Report No. 1384

New York State Bar Association Tax Section

Report on the Treatment of Share Repurchases under Section 355(e)

January 5, 2018

TABLE OF CONTENTS

PAGE

I. INTRODUCTION 1

II. SUMMARY OF RECOMMENDATIONS: COUNTING CONVENTIONS FOR PUBLIC SHARE REPURCHASES 1

III. BACKGROUND – COUNTING CONVENTIONS FOR PUBLIC SHARE REPURCHASES 3

A. Basic Computational Approach to Repurchases 5

IV. PRORATION 7

A. Service's Current Ruling Practice 10

B. Discussion 15

1. Elements of the Proration Rule 16

2. Rationale for the Proration Rule 20

V. NETTING 26

A. Service's Current Ruling Practice 29

B. Discussion 31

VI. EFFECT OF NON-PLAN REPURCHASES 34

A. Service's Current Ruling Practice 35

B. Discussion 36

C. Pre-Existing Share Repurchase Programs and Plan Analysis 42

VII. CONCLUSION 45

New York State Bar Association Tax Section

Report on the Treatment of Share Repurchases under Section 355(e)

I. INTRODUCTION

This report (the "**Report**") of the Tax Section of the New York State Bar Association comments on the treatment of share repurchases under Section 355(e) of the Code.[1] In particular, the Report addresses repurchases made by a public corporation on the open market, in an accelerated share repurchase ("**ASR**") program, or through a self-tender generally open to all shareholders ("**Public Share Repurchases**"). As described below, the Report recommends that the Treasury Department ("**Treasury**") and the Internal Revenue Service (the "**Service**," and, together with Treasury, the "**government**") publish a revenue ruling providing certain counting conventions for measuring the shift in ownership for Section 355(e) purposes resulting from Public Share Repurchases.[2]

II. SUMMARY OF RECOMMENDATIONS: COUNTING CONVENTIONS FOR PUBLIC SHARE REPURCHASES

We recommend that the government publish a revenue ruling reaching the following technical conclusions:

[1] Except as otherwise indicated, all "**Section**" references are to sections of the Internal Revenue Code of 1986, as amended (the "**Code**"), and the Treasury Regulations promulgated thereunder.

[2] The principal drafters of this Report are James Coss, Samantha Evei, Nicole Field, Lawrence Garrett, Joshua Holmes, and Rachel Reisberg. Significant contributions and comments were received from William Alexander, John Barrie, Daniel Berger, Andy Braiterman, Michael Farber, Morris Kramer, Stephen Land, Eric Lowenstein, Michael Mollerus, Richard Nugent, Deborah Paul, Michael Schler, Jodi Schwartz, David Sicular, Eric Solomon, Karen Sowell, Linda Swartz, Shun Tosaka, Davis Wang, Gordon Warnke, and Sara Zablotney. This Report reflects solely the views of the Tax Section of the New York State Bar Association and not those of the NYSBA Executive Committee or the House of Delegates.

1. To the extent Public Share Repurchases by a distributing corporation or a controlled corporation are part of a plan (or series of related transactions) including a distribution otherwise qualifying under Section 355, such repurchases will be treated as being made on a *pro rata* basis from all shareholders of the repurchasing corporation holding shares of the same class of stock, other than (a) "ten-percent shareholders" within the meaning of Treasury Regulations Section 1.355-7(h)(14) ("**10% Shareholders**") or (b) "controlling shareholders" within the meaning of Treasury Regulations Section 1.355-7(h)(3) ("**Controlling Shareholders**" and, shareholders other than those described in clauses (a) and (b), "**Public Shareholders**"), if the following criteria are satisfied: (i) the class of shares from which the repurchases are made is widely held and listed on an established market (the "**Widely Held Requirement**") and (ii) the repurchases are made in the open market, through an ASR program, or through a tender offer generally open to all Public Shareholders (the "**Open Participation Requirement**"). Finally, where such repurchases are made pursuant to an agreement, understanding, or arrangement (an "**AUA**")[3] designed to increase or decrease the ownership percentage of any particular shareholder or group of shareholders, including holders of another class of stock, or where there is actual knowledge regarding the extent of participation by any particular shareholder or group of shareholders, including holders of another class of stock, the AUA or

[3] For purposes of this Report, an understanding or arrangement exists only where there is a clear understanding (albeit not formalized into binding agreement) between the relevant parties that an acquisition will occur and of the critical aspects of that acquisition, including economic terms and timing. For example, an informal conversation between parties where key economic terms are neither discussed nor agreed upon generally would not constitute an AUA.

actual knowledge will be taken into account in measuring the shift in ownership for Section 355(e) purposes resulting from the Public Share Repurchases (the "**Knowledge-Based Counting Convention**").

2. Any direct or indirect increase in the percentage of either voting power or value of the stock of a repurchasing corporation held by a shareholder by virtue of a Public Share Repurchase will be taken into account for purposes of Section 355(e) only after reducing such increase for any direct or indirect decrease in such percentage interest resulting from any repurchase or any disposition of stock by such shareholder or issuance of stock by the repurchasing corporation that is part of a plan (or series of related transactions) with the Section 355 distribution (*i.e.*, netting). Netting would be permitted over a defined testing period or, under an alternative approach, where either (a) two or more transactions are reasonably proximate to each other or (b) at the time of the first transaction, there is an AUA that the second transaction will occur.

3. The effect of a repurchase will be taken into account under Section 355(e) only to the extent such repurchase is otherwise treated for purposes of Section 355(e) as part of a plan (or series of related transactions) with a distribution.

III. BACKGROUND – COUNTING CONVENTIONS FOR PUBLIC SHARE REPURCHASES

Under Section 355(e), a distribution by a distributing corporation ("**D**") of the stock of a controlled corporation ("**C**") that otherwise satisfies the requirements for non-recognition treatment under Section 355 or Section 361 will be taxable to D if the distribution "is part of a plan (or series of related transactions) pursuant to which 1 or more persons ***acquire*** directly or indirectly stock representing a 50-percent or greater interest in" D or C (a "**Section 355(e)**

Plan").[4] A "50-percent or greater interest" is stock in a corporation having at least 50% of the total combined voting power of all classes of stock entitled to vote or at least 50% of the total value of the shares of all classes of stock.[5]

Neither the Code nor the regulations promulgated thereunder, including Treasury Regulations Section 1.355-7 (which provides further guidance on the application of the general rule in Section 355(e)), define the term "acquire" for this purpose. A question that often arises in applying Section 355(e) is whether, and to what extent, a repurchase of stock by D or C from its respective shareholders (a "**repurchase**") constitutes an acquisition for purposes of Section 355(e). A repurchase can be viewed as an indirect acquisition of D or C stock by shareholders who do not participate in such repurchase (*i.e.*, as an increase in the proportionate ownership by non-redeemed shareholders of D or C)[6] and, indeed, the Service's ruling history supports this view.[7]

---

[4] *See* Section 355(e)(2)(A) (emphasis added). In particular, where Section 355(e) applies, the stock or securities of C are not treated as qualified property for purposes of Section 355(c)(2) or Section 361(c)(2), thus causing D to recognize gain on the distribution. Regulations limit gain recognition in the context of certain acquisitions involving a predecessor of D. *See* Treas. Reg. § 1.355-8T(e). In addition, where Section 355(e) applies to an intra-group distribution among members of an affiliated group of corporations (within the meaning of Section 1504(a)), Section 355(f) applies to prevent the application of Section 355 to such intra-group distribution. A discussion of the amount and types of gain recognized in a distribution subject to Section 355(e) is beyond the scope of this Report.

[5] *See* Section 355(e)(4) (importing the definition in Section 355(d)(4) for purposes of Section 355(e)). This Report makes a simplifying assumption that all corporations discussed in the examples have a single class of stock outstanding, and, therefore, the discussion herein will reference shares of stock rather than the vote or value attributable to such shares.

[6] A repurchase involves a direct acquisition by the redeeming corporation (D or C) itself, but such acquisition by the issuing corporation of its own stock should not be relevant for purposes of the Section 355(e) analysis, as the redeeming corporation is not treated as owning an interest in itself. Section 355(e)(4)(C)(ii) (providing that ownership of stock for Section 355(e) purposes is determined applying the "upward" attribution rules of Section 318(a)(2), determined without regard to the 50% threshold in Section 318(a)(2)(C)).

[7] *See, e.g.*, Private Letter Ruling 200046001 (Nov. 17, 1999) (in ruling that there had not been an acquisition of a 50% or greater interest in D or C for purposes of Section 355(e), the Service acknowledged that if "acquisitions" under stock repurchase programs, when aggregated with other acquisitions, had been treated as part of a plan for purposes of Section 355(e), they would not, by themselves, have caused an acquisition of a 50% or greater interest in D or C; ruling (ii)); Private Letter Ruling 19910026 (Dec. 10, 1998) (in ruling that there had not been an acquisition of a 50% or greater interest in D or C for purposes of Section 355(e), the Service acknowledged that if open-market stock repurchases, when aggregated with other acquisitions, had been treated as part of a plan for

Assuming that a repurchase can result in an "acquisition" within the meaning of Section 355(e), the issuer must then determine whether such acquisition is part of a Section 355(e) Plan. If a repurchase (and any resulting acquisition) is not part of a Section 355(e) Plan, then such acquisition generally should have no bearing on the Section 355(e) analysis.[8] If, however, a repurchase (and/or any resulting acquisition) is part of a Section 355(e) Plan (*i.e.*, under the rules of Treasury Regulations Section 1.355-7), the taxpayer must calculate the percentage of the vote and value of the relevant corporation (D or C) acquired (the "**Section 355(e) Ownership Shift**") as a result of such repurchase. This calculation raises a number of questions that are the subject of this Report.

A. Basic Computational Approach to Repurchases

Calculating the Section 355(e) Ownership Shift where shares are acquired pursuant to a Section 355(e) Plan (a "**Plan Acquisition**" and the shares acquired in such transaction "**Plan Shares**") is relatively straightforward in the context of a direct acquisition of shares. Conceptually, the Section 355(e) Ownership Shift can be determined by comparing the shareholder's ownership immediately before and after the Plan Acquisition. Mathematically, the Section 355(e) Ownership Shift can be expressed as a percentage, calculated by dividing the total number of Plan Shares acquired (the "**Numerator**") by the total number of shares outstanding immediately after the Plan Acquisition (the "**Denominator**" and such quotient, the "**Plan Acquisition Percentage**").

---

purposes of Section 355(e), they would not, by themselves, have caused an acquisition of a 50% or greater interest in D or C; ruling (ppp)); Private Letter Ruling 200125044 (Mar. 22, 2001) (ruling that no stock repurchase by D prior to the distribution was an acquisition that was part of a plan or series of related transactions (within the meaning of Section 355(e)) that included the distribution; ruling (17)).

[8] See Part V below for a discussion of repurchases that are not part of a Section 355(e) Plan.

Example 1: D has outstanding 100 shares of stock. A and B each own 50 shares. D distributes 100% of the stock of its wholly owned subsidiary, C, to D's shareholders. On Date 1, A purchases 10 D shares from B in a Plan Acquisition.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**
A	50	50%	60	60%
B	50	50%	40	40%
Total	100	100%	100	100%

In this example, the Section 355(e) Ownership Shift is 10%. Immediately before the Plan Acquisition, A owned 50% of the stock of D, and immediately after the Plan Acquisition, A owns 60% of the stock of D. A has acquired 10 Plan Shares and the Plan Acquisition Percentage is 10% (*i.e.*, 10 Plan Shares/100 total shares outstanding immediately after the Plan Acquisition). While the computational results in the case of a single direct acquisition are relatively straightforward, the results in the case of a repurchase occurring pursuant to a Section 355(e) Plan (a "**Plan Repurchase**") are more nuanced because the repurchase reduces the number of shares outstanding.

Example 2: D has outstanding 100 shares of stock. A and B each own 50 shares. D distributes 100% of the stock of its wholly owned subsidiary, C, to D's shareholders. On Date 1, D redeems 10 D shares from B in a Plan Acquisition.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**
A	50	50%	50	55.5%
B	50	50%	40	44.5%
Total	100	100%	90	100%

At first blush, it may seem appropriate to create parity between the Plan Repurchase in Example 2 and the direct acquisition between shareholders in Example 1, because both cases involve an acquisition of 10 shares. However, given that Section 355(e) focuses on percentage

changes in economic ownership and voting power pursuant to Section 355(e)(3)(A)(iv) and (e)(4)(C), this approach is inappropriate, as evidenced by the fact that the two transactions have different economic results. Namely, the Plan Repurchase in Example 2 has increased A's stock ownership in D from 50% to approximately 55.5%, rather than from 50% to 60% as in Example 1. Consequently, if one were to deem the Plan Repurchase in Example 2 as resulting in an acquisition of 10 Plan Shares by A, the Plan Acquisition Percentage of Example 2 would overstate the amount of the Section 355(e) Ownership Shift. Instead, it is necessary to calculate the number of Plan Shares *indirectly* acquired by shareholders who do not participate in the repurchase (the "**Non-Participating Shareholders**") in a Plan Repurchase. Conceptually, the number of Plan Shares indirectly acquired by A is measured by the extent to which A under-participated in the repurchase; if the repurchase had been *pro rata* among all D's shareholders, D would have redeemed 5 shares from A. Thus, the Numerator (as compared to Example 1) should, in fact, be 5.[9] Furthermore, the Plan Repurchase reduces the Denominator by 10. Consequently, the Plan Acquisition Percentage is approximately 5.55% (*i.e.*, 5 Plan Shares/90 total shares outstanding immediately after the Plan Acquisition).

IV. PRORATION

As demonstrated above, in calculating the Section 355(e) Ownership Shift resulting from a Plan Repurchase, the issuer must determine the number of Plan Shares indirectly acquired by the Non-Participating Shareholders. However, this calculation rests on a determination of which shareholders should be treated as participating in the repurchase (the "**Participating**

[9] This amount can be computed by multiplying A's total shares prior to the repurchase (50) by the percentage of the issuer's stock that is redeemed in the Plan Repurchase (*i.e.*, the quotient of the number of shares repurchased in the Plan Repurchase over the total outstanding shares immediately before the Plan Repurchase (10/100) (the "**Repurchase Percentage**"). Thus, A has indirectly acquired 5 Plan Shares.

Shareholders"). In fact patterns where the identity of the Participating Shareholders and the extent of their participation in the repurchase is known, this determination is straightforward.

> Example 3: D has outstanding 100 shares of stock, owned in equal proportion by each of ten shareholders. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, D repurchases 50 shares of its stock in a Plan Repurchase,[10] redeeming in full each of five shareholders in a privately negotiated transaction.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**
Sh. 1	10	10%	0	0%
Sh. 2	10	10%	0	0%
Sh. 3	10	10%	0	0%
Sh. 4	10	10%	0	0%
Sh. 5	10	10%	0	0%
Sh. 6	10	10%	10	20%
Sh. 7	10	10%	10	20%
Sh. 8	10	10%	10	20%
Sh. 9	10	10%	10	20%
Sh. 10	10	10%	10	20%
Total	100	100%	50	100%

Under these facts, D has had a Section 355(e) Ownership Shift of 50%. The Non-Participating Shareholders have indirectly acquired 25 Plan Shares (or have under-participated in the repurchase by 25 shares, *i.e.*, had the repurchase been made *pro rata* among all shareholders, D would have redeemed 5 shares from each of the five Non-Participating Shareholders),[11] and the Plan Acquisition Percentage is 50% (*i.e.*, 25 Plan Shares/50 total shares outstanding

[10] If such repurchases were made after the date of the distribution of C stock, and, at the time of the distribution, it was D's plan or intention for the aggregate amount of repurchases to equal or exceed 20% of D's outstanding stock, the repurchases would likely be viewed as evidence of device. *See* Section 355(a)(1)(B); Treas. Reg. § 1.355-2(d)(2)(iii); Rev. Proc. 96-30, Section 4.05(1)(b). In addition, such repurchases could implicate the continuity of interest requirement. *See* Treas. Reg. § 1.355-2(c). A discussion of considerations relevant to repurchases under the "device" and continuity of interest rules is beyond the scope of this Report.

[11] The number of Plan Shares also can be calculated as follows: 50 shares owned by Non-Participating Shareholders x (50 shares repurchased/100 total shares outstanding immediately prior to the repurchase) = 25 Plan Shares.

immediately after the Plan Acquisition). Because D privately negotiated the repurchases with 5 shareholders and is able to identify the Participating Shareholders and the extent of their participation, the appropriate results are clear.

However, the determination as to who should be treated as a Participating Shareholder and the calculation of the Section 355(e) Ownership Shift is not straightforward in many fact patterns. What if D's stock is publicly traded and widely held and D undertakes open-market repurchases that are available to all D shareholders (and is indifferent as to participation by any particular shareholder or group of shareholders), such that there is no reasonable way to identify Participating and Non-Participating Shareholders and the extent of any such participation or under-participation?

> Example 4: D is a publicly traded corporation and has outstanding 10,000,000 shares of stock, which are widely held. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, D repurchases 5,000,000 shares of its stock in a Plan Repurchase through open-market repurchases that are available to all D shareholders.

In this context, the proper calculation of the Section 355(e) Ownership Shift is unclear. There are two possible approaches. One approach would be to treat the repurchase as being made entirely from a fictional group of shareholders who own an amount of stock in D equal to the amount of the repurchase (*i.e.*, 5,000,000 shares) (the "**Fictional Group Approach**").[12] Under the Fictional Group Approach, the Non-Participating Shareholders would be treated as indirectly acquiring 2,500,000 Plan Shares (*i.e.*, 5,000,000 shares owned by Non-Participating

[12] This approach operates in a similar manner to the segregation rules under Section 382. In the context of a repurchase, these rules generally require that each direct public group that exists immediately before the repurchase must be segregated (at that time and thereafter) so that the stock acquired in the repurchase is treated as owned by a separate public group from each public group that owns stock that is not acquired. *See* Treas. Reg. § 1.382-2T(j)(2)(iii)(C).

Shareholders x the Repurchase Percentage (5,000,000 shares repurchased/10,000,000 total shares outstanding immediately prior to the repurchase)), and the Plan Acquisition Percentage would be 50% (*i.e.*, 2,500,000 Plan Shares/5,000,000 total shares outstanding immediately after the Plan Acquisition). In cases where the identity of the Participating Shareholders and the extent of their participation in the repurchase is not known, the Fictional Group Approach is unduly punitive, assuming counterfactually that a fictional block of shareholders has been fully redeemed and overstating the resulting Section 355(e) Ownership Shift.

A second approach would be to treat the repurchase as being made *pro rata* from all of D's Public Shareholders ("**Proration Treatment**"). Thus, as a result of the repurchase, each of D's shareholders (assuming all of them are Public Shareholders) would reduce the number of shares it owns by the same relative amount as each other D shareholder, with each D shareholder's percentage ownership immediately prior to the repurchase remaining equal to each D shareholder's percentage ownership immediately following the repurchase. Therefore, there is no indirect acquisition (because there are no Non-Participating Shareholders), there are no Plan Shares acquired in the repurchase, and the Plan Acquisition Percentage and Section 355(e) Ownership Shift are 0%.

A. Service's Current Ruling Practice

In situations involving fact patterns similar to Example 4, including in at least eight private letter rulings issued since 2009,[13] the Service has applied Proration Treatment, to the

[13] *See, e.g.*, Private Letter Ruling 201748007 (June 13, 2017) (following a distribution, D expected to repurchase shares through open market repurchases, ASR programs, and/or tender offers open to all D shareholders; D had non-public shareholders but anticipated that only public shareholders would participate in the share repurchases; D represented, *inter alia*, that repurchases were not motivated to any extent by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders; the Service ruled that, to the extent the repurchases are treated as part of a Section 355(e) Plan, the repurchases would be treated as being made from all public shareholders of D stock on a *pro rata* basis for purposes of Section 355(e) (ruling (1)); Private Letter Ruling

extent a repurchase is otherwise treated as part of a Section 355(e) Plan, to reduce[14] or eliminate an indirect acquisition by the Non-Participating Shareholders.

201721002 (Feb. 17, 2017) (following a "Reverse Morris Trust" transaction, taxpayer represented that C might carry out open-market share repurchases or ASRs made with respect to widely held shares and not motivated by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders; the Service ruled that, to the extent the share repurchases are treated as part of a Section 355(e) Plan, the share repurchases would be treated as being made from all public shareholders of C on a *pro rata* basis for purposes of Section 355(e) (ruling (9)); Private Letter Ruling 201627001 (Jan. 4, 2016) (following a pre-distribution merger transaction, merger partners and D had share repurchase programs in place and D expected to repurchase shares after the distribution through open-market repurchases, ASR programs, and/or tender offers open to all D shareholders; D's stock was widely held; the Service ruled that, for purposes of Section 355(e), to the extent otherwise treated as part of a Section 355(e) Plan, the repurchases would be treated as being made from all public shareholders of D on a *pro rata* basis (ruling (9)); Private Letter Ruling 201601009 (Oct. 2, 2015) (following a post-distribution acquisition of a target corporation by D in exchange for D stock, D authorized a new share repurchase program and repurchased stock under the program, subsequently raised the cap on authorized repurchases, and taxpayer represented that D might engage in additional repurchases, in each case, through an open-market share repurchase program available to all D shareholders, with respect to widely held stock, and with respect to which D was indifferent as to the identity of participating shareholders (and would not know the identity of any shareholder from which stock was repurchased); taxpayer represented that repurchases were not motivated to any extent by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders; the Service ruled that, to the extent the repurchases are treated as part of a Section 355(e) Plan, the repurchases would be treated as being made from all holders of D stock on a *pro rata* basis for purposes of Section 355(e)); Private Letter Ruling 201250021 (Sept. 6, 2012) (following a post-distribution acquisition of a target corporation by C in exchange for C stock, C intended to repurchase shares of widely held C stock through an open-market share repurchase program open to all C shareholders and/or ASR program, in each case, with respect to which C will be indifferent as to which shareholders participate (and will not know with certainty the identity of any shareholder from which stock is repurchased); taxpayer represented that the repurchases were not motivated to any extent by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders and there have been no discussions regarding the repurchases with any particular shareholder or group of shareholders; the Service ruled that the repurchases would be treated as being made from all holders of C stock on a *pro rata* basis for purposes of Section 355(e), to the extent such repurchases are otherwise treated as part of a Section 355(e) Plan (ruling (2)); Private Letter Ruling 201249011 (Sept. 6, 2012) (same); Private Letter Ruling 201047016 (Aug. 19, 2010) (post-distribution, C adopted a share repurchase program with respect to its widely held stock; the Service ruled that the repurchases would be treated as being made from all holders of C stock on a *pro rata* basis for Section 355(e) purposes, to the extent such repurchases are otherwise treated as part of a Section 355(e) Plan (ruling (31)); Private Letter Ruling 201037024 (June 8, 2010) (D had repurchased shares in open-market transactions pre-distribution and intended to continue to do so in open-market repurchases open to all D shareholders and with respect to which D is indifferent as to which of its shareholders participate (and is not motivated to any extent by a desire to increase or decrease the percentage ownership of any particular shareholder or group of shareholders), or in privately negotiated transactions; the Service ruled that (1) the open-market repurchases would be treated as being made *pro rata* from the public shareholders to the extent D can demonstrate that such open-market repurchases were not made from one or more of D's controlling shareholders or from a specific (presumably, significant) shareholder and (2) any such open-market repurchases will not affect the determination of the percentage of the total combined voting power or value of D stock acquired by any particular public shareholder for purposes of Section 355(e) (ruling 2a)); Private Letter Ruling 201004001 (Oct. 22, 2009) (following a "Reverse Morris Trust" transaction, taxpayer represented that merger partner might authorize open-market repurchases of its stock; the Service ruled that the repurchases would be treated as being made from all holders of merger partner stock on a *pro rata* basis for Section 355(e) purposes, to the extent such repurchases are otherwise treated as part of a Section 355(e) Plan (ruling (28)).

[14] As described below, certain private letter rulings only apply Proration Treatment to specified groups of shareholders, while other rulings apply Proration Treatment to all of D's or C's shareholders.

In a recent ruling adopting Proration Treatment, Private Letter Ruling 201721002,[15] the Service ruled that post-distribution repurchases of shares of C stock would be treated as made *pro rata* from all Public Shareholders. The ruling was, in part, based on the fact the repurchases were (1) made with respect to widely held shares, (2) made in open-market tractions and/or repurchases under an ASR,[16] and (3) not motivated by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders. Other private rulings reach the same result based on similar facts and representations.[17] For example, Private Letter Ruling 201627001[18] involved a pre-distribution merger transaction between D and two merger partners, and both pre- and post-distribution repurchases of the stock of each such corporation were relevant, including repurchases conducted via tender offer. The taxpayer in that ruling also made certain representations regarding the absence of Controlling Shareholders and 10% Shareholders, and the Service applied Proration Treatment, deeming the repurchases as being made *pro rata* from all Public Shareholders.

In Private Letter Ruling 201037024,[19] the Service issued a similar ruling with respect to open-market repurchases of D stock, where such stock was held by certain significant shareholders, and D engaged in privately negotiated repurchases as well as open-market repurchases. One shareholder ("**Shareholder**") owned a certain (presumably significant) percentage of D stock and had a nomination right with respect to certain of D's and C's directors,

[15] (Feb. 17, 2017).

[16] Typically, an ASR program involves the repurchase by the relevant corporation of a specified number or volume range of its shares from a third-party investment bank at an agreed-upon price per share or other price mechanism, where the bank borrows the shares to be repurchased and then buys shares, usually on the open market, over time to return such borrowed shares.

[17] *See, e.g.*, Private Letter Ruling 201601009 (Oct. 2, 2015); Private Letter Ruling R 201037024 (June 8, 2010).

[18] (Jan. 4, 2016).

[19] (June 8, 2010) *supplementing* Private Letter Ruling 200851014 (Aug. 26, 2008).

but did not and would not actively participate in the management or operations of D, and another shareholder ("**Person**") owned a certain percentage of D stock and had the right to vote all of the shares of D stock owned by Shareholder. The taxpayer represented that, other than Shareholder, Person, and two investment advisors (who presumably did not have beneficial ownership of D stock nominally held), there were no other shareholders who held five percent or more of D stock (effectively representing that there were no 10% Shareholders). The Service ruled that pre- and post-distribution open-market repurchases would be treated as being made *pro rata* from shareholders other than Controlling Shareholders, Shareholder, and Person, to the extent D could demonstrate that such repurchases were not made from a Controlling Shareholder, Shareholder, or Person. In support of this ruling, the taxpayer represented that (1) all D shareholders were permitted to participate in, and benefit from, the open-market repurchases, (2) D was indifferent as to which of its shareholders participated in the open-market repurchases, and (3) the open-market repurchases were not motivated to any extent by a desire to increase or decrease the ownership percentage of any particular shareholder or group of shareholders.

In at least three private rulings (Private Letter Rulings 201601009,[20] 201250021,[21] and 201249011[22]), the Service appears to have drawn a distinction between Controlling Shareholders and 10% Shareholders for purposes of determining whether Proration Treatment should apply. In each such ruling, in the context of a post-distribution acquisition of a target corporation by D or C in exchange for stock D or C, as applicable, the taxpayer made certain representations regarding the absence of Controlling Shareholders, but no similar representations were made with respect to 10% Shareholders. Further, the taxpayer represented that (1) no discussions were

[20] (Oct. 2, 2015).

[21] (Sept, 6, 2012).

[22] (Sept. 6, 2012).

had regarding the repurchases with any particular shareholders or groups of shareholders, (2) all shareholders of the repurchasing corporation were allowed to participate in and benefit from the repurchases, (3) the repurchasing corporation was indifferent as to which shareholders participated, and (4) the repurchasing corporation would not know the identity of any shareholder from which stock was repurchased.[23] In each ruling, the Service ruled that the repurchases would be treated as being made *pro rata* from *all* holders of D stock (*i.e.*, including, if relevant, 10% Shareholders) for purposes of Section 355(e).

Indeed, in at least two private rulings (Private Letter Rulings 201047016[24] and 201004001[25]), the Service ruled that post-distribution repurchases of C stock (or its successor's) stock would be treated as being made *pro rata* from *all* holders of C stock (or stock of C's successor) for purposes of Section 355(e), without any specific representations regarding the existence (or non-existence) of Controlling Shareholders or 10% Shareholders.[26]

While there are nuanced differences in the Service's application of Proration Treatment to pre- and post-distribution open-market repurchases of widely held stock of D, C, or their relevant predecessors or successors, especially with respect to the appropriate scope and treatment of "non-public shareholders," the Service appears to have applied Proration Treatment

[23] In Private Letter Ruling 201601009 (Oct. 2, 2015), the taxpayer further represented that non-management shareholders had had no influence over the decision to engage in the repurchases. In Private Letter Ruling Rs 201250021 (Sept. 6, 2012) and 201249011 (Sept. 6, 2012), the taxpayer further represented that C was indifferent as to which shareholders lent or sold shares to the bank in connection with the ASR program and that it would not know with certainty the identity of any shareholders from which the bank borrowed or purchased shares.

[24] (Aug. 19, 2010).

[25] (Oct. 22, 2009).

[26] *See* Private Letter Ruling 201047016 (Aug. 19, 2010) (in connection with a split-off of C to public shareholders of D, taxpayer represented that post-distribution share repurchases by C would be made in the open market with respect to widely held stock); Private Letter Ruling 201004001(Oct. 22, 2009) (in connection with a post-distribution acquisition of C, taxpayer represented that post-acquisition share repurchases by the acquirer would be made in the open market).

consistently. We believe this represents a sensible solution in the context of Public Share Repurchases.

B. Discussion

We believe that Proration Treatment, appropriately modified to account for the existence of significant shareholders or different classes of stock, is the better method of calculating the impact of pre- and post-distribution Public Share Repurchases that occur pursuant to a Section 355(e) Plan in most situations involving widely held, publicly traded stock of D or C (or their relevant predecessors or successors). However, because taxpayers cannot rely on private letter rulings issued to other taxpayers,[27] despite the consistent nature of the Service's application of Proration Treatment, taxpayers do not have certainty as to whether Proration Treatment will apply to particular Public Share Repurchases. Where certainty in the calculation of the Section 355(e) Ownership Shift (including the methodology for determining the impact of repurchases) is crucial to determining whether a distribution will satisfy the requirements of Section 355 (*i.e.*, where the aggregate impact of acquisitions that are part of a Section 355(e) Plan would, without application of Proration Treatment, potentially result in a 50% or greater Section 355(e) Ownership Shift), taxpayers will often seek individual private letter rulings.[28] In light of the Service's consistent ruling position, we believe that publishing guidance in the form of a revenue ruling on which all taxpayers may rely would be appropriate and efficient, avoiding the need to

[27] *See* Section 6110(k)(3).

[28] Even if the application of an adverse counting convention would not cause a 50% or greater Section 355(e) Ownership Shift based on pre-existing Plan Acquisitions, certainty as to the treatment of repurchases is desirable in any event to allow a taxpayer to better understand its ongoing flexibility to undertake other transactions giving rise to direct or indirection acquisitions of D or C stock for Section 355(e) purposes during the relevant period. Our understanding is that the Service will not issue rulings with respect to the methodology for calculating the impact of a particular acquisition for purposes of Section 355(e) unless "an adverse ruling on such question would result in there being a direct or indirect acquisition by one or more persons of stock representing a 50-percent or greater interest" in D or C pursuant a Section 355(e) Plan. *See* Rev. Proc. 2018-3, 2018-1 I.R.B. 130, Section 3.01(56)..

devote both government and taxpayer resources to the request for, and issuance of, private rulings in this area. Thus, we recommend that the Service publish a revenue ruling adopting Proration Treatment in Public Share Repurchases subject to the limitations and conditions described below (the "**Proration Rule**").

The revenue ruling would provide that, to the extent, for purposes of Section 355(e), a repurchase of shares of D or C is part of a plan (or series of related transactions) including a distribution otherwise qualifying under Section 355, such repurchase will be treated as being made from all Public Shareholders of the repurchasing corporation owning stock of the same class as the repurchased shares on a *pro rata* basis, if the following criteria are satisfied: (1) the class of shares of repurchased stock is widely held and listed on an established market[29] (*i.e.*, the Widely Held Requirement) and (2) such repurchase is made in the open market, through an ASR program, or through a tender offer generally available to all Public Shareholders (*i.e.*, the Open Participation Requirement). Finally, to the extent such repurchase is made pursuant to an AUA designed to increase or decrease the ownership percentage of any particular shareholder or group of shareholders, or there is actual knowledge of the increase or decrease of any particular shareholder or group of shareholders, this will be taken into account for purposes of computing the Section 355(e) Ownership Shift resulting from such repurchase (*i.e.*, the Knowledge Based Counting Convention).

1. Elements of the Proration Rule

Each of the Widely Held Requirement, the Open Participation Requirement, the Knowledge-Based Counting Convention, and the limited application of Proration Treatment to Public Shareholders is intended to ensure that repurchases subject to the Proration Rule reflect

[29] *See* Treas. Reg. § 1.355-7(h)(7).

the factual underpinnings of the Service's private rulings that have afforded Proration Treatment and that the computational effects of Proration Treatment are not at odds with the actual or intended effects of a repurchase on ownership percentages.

The principle underlying the Widely Held Requirement is that the Proration Rule should only apply in situations where there are significant practical difficulties associated with identifying Participating and Non-Participating Shareholders (and distinguishing shareholders' transactions as part of the repurchase from those independent of the repurchase). As an initial matter, although we acknowledge that the term "widely held" lacks precision, we note that the term has been used without precise definition in prior guidance[30] and in each of the Service's rulings applying Proration Treatment discussed above, which included a statement that the stock to be repurchased was widely held and/or publicly traded.

We believe that the Widely Held Requirement should be satisfied in all instances where stock is publicly traded, regardless of concentration of ownership, as there are significant practical difficulties associated with tracking ownership changes of all publicly traded stock due to the virtual impossibility of matching a particular buyer with a particular seller. If a precise definition is necessary, we recommend importing the definition from Section 897, which, for purposes of defining the term "United States real property interest," exempts "any class of stock of a corporation [that] is regularly traded on an established securities market."[31] However, if the government feel that concentration of ownership should also be a relevant characteristic in determining satisfaction of the Widely Held Requirement, we recommend importing the definition from Section 856(h), which provides that an entity is "closely held" if more than 50%

[30] *See* Rev. Rul. 99-58, 1999-2 C.B. 701.

[31] Section 897(c)(3). *See also* Treas. Reg. §1.897-1(c)(2)(iii).

of the value of its shares is owned directly or indirectly by or for five or fewer individuals at any time during the last half of the entity's tax year.

The Open Participation Requirement is intended to confirm that the repurchasing corporation (1) offers the opportunity to tender to all Public Shareholders (such that any resulting ownership shifts are caused by shareholders' independent investment decisions about whether or not to participate and not by the design of the issuer) and (2) does not have control over the identity of or participation by particular shareholders from whom repurchases are made. The repurchasing corporation's inability to control the impact of the repurchases on the relative ownership among shareholders suggests that it did not undertake the repurchases for the purpose of facilitating a particular acquisition and supports the idea that Proration Treatment is a reasonable methodology that is not inconsistent with the underlying transaction (*i.e.*, if the repurchasing corporation cannot control the result achieved by Public Share Repurchases among Public Shareholders of a particular class – or even have any significant visibility into the result so achieved – it is difficult to imagine what deemed result would be more appropriate than one that maintains *pro rata* ownership as a proxy for the uncontrollable actual result). Further, Proration Treatment mitigates certain administrative difficulties that would arise when attempting to calculate the impact of the repurchases in the absence of complete information about the makeup of Participating and Non-Participating Shareholders.[32]

[32] We note that where repurchases are effected via tender offer, identifying individual participating shareholders may be possible, though administratively burdensome. However, it is not clear that the repurchasing corporation could adequately identify Non-Participating Shareholders with certainty (*e.g.*, because of trading frequency). Even if the repurchasing corporation could identify such Non-Participating Shareholders, a tender offer does not afford the repurchasing corporation the ability to influence or control the identity of Participating and Non-Participating Shareholders or the amount of stock repurchased from any particular Participating Shareholder. Indeed, U.S. securities laws effectively eliminate any such manipulation or electivity by a repurchasing corporation.

Consistent with the Service's ruling practice, we believe that a repurchase made pursuant to a tender offer open to all shareholders or a typical ASR program should be treated the same as an open-market repurchase for purposes of the Open Participation Requirement. For example, an ASR program in its typical form merely provides a mechanic for a repurchasing corporation to repurchase a desired number of shares quickly and efficiently through a third-party bank intermediary.[33] Despite the fact that, in form, the repurchasing corporation acquires its shares from a single "shareholder" (the bank), the bank is in effect merely acting as an intermediary between the repurchasing corporation and its existing and future Public Shareholders. From the perspective of the repurchasing corporation and with respect to the lack of control over the identity of and participation by Participating Shareholders, there is little substantive difference between repurchases made in the open market and those made pursuant to an ASR program. This rationale also supports the extension of the Proration Rule to repurchases made via tender offers.

The Knowledge-Based Counting Convention ensures that application of the Proration Rule does not lead to inappropriate results in situations where the repurchasing corporation utilizes a repurchase to shift ownership levels between particular shareholders or groups of shareholders.[34] If repurchasing corporations attempt to facilitate targeted ownership shifts in such a manner, the Proration Rule should operate to reflect the realities of the transactions that occurred. If a repurchase is made pursuant to an AUA, such AUA will be taken into account when applying the Proration Rule. For example, if a repurchasing corporation has an AUA with a particular group of Public Shareholders not to participate in the repurchase, the Proration Rule should not apply to that particular group of Public Shareholders (but it may still apply to other

[33] See footnote 16 above for a description of the key elements of a typical ASR program.

[34] As discussed above, this convention applies equally to groups of shareholders that hold different classes of stock of the repurchasing corporation.

groups of Public Shareholders, assuming the other requirements are satisfied). Similarly, where there is actual knowledge regarding participation in a repurchase by a particular shareholder or group of shareholders, the Proration Rule will not apply to deem a result that is contrary to such actual knowledge; rather, computation of the Section 355(e) Ownership Shift should take into account any actual knowledge regarding participation in a repurchase.

Finally, limiting the application of Proration Treatment to Public Shareholders (*i.e.*, deeming all Public Share Repurchases to have been made *pro rata* among Public Shareholders only, regardless of the existence of or participation by 10% Shareholders or Controlling Shareholders) ensures that repurchases are not eligible for the Proration Rule to the extent that such repurchases are made from significant shareholders who either are actively involved in the management of the repurchasing corporation or whose ownership stake is sufficiently large that tracking their participation in repurchases is not likely to raise similar administrative concerns.[35]

2. Rationale for the Proration Rule

The Proration Rule is rooted in both administrative and policy-based considerations. As an administrative matter, it is impractical for the taxpayers or for the Service to determine the identity of Participating and Non-Participating Shareholders and the extent to which such shareholders participate or refrain from participating. Where the Widely Held Requirement and the Open Participation Requirement are satisfied, it is practically impossible to calculate the

[35] The government may wish to consider whether it is appropriate to add a qualitative metric to the quantitative threshold for 10% Shareholders (*e.g.*, whether such 10% Shareholder has had discussions with management regarding the share repurchases or is engaged in influencing the overall management of the corporation although not represented on its board of directors). In situations where a 10% Shareholder is truly passive with respect to the management of the repurchasing corporation, it can be argued that the policy underlying Section 355(e) (*i.e.*, policing situations where acquisitions are part of a "plan" with the distribution) does not warrant differential treatment between Public Shareholders and such passive 10% Shareholders, neither of which influence or determine the relevant corporation's "plan." Share repurchases are unlikely to be part of a plan to benefit passive 10% Shareholders, although it may be difficult to prove this fact given that D or C is necessarily involved in repurchases.

actual Section 355(e) Ownership Shift. Especially in light of trading frequency and daily trading volume, it is impractical for taxpayers to determine which shareholders tendered shares, which shareholders retained shares, and which shareholders transacted in the open market (in secondary transactions) independent from the relevant repurchases. Some form of counting convention seems necessary as an administrative matter. Moreover, where these requirements are satisfied, as discussed above, the repurchasing corporation cannot control or influence the result achieved by any Public Share Repurchase, suggesting that Proration Treatment is an appropriate proxy for the actual result that arises based on the independent investment decisions of Participating and Non-Participating Shareholders.

Without guidance on which taxpayers can rely absent a private letter ruling, in order to ensure that there has not been a Section 355(e) Ownership Shift of 50% or more, taxpayers may be forced to apply an unduly punitive approach—*i.e.*, the Fictional Group Approach. The Fictional Group Approach is unrealistic as a practical matter because it assumes that each Participating Shareholder sold all of its shares and no Public Shareholder sold only some of its shares. Moreover, this approach may achieve an unjustifiably harsh result, often overstating the Section 355(e) Ownership Shift by a substantial amount.[36]

While the Proration Rule also is not realistic in making the assumption that every Public Shareholder participates in a *pro rata* fashion, we believe that it is preferable as a policy matter. While the repurchasing corporation may engage in a Plan Repurchase, the resulting Section 355(e) Ownership Shift should measure only the impact of the repurchases on shareholders other

[36] We note that in more complicated fact patterns, such as those involving multiple public shareholder groups, proper application of the Fictional Group Approach would be unclear.

than Public Shareholders ("**Non-Public Shareholders**") or Public Shareholders of a class of stock not participating in the Plan Repurchase. This the Proration Rule achieves.

Application of the Proration Rule only affects whether a portion of the Public Shareholders of the class of stock participating in the Plan Repurchases will be treated as indirectly acquiring Plan Shares. Because the Proration Rule has no differential effect on the Denominator (as compared to the Fictional Group Approach), the Proration Rule accurately measures the Section 355(e) Ownership Shift attributable to Non-Public Shareholders.

> Example 5: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 20 shares, all of which were acquired in a Plan Acquisition, and the remaining 80 shares are held by Public. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, D makes a Plan Repurchase of 20 shares of its stock from its Public Shareholders.

Proration Rule

Shareholder	**# of Shares (Start)**	**% Owner-ship**	**# of Shares (Date 1)**	**% Owner-ship**
A	20	20%	20	25%
P	80	80%	60	75%
Total	100	100%	80	100%

Fictional Group Approach

Shareholder	**# of Shares (Start)**	**% Owner-ship**	**# of Shares (Date 1)**	**% Owner-ship**
A	20	20%	20	25%
P1	60	60%	60	75%
P2	20	20%	0	0%
Total	100	100%	80	100%

The Section 355(e) Ownership Shift attributable to A is 25% (20 Plan Shares/80 total shares outstanding immediately after the last Plan Acquisition) whether the Proration Rule or the Fictional Group Approach is applied. The only difference is in whether some of the Public Shareholders will be treated as indirectly acquiring Plan Shares as a result of the Plan Repurchase. Applying the Proration Rule, there is no Section 355(e) Ownership Shift attributable to P while, under the Fictional Group Approach, P1 has a Section 355(e) Ownership Shift of 15% (12 Plan Shares[37]/80 total shares outstanding immediately after the last Plan Acquisition). As this example demonstrates, the Section 355(e) Ownership Shift attributable to Non-Public Shareholders is fully captured regardless of whether the Proration Rule applies.[38]

In contrast, if the repurchase program is open to all shareholders (and there is no AUA between the repurchasing corporation and any shareholder or group of shareholders regarding non-participation in the Plan Repurchases), any resulting ownership shifts (*i.e.*, acquisitions) among Public Shareholders occur as the result of independent investment decisions by those shareholders, such that those acquisitions are not within the control of the repurchasing corporation. The inability to apply the Proration Rule in this circumstance would result in these

[37] P1 would be viewed as having under-participated in the repurchase by 12 shares (*i.e.*, had D repurchased shares *pro rata* from all holders, it would have repurchased 0.2 shares per each D share held, with P1 holding 60 shares).

[38] Consistent with this fact, the IRS has applied Proration Treatment in private letter rulings where the facts indicate that the repurchasing corporation had multiple Non-Public Shareholders, *see* Private Letter Ruling 201037024 (June 8, 2010), *supplementing* Private Letter Ruling 200851014 (Aug. 26, 2008), where the taxpayer indicated, to its knowledge, there were no Non-Public Shareholders during a relevant period prior to the external distribution, but made no statement about the absence of Non-Public Shareholders after the external distribution, *see* Private Letter Ruling 201627001 (Jan. 4, 2016) and where there was no clear indication of the existence or absence of Non-Public Shareholders, *see, e.g.*, Private Letter Ruling 201004001 (Oct. 22, 2009). Moreover, any stipulation in a private letter ruling as to the absence of Non-Public Shareholders may be motivated by the particular facts of a taxpayer and may not be an indication that the Service generally views such absence as a determinative factor in considering the appropriateness of Proration Treatment. Commonly, a distribution under Section 355 occurs in connection with a business combination transaction that results in a Section 355(e) Ownership Shift very close to 50%. In these cases, application of Proration Treatment would not be helpful if there were one or more Non-Public Shareholders whose percentage interest would increase as a result of a Plan Repurchase. Accordingly, the application of Proration Treatment in circumstances involving Non-Public Shareholders is entirely consistent with the logic and policy motivating Proration Treatment, discussed above.

acquisitions being taken into account in the calculation of the Section 355(e) Ownership Shift, despite the fact that the actions of the individual shareholders were independent of any Section 355(e) Plan and the repurchasing corporation had no control over the ultimate makeup of Participating Shareholders. Where the requirements of the Proration Rule are satisfied, we think a measurement method that assumes repurchases to have occurred on a *pro rata* basis is as appropriate as any other. In particular, the Knowledge-Based Counting Convention ensures that the Proration Rule is not utilized to achieve inappropriate results under Section 355(e).[39]

In this sense, the Proration Rule is conceptually consistent with Safe Harbor VII in Treasury Regulations Section 1.355-7(d)(7), which provides that an acquisition of stock by one shareholder from another shareholder (in each case, other than where such shareholders are certain parties related to D and/or C or Controlling Shareholders or 10% Shareholders thereof) where such stock is listed on an established market is not considered part of a Section 355(e) Plan. Safe Harbor VII is supported by (i) the general understanding that actions by Public Shareholders are not within the control of the relevant corporation and therefore should not be attributed to such corporation for purposes of deeming such actions to be undertaken pursuant to a Section 355(e) Plan and (ii) the administrative burden and impracticality of tracking the sale

[39] As discussed above, in situations where a repurchase is made pursuant to an AUA to increase or decrease the ownership of a particular shareholder or group of shareholders, or there is actual knowledge regarding participation, we believe this fact should be taken into account for purposes of computing the Section 355(e) Ownership Shift. Where it applies, the Proration Rule assumes that all repurchases are made *pro rata* from only Public Shareholders, regardless of actual participation by Non-Public Shareholders. In the majority of fact patterns, this assumption results in a "worst-case" set of facts with respect to calculating ownership shifts among Non-Public Shareholders, because it assumes that the entire indirect ownership shift resulting from a Public Share Repurchase increases the ownership of such Non-Public Shareholders. If, for example, a repurchasing corporation has knowledge that a Non-Public Shareholder participated, the Proration Rule should not produce a worse result under Section 355(e) than what actually occurred. By contrast, in certain fact patterns, this assumption could operate to reduce the Section 355(e) Ownership Shift. For example, assume that following a distribution, a distributing corporation merges with an unrelated corporation and the sole shareholder of the distributing corporation, A, receives 50% of the stock of the unrelated corporation. Following the merger, the unrelated corporation makes a Plan Repurchase in which, pursuant to an AUA, A participates *pro rata*. The Knowledge-Based Counting Convention ensures that A's ownership percentage is not deemed to increase by virtue of the Proration Rule and achieves a computational result that reflects what actually occurred.

and exchange of stock among Public Shareholders. Thus, when two Public Shareholders not involved in the issuing corporation's management determine to transact, resulting in an acquisition for purposes of Section 355(e), the regulations allow taxpayers to treat any such acquisition as not being part of a Section 355(e) Plan.

The result is substantially similar in Public Share Repurchases from Public Shareholders, where Public Shareholders who are not involved in the repurchasing corporation's decision to undertake a repurchase decide to participate, effectively shifting all or a portion of their ownership to other Public Shareholders. If the Participating and Non-Participating Shareholders had instead effected the ownership shift via a secondary market transaction, the resulting acquisition would clearly be deemed not to have been made pursuant to a Section 355(e) Plan. Absent the ability to apply the Proration Rule, where the repurchase is a Plan Repurchase, the resulting indirect acquisition by Non-Participating Shareholders would be taken into account in calculating the Section 355(e) Ownership Shift. It does not seem, however, that this result is appropriate. For example, while the repurchasing corporation controls the decision whether or not to undertake a repurchase, in situations covered by the Proration Rule, the repurchasing corporation cannot control the impact of the repurchase on the relative ownership of shareholders. Equally, the requirements of the Proration Rule ensure that the Participating Shareholders did not participate in the repurchasing corporation's "plan." It would be incongruous to treat an indirect acquisition by a Non-Participating Shareholder as an acquisition pursuant to a Section 355(e) Plan where a direct acquisition by the same shareholder in a secondary market transaction would not be taken into account for purposes of Section 355(e). Allowing taxpayers to neutralize the impact of such acquisitions by adopting the Proration Rule would put similar transactions on more equal footing and consistently reflect the fact that

independent investment decisions by Public Shareholders should not give rise to Plan Acquisitions.

V. NETTING

A second issue that arises is how properly to calculate the Section 355(e) Ownership Shift when there are multiple transactions occurring pursuant to a Section 355(e) Plan. There is no published guidance that addresses how to compute the Section 355(e) Ownership Shift in the context of multiple Plan Acquisitions.

> Example 6: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 25 shares and the remaining 75 shares are held by Public 1. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, A sells 10 shares of D stock to B in a Plan Acquisition. On Date 2, D redeems 25 shares of stock from Public 1 in a Plan Repurchase.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**	**# of Shares (Date 2)**	**% Ownership**
A	25	25%	15	15%	15	20%
P1	75	75%	75	75%	50	66.6%
B	0	0%	10	10%	10	13.3%
Total	100	100%	100	100%	75	100%

There are multiple possible approaches to calculating the Section 355(e) Ownership Shift. One possibility is to calculate the Plan Acquisition Percentage after each Plan Acquisition, and aggregate the total of each individual calculation (the "**Gross Aggregation Approach**"). Under this approach, D would have a Section 355(e) Ownership Shift of 18.3%, determined by adding the 10% Plan Acquisition Percentage from the Date 1 transaction (*i.e.*, 10 Plan Shares/100 total shares outstanding immediately after the Plan Acquisition) and the approximately 8.3% Plan Acquisition Percentage from the Date 2 transaction (*i.e.*, A indirectly acquires 3.75 Plan Shares

(or under-participates in the repurchase by 3.75 shares)[40] and B indirectly acquires 2.5 Plan Shares (or under-participates in the repurchase by 2.5 shares)[41] so the Plan Acquisition Percentage from the Date 2 transaction is (6.25 Plan Shares/75 total shares outstanding immediately after the Plan Acquisition)). Under the Gross Aggregation Approach, this result is reached notwithstanding the fact that, following the Date 2 transaction, the historic shareholders of D, A and P1, have retained approximately 86.6% of the stock of D. Furthermore, it is possible that Plan Shares can be "double counted" under the Gross Aggregation Approach.

> Example 7: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 25 shares and the remaining 75 shares are held by Public 1. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, A sells 25 shares of D stock to B in a Plan Acquisition. On Date 2, B sells 25 shares of D stock to E in a Plan Acquisition. On Date 3, E sells 25 shares of D stock to F in a Plan Acquisition.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**	**# of Shares (Date 2)**	**% Ownership**	**# of Shares (Date 3)**	**% Ownership**
A	25	25%	0	0%	0	0%	0	0%
P1	75	75%	75	75%	75	75%	75	75%
B	0	0%	25	25%	0	0%	0	0%
E	0	0%	0	0%	25	25%	0	0%
F	0	0%	0	0%	0	0%	25	25%
Total	100	100%	100	100%	100	100%	100	100%

Under these facts and under the Gross Aggregation Method, D would have a Section 355(e) Ownership Shift of 75%, determined by aggregating the Plan Acquisition

[40] If D had repurchased shares *pro rata* from all shareholders, it would have repurchased 0.25 shares per D share, or 3.75 shares in respect of A's 15 shares. Alternatively, this could be calculated as follows: 15 shares x (25 repurchased shares/100 total shares outstanding immediately prior to the repurchase) = 3.75.

[41] If D had repurchased shares *pro rata* from all shareholders, it would have repurchased 0.25 shares per D share, or 2.5 shares in respect of B's 10 shares. Or, 10 shares x (25 repurchased shares/100 total shares outstanding immediately prior to the repurchase) = 2.5.

Percentages from Dates 1, 2, and 3. Given that the historic shareholders of D have retained 75% of the D stock, there should not be a 50% or greater Section 355(e) Ownership Shift on these facts. However, "double counting" is illustrative of an extreme application of the logic underlying the Gross Aggregation Approach, namely, that each Plan Acquisition should be considered without regard to the impact of other Plan Acquisitions.

An alternative approach is to compute the Section 355(e) Ownership Shift by a cumulative determination of the percentage of stock in the relevant corporation actually acquired during a testing period that is bounded by two points in time: (i) immediately before the earlier of the first Plan Acquisition or the distribution of C and (ii) immediately after the later of the last Plan Acquisition and the distribution of C (the "**Testing Period Netting Method**" and such period, the "**testing period**").[42] Under the Testing Period Netting Method, any increase, directly or indirectly, in a shareholder's ownership percentage in the relevant corporation is taken into account for purposes of Section 355(e) only after reducing such increase to reflect any reductions that occur as a result of Plan Acquisitions occurring during the testing period. Under the Testing Period Netting Method, the Plan Acquisition Percentage would only be calculated once, at the end of the testing period. In applying the Testing Period Netting Method to Example 6, the Numerator would have 10 Plan Shares. The indirect acquisition by A as a result of the Date 2 Plan Repurchase is not reflected in the Numerator because A's percentage ownership in D has decreased from 25% to 20% over the testing period (*i.e.*, from 25 shares/100 total shares outstanding to 15 shares/75 total shares outstanding). Furthermore, the indirect acquisition by B will be taken into account by reducing the Denominator to reflect the 75 shares outstanding

[42] See the discussion below for a discussion of potential limitations on the testing period or an alternative form of netting.

immediately after the Plan Repurchase. As a result, the Plan Acquisition Percentage is 13.33% (*i.e.*, 10 Plan Shares/75 total shares outstanding immediately after the Plan Acquisitions). This result comports with the cumulative economic results of the transactions and reflects the fact that the historic shareholders of D have retained 86.67% of D's stock.

A. Service's Current Ruling Practice

The Service has approved various forms of netting in a number of private letter rulings. Private Letter Ruling 201627001,[43] discussed above, involved a pre-distribution merger between D and two merger partners, and both pre- and post-distribution repurchases of the stock of each such corporation were relevant, including repurchases conducted via tender offer. The Service ruled that "[a]ny increase in either voting power or value of the stock of [the relevant corporation] owned by a shareholder by virtue of the [repurchase] will be taken into account for purposes of Section 355(e) only after reducing such increase for any reduction, directly or indirectly, in such shareholder's interest resulting from the [repurchase]."

The Service reached a similar conclusion in Private Letter Ruling 201603005.[44] In that ruling, Distributing 2 distributed all the stock of Controlled 2 to its shareholder. Controlled 2 then merged with another corporation, Controlled 1, with Controlled 2 surviving. As part of the overall transaction, certain persons received exchange rights that allowed them to receive cash for each of their units equal to the value of a share of Controlled 2 stock, with Controlled 2 having the option of giving those persons Controlled 2 stock instead of cash. The Service ruled that, in applying Section 355(e)(2)(A)(ii) to Controlled 2, "any increase in the percentage, by vote or value, of Controlled 2 common stock owned by a shareholder as a result of the exercise

[43] (Jan. 4, 2016).

[44] (Sept. 22, 2015) (ruling 3).

of the Controlled 2 Exchange Rights will offset and reduce any decrease in that shareholder's percentage owned, by vote or value, of the Controlled 1 common stock as a result of the [merger] (determined without regard to any other acquisition)."

Similarly, in Private Letter Ruling 201538015,[45] Distributing 1 conducted negotiations and was evaluating "one or more possible acquisitions or combination transactions (the "**Acquisitions**")" and believed that it was "highly likely" that it would pursue one or more of them. The Service ruled that "[p]rovided the Acquisitions are treated as pursuant to a plan under §355(e)(2)(A)(ii), the increases in the percentage of either voting power or value of the stock of Distributing 1, Distributing 2, or Distributing 3 acquired, directly or indirectly, by Third Parties in the Exchanges will be treated as acquisitions that are taken into account for purposes of §355(e) only after reducing such increases for any dilution, directly or indirectly, in such respective interests resulting from any Acquisition." Accordingly, in Private Letter Ruling 201538015, the Service netted the shifts in stock ownership resulting from a series of plan acquisitions.[46]

---

[45] (Apr. 28, 2015) (ruling 1).

[46] *See also* Private Letter Ruling 201748007 (June 13, 2017) (ruling 2: "Any increase, directly or indirectly, in the percentage of either voting power or value of the stock of Distributing 2 owned by a shareholder by virtue of the Share Repurchases or acquisitions of the stock of Distributing 2, if any, as part of a plan (or series of related transactions) with the Distributions will be taken into account for purposes of section 355(e) only after reducing such increase for any reduction in such percentage interest, directly or indirectly, resulting from the Share Repurchases and any disposition of stock of Distributing 2 by such shareholder or issuance of stock by Distributing 2, if any, as part of a plan (or series of related transactions) with the Distributions"); Private Letter Ruling 201505007 (Oct. 10, 2014) (ruling 2: "For purposes of testing whether the Stock Unification and Distribution will result in a direct or indirect acquisition of Distributing stock for purposes of Section 355(e)(2)(A)(ii), any increase in the percentage, by vote or value, of Distributing stock owned by any shareholder that may result from the Stock Unification will be disregarded (and not be treated as an acquisition within the meaning of Section 355(e)(2)(A)(ii)) to the extent of any decrease in that shareholder's percentage ownership, by vote or value, of Distributing stock prior to the Stock Unification."); Private Letter Ruling 201004001 (Oct. 22, 2009) (ruling 25: "For purposes of testing the effect of the Automatic Conversion on the Split-off under Section 355(e), any increase in the percentage of the voting power of Controlled stock owned by the Distributing Group 1 Public Shareholders that results from the Automatic Conversion will be disregarded (and not treated as an acquisition for purposes of Section 355(e)(2)(A)(ii)) to the extent of any decrease in the percentage of the voting power of Controlled stock owned by such holders that results from the Combination."); Private Letter Ruling 201422004 (Dec. 20, 2013); Private Letter

B. Discussion

We believe that netting is the appropriate way to calculate the impact of a Plan Repurchase on the Section 355(e) Ownership Shift in the context of multiple Plan Acquisitions, at least in certain circumstances. As noted above, although the Service has consistently applied netting in its ruling practice, taxpayers cannot rely on private letter rulings issued to other taxpayers. Published guidance regarding the application of netting to Plan Repurchases in the context of multiple Plan Acquisitions involving repurchases would eliminate the need to devote government and taxpayer resources to requesting and issuing rulings in this context and provide taxpayers with additional certainty as to how to calculate the Section 355(e) Ownership Shift in similar fact patterns.

Furthermore, the issuance of published guidance would be appropriate because the application of netting is consistent with the pertinent statutory language and regulatory framework under Section 355(e). First, netting flows logically from the text of Section 355(e)(2)(A)(ii), which focuses on whether there has been an acquisition of a 50% or greater interest in stock of a corporation "as part of a plan (or series of related transactions)." For example, by calculating the Section 355(e) Ownership Shift by reference to the cumulative changes in share ownership over the testing period in appropriate circumstances, the Testing Period Netting Method disregards temporary fluctuations in share ownership that may occur during the testing period.

> Example 8: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 25 shares, and the remaining 75 shares are held by Public 1. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders

---

Ruling 201037024 (June 8, 2010), *supplementing* Private Letter Ruling 200851014 (Aug. 26, 2008); Private Letter Ruling 201030013 (Mar. 23, 2010); Private Letter Ruling 201030007 (Mar. 23, 2010).

on a *pro rata* basis. On Date 1, A sells 10 shares of D stock to B in a Plan Acquisition. On Date 2, D redeems 10 shares of stock from Public 1 in a Plan Repurchase. On Date 3, A sells 10 shares to a new public group, Public 2. Assume that Dates 1 – 3 are within a reasonable duration such that it is appropriate to apply netting.

Share-holder	**# of Shares (Start)**	**% Owner ship**	**# of Shares (Date 1)**	**% Owner ship**	**# of Shares (Date 2)**	**% Owner ship**	**# of Shares (Date 3)**	**% Owner ship**
A	25	25%	15	15%	15	16.7%	5	5.6%
P1	75	75%	75	75%	65	72.2%	65	72.2%
B	0	0%	10	10%	10	11.1%	10	11.1%
P2	0	0%	0	0%	0	0%	10	11.1%
Total	100	100%	100	100%	90	100%	90	100%

At the end of the testing period, there are two new shareholders that have increased their ownership pursuant to a Section 355(e) Plan: Shareholder B and Public 2. Although the Plan Repurchase on Date 2 causes A's ownership of D to increase temporarily from 15% to 16.7%, this increase is not taken into account because A's dispositions ultimately reduce A's ownership to 5.6%. Consequently, the Testing Period Netting Method avoids overstating the amount of the Section 355(e) Ownership Shift. Computationally, the Plan Acquisition Percentage is approximately 22.2% (*i.e.*, 10 + 10 Plan Shares/90 total shares outstanding immediately after the Plan Acquisitions). Thus, applying the Testing Period Netting Method, the Section 355(e) Ownership Shift is 22.2% in Example 8.

The appropriateness of this result is confirmed by the observation that A and Public 1, the historic shareholders of D, have retained, collectively, 77.8% of the stock of D. As this example demonstrates, in these circumstances, the Testing Period Netting Method more accurately

reflects the extent to which the Plan Acquisitions result in an acquisition of Plan Shares by taking all changes to the capital structure and ownership into account. In this manner, the Testing Period Netting Method is consistent with the text of Treasury Regulations Section 1.355-7(c)(5), which states that "[a]ll acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution . . . will be aggregated for purposes of the 50-percent test." [47]

Under the Testing Period Netting Method, a testing period of a long duration could give rise to results that violate the policy of Section 355(e). For example, it would allow a 50% or greater Section 355(e) Ownership Shift to persist for a long period. We believe that this would be inappropriate as a policy matter. For purposes of issuing sub-regulatory guidance, such as a revenue ruling, we recommend that the facts of the revenue ruling confine the testing period to a reasonable duration, such as 1 to 2 years. In addition, we recommend that the revenue ruling state as a pivotal fact that a principal purpose for engaging in a Plan Acquisition is not to extend the testing period.

As an alternative to the Testing Period Netting Method, a "testing date" approach to netting (the "**Testing Date Netting Method**") could be employed. Under the Testing Date Netting Method, the cumulative Section 355(e) Ownership Shift would be tested on each date on which there is a Plan Acquisition. If the cumulative Section 355(e) Ownership Shift equals or exceeds 50% on any testing date, Section 355(e) would be violated. However, under the Testing Date Netting Method, netting would be applied where (a) two or more Plan Acquisitions are reasonably proximate to each other (say, within 90 days of each other) or (b) at the time of the

[47] It should be noted that the particular sequence of transactions may impact calculation of the Section 355(e) Ownership Shift when applying both the Testing Period Netting Method and the Proration Rule. For example, in the above example, if A's disposition of stock to Public 2 had occurred prior to the Plan Redemption, assuming the Proration Rule applied, the Plan Repurchase would have also reduced Public 2's percentage ownership of D.

first Plan Acquisition, there is an AUA[48] for one or more Plan Acquisitions to occur subsequently within a reasonably short time period (within 90 days). As above, the applicable period to which the Testing Date Netting Method applies could not be extended by a Plan Acquisition (or AUA) undertaken with a principal purpose of extending the period.

While a majority of the Tax Section believe the Testing Period Netting Method was the more appropriate approach, a significant minority of the Tax Section favored the Testing Date Netting Method.

VI. EFFECT OF NON-PLAN REPURCHASES

A final question arises as to how properly to count the impact, if any, of a repurchase that does not occur pursuant to a Section 355(e) Plan (a "**Non-Plan Repurchase**"). If a Plan Repurchase can cause an indirect acquisition for purposes of Section 355(e), the obverse proposition is that a Non-Plan Repurchase should not have any effect on the computation of the Section 355(e) Ownership Shift.[49]

> Example 9: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 25 shares and the remaining 75 shares are held by Public 1. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, A sells 10 shares of D stock to B in a Plan Acquisition. On Date 2, D repurchases 25 shares of stock from Public 1 in a Non-Plan Repurchase.

[48] See footnote 3 above for further details as to what types of understandings and arrangements would be included as an AUA for this purpose.

[49] Transactions other than Non-Plan Repurchases may affect the Denominator, thereby indirectly influencing the amount of the Section 355(e) Ownership Shift. For example, D may issue stock pursuant to a compensatory arrangement to which Safe Harbor VIII applies. As discussed above, this Report does not address the impact of issuances on calculating the Section 355(e) Ownership Shift and therefore any conclusions as to the appropriate effect of a Non-Plan Repurchase on the Denominator may be inapplicable in the context of a Non-Plan Issuance.

Shareholder	# of Shares (Start)	% Ownership	# of Shares (Date 1)	% Ownership	# of Shares (Date 2)	% Ownership
A	25	25%	15	15%	15	20%
P1	75	75%	75	75%	50	66.7%
B	0	0%	10	10%	10	13.3%
Total	100	100%	100	100%	75	100%

Immediately after the Date 1 transaction, D has a Section 355(e) Ownership Shift of 10%. D's Plan Acquisition Percentage immediately after the Date 1 transaction is 10% (*i.e.*, 10 Plan Shares/100 total shares outstanding immediately after the Plan Acquisition). Although the Non-Plan Repurchase has the effect of increasing B's actual percentage ownership of D from 10% (*i.e.*, 10 shares/100 total shares outstanding immediately prior to the Non-Plan Repurchase) to approximately 13.3% (*i.e.*, 10 shares/75 total shares outstanding immediately after the Non-Plan Repurchase), this increase should not be taken into account because it does not occur pursuant to a Section 355(e) Plan. Computationally, this means the Non-Plan Repurchase should have no effect on either the Numerator or the Denominator of the Plan Acquisition Percentage. As a result, D's Plan Acquisition Percentage immediately after the Date 2 transaction remains 10% (*i.e.*, 10 Plan Shares/100 total shares deemed outstanding). Importantly, even though D's shares have actually been redeemed, they are treated as outstanding for purposes of the Plan Acquisition Percentage.

A. Service's Current Ruling Practice

The Service has issued a number of private letter rulings providing that a Non-Plan Repurchase will not be taken into account for purposes of Section 355(e). In Private Letter Ruling 200644012,[50] Distributing sought a ruling concerning the effect of D's stock repurchase

[50] (July 21, 2006), *supplementing*, Private Letter Ruling 200624001 (July 20, 2005), Private Letter Ruling 200626011 (Feb. 27, 2006), and Private Letter Ruling 200632008 (May, 12, 2006), *supplemented by*, Private Letter Ruling 200708064 (Oct. 19, 2007) and Private Letter Ruling 200802016 (Oct. 9, 2006).

program. Previously, D had merged with an unrelated corporation in which the shareholders of the target corporation received D stock (the "**Merger**"). Subsequently, D distributed C *pro rata* to its shareholders. D made certain representations that generally established that the stock repurchases would constitute Non-Plan Repurchases. The Service ruled that the stock repurchases would not have any effect on the determination of whether there had been an acquisition of a 50% or greater interest in D. As a result, D's stock repurchases would not impact the computation of the Section 355(e) Ownership Shift resulting from the Merger. The Service has reached similar conclusions in a number of private letter rulings, including certain rulings discussed above.[51]

B. Discussion

As a general matter, a Non-Plan Repurchase should have no effect on the computation of the Section 355(e) Ownership Shift. To the extent that a repurchase can constitute an indirect acquisition by the Non-Participating Shareholders, such acquisition should not be taken into account for purposes of Section 355(e) if it does not occur pursuant to a Section 355(e) Plan. In this manner, an indirect acquisition occurring via a Non-Plan Repurchase should be disregarded just as a direct acquisition between shareholders would be disregarded if it does not occur pursuant to a Section 355(e) Plan.

As an initial matter, it seems clear that a Non-Plan Repurchase generally should not extend the Testing Period.[52] The Testing Period has to have a finite end in order for the Testing

[51] *See, e.g.*, Private Letter Ruling 201748007 (June 13, 2017) (ruling 3); Private Letter Ruling 201627001 (Jan. 4, 2016) (ruling 9); Private Letter Ruling 201047016 (Aug. 19, 2010); Private Letter Ruling 201037024 (June 8, 2010) (ruling (2)), supplementing, Private Letter Ruling 200851014 (Aug. 26, 2008); Private Letter Ruling 200708064 (Oct. 19, 2006).

[52] See footnote 54 for a discussion of certain circumstances when it may be appropriate to extend the Testing Period.

Period Netting Method to function properly, and it makes no sense to extend the Testing Period to sweep in transactions that are not part of the Plan.

The more challenging question is how to account for a Non-Plan Repurchase that occurs between two Plan Acquisitions. Under the rationale discussed above, it seems clear, at least in determining the effect of a later Non-Plan Repurchase on a prior Plan Acquisition, that the Non-Plan Repurchase itself should not affect the Numerator or the Denominator; the Plan Acquisition represented a particular percentage of the repurchasing corporation at the time of such Plan Acquisition, and a subsequent change in the number of shares outstanding that does not occur pursuant to the Section 355(e) Plan should not alter the Section 355(e) Ownership Shift as a general matter. However, it is less clear to what extent the Non-Plan Repurchase should indirectly influence the calculation of the Plan Acquisition Percentage due to the indirect effect of the Non-Plan Repurchase on subsequent Plan Acquisitions. Depending on the approach adopted, the sequence of a Non-Plan Repurchase vis-à-vis Plan Acquisitions may impact the amount of the Section 355(e) Ownership Shift.

> Example 10: D is a publicly traded corporation and has outstanding 100 shares of stock. A owns 45 shares, B owns 35 shares, and Public 1 owns 20 shares. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, B sells 10 shares to E in a Plan Acquisition. On Date 2, D repurchases 10 shares of stock from Public 1 in a Non-Plan Repurchase. On Date 3, B sells 10 shares to F in a Plan Acquisition.

Shareholder	# of Shares (Start)	% Ownership	# of Shares (Date 1)	% Ownership	# of Shares (Date 2)	% Ownership	# of Shares (Date 3)	~% Ownership
A	45	45%	45	45%	45	50%	45	50%
B	35	35%	25	25%	25	27.77%	15	16.67%
P1	20	20%	20	20%	10	11.11%	10	11.11%
E	0	0%	10	10%	10	11.11%	10	11.11%
F	0	0%	0	0%	0	0%	10	11.11%
Total	100	100%	100	100%	90	100%	90	100%

As to the effect of the Non-Plan Repurchase itself, the indirect increase by A, B, and E as a result of the Non-Plan Repurchase should not affect the Section 355(e) Ownership Shift. Stated differently, it is clear that a Non-Plan Repurchase does not impact the Numerator of the Plan Acquisition Percentage. With respect to the effect of the Date 2 Non-Plan Repurchase on the Date 1 Plan Acquisition, the results also should be straightforward—that is, the Non-Plan Repurchase should not have any impact on the Section 355(e) Ownership Shift caused by the Date 1 Plan Acquisition. Immediately after the Date 1 Plan Acquisition, D has a Section 355(e) Ownership Shift of 10%. D's Plan Acquisition Percentage is 10% (*i.e.*, 10 Plan Shares/100 total shares outstanding immediately after the Plan Acquisition). Because the Non-Plan Repurchase is not taken into account for purposes of Section 355(e), the indirect increase by A, B and E as a result of the Non-Plan Repurchase on Date 2 should not affect the Section 355(e) Ownership Shift as calculated immediately prior to the Non-Plan Repurchase, and the Section 355(e) Ownership Shift (attributable solely to E's Date 1 Plan Acquisition) should remain 10% (*i.e.*, 10 Plan Shares/100 total shares deemed outstanding).

The appropriate results are less certain with respect to the effect of the Date 2 Non-Plan Repurchase on the Date 3 Plan Acquisition. The key question is what effect a Non-Plan Repurchase should have on the Denominator when calculating the Section 355(e) Ownership Shift attributable to a Plan Acquisition occurring after such Non-Plan Repurchase. One alternative is to treat the Non-Plan Repurchase as having no effect on the Denominator (*i.e.*, the redeemed shares are treated as still outstanding) in calculating the Section 355(e) Ownership

Shift from the later transaction. Under this approach, in Example 10, the Section 355(e) Ownership Shift attributable to F's Date 3 Plan Acquisition would be 10% (*i.e.*, 10 Plan Shares/(90 shares actually outstanding immediately after the Plan Acquisition + 10 shares deemed outstanding)). The other alternative is to reduce the Denominator for purposes of calculating the Section 355(e) Ownership Shift resulting from the Date 3 Plan Acquisition. Under this approach, the Section 355(e) Ownership Shift attributable to F's Date 3 Plan Acquisition would be 11.11% (*i.e.*, 10 Plan Shares/90 shares actually outstanding immediately after the Plan Acquisition).

Valid arguments can be made in support of either approach. Although reducing the Denominator for the Non-Plan Repurchase has the effect of indirectly taking the Non-Plan Repurchase into account, F has actually purchased 11.11% of the stock of D in a Plan Acquisition. Accordingly, requiring that Non-Plan Repurchases reduce the Denominator for purposes of measuring the effect of a subsequent Plan Acquisition may be appropriate in the sense that it more accurately measures the actual economic impact of such Plan Acquisition. Further, although the rule places a premium on sequence, with calculations differing depending on whether the Plan Acquisition occurs before or after the Non-Plan Repurchase, the economic impact of the Non-Plan Repurchase on E and F would differ as well. In this vein, if the sequence of a Plan Acquisition and a Non-Plan Repurchase has economic significance, there is logic to calculating the Section 355(e) Ownership Shift in a manner that gives effect to that difference.

On the other hand, indirectly taking the Non-Plan Repurchase into account for purposes of calculating the Section 355(e) Ownership Shift resulting from a subsequent Plan Acquisition is arguably inconsistent with Section 355(e)(2)(A)(ii), which focuses on whether there has been an acquisition of a 50% or greater interest in stock of a corporation "as part of a *plan* (or series of

related transactions)." [Emphasis added.] Although E and F achieve the same ultimate ownership of D, the calculation of the Section 355(e) Ownership Shift resulting from the Plan Acquisition undertaken by each is different, and this difference arises from the effect of a Non-Plan Repurchase, which is, by definition, not part of the same plan as the Date 1 or Date 3 Plan Acquisitions.

In addition, we note that reducing the Denominator for purposes of calculating the Section 355(e) Ownership Shift attributable to Plan Acquisitions subsequent to Non-Plan Repurchases may involve a high degree of administrative complexity. Because the Denominator changes over the testing period, the ownership percentages will not add to 100%, which is counterintuitive.[53] Moreover, a Non-Plan Repurchase may be implemented through a program involving periodic (perhaps daily) repurchases conducted over months or years. Similarly, a Plan Acquisition may occur in the form of a series of small transactions (*e.g.*, a large shareholder selling down its stake). Consequently, computing the Section 355(e) Ownership Shift could involve dozens or hundreds of calculations dependent on actual knowledge of the precise amount of shares repurchased prior to the particular day on which a Plan Acquisition occurs.

As a general matter, because a Non-Plan Repurchase and any Plan Acquisitions are, by definition, unrelated, and because of the potential computational complexity associated with reducing the Denominator, we think, on balance, the better answer is that Non-Plan Repurchases should not affect the Denominator, consistent with what appears to be the Service's current ruling policy. Nonetheless, we acknowledge that reasonable people could disagree about the correct result and further note there may be unusual circumstances in which it may be

[53] *Cf.* Notice 2010-50, 2010-27 I.R.B. 12 (addressing fluctuations in value for Section 382 ownership shift calculation purposes, which has a similar effect).

appropriate to take a Non-Plan Repurchase into account when computing the Section 355(e) Ownership Shift even where the Plan Acquisition occurs before the Non-Plan Repurchase (including, potentially, when the Non-Plan Repurchase occurs after the Testing Period).

> Example 11: D is a publicly traded corporation and has outstanding 100 shares of stock, all held by Public 1. D distributes 100% of the stock of its wholly owned subsidiary, C, to D shareholders on a *pro rata* basis. On Date 1, A acquires 25 shares of D in a Plan Acquisition. On Date 2, D redeems 10 shares from Public Shareholders in a Non-Plan Repurchase pursuant to a previously announced programmatic buyback program. On Date 3, A acquires 24 shares of D in a Plan Acquisition.

Shareholder	**# of Shares (Start)**	**% Ownership**	**# of Shares (Date 1)**	**% Ownership**	**# of Shares (Date 2)**	**% Ownership**	**# of Shares (Date 3)**	**~% Ownership**
A	0	0%	25	25%	25	27.8%	49	54.4%
P1	100	100%	75	75%	65	72.2%	41	45.6%
Total	100	100%	100	100%	90	100%	90	100%

In this example, if the Non-Plan Repurchase is not taken into account, the Section 355(e) Ownership Shift is 49% because the Non-Plan Repurchase does not reduce the Denominator (*i.e.*, 25 + 24 Plan Shares/90 shares actually outstanding immediately after the Plan Acquisitions + 10 shares deemed outstanding). However, A has actually acquired 54.4% of the stock of D. Because of the previously announced buyback program, A could know with reasonable certainty that its acquisition of 49 shares ultimately would result in A's ownership of 50% or more of the stock of D. Consequently, in these circumstances, disregarding a Non-Plan Repurchase could facilitate a result contrary to the intent of Section 355(e)—the acquisition of a 50% or greater interest in stock of a corporation pursuant to a Section 355(e) Plan. In circumstances where A and D actually coordinate their respective acquisitions and repurchases to effectuate this result, it seems clear that the repurchase will constitute a Plan Repurchase and will, accordingly, be taken into account in computing the Section 355(e) Ownership Shift. However, where a repurchase is

clearly a Non-Plan Repurchase but is also reasonably certain to occur (*e.g.*, a buyback program), then it may be possible for a shareholder to utilize a Non-Plan Repurchase to acquire a 50% or greater interest in the stock of a corporation pursuant to a Section 355(e) Plan. We believe that in the unusual situations where a single shareholder (or group of shareholders acting in concert) acquire a concentrated position in a corporation's stock with the intent of utilizing a Non-Plan Repurchase that is reasonably certain to occur in order to ultimately acquire a 50% or greater interest pursuant to the Section 355(e) Plan could be appropriately addressed by an anti-abuse provision that operates to reduce the Denominator to reflect a Non-Plan Repurchase for the purpose of calculating the Section 355(e) Ownership Shift attributable to any Plan Acquisition undertaken with such intent.[54]

C. Pre-Existing Share Repurchase Programs and Plan Analysis

A question related to the appropriate counting convention for Non-Plan Repurchases is whether the government should issue guidance providing a safe harbor treating certain repurchases made by public corporations as not resulting in Plan Acquisitions. The determination of whether an acquisition is a Plan Acquisition is based on all facts and circumstances.[55] The regulations set forth non-exclusive factors to be considered in demonstrating whether an acquisition is a Plan Acquisition, as well as certain safe harbors establishing when an acquisition is a non-Plan Acquisition. Acquisitions during the four-year period beginning on the date which is two years before the date of the distribution are presumed

[54] Similarly, where a repurchase is clearly a Non-Plan Repurchase but it is also reasonably certain to occur (*e.g.*, a programmatic share repurchase program), and a shareholder makes a significant Plan Acquisition with the certain knowledge that the share repurchase program will cause that shareholder's percentage interest to equal or exceed 50%, we think an anti-abuse rule could be applied to extend the Testing Period and recalculate the Section 355(e) Ownership Shift attributable to such Plan Acquisition with a reduced Denominator.

[55] *See* Treas. Reg. § 1.355-7(b)(1).

to be Plan Acquisitions unless established to the contrary.[56] In light of this statutory presumption, in conjunction with the uncertain application of existing safe harbors in the Regulations to repurchases, we believe that the government should consider issuing guidance specifying that certain Public Share Repurchases made pursuant to a pre-existing share repurchase program will be presumed not to result in Plan Acquisitions.[57]

Treasury Regulations Section 1.355-7(b)(4)(iv) provides that the fact that a distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition is among the factors tending to establish that a post-distribution acquisition is a non-Plan Acquisition. Consistent with this, we believe that the government should issue a revenue ruling setting forth a safe harbor which provides that Public Share Repurchases under a share repurchase program will be Non-Plan Repurchases where (i) the share repurchase program was neither established nor modified in contemplation of the distribution; and (ii) the distribution has no or minimal impact on the timing or amount of the repurchases (*i.e.*, repurchases are expected, in all material respects, to occur at approximately the same times, and to be in the same or lesser amount, as the repurchases that would have occurred in the absence of a distribution).

We believe that the impact of one transaction on the timing and form of another transaction is a significant fact in establishing the level of relatedness between transactions. While the regulations focus on the time and amount of the distribution,[58] private letter rulings

---

[56] Section 355(e)(2)(B).

[57] We consider the issuance of published guidance addressing the three principal technical conclusions discussed above regarding counting conventions for the repurchases to be of a much higher priority. As a practical matter, issuance of that guidance will resolve most concerns about the repurchases without having to address Section 355(e) Plan issues. Nevertheless, the "safe harbor" guidance discussed briefly below also would be helpful.

[58] *See also* Rev. Rul. 2005-65, 2005-2 C.B. 684 (holding that a pre-distribution merger was not a Plan Acquisition despite the presence of certain factors indicating the distribution and merger were part of a Section 355(e) Plan

addressing share repurchase programs tend to focus instead on the timing and amount of repurchases. For example, the Service has ruled that pre-distribution repurchases by D pursuant to a share repurchase program would not be treated as occurring pursuant to a Section 355(e) Plan where the taxpayer represented that the prior repurchases were not related to the proposed transaction and "the amount and timing of such repurchases would have been the same regardless of the [proposed transaction]."[59] In Private Letter Ruling 201627001,[60] the taxpayer similarly represented, with respect to post-distribution repurchases, that such repurchases were not, and would not be, related to the proposed transaction, and were expected to occur at approximately the same times, and to be in the same or lesser amount, as the repurchases that would have occurred if no distribution had been made to the public shareholders. The Service applied Proration Treatment, but only to the extent the repurchases were otherwise treated for purposes of Section 355(e) as part of a plan with the relevant distributions.[61] The Service did not address whether the repurchases would be treated as a Plan Repurchase based on the representations given.

We believe the proposed safe harbor could be implemented through the issuance of a revenue ruling addressing the criteria described above. In order to make clear that the criteria set forth establish only a safe harbor, the ruling should include a factual scenario in which the safe harbor criteria are not met, and conclude that the determination of whether a Section 355(e) Plan exists is to be made based on all of the facts and circumstances.

---

where (i) distribution would have occurred at approximately the same time and in similar form regardless of the acquisition, and (ii) the distribution was motivated by a business purpose (to increase available capital) other than a business purpose to facilitate the acquisition or a similar acquisition).

[59] *See e.g.,* Private Letter Ruling 200736015 (June 5, 2007); Private Letter Ruling 200750009 (Sept. 12, 2007).

[60] (Jan 4, 2016).

[61] *See, e.g.*, Private Letter Ruling 201627001 (Jan. 4, 2016).

VII. CONCLUSION

As described above, publication of a sub-regulatory guidance on the proper treatment of repurchases, focusing principally on the applicable counting conventions in a manner essentially consistent with the Service's existing ruling policies, would provide greater certainty to taxpayers and the government alike. Moreover, such guidance would obviate the need for taxpayers to seek repetitive private rulings, reducing compliance burdens for taxpayers and conserving government resources.