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Tax Update

Proposed Regulations Would Block Some Spinoffs

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Proposed regulations issued on July 14, 2016 generally would prevent tax-free spinoffs involving companies with less than 5% active business assets and spinoffs where one company holds a substantial amount of nonbusiness assets and the other company does not. These rules generally would apply to transactions occurring on or after the publication date of final regulations, subject to generous transition rules.

A spinoff is taxable to a distributing company and its shareholders if it is a "device" for the distribution of corporate earnings, as determined under a multi-factor test in the current regulations. The proposed regulations generally limit the relative and absolute amounts of nonbusiness assets that any company involved in a tax-free spinoff can hold without implicating these rules.

A spinoff generally would be taxable as a "per se" device if (i) one company's percentage of nonbusiness to total assets is 66.67% – 79.99%, and the other's is less than 30%, (ii) one company's nonbusiness asset percentage is 80% - 89.99%, and the other's is less than 40%, *or* (iii) one company's nonbusiness asset percentage is at least 90%, and the other's is less than 50%.

Evidence of device would also exist if each company's percentage of nonbusiness assets exceeds 20%, *or* the companies' respective percentages of nonbusiness assets differ by at least 10%. The existence of a business purpose for separating a company's business and nonbusiness assets generally would not outweigh this evidence of device.

The IRS has indicated that it is considering additional guidance on spinoff issues, raising the possibility that additional regulations will follow.

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