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Tax Notes Today

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DEPARTMENT: News, Commentary, and Analysis; News Stories

CITE: 2015 TNT 218-1

HEADLINE: #1

2015 TNT 218-1 DARDEN RECEIVES LETTER RULING CONFIRMING TAX-FREE REIT SPINOFF. (Section 355 -- Controlled Firm Stock) (Release Date: NOVEMBER 10, 2015) (Doc 2015-24839)

CODE: Section 355 -- Controlled Firm Stock;
Section 856 -- Real Estate Trusts;
Section 857 -- REIT Taxation;
Section 1031 -- Like-Kind Exchanges

ABSTRACT: After the markets closed November 9, Darden Restaurants Inc. announced that it had successfully completed a planned tax-free spinoff of much of its owned real estate -- primarily its Olive Garden restaurants -- after receiving a letter ruling from the IRS on "issues relevant to the qualification of the spin-off as tax-free."

SUMMARY: Published by Tax Analysts(R)

After the markets closed November 9, Darden Restaurants Inc. announced that it had successfully completed a planned tax-free spinoff of much of its owned real estate -- primarily its Olive Garden restaurants -- after receiving a letter ruling from the IRS on "issues relevant to the qualification of the spin-off as tax-free."

Darden said it also received opinions from Skadden, Arps, Slate, Meagher & Flom LLP and KPMG LLP on the real estate investment trust spinoff, involving the newly formed Four Corners Property Trust Inc. (FCPT), which according to the Darden release "intends to elect and qualify to be treated as a real estate investment trust (REIT) effective January 1, 2016." Darden announced October 21 that the spinoff was scheduled to occur November 9.

According to the final separation and distribution agreement, dated October 21, the Skadden opinion was expected to confirm "that the Reorganization and Distribution, together with certain related transactions, will qualify as tax-free to Darden, FCPT and holders of Darden Common Stock for U.S. federal income tax purposes under Sections 355, 368(a)(1)(D) and 361 and related provisions of the Code."

IRS officials have in recent months expressed concerns regarding OpCo-PropCo structures like the one effected as a result of Darden's REIT spinoff, in which Darden, the operating company of its restaurant franchises, will lease back the restaurant properties spun off into the FCPT REIT (or property company) under long-term arrangements.

In Rev. Proc. 2015-43, 2015-40 IRB 459, the IRS announced that it would no longer issue rulings on many REIT spinoffs. However, the restrictions applied only to ruling requests submitted after September 14 and didn't affect those, including Darden's, submitted before then.

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REFERENCES: Subject Area:
RICs, REITs, and REMICs;
Mergers, acquisitions, and reorganizations;
Corporate taxation;
Tax reform;
Tax system administration;
Deferral of taxes;

Like-kind exchanges

TEXT: Release Date: NOVEMBER 10, 2015

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In Rev. Proc. 2015-43, 2015-40 IRB 459 (Doc 2015-20739), the IRS announced that it would no longer issue rulings on many REIT spinoffs. However, the restrictions applied only to ruling requests submitted after September 14 and didn't affect those, including Darden's, submitted before then.

Richard M. Nugent of Cadwalader, Wickersham & Taft LLP told Tax Analysts that while it's possible that Darden's letter ruling from the IRS addressed the active trade or business (ATB) requirement in section 355(b), no one will know for sure until the redacted ruling is made public. "Nor do we know the assumptions and representations that underlie the ruling. Those could be critical," he said.

Nugent added that a challenge to Darden's REIT spinoff on section 337(d) grounds "is unlikely." Section 337(d) gives Treasury fairly broad authority to issue regulations that prevent the avoidance of *General Utilities* doctrine repeal by way of transactions involving tax indifferent or quasi-passthrough entities like REITs. However, absent an election for immediate gain recognition, the section 337(d) regulations currently in effect simply impose a section 1374 built-in gains tax at the highest corporate rate on any converted property if it is sold by the REIT within a period up to 10 years. Darden has said it plans to diversify the real estate in its REIT through the use of section 1031 like-kind exchanges.

Another practitioner with experience submitting spinoff rulings to the IRS told Tax Analysts that the Darden announcement is somewhat surprising given that Yahoo Inc., which like Darden had been planning a tax-free spinoff by way of placing a small ATB into its SpinCo, was unable to secure a letter ruling -- either favorable or adverse -- on its spinoff because the IRS had decided "in the exercise of its discretion" not to grant Yahoo a ruling. (Prior coverage (Doc 2015-20379).)

Darden said it planned to satisfy the ATB test by placing six operating businesses -- all LongHorn Steakhouse restaurants -- into a subsidiary of its SpinCo REIT largely containing the Olive Garden real estate, whereas Yahoo said it plans to satisfy the ATB test by placing what was at one time a $ 50 million website design and hosting business into its SpinCo, largely containing public shares of Alibaba Group Holding Ltd. (Prior coverage (Doc 2015-21532), (Doc 2015-15947).)

"They booted Yahoo out but they didn't boot [Darden] out," the practitioner said. Both rulings were submitted to the IRS before the new no-rule went into effect. The practitioner added that the guidance issued in conjunction with the new no-rule -- Notice 2015-59, 2015-40 IRB 467 (Doc 2015-20740) -- makes clear that "the Service is extremely concerned about small active businesses when coupled together with cash or portfolio stock," adding, "I think there's a major difference in their mind between that and the situation where it's real estate assets."

Robert Wellen, IRS associate chief counsel (corporate), said publicly that real estate is not considered an investment asset for purposes of the new no-rule. (Prior coverage (Doc 2015-21890).)

Speaking October 21 in New York at a Practising Law Institute conference on corporate tax strategies, Wellen said that his office has been asked whether real property or cash-like assets used for working capital are considered investment assets for purposes of Rev. Proc. 2015-43. "It's clear that real property is not an investment asset," Wellen said. "Cash and cash-like assets are in the investment asset category, and the no-rule on its face doesn't focus on the distinction between working capital and other cash."

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