

GIBSON DUNN



Tax Update

October 20, 2026

IRS and Treasury Withdraw “Per Se” Device Test and Related Anti-Abuse Rules Under Section 355

The IRS and Treasury have withdrawn part of the proposed regulations issued in 2016 under section 355. The withdrawn rules include the “per se” device test, under which a distribution generally would have been a device regardless of its business purpose. Although the withdrawal is welcome, it is less helpful than it might have been because the IRS and Treasury left in place a different proposed rule that would undercut a taxpayer’s ability to use even a strong business purpose for separating nonbusiness assets from business assets as evidence of nondevice.

On October 20, 2026, the IRS and Treasury released a notice (the Withdrawal Notice) partially withdrawing proposed regulations under section 355.^[1] regarding the device prohibition and the active trade or business (ATB) requirement (the 2016 Proposed Regulations).^[2] The Withdrawal Notice withdraws Prop. Treas. Reg. §§ 1.355-2(d)(2)(iv)(E) and (d)(5) and 1.355-9(d), which contained (i) a per se device test, (ii) anti-abuse rules relating to the device prohibition, and (iii) an anti-abuse rule relating to a proposed minimum ATB requirement. The rest of the 2016 Proposed Regulations remains outstanding.^[3]

I. The Withdrawn Rules

Section 355 does not apply to a transaction “used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both.” Under the existing regulations, whether a transaction is a device generally is determined “from all of the facts and circumstances,” including the presence of specified device factors and nondevice factors.^[4] A corporate business purpose is a nondevice factor, and “[t]he stronger the evidence of device . . . , the stronger the corporate business purpose required to prevent the determination that the transaction was used principally as a device.”^[5]

The per se device test would have replaced that weighing with mechanical rules. Under that test, if a corporation’s “Nonbusiness Asset Percentage” (generally, the share of its gross assets, by value, that are not used in a trade or business, with reasonable working capital and certain required reserves treated as business assets) exceeded specified percentages, both individually and in comparison to the other corporation’s Nonbusiness Asset Percentage, the transaction would have been “considered a device notwithstanding the presence of any other nondevice factors,” such as a corporate business purpose, with limited exceptions.^[6] The test would have applied if (i) one corporation’s Nonbusiness Asset Percentage was 66⅔ percent or more and (ii) the other corporation’s Nonbusiness Asset Percentage was less than 30, 40, or 50 percent, depending on whether the first corporation’s percentage was less than 80 percent, less than 90 percent, or 90 percent or more.^[7]

The anti-abuse rules would have disregarded a transaction or series of transactions, such as “a change in the form of ownership of an asset; an issuance, assumption or repayment of indebtedness; or an issuance or redemption of stock,” undertaken with a principal purpose of affecting a corporation’s Nonbusiness Asset Percentage to avoid running afoul of the device prohibition or, in the case of Prop. Treas. Reg. § 1.355-9(d), its “Five-Year-Active-Business Asset Percentage” to avoid failing the minimum ATB requirement.^[8] The anti-abuse rules generally would not have applied to non-transitory acquisitions or dispositions of assets or to non-transitory transfers of assets between the distributing corporation and the controlled corporation.

II. The Rules That Remain Outstanding

The Withdrawal Notice leaves three significant proposals in the 2016 Proposed Regulations in place.

- **Nature and use of assets factor.** Under the 2016 Proposed Regulations, a corporation’s ownership of Nonbusiness Assets, and a difference between the two corporations’ Nonbusiness Asset Percentages, each would be evidence of device, and the larger the percentage or the difference, the stronger that evidence would be.^[9] Ownership of Nonbusiness Assets ordinarily would not be evidence of device if neither corporation’s Nonbusiness Asset Percentage is 20 percent or more, and a difference between the two corporations’ percentages ordinarily would not be evidence of device if it is less than 10 percentage points.^[10]
- **Business purpose nondevice factor.** The 2016 Proposed Regulations would narrow the business purpose nondevice factor. Specifically, “[a] corporate business purpose that relates to a separation of Nonbusiness Assets from one or more Businesses or Business Assets . . . is not evidence of nondevice unless the business purpose involves an

exigency that requires an investment or other use of the Nonbusiness Assets in one or more Businesses of the distributing corporation, the controlled corporation, or both.”^[11]

- **Minimum ATB requirement.** Each of the distributing corporation and the controlled corporation would be required to have a Five-Year-Active-Business Asset Percentage (generally, the share of its gross assets, by value, that are used in a trade or business that satisfies the five-year ATB requirement) of at least five percent.^[12]

Each of these rules would apply only to transactions occurring on or after the date final regulations are published, subject to transition rules.^[13] According to the Withdrawal Notice, the IRS and Treasury will continue to study the issues addressed in the 2016 Proposed Regulations.

III. Observations

The withdrawal of the per se device test is a welcome change. Under that test, no business purpose, however strong, would have been sufficient to address a device presumption under the mechanical rules. As a result of the withdrawal, a distribution involving significant assets not used in an ATB will continue to be tested under the facts-and-circumstances rules of the existing regulations. Importantly, however, if the IRS and Treasury were to finalize the portion of the 2016 Proposed Regulations relating to business purpose as a nondevice factor, the withdrawal of the per se device test would be cold comfort to many taxpayers. That is, the inability to use a strong business purpose as evidence of nondevice would still adversely impact many transactions to which the per se rule would have applied.

The withdrawal of the anti-abuse rules is also welcome but not as significant. Transactions undertaken to change a corporation’s asset mix remain subject to various judicial anti-abuse doctrines, and the existing regulations take into account “the nature, kind, amount, and use of the assets” of each corporation immediately after the transaction.^[14] In addition, the Withdrawal Notice withdraws the anti-abuse rule for the minimum ATB requirement, but, without explanation, not the substantive requirement itself.

For now, a distribution that leaves either corporation with a large proportion of nonbusiness assets should continue to be supported by a strong, well-documented business purpose, and taxpayers planning such a distribution should watch for further action on the proposals that remain outstanding.

^[1] Unless indicated otherwise, all “section” references are to the Internal Revenue Code of 1986, as amended (the Code), and all “Treas. Reg. §” and “Prop. Treas. Reg. §” references are to the final and proposed Treasury regulations, respectively, promulgated under the Code, in each case as in effect as of the date of this alert. “IRS” refers to the Internal Revenue Service, and “Treasury” refers to the U.S. Department of the Treasury.

^[2] Guidance Under Section 355 Concerning Device and Active Trade or Business; Partial Withdrawal, REG-134016-15, RIN 1545-BN47. The Withdrawal Notice was released for public inspection on October 20, 2026, and is expected to be published in the Federal Register on October 21, 2026. The 2016 Proposed Regulations were published at 81 Fed. Reg. 46,004 (July 15, 2016).

[3] The Withdrawal Notice follows the withdrawal on September 30, 2025, of proposed regulations under sections 355, 357, 361, and 368, and of related multi-year reporting regulations, each published on January 16, 2025, as well as the issuance of Rev. Proc. 2025-30, which superseded Rev. Proc. 2024-24. In both cases, the IRS and Treasury withdrew the proposed rules in response to critical comments. See REG-112261-24 and REG-116085-23, 90 Fed. Reg. 46,776 (Sept. 30, 2025); Rev. Proc. 2025-30, 2025-42 I.R.B. 489.

[4] Treas. Reg. § 1.355-2(d)(1).

[5] Treas. Reg. § 1.355-2(d)(3)(ii).

[6] 81 Fed. Reg. at 46,010; Prop. Treas. Reg. § 1.355-2(d)(5)(i).

[7] 81 Fed. Reg. at 46,010; Prop. Treas. Reg. § 1.355-2(d)(5)(iii).

[8] 81 Fed. Reg. at 46,012; Prop. Treas. Reg. §§ 1.355-2(d)(2)(iv)(E) and (d)(5)(iv) and 1.355-9(d).

[9] Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(C).

[10] Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(C); 81 Fed. Reg. at 46,010.

[11] Prop. Treas. Reg. § 1.355-2(d)(3)(ii).

[12] Prop. Treas. Reg. § 1.355-9(b); 81 Fed. Reg. at 46,011.

[13] Prop. Treas. Reg. §§ 1.355-2(i)(1) and 1.355-9(e).

[14] Treas. Reg. § 1.355-2(d)(2)(iv)(A).

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Gibson Dunn lawyers are available to assist in addressing any questions you may have regarding this decision. To learn more about these issues or discuss how they might impact your business, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any member of the firm's [Tax](#) and [Tax Controversy and Litigation](#) practice groups:

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