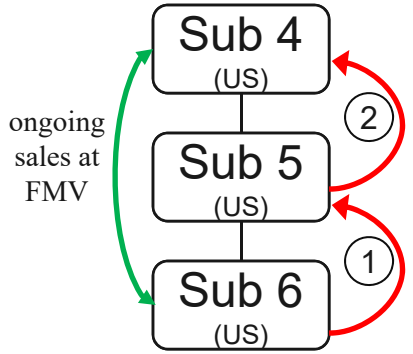
Resulting Structure



PLR 201731008 – Ordering Respected

Relevant Authorities

- Treas. Reg. section 301.7701-3(g)(1)(iii) provides that when an eligible entity classified as an association elects to be disregarded, the association is deemed to distribute "all of its assets and liabilities to its single owner in liquidation of the association."
- Treas. Reg. section 301.7701-3(g)(2)(i) provides that the federal income tax consequences of such an election "is determined under all relevant provisions of the [Code] and general principles of tax law, including the step transaction doctrine."
- Treas. Reg. section 301.7701-3(g)(2)(ii) provides that for purposes of satisfying the formal plan of liquidation requirement under section 332, unless a formal plan is adopted on an earlier date, the making of the election is deemed to be such an adoption and is deemed to occur immediately before the deemed liquidation.
- Treas. Reg. section 301.7701-3(g)(3)(i) provides that deemed distribution occurs immediately before the close of the day before the election is effective.
- Old caselaw suggests that section 332 may not be applicable where both the parent and subsidiary liquidate simultaneously. *See Fairfield Steamship Corp. v. Comm'r*, 157 F.2d 321 (2d Cir. 1946); *Manilow v. U.S.*, 315 F.Supp. 28 (N.D. Ill. 1970); *Kamis Engineering Co. v. Comm'r*, 60 T.C. 763 (1973).



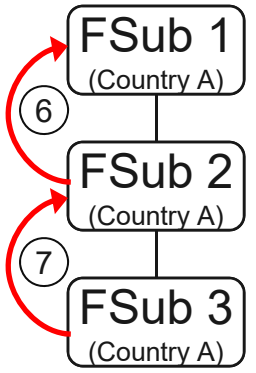
Questions

- Are *Fairfield*, *Manilow*, and *Kamis* still good law? Are they inconsistent with current law? Are Rulings 1 and 3 comfort rulings?
- Based upon these rulings, is it the Service's position that it will respect the date and time of a board of directors' formal adoption of a plan of liquidation as the date upon which the first liquidating distribution will be treated as occurring? Or is this unique to the facts of this taxpayer (taking into account that several of the steps are mandated by regulators)?

PLR 201731008 – Ordering Respected (Cont'd)

Relevant Authority

- Treas. Reg. section 301.7701-3(g)(3)(iii) provides that when elections are made for a series of tiered entities on the same day, taxpayer may specify order on Form 8832. If no order specified, default rule provides for top-down approach.



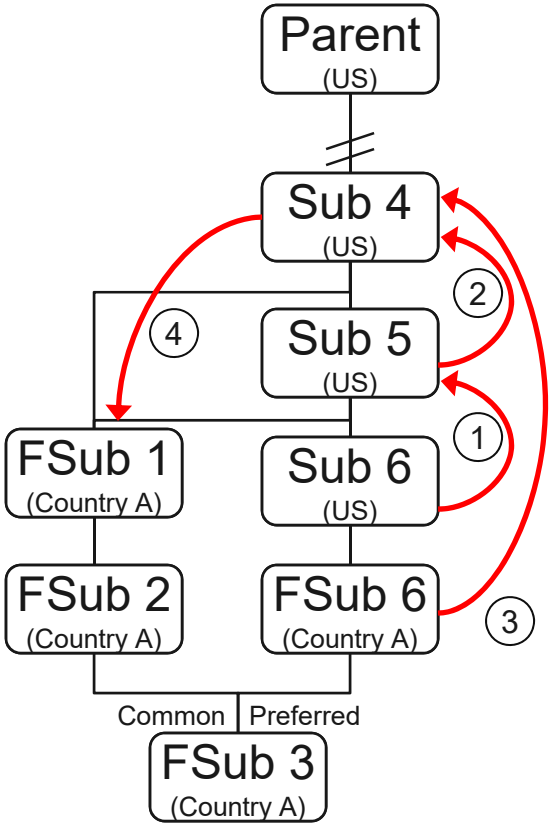
Questions

- The facts of the PLR do not indicate whether the taxpayer would indicate on its Form 8832 the order of the FSub2 liquidation and the FSub3 liquidation—whether top down or bottom up. Does it matter?
- The facts also do not indicate whether Parent's senior management/board of directors, when meeting to give "final approval" for, among other steps, the FSub2 liquidation and the FSub3 liquidation, indicated that they adopted a plan of liquidation for a particular time for each liquidation such that one would occur before the other. Did they provide such instructions? Does it matter?

PLR 201731008 – Liquidation/Reincorporation

Relevant Authority

- Treas. Reg. section 1.332-2(d) provides that "[i]f a transaction constitutes a distribution in complete liquidation within the meaning of the [Code] and satisfies the requirements of section 332, it is not material that it is otherwise described under local law."
- Treas. Reg. section 1.368-2(d)(4)(i) (anti-*Bausch & Lomb* regulation allowing for upstream C reorganizations).
- Treas. Reg. section 1.368-2(k) provides that "[a] transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided [certain requirements are satisfied]."
- *Telephone Answering Serv. Co.*, 63 T.C. 423 (1974), *aff'd*, 546 F2d 423 (4th Cir. 1976), *cert. denied*, 431 U.S. 914 (1977) (anti-liquidation-reincorporation decision where 15% of assets reincorporated).



Representations

1. The FSub 3 Preferred Stock constitutes less than 30% of the gross fair market value of the combined assets of Sub 5, Sub 6, and FSub 6.
2. The FSub 3 Preferred Stock constitutes less than 30% of the gross fair market value of the combined assets of Sub 6 and FSub 6.

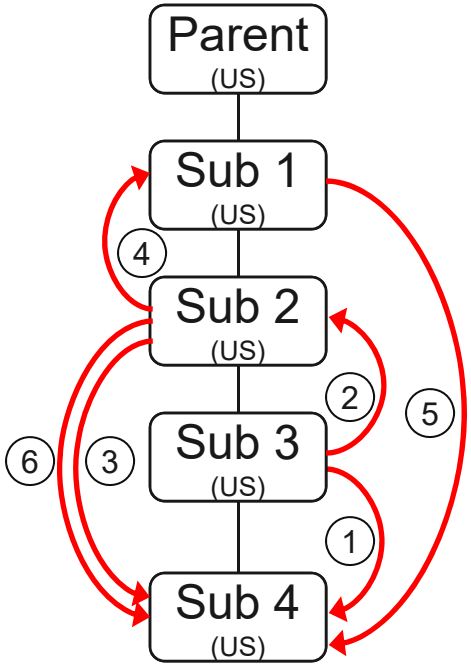
Questions

- Is the Service's view that when the requirements of both section 332 and section 368 are satisfied that section 332 supercedes section 368? Is that consistent with Treas. Reg. section 1.332-2(d)?
- Has the Service considered issuing a revenue procedure or regulation providing for a 30% gross fair market value safe harbor on "reincorporation"?

PLR 201731008 – U.S. Restructuring

Steps

1. Sub 3 transfers all of its assets to Sub 4, including its existing Sub 4 stock, in exchange for a new class of Sub 4 stock ("Class A Sub 4 stock").
2. Sub 3 distributes the Class A Sub 4 stock to Sub 2 and dissolves (together with step 1, intended to qualify under section 368(a)(1)(C) and/or (D)).
3. Except for an amount being retained to satisfy certain redacted legal requirements, Sub 2 transfers all of its assets to Sub 4, including the Class A Sub 4 stock, in exchange for a new class of Sub 4 stock ("Class B Sub 4 stock").
4. Sub 2 distributes the Class B Sub 4 stock to Sub 1 (together with step 3, intended to qualify under section 368(a)(1)(D)).
5. At least one day after step 4, Sub 1 contributes its Sub 2 stock to Sub 4.
6. At least one day after step 5, Sub 2 distributes all of its assets to Sub 4 and dissolves.



Representations

1. Sub 4 stock will constitute at least 90% of the net FMV and at least 70% of the gross FMV of the assets held by Sub 3 immediately before step 1.
2. Sub 4 stock will constitute at least 90% of the net FMV and at least 70% of the gross FMV of the assets held by Sub 2 immediately before step 3.

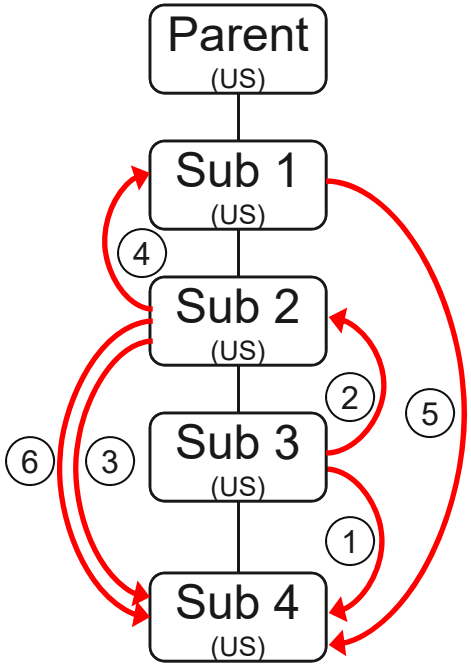
Rulings

1. Sub 3 and Sub 2 will be treated as having transferred substantially all of their respective assets to Sub 4 in steps 1 and 3, respectively, for purposes of sections 368(a)(1)(C) and/or 354(b)(1)(A).
2. The retention of minimum assets by and continued legal existence of Sub 2 until step 6 will not preclude the relevant steps from qualifying under section 368(a)(1)(D).

PLR 201731008
Section 368(a)(1)(D) Control Requirement

Relevant Authority

- Section 368(a)(1)(D) provides that immediately after the target corporation's transfer of substantially all of its assets, [the target corporation] or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of [the acquiring corporation]…".
- Rev. Rul. 68-526, 1968-2 C.B. 156 (parent and subsidiary transfer all of their assets to sister acquiring corporation solely for acquiring voting stock and then liquidate; Service concludes that subsidiary's asset transfer qualifies as a C reorganization notwithstanding that its shareholder, parent, does not hold acquiring stock immediately after transaction thereby possibly violating the COI requirement); *see also Resorts International, Inc.*, 60 T.C. 778 (1973) (similar).



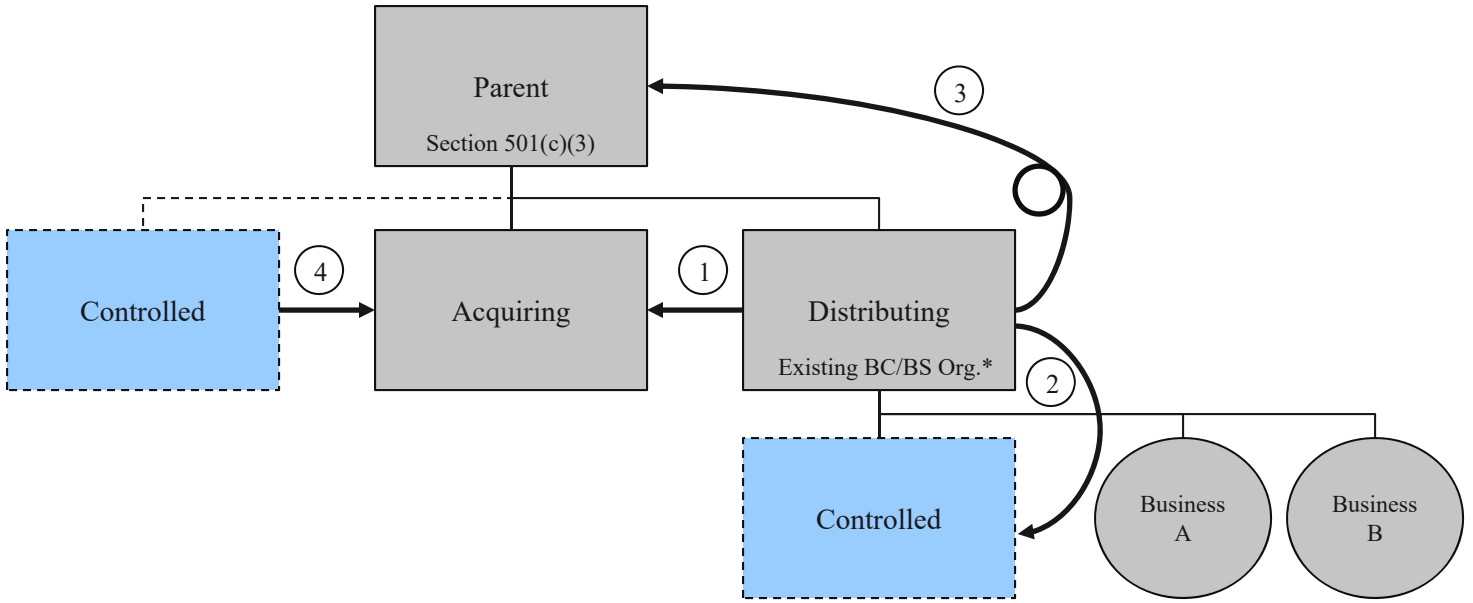
Analysis and Questions

- The Service rules that Sub 3 will be treated as transferring substantially all of its assets to Sub 4 for purposes of section 368(a)(1)(C) **and/or** section 354(b)(1)(A) (the D reorganization "substantially all" requirement).
- The Service does not provide the taxpayer with a ruling that Steps 1 and 2 qualify as a D reorganization or that the shareholder control requirement under section 368(a)(1)(D) is satisfied.
- May the acquisition of Sub 3 qualify as a D reorganization or does that acquisition fail the control test applicable to D reorganizations, because the former shareholder of Sub 3 (i.e., Sub 2) owns no stock in the acquiring corporation (i.e., Sub 4) immediately after the transaction?
  - *See*, *e.g.*, PLR 200706007 (Feb. 9, 2007) (concluding that in a similar fact pattern that the transaction qualified as a D reorganization).

Spin-Off Rulings

PLR 201734004

PLR 201734004



1) In month 1, Year 1, certain management and operational employees of Business B were transferred from Distributing to Acquiring (the "Employee Transfer").
2) Proposed Transaction Step 1: Distributing will form Controlled, a domestic corporation, and contribute all of the Business B assets to Controlled (the "Contribution").
3) Proposed Transaction Step 2: Distributing will distribute all of the Controlled stock to Parent (the "Distribution").
4) Proposed Transaction Step 3: Controlled will merge with and into Acquiring, with Acquiring surviving.

- Following the Proposed Transaction, Distributing may provide a guarantee to third-party customers of Business B if such customer requests a guarantee.

* Parent owns the sole "membership interest" in Distributing, a State A non-stock corporation and an "existing Blue Cross or Blue Shield organization" within the meaning of section 833(c)(2).

PLR 201734004

- Representations
  - Parent has no plan or intention to cease to be exempt from federal income tax under section 501(c)(3).
  - Parent has no plan or intent to sell or to otherwise dispose of any portion of the stock of Distributing, Controlled, or Acquiring.
  - If section 355 did not apply to the Distribution, the receipt of the stock of Controlled would not be taxable to Parent.
- Rulings
  - The membership Parent holds in Distributing will be treated as stock for purposes of section 355(a)(1)(A).
  - The Employee Transfer will not prevent Controlled from satisfying the ATB requirement with respect to the Distribution.
  - Because Parent is exempt from tax under section 501(c)(3) and because Parent is the sole shareholder of Distributing, the Distribution does not present evidence of device. Treas. Reg. § 1.355-2(d).

PLR 201734004: The "Stock" Issue

- Background
  - The term "stock" is not defined in the Code.
  - Section 7701(a)(7) only tells us that stock includes "shares in an association, joint stock company or insurance company."
  - The courts view stock as embodying the permanent proprietary ownership or equity interest in a corporation, entitling the holder to a combination of rights, composed of: (1) interests in the control of the corporation through voting; (2) interests in the earnings of the corporation through dividends; and (3) interests in the assets of the corporation upon liquidation. *See Himmel v. Comm'r*, 338 F2d 815 (2d Cir. 1964).
  - *Community T.V. Association of Havre v. United States*, 203 F. Supp. 270 (D. Mont. 1962) ("Class B stock" that did not have voting rights or any rights to dividends but entitled holder to liquidation proceeds only after all Class A stock was paid in full and the Class B stock could be redeemed at par value at any time was not "stock" for purposes of section 1032 because only economic benefit Class B shareholder would receive was possible return of initial investment, without dividends or profit).
  - *Affiliated Government Employees Distributing Company v. United States*, 322 F.2d 872 (9th Cir. 1963) (not stock although memberships had some right to vote for the management and right to share in assets upon dissolution, because members did not share in the profits or potential growth of the corporation during its life).
  - Revenue Ruling 54-65, 1954-1 C.B. 101 (special stock not stock because holders did not share ratably in either earnings or assets upon liquidation).

- Relevant Facts
  - Parent owns the sole "membership interest" in Distributing, a nonstock corporation.
  - Terms of membership interest in nonstock corporation may include **[insert]**.

PLR 201734004: Active Trade or Business Issue

- Background
  - Section 355(b)(1)(A) provides that both Distributing and Controlled must each be engaged in the active conduct of a five-year trade or business immediately after the distribution.
  - Ruling 2 provides that the Employee Transfer will not prevent Controlled from satisfying the ATB requirement w/r/t the Distribution.
  - Rev. Rul. 79-394 concludes that where P wholly owns X and Y where Y is in the real estate business, has no employees, and uses X's employees, the X employees are imputed to Y for purposes of satisfying the active trade or business requirement. *See also* Rev. Rul. 81-181 (same facts as Rev. Rul. 79-394 with same conclusion even if Y did not compensate X for the use of its employees).
- Questions
  - Would the active trade or business requirement be satisfied if the Employee Transfer were to an entity other than Controlled or Acquiring?
  - Does the Employee Transfer implicate Treas. Reg. section 1.355-3(b)(4)(iii)? Is the Employee Transfer-related ruling redundent?
  - How should the Employee Transfer be treated? As a distribution followed by a contribution? As a contribution of the transferred employees to Controlled?

PLR 201734004: The Device Issue

- Background
  - An "existing Blue Cross or Blue Shield organization" within the meaning of section 833(c)(2) is subject to federal income tax, albeit with significant tax benefits.
  - A section 501(c)(3) corporate shareholder's receipt of a distribution of stock from a subsidiary is not subject to federal income tax regardless of whether such subsidiary has E&P.

- Ruling 3 provides "Because Parent is exempt from tax under section 501(c)(3) and because Parent is the sole shareholder of Distributing, the Distribution does not present evidence of device. Treas. Reg. § 1.355-2(d)."

- Why require Parent to represent that it has no plan or intent to sell the stock Distributing, Controlled, or Acquiring? Does this suggest that there is a *General Utilities* repeal concern?

- What if Parent was a foreign corporation in a jurisdiction that has a comprehensive income treaty with the United States that provides for 0% withholding on dividends where Parent owns at least 10% of Distributing? Same ruling available?

PLR 201721002

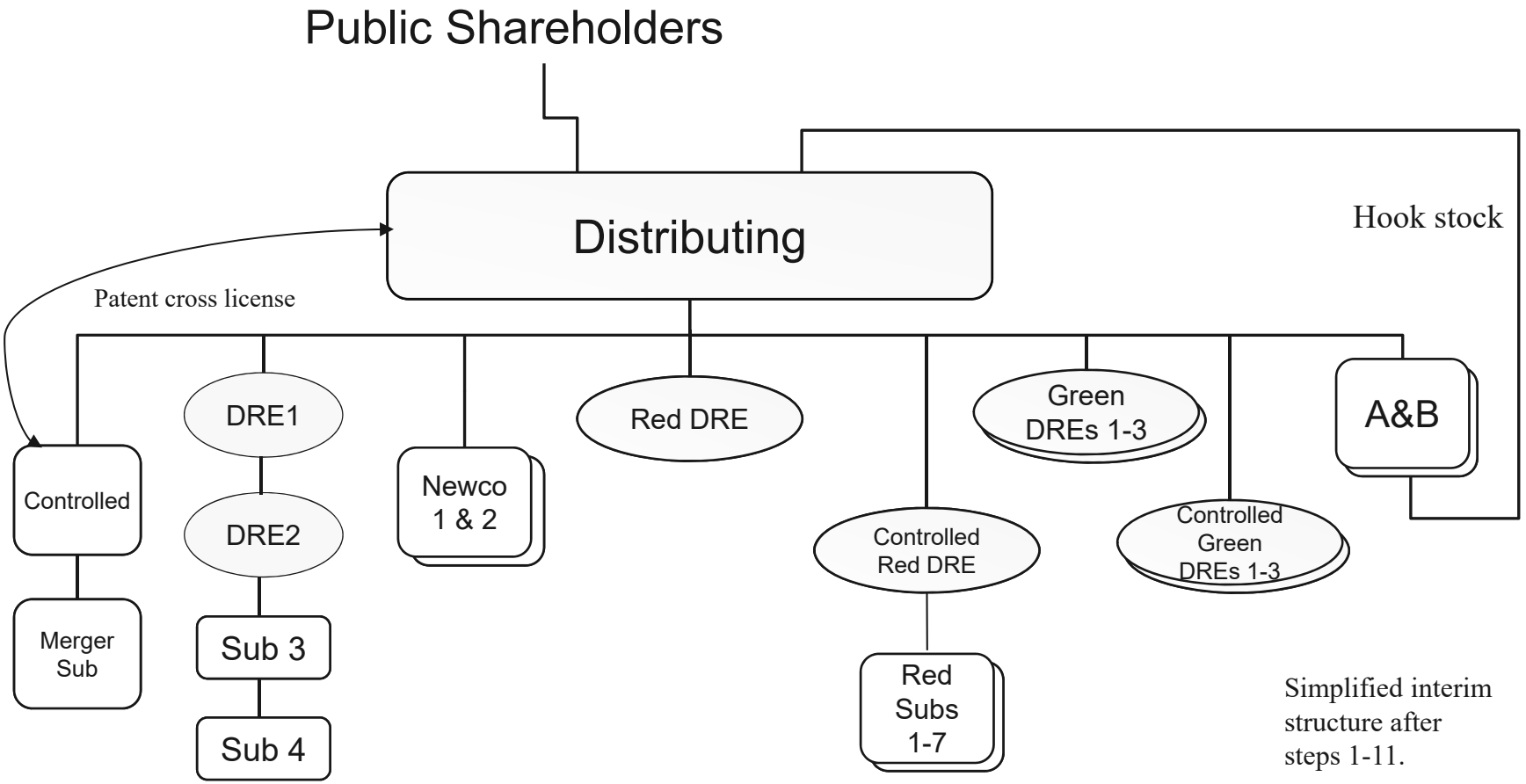
Service Ruling Policy/Practice

- Rev. Proc. 2013-3 added to no-rule list whether section 355 or section 361 applies to Distributing's distribution of stock or securities of Controlled in exchange for, and in retirement of, any putative debt of Distributing if such Distributing debt is issued in anticipation of distribution.
- Rev. Proc. 2017-38 removed this item from the no-rule list.
- Important because basis limitation does not apply to exchange of Controlled securities for Distributing debt in D/355 (unlike assumptions of liabilities and cash distributions to pay Distributing debt).
- Service did not provide substantive rules or safe harbors (unlike when recaps into control (Rev. Proc. 2016-40) and north-south transactions (Rev. Rul. 2017-09) came off no-rule list).
- Are debt exchanges too fact dependent for that type of rulemaking?
- Prior rulings tended to adopt consistent standards:
  - 5/14 standard—No exchange agreement between Distributing and bank for at least 5 days after bank acquires Distributing debt (event risk), and no exchange for at least 14 days (credit risk). Similar standard for "travelling/exchangeable notes." *E.g.,* PLR 201232014 (notes issued 5 days before distribution declared and 14 days before distribution actually occurs).
  - Size limitation—e.g., for exchange of new debt, amount of Distributing debt exchanged for Controlled debt will not exceed Distributing's average outstanding debt for one-year period before Distributing's board first discussed spin.
  - Are these standards likely to be adopted in future rulings?

PLR 201721002
Debt-for-Debt Exchange and Reverse Morris Trust

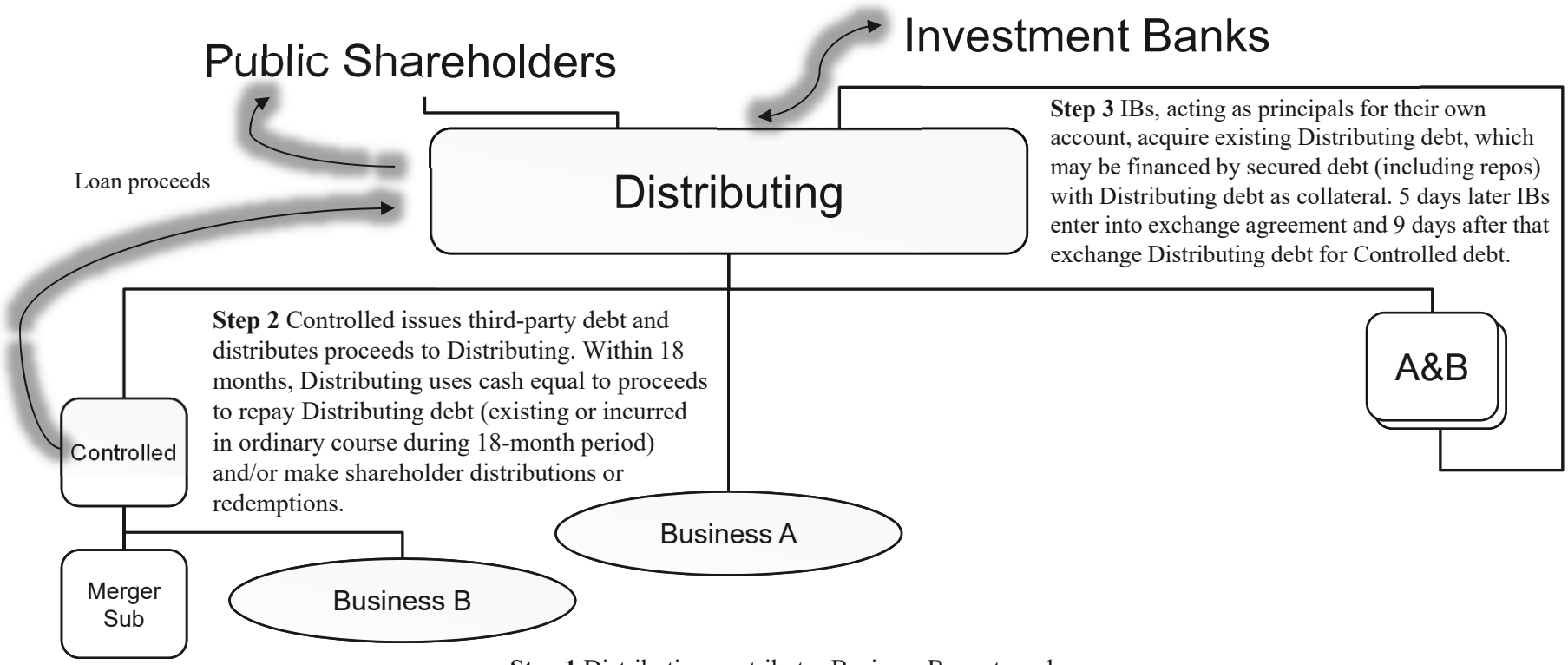
- Released May 26, 2017.
- Publicly traded US corporation wants to separate Business A from Business B.
- A portion of Distributing's outstanding stock is held by two of its corporate subsidiaries (i.e., hook stock).
- Distributing wants to use Controlled securities to satisfy Distributing debt, which Investment Bank will have acquired for its own account.
- After distribution, Controlled will acquire unrelated Target in a reverse triangular merger in which Controlled's pre-merger shareholders will retain stock with more than 50% of the vote and value of Controlled.

PLR 201721002: Preliminary Structure

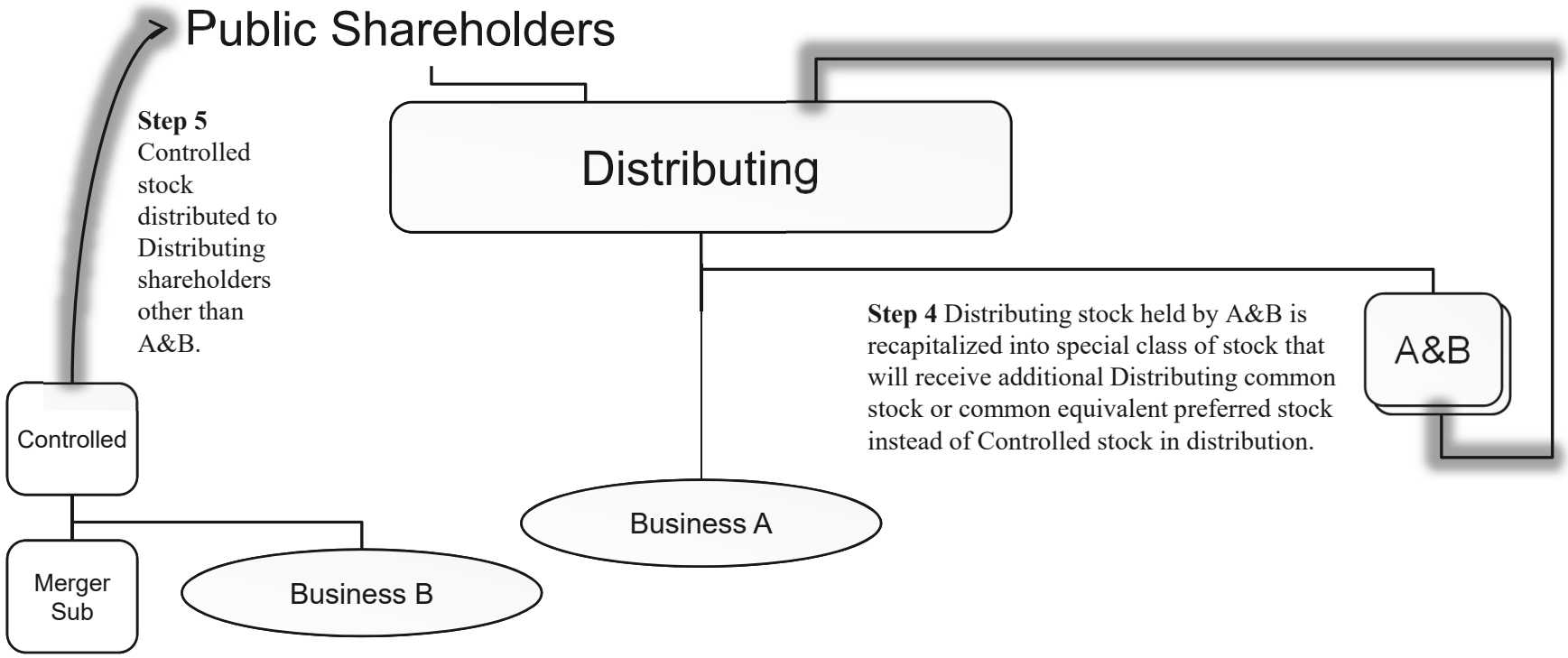


Simplified interim structure after steps 1-11.

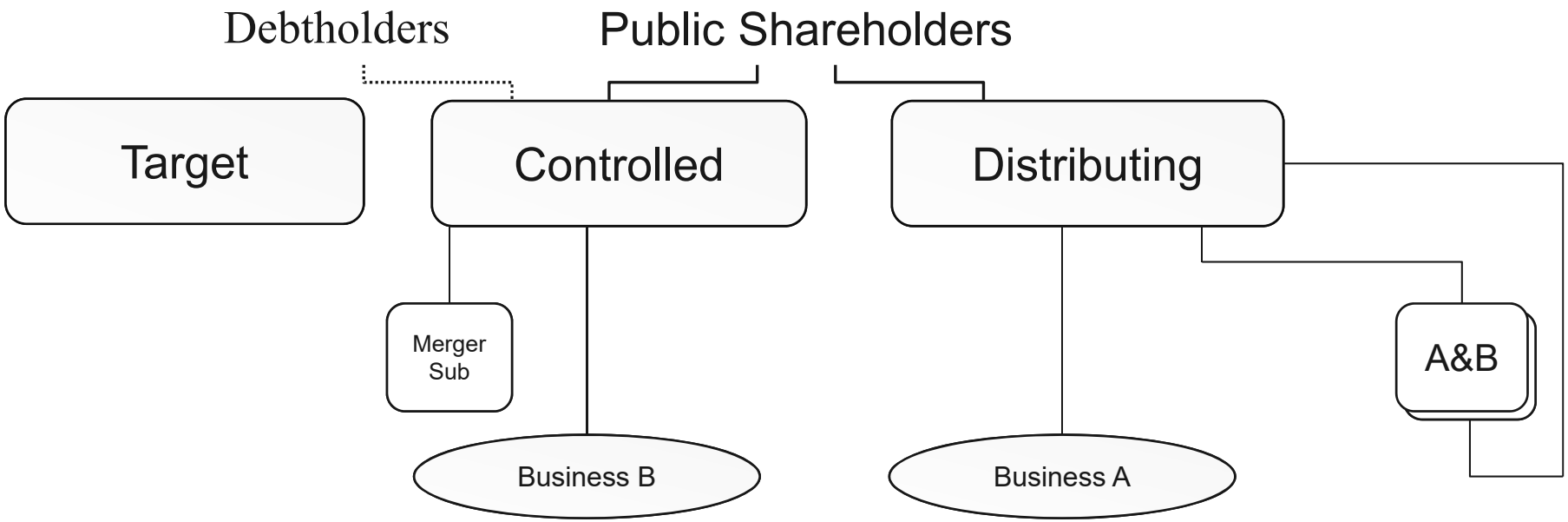
PLR 201721002: Contributions to Controlled and Debt Financed Distributions



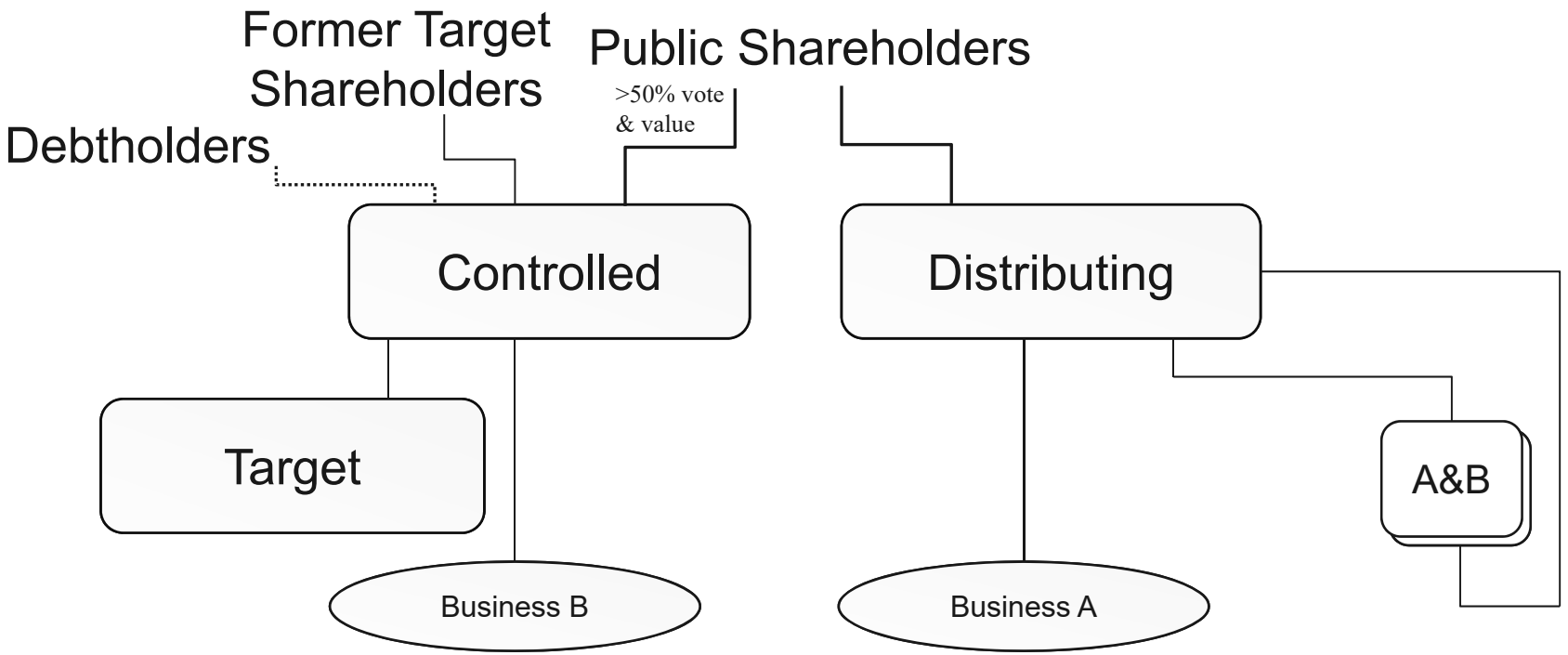
PLR 201721002: Recap and External Distribution



PLR 201721002: Post-Spin | Pre-Merger



201721002: Post-Merger



Post-merger, Controlled may carry out open-market share repurchases or accelerated share repurchases that, if consummated, will be motivated by a corporate business purpose, and made with respect to widely held shares, and will not be motivated by desire to increase or decrease ownership percentage of any particular shareholder or group of shareholders.

201721002: Significant Representations

- None of the Distributing exchange debt will have been issued in anticipation of the distribution.
- 5/14 representation, with facts specifically mentioning secured financing (including repos) using Distributing debt as collateral.
- Any share repurchases will not be related to the proposed transactions, and are expected to occur at approximately the same times, and to be in the same or a lesser amount, as the share repurchases that Target would have undertaken if the merger did not occur.
  - Safe harbor akin to Section 4.05(1)(b) of Rev. Proc. 96-30 (revoked by Rev. Proc. 2003-48)?
  - Why focus on Target's repurchase plan? Facts state that share repurchases will not be motivated by a desire to increase or decrease the percentage ownership of any particular shareholder group.
- Cash is fungible; facts specifically mention that cash proceeds of Controlled borrowing distributed to Distributing will not be held in a separate account, but an amount ≥ equal to such proceeds will be used within 18 months to make purging debt repayments and stock distributions/redemptions.

201721002: Significant Rulings

- The involvement of the investment banks in the debt exchange will not preclude the application of sections 361(c)(3) to the debt exchange.
- Provided Distributing debt exchanged (or other Distributing debt in satisfaction of which Controlled debt is distributed) constitutes "securities" for purposes of sections 355 and 361, and the Controlled debt to be transferred in cancellation of the Distributing debt has comparable terms (e.g., comparable remaining period to maturity, but not necessarily comparable interest rate), Controlled debt will constitute "securities" for purposes of sections 355 and 361 under the principles of Rev. Rul. 2004-78. See also PLR 201537004.

201721002: Significant Rulings

- To the extent that Controlled shareholders are widely held, publicly traded mutual funds that are also Target shareholders immediately prior to the merger, for purposes of section 355(e), the increase in direct or indirect (based on the attribution principles under section 318(a)(2)(C)) ownership percentage of Controlled stock by reason of being a Target shareholder immediately prior to the merger is offset by the decrease in such ownership percentage by reason of being a Controlled shareholder immediately prior to the merger, determined without regard to changes in ownership of such funds by their public shareholders.
  - Overlap rule of section 355(e)(3)(A)(iv).
  - Different formulation than prior rulings (or assumptions in rulings), which referenced "the methodology in the legislative history to §355(e)(3)(A)(iv)." S. Rep. No. 105-174, at 174-175 (1998). *See* PLRs 201603006, 200624001. Any substantive difference?
- For purposes of section 355(e), in calculating the offset, by reason of being a Controlled shareholder immediately prior to the merger, of any increase of a shareholder's Controlled stock ownership percentage, Distributing, absent actual knowledge, may rely upon publicly filed documents reporting ownership as of closest point in time preceding the merger that disclose the relevant shareholders' ownership percentage of stock in the relevant corporation.

201721002: Significant Rulings

- To the extent the share repurchases are treated as part of a plan (or series of related transactions) with the distribution for purposes of section 355(e), the share repurchases will be treated as being made from all public shareholders (defined as shareholders who are not a "controlling shareholder" or a "ten-percent shareholder" within the meaning of Treas. Reg. section 1.355-7(h)(3) and (14)) of Controlled common stock on a pro rata basis for purposes of testing the effect of the share repurchases on the distribution under section 355(e). No impact on relative percentage ownership of Controlled by Target shareholders.
- The initial designations of the post-merger members of the Controlled board of directors will not affect the determination of the total voting power or value of the stock of Controlled acquired by the Target shareholders under section 355(e). Are there facts (not provided in PLR) relevant to this ruling?
- No-rule on hook stock under Rev. Proc. 2017-3, §4.02(11). Tax-free stock distribution under section 305(a)?

201721002: Significant Rulings

- The amount of any §361(b) other property received by Distributing from Controlled after the external spin and attributable to a taxable period ending on or before the external spin will be treated for purposes of §§361(b) and (c) as distributed (i) by Controlled to Distributing pursuant to the plan of reorganization in an amount equal to the cumulative excess (the "Excess") of the gross amount of such other property received by Distributing over the gross amount of property transferred by Distributing to Controlled after the external spin attributable to a taxable period ending on or before the external spin (as measured on a rolling basis, 18 months after each receipt of such other property by Distributing) and (ii) by Distributing pursuant to the plan of reorganization, provided that Distributing uses a cumulative amount (measured on a rolling basis) equal to the Excess pursuant to purging debt repayments and stock distributions/redemptions (within 18 months from the date of each such receipt).

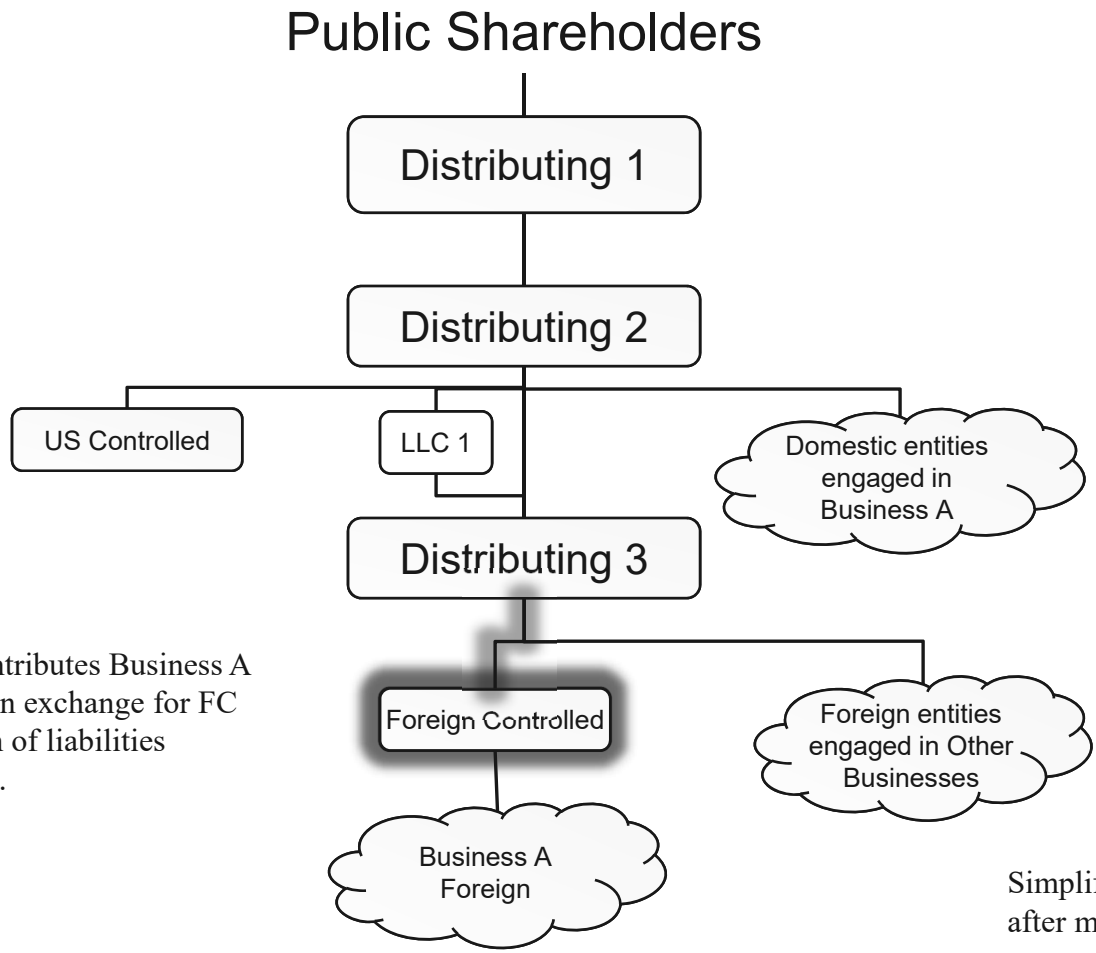
- Is this ruling intended to apply only to payments pursuant to continuing relationships? What if Distributing contributes additional Business B property and Controlled distributes cash? No mention of "Delayed Asset Transfers" as in PLR 201731004.

PLR 201731004

PLR 201731004: Debt-for-Stock Exchange

- Released August 4, 2017.
- Publicly traded US corporation (D1) engaged in five businesses through US and foreign subsidiaries.
- Plans to separate Business A from Other Businesses.
- Controlled (USC) will have two classes of stock:
  - Class B (high vote) will be distributed to D1's public shareholders.
  - Class A (low vote) will be retained by D1's wholly owned subsidiary D2 and exchanged for D2's outstanding debt, which Investment Bank will have acquired for its own account.

PLR 201731004: Preliminary Structure



D3 forms FC and contributes Business A foreign assets to FC in exchange for FC stock and assumption of liabilities related to Business A.

Simplified interim structure after multi-steps 1-4.

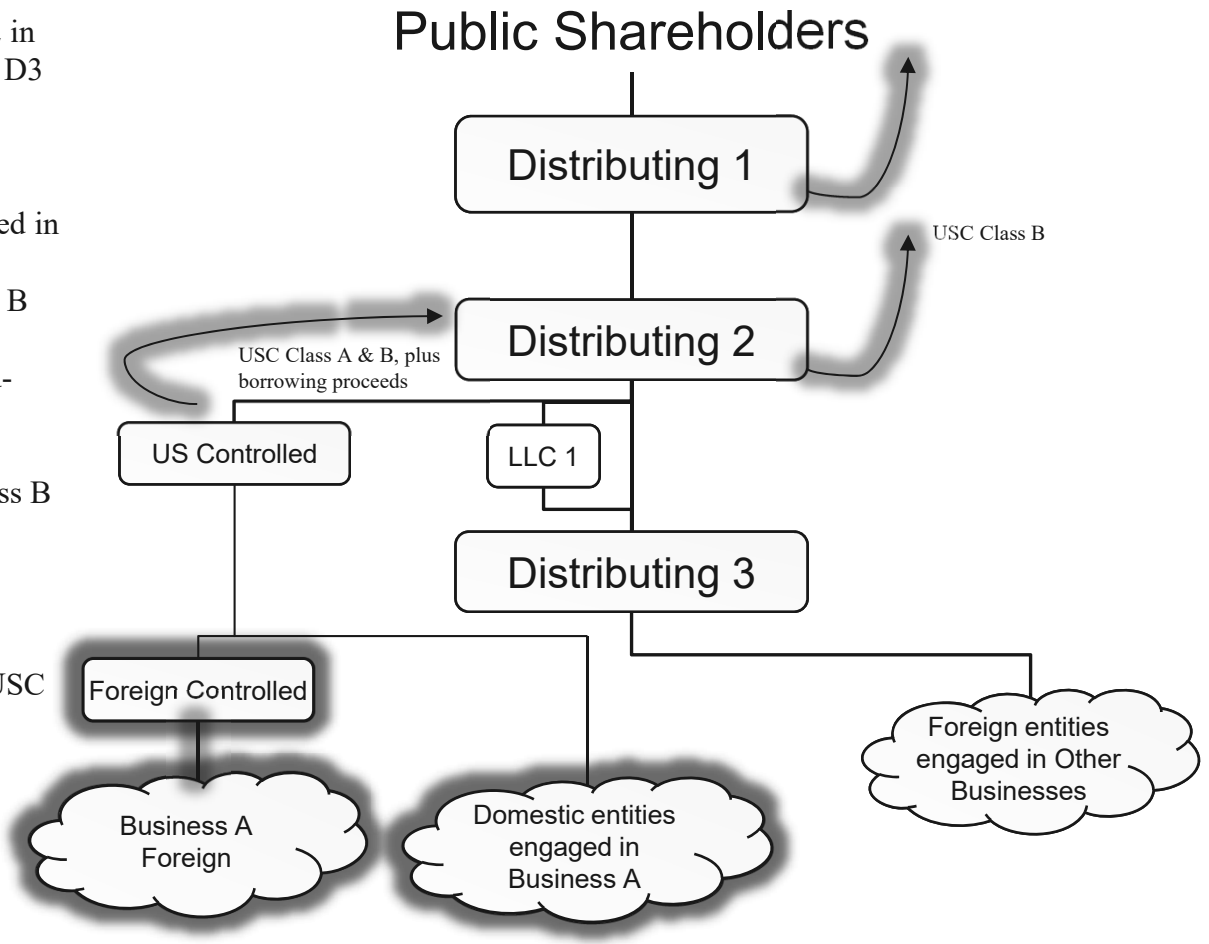
PLR 201731004: Internal Split-Off, Contribution and Distribution

D3 distributes FC to D2 in exchange for portion of D3 stock held by D2.

D2 contributes FC and domestic entities engaged in Business A to USC in exchange for Class A & B stock of USC plus cash financed by USC's third-party borrowing.

D2 distributes USC Class B stock to D1, then D1 distributes it to Public Shareholders.

Distributing 2 retains USC Class A stock.

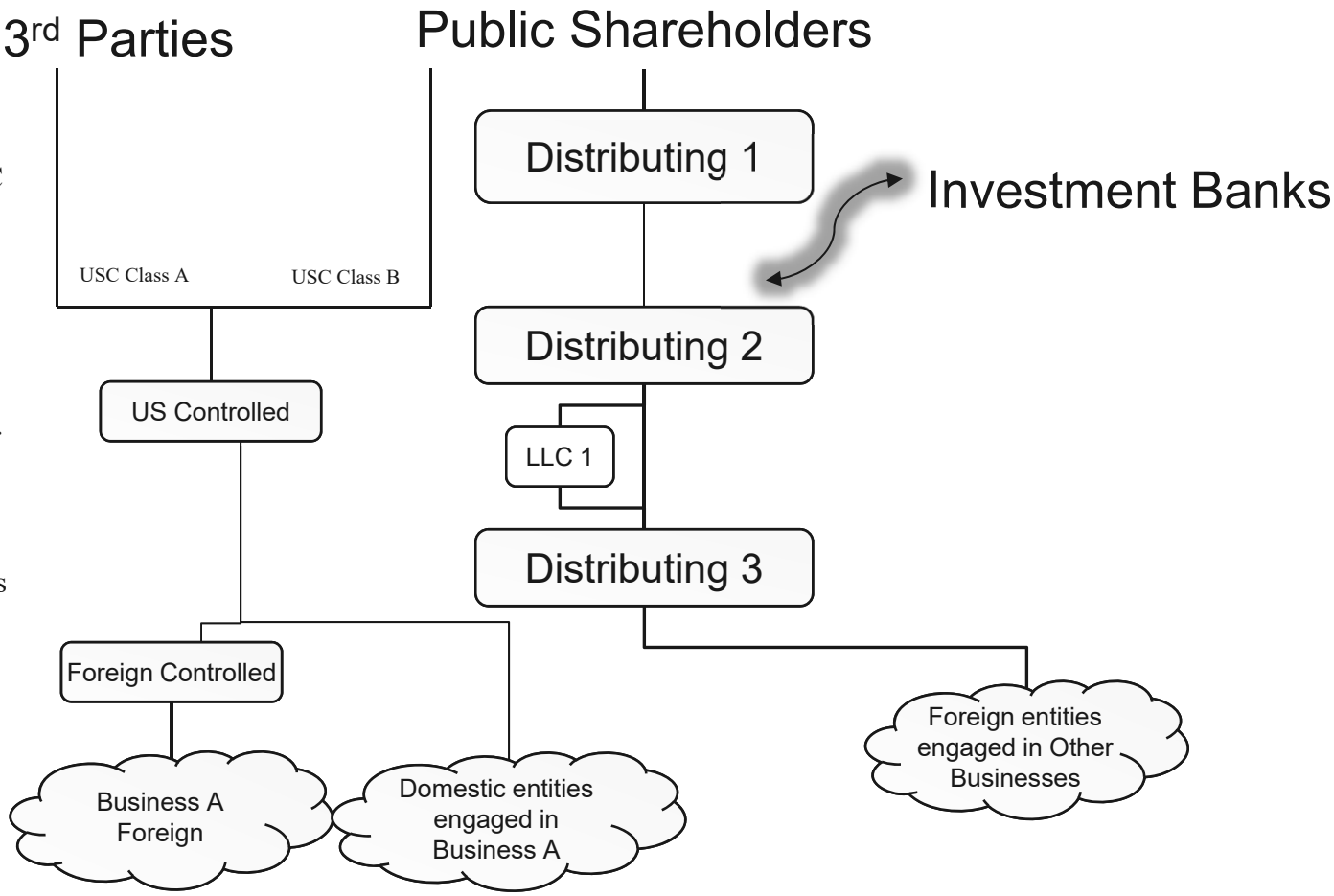


PLR 201731004: Debt-for-Stock Exchange

After D2 distributes USC Class B stock to D1, IBs acquire existing D2 third party debt for their own account.

5 days after purchase of D2 debt, IB and D2 enter into an exchange agreement, and 9 days after that, D2 debt is exchanged for USC Class A stock.

IBs sell USC Class A stock to unrelated third parties.



PLR 201731004: Significant Representations

- D2's plan to retain the USC Class A stock is motivated by the business purpose to use the retained stock to repay a portion of its existing third party debt, which is expected to (i) meaningfully reduce the debt load of the D1 group consistent with its publicly stated goals, (ii) avoid a potential credit downgrade following the proposed transaction, and (iii) reduce borrowing costs.
- None of the D2 debt to be exchanged for retained stock pursuant to the debt exchanges was issued in anticipation of the proposed transaction.
- 5/14 representation, with facts specifically stating that Controlled stock for Distributing debt exchanges will occur at least 14 days after debt purchases and the exchange ratio will reflect arm's length terms based on FMV of stock and debt as of the date of the exchange. Could there be a signing date rule for purposes of Section 355?
- All debt exchanges will occur within 12 months after the distribution of the USC Class B stock to D1 (the "Second Distribution"). If D2 continues to own any retained stock after the final debt exchange, D2 will dispose of all remaining retained stock as soon as such dispositions are warranted, consistent with the business purpose for the retention, but in no event later than 5 years after the Second Distribution.

PLR 201731004: Significant Representations

- No action will be taken (including the adoption of any plan or policy), at any time before the earlier of (i) the date of the final debt exchange ("Date X"), or (ii) the date that is 12 months after the date of the Second Distribution ("Date Y"), by USC's board of directors, its management, or any of its controlling shareholders that would (if implemented) actually or effectively result in an unwind of the dual class structure. D2 may continue to hold retained stock after Date X.
- USC will not engage in a transaction with one or more persons (for example, a merger of USC with another corporation) that results in an unwind of the dual class structure within 24 months after the earlier of Date X or Date Y, unless: (1) there is no agreement, understanding, arrangement, or substantial negotiations or discussions concerning the transaction or a similar transaction, at any time during the 24-month period ending on the earlier of Date X or Date Y; and (2) no more than 20% of the interest in the other party, in vote or value, is owned by the same persons that own more than 20% in vote or value of the stock of USC, applying attribution rules and, for public companies, limited to controlling shareholders and 10% shareholders. Other than with respect to a transaction with one or more persons described in clauses (1) and (2) of this representation, no action will be taken (including the adoption of any plan or policy), at any time prior to 24 months after the earlier of Date X or Date Y, by USC's board of directors, its management, or any of its controlling shareholders that would (if implemented) actually or effectively result in an unwind of the dual class structure.

PLR 201731004: Significant Representations

- Reps track Rev. Proc. 2016-40. What is the import of staged timing of reps? Does it relate to the fact that the facts indicate that market conditions and sound business judgment may prevent Distribution from disposing of any or all of the retained stock, in which case it will be disposed of as soon as warranted but in no event later than 5 years after the Second Distribution. Distributing was looking for an outside date after which it could unwind?

- Rev. Proc. 2016-40 was released July 15, 2016.

- PLR is dated February 16, 2017, and was signed by Robert H. Wellen.

PLR 201731004: Significant Rulings

- The retention by D2 of the USC Class A stock will not be 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) and Treas. Reg. §1.355-2(e).
- Provided that the debt exchanges occur within 12 months following the date of the Second Distribution, and provided that the Second Distribution otherwise would satisfy the requirements of section 355 if all Controlled stock had been distributed in the Second Distribution, the retained stock transferred in the debt exchanges will be treated as being distributed pursuant to the Second Distribution plan of reorganization for purposes of sections 361(c)(1) and 361(c)(3).
- Provided that the debt exchanges occur within 12 months following the date of the Second Distribution, the involvement of the Investment Banks in the debt exchanges will not preclude the application o f section 361(c)(3) to the debt exchanges.