Tax Report #~~946~~ 968

New York State Bar Association

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TAX SECTION

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March 22, 2000

The Hon. Jonathan Talisman
Acting Assistant Secretary,
Tax Policy
Department of the Treasury, Room 1334 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Talisman:

On behalf of the New York State Bar Association, I enclose a report dealing with the Proposed Regulations under section 1.355-7.

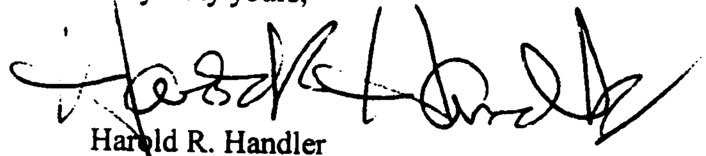
As we indicate in this report, we believe that the Proposed Regulations are a valuable first step in providing the necessary guidance to deal with issues arising under section 355(e) of the Internal Revenue Code of 1986, as amended. As we mention, a key policy issue is guidance concerning what constitutes "a plan (or series of related transactions)" under that section. We support wholeheartedly the effort of the Proposed Regulations to create a safe harbor concept for certain acquisitions.

However, there are a number of issues which we believe should be addressed in clarifying the policy requirements of section 355(e). Many of these comments relate to the Proposed Regulations treating as part of a "plan" acquisitions that were not intended by any of the constituent corporations to the spin-off transaction. We suggest revising these Proposed Regulations to provide a safe harbor for certain acquisitions that occur more than six months after the distribution by relying on a different formulation for what constitutes a

"plan", and providing a further facts and circumstances test for other transactions so that the safe harbor is not the exclusive means of rebutting the statutory presumption. We believe this would satisfy the policy goals of the statute without the chilling effect on proposed transactions which we are concerned would be the result of the Proposed Regulations in their current form.

We are, of course, available to discuss this with you in greater detail at your earliest convenience and look forward to a dialogue that would produce guidance to remove unwarranted constraints on corporate transactions.

Very truly yours,



Harold R. Handler

cc: Eric Solomon, Esq.
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William Alexander, Esq.

NEW YORK STATE BAR ASSOCIATION TAX SECTION COMMITTEES ON CORPORATIONS AND REORGANIZATIONS REPORT ON PROPOSED REGULATIONS SECTION 1.355-7

I. Introduction

This Report[1] comments on the regulations proposed on August 19, 1999, interpreting the concept of a "plan (or series of related transactions)" for purposes of section 355(e)(2)(A)(ii), (B) and (C)[2], enacted by Section 1012 of the Taxpayer Relief Act of 1997.[3]

As we noted in our Report dated December 8, 1998[4], we believe that providing guidance for what constitutes a "plan (or series of related transactions)" (collectively referred to herein as a "plan") for section 355(e) purposes is a critical objective. Since the enactment of section 355(e), taxpayers and tax practitioners have been faced with interpretation of a standard which is at best vague and with respect to which the legislative history is sparse. Absent interpretive guidance, the four-year statutory presumption and the unpredictability of rebuttal, coupled with the often-dire consequences of being wrong, will inevitably deter transactions which do not involve the

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1 The principal authors of this report are Risa Sackmary, Lawrence Garrett, Kathleen Ferrell and Jodi J. Schwartz. Helpful comments were received from Harold Handler, Michael Schler, Peter Canellos, Kimberly S. Blanchard, Glen Kohl and Robert Jacobs.

2 All "section" references, except as expressly otherwise provided, are to the Internal Revenue Code of 1986, as amended and the Treasury Regulations promulgated thereunder.

3 The report deals only with distributions followed by acquisitions, the pattern of the traditional "Morris Trust" transaction.

4 "Defining 'Plan' in the Anti-Morris Trust Provisions," NYSBA Tax Section Committees on Corporations and Reorganizations, as reprinted in Tax Notes, Jan. 11, 1999 (hereinafter, the "Prior Report").

perceived abuse (the deemed taxable sale through the spin-off/acquisition combination) which led to the enactment of Section 355(e).

We commend the Service and Treasury for taking on the difficult task of providing such necessary guidance. Given the ambiguity inherent in the statutory language, we believe that the proposed regulations are a meaningful first step. We also believe, however, that they require considerable modification before they can provide useful guidance to practitioners while protecting the government's legitimate interests.

The key policy issue, as we see it, is whether the "plan" concept will be left entirely ad hoc (reliant on the common law that has developed in analogous settings) or whether it will be defined by safe harbors and/or presumptions supplementing the statutory four-year presumption. We believe that the statutory presumption sweeps in too many transactions to be effective as a filter between "good" and "bad" transactions. We wholeheartedly support the effort in the Proposed Regulations to confine the "plan" concept by creating a safe harbor (the "general rebuttal") for certain acquisitions occurring more than six months after a spin-off. Indeed, we believe that realistic safe harbors are essential to the effective application of the statute.

We have two major comments regarding the Proposed Regulations. First, as currently drafted the general rebuttal unreasonably treats as part of a "plan" acquisitions that were not intended by any of the constituent corporations. This is a function of one of the most difficult aspects of the Proposed Regulations, the fact that independent companies in a public marketplace may take steps that are neither intended nor desired by the distributing or controlled corporation. (This problem is aggravated by the near impossibility of satisfying the "alternative rebuttal", which applies if the general rebuttal is not available). Second, we believe that taxpayers falling

outside the regulatory rebuttals should nevertheless have the opportunity to establish that the acquisitions in question were not, in fact, part of a "plan".

Changes to address these concerns we feel, would go far toward removing unwarranted constraints on corporate transactions. Because of the importance of these issues, we urge that the IRS and Treasury give immediate consideration to the proposed changes outlined below, as well as those suggested by others, with the objective of releasing, as soon as possible, an outline of a revised proposed regulation that would eliminate the chilling effect on proposed transactions caused by the Proposed Regulations.

II. Congressional Intent and the Role of Regulatory Guidance

Congress intended that section 355(e) impose corporate-level tax in situations in which a spin-off transaction closely resembles a sale of either the distributed or controlled corporation. According to the House Budget Committee Report, the Senate Report and the Blue Book:

> "section 355 was intended to permit the tax-free division of existing business arrangements among existing shareholders. In cases in which it is intended that new shareholders will acquire ownership of a business in connection with a spinoff, the transaction more closely resembles a corporate level disposition of the portion of the business that is acquired."[5]

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[5] H. Rep. No. 148, 105th Cong. 1st Sess. 462, 463 (6/24/97) ("House Report"); S. Rep. 105-33, 105th Cong., 1st Sess. 139-40; Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97), 198 (12/17/97) ("Blue Book").

The enactment of section 355(e) seems to have been spurred by the publicity surrounding certain cases which "involved a significant shift in debt . . . such that the business that changes hands retains a greater proportion (to value) of debt than the combined corporate group before the transaction, while the group remaining with the old shareholders obtains a more favorable balance sheet after the transaction."[6] While we recognize that the statute went beyond the problem of leverage in spin-offs that also involve a change in control, and we acknowledge that the words of the statute are susceptible to a variety of interpretations, it is our view that the underlying purpose of the statute is not sufficiently reflected in the Proposed Regulations.

As we stated in the Prior Report, certain transactions are clearly within the scope of section 355(e).[7] For example, it is clear that the classic Morris Trust transaction involving a post-distribution acquisition of 50% or more of the distributing corporation pursuant to an agreement executed prior to, and in connection with, the distribution is subject to corporate-level

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6 Description and Analysis of Certain Revenue-Raising Provisions Contained in the President's Fiscal Year 1998 Budget Proposal; 105th Cong., 1st Sess; JCS-10-97. See also the comments made by Hon. Bill Archer, Rep. from Texas made when introducing the legislation:

> "Mr. Speaker, several recent news reports describe corporate acquisition transactions in which one corporation distributes the stock of one—or—more of its subsidiaries to its shareholders in a so-called spinoff and, pursuant to a prearranged plan, either the distributing subsidiary or the old parent corporation is acquired by another, unrelated corporation. Often, the corporation that is to be acquired borrows or assumes a large amount of debt incurred prior to the spinoff, while the proceeds of such indebtedness are retained by the other corporation. . .
>
> Congress did not intend that section 355 apply to insulate these transactions from tax. Section 355 was intended to permit tax-free restructurings of several businesses among existing shareholders, with limitations to prevent the bail-out of corporate earnings and profits to the shareholders as capital gains. The recent transactions that raise concerns have very little to do with individual shareholder tax planing. Rather they are prearranged structures designed to avoid corporate-level gain recognition. In essence, these transactions resemble sales. If such transactions were treated as sales for tax purposes, the remaining corporation would recognize gain with respect to the stock of the acquired corporation.
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> Today's introduced legislation is intended to treat transactions occurring after April 16, 1997, the general effective date of the bill, as sales at the corporate level."

7 The Prior Report at 251.

tax pursuant to section 355(e). Similarly, a post-distribution acquisition pursuant to pre-distribution negotiations would be expected to be covered by section 355(e) (see Commissioner vs. Court Holding, 324 US 331 (1945)). However, we do not believe that Congress intended, for example, that unilateral or internal plans of a potential acquiring corporation should cause section 355(e) to apply.[8]

While the House Report stated that acquisitions that are "pursuant to a plan or arrangement in existence on the date of distribution" are clearly covered by section 355(e), and that "[t]axpayers can avoid gain recognition by showing that an acquisition occurring during this four-year period was unrelated to the distribution," the legislative history does not clearly describe whose "plan or arrangement" is determinative or what makes a transaction "related".[9] The language in the Blue Book is equally oblique; according to the Blue Book, a spin-off will be subject to section 355(e) if "it is intended [in the spin-off] that new shareholders will acquire ownership of a business in connection with" the spin-off, but, again, did not specify whose "intentions" should be examined.[10]

As discussed further below, the Proposed Regulations add some measure of objectivity by setting forth two rebuttal rules: the general rebuttal and the alternative rebuttal. While the idea of providing specific rebuttal rules is helpful, the rebuttal tests set forth in the Proposed Regulations are deficient in three respects: (i) the general rebuttal can be rendered unavailable by the unanticipated acts of others or the unintended consequences of the acts of the constituent

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8 Id.

9 House Report at 463.

10 The Blue Book at 198.

corporations; (ii) the alternative rebuttal is too narrow to be of any practical use; and (iii) there is no "facts and circumstances" rebuttal for transactions falling outside the scope of these two rebuttals.

We believe that the "reasonable anticipation test" contained in the alternative rebuttal, which requires the distributing and controlled corporation to "foresee actions others might take in response"[11] to the spin-off in determining whether a "plan" exists, clearly exceeds Congress' intent. Nothing in the legislative history compels the conclusion that Congress intended to impose corporate-level tax in the case where the distributing and controlled corporations have not been in prior discussions with any third party, the identity of the acquiring corporation was not known, or the distributing or controlled corporation actually resists the post-spin acquisition (such as in a hostile takeover). In the context of rapidly changing and volatile public securities markets the notion that tax consequences are determined by reference to actions others may take is highly questionable as a tax policy matter.

The preamble to the Proposed Regulations reads a great deal into a statement that is contained in the General Explanation of the Staff of the Joint Committee on Taxation to the effect that "[a] public offering of a sufficient size can result in an acquisition" described in section 355(e) and concludes that this indicates that "Congress did not believe that negotiations between the distributing corporation and the acquiror were necessary."[12] Based upon this, and a change from the Administration proposal which relied on a Section 355(d) concept of "a person" as the acquiror to the final Section 355(e) which applies to "one or more persons," the Treasury

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[11] Notice of Proposed Regulations 1999-36 IRB 392 at 395.

concluded that "indications are that Congress intended plan (or series of related transactions) to be interpreted broadly." We believe that this conclusion reads far too much into the reference to public offerings. A public offering with respect to which the taxpayer has taken significant preparatory steps prior to the spinoff is quite different from an unexpected tender offer for a newly spunoff company, even if the taxpayer was well aware of market dynamics favoring consolidation. Whereas the public offering might be said to be part of a plan because it was "intended" or "reasonably anticipated" by the taxpayer, as evidenced by the taxpayer's own actions, treating an unexpected tender offer as "reasonably anticipated" and therefore "intended" and (and therefore part of a plan) merely because the particular industry is in a consolidating mode is far too broad an interpretation of "plan (or series of related transactions)." In the case of a spinoff involving public companies, it would be difficult to say, in the face of a proposed acquisition, that it could not reasonably have been anticipated that there would be an acquisition of either the distributing or the spunoff entity in the two years following the spinoff. This is unwarranted in light of the context in which the statute was enacted, that is, a decision by Congress to tax spin-off transactions which were substitutes to corporate level sales.

III. The Proposed Regulations

As noted above, Proposed Regulations Section 1.355-7 addresses how taxpayers can rebut the statutory presumption that a particular acquisition was part of a plan (or series of related transactions). There are separate rules for post-acquisition distributions and pre-acquisition distributions. The proposed regulations provide two ways to rebut the presumption if an

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(footnote continued)

[12] Id. At 392.

acquisition occurs within two years after a distribution, which are referred to as the "general rebuttal" and the "alternative rebuttal."

The "general rebuttal" cannot be used as to a particular acquisition if such acquisition occurs within six months after the distribution or if there was an "agreement, understanding, arrangement, or substantial negotiations" regarding the acquisition at the time of the distribution or within the six-month period. The second element of the general rebuttal focuses on the corporate business purpose or purposes for the distribution. The taxpayer must establish that the distribution was motivated in whole or in substantial part by an acceptable "non-acquisition" corporate business purpose, a business purpose other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired.

The regulations do not define the term "agreement, understanding, arrangement, or substantial negotiations." The regulations merely state that the parties do not necessarily need to have reached agreement on all terms to have an agreement, understanding, or arrangement. In addition, the preamble states that it is possible to have an agreement, understanding, or arrangement without an identified acquiror.

If an acquisition occurs within six months of the distribution, the proposed regulations state that the presumption cannot be rebutted as to such acquisition solely by proof of a non-acquisition purpose. In this situation, the proposed regulations offer an alternative rebuttal that requires a more thorough, and in most cases practically impossible, examination of the parties' intentions and expectations. The alternative rebuttal also must be used if there is not a substantial non-acquisition purpose for the distribution.

The alternative rebuttal requires satisfaction of a three-part test.[13] First, the taxpayer must establish that either (1) at the time of the distribution, the distributing corporation, the controlled corporation, and their controlling shareholders did not intend that any one or more persons would acquire the prohibited 50% or greater interest in the distributing corporation during the two-year presumption period or (2) the distribution was not motivated in whole or in part by an intention to facilitate an acquisition of any interest in the distributing corporation or the controlled corporation.[14]

The second part of the alternative rebuttal requires the distributing corporation to establish that, at the time of the distribution, neither it, the controlled corporation, nor their controlling shareholders reasonably anticipated that it was more likely than not that a prohibited acquisition would occur within 2 years after the distribution (or later if an agreement-understanding, etc., exists) by persons who would not have acquired stock in the distributing corporation even if the distribution[15] had not occurred. This part of the test is not violated if the relevant parties did not reasonably anticipate a 50% or greater ownership change.

The preamble describes the second prong of the alternative rebuttal as the "reasonable anticipation" test. This test defines, in effect, the outer boundaries of the term "plan (or series of related transactions)" for any fact situation subject to the alternative rebuttal. This test requires the distributing corporation and its management to prove their reasonable expectations at the time of the distribution regarding a possible acquisition of either the distributing corporation or

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13 Prop. Regs. §1.355-7(a)(2)(ii).

14 Prop. Regs. §1.355-7(a)(2)(iii)(A).

15 Prop. Regs. §1.335-7(a)(2)(iii)(B).

the controlled corporation within the following 2-year period. This test measures those expectations only. It does not require an identified acquiror, or negotiations or discussions with any other party. As described above, the preamble defends this approach, in part, by the need to include public offerings within the Section 355(e) rules because the legislative history mentioned public offerings.[16] The reasonable anticipation test goes well beyond that situation.

Finally, under the third prong of the test, the distributing corporation must establish that the distribution was not motivated in whole or in substantial part by an intent to decrease the likelihood that one or more businesses would be acquired by separating them from other businesses that are likely to be acquired.[17]

As discussed above, we believe that certain aspects of the Proposed Regulations do not properly reflect Congressional intent.

First, the general rebuttal, which is the one most taxpayers will seek to satisfy, is not available if the admitted purpose of the spin-off is to facilitate a less-than-50 percent acquisition of either the distributing or controlled company. Thus, if a spin is undertaken to permit the controlled company to acquire a smaller target, or to issue stock to an ESOP or options to a key employee, the transaction may be caught by section 355(e) if there is an unrelated acquisition of controlled or even distributing stock within six months after the spin-off, even a hostile acquisition. There is no apparent reason why this consequence should result from a subsequent acquisition, which is not in fact part of a plan which includes the spin-off.

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16 H.R. Rep. No. 105220, 1 at 533 (1997) (the Conference Report).

17 Prop. Regs. §1.355-7(a)(2)(iii)(C).

Second, in the alternative rebuttal, the Proposed Regulations define "related" transactions to include acquisitions of stock that none of the parties to the distribution intend to facilitate, but that might be reasonably anticipated to occur. Even the broadest version of the step transaction doctrine – the end result test – integrates only transactions that the parties intend to facilitate. By contrast, we believe that the touchstone of any regulatory definition of the term "plan (or series of related transactions)" should be the purpose or purposes underlying the distribution and their relationship to the acquisition being tested.

The scope of "plan (or series) related transactions" concept as implemented in the Proposed Regulations is substantially more expansive than any version of the step transaction doctrine. None of the three traditional step transaction tests -- binding commitment, mutual interdependence or end result -- would "step" transactions together based on "reasonable anticipation" without, at a minimum, the presence of negotiations between the parties before the first transaction.[18]

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[18] The three versions of the step transaction doctrine include:

1. The Binding Commitment Test: Under this test, a transaction will be aggregated with other transactions if there is a binding commitment to do the other transactions. See Comm'r v. Gordon, 391 U.S. 83 (1968); J.E. Seagram v. Comm'r, 104 T.C. 75 (1995); Intermountain Lumber Co. v. Comm'r, 65 T.C. 1025 (1976).

2. The Mutual Interdependence Test: Under this test, courts consider whether steps are so independent that the legal relationships created by one transaction would be fruitless without the completion of the entire series of transactions. See Manhattan Bldg. Co. v. Comm'r, 27 T.C. 1032 (1957), acq. 1957-2 C.B. 5; American Bantam Car Co. v. Comm'r, 11 T.C. 397 (1948), aff'd per curiam, 177 F.2d 513 (3d Cir. 1949), cert. denied, 339 U.S. 920 (1950).

3. The End Result Test: Under this test, separate transactions are combined when it appears they were really component steps of a single transaction and that each of the steps was intended to be taken for the purpose of reaching a specific end result. See Kuper v. Comm'r, 533 F.2d 152 (5th Cir. 1976); King Enterprises, Inc. v. U.S., 418 F.2d 511 (Ct. Cl. 1969).

By amalgamating an acquisition and a spin-off simply because it is reasonably foreseeable that an acquisition by an unknown third party may occur within the two year period subsequent to the spin-off, the Proposed Regulations adopt an approach which is much more expansive than even the "end result" test, the most expansive interpretation of the step transaction doctrine. In the context of highly fluid public markets, the requirement to determine the likely reactions of others to the announcement of or consumption of a spin-off is inappropriate, and almost impossible to satisfy. Absent a strong indication of Congressional intent that such an expansive reading is compelled, we believe this interpretation is unwarranted.

Third, the Proposed Regulations set forth the "general rebuttal" and "alternative rebuttal" as the exclusive means for rebutting the statutory presumption of relatedness in the two-year period. Section 355(e) itself provides that it applies "unless it is established" that the acquisitions and dispositions were not part of a plan (or series of related transactions). It is appropriate for the Service to set out safe harbors that provide certainty of result for taxpayers and the Service alike. However, taxpayers not qualifying under the safe harbors should be able to establish that an acquisition is unrelated to the distribution under all of the facts and circumstances. As one commentator has put it, "[t]his result is almost compelled by the statutory language. It also makes sense because no set of specific rebuttals can possibly cover all cases. Moreover, no specific set of rules for acquisitions before and after a distribution can avoid the anomalies and inconsistencies [inherent in the rebuttals in the Proposed Regulations]."[19]

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19 Michael L. Schler, *What is a Plan (or Series of Related Transactions under Section 355(e)?*, Tax Notes, Vol. 85, #7 (11/15/99), and Vol. 85, #8 (11/22/99).

Fourth, the Proposed Regulations demand that each element of a rebuttal be established by clear and convincing evidence. This standard is too high, especially given the nature of what must be proved under the "reasonable anticipation" test contained in the Proposed Regulations.[20] In light of the realities of the marketplace, it will be virtually impossible for the taxpayer to meet its burden with any certainty in most cases. Taxpayers will, in effect, be seeking to prove retrospectively that an event that actually occurred was, in fact, not likely to occur as of the distribution date. Many of the key elements of the rebuttals will be difficult if not impossible to demonstrate with this level of certainty since it is difficult, if not impossible, to prove a "negative" (i.e., the absence of a plan) by clear and convincing evidence. Treasury seems to believe that it must require the taxpayer to establish the absence of a "plan (or series of related transactions)" by "clear and convincing evidence" a standard of proof that is greater than a preponderance of the evidence because of the existence of the statutory 4 year presumption. A substantial portion of the Committee believed that this standard was not necessary to enforce Congressional intent. However, a majority of the Committee believes that most of the objections to this standard can be overcome by making the kinds of changes to the rebuttals suggested below, so that taxpayers have access to meaningful bright-line tests, and by making it clear that the existence of a clear and convincing evidence standard will not preclude the IRS from issuing private letter rulings on these issues.

IV. Outline of Proposed Alternative Framework for Testing Post-Distribution Acquisitions[21]

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[20] Prop. Regs. §1.355-7(a)(2)(iii)(B).

[21] The Committees understand that these comments do not address a number of other issues under the proposed regulations, such as the per se rule for pre-distribution acquisitions where a person becomes a controlling

(footnote continued)

General Framework.

As described above, the definition of "plan (or series of related transactions)" implied by the Proposed Regulations is far too broad. The Committees' proposal, summarized below, addresses these problems with the Proposed Regulations discussed above. The proposal makes the business purpose for the distribution the key determinant of whether pursuant to a "plan or series of related transactions" one or more persons acquire a 50% or greater stake in the distributing or controlled corporation. Various factors would be considered relevant in making this determination. Although the likelihood that such an acquisition would occur potentially would be relevant, this factor would not be dispositive.

The proposal would provide a safe harbor for certain acquisitions that occur more than 6 months after the distribution and that are not pursuant to an agreement, understanding, or arrangement, or substantial negotiations entered into within this period. Acquisitions that are not covered by the safe harbor would be tested to determine if they are part of an integrated transaction including the distribution under a facts and circumstances test, taking into account certain enumerated factors. That is, the safe harbor would not be the exclusive means of rebutting the statutory presumption.

The safe harbor would largely be based upon the general post spin-off rebuttal except that it would not deny the benefits of the safe harbor to an acquisition merely because the principal purpose of the spin-off was to facilitate another unrelated acquisition. Under the safe harbor, any

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(footnote continued)

shareholder as a result of the acquisition or within two after the distribution. These issues will be the subject of a subsequent report.

acquisition occurring more than six months after a distribution would be considered to be unrelated to the distribution if (i) the acquisition was not made pursuant to an agreement, understanding, or arrangement entered into within the six-month period and there were no "substantial negotiations" before the spin-off or within the six-month period[22] and (ii) the taxpayer demonstrates that the distribution was motivated, in whole or substantial part, by a corporate business purpose other than a purpose to facilitate the acquisition by one or more persons of 50% or more of the stock of either the distributing or controlled. As with the general rebuttal of the Proposed Regulations, qualifying business purposes potentially would include distributions to enable the distributing or controlled corporation to borrow on more favorable terms, to produce administrative cost savings, or to improve the "fit and focus" of diverse business segments. Unlike the Proposed Regulations, an acquisition-oriented business purpose also would qualify if the taxpayer could demonstrate that the business purpose does not ultimately involve the acquisition by one or more persons of 50 percent or more of the distributing or controlled corporation that actually occurred. Thus, for example, a distribution intended to facilitate the issuance of 20 percent of the controlled corporation's stock to an employee stock ownership plan, or to the public in a public offering would qualify, provided that

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[22] A minority of the Committee was concerned with retaining the no "substantial negotiations" provision of the test. The concern is that this standard cannot be applied with any reasonable degree of certainty by the Service or by taxpayers. Innumerable questions arise under the substantial negotiations standard. What distinguishes discussions from negotiations? When do negotiations rise to the level of substantial? Where negotiations are broken off before the end of the six-month period, but resumed some time thereafter, are negotiations deemed to have commenced during the six-month period? If negotiations are commenced with one acquiror during the six-month period, but another acquiror ultimately succeeds in acquiring the distributing or controlled corporation, are negotiations considered to have commenced within the six-month period?

the taxpayer could show that additional issuances of 30 percent or more of such stock are not planned or intended.

Acquisitions not qualifying for the safe harbor that occur within two years (or thereafter pursuant to an agreement or understanding reached within six months) of the distribution would be subject to a facts and circumstances test. To avoid treating the acquisition as related to the distribution, we recommend that the taxpayer be required to show that the purpose and effect of the distribution, in whole or substantial part, was not to facilitate the acquisition. If the acquisition occurs more than two years after, and is not pursuant to an agreement or understanding reached within six months of, the distribution, the burden of proof would be shifted to the Service to demonstrate, by a preponderance of the evidence, that the purpose and effect of the distribution, in whole or in substantial part, was to facilitate the acquisition. Ordinarily, relatedness would not exist if there is no agreement, arrangement, or understanding concerning the acquisition prior to the close of the two-year period.

In order to provide guidance for both the Service and taxpayers in applying the facts and circumstances test, the Committee proposes that the regulations enumerate a non-exclusive list of factors that would be relevant in proving the above standard. These factors would include:

- Whether there were negotiations or discussions between the parties (or their agents) that occurred prior to, or within six months after, the distribution?
- Whether the distributing or controlled corporation (or their agents) initiated contact with the acquiror?

- Whether the distributing or controlled corporation, as a practical matter, had the ability to effectuate the acquisition unilaterally?

- Whether the particular acquisition was likely or unlikely at the time of the distribution?

- Whether there was an identifiable intermediate event between the distribution and the acquisition that made the acquisition more or less likely to occur?

- Whether the acquisition likely would have occurred in the absence of the distribution?

- Whether the acquisition involves the issuance of stock under a bona fide compensatory arrangement?

- Whether, in the case of a publicly traded corporation, public announcements or filings made in connection with the distribution contemplate the acquisition?

- Whether the allocation of debt in connection with the spin-off is designed to facilitate the financing plans of a subsequent acquiror or represents a reasonable allocation of overall corporate debt?

- Whether a transaction is ultimately contemplated but with a different purchaser after negotiations are terminated with a first potential buyer, or whether negotiations that had commenced prior to the distribution terminated and were reinstituted with the same potential buyer but on different terms?

V. Conclusion

We believe that our proposed framework for revising the Proposed Regulations would help to create workable standards. By providing a meaningful safe harbor, taxpayers will be better able to determine the tax consequences of the spin-off at the time of the spin-off and the marketplace will have greater certainty and stability.