

Important Updates on Spin-Offs and Debt Exchanges: Revenue Procedure 2024-24 and Notice 2024-38

Client Alert | May 6, 2024

The U.S. Internal Revenue Service and the Treasury Department have released Revenue Procedure 2024-24 providing updated guidelines for requesting private letter rulings regarding transactions intended to qualify under section 355, focusing specifically on “Divisive Reorganizations” and related debt exchanges. The Internal Revenue Service (the “IRS”) and the Treasury Department (“Treasury”) have released Rev. Proc. 2024-24 (the “Rev. Proc.”) providing updated guidelines for requesting private letter rulings regarding transactions intended to qualify under section 355,^[1] with significant focus on “Divisive Reorganizations” and related debt exchanges.^[2] The Rev. Proc. modifies Rev. Proc. 2017-52 and supersedes Rev. Proc. 2018-53.^[3] The IRS and Treasury also released Notice 2024-38 (the “Notice”) requesting public comment on select issues addressed by the Rev. Proc. and outlining the IRS and Treasury’s current perspectives and concerns related to those issues. The Rev. Proc. was highly anticipated and is of critical importance for taxpayers considering a spin-off, particularly for spin-offs that involve debt exchanges. It applies to all ruling requests postmarked or, if not mailed, received by the IRS after May 31, 2024. **I. Background**

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A. Sections 355 and 361

Section 355 permits a corporation (“Distributing”) to distribute, or “spin off,” a subsidiary corporation (“Controlled”) to its shareholders in a transaction that is tax-free to both shareholders and the corporation (a “Spin-off”). Spin-offs typically occur as part of a larger divisive reorganization (a “Divisive Reorganization”), although sometimes involve the more straightforward distribution of the stock of an existing subsidiary (a “Section 355(c) Distribution”). In either case, the distribution must satisfy numerous requirements to be tax-free to both Distributing and its shareholders, including that Distributing must distribute stock that carries with it at least 80 percent of the voting power of Controlled. Subject to additional requirements, however, Distributing may retain some Controlled stock or securities after the date of the distribution provided the retention does not have a principal purpose of tax avoidance (the “Control Distribution Date”). In the context of Divisive Reorganizations, but not Section 355(c) Distributions, the Code provides fairly broad flexibility to Distributing to allocate its liabilities between Distributing and Controlled or to retire its liabilities on a tax-free basis. Specifically, Distributing may use Controlled stock and/or securities to retire its obligations to creditors tax-free, and, if Distributing receives money or property other than Controlled stock or securities (commonly known as “boot”) from Controlled, Distributing may use that boot to retire its obligations to creditors, but only to the extent of the net tax basis of the assets transferred to Controlled.^[4] These distributions to creditors (including use of Controlled stock to retire debt) may occur on a delayed basis following the Control Distribution Date as part of the spin-off plan. The exchanges of Controlled stock and/or securities for Distributing debt – so-called debt-for-debt and debt-for-equity exchanges – have a storied history in terms of IRS ruling policy, making this recent guidance particularly important and, inevitably, controversial.

B. Previous Ruling Guidelines Regarding Retentions of Controlled Stock, Securities or Debt

The IRS has historically issued favorable rulings with respect to delayed distributions after the Control Distribution Date as well as retentions of Controlled stock and securities based on requirements outlined in Appendix B of Rev. Proc. 96-30 (including a sufficient business purpose and no overlapping directors or officers between Distributing and Controlled for the period during which stock and securities are retained (or sufficient business purpose for the overlap)). That is, historically, the IRS has issued rulings that a retention of Controlled stock and securities after the Control Distribution Date will not be in pursuance of a plan having a principal purpose of avoiding federal income tax under section 355(a)(1)(D)(ii) in situations in which a taxpayer indicates a fixed intention to retain shares or securities and sell them in a taxable sale, as well as in situations in which taxpayers otherwise expected to make a delayed distribution of Controlled stock and securities that is “part of the distribution” (within the meaning of section 355(a)(1)(D)) or “in pursuance of the plan of reorganization” (within the meaning of section 361).

C. Previous Ruling Guidelines Regarding Debt Exchanges

The IRS’s approach to debt-for-debt and debt-for-equity exchanges has changed over time, including its approach to debt exchanges involving financial institutions that would acquire Distributing debt in order to engage in a debt exchange with Distributing. Before the issuance of Rev. Proc. 2018-53, taxpayers typically used an “intermediated exchange” model in which the intermediary bank would purchase Distributing debt, hold it for at least five days, and then enter into an exchange agreement with Distributing to exchange that debt for Controlled securities or Controlled stock, with the exchange occurring at least 14 days after the bank’s purchase of the Distributing debt. The issuance of Rev. Proc. 2018-53 modified the types of debt-for-debt and debt-for-equity exchanges on which the IRS would rule. Rev. Proc. 2018-53 contained numerous requirements, continuing the basic theme of permitting Distributing to allocate or retire amounts of its historical debt. Further eschewing the formalism of the IRS’s previous ruling practice, Rev. Proc. 2018-53 permitted new debt to be allocated or retired so long as the total amount of debt allocated or retired was in line with historical debt levels. **II. Rev. Proc. 2024-24 and Notice 2024-38** The Rev. Proc. changes the playing field in a number of areas, including (A) transactions involving delayed distributions and retentions of Controlled stock, securities, or debt and (B) exchanges of Distributing debt for Controlled stock, Controlled securities or other debt obligations, or money or other property (“[Section 361 Consideration](#)”). This Update discusses each of these principal topics, as well as related commentary in the Notice. Other topics addressed in the Rev. Proc. are discussed in Exhibit I to this Update.

A. Transactions Involving Delayed Distributions and Retentions of Controlled Stock, Securities, or Debt

The Code contemplates that Distributing will distribute all the Controlled stock and securities it owns but permits taxpayers to make the distributions over time or retain some stock or securities. Consistent with the way the tax bar approaches these matters, the Rev. Proc. and Notice distinguish between “Delayed Distributions” and “Retention” transactions.

1. Delayed Distributions

In a “Delayed Distribution,” the intention and plan is for all Section 361 Consideration to be distributed to Distributing’s stockholders or transferred to Distributing’s creditors as promptly as possible. Toward that end, consistent with prior ruling practice, the Rev. Proc. requires Distributing to represent that it will hold the Controlled stock and securities no longer than is necessary and, in any event, that it will make the final distribution no later than 12 months after the date of the first distribution that was part of the Divisive Reorganization (the “[First Distribution Date](#)”).^[5] Taxpayers must submit relevant facts and analysis establishing that the distribution of Controlled stock or securities over a period of time is “part of the distribution” (within the meaning of section 355(a)(1)(D)) or “in pursuance of the plan of reorganization” (within the meaning of section 361).^[6] The

Rev. Proc. notes that although the length of time between the First Distribution Date and later distributions is not dispositive, it will be the primary factor in determining whether a favorable ruling will be granted.[\[7\]](#) The Rev. Proc. also requires that, absent “substantial business reasons,” any transfers to creditors must be made within 90 days after the First Distribution Date and, other than as a result of any Post-Distribution Payments (as defined below), all transfers of Section 361 Consideration by Distributing in repayment of its historical debt must be made within 12 months after the First Distribution Date.[\[8\]](#)

2. Retentions

Taxpayers seeking a ruling that a retention of Controlled stock or securities after the Control Distribution Date that does not constitute a Delayed Distribution (a “Retention”) will not be in pursuance of a plan having a principal purpose of avoiding federal income tax must submit several representations that are focused on ensuring that Distributing and Controlled do not maintain a high degree of connection (due to overlapping directors, officers or employees or the closely held nature of Controlled’s stock) and that there is a non-speculative business purpose for the Retention,[\[9\]](#) or that there is an “exigent business circumstance” necessitating the Retention.[\[10\]](#) If Distributing will hold Controlled debt after the distribution, Distributing will be required to represent that the debt will not constitute stock or securities of Controlled. Notably, the Rev. Proc. limits the requirement of an exigent business purpose to circumstances in which there is significant connection between Distributing and Controlled after the distribution (in addition to any retained interest in Controlled).[\[11\]](#) In a significant shift from prior ruling policy, under the Rev. Proc., the IRS will not entertain simultaneous requests for rulings with respect to both Delayed Distributions and Retentions (“Backstop Retention Rulings”). Backstop Retention Rulings have been important to taxpayers to ensure that Distributing’s continued ownership of Controlled shares (or their disposal in a taxable transaction) will not affect the qualification of the initial distribution under section 355. Taxpayers typically request Backstop Retention Rulings in case, contrary to their expectations, they are not able to pursue a later transaction that qualifies as a Delayed Distribution and want to be sure this inability does not preclude the entire spin-off from qualifying for tax-free treatment under section 355. This new policy therefore will be the source of significant commentary and consternation.

3. Post-Distribution Payments

With respect to any payments made by Controlled to Distributing after the Control Distribution Date that comprise Section 361 Consideration and not, for example, a payment for goods or services (e.g., cash payments made under a transition services agreement) (“Post-Distribution Payments”), the Rev. Proc. requires those payments to be deposited in a segregated account and distributed to Distributing’s shareholders or transferred to Distributing’s creditors within 90 days of receipt. Additionally, taxpayers must submit information and analysis to establish the following: (i) each Post-Distribution Payment is Section 361 Consideration, (ii) as of the date of the earliest distribution effecting the Divisive Reorganization, the fair market value of Distributing’s right to receive the Post-Distribution Payment was not (or will not be) “reasonably ascertainable,” and (iii) whether Distributing will account for its right to receive the Post-Distribution Payment under the installment method (clauses (i) through (iii), the “Post-Distribution Payment Requirements”). In the Notice, the IRS and Treasury state that they are considering the treatment of Post-Distribution Payments. The Notice explains that Treasury and the IRS believe that a Post-Distribution Payment is considered Section 361 Consideration only if the taxpayer establishes that it satisfies the Post-Distribution Payment Requirements.[\[13\]](#)

4. Solvency and Independence of Distributing and Controlled

The Rev. Proc. requires additional representations relating to the solvency and viability of Distributing and Controlled.[\[14\]](#) According to the Notice, these additional representations are aimed at ensuring that tax-free treatment is not given to “Divisive Reorganizations that burden Controlled with excessive leverage, jeopardizing its ability to continue as a viable

going concern.” Additionally, according to the Notice, the IRS and Treasury are considering the degree to which connections between Distributing and Controlled after a spin-off should prevent a transaction from qualifying under section 355. More specifically, the Notice states that the IRS and Treasury are considering the impact of (i) overlapping key employees, directors, and officers between Distributing and Controlled and (ii) continuing contractual arrangements between Distributing and Controlled that include provisions that are not arm’s length. The IRS and Treasury are concerned that these on-going relationships are inconsistent with the separation envisioned in enacting section 355, particularly if “fit-and-focus” is the stated business purpose for the transaction.

B. Exchanges of Distributing Debt for Section 361 Consideration

1. Direct Issuances and Intermediated Exchanges

One of the most important aspects of the Rev. Proc. is the effective prohibition of “Direct Issuances.” Direct Issuances are transactions in which a third-party financial institution (the “Bank”) makes a short-term loan to Distributing that uses the proceeds of that loan to retire historical Distributing debt. Subsequently, Distributing uses Controlled stock and/or securities to repay the newly incurred short-term debt. In a marked change from prior ruling practice, to qualify under the Rev. Proc., all debt that will be retired in a debt exchange must be incurred before the earliest of the following dates: (i) the date of the first public announcement of the Divisive Reorganization (or a similar transaction), (ii) the date of entry by Distributing into a binding agreement to engage in the Divisive Reorganization (or a similar transaction), and (iii) the date of approval of the Divisive Reorganization (or a similar transaction) by the board of directors of Distributing (the “Earliest Applicable Date”). As a result, under the Rev. Proc., taxpayers will need to use pre-existing debt in a debt exchange or refinance existing debt not later than the Earliest Applicable Date. This will result in a dramatic change in market practice because it will no longer be possible for Distributing to use its newly incurred short-term debt to facilitate a debt-for-debt or debt-for-equity exchange. Additionally, for both Direct Issuances and “Intermediated Exchanges” (where the Bank purchases historical Distributing debt on the open market and then enters into an exchange agreement in which the Bank agrees to accept Section 361 Consideration as repayment of the debt so acquired), the Rev. Proc. requires taxpayers to make a number of representations (and to provide supporting analysis) to ensure the independence of the Bank (similar to the representations previously contained in Rev. Proc. 2018-53). These representations include that (i) the historical debt acquired by the Bank will not be held for the benefit of Distributing, Controlled, or persons related to either Distributing or Controlled, (ii) each exchange will be effectuated based on arm’s-length terms, (iii) neither Distributing nor Controlled will participate in any profit gained by the Bank upon an exchange of the Section 361 Consideration, and (iv) the Bank will act for its own account and bear the risk of loss with respect to both (x) the acquired Distributing debt and (y) any subsequent sale or other disposition of the Section 361 Consideration transferred to the Bank to satisfy the Distributing debt.^[15] It is not clear precisely how the IRS and Treasury envision Intermediated Exchanges occurring in the future. The Notice expresses concerns that general principles of federal income tax law (including substance over form, agency, and other relevant theories) could cause Direct Issuances to be recast so the Bank is not treated as a “creditor.” In addition, the Notice expresses concerns that, in an Intermediated Exchange, the Bank could be recast as an agent of Distributing, with the result that Distributing likewise would not be treated as exchanging Section 361 Consideration for historical debt of Distributing. Nevertheless, the Notice makes clear that the government “would welcome feedback from intermediaries to help ensure that future guidance is responsive to the business and market-risk considerations that inform the mechanics of intermediated exchanges and direct issuance transactions, as opposed to mere differences in transaction costs.”

2. No Replacement of Distributing Debt

The Rev. Proc. includes a new representation regarding the replacement of Distributing debt in Divisive Reorganizations that mandates that neither Distributing nor any person

that is related to Distributing (under either section 267(b) or section 707(b)(1) (a “Related Person”)) will replace any amount of Distributing debt that is satisfied with Section 361 Consideration with borrowing anticipated or committed to before the Control Distribution Date.^[16] The new representation is a significant change from Rev. Proc. 2018-53, where the focus was only on previously committed borrowing. Importantly, the Rev. Proc. accommodates situations in which taxpayers cannot adhere to this representation. It provides that taxpayers may still secure a favorable ruling by substantiating, through detailed information and analysis, that any borrowing—whether existing at the time of the ruling submission or incurred subsequently—is justified under specific conditions. Although not explicit in the Rev. Proc., the implication from the language used is that the guidelines cover all borrowings. Specifically, (i) the borrowing was incurred in the ordinary course of business under financial arrangements such as revolving credit agreements, unrelated to and not anticipated as part of the section 355 transaction or any related transactions, and (ii) the borrowing resulted from unexpected events not related to the section 355 transaction and occurred outside the ordinary business activities of Distributing, directly arising from circumstances that were not anticipated prior to the Control Distribution Date.

3. Limitation to Historical Distributing Debt

In a Divisive Reorganization, the Rev. Proc. requires all historical Distributing debt that is intended to be satisfied with Section 361 Consideration and all liabilities of Distributing that are assumed by Controlled to have been incurred by Distributing before the Earliest Applicable Date.^[17] Additionally, with respect to contingent liabilities, the liability must be “economically attributable” to the period ending on the “Contribution Date”^[18] or be attributable to the continuation after the Earliest Applicable Date of activities in which Distributing was engaged before the Earliest Applicable Date.^[19] The Rev. Proc. also restricts the amount of Distributing debt satisfied with Section 361 Consideration or assumed by Controlled to the historical average amount of Distributing debt owed to third-party creditors that was outstanding for the prior eight fiscal quarters ending immediately before the Earliest Applicable Date (similar to the standard in effect under Rev. Proc. 2018-53 that covered the eight fiscal quarters that ended immediately before the date of approval of the Divisive Reorganization by the board of directors of Distributing).^[20]

EXHIBIT 1

Additional Matters Covered in Rev. Proc 2024-24 and Notice 2024-38 In addition to the topics discussed in the body of the Update, the Rev. Proc. and the Notice provide additional guidance and commentary on a number of other topics relating to Divisive Reorganization that are discussed below.

1. Scope of Plan of Reorganization

The Rev. Proc. requires taxpayers seeking a ruling on a Divisive Reorganization to represent that (i) each step of the proposed transaction will be described clearly in the plan of reorganization, (ii) each step is necessary to effectuate the business purpose and directly a part of the transaction, and (iii) before the first step of the proposed transaction, each party will have adopted the plan of reorganization for the transaction. The Rev. Proc. also requires that the taxpayer submit analysis establishing that each specific step of a proposed transaction is part of the plan of reorganization regarding the transaction, along with a copy of the plan of reorganization as an exhibit to the ruling request.^[21] The Notice discusses confusion and disagreement among practitioners regarding the application of the plan of reorganization requirement under section 361 to Divisive Reorganizations and notes that the representations, information, and analysis in the Rev. Proc. are intended to ensure that plans of reorganization for Divisive Reorganizations provide specificity and clarity that satisfy current Treasury regulation requirements.^[22] Specifically, the Notice identifies a concern that some tax advisors incorrectly view the applicability of the plan of reorganization requirement to be limited to situations in which there are certain temporal delays based on the procedures in Rev. Proc. 2018-53 (superseded by the Rev. Proc.).^[23] This concern is exacerbated by the fact that case law authority is unclear with

respect to what constitutes a plan of reorganization.^[24] The Notice indicates that the IRS and Treasury are particularly focused on ensuring that, while a plan of reorganization may incorporate some transactional flexibility, this flexibility should be appropriately constrained based on the relevant Treasury regulation requirements.

2. Distributing as Obligor

The Rev. Proc. also requires that taxpayers seeking a ruling on a Divisive Reorganization submit a representation that Distributing is the obligor of each Distributing debt that will be satisfied with Section 361 Consideration, as well as of any other Distributing liability (including any contingent liability) that will be assumed by Controlled.^[25] In connection with this representation, taxpayers must submit information regarding any guarantee, indemnity or similar arrangement provided by any person other than Distributing, as well as analysis establishing that Distributing is the obligor of relevant Distributing debt or other liability (including contingent liability) for federal income tax purposes regardless of the guarantee, indemnity or similar arrangement (if any).^[26]

3. Asset Basis Limitations

The Rev. Proc. outlines detailed procedures for taxpayers requesting rulings on sections 357 and 361 in the context of Divisive Reorganizations. This includes adhering to the established procedures detailed in Rev. Proc. 2017-52, except as modified by the Rev. Proc. Taxpayers engaging in Divisive Reorganizations must submit the required representations, information, and analysis to support their requests, ensuring compliance with these guidelines.^[27] The Notice, however, indicates that the IRS and Treasury are seeking public input on the distinct applications of sections 357 and 361, particularly in the context of Divisive Reorganizations. In general, section 357 addresses situations in which Controlled assumes liabilities from Distributing and provides that liability assumptions generally are not considered the receipt of money or other property by Distributing. Additionally, section 357(c) requires gain recognition to the extent that liabilities assumed exceed the aggregate basis of the transferred assets. In contrast, section 361 allows Distributing to transfer assets, including money and other property, to its creditors during a Divisive Reorganization without recognizing gain, treating these transfers as part of the reorganization plan. Similar to section 357(c), section 361(b)(3) requires gain recognition to the extent that boot distributed to Distributing's creditors exceeds the net tax basis of the transferred assets. According to the Notice, confusion and disagreement persist among tax advisors regarding the interaction between these sections, especially when Section 361 Consideration is used to satisfy liabilities that do not qualify as debt. The Notice explains that some advisors "mistakenly believe that, in such a situation, the Section 361 Consideration would qualify for nonrecognition treatment under § 361" and further that "some tax advisors also incorrectly contend that Distributing would enjoy nonrecognition treatment under § 361 through the use of Section 361 Consideration to satisfy [contingent liabilities of Distributing], which are not subject to an adjusted basis limitation under § 357(c)(3) (and, therefore, would not be subject to an adjusted basis under § 361(b)(3))." In the Notice, the IRS and Treasury state that it is their view that those interpretations are contrary to the plain language and policy intentions of sections 357 and 361, particularly concerning the adjusted basis limitations these sections impose.

4. Holders of Distributing Debt or Other Distributing Liabilities

In general, the Rev. Proc. requires that all of the historical Distributing debt that is repaid with Section 361 Consideration in connection with a Divisive Reorganization be third-party debt. If any of the historical Distributing debt is owed to a Related Person, however, the Rev. Proc. requires that the Section 361 Consideration paid to the Related Person subsequently be paid to a third-party creditor within 12 months after the First Distribution Date. Both the debt owed to the Related Person and the debt owed to the third-party creditor must have existed before the Earliest Applicable Date.

5. Distribution of Qualified Property, Money, and Other Property

The Rev. Proc. requires that all stock and securities of Controlled (“Qualified Property”), money, and other Section 361 Consideration other than Qualified Property (“Other Property”) received by Distributing be distributed by Distributing to its shareholders or transferred to Distributing’s creditors in connection with the Divisive Reorganization. Additionally, money and Other Property (but not Qualified Property) transferred by Controlled to Distributing as part of the plan of reorganization generally must not be distributed to Distributing’s shareholders or transferred to Distributing’s creditors earlier than the First Distribution Date. The Rev. Proc. does, however, allow for a taxpayer to obtain a ruling even if money or Other Property is distributed or transferred earlier than the First Distribution Date, so long as the taxpayer submits information describing those earlier distributions or transfers along with supporting analysis of the federal income tax consequences of the transfers or distributions. The Rev. Proc. requires the taxpayer to submit (i) a description of the Qualified Property, money, and Other Property to be transferred by Controlled to Distributing, (ii) a description of the transactions in which Distributing will distribute the property to its shareholders or transfer the property to its creditors, and (iii) an analysis establishing that the property will be distributed or transferred in connection with the Divisive Reorganization.

6. Effect of Transaction Related to Divisive Reorganizations on Controlled Securities or Other Qualified Property

The Rev. Proc. sets forth guidelines for handling changes to Controlled securities resulting from Divisive Reorganizations. Taxpayers must submit a representation confirming that no transaction (or series of transactions) directly or indirectly related to the Divisive Reorganization will result in a deemed exchange of any Controlled securities received by Distributing pursuant to the plan of reorganization.[\[28\]](#) Additionally, it must be asserted that Controlled will continue as the obligor of those securities after the transactions. To support these assertions, taxpayers are required to describe any changes in the terms of the Controlled securities or other qualified property received and provide analysis demonstrating that these changes will not constitute a deemed exchange pursuant to Treas. Reg. § 1.1001-3. Moreover, it must be established that Controlled will remain as the obligor after the transactions. The Notice indicates that the IRS and Treasury are actively considering the implications of modifying, including refinancing, Controlled’s securities or other debt following a Divisive Reorganization, specifically how the modifications impact the qualification of the securities or other debt as Section 361 Consideration. To assess whether changes in the structure of Controlled’s securities post-distribution could result in a recast of the transaction, the IRS and Treasury are contemplating the application of general principles of federal income tax law, including the doctrine of substance over form and other relevant theories, to these transactions. Without more guidance, this also is likely to be concerning to taxpayers and their advisors.

7. Assumption of Distributing Liabilities

The Rev. Proc. mandates that if a taxpayer requests a ruling on a Divisive Reorganization involving the assumption of Distributing liabilities, including contingent liabilities, comprehensive representations, information, and analysis must be submitted. Taxpayers may seek rulings on whether transactions between Distributing and Controlled constitute the assumption of Distributing liabilities. Taxpayers must provide specific representations to ensure that payments made by Controlled to satisfy these liabilities do not result in any control by Distributing or a Related Person.[\[29\]](#) This includes agreements made before the First Distribution Date, which must demonstrate that the liabilities were incurred in the ordinary course of business associated with Controlled’s assets and operations. In the case of the assumption of a contingent liability of Distributing, an additional representation is required, stating that all payments will be made as soon as practicable after the amounts of those payments are substantially determined.[\[30\]](#) The Rev. Proc. requires descriptions of each liability assumed, the circumstances under which they were incurred, and any third-party payment arrangements, ensuring Distributing does not retain control over the funds. Failure to comply may lead the IRS to: (i) treat the payment as Section

361 Consideration, (ii) determine that the payment does not align with the plan of reorganization, or (iii) decline to issue a ruling on the transaction. The Rev. Proc. supersedes the representation requirements from Rev. Proc. 2017-52, which stated that any liabilities assumed by Controlled were incurred in the ordinary course of business and associated with transferred assets.^[31] The new procedure adds specificity and clarity to these representations.^[32] Importantly, the Rev. Proc. refines and broadens the definition of ‘liability’ to include debts, contingent liabilities, and other obligations, whether or not they have been previously considered for federal tax purposes. It also clarifies that obligations from business contracts may qualify as liabilities if recorded as liabilities in financial statements, expanding the scope of what can be considered a liability under federal tax law.^[33]

8. No Avoidance of Federal Income Tax

The Rev. Proc. includes strict guidelines to ensure that the assumption of Distributing liabilities, including contingent liabilities, within Divisive Reorganizations does not primarily serve to avoid federal income tax and is not devoid of a bona fide business purpose. To this effect, specific representations are required from taxpayers to demonstrate the intent behind these transactions. These include a representation that no assumption by Controlled of any Distributing liability, including Distributing contingent liabilities, is principally aimed at avoiding federal income tax or is driven by any purpose other than a bona fide business purpose, as defined under section 357(b)(1). Additionally, taxpayers must assert that no proposed transaction or series of transactions is principally designed to circumvent any requirements or limitations imposed by either section 357 or section 361. Alongside these representations, taxpayers are required to submit information and analysis substantiating the accuracy of these representations. ^[1] Unless indicated otherwise, all “section” references are to the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” references are to the Treasury regulations promulgated under the Code. ^[2] The term Divisive Reorganization “means a series of transactions that qualify as a reorganization described in §§ 355(a) and 368(a)(1)(D).” Appendix to Rev. Proc. 2024-24, § 2(21). ^[3] Rev. Proc. 2017-52 established a pilot program that specifically addressed the general federal income tax consequences of section 355 transactions (except for certain no-rule issues), marking a pivotal development in formalizing the process for taxpayers to seek IRS guidance on complex corporate divisions. A year later, Rev. Proc. 2018-53 further refined the procedures, focusing on issues related to the assumption or satisfaction of Distributing debt in Divisive Reorganizations. ^[4] As used in this Update, the term net tax basis means adjusted tax basis of the assets transferred less liabilities assumed. ^[5] Rev. Proc. 2024-24, § 3.03(2). ^[6] Taxpayers also are required to submit information regarding the expected percentage of Controlled stock and securities that will not be distributed on the Control Distribution Date, as well as the expected duration of the distribution period. If the distribution period will last longer than 90 days, taxpayers also are required to submit summaries of the expected percentage of Controlled stock and securities that will not be distributed within 90 days and the duration of the distribution period as well as the business reasons for this percentage and duration. Rev. Proc. 2024-24, § 3.03(2). ^[7] *Id.* ^[8] Rev. Proc. 2024-24, § 3.05(10). Taxpayers also must submit information and analysis supporting the substantial business reasons for any delayed distributions. ^[9] Rev. Proc. 2024-24, § 3.03(3). ^[10] *Id.* To obtain a ruling with respect to a Retention, taxpayers also must submit information regarding (i) the amount and type of stock, securities and options that Distributing will hold after the Control Distribution Date, (ii) an explanation for why the Retention is necessary (including both business and any non-business reasons), (iii) the expected duration of the Retention and timing for dispositions of the retained Controlled stock or securities, and (iv) any federal income tax benefit or advantageous federal income tax treatment that results from the Retention or the disposition of retained Controlled stock or securities. ^[11] *Id.* ^[12] Rev. Proc. 2024-24, § 3.03(4). ^[13] Notice 2024-38, § 2.02(6). ^[14] Rev. Proc. 2024-24, § 3.03(3) ^[15] If the Bank’s acquisition of historical Distributing debt is close in time to the exchange of the debt for Section 361 Consideration, the Rev. Proc. requires supporting analysis be provided that establishes that the short amount of time should not cause the form to be recast. ^[16] Rev. Proc.

2024-24, § 3.02(3). This representation must be adhered to precisely by the taxpayer unless a satisfactory explanation for deviation is provided by the taxpayer to the Associate Chief Counsel (Corporate). [17] Rev. Proc. 2024-24, § 3.05(6). [18] It is an open issue as to what “Contribution Date” means, given that the Rev. Proc. neither defines “Contribution Date” nor uses that term elsewhere. [19] Rev. Proc. 2024-24, § 3.05(7). [20]

Rev. Proc. 2024-24, § 3.05(8). If any of the Distributing debt satisfied with Section 361 Consideration is owed to a Related Person, then the historical average amount is calculated taking into account the lesser of (i) the total amount of Distributing debt held by the Related Person that holds the Distributing debt to be satisfied with Section 361 Consideration or (ii) the amount of debt held by the third-party creditor to whom the Section 361 Consideration will be transferred within 12 months of the First Distribution Date. [21] Rev. Proc. 2024-24, § 3.05(1). [22] Under Treas. Reg. § 1.368-2(g), “the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 368(a), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization.” [23] See Rev. Proc. 2018-53, § 3.04(6) (stating “if satisfaction of any Distributing debt with [Section 361 Consideration] will occur more than 180 days after the date of such first distribution, the taxpayer should submit information and analysis to establish that, based on all the facts and circumstances, the satisfaction will be in connection with the plan of reorganization”). The Notice indicates that the IRS and Treasury are concerned the language above has been misunderstood to require a plan of reorganization only where there is a delayed satisfaction of Distributing debt. [24] See *J.E. Seagram Corp. v. Comm’r*, 104 T.C. 75, 96 (1995) (acknowledging that the plan of reorganization concept is “one of substantial elasticity”). [25] Rev. Proc. 2024-24, § 3.05(2). [26] *Id.* [27] Rev. Proc. 2024-24, § 3.05(3). [28] Rev. Proc. 2024-24, § 3.05(11)(a), Representation 29. [29] Rev. Proc. 2024-24, § 3(13)(b), Representations 31, 32, 33, and 34. [30] Rev. Proc. 2024-24, § 3(13)(b), Representation 35. [31] Rev. Proc. 2017-52, Appendix, § 3, Representation 17. [32] The Rev. Proc. introduces new representations required for ruling on the assumption of Distributing liability and omits the reference to “any liabilities assumed” by Controlled, and adds a new representation that each Distributing liability—including each Distributing contingent liability—that Controlled assumes will have been incurred in the ordinary course of business and associated with Controlled’s assets and business. See Rev. Proc. 2024-24, Appendix, § 3(13)(b), Representation 34. [33] Appendix to Rev. Proc. 2024-24, § 2(29). Note that, under Rev. Proc. 2017-52, “liability” was defined as “any liability or other obligation without regard to whether it has been taken into account for federal income tax purposes.” See Rev. Proc. 2017-52, Appendix, § 2(05).

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