Report No. 1370

New York State Bar Association Tax Section

Report on Temporary Regulations Dealing with "Predecessors" and "Successors" under Section 355(e)

June 1, 2017

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Report on Temporary and Proposed Regulations Dealing with "Predecessors" and "Successors" under Section 355(e)

This report of the New York State Bar Association Tax Section (this "**Report**")[1] provides comments on temporary and proposed regulations (collectively, the "**Temporary Regulations**") published by the U.S. Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**Service**") on December 19, 2016, that provide guidance regarding the treatment of predecessors and successors under Section 355(e) of the Internal Revenue Code of 1986, as amended (the "**Code**"), as well as guidance regarding the application of Section 355(f).[2] This Report is divided into four parts. Part I contains a brief introductory summary of Section 355(e) and the treatment of predecessors and successors under the Temporary Regulations and the proposed regulations they replace. Part II summarizes our recommendations with respect to the Temporary Regulations. Part III describes features of the Temporary Regulations pertinent to our recommendations, and Part IV discusses our recommendations.

[1] The principal author of this Report is Neil Barr, with substantial assistance from Patrick Sigmon and Caroline Dayton. Helpful comments were received from John Barrie, Patrick Cox, Jonathan Kushner, Benjamin Handler, Richard M. Nugent, Andrew Purcell, Michael Schler and Karen Sowell. 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.

[2] Guidance Under Section 355(e) Regarding Predecessors, Successors, and Limitation on Gain Recognition; Guidance Under Section 355(f), T.D. 9805, 81 Fed. Reg. 91,738 (Dec. 19, 2016); Guidance Regarding Predecessors and Successors Under Section 355(e); Limitation on Gain Recognition Guidance Under Section 355(f), REG-140328-15, 81 Fed. Reg. 91,888 (Dec. 19, 2016). Unless otherwise indicated, all references herein to "Section" or "§" refer to the Code, and references to the Treasury Regulations are to those in effect as of the date of this Report.

I. Introduction

Section 355(e) applies to distributions of the stock of a controlled subsidiary ("**Controlled**") otherwise intended to be tax-free under Section 355. Section 355(e) generally requires the distributing corporation ("**Distributing**") (but not its shareholders) to recognize gain with respect to the distribution if the distribution is a part of a plan (or series of related transactions) involving the acquisition of 50% or more of the stock (by vote or value) of either Distributing or Controlled (a "**Plan**").[3] Section 355(e)(4)(D) states that "any reference to a controlled corporation or a distributing corporation shall include a reference to any *predecessor* or *successor* of such corporation."[4] The terms "successor" and "predecessor" are not defined, and so are not statutorily limited to carryover basis transactions or transactions resulting in (or from) the transfer of substantially all the assets of a particular entity. Neither does the statute prescribe a scope for the application of the predecessors and successors concept by, for example, limiting its application to circumstances that might otherwise permit avoidance of Section 355(e).

[3] For purposes of the Temporary Regulations, a Plan refers to a plan within the meaning of Treasury Regulations Section 1.355-7, with certain modifications discussed below. *See* Treas. Reg. § 1.355-8T(a)(4)(ii). Where, in this Report, we refer to a "Plan" in the context of the application of the Temporary Regulations, we refer to a plan within the meaning of Treasury Regulations Section 1.355-7 as so modified, except as otherwise stated.

[4] § 355(e)(4)(D) (emphasis added). Additionally, Section 355(e) uses the term "successor" corporation two other times (in Section 355(e)(3)(A)(iii) and Section 355(e)(3)(B)). This provision does not appear to address any particular fact pattern considered by the drafters but is more in the nature of "boilerplate" that has been included in a number of modern Code provisions. *See, e.g.*, §§ 384(c)(7), 382(l)(8) and 4985(e)(2)(A). Similar provisions appear in several regulations. *See, e.g.*, Treas. Reg. §§ 1.367(e)-1(c)(3)(iv); 1.1275-6(g); 1.1502-1(f)(4).

On November 22, 2004, Treasury and the Service published proposed regulations under Section 355(e)(4)(D) (the "**2004 Proposed Regulations**").[5] The 2004 Proposed Regulations generally defined a predecessor as a corporation that transferred its property to Distributing in a "combining transfer" – *i.e.*, a transaction to which Section 381 applied – but only if the combining transfer was followed by a "separating transfer" – *i.e.*, (i) a division of the acquired property between Distributing and Controlled in which the basis of the property in the hands of Controlled was determined by reference to the basis of the property in the hands of Distributing or (ii) if the acquired property included stock of Controlled and less than all of the other acquired property was transferred to Controlled.[6] Under the 2004 Proposed Regulations, status as a predecessor of Distributing did not require that the initial transfer of the potential predecessor's property to Distributing (or the division of that property between Distributing and Controlled) be part of a Plan. As a result, the 2004 Proposed Regulations required Distributing to trace the assets of an acquired corporation indefinitely on the chance that the assets might later be separated in a distribution, even if the subsequent distribution did not occur as part of a Plan. The 2004 Proposed Regulations defined a successor as a corporation to which either Distributing or Controlled (or one of their respective successors) transferred its assets in a Section 381 transaction after the distribution.[7]

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[5] Guidance Regarding Predecessors and Successors Under Section 355(e); Limitation on Gain Recognition Under Section 355(e), REG-145535-02, 69 Fed. Reg. 67,873 (Nov. 22, 2004) [hereinafter 2004 Preamble], *withdrawn by* 81 Fed. Reg. 91,888 (Dec. 19, 2016).

[6] *See* 2004 Prop. Reg. § 1.355-8(b)(1).

[7] 2004 Prop. Reg. § 1.355-8(c).

The 2004 Proposed Regulations also included special rules intended to limit gain recognized by Distributing in the event that a 50% or greater interest in the stock of Distribution or a predecessor of Distributing (but not both) was acquired as part of a Plan.[8] The gain limitation rules of the 2004 Proposed Regulations applied to the acquisition of a 50% or greater interest in Distributing only if the acquisition occurred in the "combining transfer" (*i.e.*, a transaction with the predecessor of Distributing described in Section 381(a)).[9] In that scenario, instead of requiring Distributing to recognize all of the gain inherent in the shares of Controlled stock (the "**Statutory Recognition Amount**"), the 2004 Proposed Regulations (i) first determined the gain that would have been recognized by Distributing if it had (a) contributed only the historic assets of the predecessor to a newly formed hypothetical controlled corporation in a transaction governed by Section 351 and (b) then sold the stock of the hypothetical controlled corporation for cash and (ii) then limited Distributing's recognition of gain to that amount (if a 50% or greater interest in the predecessor was acquired) or the excess of the Statutory Recognition Amount over that amount (if a 50% or greater interest in Distributing was acquired).

We previously commented on the 2004 Proposed Regulations, generally endorsing the approach taken with respect to the definitions of predecessor and successor, but suggesting that the predecessor definition be revised to require that the initial "combining transfer" occur pursuant to a Plan.[10] We further suggested that the scope of

[8] 2004 Prop. Reg. § 1.355-8(e).

[9] 2004 Prop. Reg. § 1.355-8(e)(3).

[10] *See* NYSBA Tax Section, Report No. 1089 (June 23, 2005), *reprinted in* 2005 TNT 123-13 [hereinafter 2005 Report].

the definition of successor in the 2004 Proposed Regulations was appropriately limited to transferees in Section 381 transactions and argued against broadening that definition to include any transferee in a Section 351 or Section 721 transaction.[11] Finally, we also generally agreed with the policy underlying the 2004 Proposed Regulations' gain limitation rules, but suggested that the operation of the gain limitation rules be simplified.[12]

The Temporary Regulations retain the basic definition of successor from the 2004 Proposed Regulations,[13] but broaden the definition of a predecessor in some ways and narrow it in others. For example, in a departure from the 2004 Proposed Regulations, the "combining transfer" in which assets of a potential predecessor are transferred to Distributing is no longer limited to a transaction to which Section 381 applies. Instead, as discussed further below, a "Potential Predecessor" of Distributing may become a "Predecessor" of Distributing under the Temporary Regulations if (i) a direct or indirect interest in "Relevant Property" (very generally, any property of the Potential Predecessor) is transferred to Distributing, (ii) Distributing's basis in the stock of Controlled "reflects the basis" of that Relevant Property, (iii) gain is not recognized in full with respect to that Relevant Property and (iv) immediately after the distribution, Relevant Property is separated between Distributing or the Potential Predecessor, on the one hand, and Controlled, on the other.[14]

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[11] *Id.*

[12] *Id.*

[13] *See* Treas. Reg. § 1.355-8T(c)(2)(i).

[14] *See* Treas. Reg. § 1.355-8T(b)(1); 81 Fed. Reg. 91,738, 91,742 (Dec. 19, 2016) [hereinafter Preamble].

The Temporary Regulations very helpfully limit the scope of the predecessor definition by explicitly requiring the "combining transfer" to occur pursuant to a Plan.[15] In that regard, the Temporary Regulations also modify the application of Treasury Regulations Section 1.355-7 in determining whether a Plan exists with respect to an acquisition of a 50% or greater interest in a Potential Predecessor. For example, the Temporary Regulations generally look only to actions taken by Distributing and certain of its agents or affiliates in determining whether a distribution is made pursuant to a Plan that includes an acquisition of a Potential Predecessor, although actions taken by the Potential Predecessor (or certain of its agents or affiliates) with the implicit permission of Distributing are also taken into account for this purpose.[16]

The Temporary Regulations also include generally technical revisions to the special gain limitation rules from the 2004 Proposed Regulations, although they preserve the 2004 Proposed Regulations' application of those rules to an acquisition of a 50% or greater interest in Distributing only where the acquisition occurs in a Section 381 transaction with a Predecessor.[17] Rather than employing the construct from the 2004 Proposed Regulations of a hypothetical Section 351 transaction and subsequent hypothetical sale, the Temporary Regulations assume a hypothetical Section 368(a)(1)(D) reorganization into a newly formed hypothetical controlled corporation followed by a hypothetical distribution to which Section 355(e) applies, but the operation of the gain limitation rules under the Temporary Regulations is otherwise generally consistent with

[15] *See* Treas. Reg. § 1.355-8T(b)(2)(iv).

[16] *See* Treas. Reg. § 1.355-8T(a)(4)(ii)-(iii).

[17] *See* Preamble, *supra* note 14, at 91,745; Treas. Reg. § 1.355-8T(e)(3).

those in the 2004 Proposed Regulations.[18] The Temporary Regulations also include rules to prevent Section 355(f) and Section 355(e)(2)(C) from overriding the benefit of these gain limitation rules. Although generally not addressed in this Report, we agree that this approach is appropriate.

Further, the Temporary Regulations provide that an election may be made with respect to Controlled under Section 336, but only if Distributing recognizes the full Statutory Recognition Amount under Section 355(e).[19] Because the Section 336(e) election regulations post-date the 2004 Proposed Regulations,[20] the 2004 Proposed Regulations did not address the availability of a Section 336 election.

II. Summary of Comments

The Temporary Regulations reflect thoughtful consideration of taxpayer comments to the 2004 Proposed Regulations and address important questions unanswered by the 2004 Proposed Regulations. However, in many respects the Temporary Regulations also reflect a significant departure from the approach taken in the 2004 Proposed Regulations, and further clarification of the scope of transactions potentially subject to the new rules is needed. Our recommendations generally reflect this need.

Viewed purely as a matter of Section 355(e) policy, we agree that limiting the definition of a predecessor to include only transferors in transactions to which Section 381 applies may not capture all of the transactions that might run afoul of the policy goals underlying Section 355(e). However, we are concerned that the approach taken by the

[18] *See* Treas. Reg. § 1.355-8T(e)(1)-(4).

[19] *See* Treas. Reg. § 1.355-8T(e)(5).

[20] *See* Regulations Enabling Elections for Certain Transactions Under Section 336(e), T.D. 9619, 78 Fed. Reg. 28,467, 28,467 (May 15, 2013).

Temporary Regulations is too broad and that its scope is, in any event, unclear. Thus, we suggest that substantive and clarifying changes, conceptual and technical, be made to the Temporary Regulations.

Moreover, we agree with the Temporary Regulations' general approach to integrating the Plan concept into the predecessor definition. Embedding the requirement of a Plan into the definition of a predecessor greatly reduces the administrative burden that would have been faced by taxpayers under the 2004 Proposed Regulations. However, we suggest that the "implicit permission" concept (used in the Temporary Regulations in determining the existence of a Plan) be removed or, at the very least, clarified, because in the particular context of the Temporary Regulations, we are concerned that the concept of "implicit permission" might otherwise result in a *per se* imputation of a Potential Predecessor's prior activities to Distributing.

As discussed in our previous report on the 2004 Proposed Regulations (the "**2005 Report**"), the asset-focused approach taken in both the 2004 Proposed Regulations and the Temporary Regulations, if expanded to its logical limits, could have important implications for the application of Section 355(e) to partnership transactions, as well as other transactional patterns that involve changes in the indirect ownership of assets without any actual acquisition of stock of Controlled or Distributing.[21] For the reasons discussed in the 2005 Report, we reiterate our recommendation that the approach to defining successors in the Temporary Regulations not be expanded to apply generally any time assets of Distributing or Controlled are transferred with a carryover basis to a corporation or partnership.

[21] *See* 2005 Report, *supra* note 10.

The Temporary Regulations do not apply the special gain limitation rules in the case of an acquisition of a 50% or greater interest in Distributing unless the acquisition occurs in a Section 381 transaction with a Predecessor of Distributing. It is unclear why this restriction on the scope of application of the special gain limitation rules was included in the 2004 Proposed Regulations or perpetuated in the Temporary Regulations. We do not believe it is appropriate so to limit the application of these rules, and we suggest that the Temporary Regulations be modified to provide that the gain limitation rules apply in the case of a 50% or greater acquisition of Distributing, regardless of how the acquisition was effected.

The Temporary Regulations provide that Distributing may make a Section 336(e) election in respect of a distribution to which the Temporary Regulations apply, provided that Distributing is required to recognize the full statutory gain amount in the distribution. We believe that limiting the availability of the election to transactions in which the statutory gain amount is recognized is inequitable as a policy matter and unnecessary as an administrative matter, especially considering that application of the gain limitation rules in the Temporary Regulations already require Distributing to trace, and value, its historic asset and those of a potential predecessor separately.

We also suggest a number of miscellaneous technical changes to the Temporary Regulations, including (i) clarifying that the examples included in the Temporary Regulations do not have broader implications for the application of the step-transaction doctrine and (ii) modifying certain rules for determining when stock of a predecessor is deemed to have been acquired.

Finally, transition relief under the Temporary Regulations is drafted narrowly, and we believe it unlikely to be available to many taxpayers that may be far along in preparations for a distribution that would otherwise be subject to the rules of the Temporary Regulations. In light of the sharp departure in certain respects from the 2004 Proposed Regulations and the issues of clarity and scope described elsewhere in this Report, we question whether such narrow relief is appropriate.

III. Discussion of Temporary Regulations

A. General Approach to Predecessors

As discussed in Part I, under the 2004 Proposed Regulations, a predecessor was defined as a corporation that transferred property to Distributing in a transaction to which Section 381 applied if either (1) Distributing transferred some, but not all, of the acquired assets to Controlled or (2) the acquired assets include stock of Controlled and Distributing did not transfer all of the acquired assets other than the Controlled stock to Controlled.[22] The Temporary Regulations abandon the bright line Section 381 requirement of the 2004 Proposed Regulations in defining predecessors of Distributing. Instead, the Temporary Regulations have introduced a more conceptual approach that encompasses not only Section 381 transactions but also any other carryover-basis transfer of assets to Distributing. The Preamble indicates that this shift in approach is intended to cause Section 355(e) to apply "in cases in which, as part of a Plan, a tax-free division of the ownership of the [predecessor of Distributing]'s assets would otherwise be achieved through the use of a section 355 distribution."[23]

[22] 2004 Proposed Regulations § 1.355-8(b).

[23] Preamble, *supra* note 14, at 91,742.

B. Definition of Predecessor in the Temporary Regulations

The operation of the Temporary Regulations starts with identifying corporations that may be"Potential Predecessors" of Distributing. Any corporation (other than Distributing or Controlled) can be a "Potential Predecessor" of Distributing.[24] In general, a Potential Predecessor then becomes a "Predecessor" of Distributing if certain pre-distribution and post-distribution requirements are met.[25] The pre-distribution requirements comprise both a "Relevant Property" requirement and a "reflection of basis" requirement.[26] The Relevant Property requirement operates to identify the property that the Temporary Regulations seek to track as potentially subject to tax under Section 355(e). The requirement is met if, before the distribution and as a part of a Plan, (i) Distributing acquires Controlled stock in exchange for a direct or indirect interest in Relevant Property held, directly or indirectly, by Controlled immediately before the distribution, the gain on which is not fully recognized as part of the Plan, or (ii) any Controlled stock distributed as a part of the Plan is Relevant Property and the full amount of gain in that Controlled stock is not recognized as part of the Plan.[27] The "reflection of basis" pre-distribution requirement is satisfied if any Controlled stock distributed in the

[24] *See* Treas. Reg. § 1.355-8T(b)(2)(ii).

[25] The Temporary Regulations also employ the concept of a "Predecessor of Controlled" for limited purposes. *See* Treas. Reg. § 1.355-8T(c)(1). As used in this Report, "Predecessor" refers to a Predecessor of Distributing.

[26] *See* Treas. Reg. § 1.355-8T(b)(1)(ii). "Relevant Property" generally is property that is held directly, or indirectly, by the Potential Predecessor during the "Plan Period." Treas. Reg. § 1.355-8T(b)(2)(iv)(A). For this purpose, the "Plan Period" is "the period that ends immediately after the distribution and begins on the earliest date on which any pre-distribution step that is part of the Plan is agreed to or understood, arranged, or substantially negotiated by one or more officers of directors acting on behalf of Distributing or Controlled, by controlling shareholders of Distributing or Controlled, or by another person or persons with the implicit or explicit permission of one or more of such officers, directors or controlling shareholders." Treas. Reg. § 1.355-8T(a)(4)(iii).

[27] *See* Treas. Reg. § 1.355-8T(b)(1)(ii)(A).

distribution reflects the basis of any item of "Separated Property."[28] In general, "Separated Property" means Relevant Property that is (i) Controlled stock or (ii) contributed to Controlled as a part of the Plan and held by Controlled prior to the distribution, in each case if gain thereon is not recognized in full as part of the Plan.[29] To satisfy the post-distribution requirements, ownership of the Relevant Property must have been divided between Controlled, on the one hand, and Distributing or the Potential Predecessor, on the other.[30]

C. Plan Definition

The Temporary Regulations provide that references to a "Plan" generally are references to a plan within the meaning of Treasury Regulations Section 1.355-7.[31] For this purpose, (i) references to a distribution in Treasury Regulations Section 1.355-7 include a reference to a distribution and other related pre-distribution transactions that together effect a division of the assets of a Predecessor and (ii) references to Distributing generally include references to a Predecessor.[32] However, with respect to any "Planned 50-percent Acquisition"[33] of a Predecessor, actions of officers or directors, or controlling shareholders, of a Predecessor (or any person acting with the implicit or explicit consent of one of those parties) are not taken into account in determining the existence of any

[28] *See* Treas. Reg. § 1.355-8T(b)(1)(ii)(B).

[29] *See* Treas. Reg. § 1.355-8T(b)(2)(vii).

[30] *See* Treas. Reg. § 1.355-8T(b)(1)(iii).

[31] *See* Treas. Reg. § 1.355-8T(a)(4)(ii).

[32] *Id.*

[33] The Temporary Regulations define a "Planned 50-percent Acquisition" of a corporation to be an acquisition by one or more persons, as part of a Plan, of stock that in the aggregate represents a 50% or greater interest in the corporation. *See* Treas. Reg. § 1.355-8T(a)(1).

agreement, understanding, arrangement or substantial negotiations with regard to the acquisition of stock of the Predecessor, *unless* any such person, *inter alia*, also acts with the implicit permission of officers or directors, or controlling shareholders, of Distributing.[34] This limitation reflects the sensible design choice that "it is not appropriate to apply the rules of §1.355-7 by imputing to Distributing the actions of a [Predecessor of Distributing] or its shareholders."[35]

D. General Approach to Successors

The 2004 Proposed Regulations defined a successor of Distributing or Controlled as a corporation to which Distributing or Controlled, respectively, transferred its assets in a Section 381 transaction after the distribution.[36] The Temporary Regulations retain this definition of a successor.[37] In response to comments made with respect to the 2004 Proposed Regulations, the Preamble notes that the IRS and Treasury continue to study whether a transferee in a Section 351 or Section 721 transaction should result in successor treatment. However, unless further guidance is issued, the concept of a successor remains limited as described above.

IV. Recommendations

A. Definition of Predecessor

For the reasons discussed below, while we generally agree that some transfers to Distributing not described in Section 381 might implicate the policy concerns underlying

[34] *See* Treas. Reg. § 1.355-8T(a)(4)(ii).

[35] Preamble, *supra* note 14, at 91,742.

[36] 2004 Proposed Regulations § 1.355-8(c)(1).

[37] *See* Treas. Reg. § 1.355-8T(c)(2)(i).

Section 355(e), we question whether the scope of the predecessor definition in the Temporary Regulations might nonetheless be too broad, and suggest limiting its application to instances in which Distributing and a Potential Predecessor become members of the same affiliated group pursuant to the Plan. In addition, we believe the Temporary Regulations will leave taxpayers uncertain as to whether certain other types of transactions implicate the Temporary Regulations. We therefore recommend that Treasury and the Service provide additional guidance, particularly as to the meaning of the "reflection of basis" requirement under the Temporary Regulations.

1. *Conceptual Breadth and Meaning of Reflection of Basis*

As noted in Part III.A, Treasury and the Service indicated in the Preamble that the goal of the Temporary Regulations is to apply Section 355(e) "in cases in which, as part of a Plan, a tax-free division of the ownership of the [Predecessor's] assets would otherwise be achieved through the use of a section 355 distribution."[38] While we generally agree that this goal is sensible as a policy matter, and that limiting the definition of Predecessor by reference to transfers described in Section 381 could be under-inclusive, we question the premise that a tax-deferred transfer of Relevant Property to Distributing and subsequent tax-free distribution of a Controlled that holds less than all of the Potential Predecessor's Relevant Property implicates this goal in all cases.

In the Preamble, Treasury and the Service offer the following example as justification for broadening the definition of Predecessor in the Temporary Regulations: Corporation D2, which owns 100% of both classes (voting class A and voting Class B) of corporation D1's stock, and D1 owns all of the stock of corporation C. As part of a Plan,

[38] Preamble, *supra* note 14, at 91,742.

D2 acquires all of the stock of an unrelated corporation P in exchange for 10% of D2's only class of outstanding voting stock in a reorganization described in Section 368(a)(1)(B). After joining the D2 group, P transfers assets to D1 for less than 20% of D1's voting class A stock in a Section 351 exchange by application of Treasury Regulations Section 1.1502-34. D1 then transfers the asset to C and distributes to D2 all of the C stock with respect to its voting class B stock in a transaction qualifying under Section 355(a). D2 in turn distributes all of the C stock to its shareholders in a transaction qualifying under Section 355(a).[39] Because none of these transactions is described in Section 381, P would not have been a predecessor of D2 under the 2004 Proposed Regulations.

In the absence of further facts, it is not clear to us that the series of transactions described above implicates the concerns purporting to justify the more expansive scope of the Temporary regulations. Assuming all relevant transactions are effected as value-for-value exchanges, the value of P's voting class A stock would not be diminished by the combination of P's contribution of assets to D1 or D1's distribution of the stock of C in respect of D1's voting class B stock. The stock of D1 serves as a successor asset with respect to which all of the gain inherent in the assets contributed to C remains preserved for future recognition by the D2 group. It therefore might be argued that, while the separation of P's assets in this example might be tax-deferred, contrary to the prototypical transaction governed by Section 355(e), corporate-level tax is not avoided.

However, because P has become a member of D2's affiliated group (determined without regard to Section 1504(b), an "**Expanded Group**"), and the preservation (in P's

[39] Preamble, *supra* note 14, at 91,741, 91,742.

D1 stock) of P's built-in gain in its separated assets may be eliminated through subsequent restructuring transactions, we support expanding the scope of the 2004 Proposed Regulations, as the Temporary Regulations do, to cover this transaction. Even in the absence of the potential for a subsequent restructuring transaction to eliminate P's built-in gain, the D2 group, as a result of acquiring P, might benefit from a net decrease in unrealized gain in connection with a Section 355 transaction that is greater than that which it could have achieved if D1 had distributed only its historic assets.[40] Although there is some question whether the Temporary Regulations are the appropriate regime by which to police the latter issue,[41] on balance, we are inclined to view it as implicating the policies underlying Section 355(e).

While we generally understand the concerns motivating the more expansive scope of the Temporary Regulations where a Potential Predecessor joins an Expanded Group as a part of a Plan, we do not believe that the same concerns are implicated to the same extent by circumstances in which a Potential Predecessor does not become a member (or

[40] For example, suppose D2 has stock in D1 with $40x basis and $200x value, D1 has assets with $0x basis and $200x value and P has Asset A with $0x basis and $50x value. Assume further that P contributes Asset A to D1 in exchange for D1 stock. Further assume that D1 contributes Asset A and Asset B, which has $0x basis and $100x value, to newly formed C and distributes the stock of C to D2 in redemption of 75% of D2's stock in D1. D2 then distributes the stock of C to D2's shareholders. Immediately after the transactions, D2's remaining stock in D1 has $10x basis and $50x value, P's stock in D1 has $0x basis and $50x value and D1's remaining assets have $0x basis and $100x value. If, however, P had not contributed Asset A to D1, but D1 had instead contributed only Asset B to C, P would have retained Asset A with $0x basis and $50x value, D2 would have retained stock in D1 with $20x basis and $100x value and D1 would have retained assets with $0x basis and $100x value.

We note, however, that this result depends on the relationship between (i) the outside basis of D2 in its class A stock of D1 and (ii) D1's tax basis in its historic assets, rather than on the amount of built-in gain in the historic assets of P.

[41] Because this phenomenon may arise in any "internal" distribution, without regard to whether Distributing or a Potential Predecessor experiences an ownership change in connection with such distribution or, indeed, to whether any assets held by Controlled originated outside of Distributing's Expanded Group, it could be argued that the fact pattern, to the extent viewed as a questionable policy outcome, is better considered within the more general framework of *General Utilities* repeal and addressed, if at all, in regulations under Section 337(d) or Section 358(g).

a Section 381 predecessor of a member) of an Expanded Group of which Distributing is also a member. Specifically, we believe that there is little opportunity for subsequent elimination of the built-in gain in the Potential Predecessor's interest in stock received in exchange for assets ultimately held by Controlled outside of the Expanded Group setting. Moreover, even if one believed that the Temporary Regulations were the appropriate regime to address the ability to increase the value of Controlled, and thus reduce the amount of built-in gain of the Expanded Group of which Distributing is a member upon an internal distribution, we believe that it would be a difficult line drawing exercise outside of the setting in which a Potential Predecessor joins the Expanded Group.

Example 5 of the Temporary Regulations involves this kind of fact pattern. In Example 5, X owns 100% of the stock of P, which holds multiple assets and Y owns 100% of the stock of D. P contributes Asset 1 and Asset 2 to D, and Y contributes property to D in an exchange qualifying under Section 351. D contributes Asset 1 to C in an exchange qualifying as a reorganization under Section 368(a)(1)(D) and then distributes the stock of C to P and Y pro rata. Z then acquires 51% of the P stock. The example states that P is a predecessor of D because (i) immediately before the distribution, C holds Relevant Property (Asset 1), the gain on which was not recognized in full as part of the Plan, (ii) the C stock distributed was acquired by D in exchange for Relevant Property and the basis of the C stock reflects the basis of Separated Property (Asset 1), and (iii) immediately after the distribution, P and D each hold Relevant Property.[42]

[42] Treas. Reg. § 1.355-8T(h), Example 5.

As noted above, it is not clear that this transaction implicates the same concerns as the one discussed by Treasury and the Service in the Preamble and analyzed in the preceding paragraphs of this Report. P's gain in its contributed assets is preserved in P's D stock, and, at least on the face of the example, after the transaction there is no 80% control relationship that easily facilitates the elimination of the built-in gain through subsequent restructuring transactions, as discussed above. Moreover, because there is no "internal" distribution, the concerns regarding incremental decreases in net unrealized gain potentially present in the Expanded Group setting do not arise. Thus, Example 5 is an extremely questionable fact pattern on which to impose a Predecessor construct. Consistent with that observation, we recommend that in Example 5, in which P does not join the Expanded Group, there should be no Predecessor status.[43]

In addition to the more basic question regarding whether it is appropriate for the Temporary Regulations to apply to the transactions described in Example 5, we also note that, because of the numerous transactions involved in the example, it is unclear which transactions are most relevant in determining that P is a predecessor of D. Is the relevant division of P's assets the one between D and C, the one between P and D, the one between P and C, or some combination of the foregoing? We would therefore recommend that Treasury and the Service further clarify the intended scope of the

[43] Indeed, the facts described in Example 5 are not the most troubling fact pattern in which a Potential Predecessor does not join the Expanded Group but yet may become a Predecessor under the Temporary Regulations. Consider, for example, an upper-tier corporation holding only a minority interest in a lower-tier corporation that transfers a portion of its assets to Controlled but that does not join the Distributing Expanded Group. Theoretically, the upper-tier corporation might become a Predecessor under the Temporary Regulations because some, but not all, of its (indirect) assets have been transferred to Distributing and subsequently contributed to Controlled. *See* Jasper L. Cummings, Jr., *Spinoff Predecessors and Successors: Not What You Think*, 2017 TNT 78-7 (Apr. 25, 2017).

Temporary Regulations, through both additional exposition in the operative provisions of the regulations and more explicit indications of the dispositive facts in the examples.

Another foundational concept of the Temporary Regulations requiring additional clarification is "reflection of basis." The Temporary Regulations themselves provide limited guidance as to the meaning of the concept outside of (i) transactions that would have implicated the 2004 Proposed Regulations (*i.e.*, Section 381 transactions)[44] and (ii) direct non-recognition transfers of Relevant Property to Distributing.[45] The Preamble further suggests that reflection of basis "ensures that there is a connection between the gain in the property of a [Predecessor] and the gain that would be included under an application of section 355(e) and these temporary regulations,"[46] but it is unclear whether this concept is merely intended to supplement another prong of the Temporary Regulations' definition of Predecessor (*i.e.*, that gain on Transferred Property not be fully recognized pursuant to the Plan) or serves an independent policy objective. If the concept is intended to serve an independent policy objective, for the reasons discussed in the following paragraphs, we nonetheless believe that the appropriate scope of the "reflection of basis" concept encompasses only situations in which built-in gain, present in an asset of a Potential Predecessor at the time the asset is transferred (directly or indirectly) to Distributing, is preserved in the stock of Controlled (and then only to that extent).

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[44] *See* Treas. Reg. § 1.355-8T(h), Examples 1-4, 6-7 and 9. Indeed, the only generic exposition of the reflection of basis concept is in Temporary Regulations Section 1.355-8T(b)(2)(x), which states that, for certain purposes, "Distributing is treated as acquiring Controlled stock in exchange for a direct or indirect interest in Relevant Property if the basis of Distributing in that Controlled stock reflects the basis of the Relevant Property in whole or in part."

[45] *See* Treas. Reg. § 1.355-8T(h), Examples 5 and 8.

[46] Preamble, *supra* note 14, at 91,743.

For instance, the Temporary Regulations clearly contemplate that an indirect transfer of Relevant Property to Distributing can cause a Potential Predecessor to become a Predecessor,[47] but only if Controlled stock is, or otherwise reflects the basis of, the Relevant Property.[48] However, it is far from clear that the mere existence of some "connection" between the basis of the Relevant Property and Distributing's Controlled stock is sufficient to justify bringing a series of transactions that includes an indirect transfer (and otherwise satisfies the technical requirements of the Temporary Regulations) within the scope of the Temporary Regulations. Thus, general guidance is needed to explain what it means for Controlled stock to reflect the basis of Relevant Property.[49]

In particular, absent further guidance, it is unclear how the Temporary Regulations may (or are intended to) apply in the context of a series of transactions (i) one or more of which is governed by Section 351 or Section 721, but (ii) none of which involves a direct transfer of property to Distributing. For example, assume that unrelated P and D form new corporation X in a Section 351 transaction. P contributes Asset 1 and D contributes other property. In the transaction, D receives X stock

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[47] *See, e.g.*, Treas. Reg. § 1.355-8T(b)(2)(iv) (definition of Relevant Property).

[48] Treas. Reg. § 1.355-8T(b)(1)(ii)(B).

[49] In other contexts, Treasury and the Service have used phrases similar to the Temporary Regulations' "reflects the basis of" construct. *See* Treas. Reg. § 1.1502-20(c)(1)(iii) (1994) (stating that "an amount is reflected in the basis of a share if the share's basis would have been different without the amount"); Guidance Under Section 1502; Suspension of Losses on Certain Stock Dispositions, T.D. 9048, 68 Fed. Reg. 12,287 (Mar. 14, 2003) (in discussing "another asset that reflects the basis of stock," referring to an asset the basis of which "was determined, directly or indirectly, in whole in part, by reference to the basis of [such] stock"). In considering the applicability of these prior examples in the context of the Temporary Regulations, Treasury and the Service should give due regard to the idea that the mere fact that Distributing's basis in Controlled stock differs from what it might have been *in the absence of the recognition of income or gain in respect of Relevant Property held by Controlled* should not be deemed to create a "reflection" of the basis of the Relevant Property in the Controlled stock.

satisfying the requirements of Section 1504(a). D later contributes the X stock and other property to corporation C in a reorganization under Section 368(a)(1)(D) and distributes the C stock in a transaction intended to be governed by Section 355(a). At the time of the distribution, D's basis in the C stock attributable to the X stock reflects investment adjustments made pursuant to Treasury Regulations Section 1.1502-32 and attributable to items (assume for example rental or other periodic income) related to Asset 1 (and therefore differs from D's basis in the X stock as measured immediately after D's contribution to X). In determining whether P is a predecessor of D, and assuming the existence of a Plan, immediately before the distribution C indirectly holds Relevant Property (Asset 1) through its ownership of X, the gain on which was not recognized in full. In addition, the C stock distributed by D was acquired by D in exchange for an indirect interest in Relevant Property.

Under the Temporary Regulations, should D's basis in the distributed C stock be considered to reflect the basis of the Separated Property (Asset 1) by reason of investment adjustments? In our view, the coincidental fact that the X stock is the stock of a member of the D consolidated group and thus is allocated investment adjustments under the consolidated return regulations ought not to be a relevant fact in applying the Temporary Regulations. We accordingly recommend that the final regulations clarify that this fact pattern does not implicate the regime.

A similar question arises with respect to partnership transactions. For instance, consider the result if, in the preceding example, X were a partnership rather than a corporation. In that case, if Asset 1 were a depreciable asset, D's basis in its partnership interest would not seem initially to reflect the basis of Asset 1 (as it bears no relation to

either X's or P's basis in Asset 1), but D might be allocated partnership tax items under Section 704(c) (*e.g.*, under the "remedial method") that result in adjustments to the basis of D in its partnership interest that bear a direct connection to P's pre-contribution basis in Asset 1. Similarly, if Asset 1 was not a depreciable asset and was contributed to X with a full fair market value basis, D might be allocated taxable income, gain or loss derived from Asset 1 under Section 704(b), and these items could be measured by reference to Asset 1's basis in P's hands, which would affect D's basis in its partnership interest. In either case, should stock in C be considered to reflect the basis of Asset 1? For the reasons noted above, we believe that the final regulations should confirm that the stock of Controlled does not reflect the basis in Asset 1 merely by reason of partnership allocations in the fact patterns described.

For the foregoing reasons, finalizing the provisions of the Temporary Regulations in their current form would create an undesirable level of uncertainty for taxpayers regarding the intended scope of the Temporary Regulations.

2. *Other Clarifications*

In addition to the broader conceptual matter discussed in the preceding Subpart, we recommend several more technical revisions to the Temporary Regulations' Predecessor definition. These revisions are necessary to ensure that certain transactions, which we believe were not intended to be implicated by the Temporary Regulations, are in fact not implicated.

As discussed in Part III.B, Relevant Property includes any property held by a Potential Predecessor during the Plan Period.[50] It is not clear that this is appropriate in all

[50] *See supra* note 26.

cases. For example, we believe that the Final Regulations should make clear that after-acquired property of a Potential Predecessor is not Relevant Property if it was not acquired pursuant to a Plan. For example, if a Potential Predecessor (i) becomes a member of the Distributing consolidated group pursuant to a Plan and, (ii) later (but prior to a distribution), acquires additional property from other members of the group (*e.g.*, property that was *not* transferred directly or indirectly to Distributing pursuant to a Plan), that additional property should not be treated as Relevant Property. We think the Final Regulations should be modified to clarify that property of this type is not Relevant Property.

In addition, we believe the Temporary Regulations should be revised to clarify that fluctuations in the value of Relevant Property that occur after a transaction that constitutes part of a Plan and in which gain with respect to the Relevant Property is recognized in full will not be taken into account in determining whether gain on the Relevant Property was recognized in full pursuant to the Plan. Although we believe this is the better reading of the Temporary Regulations, because a taxpayer did, in fact, recognize the full amount of gain present in the Relevant Property at the time of the gain recognition transaction, the definition of Predecessor does not specify either (i) the gain that must be recognized in full to prevent Relevant Property from being Separated Property or (ii) which taxpayer must recognize the gain. With respect to the former, for example, suppose that D purchases Asset 1 from unrelated P for cash, but that Asset 1 appreciates in value during the Plan Period. With respect to the latter, suppose that S, a consolidated subsidiary of D, acquires the assets of P in a reorganization described in Section 368(a)(1)(C) and immediately sells Asset 1 to C in a transaction governed by

Treasury Regulations Section 1.1502-13 so that, on D's later distribution of C stock, deferred intercompany gain on the sale is taken into account by S, but that Asset 1 appreciates in value after the sale and prior to the later distribution.[51] In either case, Section 355(e) should not apply merely because of the interim appreciation of Asset 1, and the Temporary Regulations should be clarified in this regard.

B. "Implicit Permission" in Definition of Plan and Plan Period

As noted above, the Temporary Regulations define the terms Plan and Plan Period by modifying the meaning of the word "plan" as used in Treasury Regulations Section 1.355-7.[52] In particular, although the Temporary Regulations restrict the extent to which Potential Predecessor actions are considered in determining the existence of a Plan or the term of the Plan Period, they do contemplate that actions of a Potential Predecessor (through certain of its agents) and its controlling shareholders may be taken into account for those purposes if taken with the "implicit permission" of Distributing (through certain of its agents) or Distributing's controlling shareholders.[53] Neither the Temporary Regulations nor Treasury Regulations Section 1.355-7 define (or otherwise expand on the meaning of) the phrase "implicit permission." In the Preamble, Treasury and the Service suggest that, in order to be treated as having granted such "implicit" permission, the relevant Distributing-related party would, at a minimum, need to have knowledge of a

[51] This example also suggests a need for explicit coordinating rules with respect to the operation of the gain limitation rules of the Temporary Regulations and the rules applicable to gain recognized, but not immediately taken into account, under Treasury Regulations Section 1.1502-13.

[52] *See supra* notes 31-34 and accompanying text.

[53] *See* Treas. Reg. § 1.355-8T(a)(4)(ii)-(iii).

potential Planned 50-percent Acquisition of a Potential Predecessor.[54] In light of the fact that, unlike the general rules applicable to plan determinations under Treasury Regulations Section 1.355-7, the Temporary Regulations assume an actual, completed transaction (*i.e.*, a direct or indirect transfer of Relevant Property) between Distributing and a Potential Predecessor, we are concerned that the concept of implicit permission may be read too broadly, notwithstanding the helpful explanation in the Preamble. For example, if Distributing is merely aware of a fact at the time it acquires the Potential Predecessor, would Distributing's subsequent acquisition of the Potential Predecessor be sufficient to be viewed as having conferred implicit permission on the Potential Predecessor? We believe that the scope of this concept is potentially far-reaching and extremely difficult to administer in practice and thus warrants either narrowing or further elaboration.[55]

C. Successors

As noted above, we previously commented that the definition of a successor was appropriately limited in the 2004 Proposed Regulations,[56] and we reiterate here that the Temporary Regulations should not extend the definition of a successor to beyond the limited situations identified in the Temporary Regulations.

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[54] *See* Preamble, *supra* note 14, at 91,742.

[55] For instance, guidance could be included in Example 6 of the Temporary Regulations, which involves a forward triangular merger of a subsidiary of a Predecessor of Distributing into Controlled, followed by an acquisition of the Predecessor of Distributing, all of which is stated to have occurred pursuant to a Plan. Treas. Reg. § 1.355-8T(h), Example 6. The example could be revised to include facts indicating the implicit consent of Distributing.

[56] *See* 2005 NYSBA Report at 20 ("We believe that the Proposed Regulations appropriately limit the reach of the successor concept. As discussed below, we would recommend that this approach not be expanded to track ownership changes in every case in which Distributing or Controlled contributes assets downstream, notwithstanding the possibility that a third party might thereby acquire a 50% or greater interest in those assets.").

D. Scope of Gain Limitation Rules

As noted above, the Temporary Regulations retain many features of the special gain limitation rules included in the 2004 Proposed Regulations, including that the gain limitation rule with respect to the acquisition of a 50% or greater interest in Distributing applies only if the acquisition occurs in a transaction with a Predecessor described in Section 381(a).[57] It is unclear why the scope of this rule was so limited in the 2004 Proposed Regulations or why Treasury and the Service retained this limitation in the Temporary Regulations. Indeed, the scope of the gain limitation rule applicable to the acquisition of a 50% or greater interest in a Predecessor was not so limited in the 2004 Proposed Regulations and is not so limited in the Temporary Regulations,[58] and neither the 2004 Preamble nor the Preamble provides any discussion of the rationale for this distinction.[59] We do not believe that there is a justification for this distinction, particularly in light of the Temporary Regulations' expansion of the scope of the predecessor concept (so that a Potential Predecessor may become a Predecessor and acquire a greater than 50% interest in Distributing, all by virtue of a transaction that is *not* described in Section 381).[60] Thus, we recommend that the scope of the special gain

[57] *See* Treas. Reg. § 1.355-8T(e)(3); 2004 Prop. Reg. § 1.355-8(e)(3).

[58] *See* Treas. Reg. § 1.355-8T(e)(2); 2004 Prop. Reg. § 1.355-8(e)(2).

[59] In fact, the 2004 Preamble's discussion of the underlying rationale for the special gain limitation rules seems to us equally applicable to an acquisition of Distributing stock that is not made as part of a Section 381 transaction. *See* 2004 Preamble, *supra* note 5, at 67,875 ("Similarly, if a distribution and acquisitions of stock of that in the aggregate represent a 50-percent or greater interest in Distributing are part of a plan . . . , and if the excess of the gain inherent in the Controlled stock . . . over the gain attributable to the assets of the predecessor is small relative to the full amount of gain . . ., it may seem inappropriate to require that Distributing recognize the full amount of gain . . . .").

[60] For the avoidance of doubt, though the exclusion of transactions described in Section 351 is particularly troubling, we do not believe that the form of the transaction in which a 50% or greater interest in Distributing is acquired should be relevant to the application of the gain limitation rules.

limitation rules included in the Temporary Regulations be expanded to include any transaction in which a 50% or greater interest in Distributing is acquired.[61]

E. Section 336(e) Election

Section 336(e) permits a domestic corporation that owns stock of another corporation to elect to treat, *inter alia*, a distribution of stock of that other corporation that meets the requirements of Section 1504(a)(2) as an asset sale in certain circumstances. The Temporary Regulations clarify that Distributing may elect to apply the Section 336(e) regulations to a distribution of Controlled stock to which the Temporary Regulations apply, provided that the transaction otherwise satisfies the requirements of Section 336(e), and Distributing would otherwise be required to recognize the Statutory Recognition Amount with respect to the Controlled stock it distributes.

We believe the Temporary Regulations' limitation on the availability of a Section 336(e) election if the gain limitation rules would operate to limit the amount of gain recognized by Distributing on the distribution is inequitable as a policy matter and unnecessary as an administrative one. Section 336(e) is designed to provide taxpayers with relief from multiple taxation of the same economic gain that can result when a transfer of appreciated corporate stock is taxed without providing a corresponding step-up in the basis of the assets.[62] The possibility of multiple layers of corporate taxation on the same economic gain is equally present in a distribution with respect to which gain recognition is limited to that inherent in the historic assets of Distributing or a

[61] For additional discussion of this feature of the Temporary Regulations, see Cummings, note 43 above.

[62] *See* 78 Fed. Reg. 28,467, 28,467 (May 15, 2013).

predecessor of Distributing (but not both). Moreover, as described above, the operation of the special gain limitation rules of the Temporary Regulations require Distributing separately to track, and value, its historic assets and those of any predecessor of Distributing in order to avoid recognizing the full Statutory Gain Amount. Thus, any concerns regarding the administrability of permitting a Section 336(e) election for distributions in which gain is only partially recognized under the Temporary Regulations would appear unwarranted. Accordingly, we would recommend that the Temporary Regulations be modified to allow Distributing to make a Section 336(e) election in these circumstances, thereby allowing Controlled to obtain a basis step-up with respect to assets the inherent gain on which has already been subject to corporate-level tax.

F. Miscellaneous Technical Comments

1. *Step-Transaction Implications of Regulatory Examples*

The Temporary Regulations include a number of helpful examples to demonstrate the principles of the operative provisions. The Temporary Regulations expressly direct the reader to assume that each transaction described in the examples is part of a Plan that "is respected as a separate transaction under general Federal income tax principles" and that each distribution would otherwise satisfy the requirements of Section 355. However, a number of the fact patterns described in the examples could implicate step transaction principles and other authorities that might otherwise prevent the application of Section 355. We would therefore suggest including explicit language in the Temporary Regulations, beyond the mere statement that transactions should be assumed to be respected, to the effect that taxpayers should draw no inference as to the intended

application of the step transaction doctrine and other general federal tax principles to the facts recited in the examples.

2. *Stock Acquired in a Section 381 Transaction*

The Temporary Regulations include a number of special acquisition rules applicable in determining whether the acquisition of a 50% or greater interest in a Potential Predecessor has occurred. One such rule relates to deemed acquisitions of stock in Section 381 transactions: each person that owned an interest in the acquiring corporation immediately before a Section 381 transaction is treated as acquiring stock representing an interest in the distributor or transferor corporation to the extent that the owner did not hold an equivalent direct or indirect interest in the distributor or transferor before the Section 381 transaction.[63] The Temporary Regulations then give an example of the application of this rule, stating that, "if Distributing held a 25-percent interest in a Predecessor . . . before a section 381 transaction in which the Predecessor . . . transfers its assets to Distributing, each person that owns an interest in Distributing is treated as acquiring in the section 381 transaction a proportionate share of the remaining 75-percent interest in the Predecessor."[64]

We believe that this example is incorrect. This example fails to take into account the indirect interest in the Predecessor that is retained by the shareholders of the Predecessor. In any Section 381 transaction, it is necessarily the case that the historic shareholders of the Predecessor would receive at least some stock of Distributing as consideration for their Predecessor stock. Thus, in this specific example, the owners of

[63] *See* Treas. Reg. § 1.355-8T(d)(1).

[64] *See* Treas. Reg. § 1.355-8T(d)(1).

Distributing should not be treated as acquiring a 75% interest in the Predecessor, but rather an amount less than 75%, determined after taking into account the dilution of historic Distributing shareholders by the equity consideration delivered to historic Predecessor shareholders. The example should be revised to reflect this fact.

3. *Stock of Distributing as Relevant Property*

The Temporary Regulations include a rule that, for purposes of the pre-distribution requirements for Predecessor status,[65] "stock of Distributing is not Relevant Stock (and thus not Relevant Property) to the extent that the Potential Predecessor becomes, as part of a Plan, the direct or indirect owner of that stock as the result of the transfer to Distributing of direct or indirect interests in the Potential Predecessor's Relevant Property."[66] It is unclear to us how this rule is intended to operate in the context of the pre-distribution requirements, which generally relate to property owned, directly or indirectly, by Distributing. We believe that this rule's cross-reference to the pre-distribution requirements of the Temporary Regulations is a mistake and that the rule is intended to prevent stock, issued by Distributing to a Potential Predecessor in exchange for the Potential Predecessor's transfer of Relevant Property to Distributing, from causing a *per se* satisfaction of the post-distribution requirement for Predecessor status (*i.e.*, a separation of Relevant Property between Controlled and the Potential Predecessor). Consider, for example, a fact pattern in which, pursuant to a Plan, P contributed all of its assets to D in a Section 351 transaction and D, in turn, contributed all of the acquired assets to C and then distributed the stock of C. In the absence of a rule like that described

[65] *See supra* notes 26-29 and accompanying text.

[66] Treas. Reg. § 1.355-8T(b)(2)(v) (cross-referring to the pre-distribution requirements in Temporary Regulations Section 1.355-8T(b)(1)(ii)).

above, the fact that P owned D stock would cause there to be a separation of Relevant Property between P and C, notwithstanding the fact that none of the historic assets of P was separated from the others in the transactions. We therefore suggest correcting this cross-reference or, if our understanding of the intended operation of the rule is incorrect, providing an example that illustrates its intended operation. In the latter case, we nonetheless believe that a rule of the type we describe would be appropriate.

G. Transition Rules

Except as provided under certain transition rules, the Temporary Regulations apply to distributions occurring after January 18, 2017, the date on which they were published in the Federal Register.[67] Under the transition rules, the Temporary Regulations do not apply if a distribution is made pursuant to a binding agreement, described in a ruling request submitted to the Service or described in a public announcement or public filing made with the Securities and Exchange Commission, in each case, on or before December 16, 2016, the date the Temporary Regulations were released.[68] However, this transition rule applies only if the binding agreement, ruling request, announcement or filing described all steps relevant to the determination of Predecessor of Distributing status, which include not only the distribution, but "all other related pre-distribution transactions that together effect a division of the assets of a Predecessor of Distributing."[69] We are concerned that most taxpayers will not qualify for this relief despite having already expended, at the time the Temporary Regulations were

[67] Treas. Reg. § 1.355-8T(i)(1).

[68] Treas. Reg. § 1.355-8T(i)(2)(i).

[69] Treas. Reg. § 1.355-8T(i)(2)(ii).

released, significant resources with respect to a transaction that might be implicated by the Temporary Regulations (but perhaps not implicated by the 2004 Proposed Regulations) and reasonably relied on the basic framework of those regulations. Particularly as it pertains to transactions that may be ancillary, but necessary, to a distribution, we believe it unlikely that all such transactions would be described in the manner that allows a transaction to be deemed eligible for transition relief until very late in the long and expensive process of a corporate separation, if at all.[70] As such, we believe the scope of this transition relief as drafted to be extremely narrow, which we believe to be inappropriate in the context of immediately effective Temporary Regulations that substantially deviate from the proposed regulations that they replace. Our concern is further heightened in light of the significant questions regarding the appropriate and/or intended scope of the Temporary Regulations described in this Report. We therefore recommend a significant liberalization of the transition relief available to taxpayers under the Temporary Regulations. For example, we believe that it would be appropriate to extend transition relief to any distribution made pursuant to a binding contract, or described in a ruling request, public announcement or SEC filing, on or before December 16, 2016, and to remove from the Temporary Regulations the requirement that all related pre-distribution transactions be described in the relevant binding agreement, ruling request or SEC filing.

[70] Indeed, in some cases, the structure of all such transactions may not be finally determined until very late in such process.