

Revenue Ruling 2017-09: New IRC 355 North-South Spinoff Transaction Guidance and Resumption of Private Letter Rulings

THURSDAY, AUGUST 17, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Revenue Ruling 2017-9

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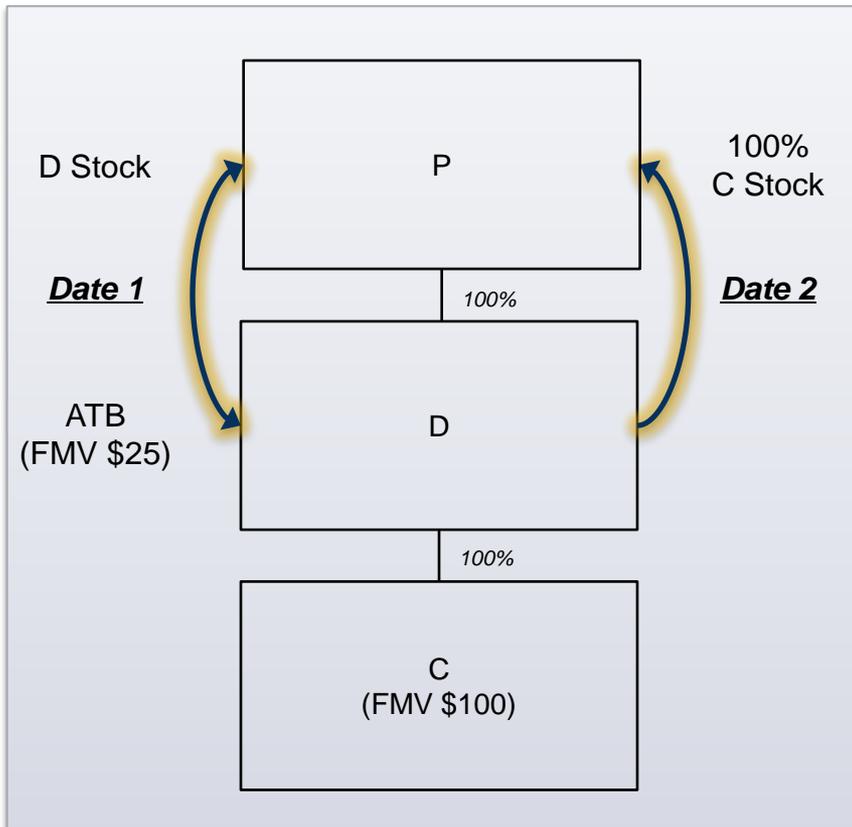
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Background

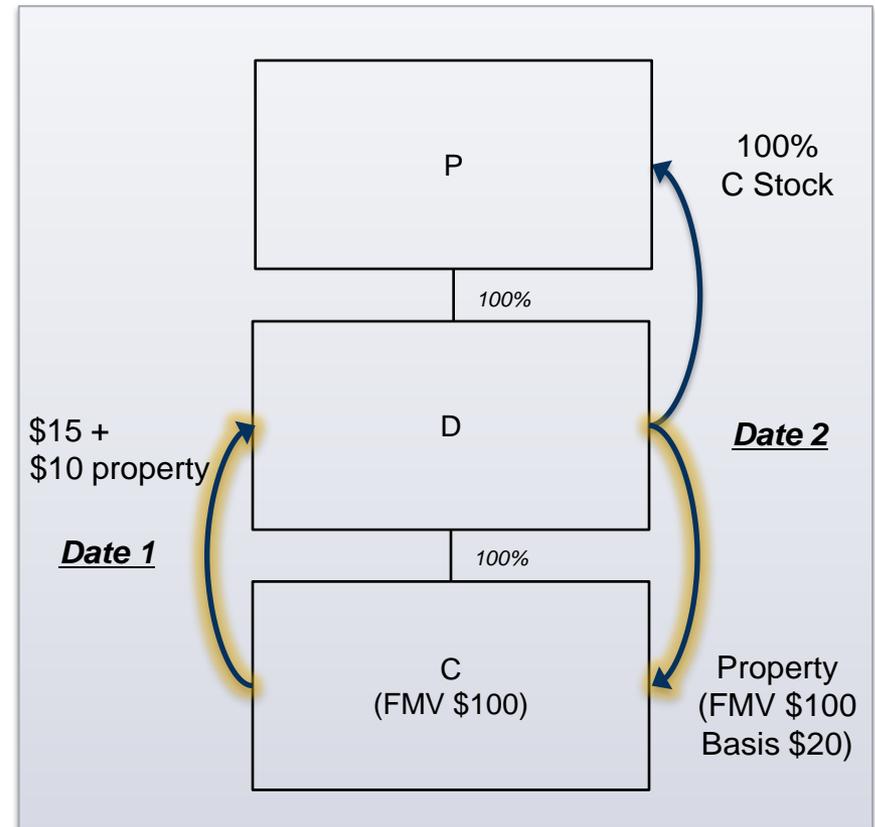
- On May 3, 2017, the IRS released Revenue Ruling 2017-9, which addresses two so-called “north-south” transactions in connection with spin-offs that are intended to be nontaxable under Section 355*
- North-south transactions involve both the contribution of assets to and the distribution of assets from a corporation pursuant to the same overall plan
- In Rev. Proc. 2013-3, the IRS issued a “no-rule” on north-south transactions and additionally indicated that such transactions were “under study”

Background

Situation 1

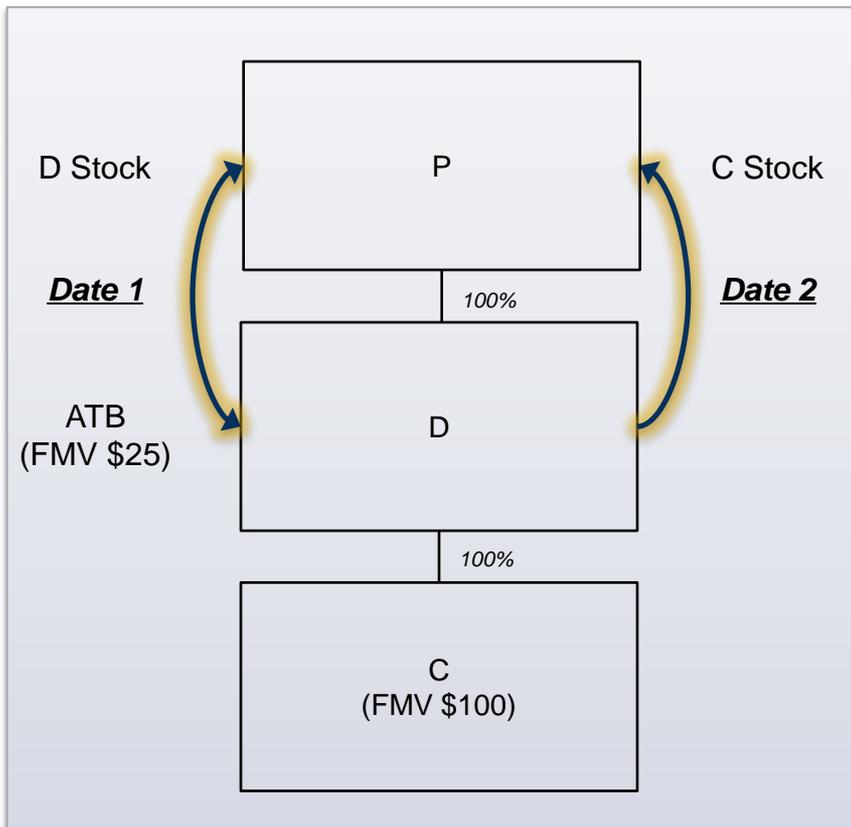


Situation 2



Background

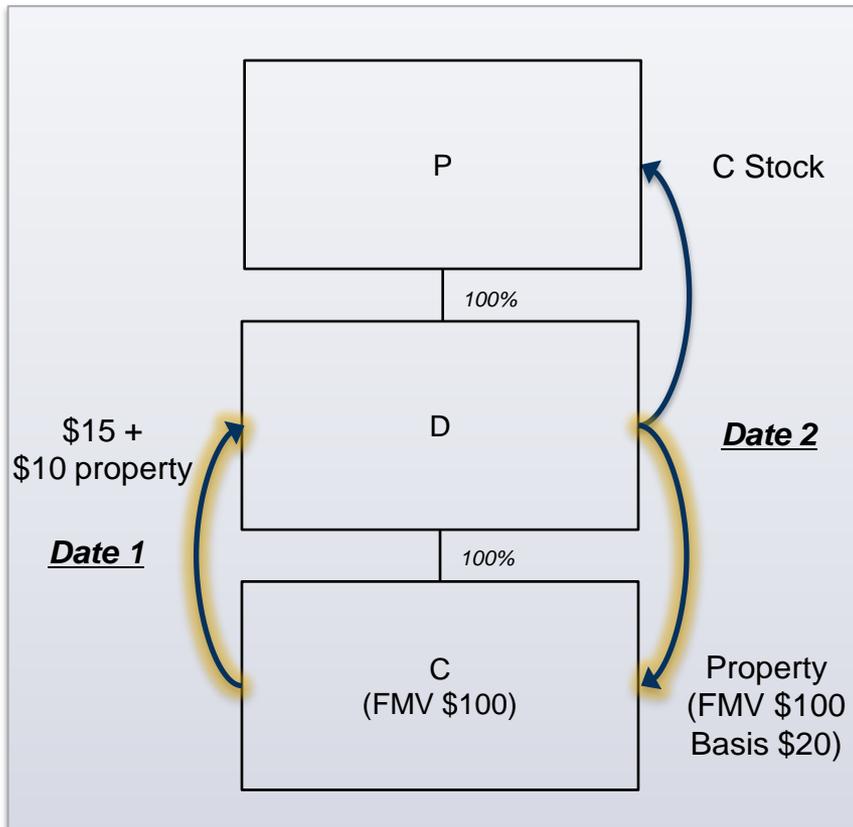
Situation 1



- If the Date 1 and Date 2 transfers are respected as separate, then:
 - The Date 1 transfer would be a Section 351 contribution; and
 - The Date 2 transfer would be treated as a Section 355 distribution
- If the Date 1 and Date 2 transfers are integrated into a single exchange, then:
 - P would be treated as transferring the ATB to D in exchange for a **portion** (i.e., \$25 worth) of the C stock in a taxable exchange under Section 1001;
 - Section 355 would not apply to the distribution of C stock because D would not have “distributed” stock constituting “control” of C; and
 - Gain would be recognized to D upon the distribution of the remaining C stock
- Binding commitment? Interdependence?

Background

Situation 2

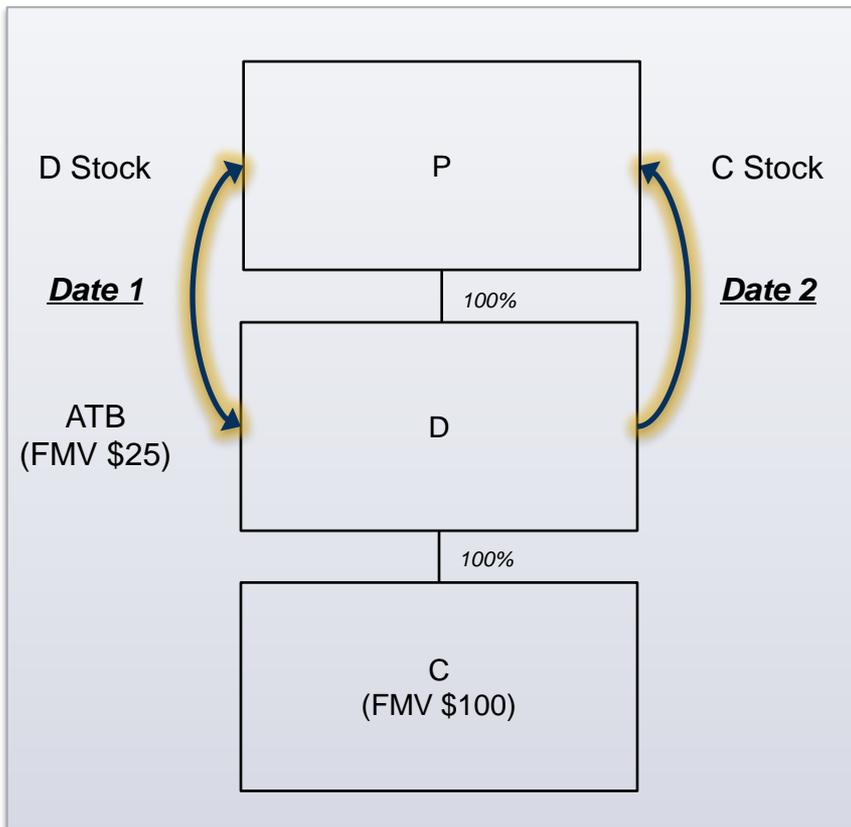


- If the distribution on Date 1 is treated as separate from the distribution of C stock on Date 2, then:
 - Section 301 would apply to D's receipt of the money and other property from C; and
 - No gain would be recognized to D upon the transfer of property to C
- If the distribution on Date 1 is treated as made in pursuance of the plan of reorganization that includes the distribution of C stock on Date 2, then:
 - The money and other property distributed by C to D would constitute "boot" to D; and
 - Gain would be recognized to D on its transfer of property to C to the extent of the amount of the money and the fair market value of the property

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Situation 1



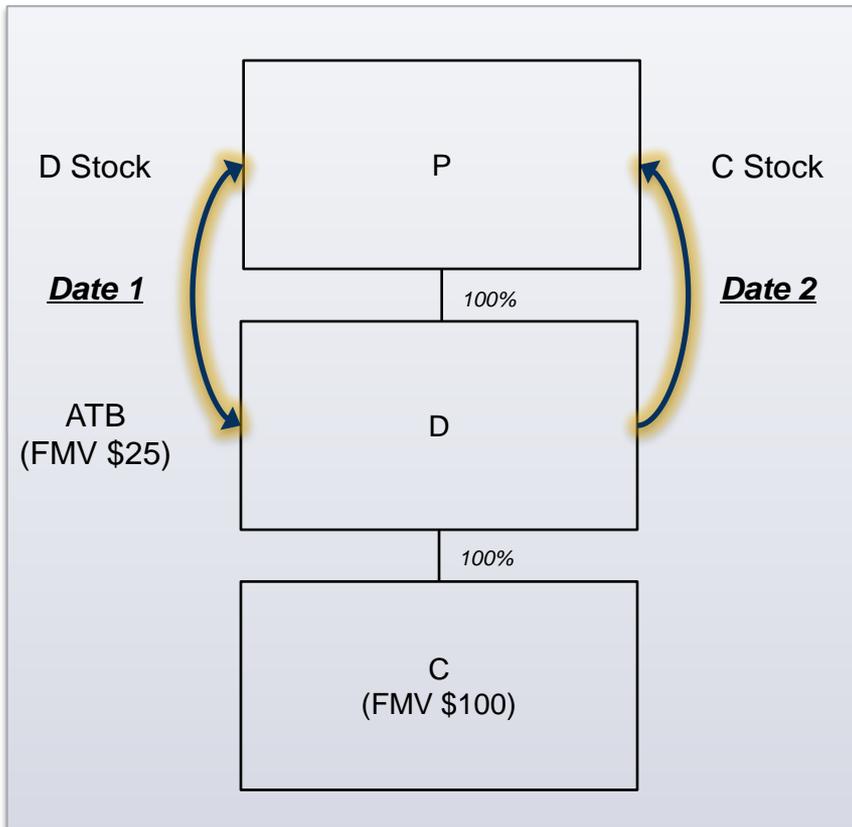
■ Holding:

- The Date 1 and Date 2 transfers will be respected as separate transactions
- Section 351 applies to P's transfer on Date 1
- Section 355 applies to D's transfer on Date 2

■ Reasoning:

- Whether to integrate steps requires review of the “scope and intent underlying each of the implicated provisions of the Code”
- The tax treatment of a transaction generally follows the taxpayer's chosen form unless:
 - ▶ there is a compelling alternative policy;
 - ▶ the effect of all or part of the steps of the transaction is to avoid a particular result intended by otherwise-applicable Code provisions; or
 - ▶ the effect of all or part of the steps of the transaction is inconsistent with the underlying intent of the applicable Code provisions

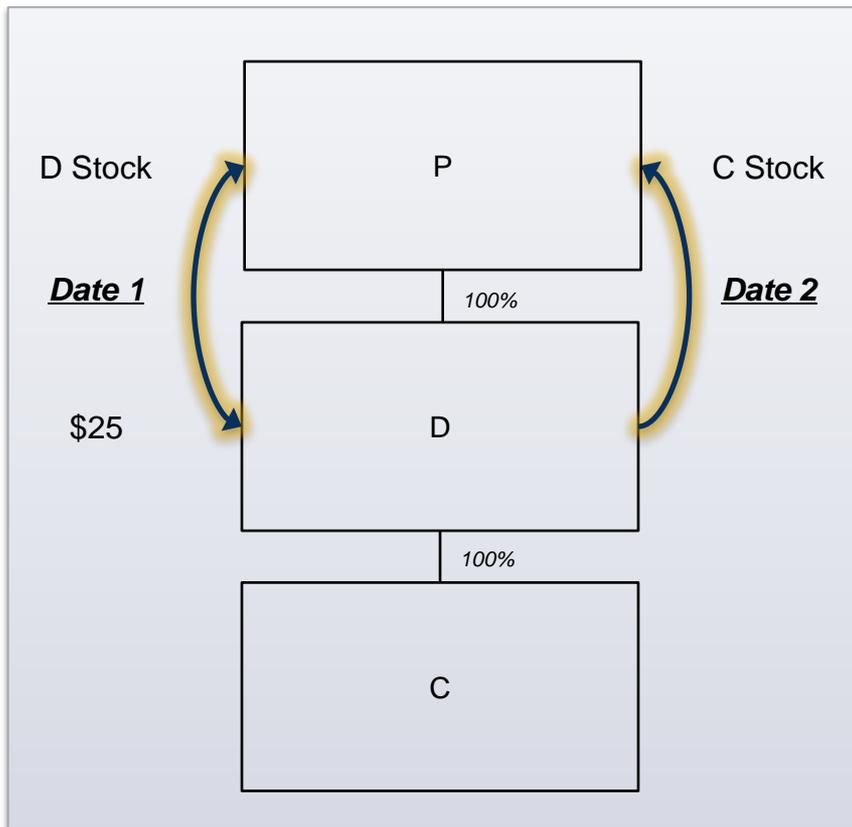
Situation 1



Reasoning (cont'd):

- Modified corporate form: Sections 351, 355, and 368 generally allow continued ownership of property in modified corporate form without recognition of gain
- Not an acquisition from an outside party: Section 355(b)(2)(C) and (D) permit the acquisition of an ATB in transactions in which no gain or loss is recognized, with the intent of preventing the acquisition of an ATB from an outside party in a taxable transaction
- Independent significance of transfer:
 - ▶ The transfer of property to D pursuant to a nonrecognition transaction “has independent significance” when undertaken in contemplation of a 355 distribution
 - ▶ The transfer “thus is respected as a separate transaction, regardless of whether the purpose of the transfer is to qualify the distribution” under Section 355(b)
 - ▶ Back-to-back nonrecognition transfers “are generally respected when consistent with the underlying intent of the applicable Code provisions”

Situation 1: Variations

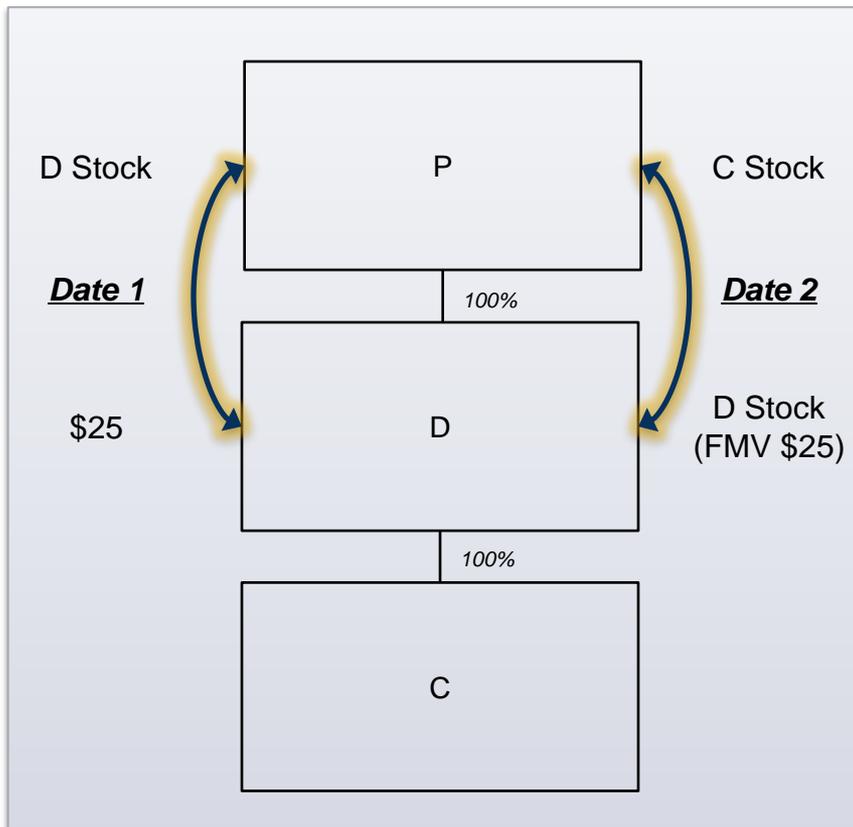


■ Cash contribution

- On Date 1, P contributes \$25 in cash to D in exchange for additional D shares
- On Date 2, D distributes all of the stock of C to P in a transaction intended to be nontaxable pursuant to Section 355

- “Acquisitions from outside parties”?
- “Independent significance of nonrecognition transfer”?
- Analysis in Situation 1 states that purpose of the transfer need not be ATB qualification
 - Robert Wellen, IRS associate chief counsel (corporate), indicated on July 22, 2017 that he does not believe a cash contribution presents a “significant issue” following Rev. Rul. 2017-9 (2017 TNT 141-4)

Situation 1: Variations



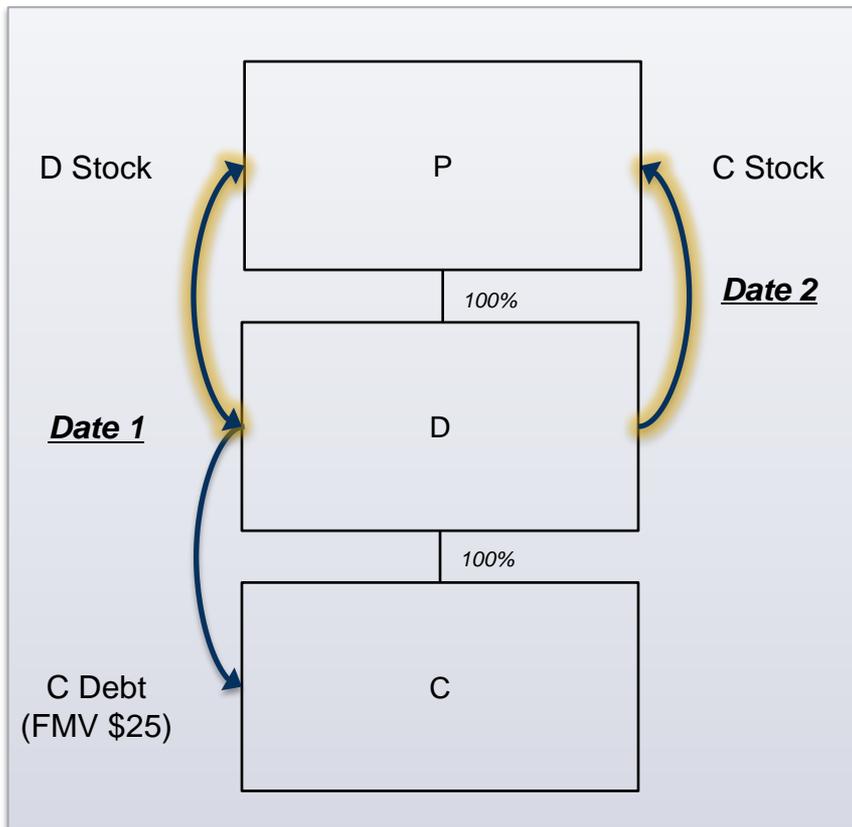
■ Cash contribution followed by share exchange

- On Date 1, P contributes \$25 in cash to D in exchange for additional D shares
- On Date 2, P exchanges the D stock received on Date 1 for \$25 of C stock held by D, and D distributes the remainder of the outstanding C stock to P, in a transaction intended to be nontaxable pursuant to Section 355

■ C stock distributed or sold?

- Rev. Rul. 70-18 (D stock issued in pre-spin merger not integrated where C stock distributed with respect to both old and new D stock)
- Rev. Rul. 57-114 (target corporation merged into D; target shareholders received D stock; immediately after merger, portion of newly-issued D stock was redeemed in split-off of C; ruled C stock exchanged for newly-issued D shares treated as exchanged for target corporation stock in Section 1001 exchange)

Situation 1: Variations



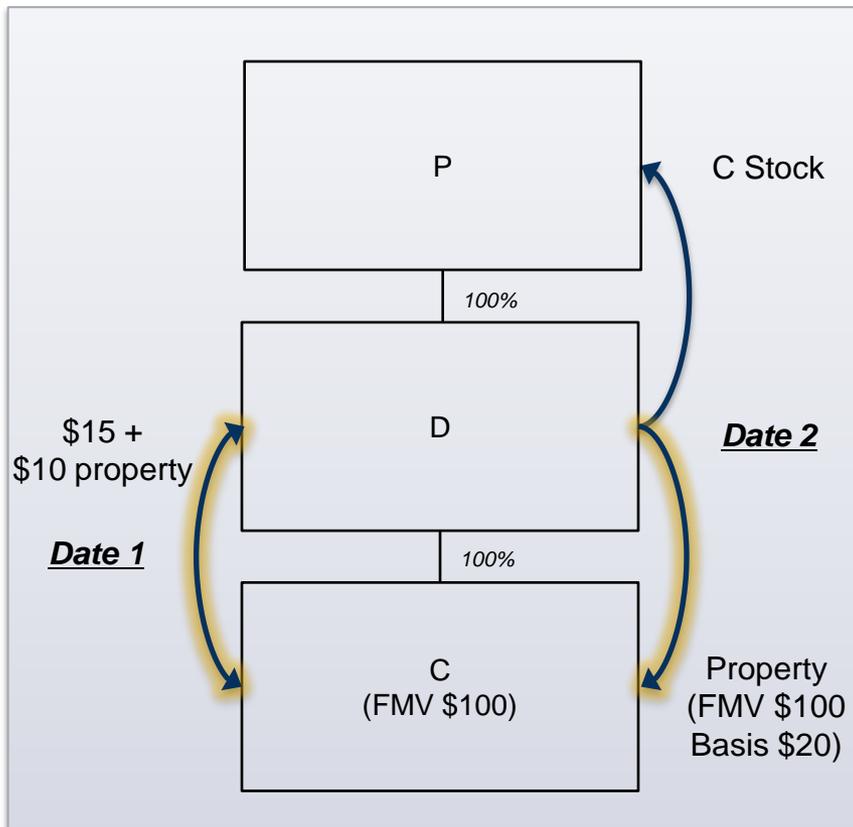
■ Intercompany debt contribution

- On Date 1, P contributes outstanding C debt to D in exchange for additional shares; D contributes debt to C
 - On Date 2, D distributes all of the stock of C to P in a transaction intended to be nontaxable pursuant to Section 355
- “Acquisitions from outside parties”?
“Independent significance of nonrecognition transfer”?
- What if C’s lenders require deleverage before the spin-off?
- Prior to 2013, the IRS had ruled privately that certain transactions would not be integrated if there was "no regulatory, legal, contractual, or economic compulsion or requirement" that the contribution be made as a condition of the spin
 - Other possible representations regarding no relationship of value contributed to value distributed

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Situation 2



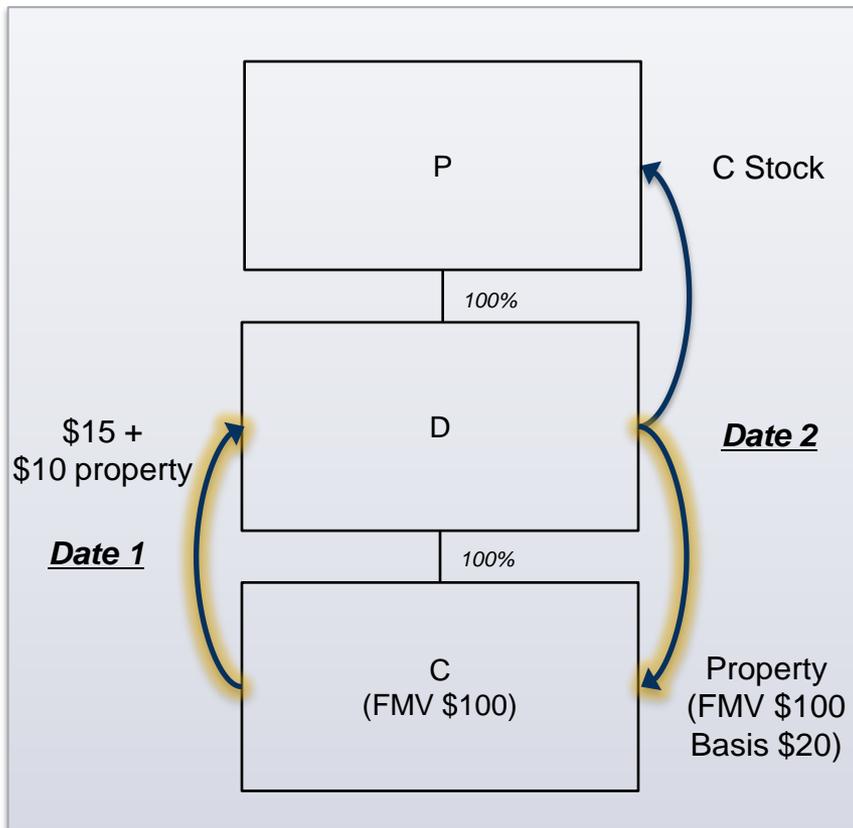
■ **Holding:**

- The distribution of money and property by C constitutes a distribution of boot under Section 361(b), and not a distribution under Section 301
- Under Section 361(b)(1)(B), gain is recognized to D on its transfer of property to C to the extent of the amount of the money and the FMV of the property

■ **Reasoning:**

- Estates of Bell (T.C.): The boot rules are “the exclusive measure of dividend income provided by Congress where cash is distributed to shareholders as an incident of a reorganization”
- Section 361 broadly looks to whether transfers of money or other property occur “in pursuance of the plan of reorganization” or “in connection with the reorganization”

Situation 2: Variations



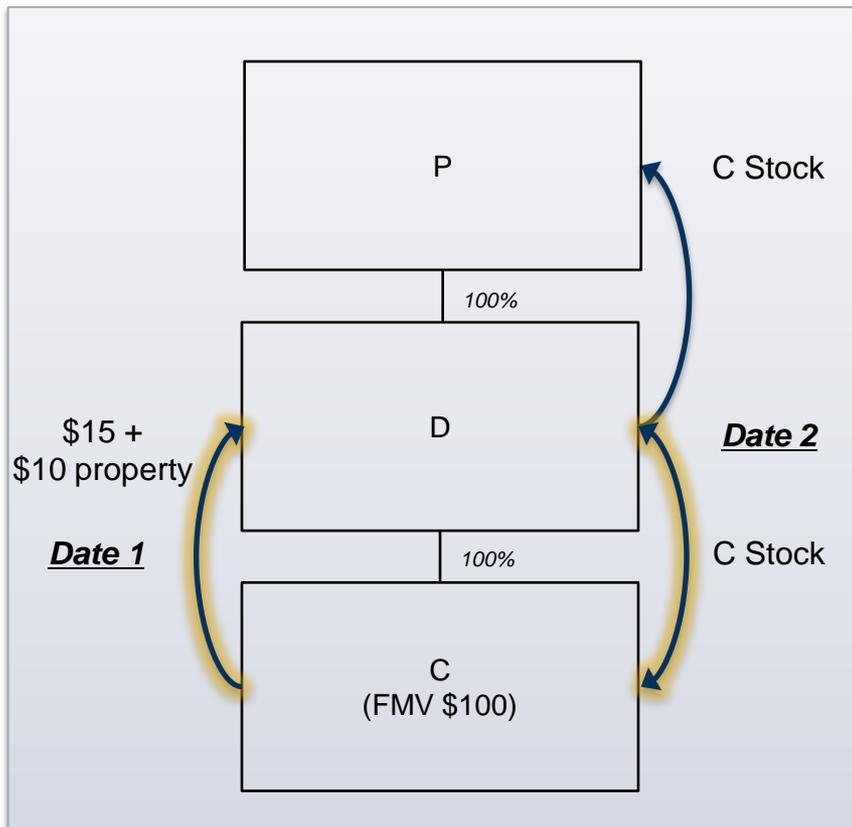
■ Regular dividend payments

- Prior to Date 1, C has made annual distributions of \$15 to D to fund D's debt service obligations
- Date 1 occurs six months after the last annual distribution

■ Is the \$10 property distribution made "in pursuance of the plan of reorganization"? Is the \$15 cash distribution?

- Treas. Reg. section 1.301-1(l): "A distribution... is within the terms of section 301 although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a formal sense"
- Rev. Rul. 2017-9, Situation 2: "Section 361(b) requires gain recognition... unless the facts establish that the distribution is in substance a separate transaction"

Situation 2: Variations



■ Recapitalization

- Same facts as Situation 2, but rather than contribute property to C, D exchanges its C stock for new C stock in a recapitalization
- Is the distribution on Date 1 “in pursuance of the plan of reorganization”?
- Rev. Rul. 61-156: Distribution in connection with a “recapitalization” is subject to Section 301
- The current vitality of Treas. Reg. section 1.301-1(l) in the context of multiparty reorganizations is unclear
- PLRs supported “bifurcated” treatment of distribution and reorganization so long as “no regulatory, legal, contractual or economic compulsion or requirement”

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Ruling Requests

- Revenue Ruling 2017-9 eliminates the IRS’s “no-rule” position on north-south transactions. Accordingly, the IRS will consider ruling requests from taxpayers that the steps in such transactions would not be integrated
 - On May 13, 2017, Susan Massey, assistant to the branch 4 chief, IRS Office of Associate Chief Counsel (Corporate), invited ruling requests where a taxpayer’s circumstances differ from those in a published ruling
 - For example, a transfer of non-ATB assets in a transaction similar to Scenario 1 is unlikely to be rejected on the basis of being a “comfort ruling”
- The IRS may decline to issue a PLR “when appropriate in the interest of sound tax administration or on other grounds when warranted by the facts and circumstances of a particular case”
- If the determination requested is “primarily one of fact,” or the transaction does not present a “significant issue,” the IRS may decline to issue a PLR
- Recent statements by IRS personnel indicate eagerness to open up the ruling process