

## Request for Comments; Areas Under Study Relating to §§ 337(d) and 355 of the Internal Revenue Code

Notice 2015-59

### SECTION 1. PURPOSE

The Treasury Department and the Internal Revenue Service (Service) are studying issues under §§ 337(d) and 355 of the Internal Revenue Code (Code) relating to transactions having one or more of the following characteristics: (i) ownership by the distributing corporation or the controlled corporation of investment assets, within the meaning of § 355(g)(2)(B), with modifications (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 active trade(s) or business(es) on which the distributing corporation or the controlled corporation relies to satisfy the requirements of § 355(b) (a Qualifying Business or Qualifying Business Assets); (ii) a significant difference between the distributing corporation's ratio of Investment Assets to assets other than Investment Assets and such ratio of the controlled corporation; (iii) ownership by the distributing corporation or the controlled corporation of a small amount of Qualifying Business Assets in relation to all of its assets; and (iv) an election by the distributing corporation or the controlled corporation (but not both) to be a regulated investment company (RIC), within the meaning of § 851, or a real estate investment trust (REIT), within the meaning of § 856.

Concurrently with the issuance of this notice, the Service is issuing Rev. Proc. 2015-43, this Bulletin, which supplements Rev. Proc. 2015-3, 2015-1 I.R.B. 129, by adding

certain of these transactions to the list of no-rule areas. This notice describes transactions that concern the Treasury Department and the Service, including transactions on which, while the relevant areas are under study, the Service ordinarily will not rule under sections 4.01(57) and (58) of Rev. Proc. 2015-3 (section 3.01 of Rev. Proc. 2015-43) and transactions on which the Service will not rule under section 5.01(26) of Rev. Proc. 2015-3 (section 3.02 of Rev. Proc. 2015-43). This notice also requests comments concerning the transactions described in this notice.

## SECTION 2. DISCUSSION

### **Background**

Section 355 of the Code generally provides that, if certain requirements are satisfied, a distributing corporation may distribute the stock (or stock and securities) of a controlled corporation to its shareholders and security holders without the distributing corporation, its shareholders, or its security holders recognizing income, gain, or loss on the distribution. However, § 355 does not apply to a distribution if the transaction is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (a device). Section 355(a)(1)(B). Numerous other requirements also must be satisfied for § 355 to apply to a distribution.

One such requirement is that the distributing corporation and the controlled corporation each be engaged in the active conduct of a trade or business immediately after the distribution (active trade or business requirement). Section 355(a)(1)(C) and (b)(1)(A). For this purpose, § 355(b)(3)(A) provides that all members of a corporation's separate affiliated group are treated as one corporation. Another such requirement is

that the transaction must be carried out for one or more corporate business purposes (business purpose requirement). Section 1.355-2(b)(1).

The Treasury Department and the Service have become aware, in part through requests for letter rulings, that some taxpayers are taking the position that certain distributions that have one or more of the characteristics described in section 1 of this notice satisfy the requirements of § 355. The Treasury Department and the Service believe that these transactions may present evidence of device for the distribution of earnings and profits, may lack an adequate business purpose or a Qualifying Business, or may violate other § 355 requirements. In addition, these transactions may circumvent the purposes of Code provisions intended to repeal the Supreme Court's decision in *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935) (*General Utilities* repeal). See, e.g., §§ 311(b), 337(d), 367(a)(5), and 367(e); H.R. Rep. No. 100-391, at 1080-1084 (1987).

### **Nature of Assets of Distributing Corporation and Controlled Corporation**

The Treasury Department and the Service are most concerned about transactions that result in (i) the distributing corporation or the controlled corporation owning a substantial amount of cash, portfolio stock or securities, or other Investment Assets, in relation to the value of all of its assets and its Qualifying Business Assets, and (ii) one of the corporations having a significantly higher ratio of Investment Assets to Non-Investment Assets than the other corporation. While these matters are under study, the Service will not rule on any issue that relates to the qualification of a distribution under § 355 and related provisions and is presented in a distribution described in section 5.01(26) of Rev. Proc. 2015-3.

## **Small Amounts of Qualifying Business Assets**

The Treasury Department and the Service are also concerned about transactions in which the distributing corporation or the controlled corporation owns a small amount of Qualifying Business Assets compared to its other assets (non-Qualifying Business Assets). Before enactment of § 355(b)(3), such transactions were common due to the restrictive nature of the “holding company” rule (§ 355(b)(2)(A) prior to its amendment by the Technical Corrections Act of 2007, Pub. L. No. 110-172, § 4(b)(1), 121 Stat. 2473, 2476 (2007)). The Treasury Department and the Service have concluded that, under current law, distributions involving small Qualifying Businesses may have become less justifiable. Accordingly, the Service ordinarily will not rule on any issue that relates to the qualification of a distribution under § 355 and related provisions and is presented in a distribution described in section 4.01(58) of Rev. Proc. 2015-3, but will consider ruling in unique and compelling circumstances.

In determining whether unique and compelling circumstances exist to justify the issuance of a ruling or determination letter, the Service will consider all facts and circumstances, including whether a substantial portion of the non-Qualifying Business Assets would be Qualifying Business Assets but for the five-year requirement of § 355(b)(2)(B) and whether there is a relationship between the business purpose for the distribution and the Qualifying Business of the distributing corporation or the controlled corporation.

## **Exception for Certain Intra-Group Distributions**

The Treasury Department and the Service generally are more concerned about transactions in which the stock of a controlled corporation is distributed outside an

affiliated group (within the meaning of § 243(b)(2)(A)), including a distribution which is part of a series of related transactions in which the stock of a controlled corporation (including, for example, a controlled corporation that was a distributing corporation with respect to a lower-tier distribution) is distributed outside an affiliated group. Accordingly, while these matters are under study, the Service will continue to follow its current ruling practice with respect to distributions within affiliated groups if there is no plan or intention for stock of any corporation to be distributed outside the affiliated group in a distribution described in section 4.01(57), 4.01(58), or 5.01(26) of Rev. Proc. 2015-3. The Treasury Department and the Service request comments concerning whether these transactions should be treated differently from other transactions, and whether other classes of transactions should be subject to similar exceptions.

### **Distributions Involving RICs or REITs**

The Treasury Department and the Service also have become concerned that an increasing number of distributions intended to qualify under § 355 involve a distributing corporation or a controlled corporation that elects to be a REIT. These distributions may involve corporations that, prior to the distribution, do not meet the requirements to be REITs and intend to separate REIT-qualifying assets from non-qualifying assets so that the distributing corporation or the controlled corporation can meet the requirements to be a REIT. In some situations, a REIT election may be made or become effective within a short period of time before the distribution. These transactions may involve relatively small Qualifying Businesses and retention of control over or use of the REIT's assets through long-term leases or other arrangements. As with the other transactions described in this notice and in Rev. Proc. 2015-43, these transactions, and similar

transactions involving RICs, involve significant concerns relating to the device prohibition, and the business purpose and active trade or business requirements under § 355, as well as the Code provisions intended to repeal the *General Utilities* decision. Accordingly, the Service ordinarily will not rule on any issue that relates to the qualification of a distribution under § 355 and related provisions and is presented in such distributions, but will consider ruling in unique and compelling circumstances.

The Treasury Department and the Service generally are not concerned about transactions in which both the distributing corporation and the controlled corporation will be and will continue to be RICs or will be and will continue to be REITs, or transactions in which the distributing corporation has been a RIC or REIT for a substantial period of time, whether or not the controlled corporation will be a RIC or REIT after the distribution. The Service will continue to consider these transactions under its current ruling practice.

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

The Treasury Department and the Service understand that, in many instances, a publicly traded corporation may structure a distribution intended to qualify under § 355 as either a pro rata distribution with respect to its stock or a non-pro rata exchange of the stock of the controlled corporation for some shareholders' stock in the distributing corporation. If the distribution is structured as a pro rata distribution, § 355(g) will not disqualify the distribution from nonrecognition treatment. Furthermore, in most instances, even if the distribution is structured as a non-pro rata exchange, § 355(g) will not disqualify the distribution from nonrecognition treatment because no single shareholder or group of related shareholders will own 50 percent or more of the stock of

either the distributing corporation or the controlled corporation after the distribution. In this regard, the Treasury Department and the Service have considered § 1.355-2(d)(3)(iii) (“The fact that the distributing corporation is publicly traded and has no shareholder who is directly or indirectly the beneficial owner of more than five percent of any class of stock is evidence of nondevice.”) and § 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.”).

The Treasury Department and the Service believe, however, that certain characteristics of a transaction may overcome both the nondevice factor of public trading and the non-pro rata structure of a distribution. These characteristics include, as described above, (i) the distributing corporation or the controlled corporation owning Investment Assets with substantial value in relation to the value of all of the corporation’s assets and the value of its Qualifying Business Assets, together with a disparity of such relationships between the distributing corporation and the controlled corporation (see § 1.355-2(d)(2)(iv), relating to the nature and use of assets); (ii) in certain situations, the distributing corporation or the controlled corporation owning a small amount of Qualifying Business Assets in relation to all of its assets; and (iii) a prompt or planned RIC or REIT election by the distributing corporation or the controlled corporation. In addition, the Treasury Department and the Service believe that these characteristics may make it less likely that a nontax business purpose for the distribution will satisfy the independent business purpose requirement set forth in § 1.355-2(b) or will qualify as a strong corporate business purpose constituting a

nondevice factor. See § 1.355-2(d)(3)(ii) (relationship between business purpose and device). Thus, sections 4.01(57), 4.01(58), and 5.01(26) of Rev. Proc. 2015-3 do not distinguish between transactions involving distributing corporations the stock of which is or is not publicly traded or between pro rata and non-pro rata distributions.

### SECTION 3. REQUEST FOR COMMENTS

The Treasury Department and the Service request comments concerning the transactions described in this notice. In particular, comments are requested with respect to: (i) the facts and circumstances relevant to whether the transactions satisfy the requirements of § 355 and/or circumvent the purposes of *General Utilities* repeal; (ii) whether investment assets, within the meaning of § 355(g)(2)(B), as modified by section 5.01(26) of Rev. Proc. 2015-3, are the appropriate assets to consider in addressing the concerns raised by the transactions; (iii) whether the treatment of transactions solely within an affiliated group should differ from the treatment of transactions in which stock of one or more corporations will be distributed outside the affiliated group; (iv) whether the Service should rule on issues presented in distributions in which the distributing corporation or the controlled corporation owns a relatively small amount of Qualifying Business Assets, and if so in what circumstances; and (v) whether other classes of transactions subject to section 4.01(57), 4.01(58), or 5.01(26) of Rev. Proc. 2015-3 should be excepted therefrom.

Written comments may be submitted to the Internal Revenue Service, CC:PA:LPD (Notice 2015-59), Room 5207, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Comments also may be hand-delivered Monday through Friday between the hours of 8:00 a.m. to 4:00 p.m. to the Courier's Desk, Internal Revenue Service, 1111



Constitution Avenue, NW, Washington, DC. Attn: CC:PA:LPD:PR (Notice 2015-59).

Comments also may be submitted electronically to

*notice.comments@irscounsel.treas.gov*. Please include "Notice 2015-59" in the subject line of any electronic submission. Comments will be available for public inspection and copying.

#### SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Stephanie D. Floyd of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice, contact Stephanie D. Floyd at (202) 317-6848 (not a toll-free call).