



IRS

IRS TO CONTINUE ISSUING SECTION 355 TRANSACTIONAL RULINGS

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In March 2019, the IRS announced that the ruling program for section 355 distributions created under Rev. Proc. 2017-52 has been extended indefinitely. The ruling program expands the scope of letter rulings and offers taxpayers the opportunity to obtain a transactional ruling for corporate distributions intended to qualify as tax-free under section 355. Due to section 355's numerous statutory requirements and the inherent high stakes in securing tax-free treatment for a section 355 distribution, taxpayers and practitioners were often hesitant to implement a section 355 distribution in the absence of a favorable IRS ruling. The ruling program allows taxpayers to obtain a transactional ruling and confidently implement a section 355 distribution.

Background: Section 355 & IRS Ruling Policy

Section 355 provides an exception to the general rule that a distribution of appreciated property from a corporation is taxable. A corporation can be divided tax-free under section 355 through a split-off, spin-off, or split-up.

- In a split-off, a divesting corporation transfers part of its assets or a segment of its business to some, but not all, of its existing shareholders.
- In a spin-off, the divesting corporation transfers assets and liabilities to a subsidiary in exchange for all the outstanding shares of the subsidiary. The shares of the subsidiary are then distributed pro-rata to the shareholders of the divesting corporation.
- In a split-up, the divesting corporation transfers all of its assets and liabilities to two or more wholly owned subsidiaries followed by a liquidation of the divesting corporation.

Rev. Proc. 2017-52 is a reversal of the IRS' prior letter-ruling policy. Starting in 2003, the IRS limited the scope of letter rulings under section 355 by refusing to rule on specific issues. In 2009 and again in 2013, the IRS further limited the scope of its section 355 ruling program and allowed taxpayers to only obtain rulings on "significant issues," rather than on whether the overall transaction qualified for tax-free treatment under section 355. Then with Rev. Proc. 2016-45, the IRS expanded the scope of issues pertaining to the "corporate business purpose" requirement, or a "significant issue" under section 355(a)(1)(B) and regulation section 1.355-2(d). The IRS would only rule on legal issues and not those that were inherently factual.

Under the Rev. Proc. 2017-52 ruling program, in addition to significant issue ruling requests, a taxpayer may request a “transactional ruling” that addresses the general federal income tax consequences of a “covered transaction.” A covered transaction is a transaction intended to qualify under sections 368(a)(1)(D) and 355, or a distribution intended to qualify under section 355(a) or section 355(c).

Although transactional rulings for section 355 distributions are now available, Rev. Proc. 2017-52 does not alter the IRS’ policy that limits rulings on the device prohibition under section 355(a)(1)(B) and regulation section 1.355-2(d), the business purpose requirement under regulation section 1.355-2(d), and whether a distribution is pursuant to a plan under section 355(e).

When submitting a Rev. Proc. 2017-52 ruling request, a taxpayer must include a description of the restructuring as well as any other transaction that is part of the restructuring. A taxpayer must also generally make all the representations

outlined in the appendix to Rev. Proc. 2017-52.

Other recent favorable section 355 developments include Rev. Rul. 2019-9 that suspended two previous IRS rulings and announced a study on the active conduct of a trade or business (ATB) requirement under section 355(a)(1)(C) and section 355(b). The ATB analysis underlying the holdings in Rev. Rul. 57-464 and Rev. Rul. 57-492 focused on the lack of income generated by the activities. Consequently, this could expand the opportunity for certain corporations, especially those that are “pre-income,” such as research and development companies, to engage in a section 355 distribution.

Conclusion

The ruling program under Rev. Proc. 2017-52 is a welcome development for taxpayers considering a potential section 355 distribution because a transactional ruling can now provide a great deal of certainty that the IRS will respect the tax-free nature of the distribution. Koley

Jessen has an active corporate and tax practice and has obtained letter rulings under the current ruling program. In our experience, the IRS has issued favorable letter rulings under Rev. Proc. 2017-52 within approximately six months from the date of submission. ◀



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