Simpson Thacher

Memorandum

Internal Revenue Service Announces Changes to Ruling Policy and New Safe Harbors for Spinoffs

July 19, 2016

Introduction

Since January 2, 2013, the Internal Revenue Service (the "IRS") would not issue private rulings on tax-free spinoffs in which a parent corporation (the "distributing corporation") acquires the requisite control of a subsidiary corporation (the "controlled corporation") through a recapitalization of the controlled corporation's stock prior to and in anticipation of the spinoff (generally to provide for high vote stock of the controlled corporation to be held by the distributing corporation).[1] On July 15, 2016, the IRS and Treasury Department released Revenue Procedure 2016-40,[2] which removed the issue from the no-rule list, allowing taxpayers to seek a ruling on spinoffs involving such a recapitalization. In addition, the Revenue Procedure provided two safe harbors under which the IRS will respect a tax-free spinoff where the distributing corporation acquires control of the controlled corporation through a recapitalization of the controlled corporation's stock, so long as (i) there is no plan or action taken to unwind the recapitalization within the 24-month period following the spinoff or (ii) the recapitalization is unwound in connection with an unanticipated third party transaction (such as a merger).

Background

Section 355 of the Internal Revenue Code of 1986, as amended, generally provides that, if certain requirements are satisfied, a distributing corporation may distribute the stock of a controlled corporation which it "controls" in a tax-free transaction. Control for these purposes means ownership of at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of each other class of stock of the corporation. Control of the controlled corporation may be acquired

[1] Rev. Proc. 2013-3 § 5.01(9), 2013-1 I.R.B. 113.

[2] 2016-31 I.R.B. 1 (the "Revenue Procedure").

by the distributing corporation pursuant to a recapitalization of the stock of the controlled corporation immediately before a spinoff so long as control is not transitory or illusory. The control requirement is a facts and circumstances test that takes into account post-distribution events, including transactions undertaken by the controlled corporation that reverse a pre-spinoff acquisition of control (such a transaction, an "unwind").

No-Rule List

The Revenue Procedure provided that spinoffs involving an acquisition of control through a recapitalization of the controlling corporation's stock in anticipation of the spinoff is no longer under IRS study. As such, taxpayers may seek a ruling from the IRS on transactions involving such a recapitalization into control.

Safe Harbors

Under the Revenue Procedure, the IRS will not assert that the distributing corporation lacks the requisite control for a tax-free spinoff where—

1. no action is taken (including the adoption of any plan or policy) by the controlled corporation's board of directors, management or any of its "controlling shareholders" in the 24-month period following the spinoff that would (if implemented) actually or effectively result in an unwind, or
2. the controlled corporation enters into a transaction with one or more unrelated persons[3] (for example, a merger) that results in an unwind, provided that there was no agreement, understanding, arrangement, substantial negotiations or discussions concerning the transaction or a similar transaction during the 24-month period ending on the date of the spinoff.

Conclusion

The Revenue Procedure allows taxpayers to seek a ruling on a recapitalization into control in anticipation of a spinoff and provides greater certainty that a transaction will comply with the control requirement by providing two safe harbors. However, the Revenue Procedure does not change the underlying substantive law, and transactions that do not fall within the safe harbors will need to be analyzed for compliance with existing law. We recommend clients pursuing a potential spinoff transaction carefully consider whether the transaction implicates any of the rules set forth in the Revenue Procedure. We will continue to monitor developments in this area, which remains subject to change, including by future IRS guidance.

[3] The controlling corporation and another person are related if they have 20% overlapping ownership, whether direct, indirect, or by attribution.

For further information, please contact one of the following members of the Firm's Tax Practice.

NEW YORK CITY

Gary B. Mandel
+1-212-455-7963
gmandel@stblaw.com

Robert E. Holo
+1-212-455-2514
rholo@stblaw.com

Jonathan Goldstein
+1-212-455-2048
jgoldstein@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000