

**Spin Offs**  
**Corporate Tax, Spring 2023**  
**Problem Set 9**

1. What are the 3 ways to divide a corporation?
2. What section would govern each corporate division in Q1 if §355 didn't apply?
3. What are the 4 basic requirements for a tax-free distribution of stock or securities under §355(a)?
4. Distributing owns 100% of the stock of Controlled, and Distributing distributes pro rata 100% of Controlled to its shareholders. Y Corp acquires 100% of the stock of Controlled in a tax-free reorg in exchange for 25% of Y Corp's stock. Assume that under common law principles, e.g., *Court Holding*, the transaction is treated as an acquisition of Distributing's stock in Controlled for 25% of Y stock, and then a pro rata distribution of the Y stock. Rev. Rul. 98-27. Also, skim very lightly §355(e)(1) and (2), which we'll return turn later.
5. Very generally, what's the device requirement aimed at? Reg. §1.355-2(d)(1).
6. Which of these factors are device or non-device factors? Reg. §1.355-2(d)(2), (3) and (5).
  - a. Distributing is publicly traded
  - b. The distribution would qualify under §302(a) if 355 didn't apply
  - c. Sale of distributing or controlled negotiated before or after the distribution
  - d. Pro rata distribution
  - e. Absence of E&Ps of controlled and distributing
  - f. Distribution to corporate shareholder
  - g. Business of either controlled or distributing is secondary business.
  - h. Corporate business purpose
7. Distributing (D) owns 100% of controlled (C), and both satisfy the active business requirement. To resolve managerial disputes between different groups of shareholders, D wants to completely redeem the dissenting SHs with shares of C. To equalize the value of the C stock and the value of the dissenting SHs' stock of D, D first makes a capital contribution to C of 13x (about 100% of the value of C before the contribution).
  - a. What kind of division is this?
  - b. Does this present device concerns? Rev. Rul. 64-102 and Reg. §1.355-2(d)(5)(iv)
  - c. What concerns does the capital contribution present?

8. Distributing (D) has 3 SHs, A, B, and C, and D owns 100% of controlled 1 (C1), controlled 2 (C2), and controlled 3 (C3). All of them satisfy the active business requirement. D distributes both C2 and C3 to SHs A & B in complete redemption of their stock. Does this transaction present device concerns? Why or why not? Reg. §1.355-2(d)(5)(v), Ex. 2.
9. Distributing (D) manufactures pharma products and owns investment securities. D contributes the investment securities to new controlled (C), and distributes the stock of C. Is the AT/B requirement satisfied? Reg. §1.355-3(b)(2)(iv)(A) and -3(c), Ex. 1.
10. Distributing (D) is engaged in the sale of consumer cleaning products and also does related R&D. D contributes the R&D department to controlled (C) and distributes controlled. C will continue its R&D activities for both D and unrelated 3<sup>rd</sup> parties. Is the AT/B requirement satisfied? Reg. §1.355-2(d)(2)(iv)(C) and Reg. §1.355-3(c), Ex. 9.
11. Distributing (D) is engaged in the sale of shoes in physical retail spaces. D creates an “Internet web site” to sell its shoes. Two years later, it transfers the web site’s assets and controlled (C) and spins off controlled. Does C satisfy the AT/B requirement? Rev. Rul. 2003-38?
12. Read Rev. Rul. 2019-09. How is the IRS considering expanding the types of activities that will satisfy the AT/B test?
13. Very generally, what are the hot dog stand proposed regs aimed at? Google could be your friend.
14. D has two businesses, B1 and B2. D’s IB informs D that if the two businesses were conducted in separate and independent corporations, the aggregate value of the stock of the resulting corporations would likely be greater than the value of D’s stock without a separation. That is,  $1 + 1 = 3$ . Ha! Any increase in aggregate stock value would benefit D because it would enhance the value of its equity-based incentive compensation to employees and preserve capital in subsequent corporate acquisitions using D stock as consideration. Accordingly, D transfers Business 2 to newly formed C Corporation and distributes pro rata the C stock among D’s shareholders. Does this transaction satisfy the business purpose requirement? Rev. Rul. 2004-23.
15. A has a basis of 40x in her shares of D, which distributes all of the shares of controlled (C) to A in a good 355 spin. The FMV of the C shares is 25x and the D shares post spin is 75x.
  - a. How much G/L does A recognize? §355(a)
  - b. What’s A’s basis in her D and C shares post spin? §358(b)(2); Reg. §1.358-2(a)(2)(iv).

16. A has a basis of 50x in her shares of D, which distributes 5x in cash and all of the shares of controlled (C) worth 45x to A in a good spin off.
- What is the \$5x called?
  - How is it taxed? §356(b)
17. A owns 40% of D stock worth \$400x. D distributes all of the shares of C (worth \$200x) to A **plus** 200x of cash in exchange for A's D shares in a good 355 transaction.
- What kind of division is this?
  - What is the \$200x of cash called?
  - What is the character of the \$200x of cash? §356(a)(2) and Rev. Rul. 93-62.
18. Distributing Corp owns 100% of Controlled Corp. Acquiring acquires 40% of Distributing for cash and 3 years later, Distributing distributes to Acquiring in a split off all of the stock of Controlled in exchange for Acquiring's Distributing stock. §355(d)(1)-(5).
19. Same as previous Q, except that Acquiring was a shareholder of Target, and Distributing acquired Target in an "A" reorg with Target merging into Distributing with Distributing surviving and Acquiring received (the 40%) Distributing shares in exchange for his Target shares. What's one additional question that you should ask? §355(d)(5)(A); and Reg. §1.355-6(b)(e).
- 20. Distributing Corp owns 100% of Sub1 and Sub2. Acquiring wishes to acquire Distributing, but for regulatory purposes it can't own Sub2. Distributing spins off Sub2, and thereafter Acquiring acquires Distributing in a tax-free "A" merger, and Acquiring shareholders acquire 60% of the merged entity.**
- Why doesn't §355(d) apply?
  - Is the acquisition evidence of a device? Reg. 1.355-2(d)(2)(iii)(E).
  - Tax consequences to Distributing? §355(e)
  - Any advice you'd give to the parties to avoid §355(e). See Rev. Rul. 2005-65
21. Last Q of the semester. Acquiring owns an appreciated minority interest (20%) in Distributing and wants to sell for \$. Distributing contributes a boat load of \$ to Controlled and an active T/B and does a split off of Acquiring's shares in Distributing for shares of Controlled. The \$ in Controlled is 70% of the FMV of Controlled.
- Putting aside §355, once Acquiring owns 100% of Controlled, can Acquiring access the \$ easily?
  - Is the transfer of cash evidence of a device? Reg. 1.355-2(d)(2)(iv)(B). What about the fact that Acquiring is redeemed? Reg. 1.355-2(d)(5)(iv).
  - Does 355(d) or 355(e) apply? §355(e)(3)(A)(ii)
  - Tax consequences? §355(g)(1), (2)(A) and (B).