Corporate Tax Developments: Part 1 of 5

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Agenda

- Recently Released Section 355 No Rules
  - Background of Section 355 Provisions
  - The No Device Requirement
  - The Active Trade or Business ("ATB") Requirement
  - IRS Ruling Policy: Where were we and how did we get here?
  - Overview of Rev. Proc. 2015-43 and Notice 2015-59
  - Small ATB No Rules
  - Opco/Propco No Rule

Background of Relevant Section 355 Provisions

Section 355 Requirements

- Statutory Requirements
  - Control Immediately Before
  - Distribution of Stock and Securities Constituting Control
  - **Not a Device for Distribution of E&P**
  - **Distributing & Controlled Engaged in an Active Trade or Business**
- **Section 355(g)**
- Section 355(a) Non-statutory Requirements
  - **Business Purpose**
  - Continuity of Shareholder Interest
  - Continuity of Business Enterprise
- Special Corporate-Level Requirements
  - Section 355(d) and (e)

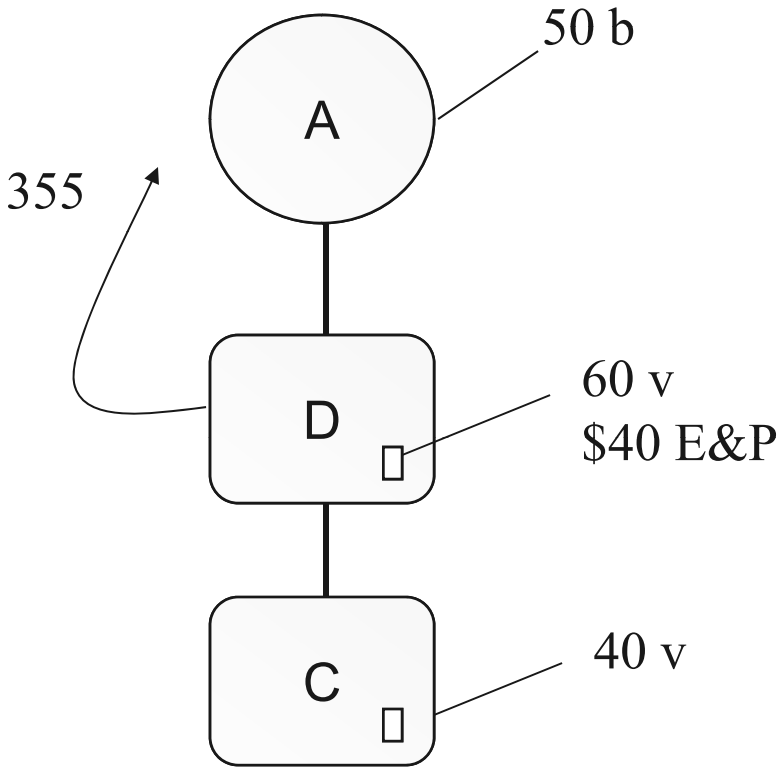
The No Device Requirement

No Device Requirement

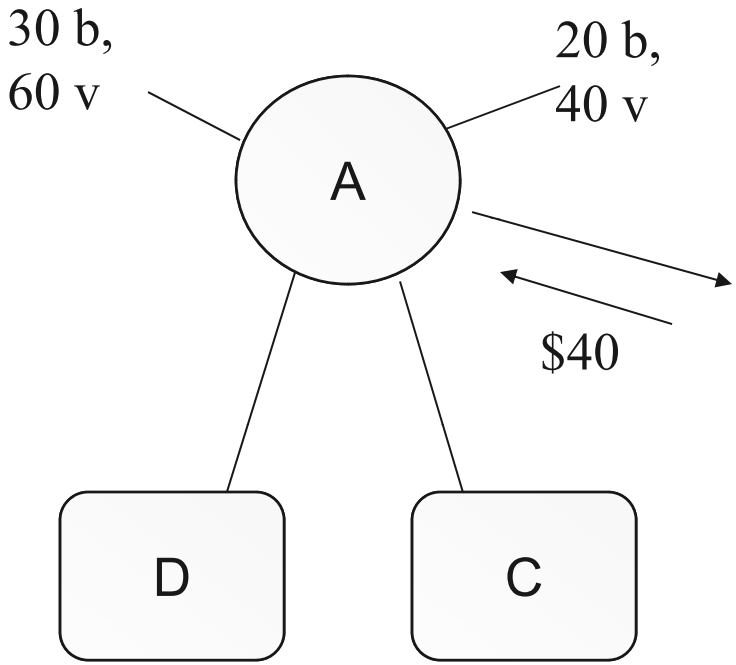
- The distribution cannot be used principally as a device for the distribution of the earnings and profits ("E&P") of either D or C.

- Seeks to prohibit bail-out of a corporation's E&P at capital gains rates.

Device – The Concern



Distribution of C
$40 dividend or 355?



IF 355 & sale of C
$20 cap. gains

Relevance to a "Unified Rate" Regime

- When capital gains rates and qualified dividend rates are the same, what is the relevance, if any, of the no device requirement?
  - What if D shareholder(s) have no basis in their D stock prior to spin off?
  - What if D shareholder(s) are eligible for a 0% withholding rate under an applicable income tax treaty?

Device: Facts & Circumstances Analysis

- Device factors (Treas. Reg. section 1.355-2(d)(2))
  - Pro-rata distribution
  - Sale or exchange of D or C after distribution
    - A sale or exchange of D or C stock pursuant to an arrangement negotiated or agreed upon prior to the distribution is substantial evidence of device
  - **D or C has excessive non-business assets**
- Non-Device factors (Treas. Reg. section 1.355-2(d)(3))
  - Corporate business purpose
  - D is publicly traded and no 5% shareholder
  - All distributee corporations entitled to DRD

Treas. Reg. Section 1.355-2(d)(5)(iv) Section 302(a) Transactions

- Treas. Reg. Section 1.355-2(d)(5)(iv)
  - A distribution is *ordinarily* considered not to have been used principally as a device if, in the absence of section 355, with respect to each shareholder distributee, the distribution would be a redemption to which section 302(a) applied.
  - Treas. Reg. section 1.355-2(d)(5)(i) provides that such distributions are ordinarily considered not to have been used principally as a device, notwithstanding the presence of *any* of the device factors described in Treas. Reg. section 1.355-2(d)(2).
  - Treas. Reg. section 1.355-2(d)(5)(i) "ordinarily" protection is not available if the same shareholder(s) receive more than one C in a split off and then one or more C is retained while one or more C is sold (the "Exception"). *See also* Treas. Reg. section 1.355-2(d)(5)(v), Ex. 2.
    - Exception presumably concerned with economically similar transaction where D splits off C where C has 2 or more businesses and then C contributes a business to C1 and spins off C1 pro rata to the shareholders split off from D.
- What does "ordinarily" mean? Is the exception to such language limited to the Exception? Is the allocation of E&P under Treas. Reg. section 1.312-10 evidence of device because it potentially enables future distributions to result in a smaller dividend?

Device (Cont'd): Nature & Use of Assets Treas. Reg. Section 1.355-2(d)(2)(iv)

- General Rule
  - The determination of whether a transaction was used principally as a device will take into account the nature, kind, amount, and use of the assets of D and C (and corporations controlled by them) immediately after the transaction.
- Non-Qualifying Assets
  - The existence of assets that are not used in a trade or business that satisfies the ATB requirement ("Non-Qualifying Assets") is evidence of device.
  - Examples include cash and other liquid assets that are not related to the reasonable needs of the ATB.
- The higher the ratio for each corporation of the value of Non-Qualifying Assets not used to the value of ATB-qualifying assets, the more evidence of device.
- In a split off, liquid assets used to equalize values *ordinarily* is not evidence of device.

Device (Cont'd): Treas. Reg. Section 1.355-2(d)(4), *Ex. 4*

- Background: Corporation X is engaged in a regulated business in State M and owns all of the stock of corporation Y, which is not engaged in a regulated business in State M. State M has recently amended its laws to provide that affiliated corporations operating in M may not conduct both regulated and unregulated businesses.
- X purchases operating assets unrelated to the Y business and transfers them to Y. X then distributes the Y stock pro rata among X's shareholders.
- As a result of the transfer of the recently acquired operating assets, the ratio of the value of its Non-Qualifying Assets to the value of its ATB-qualifying assets is substantially greater for Y than for X.
- There is no other evidence of device or evidence of nondevice.
- Conclusion: The transaction is considered to have been used principally as a device.

Nature & Use of Assets: Related Function Treas. Reg. Section 1.355-2(d)(2)(iv)(C)

- There is evidence of device if the D (or C) business is:
  - A "secondary business" that continues as such for a significant period after the spin off, and
  - Can be sold without adversely affecting the business of C (or D)
- A secondary business is a D (or C) business that's principal function is to serve the C (or D) business.
- The activities of the secondary business may consist of providing property or performing services.

Related Function Example
Treas. Reg. Sections 1.355-2(d)(2)(iv)(C), -3(c) (*Ex. 11*)

- Background: For the past eight years, corporation X has been engaged in the manufacture and sale of steel and steel products. X owns all of the stock of corporation Y, which, for the past six years, has owned and operated a coal mine for the sole purpose of supplying X's coal requirements in the manufacture of steel.
- Transaction: X distributes the stock of Y to X's shareholders where X and Y each satisfy the ATB requirement.
- The coal mine's principal function of supplying X's coal requirements continued after separation and the coal mine could be sold without adversely affecting X's steel business.
- Conclusion: Evidence of device exists.

Relevance of Business Purpose to No Device Requirement: Treas. Reg. Section 1.355-2(d)(3)(ii)

- The corporate business purpose for the transaction is evidence of nondevice.
- The stronger the evidence of device, the stronger the corporate business purpose required to satisfy the no device requirement.
- The transfer or retention of Non-Qualifying Assets can be outweighed by the existence of a corporate business purpose for such transfers or retentions.
- Strength of a corporate business purpose will be based on all of facts and circumstances, including, but not limited to, the following factors:
  - The importance of achieving the purpose to the success of the business;
  - The extent to which the transaction is prompted by a person not having a proprietary interest in D or C, or by other outside factors beyond the control of the D; and
  - The immediacy of the conditions prompting the transaction.

Section 355(g)

Section 355(g)

- Section 355 will not apply if:

  (A) Immediately after the transaction, either D or C is a Disqualified Investment Corporation ("DIC"), and

  (B) Immediately after the transaction, any person owns a 50 percent (vote or value, applying section 318 attribution) or greater interest in any DIC, but only if such person did not hold such an interest in such corporation immediately before the transaction.

- When describing "current law," the House Report briefly discusses the device requirement limiting its discussion to describe the section 302(a) ordinarily no device exception.

Disqualified Investment Corporation Definition

- D or C is a DIC if 2/3 or more of the FMV of all of its assets constitutes investment assets.
- "Investment Assets" include:
  - Cash, stock or securities, certain partnership interests, debt, options, forward or futures contract, notional principal contract, derivative, foreign currency, or any similar asset.
  - **Look-through rule when ownership of at least *20%* of the vote and value in lower-tier corporate subsidiaries.**
  - Exception for certain assets used in financial trade or business, certain mark-to-market assets.

The Active Trade or Business Requirement

Active Trade or Business Requirement

(1) D and C must each be engaged in an active trade or business ("ATB") immediately after the distribution.

(2) Both D and C's business must have been actively conducted throughout the 5-year period ending on the date of the distribution.

(3) Neither D nor C's business (nor control of a corporation conducting such business) can have been acquired in a taxable transaction within 5-years of the distribution.

Section 355(b), Treas. Reg. section 1.355-3, Prop. Treas. Reg. section 1.355-3.

Note: The ATB test was inserted in order to prevent the tax free separation of an existing corporation into active and inactive entities. S. Rept. No. 1622, 83d Cong., 2d Sess. 51 (1954).

Section 355(b)(3): ATB Tested Through "Separate Affiliated Group"

- Starting in 2006, all members of a corporation's "separate affiliated group" (i.e., the affiliated group that would be determined under section 1504(a) if such corporation were the common parent and section 1504(b) did not apply)—determined immediately after the distribution—generally are treated as a single corporation for purposes of the ATB requirement.
- Congress believed "that it is appropriate to simplify planning for corporate groups that use a holding company structure to engage in distributions that qualify for tax-free treatment under section 355." (H. Rep. No. 109-304).
- A stock acquisition that results in a corporation joining a SAG is treated as an acquisition by the SAG of the assets of that corporation.
- Note that the SAG rules use a different definition of control (i.e., 80% vote/value) from section 355's "control" requirement (i.e., 80% vote and 80% of each non-voting class).
- Under regulations proposed in 2007, certain tax-free transactions would be treated as taxable (and certain taxable transactions as tax-free) for purposes of the SAG rules.

Size of D's and C's ATB Relative to Other Assets

- Section 355(b) and Treas. Reg. section 1.355-3(b)
  - No specific reference to absolute or relative size of the ATB.
- Rev. Rul. 73-44
  - D owns three lines of business: (1) ATB-qualifying assets ("Biz1"), (2) active business assets, owned by C, that do not satisfy the ATB requirement because they were recently acquired in a transaction in which gain was recognized ("Biz2") and (3) ATB-qualifying assets ("Biz3").
  - D transfers Biz3 to C; after the transfer, Biz3 represents represents a "substantial portion" but less than 50% of the value of C's total assets.
  - "There is no requirement in section 355(b) that a specific percentage of the corporation's assets be devoted to the active conduct of a trade or business. In the instant case, therefore, it is not controlling for purposes of the [ATB] requirement that the active business assets of [C] represent less than half of the value of [C] immediately after the distribution."
  - "The fact that . . . investment assets were not involved, and that the transaction was compelled by valid business purposes are indicative of the absence of device."
  - "[T]he assets included in [C] represent operating businesses, and not assets that could be used to facilitate the distribution of [D's or C's E&P]."

General Counsel Memoranda Relating to Size of Active Trade or Business

• GCM 34238 (underlies Rev. Rul. 73-44; ATB requirement satisfied where C's only qualifying ATB assets represented approximately 5% of the net book value of its assets; C's other assets generally were not investment-type assets).

• GCM 31959 (ATB requirement satisfied where C's ATB assets were "only a small percentage" of C's total assets; C's other assets consisted of stock in wholly owned subsidiaries which held ATB assets).

• GCM 31799 (ATB requirement satisfied where ATB assets represented less than 2% of corporation's assets, but 65% of its assets consisted of stock in wholly owned subsidiaries which held ATB assets and the remainder consisted of either internal JV interests or interests in corporations shared with outside investors which also held ATB assets).

• GCM 36069 (ATB requirement satisfied where only 16% of C's assets were ATB-qualifying assets; C's other assets consisted of wholly owned subsidiary stock which only held real estate solely used by C, and a small amount of cash).

Business Purpose Requirement

Business Purpose Requirement

Gregory v. Helvering

> "The whole undertaking, though conducted according to the terms of the [statute], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization."

Business Purpose Requirement
Treas. Reg. section 1.355-2(b)

- Corporate business purpose – The distribution must be carried out for one or more corporate business purposes. The transaction must be motivated, in whole or substantial part, by such corporate purposes.

- Exigency – Provide nonrecognition only to distributions incident to readjustments of corporate structure required by business exigency.

- Other than federal income tax avoidance – Must be a real and substantial non-federal tax purpose germane to the business of D, C or D's affiliated group.

- No impractical or unduly expensive nontaxable alternative.

- Rev. Proc. 96-30 contains a non-exhaustive list of IRS-approved corporate business purposes, though the IRS stopped issuing private letter rulings on the business purpose requirement in 2003.

  - Business purposes described in Rev. Proc. 96-30 include enhancing the fit and focus of each business, providing an equity interest in a particular business to a key employee, facilitating a borrowing or stock offering, facilitating an acquisition by D or C (or of D), producing cost savings, and eliminating competition with customers or suppliers.

- Does there need to be an independent, corporate business purpose for contributing the relied upon ATB to C (or holding back the relied upon ATB in D)?

IRS Ruling Policy: Where were we and how did we get here?

Evolution of IRS Section 355 Ruling Policy

- Prior to Rev. Proc. 2003-48, private letter rulings addressing section 355 generally ruled on whether the transaction qualified in full, with few caveats.
  - Rev. Proc. 96-30 (and Rev. Proc. 86-41 before it) set forth in a checklist questionnaire the information that had to be included in requests for rulings under section 355.
  - However, under Rev. Proc. 96-43, for purposes of ATB requirement, the IRS required that the gross assets of the trades or businesses relied on to satisfy ATB requirement must have a FMV that is at least 5% of the total FMV of the gross assets of the corporation conducting the trades or businesses. *See* Section 4.01(30) of Rev. Proc. 2003-3, 2003-1 C.B. 113.
    - IRS may rule that the trades or businesses satisfy the ATB requirement if it can be established that, based upon all relevant facts and circumstances, the trades or businesses are not *de minimis* compared with the other assets or activities of the corporation and its subsidiaries.
    - Was the reason behind the IRS's willingness to rule when the ATB represented less than 5% related to IRS sympathy to structuring issues related to former section 355(b)(2)(A) which required that D or C, as the case may be, be engaged directly in an ATB or that "substantially all of [such corporation's] assets consist of stock and securities of a corporation controlled by [such corporation]"?
  - IRS willing to issue rulings on device and business purpose, among other requirements.

Evolution of IRS Section 355 Ruling Policy

- In Rev. Proc. 2003-48, the IRS instituted a pilot program (which it subsequently adopted on a more permanent basis) under which it would no longer rule on business purpose, device, or section 355(e) "plan" issues.
  - Section 4.07 of Rev. Proc. 2003-48 deleted the 5% ATB threshold by deleting section 4.01(30).
  - Though unwilling to rule on a "plan" issue, the IRS would still entertain requests for rulings on related "significant issues" under section 355(e).
  - The IRS justified the change in part by an intent to dedicate its resources to increasing the amount of published guidance under section 355.
  - The IRS also announced in Rev. Proc. 2003-48 that it would decline a request for a supplemental letter ruling unless the request presented a "significant issue."

Evolution of IRS Section 355 Ruling Policy

- Ordinarily, the IRS will not issue a letter ruling on only part of an integrated transaction.

- In Rev. Proc. 2009-25, however, the IRS instituted an optional pilot program (subsequently made more permanent and exclusive in 2013) for rulings solely under the jurisdiction of the Associate Chief Counsel (Corporate) on "significant issues" involving the tax consequences or characterization of part of a transaction that occurs in the context of a section 355 distribution.

- The IRS also announced in Rev. Proc. 2009-25 that it would generally rule on non-plan section 355(e) issues, including the effect of redemptions, if an adverse ruling would result in there being an acquisition of a 50% or greater interest as part of a plan including the spin-off.

Evolution of IRS Section 355 Ruling Policy

- Rev. Proc. 2009-25 defined "significant issue" as an issue of law that met the following tests:

  (1) the issue is not clearly and adequately addressed by a statute, regulation, decision of a court, tax treaty, or other authority published in the Internal Revenue Bulletin;

  (2) the resolution of the issue is not essentially free from doubt (i.e., taxpayer's counsel is unable to render a "will" opinion on the issue because of concern over a legal issue); and

  (3) the issue is legally significant and germane to determining the major tax consequences of the transaction.

Evolution of IRS Section 355 Ruling Policy

- In Rev. Proc. 2013-3, the IRS announced that three new areas were under study, and that it would not rule on them until publishing a revenue ruling, revenue procedure, regulations or other authority.

- These three new areas may be summarized as follows:

  (1) recapitalizations into control;

  (2) debt issued in anticipation of a spin-off; and

  (3) "north-south" transactions.

- In Rev. Proc. 2013-32, the rulings program for transactions under sections 332, 351, 355, 368 and/or 1036 was substantially cut back. Under the program, which is currently in effect, the IRS will only rule on issues that are "significant."

  – "Significant" is defined as an issue that is not essentially free from doubt and that is germane to the tax consequences of the transaction.

Overview of Rev. Proc. 2015-43 & Notice 2015-59

Rev. Proc. 2015-43 & Notice 2015-59

- IRS releases Rev. Proc, 2015-43 and Notice 2015-59 (the "Notice") on September 14, 2015.
- If guidance contemplated by the Notice is issued, would such guidance be retroactive to the date of the Notice?
- Rev. Proc. 2015-43 provides 3 no-rule policies under section 355 and related provisions for spin-offs involving relatively small ATBs or REIT/RIC conversions.
- The Notice states that Rev. Proc. 2015-43 does not distinguish between pro rata and non-pro rata distributions. *See* Slide 45 for a more detailed discussion.
- Rev. Proc. 2015-43 supplements Rev. Proc. 2015-3, and applies to all ruling requests that are postmarked (or, if not mailed, received) on or after September 14, 2015 that relate to spin offs occurring after such date.
- Rev. Proc. 2015-43 provides that the IRS will not issue a ruling on "any issue relating to the qualification under section 355 and related provisions" if one of the three no-rule policies applies.
    - What is the scope of this statement?
    - Are section 355(d) and (e) issues considered "qualification" issues?

Rev. Proc. 2015-43 & Notice 2015-59

- Notice 2015-59 (the "Notice") identifies four circumstances in which qualification of a distribution under section 355 is under study:

    1. Ownership by D or C of a small amount of ATB Assets in relation to all of its assets.

    2. Ownership by D or C of investment assets having substantial value in relation to (a) the value of all of such corporation's assets, and (b) the value of the assets of the trade(s) or business(es) relied upon to meet the ATB requirement ("ATB Assets").

    3. A significant difference between D's ratio of investment assets to assets other than investment assets and such ratio of C.

    4. An election by D or C (but not both) to be a RIC or a REIT.

Relevance of *General Utilities* Repeal to Device and ATB Requirements

- Treasury and the IRS reference sections 337(d) and 355 when discussing the four circumstances under study.
- Section 337(d) provides:
  - The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986, including—(1) regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations and part III of this subchapter) or through the use of a regulated investment company, real estate investment trust, or tax-exempt entity, and (2) regulations providing for appropriate coordination of the provisions of this section with the provisions of this title relating to taxation of foreign corporations and their shareholders.
- The preamble to the 1989 final device regulations provided that "[the IRS] is developing regulations under section 337(d) of the Code that will relate to the distribution of stock, or stock and securities, of a controlled corporation. New section 1.355-6 is reserved for this purpose."
- In March, 1989, Treasury indicated that it would be exercising its authority under section 337(d) to prevent the use of "subsidiary-tracking" stock to sell a business without triggering a *General Utilities* tax. The scheme, as explained by Treasury, was the purchase by X of D stock tracking C eventually followed by a split off of C to X.
- In 1990, Congress enacted section 355(d), effectively shutting down the transaction described immediately above.
- In 1992, Treasury closed the regulatory project reserved for under Treas. Reg. section 1.355-6 without the promulgation of regulations.
- Rev. Rul. 2003-110 (holding that "[i]n determining whether a distribution of the stock of a controlled corporation satisfies the [business purpose requirement] that the distribution be motivated, in whole or substantial part, by one or more corporate business purposes, the fact that [section] 355 permits [D] to distribute the stock of [C] without recognition of gain does not present a potential for the avoidance of Federal taxes under [Treas. Reg. section] 1.355-2(b).").
- Does the reference to section 337(d) relate to all of the no rules in Rev. Proc. 2015-43 or only the Opco/Propco no rule?

Small ATB No Rules

Small ATB No-Rule 1

- Section 3.01 of Rev. Proc. 2015-43 and Section 4.01(58) of Rev. Proc. 2015-3.
- IRS ordinarily will not rule on any issue relating to qualification under section 355 where, immediately after the distribution, the FMV of the gross ATB Assets of D or C is less than 5 percent of the total FMV of the gross assets of such corporation.
  - Is Rev. Rul. 73-44 still good law? What relevance do the GCMs relating to the underlying analysis of Rev. Rul. 73-44 have on the IRS's current thinking?
  - Is a ruling request submitted prior to September 14, 2015 still eligible to receive an ATB size ruling?
  - Will the IRS still rule on ATB if the taxpayer is able to make the 5% representation but the ratio of investment assets to Qualifying Assets is high?
- The Notice states that granting tax-free treatment to a distribution involving a small ATB has become less justifiable since the enactment of section 355(b)(3), and that IRS will only consider ruling requests involving small ATBs in unique and compelling circumstances.
- Relevant facts include: (i) the presence of assets that would be ATB Assets but for the five-year requirement of section 355(b)(2)(B), and (ii) a relationship between the business purpose for the distribution and the Qualifying Assets of D or C.

Small ATB No-Rule 2

- Section 4.01 of Rev. Proc. 2015-43 and Section 5.01(26) of Rev. Proc. 2015-3.
- IRS will not rule (until resolved by Revenue Ruling, Revenue Procedure, Regulations or otherwise) on any issue relating to the qualification under section 355 of a distribution where, immediately after the distribution, all of the following conditions exist:
    - (i) The FMV of the investment assets of D or C is two-thirds or more of the total FMV of its gross assets;
    - (ii) The FMV of the gross ATB Assets of D or C is less than 10 percent of the FMV of its investment assets; **and**
    - (iii) the ratio of the FMV of the investment assets to the FMV of the assets other than investment assets of D or C is three times or more of such ratio for the other corporation.
- Does the same entity (D or C, as the case may be) have to satisfy all 3 requirements above for the no-rule to apply?
- Must taxpayers now provide a representation as to each of these three tests when submitting ruling requests?
- With respect to prong (iii) above, is the relevant inquiry FMV of gross or net assets?

Small ATB No-Rule 2
Anti-Abuse Rule

- Section 5.01(26) of Rev. Proc. 2015-43 provides that the IRS will not rule (until resolved by Revenue Ruling, Revenue Procedure, Regulations or otherwise) on any issue relating to the qualification under section 355 of a distribution where, as part of a plan or series of related transactions:

  1. Investment assets are disposed of, or

  2. Non-investment assets (including ATB Assets) are acquired

  with a principal purpose of avoiding Small ATB No-Rule 2.

- Assume taxpayer is considering transferring either small ATB1 or big ATB2 into C. Is the anti-abuse rule tripped if taxpayer transfers big ATB2 with a principal purpose of avoiding Small ATB No-Rule 2?

Small ATB No-Rules: Special Rules & Definitions

- For purposes of determining the FMV of the gross assets and gross ATB Assets of a corporation,
    - (i) all members of a separate affiliated group ("SAG") are treated as one corporation, and
    - (ii) if D or C relies on the ATB of a partnership, it is treated as owning its ratable share of the gross assets of the partnership.
- The term "investment assets" is the same as defined in section 355(g)(2)(B) (e.g., cash, stock, debt), except that with respect to publicly traded stock and interests in publicly-traded partnerships, the look-through rule in section 355(g)(2)(B)(iv) is applied by requiring **50 percent** (vote and value) ownership.
    - The section 355(g)(2)(B) definition of "investment assets" does not include real property. Is real property excluded for purposes of the no-rule?
- Why did the IRS increase the requisite ownership interest for look-through treatment from the 20% threshold under section 355(g)(2)(B)(iv) to 50%? Did Congress already tell us what constitutes investment assets for purposes of section 355 upon the enactment of section 355(g)?

Recent Ruling History with Small ATBs

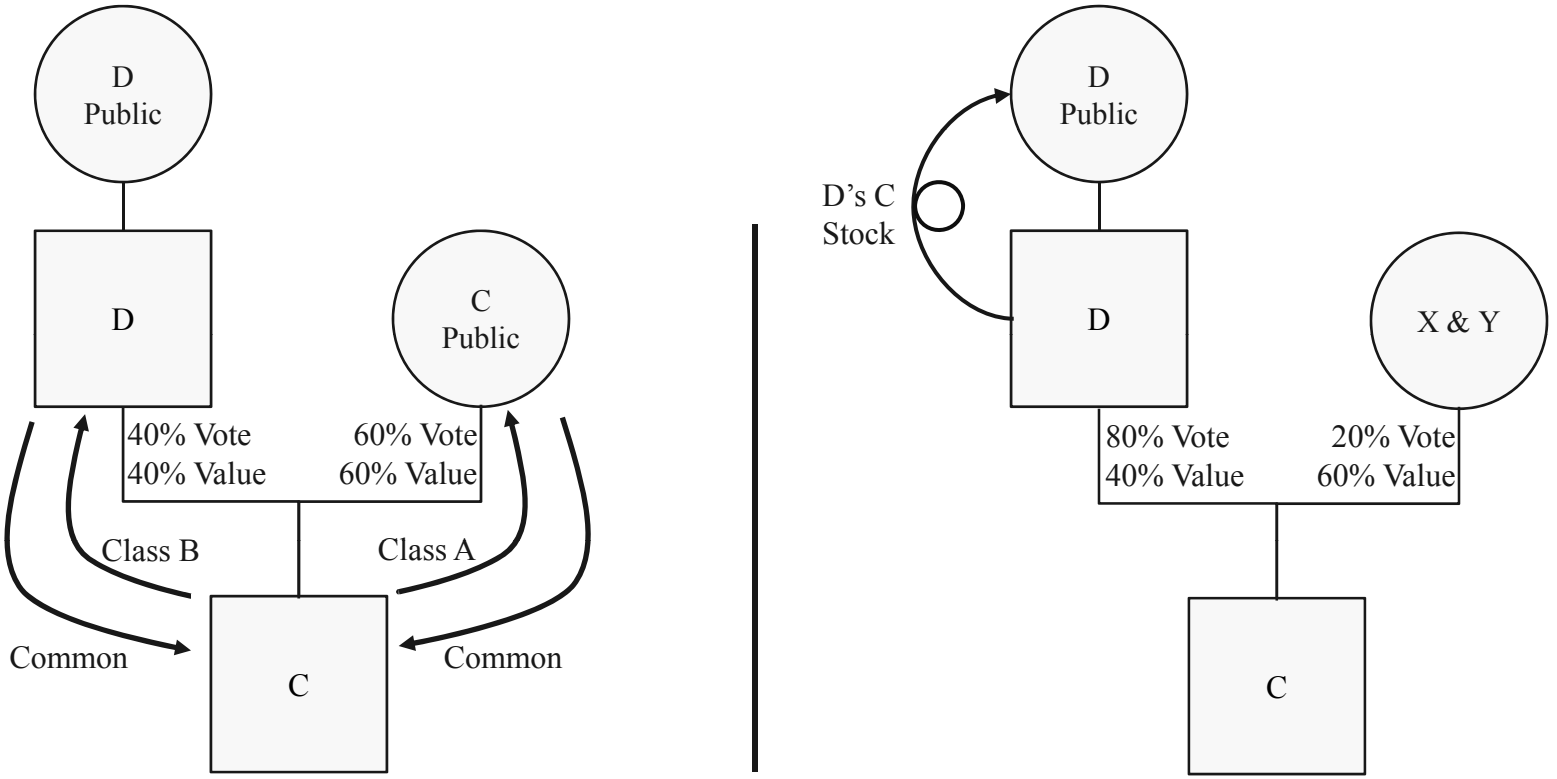
- PLR 201435005: D spun off C, the principal assets of which were a significant stake (albeit less than 80%) in a publicly traded company and business assets satisfying the ATB requirement. D received a PLR that the spin-off will qualify for tax-free treatment (no rulings on device, business purpose or 355(e)).

- PLR 201535007: Key Ruling: "Provided that Business A otherwise satisfies the requirements of section 355(b), the size of Business A will not preclude Newco TRS, Controlled 1 and Distributing from satisfying the active trade or business requirement of section 355(b)…."

- PLR 201531014: Key Ruling: "[T]he relative fair market value of the gross assets of Business A1a (as compared to the fair market value of all gross assets of Controlled 1), and the relative fair market value of the gross assets of Business B1 formerly held directly by FSub 2 (as compared to the fair market value of all gross assets of Distributing 3 or Distributing 2, as applicable), will not prevent Business A1a or Business B1 from qualifying as an active trade or business for purposes of section 355(b)."

- A taxpayer recently publicly announced that IRS refused to issue it a ruling on a request filed prior to release of Rev. Proc. 2015-43/Notice 2015-59 with respect to a transaction in which D would contribute ATB and a minority interest in a publicly-traded corporation to newly formed C followed by the pro rata distribution of C to D's public shareholders. ATB represented an extremely small percentage of C's total assets.

Recapitalization of Publicly Traded Stock



- Assuming the recapitalization is respected, is there a meaningful distinction between the example above and the facts surrounding the final bullet on the previous slide?
- If yes, what if C's Class B stock is recapitalized into Class A stock soon after the spin off subsequent to an independent shareholder vote?

Small ATB No-Rules: Exception for Certain Internal Distributions

- Neither Small ATB No-Rule 1 nor Small ATB No-Rule 2 apply to an internal distribution (i.e., C stock is distributed to one or more members of the affiliated group of which D is a member), provided it is not part of a plan or series of transactions in which there is an external distribution that is described in Sections 4.01(57), 4.01(58), or 5.01(26) of Rev. Proc. 2015-3, as supplemented by Rev. Proc. 2015-43.
    - Section 243(b)(2)(A): "The term "affiliated group" has the meaning given such term by section 1504(a), except that for such purposes sections 1504(b)(2), 1504(b)(4), and 1504(c) shall not apply."
    - 1504(b)(2) refers to insurance companies.
    - 1504(b)(4) refers to "corporations with respect to which an election under section 936 (relating to possession tax credit) is in effect for the taxable year."
- Can taxpayers obtain a private letter ruling for lower-tier spins involving relatively small ATBs?

Pro Rata Distributions and Non-Pro Rata Exchanges of Stock Treated Similarly

- In referencing split offs where the exchanging shareholders would be afforded section 302(a) treatment, the IRS stated that "[o]bviously where the transaction cannot possibly be used as a device for the distribution of earnings and profits so that there is no possibility that the [C]ongressional policy behind section 355 can be frustrated, the percentage of 'active' assets, assuming literal compliance with the statute, is of minor importance." G.C.M. 34238 (Dec. 15, 1969).

- Similarly, in G.C.M. 31959 (Apr. 7, 1961), the IRS concluded that "[s]ince the device prohibition seems to have been intended to prevent the distribution of earnings, we do not believe a transaction can be a device within the meaning of section 355(a)(1)(B) if the taxpayer could obtain capital gain treatment without resort to section 355."

- IRS notes that section 355(g) will not apply to most split offs involving publicly traded corporations "because no single shareholder or group of related shareholders will own more than 50 percent of the stock of either [D] or [C] after the distribution."

- Treasury and IRS believe that a public split off transaction where the exchanging shareholders are afforded section 302(a) treatment can still fail the device requirement where the asset mix is similar to the asset mixes described in Rev. Proc. 2015-43 and Notice 2015-9.

- What is the IRS's current view as to what the device requirement is policing? Does the IRS believe the device requirement's mandate was expanded upon the repeal of the *General Utilities* Doctrine and the enactment of section 337(d)?

Opco/Propco No Rule

The Opco/Propco No Rule

- Section 3.01 of Rev. Proc. 2015-43 and Section 4.01(57) of Rev. Proc. 2015-3.
- IRS *ordinarily* will not rule on any issue relating to the qualification under section 355 of a distribution where:

  (i) Property owned by any D or C becomes the property of a RIC or a REIT in a "conversion transaction" (*i.e.*, conversion to RIC or REIT or transfer to RIC or REIT);

  (ii) No deemed sale election under Treas. Reg. section 1.337(d)-7(c) is made; and

  (iii) The conversion transaction and the distribution are parts of a plan or series of related transactions.

- The REIT Spin-Off No-Rule does not apply if (i) both the D and C will be RICs or REITs immediately after the date of the distribution and (ii) there is no plan or intention for either D or C to cease being treated as a RIC or a REIT.
- Are there any exceptions to "ordinarily" (i.e., unique and compelling circumstances)?
- Is a ruling request submitted prior to September 14, 2015 still eligible to receive a ruling?

History of REIT Spin-Offs: Before 2001

- In Rev. Rul. 73-236, D spun off its sales business and assets as a separate entity, retaining its property rental business and assets. Immediately after the distribution, D elected REIT status.
  - At the time, section 856(d)(3) prevented entities from qualifying as REITs if they provided services to tenants or managed/operated property.
  - IRS concluded that, under section 856(d)(3), a REIT could not satisfy the ATB requirement of section 355(b)(1).

Rev. Rul. 2001-29

- The Tax Reform Act of 1986 amended section 856(d)(2)(C) to operate in conjunction with Treas. Reg. section 1.512(b)-1(c)(5), allowing REITs to provide services usually or customarily rendered in the ordinary course of renting property.
- Rev. Rul. 2001-29 concluded that REITs could now satisfy the active trade or business requirement of section 355(b)(1).
  - Rev. Rul. 73-236 was obsoleted.
- Rev. Rul. 2001-29 cautioned that "the obsolescence of Rev. Rul. 73-236 does not imply a view whether a distribution of stock involving a REIT election by the distributing or controlled corporation would otherwise satisfy the requirements of section 355, including the business purpose requirement."
- Is Rev. Rul. 2001-29 still good law? Is the IRS considering revoking the ruling?
  - Such a revocation may not reach many Opco/Propco transactions. In many Opco/Propco transactions, the real estate is subject to triple-net leases and rely on relatively small ATBs in taxable REIT subsidiaries rather than Rev. Rul. 2001-29 to satisfy the ATB requirement.

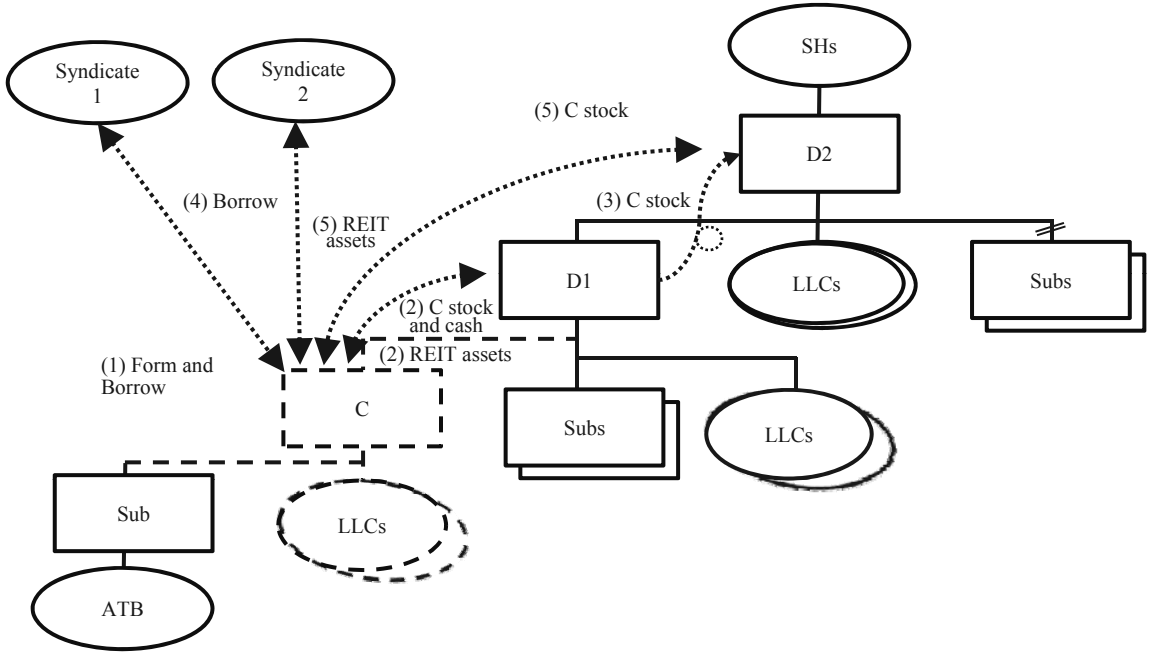
REIT Spin-Offs and Business Purpose

- Under Treas. Reg. section 1.355-2(b)(2), obtaining favorable federal tax treatment is not a valid business purpose for a section 355 distribution.
- Treas. Reg. section 1.355-3(b)(2)(iii) provides that the IRS will "carefully scrutinize" separations of owner-occupied real estate for business purpose.
- REITs are permitted to deduct, at the corporate level, any income distributed as dividends, effectively eliminating one level of tax.
  - Is the goal of obtaining REIT status for D or C an impermissible business purpose?
  - Is intent to elect REIT status following a spin-off evidence of device?
  - The IRS will no longer rule on what constitutes a valid business purpose.
    - The IRS's Section 355 Committee has accepted in the past a representation stating that a spin-off's business purpose is to increase C's value to investors by electing REIT status for C.
    - In PLR 200932018, the IRS granted tax-free treatment to the spin-off of newly-formed C, followed by the merger of C with and into a REIT, with the surviving REIT continuing to operate as such.
    - The IRS may be sympathetic to spin-offs where D owns a substantial amount of real estate, wants to separate the real estate from its other businesses due to regulatory constraints, but is not able to effect the separation unless C can compete in the marketplace as a REIT.

PLR 201337007

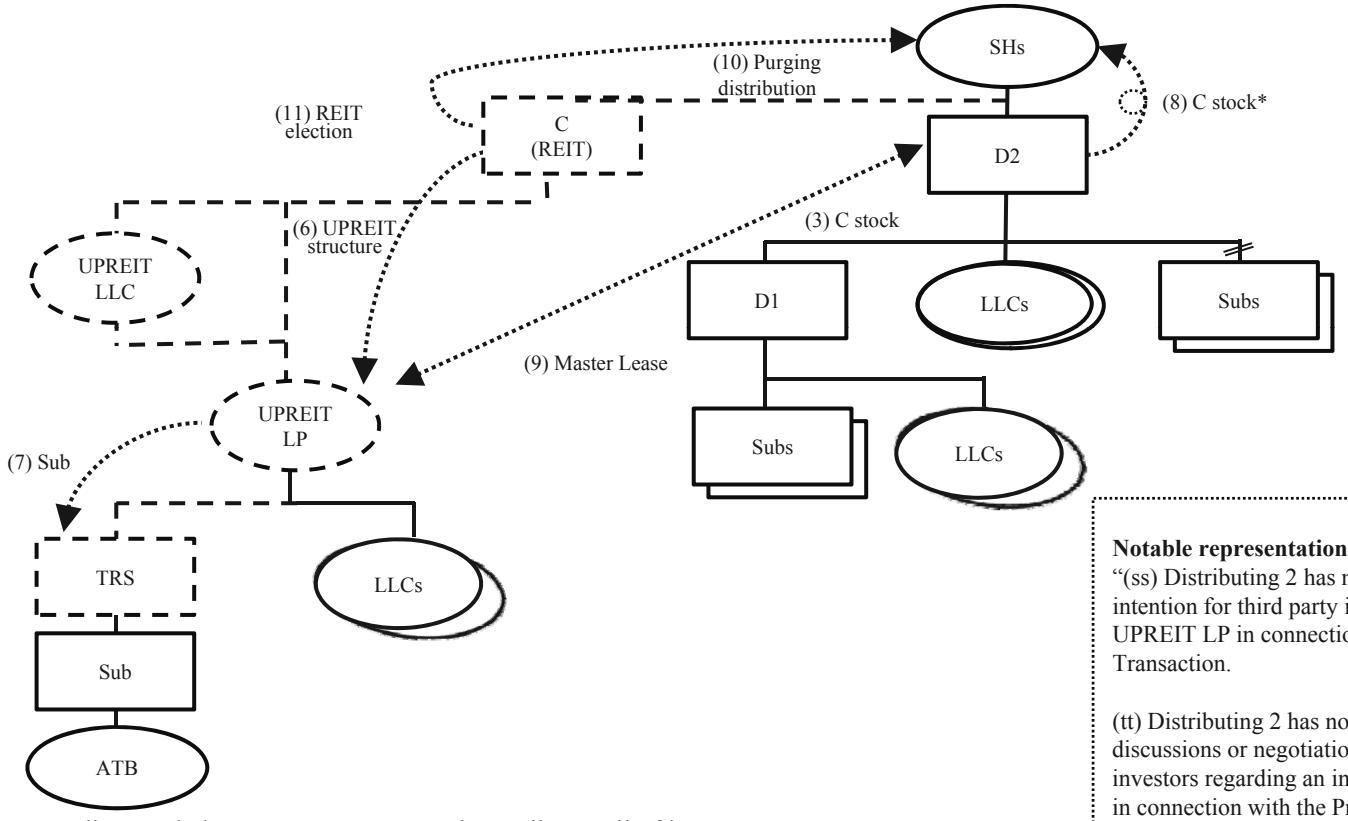
- Opco/Propco structure; first IRS-approved spin-off of a corporation intending to elect REIT status.
- Opco operates in Business A; Propco created to own and lease real property associated with Business A to companies engaged in Business A (including Opco).
- Opco contributed two operating assets to Propco (which would presumably hold them through a taxable REIT subsidiary) to satisfy the ATB requirement.
- The IRS did not rule on device or business purpose, but Opco represented that the spin-off was being carried out to facilitate strategic expansion opportunities by providing Propco the ability to (i) pursue transactions with competitors that would not pursue transactions with Opco, (ii) diversify into different businesses in which Opco, as a practical matter, could not diversify, (iii) pursue certain transactions that Opco otherwise would be disadvantaged by or precluded from pursuing due to regulatory constraints, and (iv) fund acquisitions with its equity on significantly more favorable terms than those that would be available to Opco.
- Other companies have subsequently announced spin-offs of corporations intending to elect REIT status.

PLR 201337007 (Simplified Structure)



(1) D1 forms C and C Borrows from Syndicate 1
(2) D1 contributes REIT assets and Sub to C in exchange for cash and actual or constructive shares of C stock
(3) D1 distributes the C stock to D2
(4) C borrows from Syndicate 2
(5) D2 contributes REIT assets to C in exchange for cash and actual or constructive shares of C stock

PLR 201337007 (Simplified Structure)(Cont'd)



Notable representations:
"(ss) Distributing 2 has no current plan or intention for third party investors to invest in UPREIT LP in connection with the Proposed Transaction.

(tt) Distributing 2 has not engaged in any discussions or negotiations with any third party investors regarding an investment in UPREIT LP in connection with the Proposed Transaction."

(6) C creates a disregarded UPREIT structure and contributes all of its assets to UPREIT LP
(7) UPREIT LP contributes Sub to TRS
(8) D2 distributes the C stock to its shareholders
(9) D2 and UPREIT LP enter into the Master Lease pursuant to which UPREIT LP will lease to D2 certain assets transferred to C, and further transferred to UPREIT LP, in connection with the proposed transaction
(10) C makes a purging distribution of E&P
(11) C makes a REIT election
* No single shareholder, through attribution, can own 10% or more of both D2 and C

Additional Opco/Propco Rulings Issued

- Additional Opco/Propco Rulings Issued
  - PLR 201433007
  - PLRs 201411002/201431020
  - PLR 201528006
- Several submitted Opco/Propco ruling requests yet to be issued