

Practising Law Institute

Section 355: Divisive Strategies Discussion Problems*

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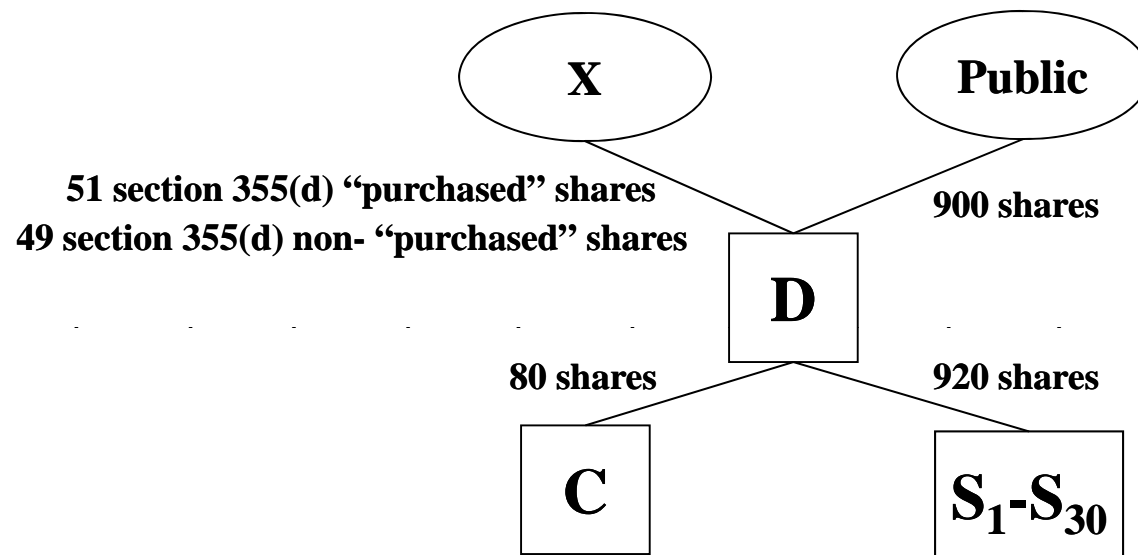
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** The authors gratefully acknowledge the assistance for this year's effort of M. Todd Prewett and Dean S. Shulman.*

Rev. Proc. 2013-32

- Pursuant to Rev. Proc. 2013-32, 2013-28 I.R.B. 55 the Service will no longer provide “no gain or loss” rulings with respect to section 355 (or sections 332, 351, 1036 or rulings on whether a transaction constitutes a reorganization within the meaning of section 368).
- The Service will instead rule only on significant issues under such sections.
 - A significant issue is an issue of law the resolution of which is not essentially free from doubt and that is germane to determining the tax consequences of the transaction. An issue the resolution of which is not essentially free from doubt under one Code section may nevertheless not be germane to determining the tax consequences of the transaction if, for instance, another Code section provides the same consequences as the first Code section
- The Service will not issue rulings with respect to significant issues which are the subject of a no-rule position (e.g., where control is acquired via the issuance of stock with disparate voting power, an exchange under section 361 for distributing debt issued in anticipation of the distribution, or a north-south transaction – see Rev. Proc. 2013-3, 2013-1 I.R.B. 113).
- The pilot program announced in Rev. Proc. 2009-25 for letter rulings on certain issues arising in the context of a section 355 distribution is discontinued.

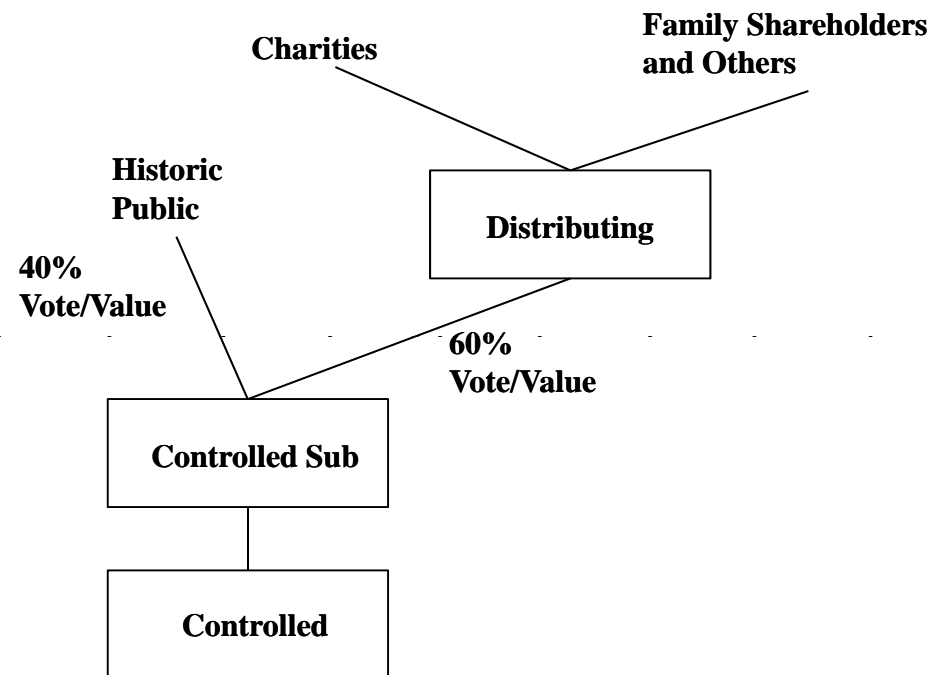
PLR 200810024: Section 355(d) Representation/Assumption (iii)



- Each share of each D, C, and all other members of the D group has \$1 FMV.
- D proposes to split-off C to Shareholder X in exchange for 80 shares of D stock.
 - Can Shareholder X specifically identify D shares tendered in the exchange for the 80 shares of C stock in accordance with Reg. §1.1012-1(c) and thus avoid application of §355(d), e.g., tendering 41 non-purchased shares and 39 purchased shares?
 - Is the tender exchange instead deemed to be made based upon a convention, e.g., pro rata or taxpayer favorable (adverse) stacking rule?

* See also PLR 200808006 (same), PLR 200810001 (same), PLR 200810018 (same).

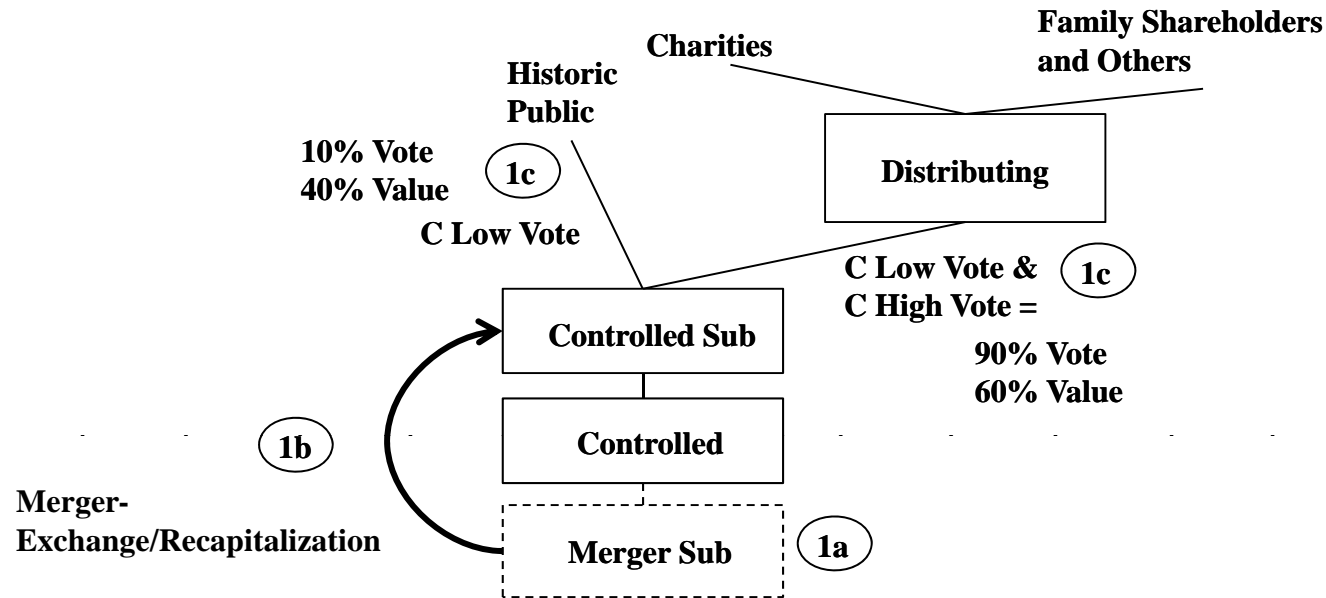
PLR 201123030 – Simplified Historic Structure



Distributing Objectives:

- **Tax-free Split-Off of 20% of Controlled shares (by value) to Distributing shareholders**
- **Tax-Free Transfer of 40% of Controlled shares (by value) to Distributing creditors tax-free**
- **Terminate Charities interest in Distributing and provide Charities ability to sell Controlled shares**

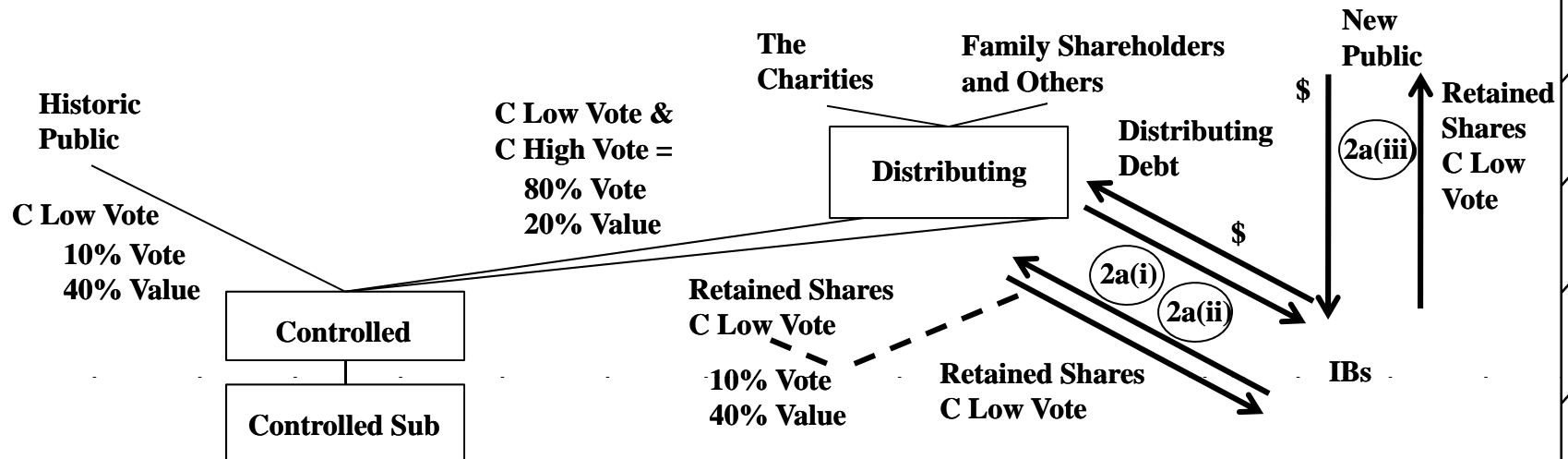
PLR 201123030 – Simplified Step 1 of 4



Step 1: (a) Controlled forms Merger Sub, (b) Merger Sub merges into Controlled Sub (the “Merger-Exchange/Recapitalization”), and (c) Controlled in the merger issues multiple classes of common stock (high vote and low vote) with Controlled Sub receiving low vote (hook stock owned by Controlled Sub is not shown), Historic Public receiving low vote, and Distributing receiving both high vote and low vote.

- Query whether acquisition of Controlled stock in the Merger-Exchange/Recapitalization is an acquisition taken into account for § 355(e)? See § 355(e)(3)(A)(i) (exception for acquisition of stock of C by D); § 355(e)(3)(A)(iv) (exception to extent no decrease in percentage ownership interest due to acquisition). PLR expressly provides that if such acquisition were taken into account for either Historic Public or Distributing, § 355(e) would apply and that such fact was considered in issuing ruling that Distributing would not recognize any gain upon distribution.
- See Rev. Proc. 2013-3, § 5.01(9) (no rule position if the high vote/low vote structure is implemented in anticipation of the distribution.)
- Query whether acquisition of control in this manner implicates ATB qualification? See Rev. Rul. 71-593; Rev. Proc. 2013-3, § 4.01(29); Treas. Reg. § 1.355-3(b)(4); but see Prop. Reg. § 1.355-3(b)(4)(ii)(A) (use of assets test).

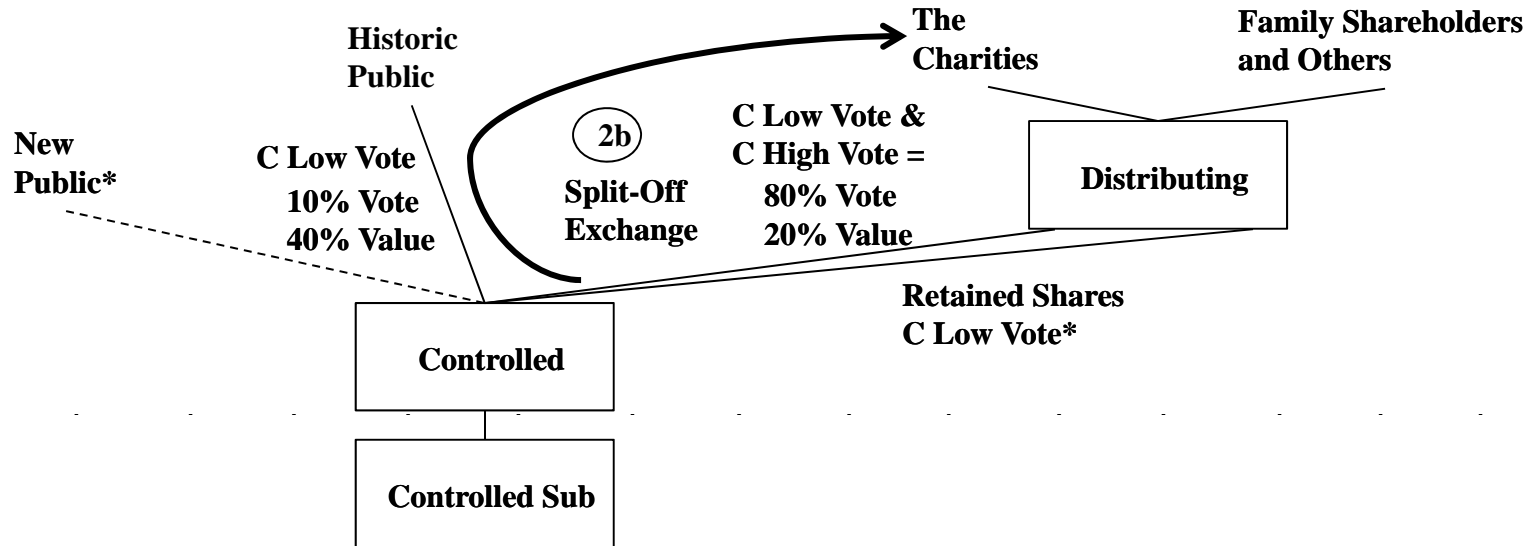
PLR 201123030 – Simplified Step 2a of 4



Step 2a: (i) Distributing issues commercial paper and/or other short term debt (the “Distributing Debt”) for cash directly to investment banks (the “IBs”), acting as principals for their own account, at least 14 days prior to the distribution of Controlled shares (the “Split-Off”) and 5 days prior to Distributing and IBs entering into any exchange agreement, (ii) Distributing expects to transfer a portion or all of the Controlled shares it will retain in the Split-Off (the “Retained Shares”) to the IBs in exchange for the Distributing Debt (the “Initial Debt-Exchange”), and (iii) the IBs expect to conduct a secondary public offering of Controlled shares acquired in the Debt-Exchange (the “First Public Offering”).

See Rev. Proc. 2013-3, § 5.01(10) (no rule position for section 351 or 361 if the debt-exchange is for Distributing debt issued in anticipation of the distribution).

PLR 201123030 – Simplified Step 2b of 4

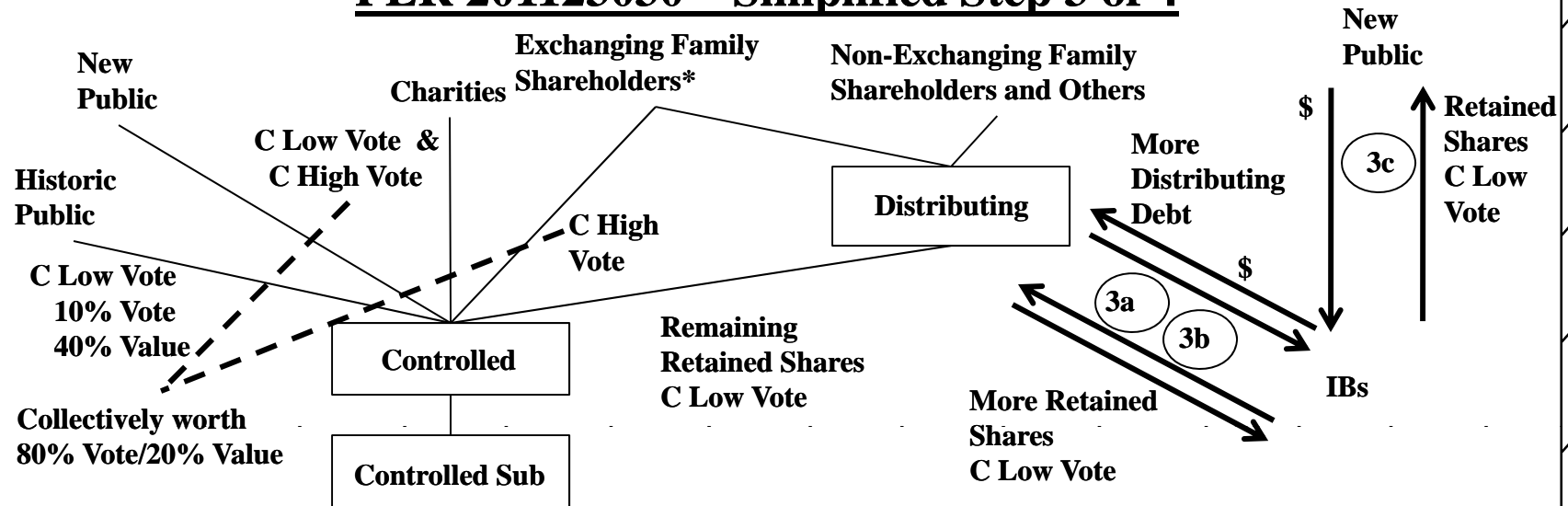


Step 2b: The Split-Off: (i) assume **Distributing** keeps a portion of the **Retained Shares** so that more than one public offering is required, (ii) **Charities** exchange all of their **Distributing** shares for high vote and low vote shares, and (iii) **Exchanging Family Shareholders** exchange some or all of their **Distributing** shares for high vote shares.

- **Retention of Controlled shares**, among other things, provides source of cash for working capital and expansion opportunities.
- **During the 5-year period following the Split-Off**, governance rights limited for certain **Controlled** shareholders.
- **Charities** may receive additional payment from **Distributing** in cash or **Retained Shares** if **Distributing** lists its common stock on a public securities exchange. No rulings address the distribution of such rights (i.e., boot or tax-free if contingent payment made solely in **Retained Shares**).

***NOTE:** **New Public** is comprised of the investors in the **First Public Offering** that receive the **Retained Shares** transferred to **IBs** in the **Initial Debt-Exchange**. The shares owned by **New Public** together with the **Retained Shares** still owned by **Distributing** comprise 10% (by vote) and 40% (by value) of **Controlled** shares of stock.

PLR 201123030 – Simplified Step 3 of 4

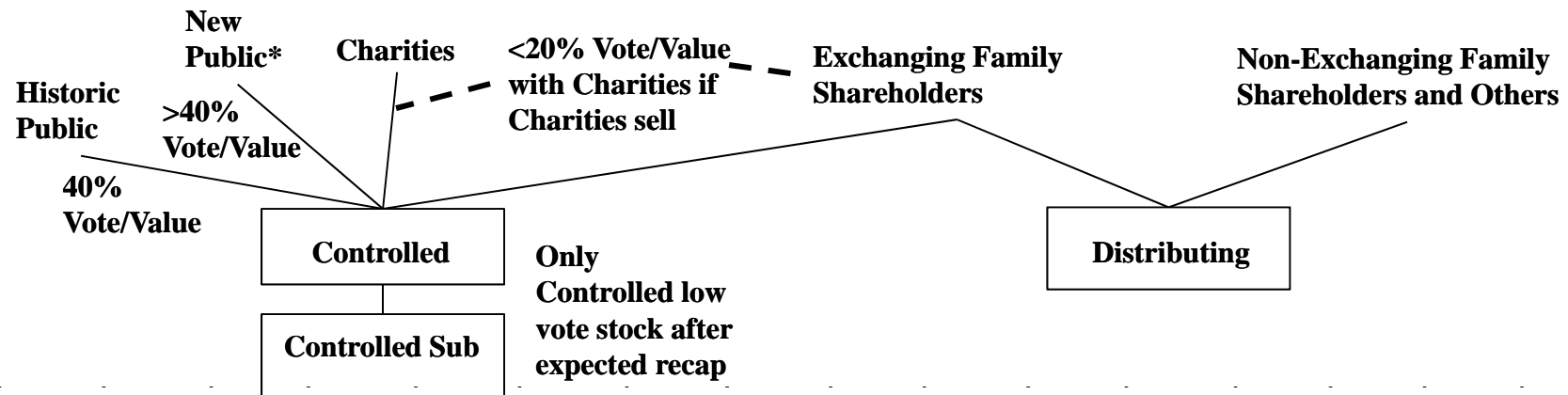


Step 3: Remaining Retained Shares are expected to be exchanged in additional follow-up exchanges (“Follow-On Debt Exchanges”) and transferred in follow-up secondary offerings (“Additional Public Offerings”). The Charities can sell Controlled shares in Additional Public Offerings or thereafter, demand an underwritten secondary offering to sell their shares. The Debt Exchanges must occur within § months after the Split-Off. Any Retained Shares not disposed of in the Debt Exchanges must be disposed of no later than 5 years after the Split-Off. Query the apparent different time periods for disposing of the Retained Stock and completing the Debt Exchanges?

- **Controlled obligated to maintain a shelf registration statement after underwriter’s lock-up expires until second anniversary of Split-Off for the sale of Controlled shares owned by the Charities in open market through a broker that would not involve an underwriting. PLR expressly provides that any shelf-sale by the Charities that is considered “similar to a public offering” would cause § 355(e) to apply and that such fact was considered in issuing ruling that Distributing would not recognize any gain or loss upon the Split-Off. See Treas. Reg. § 1.355-7(h)(11) (public offering is acquisition of stock for cash where terms of acquisition are established by acquiring corporation (Distributing or Controlled) or seller with the involvement of one or more investment bankers and potential acquirers have no opportunity to negotiate terms of acquisition).**

***NOTE: Assumes Exchanging Family Shareholders retain some of their Distributing stock.**

PLR 201123030 – Simplified Step 4 of 4 – Resulting Structure



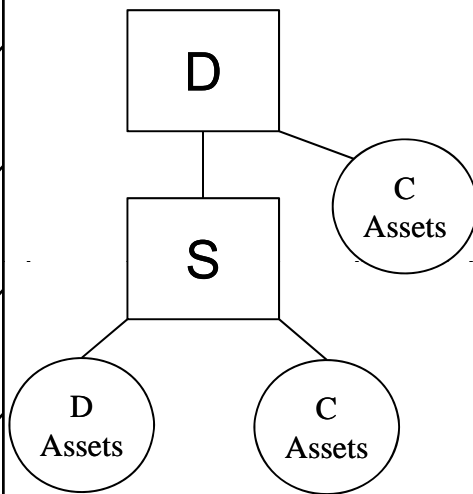
- **Controlled expects that, following the Split-Off and Initial Debt Exchange, in its connection with first annual shareholder meeting, the Controlled board of directors will consider a proposal to unwind the multiple class stock structure by converting the high vote stock to low vote stock.**
 - **No binding commitment or other assurance by Controlled or its board of directors to consider or resolve to present conversion proposal. Unwinding the multiple class stock structure also would require a vote of the majority of all classes of stock voting together as single class with each share having one vote.**
 - **PLR expressly provides that the increased voting interest the Historic Public would acquire if such a conversion were treated as an acquisition would cause § 355(e) to apply and that such fact was considered in issuing ruling that Distributing would not recognize any gain or loss upon the Split-Off. This implicit ruling is most likely explained as a netting rule that compares the ownership at beginning of the plan to ownership at the end of plan to determine the amount of increase. See also, PLR 201004001 (Oct. 22, 2009) (ruling 25; netting increases in voting power resulting from one part of plan with decreases in voting power resulting from another part of plan).**

***NOTE: Includes those investors in any secondary offerings by the IBs and purchasers of Controlled stock from Charities.**

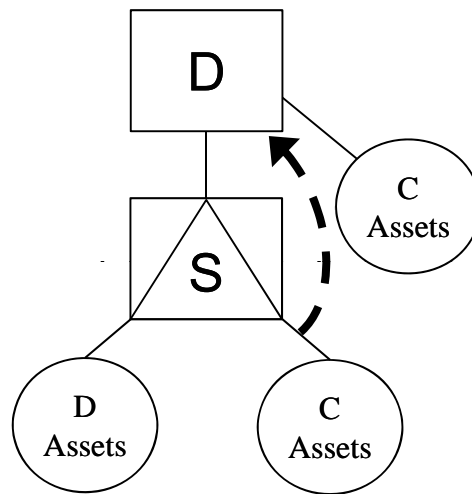
Liquidation-Reincorporation in Connection with a Section 355

Transaction?

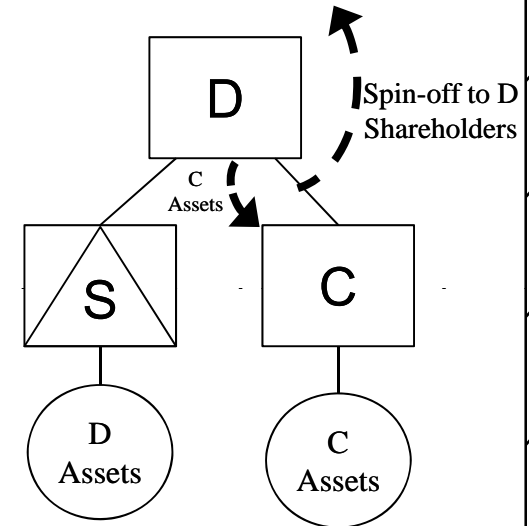
Beginning Structure



S converts to an LLC under state law and thereafter distributes C Assets to D



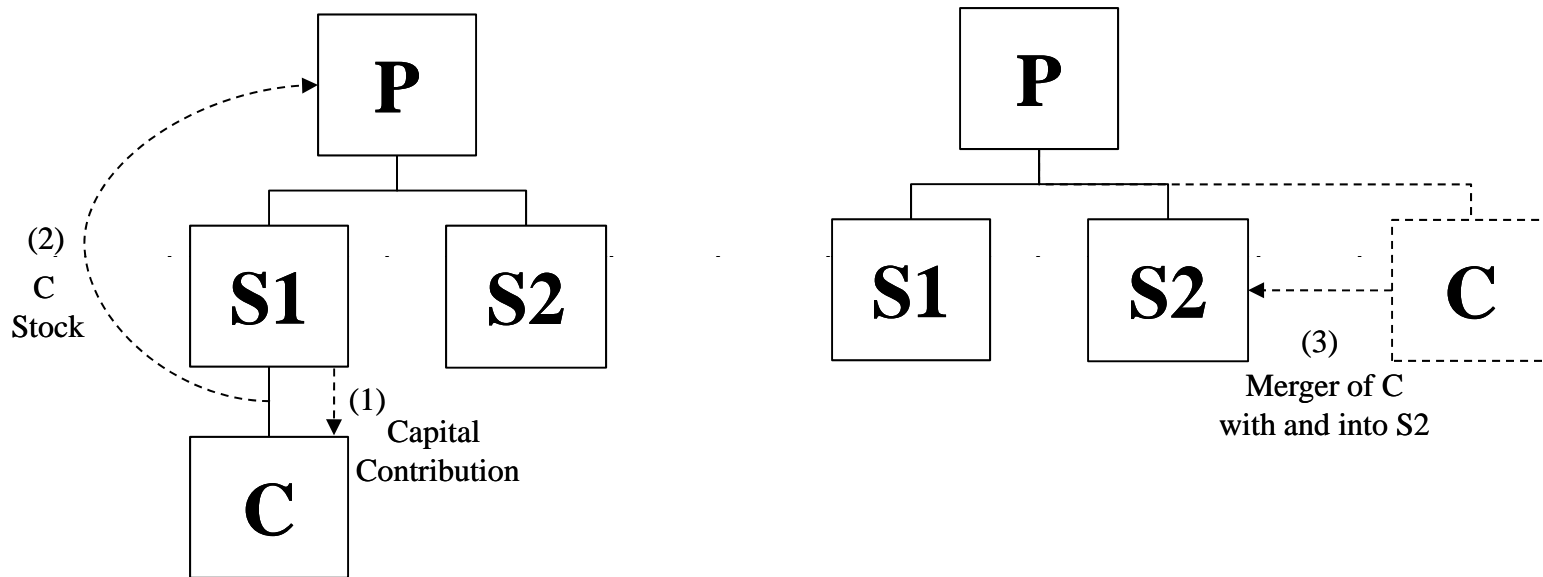
D contributes all C Assets to C and spins off C to D Shareholders



Issues

1. Is conversion a tax-free liquidation under Sections 332 and 337 or does liquidation/re-incorporation doctrine apply?
2. Is conversion an “upstream” C reorganization, subject to Treas. Reg. §1.368-2(k) (COBE is satisfied through D's ownership of D assets)?
3. Could the transaction be viewed as a taxable transfer of C assets by S to C?
4. IRS view appears to be Sections 332 and 337 apply ((e.g.) PLR 200725002)
 - a. C is not S's alter-ego
 - b. C assets move closer to D shareholders via spin-off.
5. What if all S's assets are reincorporated?
6. Does it matter if C assets are dropped below C?

North-South No-Rule Transaction Examples - Slide 3: Affiliated Group Reverse Morris Trust Transaction



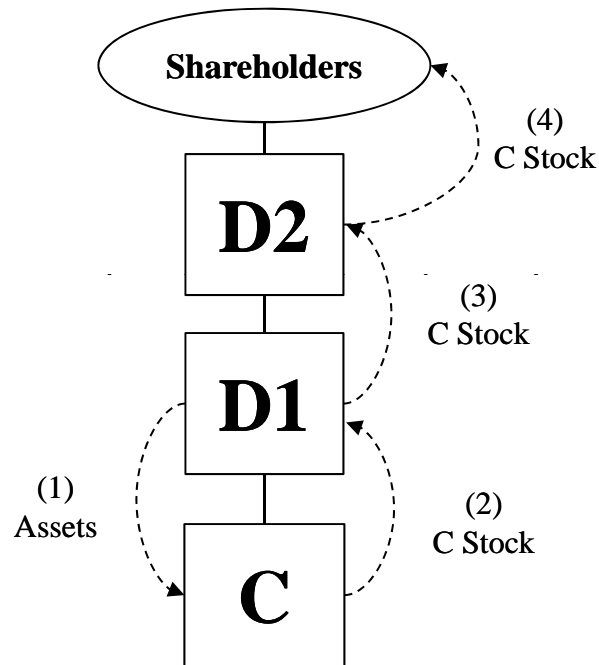
Application to Language of “North-South No-Rule”: Whether transfers of stock, money, or property by a person [S1, which will contribute property (not in exchange for stock) to pre-existing C in a capital contribution in Step (1)] to a corporation [C] and transfers of stock, money, or property by that corporation [C, which will merge with and into S2 in Step (3)] to that person (or a person related to such person [S2, as a member of an affiliated group comprised of P, S1, S2, and C]) in what are *ostensibly* two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation’s stock, a contribution to the corporation’s capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes.

North-South No-Rule Position

Rev. Proc. 2013-3 provides that, until the Service resolves the issue, it will no longer rule on:

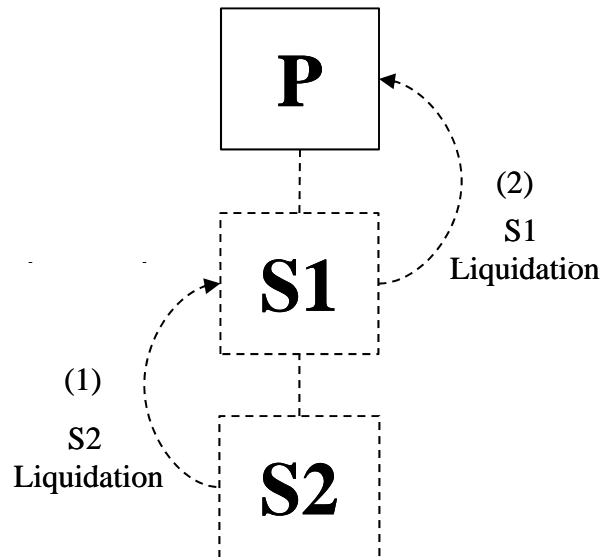
- Whether transfers of stock, money, or property by a person to a corporation and transfers of stock, money, or property by that corporation to that person (or a person related to such person) in what are ostensibly two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation's stock, a contribution to the corporation's capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes. See Rev. Proc. 2013-3, 2013-1 I.R.B. 113.

North-South No-Rule Transaction Examples -
Slide 1: Rev. Rul. 62-138



Application to Language of “North-South No-Rule”: Whether transfers of stock, money, or property by a person [C, which transfers stock to D1 in Step (1)] to a corporation [D1] and transfers of stock, money, or property by that corporation [D1, which will transfer all of its C stock to D2 in Step (3)] to that person (or a person related to such person) [D2] in what are *ostensibly* two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation’s stock, a contribution to the corporation’s capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes.

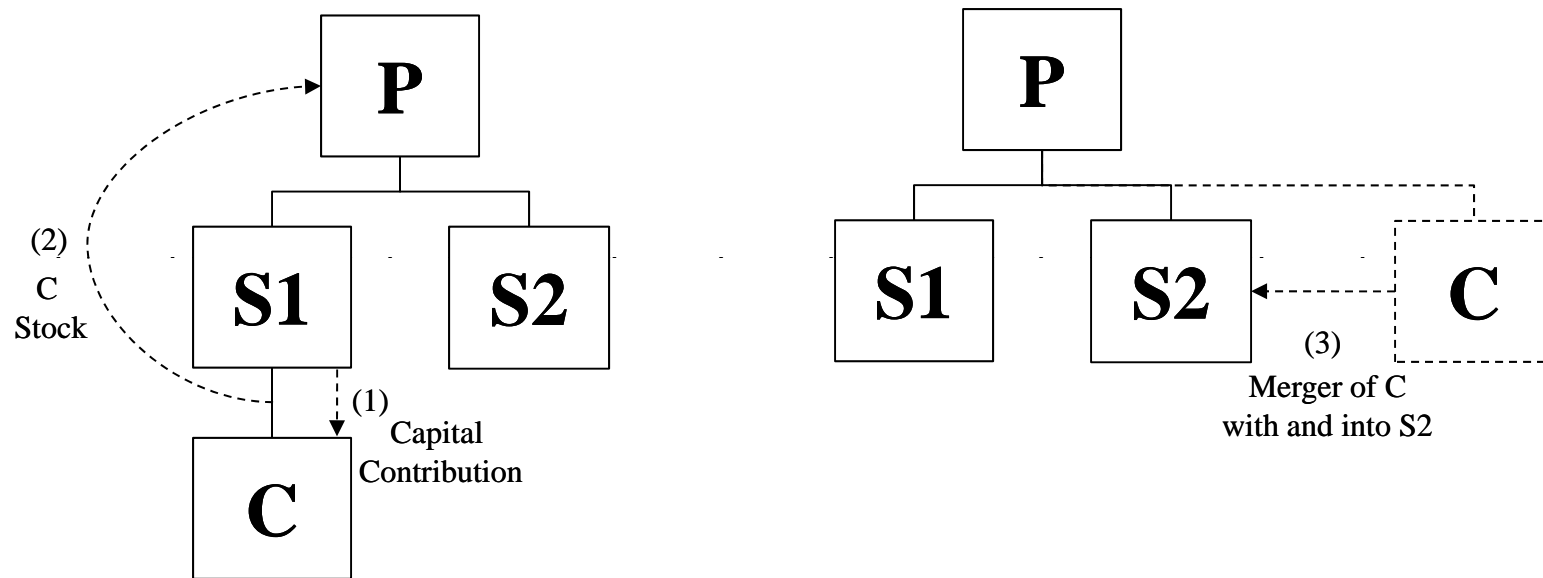
North-South No-Rule Transaction Examples - Slide 2: Tiered Liquidations under Section 332



Application to Language of “North-South No-Rule”: Whether transfers of stock, money, or property by a person [S2, which will distribute assets in complete liquidation to S1 in Step (1)] to a corporation [S1] and transfers of stock, money, or property by that corporation [S1, which will distribute assets in complete liquidation to P in Step (2)] to that person (or a person related to such person [P, as the former indirect parent of S2]) in what are *ostensibly* two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation’s stock, a contribution to the corporation’s capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes.

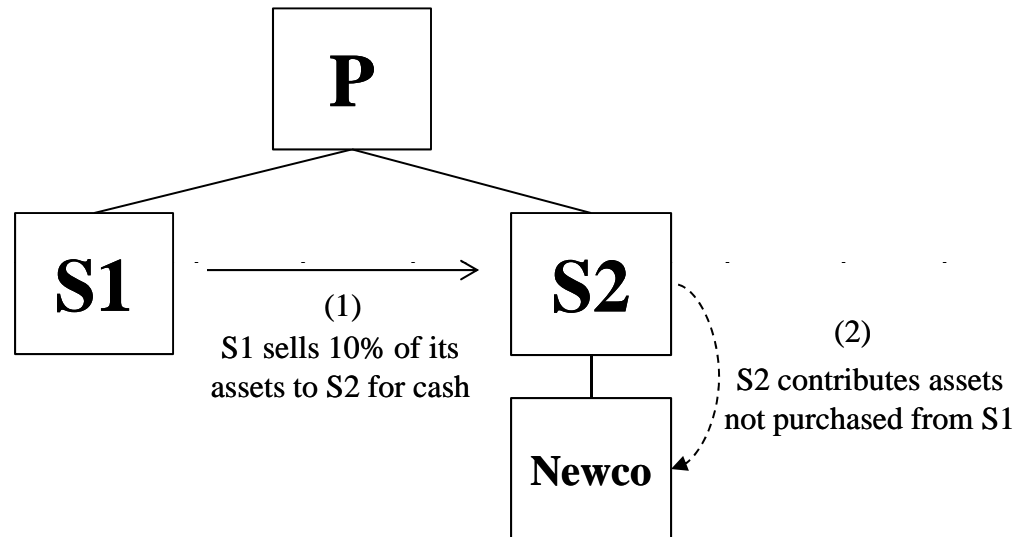
- What result if 15% of S2’s pre-liquidation value is immediately contributed by P to a newly formed subsidiary?

North-South No-Rule Transaction Examples - Slide 3: Affiliated Group Reverse Morris Trust Transaction



Application to Language of “North-South No-Rule”: Whether transfers of stock, money, or property by a person [S1, which will contribute property (not in exchange for stock) to pre-existing C in a capital contribution in Step (1)] to a corporation [C] and transfers of stock, money, or property by that corporation [C, which will merge with and into S2 in Step (3)] to that person (or a person related to such person [S2, as a member of an affiliated group comprised of P, S1, S2, and C]) in what are *ostensibly* two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation’s stock, a contribution to the corporation’s capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes.

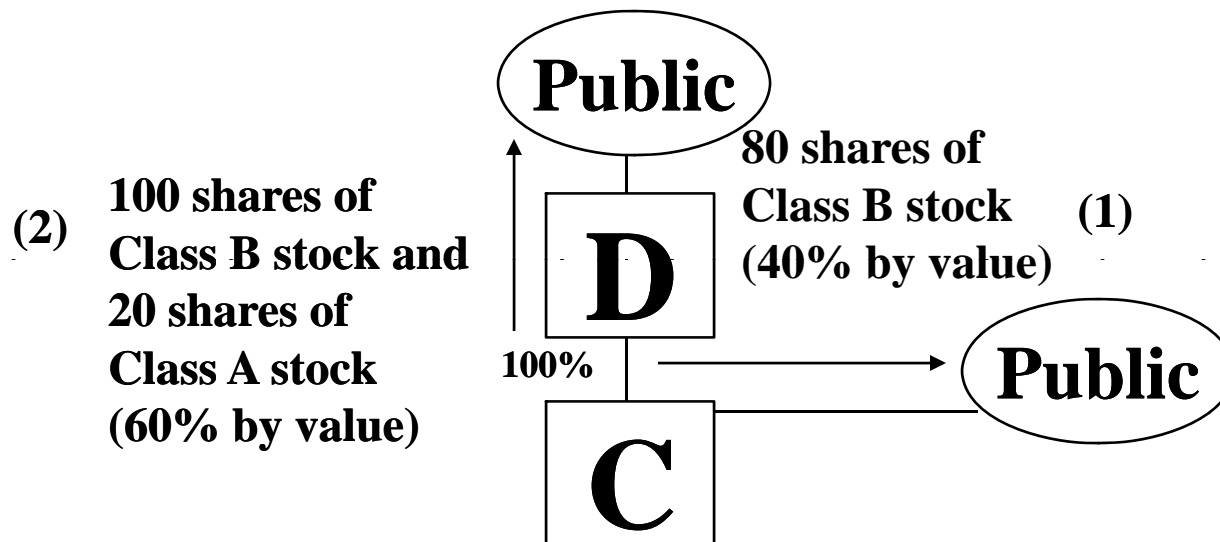
North-South No-Rule Transaction Examples -
Slide 4: A Per Se Exchange



Application to Language of “North-South No-Rule”: Whether transfers of stock, money, or property by a person [S1] to a corporation [S2] and transfers of stock, money, or property by that corporation [S2, that contributes assets to Newco in Step (2)] to that person (or a person related to such person [Newco]) in what are *ostensibly* two separate transactions (so-called “north-south” transactions), at least one of which is a distribution with respect to the corporation’s stock, a contribution to the corporation’s capital, or an acquisition of stock, are respected as separate transactions for Federal income tax purposes.

**High-Vote/Low-Vote
No Rule**

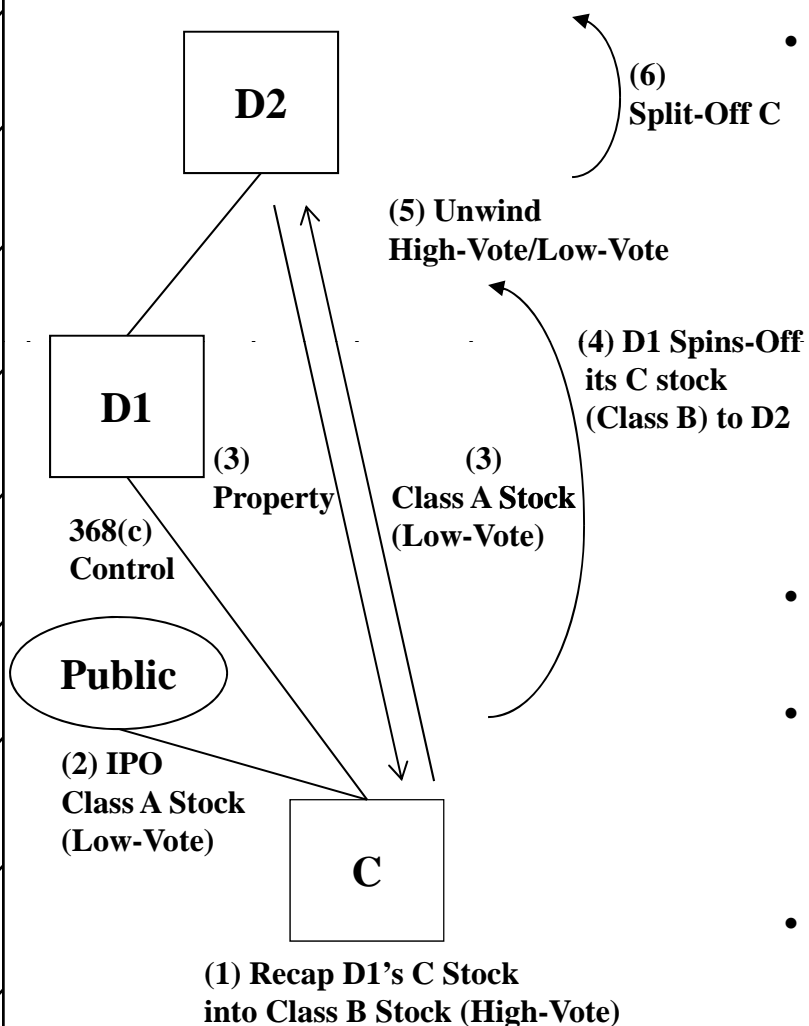
Divergent Vote and Value — Recapitalization & Spin-Off



Facts: D owns all of C's stock and recapitalizes the stock into 100 shares of Class A stock and 100 shares of Class B stock which are equal in value. Each share of Class A and Class B stock, respectively, has ten votes and one vote. D sells 80 shares of Class B stock (i.e., 40% of the value of C and less than 8% of the vote in C (80/1100)) to the public. D distributes its remaining C stock with more than 92% of the vote (1020/1100). See PLR 199935031.

Modified Facts: D owns 100% of C's stock. C borrows cash equal to 40% of its value and distributes the borrowed funds to D. C issues a new class of stock to the public for an amount which approximates the funds distributed to D, but represents only 8% of the vote. D then spins off C.

PLR 201007050 – Recap into and out of High Vote/Low Vote Structure

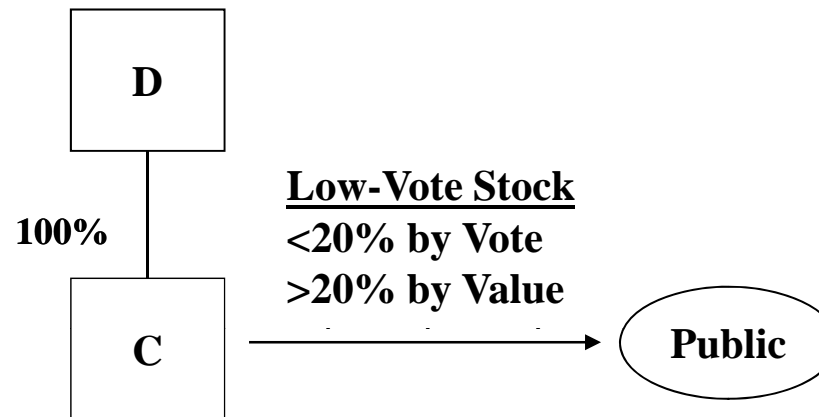


- C recapped stock held by D1 into high-vote class B stock in order for D1 to retain control following planned IPO by C of low-vote class A stock. Following the IPO, D2 contributed property to C in exchange for low-vote class A stock. D1 spun-off its C stock to D2. D2 announced exchange offer of its stock for C stock. If the exchange offer is successful, D2 will unwind high-vote/low-vote structure by converting its high-vote shares to low-vote shares and then distributing C to its shareholders. In a “single issue” ruling, the Service ruled that contemplated unwind would not cause the internal distribution to fail the “control immediately before” requirement. Cf. Rev. Rul. 98-27, 1998-1 C.B. 1159 (step transaction doctrine not applied to determine if D had control of C solely because of post-distribution acquisition or restructuring of C). Non-tax business purpose? See GCM 39088 (July 15, 1983) (§1036 has no business purpose requirement).
- Recapitalization apparently could have been avoided if property contributed through D1, which would have instead raised a north-south issue.
- Represented that: no legally binding obligation after internal distribution to (i) change voting power of any class of C stock, or (ii) proceed with remainder of proposed transactions (steps 5 and 6) absent the fulfillment of the minimum tender condition for step 6. See PLR 201007050 (Nov. 13, 2009) (reps (d) and (e)).
- Does newly codified economic substance requirement of section 7701(o) affect the analysis? See H.R. Rep. No. 111-443 (Mar. 17, 2010) (economic substance “not relevant” if tax benefit is clearly consistent with the relevant Code provisions and policies).

Rev. Proc. 2013-3 No Rule on High-Vote/Low-Vote Recapitalization

- **Rev. Proc. 2013-3 provides that, until the IRS resolves the issue, it will no longer rule on:**
 - **Whether a corporation is a “controlled corporation” within the meaning of section 355(a)(1)(A) if, in anticipation of a distribution of the stock of the corporation, a distributing corporation acquires putative control of the controlled corporation (directly or through one or more corporations) in any transaction (including a recapitalization) in which stock or securities were exchanged for stock having a greater voting power than the stock or securities relinquished in the exchange, or if, in anticipation of a distribution of the stock of the putative controlled corporation, such corporation issues stock to another person having different voting power per share than the stock held by the distributing corporation.**

High-Vote/Low-Vote No Rule - Transaction Example 1

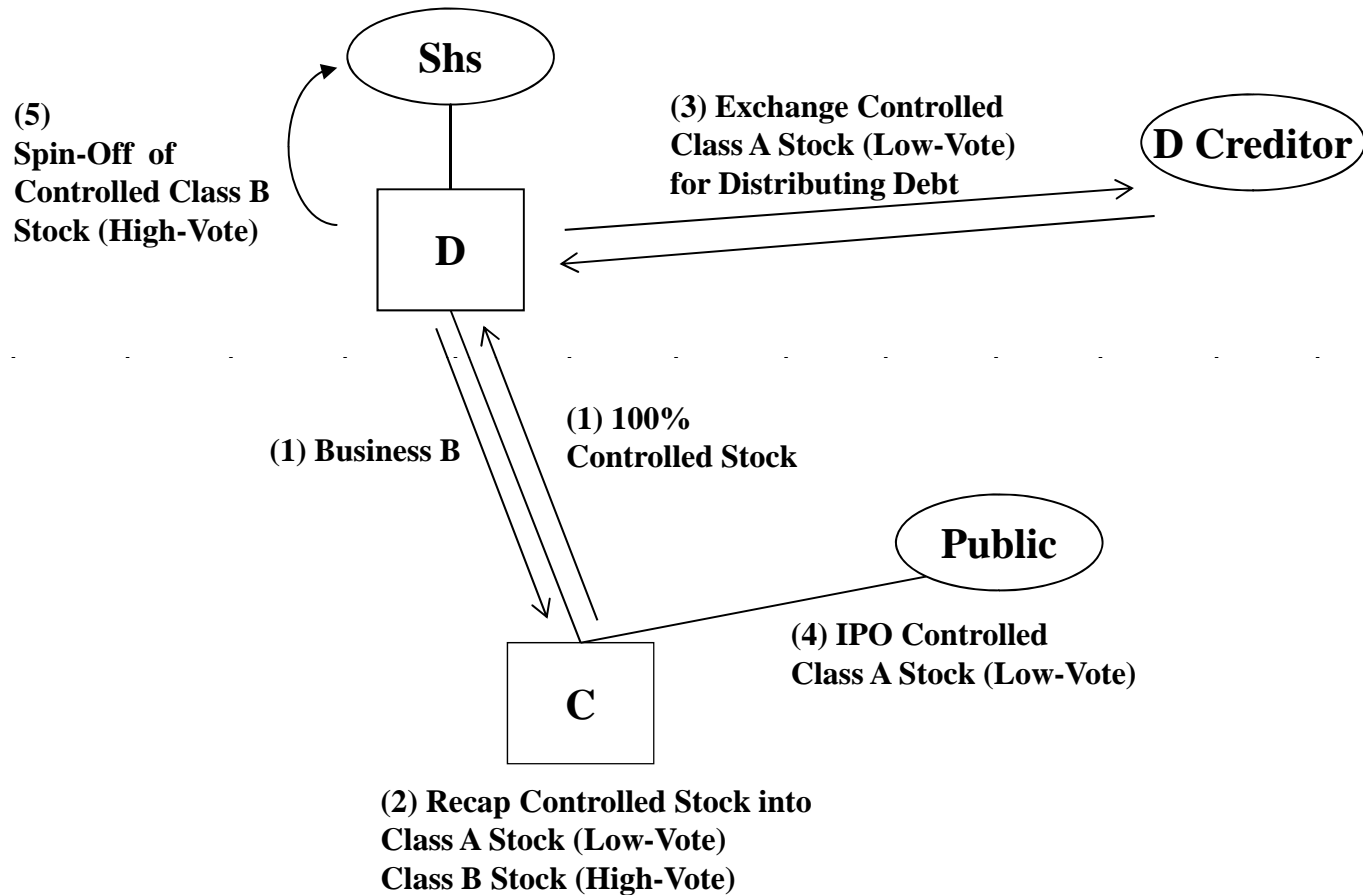


Facts: D wholly owns C, which recapitalizes and issues to public shareholders low-vote stock representing more than 20% by value and less than 20% by vote.

Questions:

- Would the transaction still be subject to the Rev. Proc. 2013-3 no-rule :
 - If C also issues low-vote stock to D?
 - If the low-vote stock was issued prior to any contemplation of the distribution?
 - If C issued the low-vote stock to D and D sold that low-vote stock to the public?
- Does it matter whether the low-vote stock is common or preferred?
- Guideposts, if any, for opinion practice?

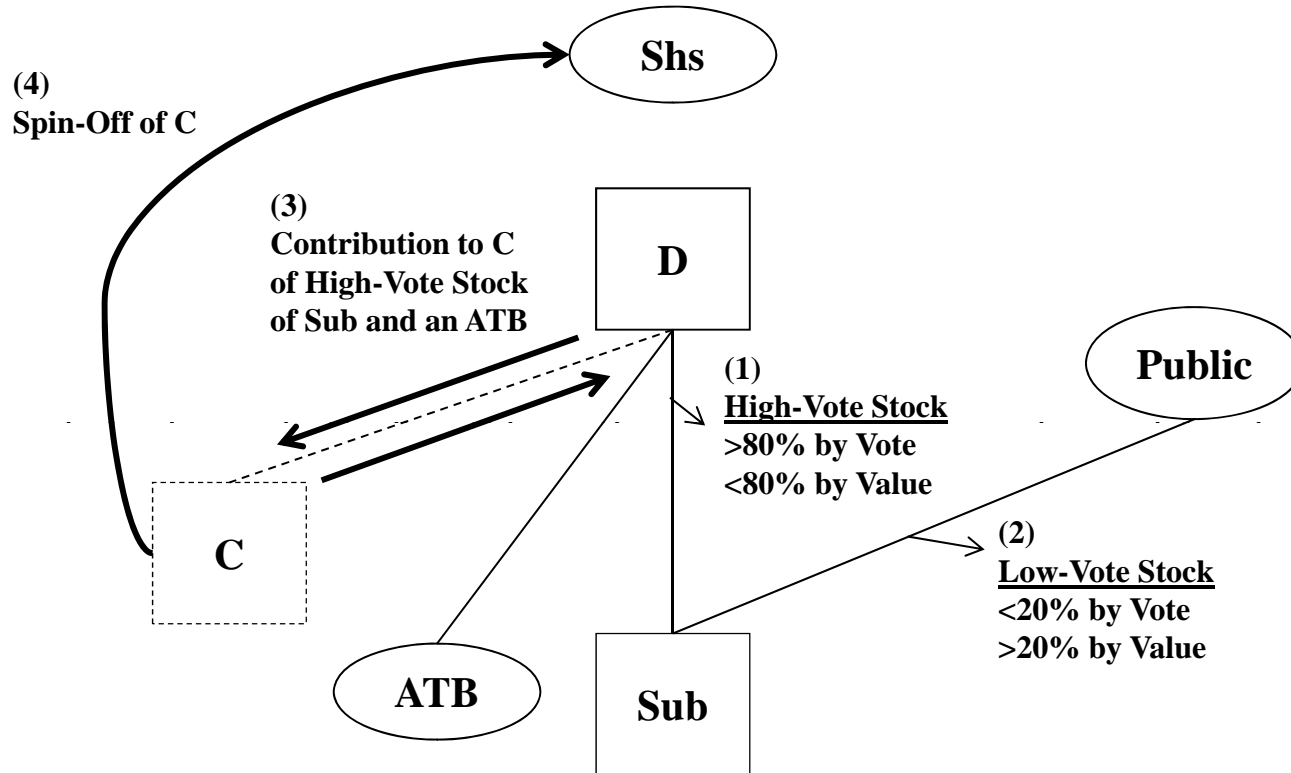
High-Vote/Low-Vote No Rule - Transaction Example 2 - PLR 200125011



Question:

- Does it matter whether the D debt owned by the D creditor constitutes a security?
- Does it matter if the D creditor is also a shareholder of D?

High-Vote/Low-Vote No Rule – Alternative Structure



Facts:

- (1) D owns all of the high-vote stock of Sub (more than 80% of the vote but less than 80% of the value);
- (2) The public owns all of the low-vote stock of Sub (less than 20% of the vote but more than 20% of the value);
- (3) D contributes to a newly-formed corporation, C, the high-vote stock of Sub and an active trade or business in exchange for all the stock of C;
- (4) D distributes C to its shareholders.

Overview of Section 336(e) Regulations **and Stock Distributions**

- The section 336(e) regulations allow deemed asset sale treatment for a qualified stock disposition, *i.e.*, the taxable disposition or series of dispositions totaling $\geq 80\%$ of the stock of a domestic corporation, within 12 months, by a domestic corporation or by shareholders of an S corporation, to any person or persons other than persons related to the disposing shareholder(s).
- Modeled on section 338(h)(10), but—
 - Section 338(h)(10) looks to a “purchase” of $\geq 80\%$ of the Stock of Target by one corporate purchaser. Stock distributions are not included.
 - Section 336(e) looks to the “disposition” of $\geq 80\%$ of the Stock of Target to any person or persons. Certain stock distributions are included.

Section 336(e) Election in Stock Distribution: **Overview of Requirements**

Unlike a section 338(h)(10) election, a section 336(e) election is available for a distribution of stock of Target by Parent to its Shareholders . But the following requirements must be met:

- Parent and Target both must be U.S. corporations.
- The distribution must be taxable to the distributing corporation (Parent).
- Parent (or members of Parent's consolidated group) must own $\geq 80\%$ of the Stock of Target.
- Parent (or members of Parent's consolidated group) must engage in a QSD, *i.e.*, Dispose of (and not re-acquire) $\geq 80\%$ of the Stock of Target within the 12-Month Disposition Period.
 - Stock Disposed of (including by distribution) to a Controlled Person is not treated as "Disposed of" for purposes of the election.
 - A combination of sales and distributions can make up a QSD.

Terminology: Disposition, QSD, Etc.

- **Disposition or Disposed of** refers to a sale, exchange or distribution of Target stock—
 - The following stock transfers are not Dispositions:
 - A transferred basis exchange (*e.g.*, gift or section 721 transfer to partnership).
 - A transfer at death in which Transferee's basis is determined under section 1014(a).
 - A transfer to which section 351, 354, 355, or 356 applies.
 - A transfer described in regulations in which the transferor does not recognize the entire amount of gain or loss realized.
 - A transfer to a Related Person, based on section 338 principles.
 - Disposition includes a distribution by Parent to a Shareholder that is not a Related Person, including a section 355 distribution in which gain would be recognized to Parent pursuant to section 355(d) or (e), but for a section 336(e) election.
 - Stock disposed of and reacquired by Parent or a member of Parent's consolidated group during 12-Month Disposition Period is not considered disposed of.
- **12-Month Disposition Period.** 12-month period beginning on the date of the first sale, exchange, or distribution of Target stock included in a QSD.
- **Disposition Date.** The first day on which there is a QSD with respect to the Target stock.
- **QSD.** "Qualified stock disposition," *i.e.*, a taxable disposition or series of dispositions totaling $\geq 80\%$ of the Stock of Target, within the 12-Month distribution Period, by Parent, to any person or persons other than persons related to Parent.

Related Person Rules

- A disposition of Target stock, including a distribution, to a person that is a “related person” to Parent is not part of a QSD.
- A person is a **Related Person** to another person if stock owned by one of the persons would be attributed to the other person under section 318(a), except—
 - Section 318(a)(4) (option attribution) does not apply.
 - Sections 318(a)(2)(A) and 318(a)(3)(A) do not apply to attribute stock ownership from a partnership to a partner or vice versa if the partner owns, directly or indirectly, a <5% interest in the partnership, by value.
- Section 338(h)(3)(C) and Reg. §1.338-3(b)(3) principles apply in determining whether a person is a Related Person.
 - Relatedness generally is tested “immediately after” the disposition.
 - But if there is a series of dispositions, relatedness is tested “immediately after” the last disposition in the series.
- In the context of a stock distribution, a Related Person to Parent most commonly would be a $\geq 50\%$ Shareholder of Parent (directly or by attribution) in a *pro rata* spin-off. In such a case, a section 336(e) election is not available.
- If a shareholder increases its ownership of Parent stock from <50% to $\geq 50\%$ in a split-off of Target to other shareholders, a section 336(e) election is available.

Section 336(e) Election in Stock Distribution: Overview of Consequences

- No gain or loss is recognized to Parent on the distribution.
- Target is deemed to dispose of all of its assets in a taxable transaction.
 - Target's gains are recognized.
 - To the extent they exceed gains, Target's losses are disallowed in the proportion that stock is distributed vs. sold during the 12-Month Disposition Period.
- Target's basis in the assets deemed sold is determined by value of stock distributed and price paid for stock sold.
- Target's tax attributes:
 - If the distribution is taxable to both Parent (section 311) and to Shareholders (section 301 or 302), Target's attributes are transferred to Parent in a deemed liquidation of Target.
 - If the distribution is taxable to Parent under section 355(d) or (e), but not to Shareholders, there is no deemed liquidation of Target, and the tax attributes remain with Target.
- Election does not affect the consequences to Shareholders. They are taxed under section 301 or 302, as applicable, and take fair market value basis in the stock, as in any other taxable distribution of property.

Section 336(e) Election in Stock Distribution Subject to Section 355(d) or 355(e): Sale-to-Self Consequences

- Target is deemed to sell its assets to an unrelated person for ADADP.
 - Gains are recognized in full.
 - To implement the policy of section 311(b), net loss is disallowed in proportion to the amount of stock distributed vs. sold during the 12-Month Disposition Period. Retained stock is excluded from the computation.
- Target is deemed to re-acquire its assets from an unrelated person for AGUB (sale to self).
- Target is *not* deemed to liquidate.
 - Target's tax attributes remain intact with Target.
 - Target's E&P is adjusted to reflect gain on the deemed sale-to self.
- Parent distributes the Target stock and recognizes no gain or loss.
- Target's deemed sale-to-self does not cause the distribution to fail any section 355 requirement, including the 5-year active trade or business requirement.
- Shareholders receive Target stock tax-free under section 355 and allocate basis in their Parent stock between Parent and Target stock, under section 358.

Collateral Consequences

□ Excess Loss Account

- IRS officials have indicated that any excess loss account (“ELA”) in the stock of Target or Target Sub is triggered, whether or not the ELA was created in connection with the distribution, notwithstanding Reg. §1.336-2(b)(2)(iii) (“No gain or loss is recognized by seller on the distribution.”). *See* Reg. §1.1502-19(b)(1)(i) (“[i]f M is treated under this section as disposing of a share of S’s stock, M takes into account its excess loss account in the share as income or gain from the disposition.”).

□ Section 197(f)(9)

- For purposes of section 197(f)(9) (intangibles amortization anti-churning rule) and section 1091 (wash sale), Target in its capacity as deemed seller “shall be treated as a separate and distinct taxpayer from, and unrelated to,” Target in its capacity as deemed buyer in the deemed sale-to-self. *See* Reg. §1.197-2(h)(8).
- What if Parent spins Target pro rata, and a Shareholder owns >20% of the Parent stock (more than the relatedness threshold under section 197(f)(9))? IRS officials have stated that the intention was not to exempt sale-to-self transactions from anti-churning where anti-churning otherwise would apply.

Disallowed Losses: **Changes from Proposed Regulations**

The final regulations modify the proposed regulations regarding loss disallowance:

- Target losses realized in the deemed asset sale are allowed to the extent of Target's "gains realized."
 - How does disallowance of net losses apply to a QSD that involves both stock sales under the installment method and stock distributions?
- Loss disallowance applies to all distributions of Target stock during the 12-Month Disposition Period, including—
 - Stock distributions after Disposition Date.
 - Stock distributions that are not part of QSD, *e.g.*, a distribution to a Related Person.

Disallowed Losses: Proportion Disallowed

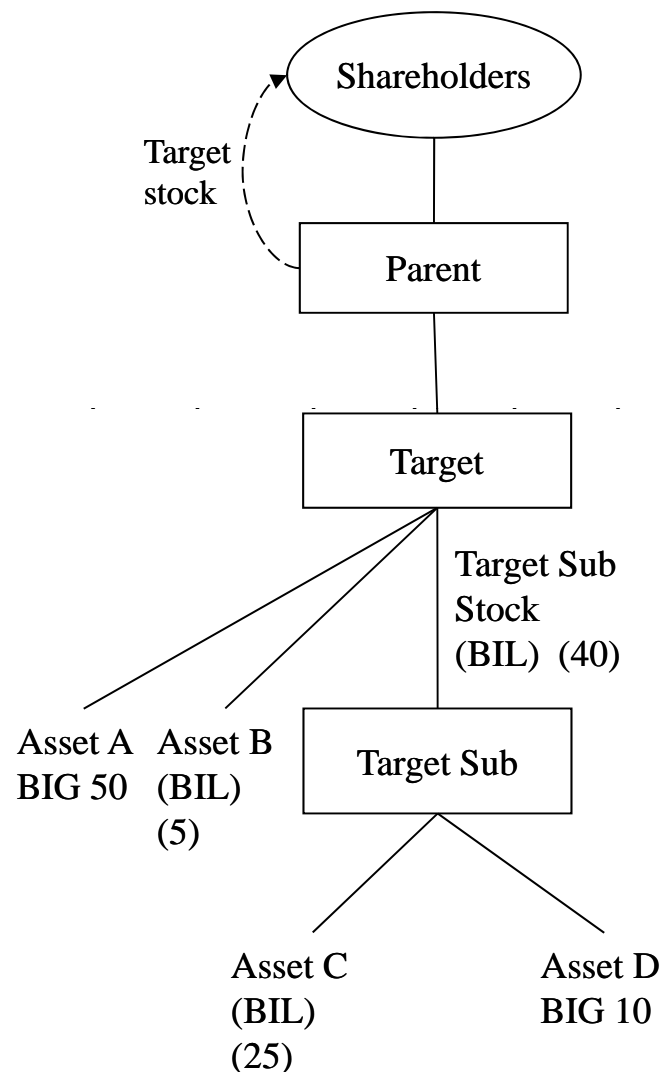
- Like the proposed regulations, the final regulations disallow losses realized in Target's deemed asset sale.
- The proportion of losses disallowed is determined by "disallowed loss fraction":
 - Numerator: Value on the Disposition Date of Target stock distributed during the 12-Month Disposition Period.
 - Denominator: Sum of—
 - Value on Disposition Date of Target stock sold during 12-Month Disposition Period as part of QSD.
 - Numerator.
- Proportion of net loss attributable to any Target stock sold during 12-Month Disposition Period as part of QSD is allowed.
- Disallowed losses are allocated among assets deemed sold at a loss in proportion with losses realized.
- Disallowed losses are permanently disallowed and do not result in any adjustment to basis of Target assets.

Disallowed Losses: Target Sub

- If Target has a Target Sub, and Target stock is distributed in a QSD, with section 336(e) elections for both Target and Target Sub, the deemed disposition of Target Sub stock is a deemed distribution of that stock.
- Loss disallowance, including netting losses against gains, is determined separately for Target and each Target Sub.
- Separate-entity netting reduces the benefit of loss netting.
 - It may be difficult to determine the value of assets held by each Target Sub.
 - Computation of ADADP can complicate the process even further, because ADADP does not necessarily reflect asset value on the Disposition Date. *See* Reg. §1.336-2(b)(2)(i)(B)(3), Example 2.
 - Difficulty is similar to that of determining location of goodwill within a corporate group, as required under Prop. Reg. §1.355-3(b)(2)(iii) (section 355 active trade or business).
 - Can the impact of separate-entity loss netting be reduced with intercompany combinations and the like?

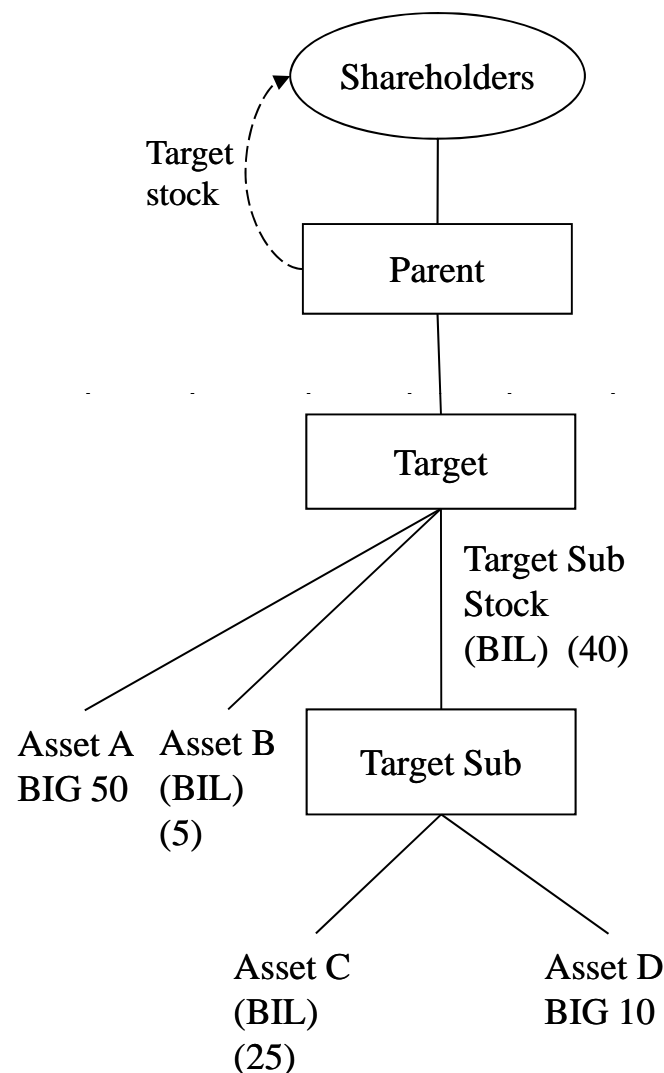
Distribution of Stock of Target with Target Sub—1

- Transactions
 - Parent distributes the Target stock to unrelated Shareholders, with protective section 336(e) elections for Target and Target Sub.
 - Target is acquired as part of a section 355(e) “plan.”
- Target deemed sale and liquidation
 - Target is deemed to sell Asset A and Asset B to an unrelated person for ADADP.
 - Target recognizes \$50 gain on Asset A, \$5 loss on Asset B.
 - Deemed sale of the Target Sub stock is disregarded.
 - Target is not deemed to liquidate into Parent.
- Target Sub deemed sale and liquidation
 - Target Sub is deemed to sell Asset C and Asset D to an unrelated person for ADADP. Target Sub realizes \$15 net loss.
 - Because all the Target stock is distributed, all the Target Sub stock is deemed distributed.
 - All of Target Sub’s net loss is allocated to Asset C and disallowed. Target Sub recognizes \$10 loss on Asset C and \$10 gain on Asset D.
 - Target is deemed to buy its assets back from the deemed buyer, completing the sale-to-self.
 - Target Sub is not deemed to liquidate into Target and retains its own tax attributes.



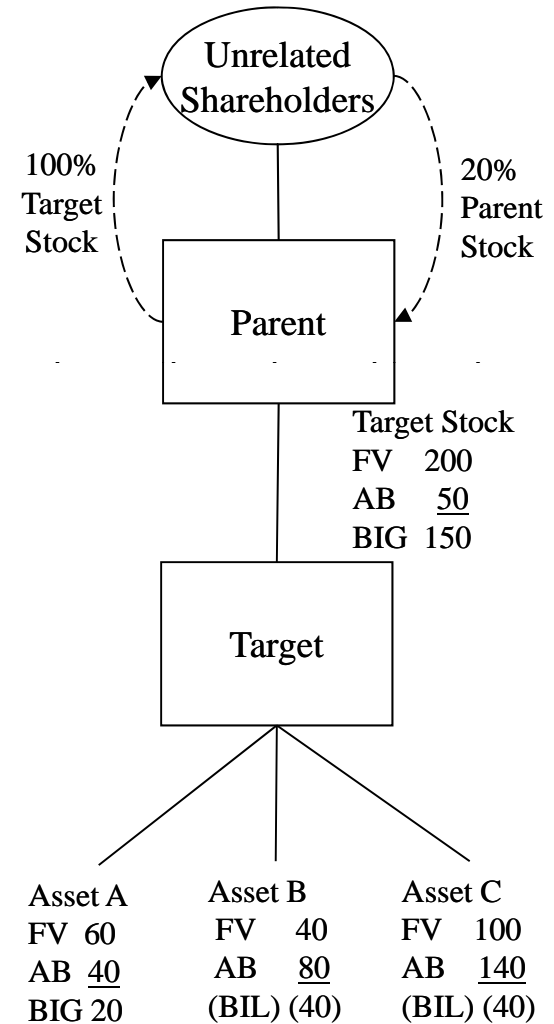
Distribution of Stock of Target with Target Sub—2

- Target as a whole has net built-in gain, regardless of whether Target Sub stock or Target Sub assets, or neither, are taken into account.
- Nevertheless, if section 336(e) elections are made for both Target and Target Sub, \$15 of the loss on Asset C will be disallowed, and the basis of Asset C will be reduced by \$15.
- If Target transfers Asset A to Target Sub under section 351, and section 336(e) elections are made for Target and Target Sub, the disallowed loss is reduced from \$15 to \$5.
- If a section 336(e) election is made for Target but not Target Sub—
 - No loss is disallowed.
 - Target Sub retains its full basis in Asset C and Asset D.
 - The consistency rules do not limit New Target's basis in Asset A to carryover basis, because, among other reasons, gain on the deemed sale of Target's assets does not increase the basis of the Target Sub stock or allow a dividend from Target Sub subject to a 100% dividends-received deduction.
- If Target Sub is liquidated or converted to a disregarded entity, or if Target is merged downstream into Target Sub, the net loss is absorbed into Target's built-in gain. If a section 336(e) election is made for the survivor, no loss is disallowed.
- Would such a section 351 transfer, liquidation, or downstream merger be disregarded or recast?
 - Anti-abuse principles (*see* Reg. §1.338-1(c)).
 - Step transaction, assignment of income, COBE.



Distribution to Unrelated Shareholders—1

- Transactions
 - In a tender offer, Parent distributes the Target stock to Unrelated Shareholders in exchange for 20% of the Parent stock, at a premium.
 - Parent makes a section 336(e) election.
 - Target is acquired as part of a section 355(e) “plan.”
- Target is deemed to sell all its assets to an unrelated person for ADADP (assume \$200).
 - Target realizes \$60 net loss.
 - Because all the Target stock is distributed (not sold), all the net loss is disallowed.
 - Disallowed loss is allocated 50% (\$30) each to Asset B and Asset C. Target recognizes \$20 gain on Asset A, \$10 loss on Asset B, and \$10 loss on Asset C.
- Target is deemed to purchase the assets from an unrelated person for AGUB (assume \$200).
- Are ADADP and AGUB determined by the value of the distributed Target stock or of the Parent stock redeemed?
- If the value of the Target stock is determinative, does *Pope & Talbot, Inc. v. Commissioner*, 162 F.3d 1236 (9th Cir. 1999) (section 311 gain determined by value of distributed property to distributing corporation, not traded price) control?
- Target is not deemed to liquidate and retains its tax attributes.



Intragroup Distribution

– Transactions

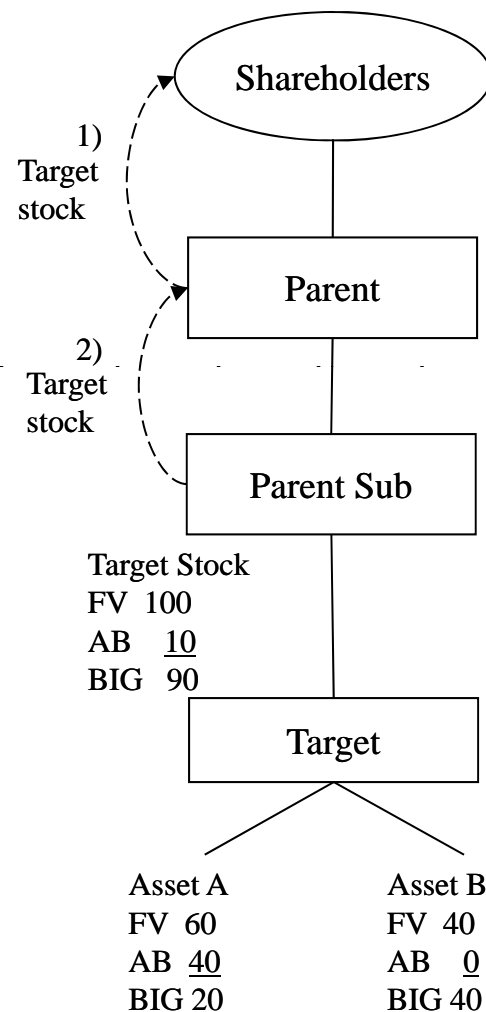
- Parent Sub distributes the Target stock to Parent.
- Parent distributes the Target stock to unrelated Shareholders with a protective section 336(e) election.
- Target is acquired as part of a section 355(e) “plan.”

1) Parent Sub’s distribution of Target stock to Parent is not a QSD, because Parent Sub and Parent are Related Persons.

- Section 355(f) treats Parent Sub’s distribution as a taxable distribution.
- Parent Sub recognizes \$90 gain on distribution of Target stock, deferred under Reg. §1.1502-13 (but accelerated by Step 2).
- Parent takes \$100 basis in Target stock.

2) Parent’s distribution of Target stock to unrelated Shareholders is a QSD.

- Target is deemed to sell its assets to an unrelated person for ADADP (\$100).
- Target recognizes \$60 gain.
- This gain increases Parent’s basis in the Target stock from \$100 to \$160.
- Target is deemed to purchase its assets from the unrelated person for AGUB (\$100) (sale-to-self).
- Target is not deemed to liquidate.
 - Target retains its tax attributes.
 - Exception: If an election is made to apply Reg. §1.1502-13(f)(5)(ii)(C), Target is deemed to liquidate into Parent under section 331, for limited purposes.
 - Parent recognizes \$60 loss. Net result: \$90 gain (\$60 gain to Target on sale-to-self and \$60 loss to Target on deemed liquidation).
 - Net gain = Parent Sub’s BIG in the Target stock and >BIG in Target’s assets.
- Parent distributes the Target stock at no gain or loss.



**ADADP, AGUB, and
Gain Recognition Election**

Aggregate Deemed Asset Disposition Price (ADADP)

- **ADADP** is the price at which Target is deemed to sell its assets and equals:
 - Grossed-up amount realized on disposition of recently disposed stock,
 - Amount realized on sale and value (on each distribution date) of stock distributed during the 12-Month Distribution Period
 - Grossed up to reflect the remaining stock
 - Plus: Target's liabilities,
 - Less: Target's transaction costs.

- Formula does not necessarily reflect Target stock or asset value on the Disposition Date, if value changes during the 12-Month Disposition Period.

Adjusted Grossed Up Basis (AGUB)—General

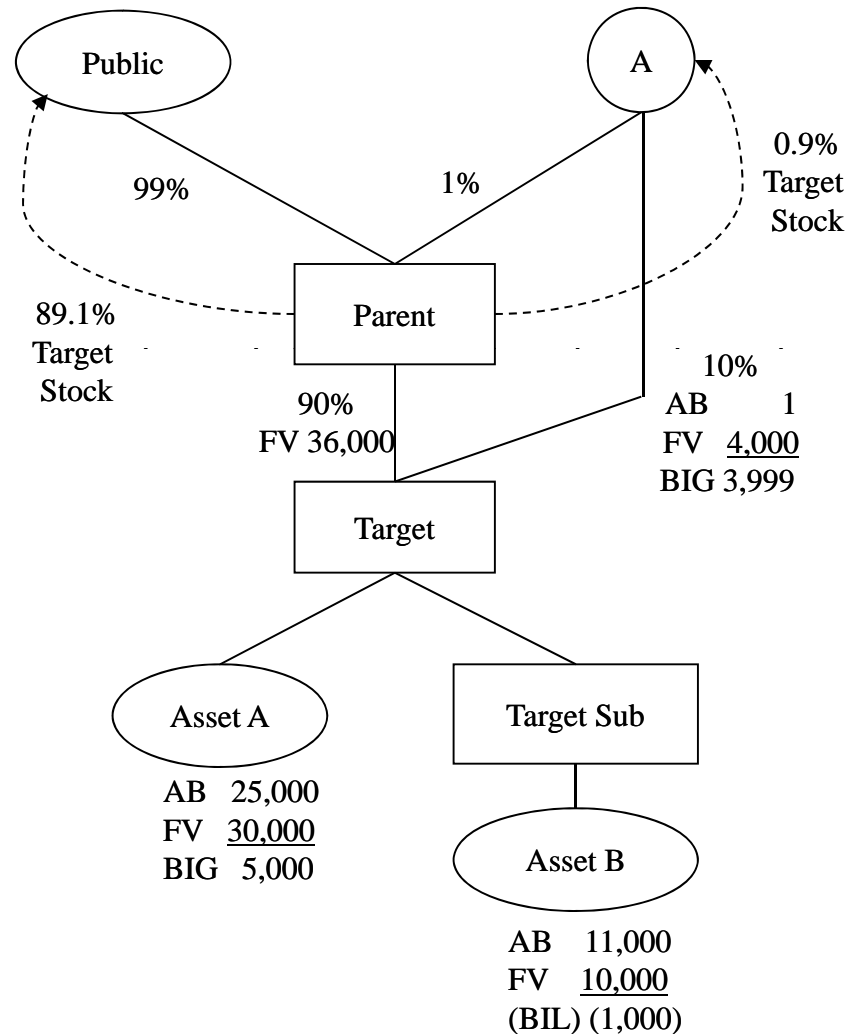
- “Adjusted grossed up basis” (AGUB) is Target’s basis in its assets resulting from the sale-to-self.
- AGUB equals the sum of:
 - Grossed-up basis in Recently Disposed Stock:
 - Price paid for any Target stock sold plus value (on each the date of each distribution) of stock distributed in the QSD.
 - Grossed up to reflect all other Target stock except “nonrecently disposed stock.”
 - Nonrecently disposed stock is Target stock acquired by the holder (other than Parent or members of its consolidated group) before the 12-Month Distribution Period, but only if the holder holds $\geq 10\%$ of the Target stock after the Disposition Date.
 - Shareholders’ aggregate basis in nonrecently disposed stock.
 - Target’s liabilities.
 - Target’s transaction costs.
- If a holder of nonrecently purchased stock makes a “gain recognition election” and recognizes its gain (but not loss) on this stock, AGUB is increased.
- A holder of nonrecently disposed stock that holds $\geq 80\%$ of the Target stock (by vote or value) is deemed to make a gain recognition election.

ADADP, AGUB, and Gain Recognition

- In many cases, ADADP will be the same as AGUB, apart from differences in the parties' transaction costs.
- AGUB may be less than ADADP if a prior Target shareholder acquires additional Target stock in the QSD, such as a split-off to a minority Target shareholder.
- The complexities of AGUB are relatively likely to arise under section 336(e), because of multiple Shareholders or stock purchasers.
- Loss disallowance can add further discrepancy between the tax treatments of Parent and Target

ADADP, AGUB, and Gain Recognition

- Transactions
 - Parent distributes its 90% Target stock to the Shareholders, *pro rata*, i.e., 0.9% to A and 89.1% to Public.
 - After distribution, Public owns 89.1%, and A owns 10.9% of the Target stock.
 - Protective section 336(e) elections are made for Target and Target Sub.
 - A does not make a gain recognition election.
 - Target is acquired as part of a section 355(e) "plan."
- Target Sub
 - ADADP = \$10,000
 - Asset Basis = \$11,000
 - Loss disallowed. No gain or loss recognized.
 - Target Sub AGUB = \$10,000
- Target
 - ADADP (excluding Target Sub) = $\$27,000 / 0.9 = \$30,000$
 - Asset Basis = \$25,000
 - Gain recognized = \$5,000
- Total
 - ADADP = \$40,000
 - Gain recognized = \$5,000
 - AGUB = $\$36,000 + \$1 = \$36,001$
- If Target and Target Sub had sold their assets for ADADP, net gain recognition would have been \$4,000, and asset basis would have totaled \$40,000.
- If A makes gain recognition election—
 - A gain recognition on Parent stock = \$3,999
 - Total AGUB = $\$36,001 + \$3,999 = \$40,000$



**Making a Section 336(e)
Election for a Stock
Distribution Subject to
Section 355(d) or 355(e)**

Making a Section 336(e) Election—General

- Reg. §1.336-2(h) provides rules for Target and Target Subs, including requirements that depend on whether Parent and Target and Target Subs are consolidated group members.
- Election generally requires:
 - Binding, written agreement to make the election.
 - Attaching election statement to relevant returns of Parent and Target.
- In the case of a stock distribution subject to section 355(d) or 355(e), Target must report information concerning deemed sale-to-self on two Forms 8883, “Asset Allocation Statement under Section 338,” with adjustments to reflect the section 336(e) election.

Making a Section 336(e) Election—Consolidated or Non-Consolidated Parent and Target

- Consolidated Parent and Target
 - Parent and Target enter into a written, binding agreement to make the section 336(e) election on or before the due date of the group's return for the year that includes the Disposition Date.
 - Common parent retains a copy of the agreement.
 - Common parent attaches a section 336(e) statement to the group's return for the year that includes the Disposition Date.
 - Common parent provides a copy of the election statement to Target on or before the due date of the group's return.
- Affiliated, Non-Consolidated Parent and Target
 - Parent and Target enter into a written, binding agreement on or before the due date of the earlier of Parent's return or Target's return for the year that includes the Disposition Date.
 - Parent and Target each retains a copy of the agreement.
 - Parent and Target each attaches a section 336(e) election statement to its return for the year that includes the Disposition Date.

Making a Section 336(e) Election - Target Sub

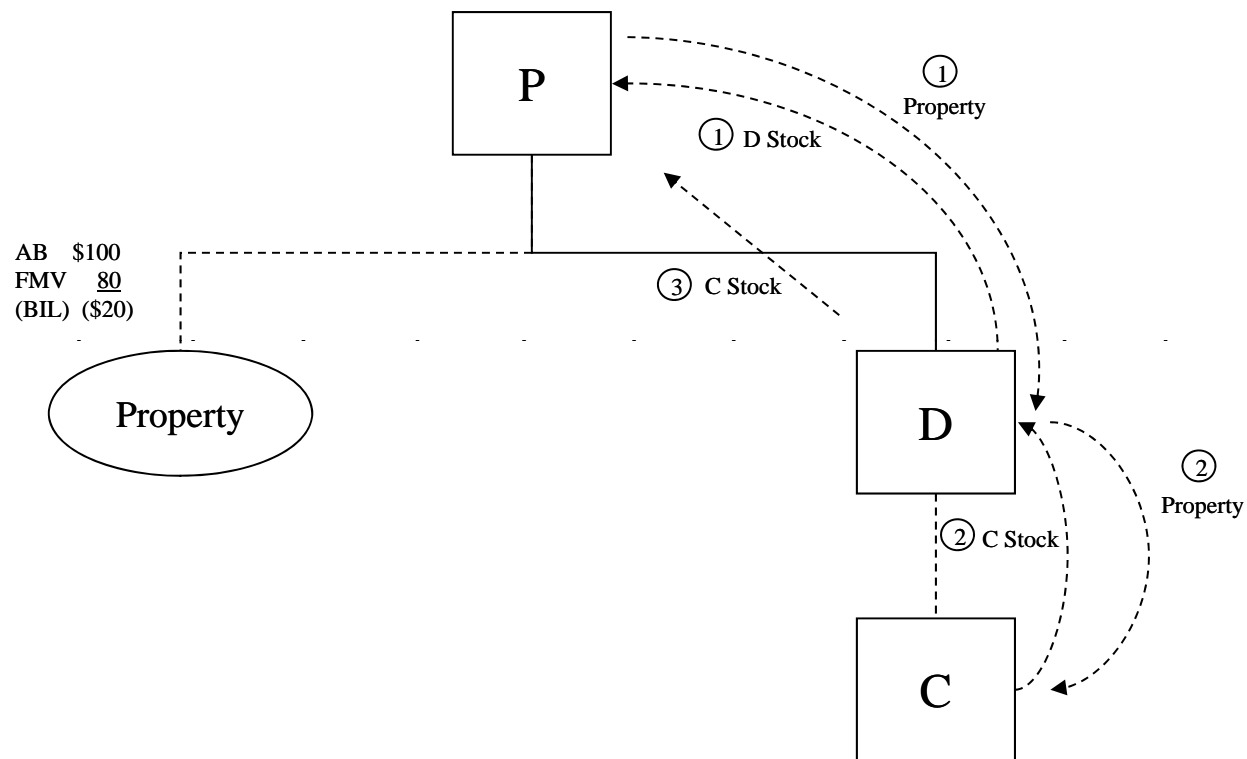
- Target Sub must meet the written, binding agreement requirement but can be included in the Target's agreement or a separate agreement.
- A separate section 336(e) election statement is required for each Target Sub.

Protective Section 336(e) Election

- A protective section 336(e) election should be considered in connection with any intended tax-free spin-off.
 - Such an election would mitigate the tax cost to Parent of the distribution becoming taxable under section 355(d) or 355(e).
 - The tax sharing agreement between Parent and Target could allocate the benefits of any basis step-up to the party that bears the cost of the spin-off becoming taxable.
 - The mitigation will be less effective if Target or any Target Sub realizes net loss on a separate basis.
 - Steps to reduce or eliminate net losses in Target Subs should be considered.
 - If a net loss is large enough, a protective election could be counter-productive.
- IRS officials have stated that IRS may be willing to issue an advance ruling that such a protective election is effective.
 - Will the general no-rule for section 355 distributions (Rev. Proc. 2013-32) affect IRS's willingness to rule on this issue?
 - Will a “significant” issue regarding the election be required?

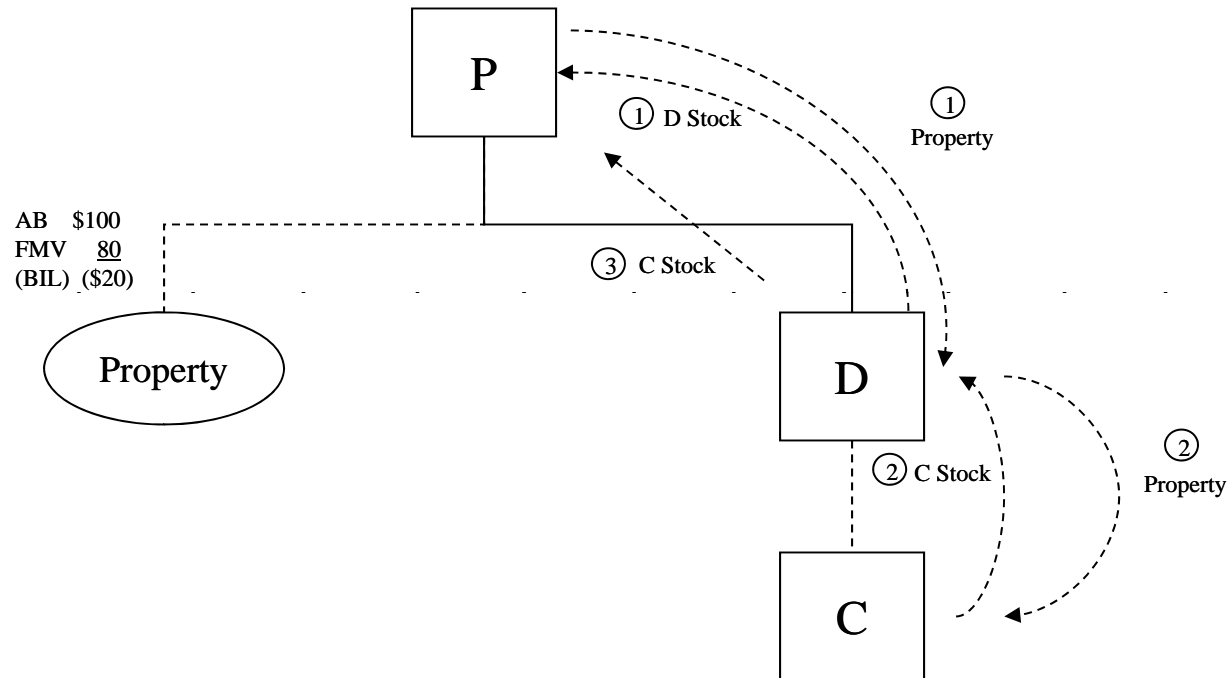
**Sections 355, 336(e) and
362(e)(2)**

Sections 355, 336(e) and 362(e)(2): Facts



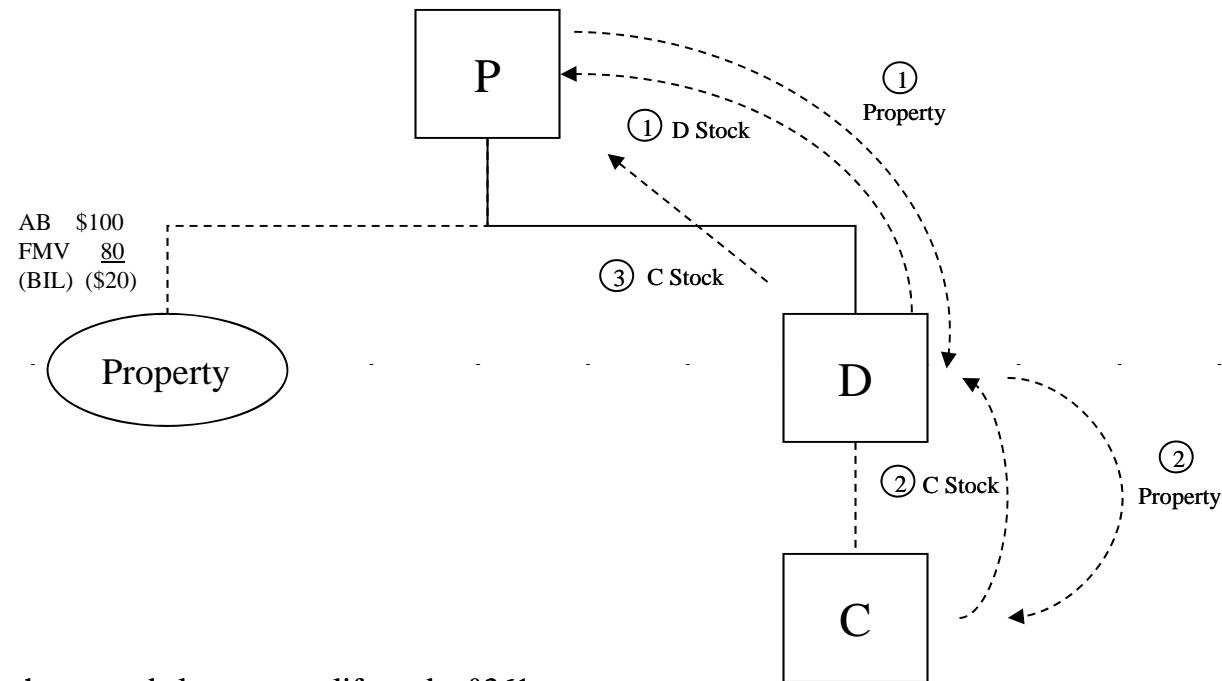
- 1) P transfers Property to D in exchange for D stock.
- 2) D transfers Property to C in exchange for C stock.
- 3) D distributes the C stock to P.

Sections 355, 336(e) and 362(e)(2): Step 1 Analysis



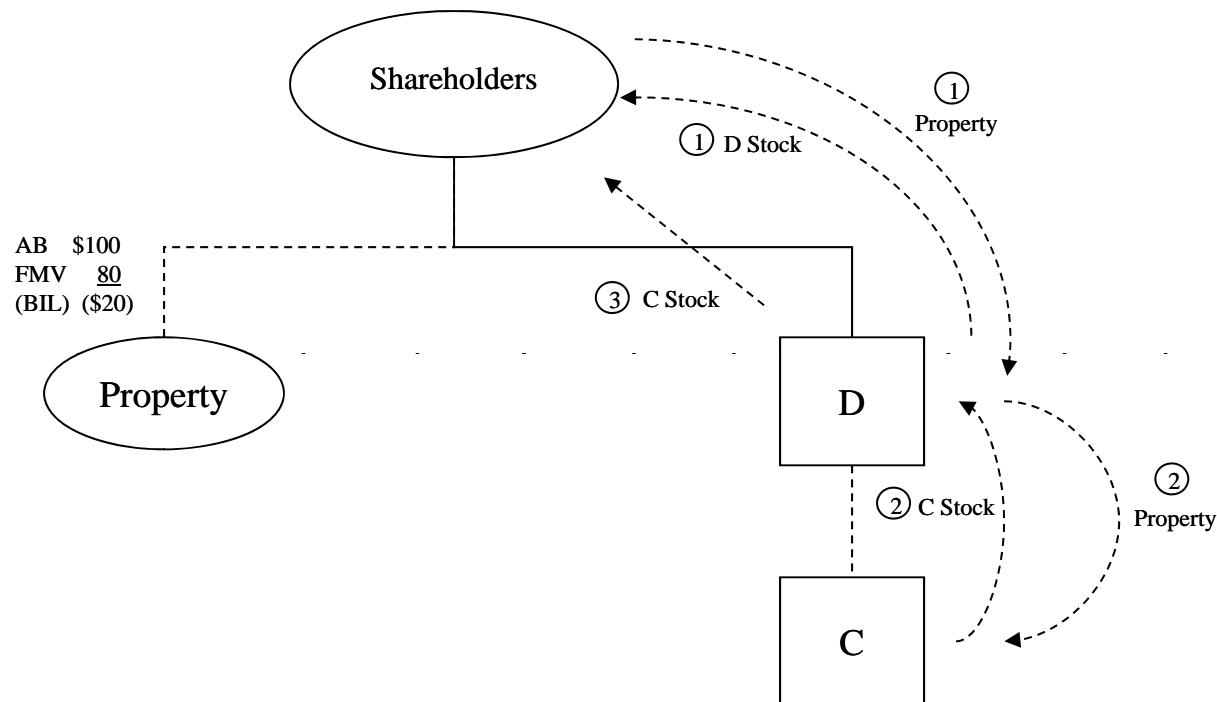
- Step 1 is likely a §351 exchange. If so, §362(e)(2) applies.
 - D's basis in Property is reduced from \$100 to \$80.
 - Or, P may elect to reduce its basis in the D stock by \$20 and allow D its full \$100 basis in Property. §362(e)(2)(C).

Sections 355, 336(e) and 362(e)(2): Steps 2 and 3 Analysis



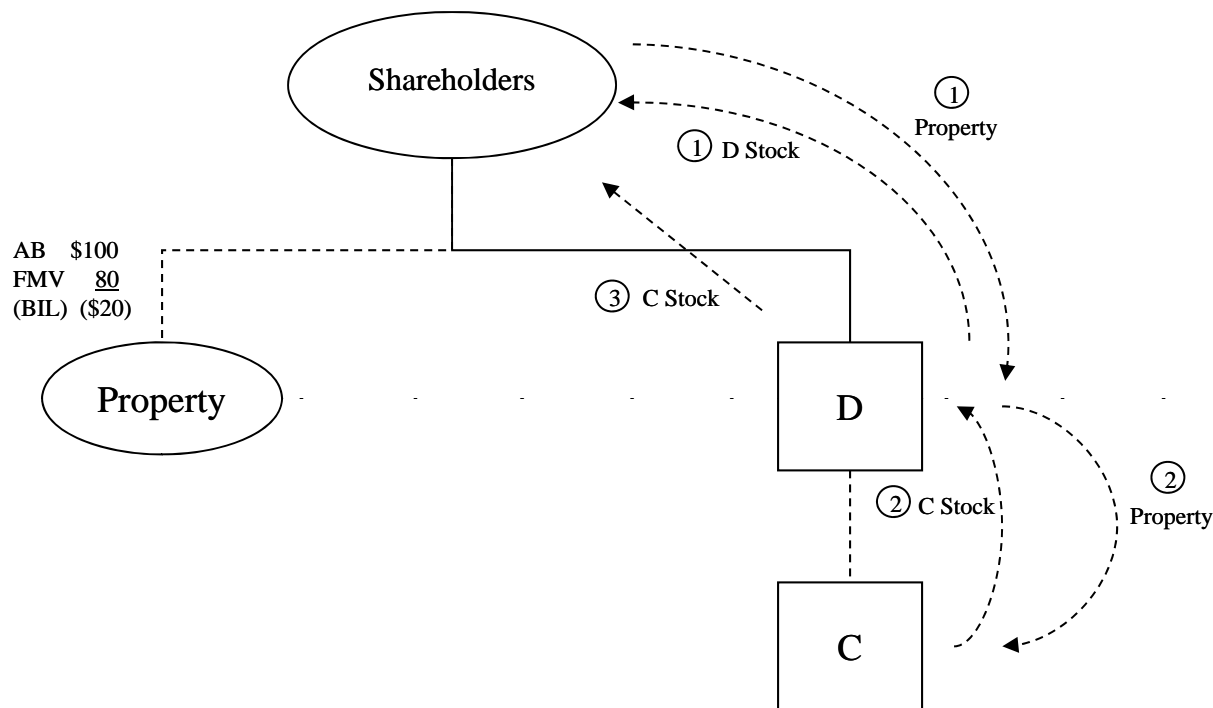
- Step 2 is a §351 exchange and also may qualify under §361.
 - If—
 - In Step 1 P elects to reduce its basis in the D stock, and
 - Step 3 is tax-free under §355,
 §362(e)(2) DOES NOT APPLY to Step 2. C's basis in Property remains \$100. Reg. §1.362-4(c)(1).
 - If Step 3 is not tax-free under §355 or is subject to §355(d) or (e), §362(e)(2) DOES APPLY to Step 2.
 - C's basis in Property is reduced from \$100 to \$80.
 - Or, D may elect under §362(e)(2)(C) to reduce its basis in the C stock by \$20 and so increase its gain, or reduce its (disallowed) loss on the distribution of the C stock, by \$20.
 - Because P and D are "related persons," D may not make a §336(e) election for Step 3.

Sections 355, 336(e) and 362(e)(2) Variation: Facts



- Several unrelated persons hold the D stock (instead of P), with no $\geq 50\%$ shareholder.
- In Step 1, Shareholders elect, under §362(e)(2)(C), to reduce their basis in the D stock, instead of D reducing its basis in Property.
- Step 3 is not tax-free under §355, or it is subject to §355(d) or (e).

Sections 355, 336(e) and 362(e)(2) Variation: Steps 2 and 3 Analysis



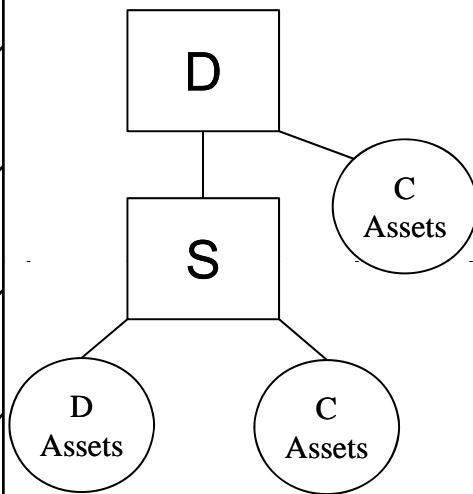
D may make a §336(e) election for Step 3. There are four possible outcomes:

- **§362(e)(2)(C) election in Step 2 / §336(e) election in Step 3.** Deemed sale by C of its assets, including Property. C's net gain or (disallowed) loss reflects historic \$100 basis in Property. Basis in C stock is eliminated, so that reduction in stock basis under §362(e)(2)(C) has no effect.
- **§362(e)(2)(C) election in Step 2 / No §336(e) election in Step 3.** Gain on C stock is recognized to D. Any such gain is increased by the \$20 reduction in D's basis in the C stock.
- **No §362(e)(2)(C) election in Step 2 / §336(e) election in Step 3.** Deemed sale by C of its assets, including Property. C's net gain or (disallowed) loss reflects reduced basis in Property (\$80). Full basis of C stock (increased by \$100 in Step 2) is eliminated with no effect.
- **No §362(e)(2)(C) election in Step 2 / No §336(e) election in Step 3.** Gain on C stock is recognized to D. Any such gain reflects \$100 increase to D's basis in the C stock, in Step 2. C's basis in Property is \$80 instead of \$100.

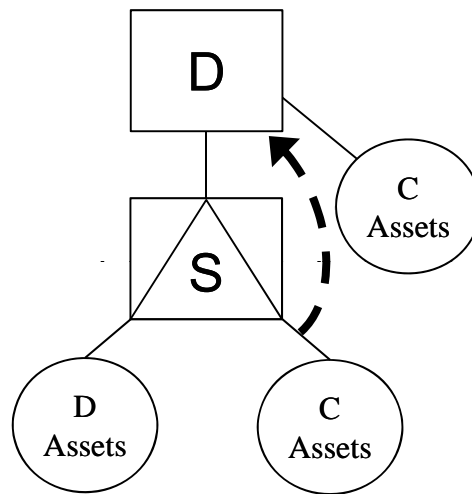
Liquidation-Reincorporation in Connection with a Section 355

Transaction?

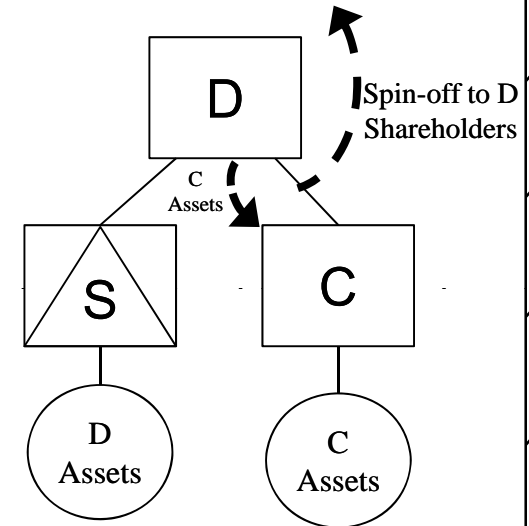
Beginning Structure



S converts to an LLC under state law and thereafter distributes C Assets to D



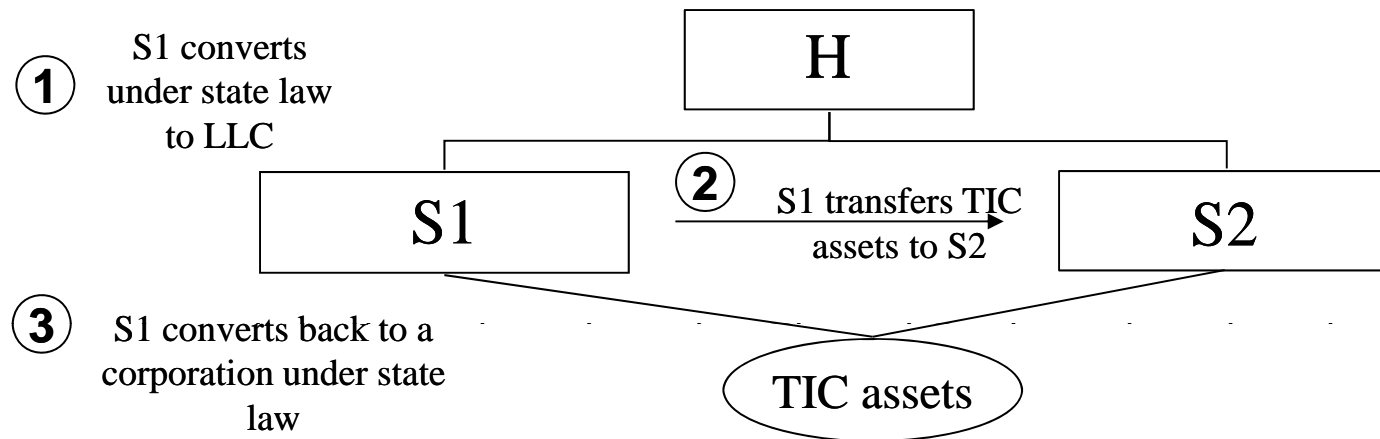
D contributes all C Assets to C and spins off C to D Shareholders



Issues

1. Is conversion a tax-free liquidation under Sections 332 and 337 or does liquidation/re-incorporation doctrine apply?
2. Is conversion an “upstream” C reorganization, subject to Treas. Reg. §1.368-2(k) (COBE is satisfied through D's ownership of D assets)?
3. Could the transaction be viewed as a taxable transfer of C assets by S to C?
4. IRS view appears to be Sections 332 and 337 apply ((e.g.) PLR 200725002)
 - a. C is not S's alter-ego
 - b. C assets move closer to D shareholders via spin-off.
5. What if all S's assets are reincorporated?
6. Does it matter if C assets are dropped below C?

Liquidation-Reincorporation in Controlled Groups? PLR 201127004 and PLR 200952032



- In PLR 200952032, H owned 100% of S1 and S2, each a domestic corporation. S1 and S2 directly owned certain assets and also held assets as a tenants-in-common. S1 incorporated in State X and State Y and S2 incorporated only in State Y. S1 desired to transfer its TIC assets to S2 in a tax-free manner. S1 (i) converted to a single-member LLC (treated as a disregarded entity for Federal income tax purposes) under “State X” law, (ii) transferred the TIC assets to S2 for no consideration, and (iii) converted back to a corporation under “State X” law. S1’s interest in the TIC assets represented approximately “c%” of S1’s gross assets and “d%” of S1’s net assets.
 - IRS ruled that transactions qualified as an upstream C reorganization of S1 into H, followed by section 368(a)(2)(C) drops by H to S1 (in the reincorporation) and S2 (i.e., a deemed drop of the TIC assets).
 - Why is the transaction not an F reorganization with a taxable distribution of TIC assets? See Treas. Reg. §1.368-2(k) (“shall not be recharacterized”); But see *TASCO v. Comm’r*, 63 T.C. 423 (1974), *aff’d* without opinion, 546 F.2d 423 (4th Cir. 1976) relating to liquidation treatment.
- What if instead S1 had converted to an LLC and transferred all of its assets to S2, a newly-formed corporation, without S1 later reincorporating? See section 368(a)(1)(F) (“however effected”); Treas. Reg. §1.368-2(k).

Rev. Proc. 2013-3 No Rule on Debt Issued **“in Anticipation of” Distribution**

- **Rev. Proc. 2013-3 provides that, until the IRS resolves the issue, it will no longer rule on:**
 - **Whether either 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* the distribution.**
 - **What about the payment of cash pursuant to section 361(b)(3) to satisfy (or an assumption pursuant to section 357(a)/Rev. Rul. 79-258 of) Distributing debt issued *in anticipation of* the distribution?**
- **Proposed legislation from time to time has addressed Controlled securities and Controlled nonqualified preferred stock exchanged for Distributing debt – *whether or not* issued in anticipation of the distribution.**

Questions

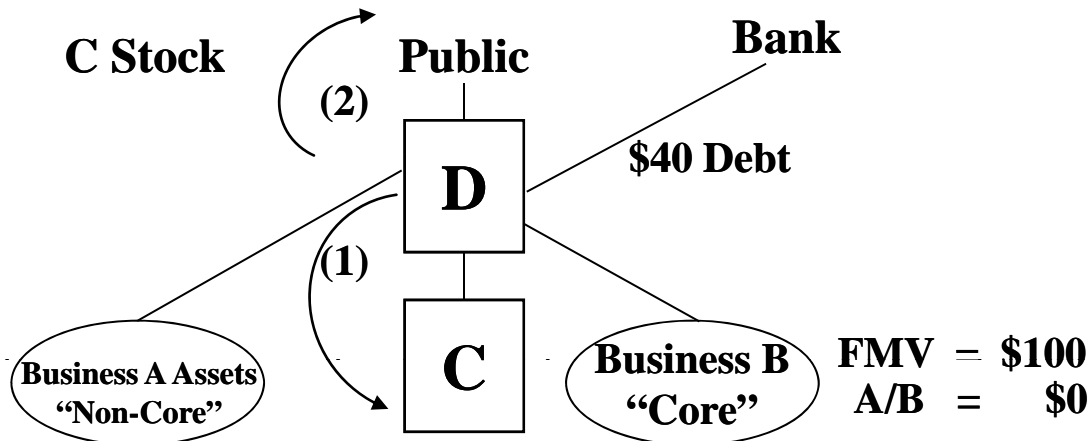
- **Is Distributing Debt that would be issued irrespective of the consummation of the Distribution issued “in anticipation” of such distribution? For example:**
 - **Refinanced debt that would qualify for tax-free assumption under Rev. Rul. 79-258 and for which the Service would provide a favorable advance ruling for such assumption?**
 - **Trade payables incurred in the ordinary course of business that are within historic debt levels?**
 - **Debt arising from a binding agreement entered into prior to the decision to spin, but closing thereafter (e.g., a debt financed acquisition announced prior to the first discussion relating to the spin, but closed after such first discussion)?**
 - **Debt issued from time to time during the 10-year period prior to the spin-off, where the board of directors repeatedly considered and rejected the spin-off during the same 10-year period?**

Divisive Reorganizations — Establishing Capital Structure

Relevant Authority

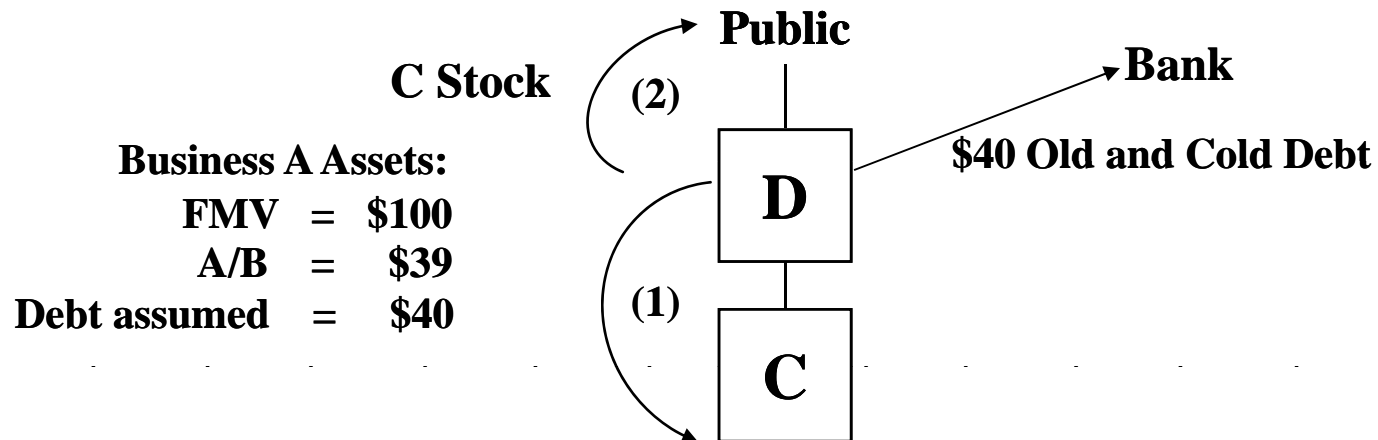
- §§ 357, 361
- §1.1502-13(g)
- Common Law

FMV = \$100
A/B = \$20



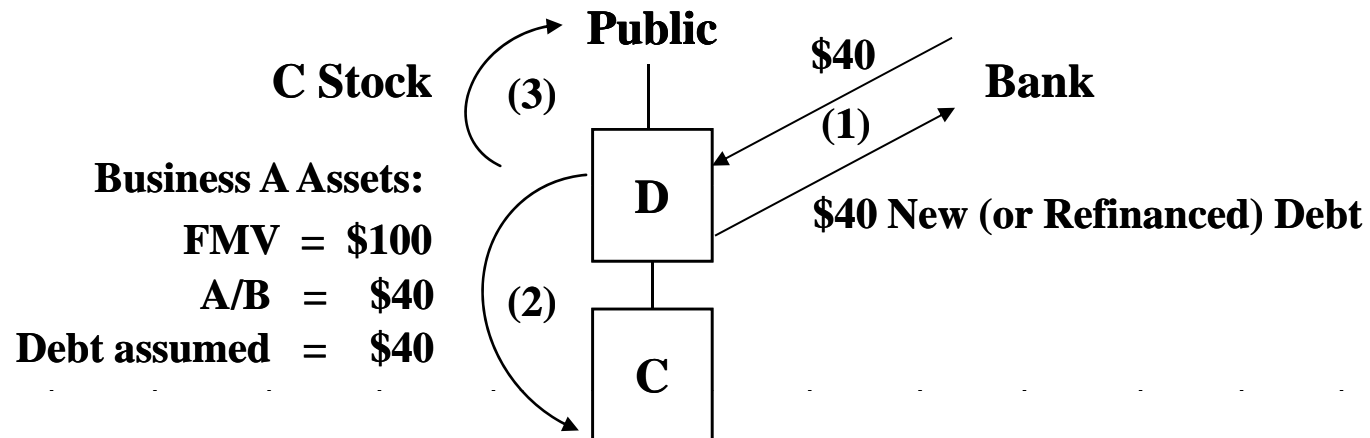
- **Base Case:**
 - D is engaged in Non-Core Business A (\$100 FMV and \$20 A/B) and Core Business B (\$100 FMV and \$0 A/B)
 - D seeks to spin off newly formed C which will own Non-Core Business A
 - D will retain Core Business B
 - D has determined that an appropriate capital structure for C includes \$40 debt and \$60 equity
- **Base Alternatives for Establishing Initial Capital Structure:**
 - C assumes \$40 of D's debt in connection with D's contribution of Business A
 - C borrows \$40 and distributes the proceeds to D
 - C issues \$40 securities to D
 - Combinations of the above
 - D instead contributes Core Business and cash (financed by Business A) to C which is spun off

Debt Allocation - Basic Debt Assumption



- **General rule:** no gain recognized when C assumes D debt. Section 357(a).
- **Excess Liabilities:** D recognizes gain to the extent debt assumed exceeds D's adjusted basis in the assets. Section 357(c).
- **Result:** D recognizes \$1 gain (\$40, if Section 357(b) is applicable).
- **Principle of section 357(c) incorporated into section 361(b)(3)** which imposes basis limitations on “boot purge” to D creditors providing for the same tax treatment for cash or “other property” distributions by C used by D to repay its creditors, but not for cash or “other property” distributed to D shareholders.

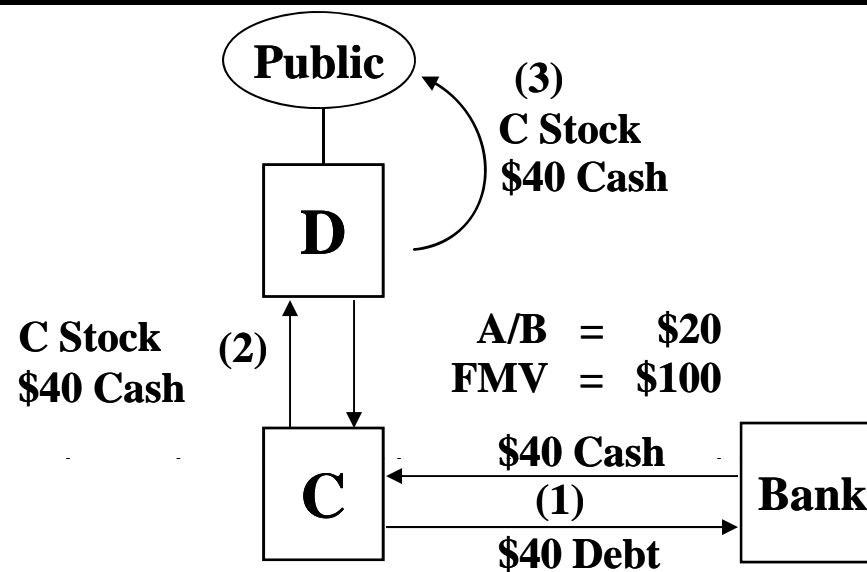
Debt Allocation - Debt Assumption & Substance Over Form



Identity of tax debtor: If C is the true debtor, D's retention of financed cash will be taxable.

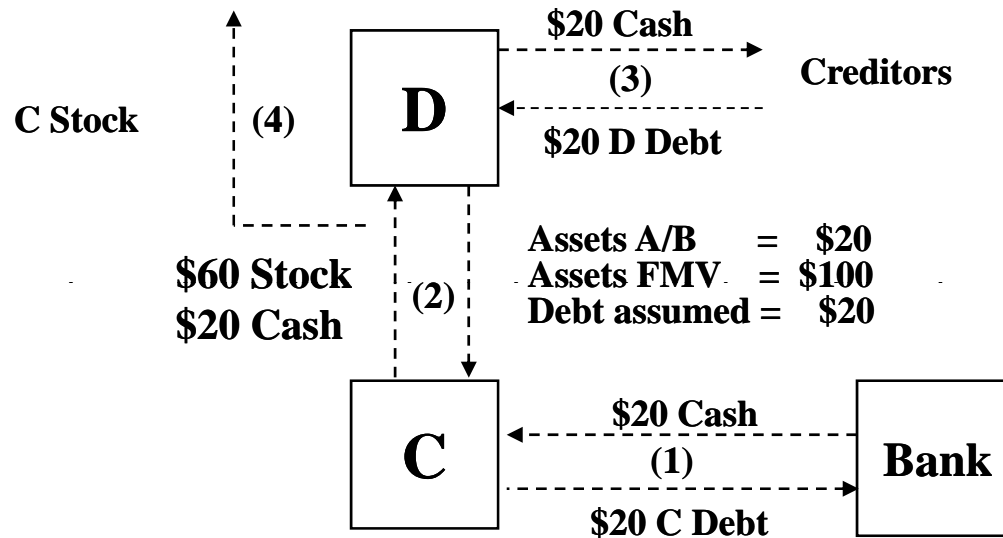
- **Rev. Rul. 79-258, 1979-2 C.B. 143** (D respected as borrower of new assumable debt which refinanced pre-existing non-assumable debt incurred in connection with the business transferred to C; D's debt level not increased by virtue of the refinancing).
- **Southwest Consolidated Corp., 315 U.S. 195 (1942)** (acquiring treated as distributing cash to target and not as having assumed liabilities; target had borrowed funds and transferred the liability to acquiring pursuant to the overall acquisitive reorganization plan; "solely for voting stock" requirement for "C" reorganization not satisfied).
- **See e.g., PLR 9751043 (Sept. 28, 1997)** (D refinanced old debt with newly-incurred third-party debt; C assumed new debt; D represented new debt was attributable to business contributed to C).

§361(b)(1) - Leveraged Distribution to Shareholders



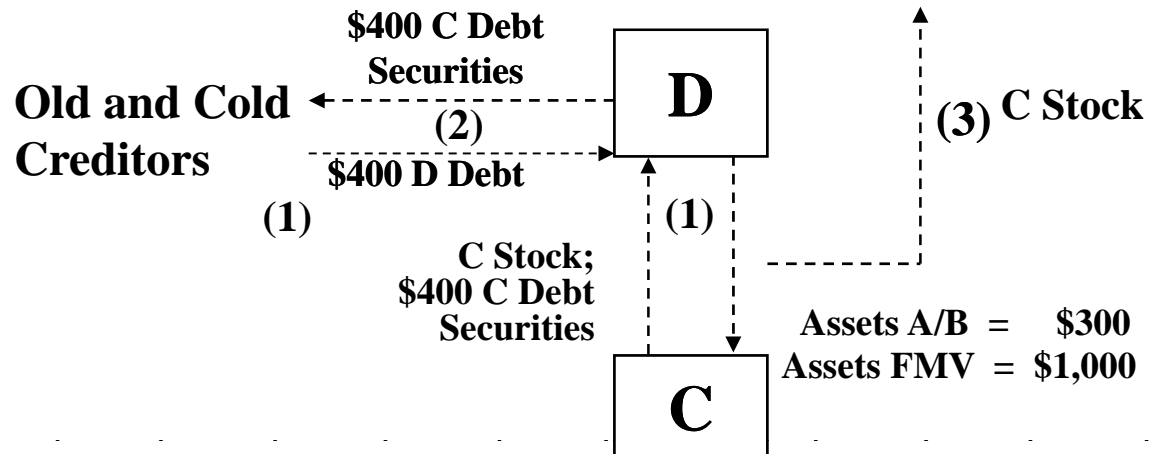
- **Cash Retained by D.** D will recognize gain. Section 361(b)(1)(B).
- **Shareholder Distribution.** D will not recognize gain if boot is distributed in pursuance of the plan of reorganization. Section 361(b)(1)(A). “Distribution” includes:
 - Dividend Distribution. See PLR 200645012 (Aug. 7, 2006); PLR 200608016 (Nov. 27, 2005).
 - Redemption/Buyback. See PLR 200035001 (Mar. 28, 2000); PLR 200252058 (Sept. 6, 2002).
- IRS has not squarely addressed whether cash distributed in excess of stock basis may trigger gain via ELA if D and C consolidate for tax purposes; if not consolidated, risk depends on concepts of negative basis.
- Basis limitation on “boot purge” in Section 361(b)(3) inapplicable since this is a distribution to shareholders.
- Query: What distributions will qualify as “pursuant to a plan”- e.g., funding regular quarterly dividends or only distributions in excess of regular dividends; any stock redemption pursuant to a previously authorized stock buy back program or only redemptions excess of historic redemption levels? See, PLR 200725016 (Mar. 20, 2007) (D’s existing stock repurchase program increased in connection with spin).
- Does distributed cash have to be segregated and traced? PLR 200632008 (May 11, 2006) (commingling of funds permitted).

§361(b)(3) - Leveraged Distributions to Creditors: Tax-Free Treatment
Limited to Basis of Assets Transferred Less Liabilities Assumed



- Section 357(c) inapplicable because assumed liabilities do not exceed basis.
- Section 361(b)(3) provides the amount available for tax-free cash distributions to creditors is reduced by the amount of assumed liabilities.
- Thus, D would recognize \$20 gain, as in the equivalent cases in which (i) C distributes \$40 cash that D uses to pay creditors and assumes no liabilities or (ii) C assumes \$40 liabilities and distributes no cash.

§§358 and 361 — Use of Securities to Pay D Debt

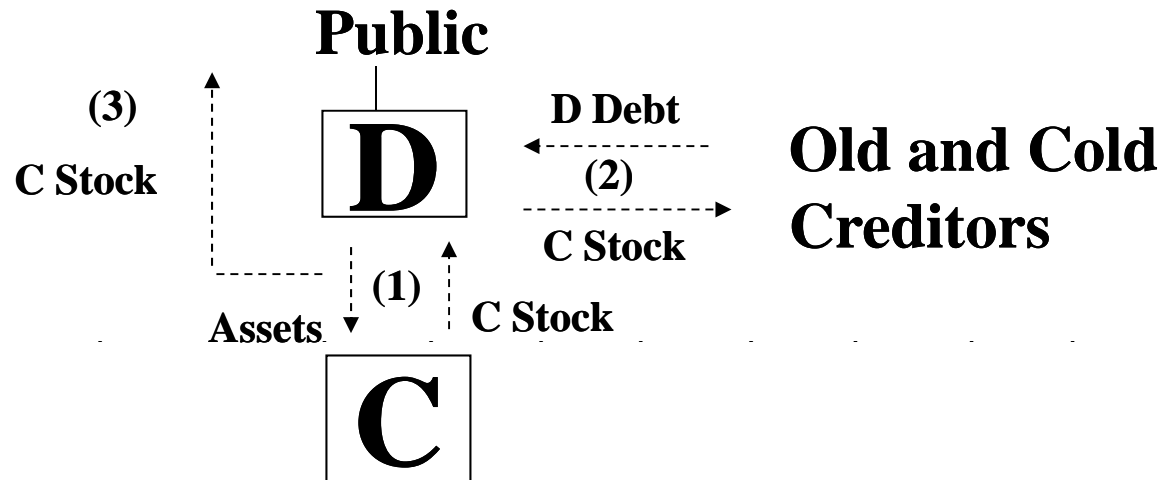


D owns, among other things, Assets with \$1,000 FMV and \$300 A/B. D's ordinary course indebtedness includes \$400 of D Debt.

- (1) D contributes Assets to C for all the outstanding C Stock and \$400 of C Debt Securities.
- (2) D immediately uses C Debt Securities to retire \$400 of D Debt.
- (3) D distributes all the C Stock to D's shareholders.

- Reg. § 1.1502-13(g)(3)(i)(B)(7) (exception from deemed satisfaction/reissuance rule with respect to transfer of C securities issued pursuant to plan of reorganization and distributed to nonmember shareholders or creditors). Prior to amendment of Reg. § 1.1502-13, under apparent varying analyses, IRS had ruled, alternatively, that (i) Reg. §1.1502-13(g) did not apply to cause income or gain to be recognized or otherwise result in a tax liability (see §§361(a), 361(c)(2)(B)(ii), 361(c)(3), 358(b); Reg. §§1.1502-13(c) and 1.1502-13(g); PLR 200345049 (Aug. 2, 2002) (ruling 9); PLR 200310005 (Nov. 21, 2002) (ruling 26)); and (ii) Reg. §1.1502-13(g) applied but that the gain was excluded under Reg. §1.1502-13(c)(6). See PLR 200701010 (Sept. 1, 2006) (ruling 22); PLR 200624001 (ruling 8).
- § 361(b)(3) does not affect this analysis. Securities (and §351(g) NQPS) are not "other property" such that §361(b) is not implicated. But see, Job Creation and Tax Cut Act of 2010 (S. 3793) ("Baucus Bill") (treating C securities and NQPS as "other property").
- §361(c)(3): Transfer of "qualified property" to creditors in connection with the reorganization is treated as a distribution to shareholders in pursuance of the plan of reorganization.
- §358(b)(2): Receipt of securities constituting qualified property does not create or increase an ELA.
- What result if the D Creditors are D's investment bankers who acquired the D Debt as principal for their own account in the market at least 5 days before entering into an agreement to exchange the C Debt Securities for the D Debt and at least 14 days before making such exchange? See TAM 8738003 (May 22, 1987) (key to analysis is "tax ownership" of debt securities).

§361(c) — Use of C Stock to Pay D Debt



Case 1:

- (1) D transfers Assets to C in exchange for all the stock of C.
- (2) D transfers 20% of the C Stock to Creditors to satisfy D Debt.
- (3) D distributes the remaining 80% of the C Stock (possessing §368(c) control of C) to D's shareholders.

Case 2:

Same facts as Case 1, but D transfers 40% of C stock with respect to D debt (50% of which constitute securities) owned by Creditors, who also own 2% of D stock.

If more than 20% of the sole class of C Stock is transferred to creditors in satisfaction of debt, the transaction would fail to qualify as a D reorganization (except, potentially, in the case of shareholder-creditor overlap) since control must be distributed to D shareholders; a high vote/low vote structure, however, can offer the ability to transfer more than 20% of the value of C stock to creditors. But see Rev. Proc. 2013-3, §5.01(9) (no rule position if high vote/low vote structure is implemented in anticipation of the distribution).

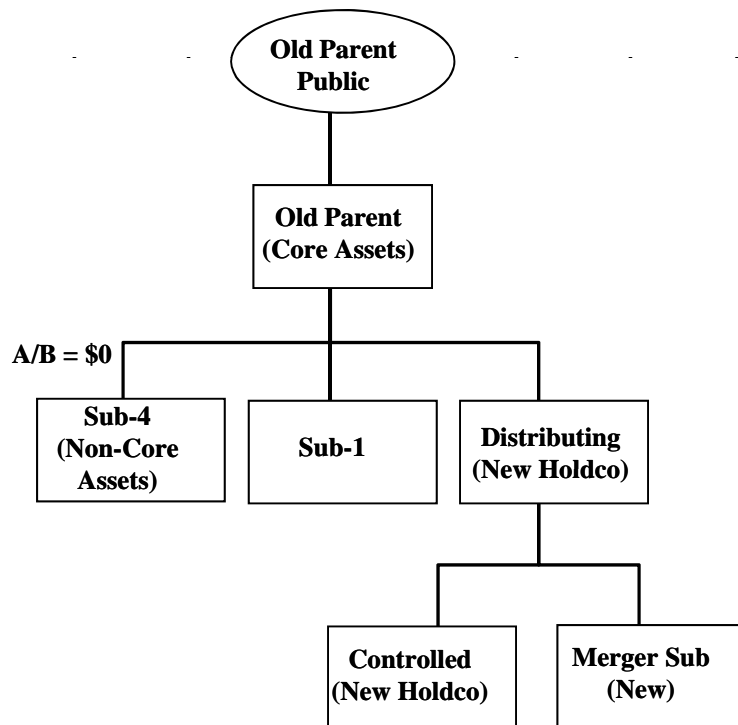
PLR 200708016/Lever D Rather Than C:
Sponsored Spin-Off/Reversing Direction – Slide 1

- Significant pre-spin dividend funded by borrowing at, and equity investment in, Distributing prior to spin – non-core business assets remained with Distributing.
- PE investment limited to less than 50% of economic interest in Distributing.
- Pre-spin “F” reorganization of Distributing facilitates efficient leverage mechanics; avoids obtaining creditor consents.

PLR 200708016/Lever D Rather Than C: Sponsored Spin-Off/Reversing Direction – Slide 2

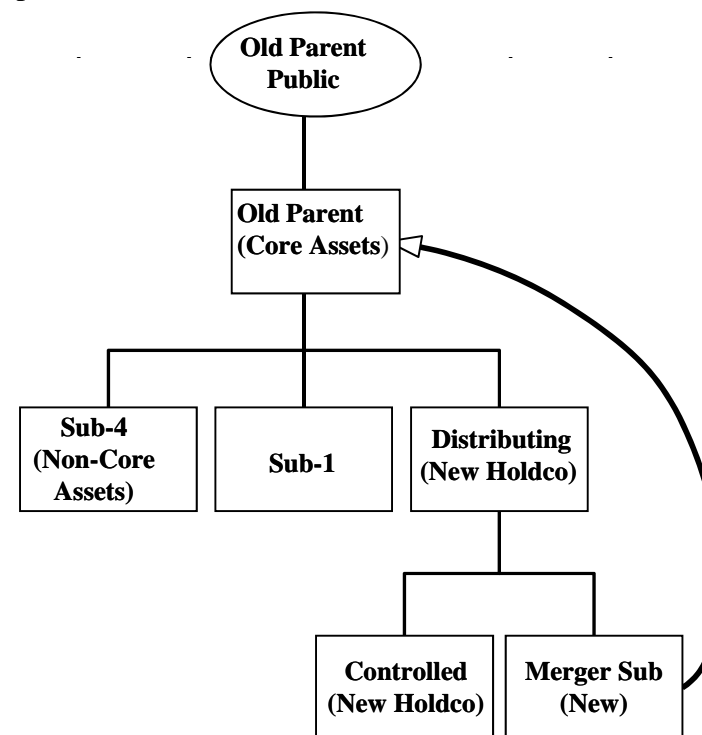
PRE – TRANSACTION STRUCTURE

- Insufficient basis in Sub-4 (PE targeted business) to pay tax-free dividend to Old Parent prior to spin-off.
- Old Parent liabilities cannot be assumed without creditor consent.



STEP 1: OLD PARENT MERGER

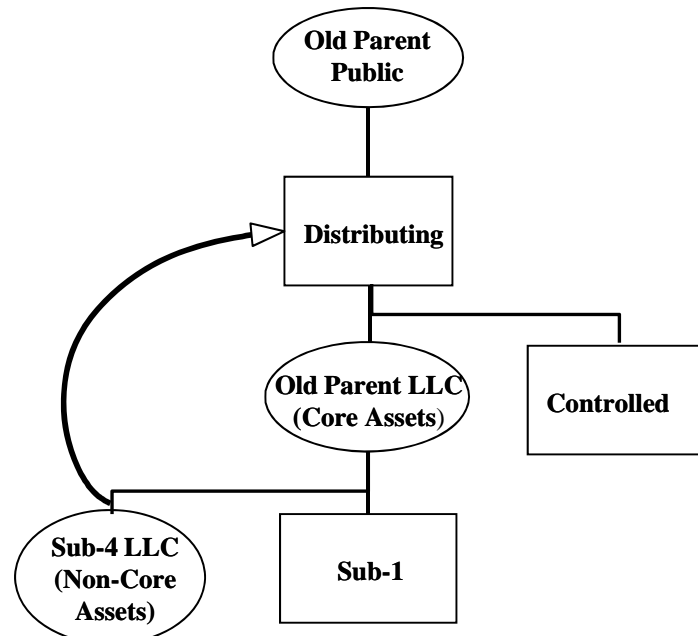
- Merger sub merges with and into Old Parent with Old Parent surviving as direct, wholly owned subsidiary of Distributing.
- Three new corporations formed to avoid gain recognition and separate Core Assets from Non-Core Assets



PLR 200708016/Lever D Rather Than C: Sponsored Spin-Off/Reversing Direction – Slide 3

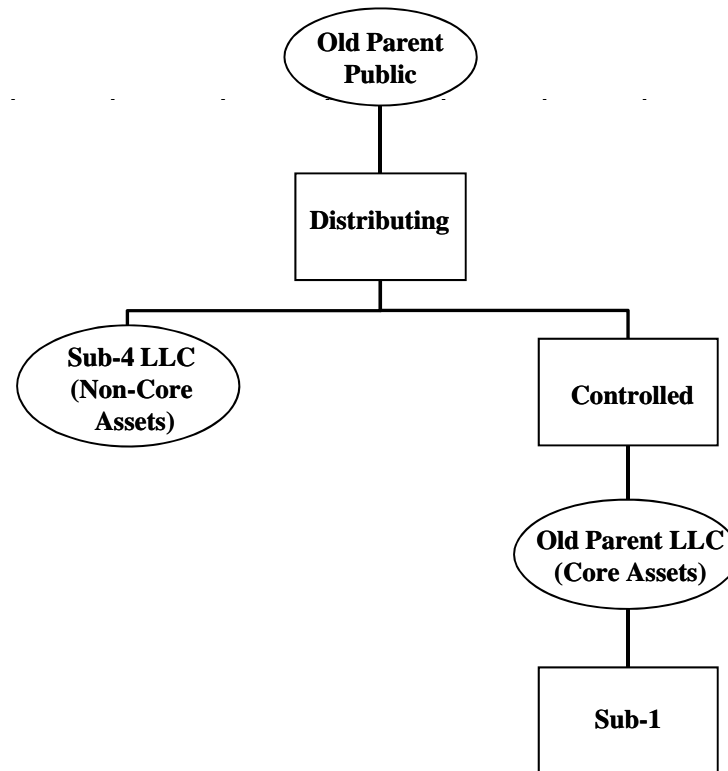
STEPS 2 and 3: CONVERSIONS & SUB-4 DISTRIBUTION

- Old Parent converts to Old Parent LLC resulting in an F reorg making Distributing successor to Old Parent.
- Old Parent liabilities remain in Old Parent LLC without need for creditor consent.
- Sub 4 converts to Sub 4 LLC.
- Old Parent LLC distributes interest in Sub 4 LLC.



STEP 4: OLD PARENT LLC CONTRIBUTION

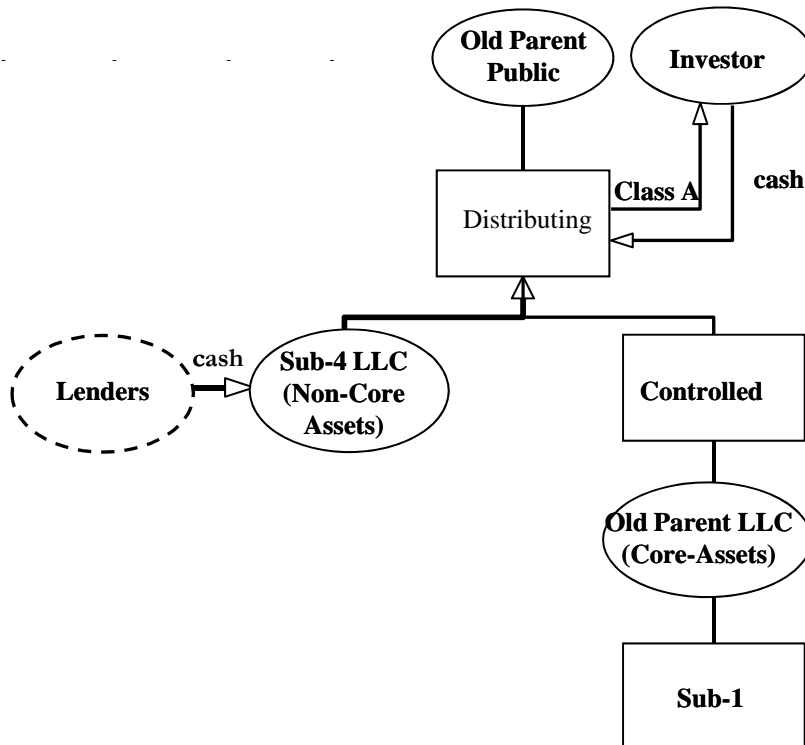
- Distributing contributes Old Parent LLC to Controlled.
- Contribution of Old Parent LLC permits transfer of Core Assets without need for creditor consents.



PLR 200708016/Lever D Rather Than C: Sponsored Spin-Off/Reversing Direction – Slide 4

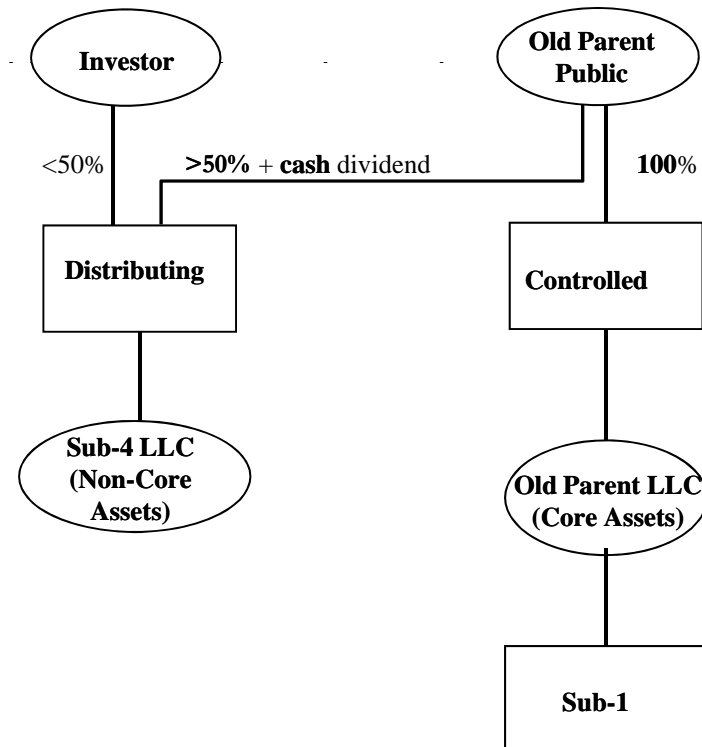
STEP 5: FINANCING AND SHARE ISSURANCE

- Investor purchases class A shares of Distributing (less than 50 percent (by vote and value)) for cash.
- Class A shares will not participate in pre-spin dividend or spin, but will convert to common stock immediately after.
- Sub-4 borrows and transfers proceeds to Distributing.

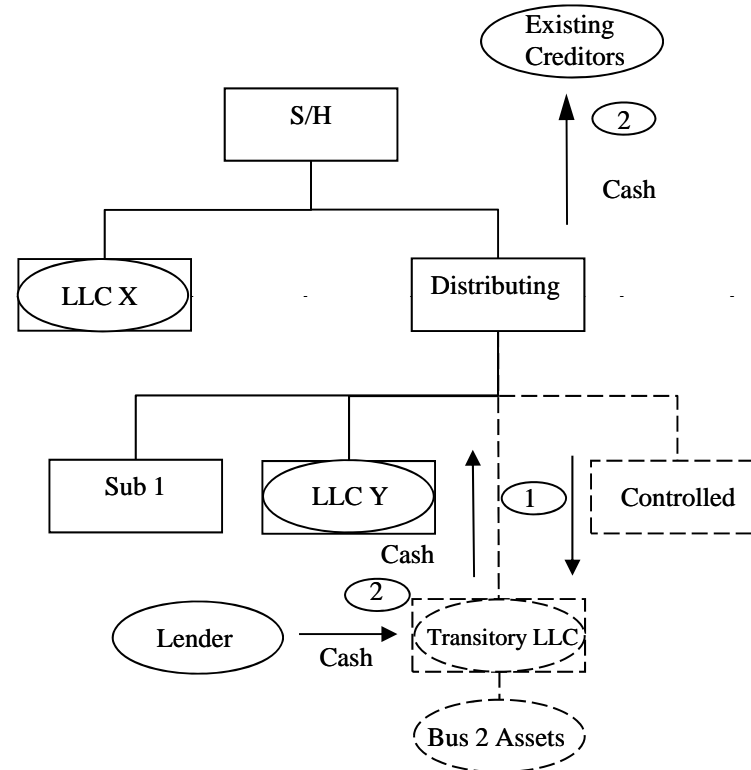


END RESULT

- Distributing pays dividend to Old Parent public shareholders and distributes stock of Controlled to Old Parent public shareholders, in each case excluding Investor.
- Leverage in separation is subject to limitation by section 355(g), device, and fraudulent conveyance rules.



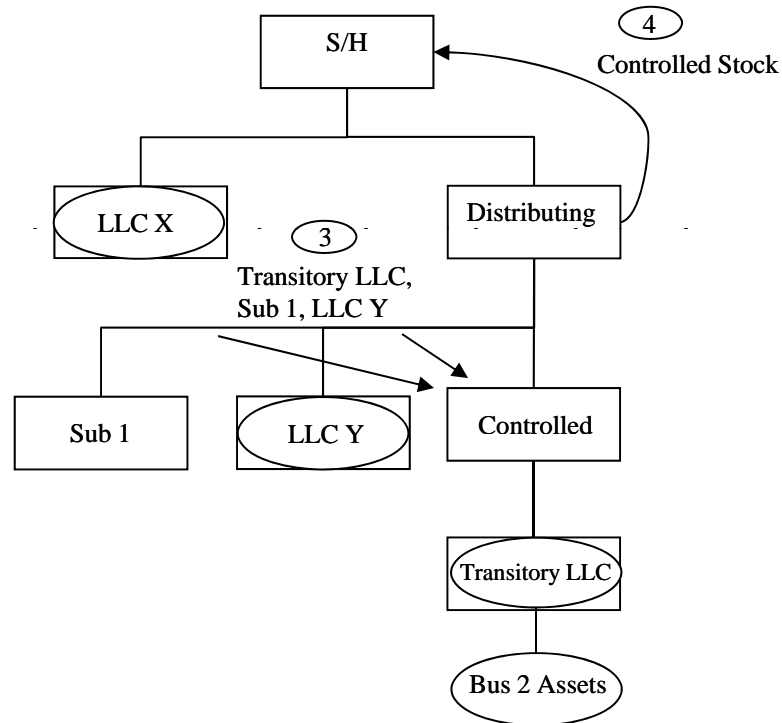
Rev. Rul. 79-258 Revisited: Simplified PLR 201132010 – Slide 1



- Step 1: Distributing forms Controlled and transfers all the Business 2 Assets to newly formed Transitory LLC.
- Step 2: Transitory LLC borrows cash from Lender in a borrowing for which Distributing has no responsibility, then distributes the cash to Distributing, which uses it to pay off a portion of its debt.

Rev. Rul. 79-258 Revisited: Simplified

PLR 201132010 – Slide 2

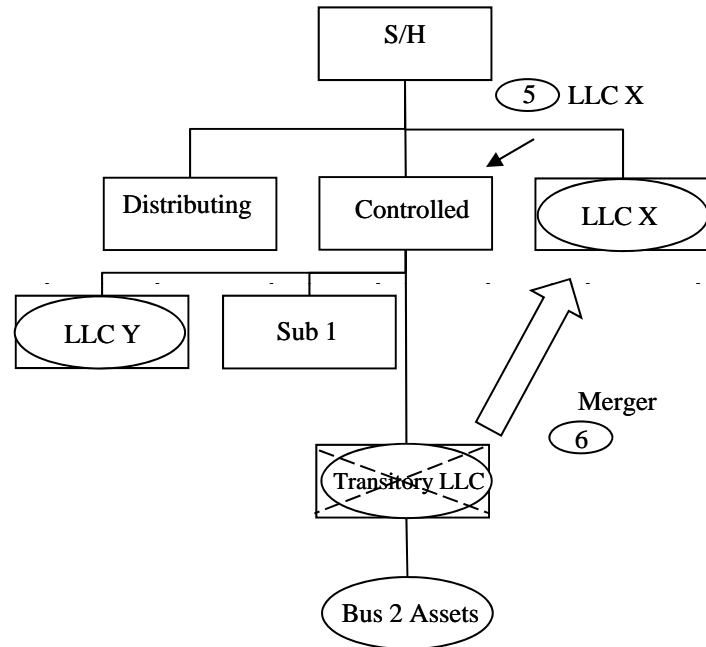


Step 3: Distributing contributes Transitory LLC, Sub 1, and LLC Y to Controlled (the “Contribution”)

Step 4: Distributing distributes Controlled to Shareholder (the “Distribution”)

Rev. Rul. 79-258 Revisited: Simplified

PLR 201132010 – Slide 3



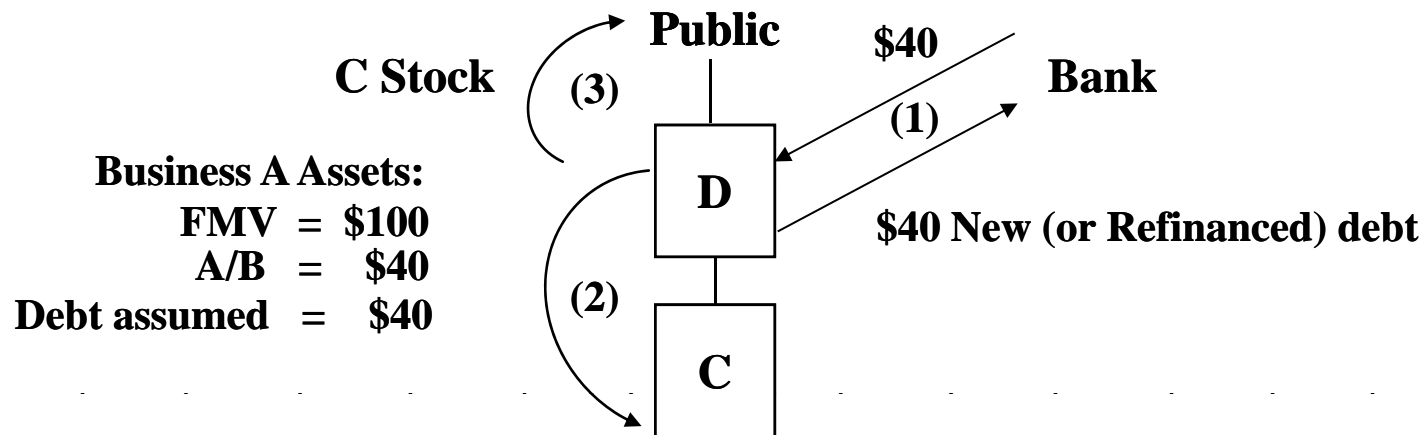
Step 5: Shareholder contributes LLC X to Controlled

Step 6: Transitory LLC merges with and into LLC X with LLC X surviving

Ruling - Treated as if (i) Distributing contributed all of its interests in Transitory LLC, Sub 1, and LLC Y in exchange for Controlled stock, (ii) Controlled borrowed cash from lender, and (iii) Controlled distributed the borrowed cash to Distributing after the Contribution (as part of the D/355 reorganization)

Compare – Rev. Rul. 79-258, 1979-2 C.B. 143 ruling that debt issued to Distributing for purposes of permitting assumption by Controlled respected as an assumption by Controlled not requiring § 361 boot purge.

Debt Allocation - Liability Assumption Treated as Boot



Entire liability assumption treated as boot under Section 357(b) if principal purpose (a) was to avoid tax on the exchange, or (b) was not a bona fide business purpose.

- **Rev. Rul. 79-258:** Assumed liabilities were traceable to the business transferred to C.
- **Rev. Proc. 96-30:** Requesting a representation that often cannot be made: “[the assumed liabilities] were incurred in the ordinary course of business and are associated with the assets being transferred.”
- **Private Letter Rulings:** Above representation modified to reflect that the liability assumption was intended to establish an appropriate capital structure. See e.g., PLR 200217006 (Dec. 21, 2001); PLR 200146019 (July 11, 2001).
- **Rev. Rul. 2003-110:** Consider significance of ruling in analyzing § 357(b): avoiding gain on C stock is not tax avoidance in the context of a spin-off.