DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–112261–24]

RIN 1545–BR32

Guidance Regarding Certain Matters Relating to Nonrecognition of Gain or Loss in Corporate Separations, Incorporations, and Reorganizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding certain matters relating to corporate separations, incorporations, and reorganizations qualifying, in whole or in part, for nonrecognition of gain or loss. These matters include distributions and retentions of controlled corporation stock, assumptions of liabilities by controlled corporations, exchanges of property between distributing corporations and controlled corporations, and distributions and transfers of consideration to distributing corporation shareholders and creditors. The proposed regulations would affect corporations and their shareholders and security holders. Proposed regulations modifying the reporting requirements for corporate separations are published elsewhere in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Written or electronic comments and requests for a public hearing must be received by March 17, 2025.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG–112261–24) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the ''Comments and Requests for a Public Hearing'' section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments to the IRS's public docket. Send paper submissions to CC:PA:01:PR (REG–112261–24), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Justin R. Du Mouchel at (202) 317–6975 (not a toll-free number); concerning submissions of comments and requests for a hearing, contact the Publications and Regulations branch at (202) 317–6901 (not a toll-free number) or by email to *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed regulations under sections 355, 357, 361, and 368 of the Internal Revenue Code (Code) that would amend 26 CFR part 1 (Income Tax Regulations) by providing guidance regarding certain matters relating to corporate separations, reorganizations, and incorporations qualifying, in whole or in part, for nonrecognition of gain or loss. The proposed additions and amendments to the Income Tax Regulations are issued pursuant to the express delegations of authority to the Secretary of the Treasury or her delegate (Secretary) provided under sections 337(d), 361(b)(3), and 7805(a) of the Code.

Section 337(d) states, in part, that ''[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986,'' including regulations ''to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations and part III of this subchapter).'' Relating to the treatment of transfers to creditors, the second sentence of section 361(b)(3) states that ''[t]he Secretary may prescribe such regulations as may be necessary to prevent avoidance of tax through abuse of the preceding sentence or [section 361](c)(3).'' Finally, section 7805(a) authorizes the Secretary to ''prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.''

Background

I. Overview of Section 355

A. Section 355 Transactions

1. In General

If a transaction satisfies the requirements of section 355 (section 355 transaction) and other relevant provisions of the Code and Income Tax Regulations, the transaction may occur without recognition of any gain or loss to the distributing corporation (within the meaning of section 355(a)(1)(A)) and without recognition of any gain or loss to, or the inclusion of any amount in the income of, the shareholders or security holders of the distributing corporation. A section 355 transaction may take one of the following forms: (i) a spin-off, which is a pro rata distribution of stock of the controlled corporation (within the meaning of section 355(a)(1)(A)) to shareholders of the distributing corporation; (ii) a split-off, which is a distribution of stock of the controlled corporation to some (but not all) shareholders of the distributing corporation in exchange for some or all of their stock of the distributing corporation; or (iii) a split-up, which is a liquidating distribution in which the distributing corporation distributes to its shareholders, either pro rata or non-pro rata, the stock of more than one controlled corporation. As discussed in parts I.A.3 and I.A.4 of this Background, a section 355 transaction may occur either as a ''section 355(c) distribution'' or as part of a ''divisive reorganization.''

2. General Utilities Repeal

In *General Utilities & Operating Co.* v. *Helvering,* 296 U.S. 200 (1935), the Supreme Court of the United States (Supreme Court) held that corporations generally could distribute appreciated property to their shareholders without the recognition of any corporate-level gain (*General Utilities* doctrine). Congress repealed the *General Utilities* doctrine beginning with legislation in 1969 and culminating with the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2085), which, among other changes, amended sections 311, 336, and 337 of the Code (originally enacted in the Internal Revenue Code of 1954 (1954 Code) (Public Law 83–591, 68A Stat. 3) to apply gain and loss recognition to non-liquidating and liquidating distributions, respectively.

Notwithstanding the repeal of the *General Utilities* doctrine, section 355 allows a distributing corporation to distribute the stock and securities of a subsidiary (that is, a controlled corporation) to its shareholders without imposing a corporate-level tax on the distribution. Accordingly, as observed by the United States Tax Court (Tax Court), ''more attention has been directed toward [s]ection 355 today than was ever the case in the past [because] it is one of the few (some might say the only) viable opportunity to escape the repeal of the *General Utilities* doctrine.'' *McLaulin* v. *Comm'r,* 115 T.C. 255, 266 (2000).

In connection with the repeal of the *General Utilities* doctrine, Congress authorized the Treasury Department to promulgate regulations to carry out the purposes of that repeal, including by

preventing its avoidance. Specifically, section 337(d) directs the Secretary to prescribe regulations that are necessary or appropriate to carry out the purposes of *General Utilities* repeal, including ''regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including . . . part III of this subchapter).'' Section 355, among other corporate organization and reorganization provisions, is included in part III of subchapter C of chapter 1 of the Code (subchapter C).

3. Section 355(c) Distributions

The general rule set forth in section 355(c)(1) provides that no gain or loss is recognized to a distributing corporation upon any distribution to which section 355 (or so much of section 356 of the Code as relates to section 355) applies and that is not made pursuant to a plan of reorganization (section 355(c) distribution). However, if the distributing corporation distributes any property other than stock or securities of a controlled corporation (that is, any property other than qualified property, as defined in section 355(c)(2)(B)) in a section 355(c) distribution, and if the fair market value of that property exceeds the distributing corporation's adjusted basis in that property, then section 355(c)(2)(A) requires the distributing corporation to recognize gain as if the property were sold to the distributee at its fair market value. This Federal income tax treatment reflects the status of section 355 as a narrow exception to *General Utilities* repeal. *Compare* section 311(b).

Because a section 355(c) distribution is not made pursuant to a plan of reorganization, a section 355(c) distribution (unlike a divisive reorganization) does not permit the distributing corporation to satisfy distributing corporation debt constituting securities with property other than qualified property. In other words, because a section 355(c) distribution does not qualify as a reorganization under the definitional provisions of section 368(a)(1), the operative provision set forth in section 361(b)(3) is not applicable. Therefore, in a section 355(c) distribution, a distributing corporation cannot transfer any property other than qualified property to its creditors (including its security holders) without recognizing gain or loss on that transfer.

4. Divisive Reorganizations

A distributing corporation may carry out a section 355 transaction as part of a transaction that qualifies as a reorganization under section 368(a)(1)(D) or (G) and to which section 354 of the Code (or so much of section 356 as relates to section 354) does not apply (divisive reorganization). Section 368(a)(1)(D) provides, in part, that a reorganization includes a transfer by the distributing corporation of all or a part of its assets to a controlled corporation if, immediately after the transfer, the distributing corporation or one or more of its shareholders (including persons who were shareholders immediately before the transfer) are in control (within the meaning of section 368(c)) of the controlled corporation; but only if, pursuant to the plan of reorganization, stock or securities of the controlled corporation are distributed in a transaction that qualifies under section 355 or 356.

Under section 368(a)(1)(G), a transfer by a distributing corporation of all or a part of its assets to a controlled corporation in a case under title 11 of the United States Code or a similar case described in section 368(a)(3)(A)(ii) (title 11 or similar case) also is a divisive reorganization if, pursuant to the plan of reorganization, stock or securities of the controlled corporation are distributed in a transaction that qualifies under section 355 (or so much of section 356 as relates to section 355). Section 368(a)(3)(C) provides an ordering rule under which a transaction that would qualify both under section 368(a)(1)(G) and, among other provisions, under section 368(a)(1)(D) or section 351 of the Code, is treated as qualifying solely under section 368(a)(1)(G) for all purposes of subchapter C other than section 357(c)(1).

If a transaction satisfies the definitional requirements of section 368(a)(1)(D) or (G), the distributing corporation may qualify for nonrecognition treatment for (i) its exchange of property with the controlled corporation, (ii) its distribution of certain property to its shareholders, and (iii) its transfer of certain property to its creditors. Under section 357(a), the controlled corporation generally may assume distributing corporation liabilities without the distributing corporation recognizing gain or loss, except as provided in (i) section 357(b) (if the principal purpose for the liability assumption is to avoid Federal income tax or is not a bona fide business purpose), and (ii) section 357(c) (if the sum of the amount of liabilities assumed by the controlled corporation is greater than the total adjusted basis of assets transferred in the exchange).

Under section 361(a), the distributing corporation recognizes no gain or loss if it exchanges property pursuant to the plan of reorganization solely for stock and securities in the controlled corporation. Under section 361(b)(1)(A), if section 361(a) would apply to an exchange but for the fact that the property received by the distributing corporation also includes money or other property, no gain will be recognized by the distributing corporation if it distributes the money or other property pursuant to the plan of reorganization. Under section 361(b)(3), the distributing corporation also generally may transfer that money or other property in connection with the reorganization to its creditors in satisfaction of distributing corporation debt held by those creditors, without recognition of gain or loss under section 361(b)(1)(A) to the extent the sum of the money and the fair market value of the other property transferred to such creditors does not exceed the adjusted bases of such assets transferred (reduced by the amount of liabilities assumed within the meaning of section 357(c)).

Under section 361(c)(1), the distributing corporation recognizes neither gain nor loss on its distribution of qualified property to its shareholders pursuant to the plan of reorganization. For this purpose, section 361(c)(2)(B) defines ''qualified property'' as any stock in, right to acquire stock in, or obligation of (i) the distributing corporation, or (ii) another corporation that is a party to the reorganization (for example, the controlled corporation) if such stock, stock right, or obligation is received by the distributing corporation in the exchange. In connection with the reorganization, the distributing corporation also generally may transfer that qualified property to its creditors in satisfaction of distributing corporation debt held by those creditors, without recognition of gain or loss under section 361(c).

For purposes of this preamble, the term ''section 361 consideration'' means, as described in section 361(a) and (b), the consideration received by a target corporation from an acquiring corporation in exchange for property transferred by the target corporation to the acquiring corporation pursuant to a plan of reorganization. Accordingly, in the context of a divisive reorganization, the term ''section 361 consideration'' means, for purposes of this preamble, the consideration received by the distributing corporation from the controlled corporation in exchange for property transferred by the distributing corporation to the controlled corporation pursuant to the plan of reorganization.

B. General Federal Income Tax Consequences to Distributing Corporation Shareholders

Section 355(a)(1) provides that, if a distributing corporation distributes to its shareholders with respect to its stock, or distributes to its security holders in exchange for their securities, solely stock or securities of a controlled corporation, and if certain other requirements are satisfied, then no gain or loss is recognized by, and no amount is included in the income of, the distributing corporation's shareholders or security holders upon the receipt of stock or securities of the controlled corporation. However, if any property is received that is not permitted to be received under section 355(a)(1), then section 356 (and not section 355) applies to the receipt of such property as provided in sections 355(a)(4)(A) and 356.

C. General Requirements for Qualification Under Section 355

To qualify as a section 355 transaction under section 355(a)(1), a transaction must satisfy the following requirements. First, under section 355(a)(1)(A), the distributing corporation must distribute stock or securities of a controlled corporation to a shareholder with respect to distributing corporation stock, or to a security holder in exchange for its securities. Second, under section 355(a)(1)(B), the transaction may not be used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporation, or both. Third, under section 355(a)(1)(C), the distributing corporation and each controlled corporation must satisfy the active trade or business requirements of section 355(b).

With particular regard to these proposed regulations, section 355(a)(1) imposes a fourth requirement regarding distributions of controlled corporation stock and securities. Specifically, section 355(a)(1)(D) requires that, ''as part of the distribution,'' the distributing corporation must distribute either (i) all stock and securities in the controlled corporation held by the distributing corporation immediately before the distribution, or (ii) an amount of stock in the controlled corporation constituting ''control'' within the meaning of section 368(c) (control distribution). In the case of distributions of less than 100 percent of stock in the controlled corporation, it must be established to the satisfaction of the Secretary that the retention by the distributing corporation of stock (or stock and securities) of the controlled corporation was not pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax. For purposes of this preamble, such a retention of controlled corporation stock (or stock and securities) by the distributing corporation is referred to as a ''retention,'' and the requirements in section 355(a)(1)(D) are referred to collectively as the ''distribution requirement.''

D. The Distribution Requirement and Retentions

1. Overview

As described in part I.C of this Background, the distribution requirement consists of two alternative rules. Under section 355(a)(1)(D)(i), the distributing corporation will satisfy the distribution requirement if it distributes all stock and securities in the controlled corporation held by the distributing corporation immediately before the distribution. Alternatively, under section 355(a)(1)(D)(ii), the distributing corporation will satisfy the distribution requirement if it satisfies the following two discrete requirements: (i) the distributing corporation distributes an amount of controlled corporation stock sufficient to qualify as a control distribution; and (ii) the distributing corporation establishes to the satisfaction of the Secretary that the retention of any controlled corporation stock or securities was not pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax.

2. Requirements for Control Distribution; Commissioner v. Gordon

Section 355(a)(1)(D) provides that, if a distributing corporation does not distribute all its stock and securities in the controlled corporation, the distributing corporation must make a control distribution as ''part of the distribution.'' However, section 355(a)(1)(D) does not expressly impose a temporal requirement for making a control distribution. Accordingly, section 355(a)(1)(D) could be read as permitting a control distribution to occur over multiple taxable years of the distributing corporation.

In *Commissioner* v. *Gordon,* 391 U.S. 83 (1968), the Supreme Court considered the application of the distribution requirement to distributions by Pacific Telephone and Telegraph Company (Pacific) of stock of a newly formed, wholly owned subsidiary (Northwest) over multiple taxable years of Pacific. American Telephone and Telegraph Company (AT&T), which owned approximately 90 percent of the stock of Pacific, decided to separate Pacific into two separate companies and, to effectuate that separation, caused Pacific to engage in the following transactions. First, pursuant to a plan of reorganization submitted to its shareholders, Pacific issued to its shareholders (including the taxpayer) transferable rights to acquire approximately 57 percent of the stock of Northwest on September 29, 1961. That plan of reorganization also provided that Pacific had an ''expectation'' that the remaining 43 percent of Northwest stock would be offered to Pacific's shareholders. Among other reasons for not distributing 100 percent of its Northwest stock, Pacific desired to achieve an appropriate capital structure and avoid potential State regulatory issues. On June 12, 1963, Pacific issued to its shareholders transferable rights to acquire the remaining 43 percent of Northwest stock. The taxpayer contended that the 1961 and 1963 distributions collectively qualified under section 355.

The Court concluded that neither distribution qualified under section 355, notwithstanding Pacific's ''expectation'' regarding the second distribution and its purposes for making multiple distributions. *Gordon,* 391 U.S. at 98. In its analysis, the Court expressed a general principle of Federal income tax that, ''[a]bsent other specific directions from Congress, Code provisions must be interpreted so as to conform to the basic premise of annual tax accounting.'' *Id.* at 96. With regard to the distribution requirement, the Court noted that, if an initial transfer of less than a controlling interest in the controlled corporation is to be treated for Federal income tax purposes as a mere first step in the divestiture of control, ''it must at least be identifiable as such at the time it is made.'' *Id.* The Court further stated that the requirement that the character of a transaction be determinable ''does not mean that the entire divestiture must necessarily occur within a single tax year,'' but it does mean that, if one transaction is to be characterized as a ''first step,'' then ''there must be a binding commitment to take the later steps.'' *Id.* Of particular relevance to both the IRS's administrative function and the objective of these proposed regulations to provide increased certainty (*see* part IV of this Background), the Court expressed that it would be wholly inconsistent with the annual accounting premise to hold that the essential character of a transaction, and its Federal income tax impact, should remain ''not only undeterminable but unfixed for an

indefinite and unlimited period in the future, awaiting events that might or might not happen.'' *Id.*

The Court found that the facts and circumstances of Pacific's staggered distributions of Northwest stock, as reflected in Pacific's plan of reorganization, failed the binding-commitment standard set forth by the Court. *Id.* at 97. Although Pacific's plan of reorganization evidenced an expectation to distribute its remaining Northwest stock within a three-year period following its initial 57-percent distribution, the Court emphasized that ''there is obviously no promise to sell any particular amount of stock, at any particular time, at any particular price'' set forth in that document. *Id.* Instead, Pacific's plan of reorganization merely stated that such subsequent distributions would occur ''[a]t a time or times related to its (Pacific's) need for new capital.'' *Id.* Consequently, the Court reasoned that, ''[i]f the 1961 distribution played a part in what later proved to be a total divestiture of the Northwest stock, it was not, in 1961, either a total divestiture or a step in a plan of total divestiture.'' *Id.* at 97–98.

3. Retentions

Section 1.355–2(e), which reiterates the distribution requirement, provides that the corporate business purpose or purposes for the distribution ordinarily will require the distribution of all stock and securities of the controlled corporation. If the distributing corporation retains any controlled corporation stock or securities, and if it is not established to the satisfaction of the Commissioner that the retention was not pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax, section 355 does not apply to the entire distribution (that is, the entire distribution fails to qualify as a section 355 transaction).

In Rev. Rul. 75–321, 1975–2 C.B. 123, the IRS addressed whether the retention by a widely held and publicly traded corporation (Distributing) of stock in its banking subsidiary (Controlled) complied with section 355(a)(1)(D)(ii) (that is, whether the retention was pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax). In this revenue ruling, Distributing distributed 95 percent of the stock of Controlled to Distributing's shareholders to comply with Federal banking laws in a transaction that otherwise satisfied the requirements of section 355. Distributing retained 5 percent of Controlled's stock to meet collateral requirements for short-term financing. The IRS concluded that the retention was not pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax, because (i) a genuine separation of the corporate entities was effectuated, (ii) retention of a 5-percent stock interest in Controlled would not enable Distributing to maintain practical control over Controlled following the distribution, and (iii) a sufficient corporate business purpose existed for Distributing's retention of the 5-percent interest in Controlled. *See also* Rev. Rul. 75–469, 1975–2 C.B. 126 (similar ruling with respect to a distributing corporation's retention of controlled corporation securities to serve as collateral for a bank loan to the distributing corporation).

Similarly, in G.C.M. 32136 (Oct. 23, 1961), the IRS considered whether the retention by a distributing corporation (Distributing) of stock in a newly formed controlled corporation (Controlled) was pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax. Under the facts described in that memorandum, Distributing distributed 80 percent of Controlled stock to Distributing's shareholders to comply with State banking laws in a transaction that otherwise satisfied the requirements of section 355, and Distributing retained 20 percent of Controlled stock. The avowed purpose for the retention was to permit a controlling group of Distributing's shareholders to maintain effective control over Controlled. In concluding that Distributing had a Federal income tax avoidance purpose for the retention, the IRS determined that the requirement that a retention be specially justified ''seems most likely to be intended to insure a genuine separation.'' *See also* G.C.M. 32380 (Aug. 24, 1962) (reiterating that view).

II. Definitional and Operative Provisions Regarding Reorganizations

A. Overview

Subchapter C generally includes (i) definitional provisions, including under section 368, and (ii) operative provisions, including under sections 354, 356, 357, and 361. *See, for example, Microdot, Inc.* v. *United States,* 728 F.2d 593, 598 (2d Cir. 1984) (''Section 368(a)(1) is a definitional section, wholly distinct from [section] 354.''). As described in greater detail in part II.B of this Background, section 368(a)(1) defines the term ''reorganization'' as seven specifically described types of transactions under subparagraphs (A) through (G). Qualification of a transaction (or series of transactions) for a definitional provision under section 368(a)(1) is the sole manner by which the application of an operative provision relating to a reorganization can occur. This statutory structure ensures that the tax-advantaged treatment provided by such operative provisions applies exclusively to those transactions that satisfy all statutory, regulatory, and judicial requirements for a particular definitional provision (for example, the continuity of interest and continuity of business enterprise requirements). As discussed in greater detail in part III of this Background, a primary purpose of the ''plan of reorganization'' requirement is to ensure that a transaction to which an operative provision is purported to apply is sufficiently connected to a reorganization defined in section 368(a)(1).

B. Section 368: Definitions Relating to Corporate Reorganizations

Section 368(a)(1) is the primary definitional provision of subchapter C with regard to reorganizations. For purposes of parts I through III of subchapter C, section 368(a)(1) defines the term ''reorganization'' to mean any of the seven types of transactions described in section 368(a)(1)(A) through (G), including triangular reorganizations (as defined in § 1.358–6(b)(2)) that are variants of such transactions and divisive reorganizations described in section 368(a)(1)(D) and (G). Section 368(a)(2) provides special rules that support the definitional provisions set forth in section 368(a)(1), and section 368(a)(3) similarly provides additional rules relating to title 11 or similar cases.

Section 368(b) and (c) also contains definitional provisions. For purposes of part III of subchapter C, section 368(b) generally defines the term ''a party to a reorganization'' to include (i) a corporation resulting from a reorganization, and (ii) both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another. Section 368(b) defines other corporations as parties to a transaction depending on the type of transaction. *See also* § 1.368–2(f).

For purposes of subchapter C (other than sections 304 and 385 of the Code), section 368(c) defines the term ''control'' to mean the ownership of (i) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and (ii) at least 80 percent of the total number of shares of all other classes of stock of the corporation. *See also* Rev. Rul. 59–259, 1959–2 C.B. 115 (requiring

ownership of (i) stock possessing at least 80 percent of the total combined voting power of all classes of voting stock, and (ii) at least 80 percent of the total number of shares of each class of outstanding non-voting stock).

C. Section 357: Assumptions of Liabilities by Transferee Corporations

1. Overview

Section 357 is an operative provision that facilitates exchanges involving the assumption of liabilities by generally preventing such assumptions from (i) being treated as the receipt of money or other property in an exchange, and (ii) disqualifying the exchange for nonrecognition treatment. *See* section 357(a); *see also* the anti-abuse rule in section 357(b) and the adjusted basis limitation in section 357(c). Section 357 reflects Congress's view that, ''[i]n typical transactions changing the form or entity of a business it is not customary to liquidate the liabilities of the business and such liabilities are almost invariably assumed by the corporation which continues the business,'' but that nonrecognition treatment in section 357 should be limited solely to ''bona fide transactions of this type.'' H.R. Rep. No. 76–855, at 19 (1939) (Conf. Rep.).

2. Response to United States v. Hendler

The original predecessor to current section 357, section 112(k) of the Internal Revenue Code of 1939 (1939 Code), was enacted by Congress as section 213(a) of the Revenue Act of 1939 (Public Law 76–155, 53 Stat. 862, 870) to address the adverse consequences of judicial and taxpayer interpretations of the Supreme Court's decision in *United States* v. *Hendler,* 303 U.S. 564 (1938). *See* S. Rep. No. 76–648, at 3 (1939) (referencing the *Hendler* opinion by name). In *Hendler,* the Court examined the Federal income tax consequences of a transaction that qualified as a reorganization under section 112 of the Revenue Act of 1928 (Public Law 70–562, 45 Stat. 791). As part of the reorganization, the transferee corporation (Borden Company) assumed and paid the indebtedness of the transferor (Hendler Company). The Court regarded the assumption and payment in substance as though the Borden Company had made the payment directly to the Hendler Company. *Hendler,* 303 U.S. at 566. Based on that treatment, the Court viewed the Hendler Company in substance as receiving money or other property that it failed to distribute to its shareholders (because that payment was made to a Hendler Company creditor, albeit in form by the Borden Company). *Id.* Accordingly, the Court held that the Hendler Company recognized gain in the amount of that payment. *Id.* at 567.

Following the *Hendler* decision, Congress observed that the Court's analysis had ''been *broadly interpreted* to require that, if a taxpayer's liabilities are assumed by another party in what is otherwise a tax-free reorganization, gain is recognized to the extent of the assumption.'' H.R. Rep. No. 76–855, at 19 (emphasis added). In other words, as successfully argued by the IRS in cases following *Hendler,* a transferee corporation's lack of payment of the liabilities was immaterial for the *Hendler* analysis to apply to treat the transferee corporation's assumption of a transferor's liabilities as a cash payment to the transferor. *See Haass* v. *Comm'r,* 37 B.T.A. 948, 955 (1938). The IRS advocated for this broad interpretation in response to an aggressive position taken by taxpayers, who relied on the *Hendler* decision to argue that the basis of stock they had received in prior exchanges should be increased by the amount of gain that *should have been recognized and taxed* by reason of the transferee corporation's assumption of liabilities, even though that gain had not actually been taxed by the IRS (and that tax had not been paid).

However, this broad interpretation jeopardized the nonrecognition treatment of bona fide assumptions carried out as part of reorganizations that Congress originally had intended to facilitate through the enactment of the reorganization provisions. *See* H.R. Rep. No. 76–855, at 19 (''Your committee therefore believes that such a broad interpretation as is indicated above will largely nullify the provisions of existing law which postpone the recognition of gain in such cases.'').

3. Enactment of Section 357(a) and (b)

Congress enacted section 112(k) of the 1939 Code to balance (i) the need to facilitate the bona fide assumption of liabilities in transactions that satisfy the definitional requirements of a reorganization, with (ii) the need to minimize abusive tax planning through such assumptions (including through transitory transactions). Accordingly, section 112(k) of the 1939 Code provided for both (i) the general nonrecognition treatment adopted by section 357(a) of the 1954 Code and set forth in current section 357(a), and (ii) a supporting anti-abuse provision adopted by section 357(b) of the 1954 Code and set forth in current section 357(b).

Under section 357(b)(1), the total amount of liabilities assumed in an assumption described in section 357(a) is treated for purposes of section 351 or 361 (as applicable) as money received by the transferor in the exchange if *it appears* that the principal purpose of the transferor with respect to the assumption was (i) to avoid Federal income tax on the exchange, or (ii) not a bona fide business purpose. In effect, section 357(b) can apply to a transaction to preserve the treatment required by *Hendler* for such abusive assumptions.

In making the determination required by section 357(b)(1), the nature of the liabilities and the circumstances under which the arrangement for the assumption was made are taken into account. In addition, section 357(b)(2) provides that, in any suit or proceeding in which the burden is on the transferor to prove that the liability assumption should not be treated as money received in the exchange, the transferor must meet that burden by a clear preponderance of the evidence.

4. Application of Section 357(b) to Divisive Reorganizations

In Rev. Rul. 79–258, 1979–2 C.B. 143, the IRS considered the application of section 357(b) to the assumption by a newly formed transferee corporation (Controlled) of a liability incurred by the transferor (Distributing) in close temporal proximity to, and in anticipation of, a transaction that qualified as a divisive reorganization under sections 355 and 368(a)(1)(D). One of the Distributing liabilities that Distributing desired Controlled to assume was a $4,000x portion of a $25,000x long-term debt owed to an insurance company that Distributing had incurred in connection with the business transferred to Controlled, and that had been outstanding for several years before the divisive reorganization (historical Distributing debt). However, Distributing could not apportion the historical Distributing debt between it and Controlled because the insurance company refused to relieve Distributing of its primary liability for repayment.

Therefore, in exchange for $4,000x in loan proceeds, Distributing issued a new long-term note for which Distributing was primarily liable to a bank (new Distributing debt). Distributing then caused Controlled to assume the new Distributing debt in the divisive reorganization, and Distributing was relieved of its primary repayment liability (Controlled assumption). The proceeds of the new Distributing debt were used by Distributing to pay off $4,000x of the historical Distributing debt. Distributing then distributed the Controlled stock to Distributing's shareholders.

From Distributing's standpoint, having Controlled assume the new Distributing debt was desirable because, absent Controlled's assumption of this debt, Distributing's assets would be reduced by the value of the Controlled stock (which was distributed to Distributing's shareholders), but Distributing's liabilities would not be reduced by the $4,000x liability attributable to the business transferred to Controlled. As a result, Distributing's ability to borrow (and its ability to pay off the portion of the historical Distributing debt attributable to the business transferred to Controlled) could be adversely affected if Controlled did not assume the new Distributing debt.

To determine the potential application of section 357(b), the IRS engaged in a detailed analysis of the facts and circumstances relating to the issuance of the new Distributing debt and the Controlled assumption. First, the IRS observed that Distributing used the proceeds of the new Distributing debt to satisfy $4,000x of the historical Distributing debt, thereby placing Distributing and Controlled in the same net economic position after the Controlled assumption as each corporation would have been in had Controlled been able to assume $4,000x of the historical Distributing debt. Second, the IRS observed that the incurrence of the new Distributing debt and the Controlled assumption not only were necessary to effectuate the divisive reorganization, but also were a normal adjunct to the divisive reorganization given the non-assumable nature of part of the historical Distributing debt. Third, the IRS observed that Distributing's incurrence of the new Distributing debt and the Controlled assumption merely were in substitution for Controlled's assumption of a pro rata portion of the historical Distributing debt that Controlled could not assume. In that regard, because the divisive reorganization resulted in Controlled assuming a liability in an amount that properly related to its business operations and would be satisfied from earnings generated by those operations, the IRS viewed the incurrence of the new Distributing debt and the Controlled assumption as consistent with sound business practice. Accordingly, the IRS concluded that tax avoidance was not a principal purpose of the transaction and, therefore, that section 357(b) did not apply to the Controlled assumption.

Additionally, the IRS determined that the acquisition of the new Distributing debt and the Controlled assumption would not be viewed for Federal income tax purposes as if Controlled had obtained the new Distributing debt and transferred the proceeds to Distributing. In this regard, the IRS found it immaterial that Distributing and Controlled may have been able to arrange their affairs in another manner, because the taxpayer satisfied its burden of proof as required under section 357(b). *See Simpson* v. *Comm'r,* 43 T.C. 900, 916 (1965) (stating that the application of section 357(b) is limited to transactions ''arranged primarily so that the assumption of the [transferor]'s liability in the transaction itself results in tax avoidance for the transferor, or has no bona fide business purpose,'' and that section 357(b) was not intended to require recognition of gain on bona fide transactions designed to rearrange one's business affairs in such a manner as to minimize taxes in the future, consistent with existing provisions of the law); *ISC Industries, Inc.* v. *Comm'r,* T.C. Memo. 1971–283 (concluding that petitioner's principal purpose in having a new subsidiary assume liabilities placed upon the assets transferred to the subsidiary was not to avoid Federal income taxes on the transfer, but rather was to protect lines of credit for petitioner's finance business, and finding it immaterial that petitioner may have been able to arrange its affairs in another manner, or in a manner that produced more tax revenue, because section 357(b) clearly looks to the taxpayer's motives for doing what actually occurred).

5. Application of Section 357(c)

In the case of an exchange to which section 351 applies (section 351 exchange) or to which section 361 applies by reason of a divisive reorganization that qualifies under sections 355 and 368(a)(1)(D), section 357(c)(1) generally provides that, if the sum of the amount of the transferor's liabilities assumed by the transferee corporation exceeds the total adjusted basis of the assets transferred by the transferor to the transferee corporation in the exchange, then such excess is considered as a gain from the sale or exchange of a capital asset or of property that is not a capital asset, as the case may be. *See also* section 368(a)(3)(C) (providing that a reorganization that would qualify under both section 368(a)(1)(D) and (G) is treated as qualifying under section 368(a)(1)(D) for purposes of section 357(c)(1)).

However, section 357(c)(2) provides that the general rule in section 357(c)(1) does not apply to any exchange (i) to which section 357(b) applies, or (ii) that is pursuant to a plan of reorganization within the meaning of section 368(a)(1)(G) in which no former shareholder of the transferor receives any consideration for its stock. Rev. Rul. 2007–8, 2007–1 C.B. 469, holds that the general rule in section 357(c)(1) does not apply to a section 351 exchange if that transaction also qualifies as a reorganization described in section 368(a)(1)(A), (C), (D) (provided the requirements of section 354(b)(1) are satisfied), or (G) (provided the requirements of section 354(b)(1) are satisfied).

Furthermore, under section 357(c)(3), if the transferor transfers in a section 351 exchange (including a divisive reorganization that overlaps with a section 351 exchange; *see* section 357(c)(3) (referencing an exchange to which section 357(c)(1) applies)) a liability the payment of which either would give rise to a deduction or would be described in section 736(a) of the Code (concerning payments made in liquidation of the partnership interest of a retiring or deceased partner), the amount of such liability is excluded in determining the amount of liabilities assumed under section 357(c)(1) unless the incurrence of the liability resulted in the creation of (or an increase in) the basis of any property. In addition, liabilities the payment of which would give rise to a capital expenditure are not included for purposes of section 357(c)(1) unless the incurrence of the liability resulted in the creation of (or an increase in) the basis of any property. *See* Rev. Rul. 95–74, 1995–2 C.B. 36.

D. Section 361: Distributions to Shareholders of Target Corporation

1. Overview

Section 361 is an operative provision applicable to certain exchanges and distributions of property in a transaction that satisfies the definitional requirements for qualification as a reorganization under section 368(a)(1). Section 361(a) and (b) provides the Federal income tax consequences to a target corporation (such as a distributing corporation in a divisive reorganization) that (i) is a party to a reorganization, and (ii) pursuant to the plan of reorganization, exchanges property with an acquiring corporation (such as a controlled corporation in a divisive reorganization) that also is a party to the reorganization. Section 361(c) provides the Federal income tax consequences to the target corporation (such as a distributing corporation in a divisive reorganization) of the distribution by the target corporation to its shareholders, or transfer to its creditors, of certain property in pursuance of or in

connection with the plan of reorganization that includes the exchange of property with an acquiring corporation (such as a controlled corporation in a divisive reorganization) that also is a party to the reorganization. *See* the discussion in part III.A of this Background (noting that the phrases ''in pursuance of'' and ''in connection with'' in section 361 convey the same meaning).

2. Enactment of Section 361(a): Purely Paper Transactions

The original predecessor to current section 361(a) was enacted by Congress as part of section 202(b) of the Revenue Act of 1918 (Pub. L. 65–254, 40 Stat. 1057, 1060 (1919)). The applicable part of section 202(b) of the Revenue Act of 1918 was subsequently incorporated in section 112 of the 1939 Code before being adopted as section 361(a) of the 1954 Code and thereafter as current section 361(a).

Congress enacted the applicable part of section 202(b) of the Revenue Act of 1918 ''to establish the rule for determining taxable gains in the case of exchanges of property and to negate the assertion of tax in the case of certain purely paper transactions.'' S. Rep. No. 65–617, at 5 (1918). As stated in the legislative history, the substance of the original predecessor to section 361(a) is that (i) when property is exchanged for other property, the property received in the exchange should be treated as the equivalent of cash in the amount of its fair market value, but (ii) when, in connection with the reorganization or consolidation of a corporation, a person receives, in place of stock or securities, new stock or securities of no greater aggregate par value, or when a person receives, in place of property, stock of a corporation formed to take over such property, no gain or loss should be deemed to occur from the exchange. *See id.* at 5–6.

More than a century after the enactment of its original predecessor, section 361(a) continues to provide generally that a corporation (that is, the target corporation) that is a party to a reorganization (such as the distributing corporation in a divisive reorganization) recognizes no gain or loss if it exchanges property pursuant to the plan of reorganization solely for stock and securities in another corporation (that is, the acquiring corporation) that is a party to the reorganization (such as a controlled corporation in a divisive reorganization).

3. Enactment of Section 361(b): Conduit for Distribution to Shareholders

The original predecessor to current section 361(b) was enacted by Congress as section 203(e) of the Revenue Act of 1924 (Pub. L. 68–176, 43 Stat. 253, 256). Section 203(e) of the Revenue Act of 1924 was subsequently incorporated in section 112 of the 1939 Code before being adopted as section 361(b) of the 1954 Code and thereafter as current section 361(b).

Congress enacted section 203(e) of the Revenue Act of 1924 to provide that (i) if the corporation that sells its assets in connection with the reorganization ''acts merely as a conduit'' in passing the sale proceeds on to its shareholders, no gain to the corporation is to be recognized, but (ii) if the corporation ''retains the entire amount of proceeds with the result that the transaction is in substance a real sale, then the gain shall be recognized.'' S. Rep. No. 68–398, at 16 (1924). This stated policy is reflected in current section 361(b)(1).

Section 361(b)(1)(A) provides that, if section 361(a) would apply to an exchange but for the fact that the property received by the target corporation also includes money or other property, no gain will be recognized by the target corporation if it distributes the money or other property pursuant to the plan of reorganization. Congress has enacted no limitation on the aggregate amount of cash and the fair market value of other property that a target corporation can distribute to its shareholders (as opposed to creditors) under section 361(b)(1)(A) (although section 368 limits the amount of money or other property that may be received in certain corporate reorganizations).

Section 361(b)(1)(B), which reflects congressional intent with respect to a target corporation's failure to act solely as a conduit in distributing the sale proceeds (that is, money or other property) to its shareholders, provides that the target corporation (such as the distributing corporation in a divisive reorganization) recognizes gain in an amount that does not exceed the sum of the money and fair market value of the other property that the corporation fails to distribute pursuant to the plan of reorganization.

4. Section 361(c): Distributions of Appreciated Property to Target Corporation Shareholders

Section 361(c) originally was enacted by Congress as section 1804(g)(1) of the Tax Reform Act of 1986. As part of a wholesale rewrite of section 361, Congress amended section 361(c) by enacting section 1018(d)(5)(A) of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100–647, 102 Stat. 3342, 3578) so that the statute ''conforms the treatment of distributions of property by a corporation to its shareholders in pursuance of a plan of reorganization to the treatment of nonliquidating distributions (under section 311).'' S. Rep. No. 100–445, at 393 (1988).

Section 311(a) generally provides that, except as provided in section 311(b) (concerning distributions of appreciated property), no gain or loss is recognized by a corporation on the distribution (not in complete liquidation) with respect to its stock of (i) its stock (or rights to acquire its stock), or (ii) property. Accordingly, section 361(c)(1) generally provides that, except as provided in section 361(c)(2) (concerning distributions of appreciated property), no gain or loss is recognized by a target corporation that is a party to a reorganization upon a distribution of property to its shareholders pursuant to a plan of reorganization.

Consistent with section 311(b), section 361(c)(2)(A) provides that, if the target corporation distributes property other than qualified property in a distribution described in section 361(c)(1), and if the fair market value of that other property exceeds the corporation's adjusted basis in that other property, then gain is recognized by the target corporation as if the property were sold to the distributee at its fair market value. The term ''qualified property'' is defined in section 361(c)(2)(B) to mean (i) any stock, right to acquire stock, or obligation (including a security) of the corporation, and (ii) any stock, right to acquire stock, or obligation (including a security) of another corporation that is a party to the reorganization received by the target corporation in the exchange.

Therefore, although a target corporation would recognize no gain on an exchange described in section 361(a) (section 361(a) exchange) if that corporation received appreciated non-qualified property and distributed that property to its shareholders pursuant to section 361(b)(1)(A), that corporation nonetheless would recognize gain on the distribution to its shareholders under section 361(c)(2)(A). If any such property is subject to a liability, or if the shareholder assumes a liability of the target corporation in connection with the distribution, section 361(c)(2)(C) provides that the fair market value of that property is treated as not less than the amount of that liability for purposes of section 361(c)(2)(A).

5. Safe Harbors for Transfers to Creditors of the Distributing Corporation

Congress added section 361(b)(3) and (c)(3) as part of the wholesale rewrite of section 361 in the Technical and Miscellaneous Revenue Act of 1988. Section 361(b)(3) provides that, for purposes of section 361(b)(1), any transfer of the money or other property received in the exchange by the target corporation to its creditors in connection with the reorganization is treated as a distribution pursuant to the plan of reorganization. Similarly, section 361(c)(3) provides that, for purposes of section 361(c), any transfer of qualified property by the target corporation to its creditors in connection with the reorganization is treated as a distribution to its shareholders pursuant to the plan of reorganization.

6. Response to Supreme Court's Decision in Minnesota Tea Company

In *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609 (1938), the Supreme Court held that a distribution by a target corporation to its shareholders of cash received from an acquiring corporation in a reorganization was not a qualifying ''distribution'' for purposes of the predecessor to section 361(b)(1)(A), because the shareholders immediately used that distributed cash to pay the target corporation's creditors as part of a prearranged plan. Citing *Gregory* v. *Helvering,* 293 U.S. 465, 469 (1935), as providing the ''controlling principle'' for its decision, the Court determined that the payment of indebtedness, and not the distribution of dividends, ''was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect.'' *Minnesota Tea,* 302 U.S. at 613–14. Because the Minnesota Tea Company ''received the same benefit as though it had retained that amount from [the] distribution and applied it to *the payment of such indebtedness,*'' the Court concluded that the company failed to satisfy the predecessor to section 361(b)(1)(A). *See id.* at 613 (emphasis added).

In describing the rationale for enacting section 361(b)(3) and (c)(3), the legislative history explains that each provision ''overrules the holding in *Minnesota Tea Company* v. *Helvering.*'' S. Rep. No. 100–445, at 393 n.102 (1988); *see also* H.R. Rep. 100–795, at 372 (1988). The legislative history described the substance of the safe harbor in section 361(b)(3) as providing that ''*transfers of property to creditors in satisfaction of the corporation's indebtedness* in connection with the reorganization are treated as distributions pursuant to the plan of reorganization for this purpose.'' S. Rep. No. 100–445, at 393 (1988) (emphasis added). Likewise, the legislative history described the corresponding safe harbor in section 361(c)(3) as providing that ''the *transfer of qualified property by a corporation to its creditors in satisfaction of indebtedness* is treated as a distribution pursuant to the plan of reorganization.'' *Id.* (emphasis added). By treating transfers of property to creditors in satisfaction of indebtedness as distributions pursuant to the plan of reorganization, Congress balanced the dual policy objectives of (i) preserving consistency with the fundamental requirement of section 361 that property be distributed, and (ii) enacting a provision to address transfers to creditors in satisfaction of indebtedness that overruled the holding in *Minnesota Tea.*

7. Adjusted Basis Limitation for Purposes of Section 361(b)(3)

In the case of a divisive reorganization described in sections 355 and 368(a)(1)(D), the third sentence in section 361(b)(3) (adjusted basis limitation) limits the extent to which a transfer of money or other property to a creditor is treated as a distribution pursuant to the plan of reorganization for the purposes of section 361. Specifically, section 361(b)(3) applies solely to the extent the sum of the money and the fair market value of the other property transferred to creditors of the distributing corporation does not exceed the aggregate adjusted bases of the assets transferred to the controlled corporation in the section 361(a) exchange, reduced by the amount of the distributing corporation's liabilities that the controlled corporation actually assumes within the meaning of section 357(c).

Congress enacted the adjusted basis limitation in section 361(b)(3) as part of the American Jobs Creation Act of 2004 (Pub. L. 108–357, 118 Stat. 1418) based on the concern stated in the legislative history that taxpayers had developed tax-planning strategies to circumvent the adjusted basis limitation in section 357(c) on actual assumptions by controlled corporations in divisive reorganizations. *See* S. Rep. No. 108–192, at 185 (2003). Specifically, the committee report observed that a distributing corporation (i) could cause the controlled corporation to borrow money from a financial institution and transfer that money to the distributing corporation in the section 361(a) exchange, and then (ii) could use that money to pay its creditors. *Id.* The committee report concluded that, although this series of transactions does not involve an actual assumption by the controlled corporation within the meaning of section 357, it is ''economically similar to the actual assumption'' because, at the end of the series of transactions, the distributing corporation has reduced its indebtedness to its creditor and the controlled corporation has become indebted to a creditor (albeit a different creditor) for an equal amount. *See id.* Accordingly, ''because section 361(b) [did] not contain a limitation on the amount that can be distributed to creditors,'' Congress limited the scope of the section 361(b)(3) safe harbor to ''the amount of the basis of the assets contributed to a controlled corporation in a divisive reorganization.'' *Id.*

8. Express Grant of Authority

As stated previously in the Authority section of this preamble, the second sentence of section 361(b)(3) provides the Secretary with an express grant of authority to prescribe such regulations as may be necessary to prevent avoidance of Federal income tax through abuse of the safe harbors in section 361(b)(3) and (c)(3). Congress included this grant of authority in section 361(b)(3) when Congress enacted both provisions as part of the Technical and Miscellaneous Revenue Act of 1988.

III. Plan of Reorganization; Party to a Reorganization

A. Overview

For more than a century, the ''plan of reorganization'' requirement has served to limit the application of the operative provisions in subchapter C solely to those transactions with a sufficiently proximate relationship to transactions that satisfy the definitional requirements in subchapter C for a reorganization (proximate relationship requirement). For example, *see* section 202(b) of the Revenue Act of 1918 (providing that an exchange did not qualify for nonrecognition treatment unless the transaction was ''in connection with'' a reorganization). In other words, Congress has long viewed the proximate relationship requirement as an integral tool for preventing the nonrecognition provisions in subchapter C from applying to transactions to which general gain or loss provisions of the Code (for example, section 1001 of the Code) should apply.

This long-standing congressional purpose is illustrated by the evolution of section 202(c)(1) of the Revenue Act

of 1921 (Pub. L. 67–98, 42 Stat. 227). That provision originally provided nonrecognition treatment for an exchange of property held for investment or for productive use in a trade or business, with no exception for stock or securities, and with no proximate relationship requirement. Tax advisors took advantage of this provision by structuring exchanges of portfolio investment securities for other securities in transactions that resulted in no recognition of Federal income tax. After receiving a request from the Treasury Department to address this abuse, Congress amended section 202(c)(1) by removing exchanges of stock and securities from nonrecognition treatment except for exchanges occurring in the context of a reorganization. *See An Act to Amend the Revenue Act of 1921 in Respect to Exchanges of Property,* Public Law 67–545, 42 Stat. 1560 (1923); J. Seidman, *Legislative History of Federal Income Tax Laws: 1938–1861,* at 798 (1938); *see also* Letter from A. W. Mellon, Secretary of the Treasury, to Congressman William R. Green, Acting Chairman of the Committee on Ways and Means (Jan. 13, 1923).

Since first establishing the proximate relationship requirement, Congress has implemented that requirement through various linguistic formulations over time. However, Congress has indicated that such variations in language were not intended to reflect substantive differences. For example, Congress replaced ''in connection with'' in section 202(b) of the Revenue Act of 1918 with ''in the reorganization'' in section 202(c) of the Revenue Act of 1921. When describing section 202(c) of the Revenue Act of 1921, a congressional committee print explicitly referred to the proximate relationship under that section as requiring an ''in connection with'' relationship. *See* S. Comm. on Finance, 68th Cong., *Statement of the Changes Made in the Revenue Act of 1921 by H.R. 6715 and the Reasons Therefor,* at 5–6 (Comm. Print 1924).

In section 203(c) of the Revenue Act of 1924, Congress restated the proximate relationship requirement as requiring an ''in pursuance of a plan of reorganization'' relationship. This requirement, like the ''in connection with'' requirement, exists in the current definitional and operative provisions of subchapter C. The legislative history underlying section 203 of the Revenue Act of 1924 explicitly refers to the ''in pursuance of the plan of reorganization'' formulation in several instances as ''in connection with the reorganization.'' *See* H.R. Rep. No. 68–179, at 13–16 (1924). In particular, at one point, the Committee on Ways and Means described the change in formulation of the proximate relationship requirement as a result of ''minor changes in phraseology.'' *See id.* at 13.

B. Definition of ''Plan of Reorganization''

The term ''plan of reorganization'' is not defined in subchapter C. Instead, the sole authoritative guidance defining this term is set forth in the Income Tax Regulations. Specifically, § 1.368–2(g) provides that the term ''plan of reorganization'' refers to a ''consummated transaction specifically defined as a reorganization under section 368(a),'' and that ''[s]ection 368(a) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.'' Section 1.368–2(g) further provides that the term ''plan of reorganization'' ''is not to be construed as broadening the definition of reorganization as set forth in section 368(a),'' but rather ''is to be taken as limiting the nonrecognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 368(a).'' Section 1.368–2(g) further provides that 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 also that ''the readjustments involved in the exchanges or distributions effected in the consummation [of the plan of reorganization] must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization.''

However, significant uncertainty and confusion have arisen regarding the scope, purpose, and application of § 1.368–2(g). As expressed by the Tax Court in an observation often referenced by courts and commentators, ''the above definition is imbued with qualities of flexibility and vagueness, with the result that it does not present precise self-executing guidelines.'' *Int'l Telephone & Telegraph Corp.* v. *Comm'r,* 77 T.C. 60, 75 (1981); *see also J.E. Seagram Corp.* v. *Comm'r,* 104 T.C. 75, 96 (1995) (relying on the quote in *Int'l Telephone* in observing that § 1.368–2(g) provides ''substantial elasticity''). As a result, § 1.368–2(g) (including its proximate relationship requirement) has created significant uncertainty and confusion for taxpayers and the IRS in determining the scope of transactions that properly should be taken into account for purposes of applying the definitional and operative provisions of subchapter C.

Section 1.368–1(c) further describes the ''plan of reorganization'' concept and provides important context regarding the application of this concept and its embedded proximate relationship requirement. Specifically, § 1.368–1(c) provides, in part, that ''[t]he provisions of [part III of subchapter C] referred to in this paragraph *are inapplicable unless there is a plan of reorganization*'' (emphasis added). Section 1.368–1(c) further provides that ''[a] plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 368(a) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed.'' That transaction, and those acts, must be an ''ordinary and necessary incident of the conduct of the enterprise and must provide for a continuation of the enterprise.'' *Id.* Finally, § 1.368–1(c) provides that a scheme involving ''an abrupt departure from normal reorganization procedure in connection with a transaction on which the imposition of tax is imminent, such as a mere device that puts on the form of a corporate reorganization as a disguise for concealing its real character, and the object and accomplishment of which is the consummation of a preconceived plan having no business or corporate purpose, is not a plan of reorganization.''

Consistent with the discussion in part III.A of this Background, § 1.368–1(c) reflects the function of the ''plan of reorganization'' concept and its embedded proximate relationship requirement—namely, to limit the application of the definitional and operative provisions of subchapter C to those transactions included in the plan of reorganization. Section 1.368–1(c) also requires all transactions properly included in the plan of reorganization to be consistent with, and to facilitate satisfaction of, a principal requirement for nonrecognition treatment under the reorganization provisions of subchapter C (that is, the continuation of an enterprise). Finally, § 1.368–1(c) reflects that devices and sham transactions cannot properly be included in a plan of reorganization.

C. Party to a Reorganization

Section 368(b) generally provides that the term ''a party to a reorganization'' includes (i) a corporation resulting from a reorganization, and (ii) both corporations, in the case of a reorganization resulting from the

acquisition by one corporation of stock or properties of another. Consistent with section 368(b), § 1.368–2(f) defines the term ''party to a reorganization'' as including ''a corporation resulting from a reorganization, and both corporations in a transaction qualifying as a reorganization where one corporation acquires stock or properties of another corporation.'' Section 1.368–2(f) further articulates which entities are parties to a reorganization in various types of reorganizations defined in section 368(a)(1). However, the uncertainty regarding the meaning of ''plan of reorganization,'' described in part III.B of this Background, has resulted in confusion regarding the proper identification of parties to a reorganization.

D. Reporting and Recordkeeping Requirements for Corporate Reorganizations

Section 1.368–3 sets forth reporting and recordkeeping requirements for corporate reorganizations. Section 1.368–3(a) requires a plan of reorganization to be adopted by each corporation that is a party to the reorganization, and it requires each such corporation to include a statement with its Federal income tax return that includes certain limited information about the reorganization. However, § 1.368–3(a) provides no additional detail on the manner in which the plan of reorganization must be adopted, and it does not require the plan of reorganization to be reflected in any documentation or records of the parties to the reorganization.

Current § 1.368–3(a) contrasts starkly with a prior version of § 1.368–3(a), which provided that the plan of reorganization ''must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation.'' *See* § 1.368–3(a) (effective from November 26, 1960, to May 29, 2006) (prior § 1.368–3(a)).

Prior § 1.368–3(a) also imposed additional requirements to facilitate the IRS's administration of the reorganization provisions in part III of subchapter C. In particular, prior § 1.368–3(a) required the parties to a reorganization to file with the IRS a ''copy of the plan of reorganization, together with a statement, executed under the penalties of perjury, showing in full the purposes thereof and in detail all transactions incident to, or pursuant to, the plan.'' In contrast, taxpayers currently are not required by § 1.368–3 to provide as part of their Federal income tax return a plan of reorganization that describes the transactions to which taxpayers intend to apply the nonrecognition provisions of subchapter C.

In addition, prior § 1.368–3(a) required taxpayers to file with the IRS ''a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the reorganization.'' Current § 1.368–3(a) contains no such requirement. Therefore, the IRS currently does not receive as part of a taxpayer's Federal income tax return a statement of facts necessary to determine the proper application of the nonrecognition provisions of subchapter C to the transactions comprising a corporate reorganization.

Instead, current § 1.368–3(a) merely requires each corporate party to a reorganization to include a statement, on or with its return for the taxable year of the exchange, that includes: (i) the names and employer identification numbers (if any) of all such parties; (ii) the date of the reorganization; (iii) the value and basis of the assets, stock, or securities of the target corporation transferred in the transaction, determined immediately before the transfer in the manner described in § 1.368–3(a); and (iv) the date and control number of any one or more private letter rulings issued by the IRS in connection with the reorganization. Current § 1.368–3(b) imposes similar requirements on significant holders of stock or securities of the target corporation.

Like prior § 1.368–3(c), current § 1.368–3(d) requires taxpayers to retain their permanent records with respect to a corporate reorganization.

IV. TIGTA Report To Improve Enforcement of Corporate M&A Transactions

In 2019, the Treasury Inspector General for Tax Administration (TIGTA) published a report titled ''A Strategy Is Needed to Assess the Compliance of Corporate Mergers and Acquisitions With Federal Tax Requirements,'' Ref. No. 2019–30–050 (Sept. 5, 2019) (TIGTA Report). In that report, TIGTA considered the scope of information required to be provided under § 1.368–3(a) and expressed that ''the forms previously detailed represent only a small portion of the information that may be filed, and certain forms used to report merger and acquisition (M&A) transactions may not be providing sufficient information to identify noncompliance.'' *Id.* at 14–15.

Accordingly, TIGTA recommended that, if the IRS finds that the current forms do not contain information sufficient for identifying potential noncompliance in M&A transactions, the IRS ''should consider amending the filing criteria and information required in the forms to develop useful compliance tools.'' *Id.* at 14. The IRS agreed with this recommendation, stating that it will continue to consider how to use M&A transaction information in its compliance efforts.

V. Reporting Requirements for Section 355 Transactions

In a notice of proposed rulemaking (REG–116085–23) published elsewhere in the Proposed Rules section of this issue of the **Federal Register**, the Treasury Department and the IRS are issuing proposed regulations to revise current § 1.355–5 (proposed § 1.355–5) to enhance the IRS's ability to administer and enforce the requirements of section 355. Similar to current § 1.368–3 (previously discussed in part III.D of this Background), current § 1.355–5 requires the distributing corporation and each significant distributee (as defined in current § 1.355–5(c)(1)) to include a statement with its tax return that includes certain limited information about the section 355 transaction. To implement the recommendation in the TIGTA Report described in part IV of this Background, proposed § 1.355–5 would require taxpayers to submit new IRS Form 7216, *Multi-Year Reporting Related to Section 355 Transactions* (or any successor form), to provide the IRS with additional information to help the IRS identify potential noncompliance in section 355 transactions.

VI. Revenue Procedure 2024–24 and Notice 2024–38

On May 2, 2024, the Treasury Department and the IRS released Rev. Proc. 2024–24, 2024–21 I.R.B. 1214, to provide procedures for requesting private letter rulings from the IRS regarding certain matters relating to section 355 transactions. Rev. Proc. 2024–24 superseded Rev. Proc. 2018–53, 2018–43 I.R.B. 667, and made several significant changes to the requirements of that revenue procedure and to Rev. Proc. 2017–52, 2017–41 I.R.B. 283.

Also on May 2, 2024, the Treasury Department and the IRS released Notice 2024–38, 2024–21 I.R.B. 1211, to describe their views and concerns relating to certain matters addressed in Rev. Proc. 2024–24, and to solicit feedback on the provisions set forth in Rev. Proc 2024–24. In section 2.01 of Notice 2024–38, the Treasury Department and the IRS requested that such feedback take into account the

following three objectives for potential future guidance: (i) the guidance will be consistent with all relevant provisions of the Code (compliance objective); (ii) the guidance will provide certainty to taxpayers and the IRS regarding the application of all relevant provisions of the Code to purported section 355 transactions (increased certainty objective); and (iii) the guidance will be responsive to the manner in which section 355 transactions are engaged in by taxpayers and reflect current market practices and preferences (transaction facilitation objective), to the extent that such approach does not conflict with the first two objectives.

Explanation of Provisions

The purpose of these proposed regulations is to establish a comprehensive set of rules to implement certain core definitional and operative provisions of subchapter C that address corporate separations, incorporations, and reorganizations. The current regulatory framework underlying these provisions is incomplete, outdated, and not reflective of their importance to the Federal corporate income tax system, given the trillions of dollars of corporate transactions governed by these statutory provisions. Due to the lack of up-to-date regulatory guidance, taxpayers and the IRS must rely on a patchwork of caselaw, IRS revenue rulings and revenue procedures, and non-authoritative IRS documents to discern the current state of the law with respect to these core provisions of subchapter C.

Accordingly, providing comprehensive regulatory guidance to facilitate the implementation of these core definitional and operative provisions of subchapter C would promote taxpayer certainty and sound tax administration. Although Notice 2024–38 focused on Federal income tax issues regarding section 355 transactions, these core definitional and operative provisions also address incorporations and acquisitive reorganizations. Therefore, the proposed regulations would implement those statutory provisions for all corporate M&A transactions, in a manner that reflects the three objectives described in section 2.01 of Notice 2024–38 (that is, the compliance objective, the increased certainty objective, and the transaction facilitation objective) in accordance with their respective priorities as set forth therein.

A principal objective of the Treasury Department and the IRS in issuing these proposed regulations is to significantly improve horizonal equities among taxpayers and tax advisors. In other words, based on feedback from tax advisors, the lack of authoritative guidance in this area effectively has transformed a taxpayer's option to request a private letter ruling on the application of certain definitional and operative provisions into a requirement. Indeed, tax advisors have directly reached out to the Treasury Department and the IRS to emphasize the mandatory nature of private letter rulings on certain topics in this area because, based on the current state of authoritative guidance, those tax advisors could not provide tax opinions at a sufficient level of comfort in the absence of a private letter ruling. Therefore, these tax advisors have stressed the importance of engaging in bar association panels and other professional speaking engagements to access the perspectives of Treasury Department and IRS officials regarding the government's current views on certain fundamental corporate tax issues.

These proposed regulations would provide, through publicly accessible authoritative guidance, core definitional and operative provisions. This guidance is intended to facilitate the ability for taxpayers to achieve increased comfort on the Federal income tax treatment of their corporate M&A transactions without the need for a private letter ruling. Just as importantly, this guidance is intended to encourage the submission of private letter ruling requests and facilitate the IRS private letter ruling process. In particular, these proposed regulations are intended to help direct the focus of tax advisors to those issues that raise significant Federal income tax compliance concerns, and consequently improve the organization and focus of their private letter ruling submissions. Similarly, these proposed regulations are intended to increase the efficiency of the private letter ruling program by allowing submission reviewers to focus primarily on such significant issues, rather than those issues that would be addressed directly by this guidance.

In explaining the provisions of these proposed regulations, this Explanation of Provisions discusses issues described in Notice 2024–38 and the feedback received in response to Notice 2024–38. Such feedback has informed the development of these proposed regulations. This Explanation of Provisions also references proposed regulations, published elsewhere in the Proposed Rules section of this issue of the **Federal Register**, that would implement enhanced reporting requirements for section 355 transactions. Those enhanced reporting requirements are integral to the proposed substantive guidance set forth in these proposed regulations. Specifically, as described further in this Explanation of Provisions, this proposed substantive guidance reflects the long-standing reality that corporate transactions typically are carried out over multiple taxable years. The increased transactional flexibility that would be provided by these proposed regulations is conditioned on the IRS's ability to track the execution of these transactions throughout their lifecycle, and the enhanced reporting requirements for section 355 transactions would facilitate the IRS's ability to carry out its administrative function with respect to these transactions.

I. Distinction Between Delayed Distributions and Retentions; Rules for Qualifying Retentions

A. Notice 2024–38

Section 2.02(1) of Notice 2024–38 stated the view of the Treasury Department and the IRS that the Code provides separate and distinct treatment for three instances in which a distributing corporation temporarily continues to hold controlled corporation stock or securities following the date on which the distributing corporation has distributed an amount of controlled corporation stock constituting control (within the meaning of section 368(c)) (control distribution date). These three instances are: (i) a delayed distribution of controlled corporation stock or securities that is ''part of the distribution'' (within the meaning of section 355(a)(1)(D)); (ii) a delayed distribution of controlled corporation stock or securities that is ''in pursuance of the plan of reorganization'' (within the meaning of section 361); and (iii) a retention of controlled corporation stock or securities.

Section 2.02(2) of Notice 2024–38 stated the view of the Treasury Department and the IRS that section 355(a)(1)(D) effectively creates a rebuttable presumption that any retention evidences a plan to achieve a Federal income tax avoidance purpose. Section 2.02(2) of Notice 2024–38 also stated that the Treasury Department and the IRS are considering the degree to which connections between the distributing corporation and the controlled corporation (and, as appropriate, the DSAG and the CSAG) after the control distribution date would prevent a transaction from qualifying under section 355. (The terms ''DSAG'' and ''CSAG'' mean the separate affiliated group (as defined in section 355(b)(3)(B)) of which the distributing

corporation or the controlled corporation, respectively, is the common parent.)

Section 2.02(2) of Notice 2024–38 also stated the view of the Treasury Department and the IRS that overlapping directors, officers, or key employees and the existence of continuing contractual agreements between the distributing corporation (and other members of the DSAG) and the controlled corporation (and other members of the CSAG) that include provisions that are not arm's-length weigh against a determination of qualification under section 355.

B. Stakeholder Input

1. Existence of Rebuttable Presumption Under Section 355(a)(1)(D)(ii)

As an initial matter, some stakeholders have contended that section 355(a)(1)(D)(ii) does not create a rebuttable presumption that a retention evidences a plan with a principal purpose of avoiding Federal income tax, notwithstanding the explicit statutory requirement that the Secretary must be satisfied that such a purpose does not exist. Instead, these stakeholders have asserted that Congress's intent in including the ''no tax avoidance purpose'' language in section 355(a)(1)(D)(ii) is unclear, and that the legislative history of section 355 does not give further details about the meaning of this language.

Accordingly, these stakeholders have suggested that, rather than include a rebuttable presumption, the proposed regulations should place greater emphasis on (i) an examination of the corporate business purpose for the section 355 transaction, and (ii) a determination of whether the retained controlled corporation stock is disposed of as ''part of the distribution'' (*see* section 355(a)(1)(D)) or ''in pursuance of the plan of reorganization'' (*see* section 361(c)). These stakeholders contend that their view is supported by sections 354, 355, and 361, as well as by § 1.368–2(g), which requires readjustments involved in the exchanges or distributions effected in consummating a plan of reorganization to be ''undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization.''

2. Application of Plan of Reorganization With Regard to Section 355(a)(1)(D)(ii)

Stakeholders also have requested clarification in the proposed regulations that all delayed distributions, whether before or after the control distribution date, are treated as part of the distribution (within the meaning of section 355(a)(1)(D)) if they are effectuated pursuant to the plan of reorganization. Relatedly, stakeholders have recommended that the proposed regulations employ the same standard (that is, the same level of proximate relationship) in considering whether a transaction is ''part of the distribution'' and ''in pursuance of a plan of reorganization.'' Stakeholders have further requested confirmation in the proposed regulations that the ''no tax avoidance purpose'' requirement in section 355(a)(1)(D)(ii) applies only to the extent a delayed distribution fails to qualify under the operative provisions.

Based on their analogy to their view of the ''plan of reorganization'' concept, these stakeholders have contended that the ''as part of the distribution'' requirement in section 355(a)(1)(D) provides substantial flexibility to the distributing corporation regarding the timing and manner of dispositions of controlled corporation stock (for example, in a delayed distribution of controlled corporation stock to shareholders of the distributing corporation). In this regard, stakeholders have recommended that the phrase ''as part of the distribution'' be interpreted to provide section 355 qualification for situations in which the distributing corporation contemplates—but provides no further level of commitment to—a spectrum of potential dispositions of controlled corporation stock, so long as the distributing corporation eventually achieves one or more of those contemplated possibilities or related variants. As described by such stakeholders, the distributing corporation need not identify the timing of those dispositions (regardless of whether they span multiple taxable years of the distributing corporation), the potential recipients of controlled corporation stock (for example, creditors of the distributing corporation), or the method of disposing of that stock.

The stakeholder input described in the foregoing paragraphs ultimately focuses on two aspects of the IRS private letter ruling program for section 355 transactions: (i) the requirement set forth in section 3.03(3)(a)(ii) of Rev. Proc. 2024–24 (the so-called ''pick a lane'' requirement); and (ii) the elimination under that revenue procedure of so-called ''backstop retention rulings.''

With regard to the ''pick a lane'' requirement, these stakeholders read section 3.03(3)(a)(ii) of Rev. Proc. 2024–24 as providing that the IRS will entertain a request for rulings that: (i) a delayed distribution of controlled corporation stock or securities will be, as applicable, ''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); and (ii) a retention of controlled corporation stock or securities that is not included in a ruling request described in clause (i) of this sentence will not be in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax (within the meaning of section 355(a)(1)(D)(ii)). Stakeholders have further stated that, to comply with the so-called ''pick a lane'' requirement, a taxpayer must specify the portions of controlled corporation stock remaining after the control distribution (i) to which the taxpayer intends section 361(c) to apply, and (ii) which the taxpayer intends to retain and not dispose of under section 361(c). *See* section 3.03(3)(d) of Rev. Proc. 2024–24.

In practice, the ''pick a lane'' requirement requires a taxpayer to identify to the IRS those transactions that the taxpayer intends to carry out as part of its plan of reorganization. However, stakeholders have contended that this requirement is problematic because Rev. Proc. 2024–24 also has eliminated the availability of ''backstop retention rulings,'' which stakeholders have described as ''protective rulings'' affording taxpayers a determination by the IRS, before the first step of a divisive reorganization, that a retention at no point will have failed to satisfy the ''no tax avoidance purpose'' requirement in section 355(a)(1)(D)(ii).

Stakeholders have contended that these changes in private letter ruling policy, combined with the requirement that all controlled corporation stock or securities be distributed within 12 months of the date of the first distribution (first distribution date) to receive a ruling that the distribution qualifies for nonrecognition treatment under section 355 (*see* section 3.03(2)(b)(ii) of Rev. Proc. 2024–24), have created an unnecessary risk for taxpayers that an intended divisive reorganization could fail to qualify under section 355 (section 355(a)(1)(D)(ii) risk). For purposes of these proposed regulations, the term ''first distribution'' means the earliest distribution in a series of distributions made pursuant to the plan of distribution or plan of reorganization, as appropriate.

Specifically, these stakeholders have asserted that, because transactions intended to qualify for nonrecognition treatment under section 361(c) often require most of a year to complete, tax advisors now are faced with three undesirable options. First, tax advisors could recommend the premature

termination of such transactions, which otherwise would have been effectuated for bona fide business purposes for corporate taxpayers. Second, tax advisors could attempt, in an unreasonably short timeframe, to receive from the IRS a supplemental private letter ruling that the ''springing retention'' (that is, a retention that arises unexpectedly during the 12-month period) satisfies the ''no tax avoidance purpose'' requirement. Third, tax advisors could provide an opinion that the springing retention satisfies the ''no tax avoidance purpose'' requirement, notwithstanding the lack of authoritative guidance on that issue.

C. Proposed Regulations

Consistent with the statement in section 2.02(2) of Notice 2024–38, proposed § 1.355–10(c)(1) would reflect the presumption that a retention is pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax. However, the Treasury Department and the IRS appreciate the views of stakeholders regarding delayed distributions and retentions. In particular, the Treasury Department and the IRS are sensitive to the potential negative impacts of the ''pick a lane'' requirement and related requirements in Rev. Proc. 2024–24 on divisive reorganizations, and to the lack of clear, authoritative guidance regarding the ''no tax avoidance purpose'' requirement of section 355(a)(1)(D)(ii). Therefore, and consistent with the compliance, increased certainty, and transaction facilitation objectives of these proposed regulations, the Treasury Department and the IRS have proposed rules to address the uncertainty highlighted by stakeholders in a manner that facilitates the ability of (i) taxpayers to carry out bona fide section 355 transactions, and (ii) the IRS to ensure that such transactions comply with all requirements of the Code.

1. Proposed Safe Harbor To Address Section 355(a)(1)(D)(ii) Risk

a. Overview

In response to stakeholder concerns regarding the section 355(a)(1)(D)(ii) risk, these proposed regulations would provide a safe harbor that incorporates objectively verifiable conditions for retentions not to be treated as pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax (qualifying retentions). The Treasury Department and the IRS have proposed this safe harbor to enable taxpayers to satisfy the requirements of section 355(a)(1)(D)(ii) with greater certainty even in the absence of a private letter ruling from the IRS—thereby achieving an increased certainty and transaction facilitation objectives. For taxpayers that do not satisfy the requirements of the proposed safe harbor, the proposed regulations would provide for a general facts-and-circumstances determination for whether a retention is a qualifying retention.

b. Section 355(a)(1)(D)(ii) Safe Harbor

Under the section 355(a)(1)(D)(ii) safe harbor in proposed § 1.355–10(c)(3), a distributing corporation would be treated as satisfying the general facts-and-circumstances test in proposed § 1.355–10(c)(2)(ii) for a qualifying retention if all six of the following conditions are satisfied. First, the distributing corporation must have a specific corporate business purpose for the retention as of the date of adoption of the plan of distribution or plan of reorganization, as appropriate, and at all times during the period of retention. Second, stock of the controlled corporation must be widely held during the period of retention after the first distribution date. Third, any overlap between the officers, directors, or key employees of the DSAG and of the CSAG must be limited in the manner described in proposed § 1.355–10(c)(3)(iv). Fourth, any continuing arrangements between the distributing corporation and the controlled corporation during the period of retention either (i) must be negotiated on and reflect arm's-length terms, or (ii) within two years after the first distribution date, must be terminated or renegotiated to reflect arm's-length terms. Fifth, the plan of distribution or plan of reorganization, as appropriate, must reflect a definite intent in the official records of the distributing corporation that the distributing corporation dispose of all retained controlled corporation stock (or securities) by the end of the five-year period beginning on the first distribution date. Sixth, the disposition of retained controlled corporation stock (or securities) must not result in less Federal income tax to the distributing corporation (determined based on the fair market value and adjusted basis of that stock (or securities) as of the first distribution date) than if that stock (or securities) had been distributed in the first distribution. The distributing corporation must include in its plan of distribution or plan of reorganization (as applicable) a description of each agreement and transaction that establishes the satisfaction of the foregoing six conditions.

c. Rationale for Section 355(a)(1)(D)(ii) Safe Harbor

The safe harbor in proposed § 1.355–10(c)(3) is intended to balance taxpayers' need for certainty with the IRS's need to ensure taxpayer compliance with section 355(a)(1)(D)(ii). As discussed in part IV of the Background, TIGTA recommended that the IRS consider amending the filing criteria and information required in current forms to develop useful compliance tools. The inclusion of objective requirements in the section 355(a)(1)(D)(ii) safe harbor is consistent with both TIGTA's recommendation and the compliance, increased certainty, and transaction facilitation objectives for guidance described in section 2.01 of Notice 2024–38.

Moreover, under proposed § 1.355–5 and new IRS Form 7216 (*see* part V of the Background), and consistent with the recommendation in the TIGTA Report, a taxpayer would be required to report key information that would enable the IRS to ensure that the taxpayer, during each taxable year of the retention period, continues to comply with the requirements of the section 355(a)(1)(D)(ii) safe harbor. Thus, the section 355(a)(1)(D)(ii) safe harbor, coupled with the enhanced reporting requirements for section 355 transactions, would increase taxpayer certainty (by reducing the so-called section 355(a)(1)(D)(ii) risk) and would facilitate IRS administration of section 355(a)(1)(D)(ii). The Treasury Department and the IRS are of the view that these two proposals would significantly help achieve all three objectives of these proposed regulations.

The proposed regulations would not incorporate the stakeholders' recommendation that the requirements of section 355(a)(1)(D)(ii) be treated as satisfied so long as the distributing corporation disposes of all controlled corporation stock pursuant to the plan of reorganization. Such an approach would conflict with long-standing § 1.355–2(e)(2), which requires the consideration of factors aside from the manner in which the distributing corporation disposes of its retained controlled corporation stock (for example, if the distribution would be treated to any extent as a distribution of ''other property'' under section 356). The stakeholders' recommendation would not be consistent with section 355(a)(1)(D)(ii), because that recommendation, by itself, would not ensure a genuine separation.

In addition, the proposed regulations would not incorporate stakeholders' recommendation that a strong corporate

business purpose for a section 355 transaction be treated as sufficient to satisfy the requirements under section 355(a)(1)(D)(ii). This suggestion is inconsistent with the plain reading of the statute, which requires a determination that the avoidance of Federal income tax was not a principal purpose of the retention. In other words, the distributing corporation could possess a strong corporate business purpose for the section 355 transaction in general and for the retention in particular, and yet also possess a principal purpose for the retention of avoiding Federal income tax.

Ultimately, the stakeholders' recommended approaches would conflict with the purpose of section 355(a)(1)(D), which is to ensure genuine separations between the distributing and controlled corporations—a policy reflected in the legislative history of section 355(a)(1)(D) and the long-standing view of the Treasury Department and the IRS regarding that purpose as fundamental to all section 355 transactions. The legislative history of section 355(a)(1)(D) indicates that Congress's initial preference was to provide no exception to the complete-distribution requirement under section 355(a)(1)(D)(i), and that the exception for retentions originated through a subsequent Senate amendment. *See* H.R. Rep. No. 83–1337, at A121 (1954); S. Rep. No. 83–1622, at 266 (1954). Indeed, Treasury regulations that predated the enactment of section 355(a)(1)(D), and that tax advisors have acknowledged as the basis for section 355(a)(1)(D), provided that the business reasons supporting a distribution of controlled corporation stock ordinarily required the distribution of *all* controlled corporation stock owned by the distributing corporation. *See* § 29.112(b)(11)–2(c) of Regulation 111 (issued under section 112(b)(11) of the 1939 Code, the predecessor to section 355 of the 1954 Code); *see also* § 1.355–2(e)(2), which continues to reflect this language). Long-standing revenue rulings and general counsel memoranda also reflect the view that, under the plain reading of section 355(a)(1)(D)(ii), Congress intended to subject retentions to heightened scrutiny to ensure that the section 355 transaction effectuates a genuine separation of the distributing corporation and the controlled corporation. *See* Rev. Rul. 75–469; Rev. Rul. 75–321; *see also* G.C.M. 32136 (Oct. 23, 1961).

2. Facts-and-Circumstances Test for Determining Compliance With Section 355(a)(1)(D)(ii)

If a taxpayer fails to satisfy the requirements of the section 355(a)(1)(D)(ii) safe harbor in proposed § 1.355–10(c)(3), the taxpayer may establish compliance with section 355(a)(1)(D)(ii) through satisfaction of the facts-and-circumstances test in proposed § 1.355–10(c)(2)(ii). As with qualification for the proposed section 355(a)(1)(D)(ii) safe harbor, satisfaction of the proposed facts-and-circumstances test would require a determination that the distributing corporation and the controlled corporation have genuinely separated, among other requirements. This proposed facts-and-circumstances approach combined with the proposed safe harbor would provide taxpayers and the IRS with increased certainty regarding the application of section 355(a)(1)(D)(ii).

Under the facts-and-circumstances approach of proposed § 1.355–10(c)(2)(ii), the distributing corporation first must establish that the distribution resulted in a genuine separation of the DSAG and the CSAG. Second, the distributing corporation must establish that the retention does not allow the DSAG to retain any practical control over the CSAG. Third, there must be a sufficient corporate business purpose for the retention as of the date the plan of distribution or the plan of reorganization (as applicable) is adopted. Fourth, there must be a sufficient corporate business purpose for the retention at all times during the period of retention. Fifth, the disposition of retained controlled corporation stock (or securities) must not result in less Federal income tax to the distributing corporation (determined based on the fair market value and adjusted basis of that stock (or securities) as of the first distribution date) than if that stock (or securities) had been distributed in the first distribution.

Consistent with the views set forth in section 2.02(2) of Notice 2024–38, the existence of (i) overlapping officers, directors, or key employees between the DSAG and the CSAG, and (ii) non-arm's-length continuing contractual agreements between the DSAG and the CSAG, would be facts and circumstances indicating that the retention fails the requirements under section 355(a)(1)(D)(ii). For purposes of proposed § 1.355–10(c)(2)(ii), the relative weight of those indicia would depend upon all facts and circumstances, including the corporate business purpose for the section 355 transaction. For example, such continuing relationships particularly would weigh against a determination that the retention satisfies the requirements under section 355(a)(1)(D)(ii) if the purported corporate business purpose for the section 355 transaction is so-called "fit and focus" (that is, a separation to enhance the success of the separated businesses by resolving management, systemic, or other problems that arise by virtue of the distributing corporation's operation of different businesses within a single corporation or affiliated group).

3. Consistent Voting Requirements

Regardless of whether a section 355 transaction qualifies for the section 355(a)(1)(D)(ii) safe harbor, if the section 355 transaction involves a retention, proposed § 1.355–10(c)(2)(iii) would require the DSAG to vote any retained controlled corporation stock in proportion to the votes cast by the controlled corporation's other shareholders (other than persons related to the distributing corporation). This proposed requirement is consistent with the long-standing position of the Treasury Department and the IRS with regard to section 355(a)(1)(D)(ii), as expressed through several revenue rulings, revenue procedures, and other sub-regulatory guidance.

4. Plan of Distribution

Consistent with long-standing guidance, the Treasury Department and the IRS continue to agree with stakeholders that the plan of reorganization is relevant for determining the applicability of the definitional and operative provisions under subchapter C to dispositions of controlled corporation stock. *Compare* Rev. Rul. 2002–85, 2002–2 C.B. 986 (concluding that an acquiring corporation's contribution of a target corporation's assets to a subsidiary corporation subsequent to a transaction otherwise qualifying as a reorganization under section 368(a)(1)(D) was "pursuant to the plan of reorganization"; therefore, the continuity of business enterprise (COBE) requirement was not violated); Rev. Rul. 69–142, 1969–1 C.B. 107 (concluding that an acquiring corporation's exchange of its debentures for those held by bondholders of the target corporation was not part of the reorganization exchange; therefore, the "solely for voting stock" requirement in section 368(a)(1)(B) was satisfied). In this regard, the "plan of reorganization" concept provides a useful analogy for distinguishing distributions to which section 355 should apply from those to

which other sections of the Code (such as section 311) should apply.

Accordingly, proposed § 1.355–4 would set forth a series of provisions pursuant to which a taxpayer would establish its plan of distribution for distributions to which section 355(c) is purported to apply. These proposed rules generally would parallel the proposed plan of reorganization provisions in proposed § 1.368–4, as discussed in more detail in part III.C of this Explanation of Provisions.

Specifically, under the proposed rules, section 355 would apply to those distributions that are properly included in the plan of distribution and, therefore, are treated as ''part of the distribution'' within the meaning of section 355(a)(1)(D). Thus, for example, proposed § 1.355–4(d)(2)(iii) would provide that distributions that are carried out in close temporal proximity with a section 355(c) distribution are not properly included in the plan of distribution and therefore would not qualify for nonrecognition treatment under section 355 unless Federal income tax principles (including the step transaction doctrine) would apply to determine that those distributions are in substance part of the plan of distribution for the section 355(c) distribution.

Additionally, a distribution that is merely one of several (if not more) contemplated possibilities would not be properly included in the plan of distribution. Instead, proposed § 1.355–4(d)(1) would require the distributing corporation to evidence a definite intent to carry out the distribution through a written commitment in one or more official records that substantiate the plan of distribution. As previously discussed in part I.B of this Explanation of Provisions, the Treasury Department and the IRS disagree with the stakeholders' view that a plan of distribution should reflect mere transactional possibilities under a ''wait and see'' approach. Adoption of this stakeholder recommendation would conflict with the requirement of section 355(a)(1)(D)(ii) that the non-tax avoidance nature of a retention be ''established to the satisfaction of the Secretary,'' because it would not be possible for the Secretary to establish the actual nature of a hypothetical transaction. In addition, adopting this stakeholder recommendation would both significantly compromise the IRS's ability to administer and enforce the requirements of section 355 and reduce certainty regarding section 355 qualification.

Under proposed § 1.355–4(a)(2)(i) and (b)(1), the term ''plan of distribution'' generally would mean a plan of distribution established by a distributing corporation that satisfies all requirements set forth in proposed § 1.355–4(c) and that is filed with the IRS pursuant to proposed § 1.355–5. Proposed § 1.355–4(a)(2)(iii) and (b)(2) would provide that a plan of distribution also may be established based on corrections to the taxpayer-filed plan by the Commissioner based on all relevant facts and circumstances, all relevant provisions of the Code, and general principles of Federal income tax law (including the step transaction doctrine). If the taxpayer fails to file a plan of distribution under proposed § 1.355–5, proposed § 1.355–4(a)(2)(iv) and (b)(2) would provide that the Commissioner may identify a plan of distribution for the transaction.

Consistent with the objectives for guidance described in section 2.01 of Notice 2024–38, the proposed plan of distribution provisions are intended to facilitate taxpayer certainty in identifying distributions to which section 355 properly should be applied. *See, for example,* proposed § 1.355–4(c)(3)(i)(B) (providing a safe harbor presumption for timely prosecuting the plan of distribution) and (d) (providing rules for determining whether a distribution is properly included in the plan of distribution).

In addition, the plan of distribution would provide the IRS with a single, timely document that identifies all relevant distributions necessary to determine the appropriate Federal income tax treatment of the purported section 355(c) distribution. This proposal, combined with the enhanced reporting requirements for section 355 transactions under proposed § 1.355–5, would reestablish an appropriate line of sight for the IRS into taxpayer compliance under section 355, thereby helping to achieve the compliance and increased certainty objectives. *Compare* former § 1.355–5 (effective from November 26, 1960, to May 29, 2006) (requiring the taxpayer to ''attach to its return for the year of the distribution a detailed statement setting forth such data as may be appropriate in order to show compliance with the provisions of [section 355]'').

5. Treatment of Delayed Distributions and Retentions

The Treasury Department and the IRS appreciate the feedback received from stakeholders regarding the similarities between delayed distributions and retentions. The Treasury Department and the IRS agree with stakeholders that, because a section 355 transaction requires the distribution of controlled corporation stock by the distributing corporation, each of the following could apply to the same transaction: (i) the ''part of the distribution'' requirement in section 355(a)(1)(D); (ii) the ''in pursuance of the plan of reorganization'' requirement in section 361; and (iii) the retention requirements in section 355(a)(1)(D)(ii).

In particular, the Treasury Department and the IRS share the stakeholders' view that, if the distributing corporation does not distribute all its controlled corporation stock in the first distribution, the ''delayed distribution'' and ''retention'' labels give rise to a distinction without a difference in determining the existence of a genuine separation between the distributing corporation and the controlled corporation. In this respect, proposed § 1.355–2(e)(2)(iii) would focus on whether a genuine separation has occurred, without regard to whether the controlled corporation stock not distributed as part of the first distribution is disposed of through a distribution or transfer under section 361(c) or a taxable sale under section 1001.

However, the Treasury Department and the IRS continue to view the ''part of the distribution'' requirement in section 355(a)(1)(D), the ''in pursuance of the plan of reorganization'' requirement in section 361, and the ''no tax avoidance purpose'' requirement in section 355(a)(1)(D)(ii) as discrete requirements that address discrete issues reflective of discrete policies. The ''part of the distribution'' requirement in section 355(a)(1)(D) serves as a scoping provision for the applicability of section 355(a)(1)(D)(i) and (ii) to distributions of controlled corporation stock. As discussed in parts I.C.4 and III.C of this Explanation of Provisions, the proposed plan of distribution and plan of reorganization rules would facilitate the determination of which distributions are ''part of the distribution.''

As reflected in the legislative history of section 361, the ''in pursuance of the plan of reorganization'' requirement serves in large part to limit the application of the operative provisions in subchapter C to those transactions with a sufficiently proximate relationship with transactions that qualify under a definitional provision in subchapter C. *See* part II.A of the Background.

Lastly, the ''no tax avoidance purpose'' requirement in section 355(a)(1)(D)(ii) serves to ensure there is a genuine separation of the distributing corporation and the controlled corporation in situations in which the distributing corporation continues to

hold controlled corporation stock following the first distribution. This requirement applies regardless of whether that controlled corporation stock is disposed of pursuant to the plan of reorganization under section 361(c).

6. Timing Requirement for Control Distribution

Consistent with the Supreme Court's decision in *Gordon* (discussed in part I.D.2 of the Background), proposed § 1.355–2(e)(2) would require a distributing corporation, pursuant to a plan of distribution or plan of reorganization, as appropriate, to distribute an amount of stock of the controlled corporation constituting control (within the meaning of section 368(c)) either (i) within a single taxable year, or (ii) over two taxable years, but only if all distributions up to and including the control distribution are effectuated pursuant to a binding commitment that is described in the plan of distribution or plan of reorganization (as applicable). A two-year limitation for distributing control would provide taxpayers with additional transactional flexibility while facilitating the IRS's ability to administer and enforce the requirements of section 355. This approach would help achieve the increased certainty and transaction facilitation objectives of these proposed regulations.

7. Requirements for Nonrecognition Treatment

In accordance with the foregoing discussion in this part I.C, these proposed regulations would revise § 1.355–2(e) to provide that a distribution does not qualify for nonrecognition treatment under section 355(a)(1) unless the following requirements are satisfied. First, proposed § 1.355–2(e)(2)(i) and (ii) would provide that the distributing corporation must distribute an amount of stock of the controlled corporation constituting control (within the meaning of section 368(c)) either (i) within a single taxable year, or (ii) during two taxable years, subject to the ''binding commitment'' requirement described in part I.C.6 of this Explanation of Provisions. Second, proposed § 1.355–2(e)(2)(iii) would provide that any controlled corporation stock not distributed as part of the first distribution must satisfy the requirements for a qualifying retention in proposed § 1.355–10(c).

As previously discussed in parts I.C.1 through 3 of this Explanation of Provisions, to satisfy the requirements for a qualifying retention (and to thereby rebut the presumption of a tax avoidance purpose for the retention), the distributing corporation must: (i) either qualify for the section 355(a)(1)(D)(ii) safe harbor in proposed § 1.355–10(c)(3) or satisfy the facts-and-circumstances test in proposed § 1.355–10(c)(2)(ii); and (ii) vote any retained controlled corporation stock in proportion to votes cast by the controlled corporation's other shareholders (other than distributing corporation related persons). *See* proposed § 1.355–10(c)(2)(iii).

II. Non-Substantive Modifications to Section 355 Regulations

These proposed regulations would make certain non-substantive revisions to current §§ 1.355–1 and 1.355–4. For example, these proposed regulations would modify current § 1.355–1 by adding general definitions that apply for purposes of the section 355 regulations, incorporating the rules in current § 1.355–4 as proposed § 1.355–1, and moving the applicability dates from current § 1.355–1(a) to proposed § 1.355–1(e). These revisions are not intended to make any substantive change.

III. Plan of Reorganization; Party to a Reorganization

A. Notice 2024–38

As stated in section 2.02(4) of Notice 2024–38, the Treasury Department and the IRS understand that confusion and disagreement exists regarding the application of the ''plan of reorganization'' requirement to divisive reorganizations. For example, some stakeholders view the applicability of the ''plan of reorganization'' requirement to be potentially obviated by the temporal requirements set forth in section 3.04(6) of Rev. Proc. 2018–53 (concerning delayed satisfaction of distributing corporation debt). It is the view of the Treasury Department and the IRS that this is incorrect.

Section 2.02(4) of Notice 2024–38 further states that, although the ''plan of reorganization'' requirement incorporates a degree of transactional flexibility, such flexibility is limited by current §§ 1.368–1(c) and 1.368–2(g), and the Treasury Department and the IRS view this requirement as helpful to ensure that delayed distributions are not used to avoid the repeal of the *General Utilities* doctrine (*see* part I.A.2 of the Background).

B. Stakeholder Input

The Treasury Department and the IRS have received a broad spectrum of feedback from stakeholders regarding the ''plan of reorganization'' requirement. However, consistent with the view of the Treasury Department and the IRS set forth in Notice 2024–38, stakeholders uniformly have contended that this requirement should be applied in a flexible manner.

Certain stakeholders have described the guidance in current § 1.368–2(g) regarding the meaning and scope of the ''plan of reorganization'' requirement as circular and incomplete. Those stakeholders similarly have described § 1.368–1(c) as providing only conceptual guidance as to which transactions are properly included in a plan of reorganization. These stakeholders also have described § 1.368–3(a) as requiring each party to the reorganization to adopt that plan but then failing to provide any guidance on how such parties are to satisfy that requirement. Stakeholders have aptly noted that Notice 2024–38 provided little additional clarity regarding the ''plan of reorganization'' requirement.

Additionally, certain stakeholders have noted that few cases address the meaning and scope of the ''plan of reorganization'' concept, and that, even within such cases, courts often have applied the step transaction doctrine and the substance-over-form doctrine to determine the existence of a plan of reorganization. For example, one stakeholder highlighted *King Enterprises, Inc.* v. *United States,* 418 F.2d 511 (Ct. Cl. 1969), in which the U.S. Court of Federal Claims applied the step transaction doctrine to treat the acquisition of stock of a target corporation (Tenco), followed by the merger of the target corporation into the acquiring corporation (Minute Maid), as a reorganization qualifying under section 368(a)(1)(A). The court identified the threshold issue as ''whether the transfer of Tenco stock to Minute Maid is to be treated for tax purposes as an independent transaction of sale, or as a transitory step in a transaction qualifying as a corporate reorganization,'' which dictated the resolution of the central issue of ''whether the initial exchange of stock was a step in a unified transaction pursuant to a 'plan of reorganization'.'' *King Enterprises,* 418 F.2d at 514–15. Based on an analysis of the ''operative facts in this case,'' the court applied the step transaction doctrine to conclude that the two transactions comprised a single, unified transaction. *Id.* at 515–16, 519. Even though no formal plan of reorganization existed, the court relied on those facts and that analysis to identify a plan of reorganization for that unified transaction. *Id.* at 519 n.11 (relying on *Redfield* v. *Commissioner,* 34 B.T.A. 967 (1936), for the proposition

that ''[a] formal plan or reorganization is not necessary if the facts of the case show a plan to have existed'').

In *Seagram Corp.* v. *Commissioner,* 104 T.C. 75 (1995), the Tax Court considered whether to integrate (i) an acquisition of stock of a target corporation (Conoco) through a first-step tender offer made by a subsidiary of an acquiring corporation (DuPont Tenderor and DuPont, respectively), and (ii) a subsequent merger of Conoco into DuPont Tenderor. The court acknowledged that the tender offer and subsequent merger each possessed independent significance, and that the subsequent merger was subject to several contingencies. *Seagram,* 104 T.C. at 93–94. However, the court emphasized that DuPont and DuPont Tenderor ''were under a binding and irrevocable commitment to complete the culminating merger—the second step—upon the successful completion of the DuPont tender offer—the first step.'' *Id.* at 98. Based on all facts and circumstances of the tender offer and subsequent merger, including official records of DuPont and DuPont Tenderor, the court identified the existence of a plan of reorganization, reasoning that, ''because DuPont was contractually committed to undertake and complete the second-step merger once it had undertaken and completed the first-step tender offer, these carefully integrated transactions together constituted a plan of reorganization within the contemplation of section 354(a).'' *Id.* at 98–99 (relying principally on, and noting satisfaction of, the Supreme Court's binding commitment standard in *Gordon*).

Stakeholders also have noted that the Tax Court in *Seagram* characterized the ''plan of reorganization'' concept expressed in § 1.368–2(g) as one of ''substantial elasticity,'' relying on the court's prior observations on that concept in *Int'l Telephone. Seagram,* 104 T.C. at 96. (In *Int'l Telephone,* the Tax Court noted that § 1.368–2(g) ''is imbued with qualities of flexibility and vagueness, with the result that it does not present precise self-executing guidelines.'' 77 T.C. at 75.) The Tax Court in *Seagram* also relied on scholarly commentary for the proposition that, even though § 1.368–2(g) at that time required a plan of reorganization to be filed with the IRS, it was self-evident that the IRS and the courts could identify the existence of a plan of reorganization in the event the taxpayer either did not file one or filed one that was inaccurate. *See Seagram,* 104 T.C. at 96 (*quoting* Peter L. Faber, *The Use and Misuse of the Plan of Reorganization Concep*t, 38 Tax L. Rev. 515, 523 (1982–1983)).

Stakeholders also have commented on temporal considerations relating to plans of reorganization. Stakeholders have contended that the length of time between transactions effectuating a plan of reorganization should not prevent any particular transaction from being considered part of the plan. Conversely, these stakeholders have contended that the temporal proximity of one transaction to another transaction that is properly included in a plan of reorganization should not be determinative as to whether the other transaction is properly included in the plan. Stakeholders also have contended that imposing a time limitation for completing a plan of reorganization would be inappropriate.

Additionally, some stakeholders have recommended granting taxpayers the flexibility to either execute the steps identified in the plan of reorganization or change them at any time, based on each taxpayer's judgment on how best to achieve the objectives of their transaction. However, other stakeholders have recommended clarifying that entering into a new transaction not contemplated by the plan, even in the alternative, is not treated as pursuant to the plan of reorganization.

In sum, stakeholders uniformly have described the current regulations addressing the ''plan of reorganization'' requirement as lacking sufficient clarity and comprehensiveness. Accordingly, some stakeholders have requested guidance regarding the metrics needed for a taxpayer to establish a plan of reorganization. Specifically, stakeholders have requested guidance regarding (i) the means by which parties to a reorganization can adopt a plan of reorganization (in particular, some stakeholders have recommended allowing actions of a corporation's authorized representatives, and not just formal written actions of the board, to be taken into account for this purpose), (ii) transactions that may occur at a future time, are contingent, or are in the alternative, and (iii) transactions that may develop as a result of events arising after the plan of reorganization is adopted.

The stakeholder input received has highlighted not only the deficiencies in authoritative guidance regarding the meaning and scope of the ''plan of reorganization'' requirement, but also the importance of this requirement in determining whether the operative provisions of subchapter C apply to a particular transaction.

C. Proposed Regulations

1. Overview

The Treasury Department and the IRS agree with stakeholders that the current guidance regarding the ''plan of reorganization'' requirement is inadequate and creates significant confusion. Consistent with stakeholder recommendations, the proposed regulations would clarify, among other items, (i) the metrics needed for a taxpayer to establish a plan of reorganization, (ii) the manner whereby parties to a reorganization can adopt a plan of reorganization, and (iii) the requirements for prosecuting a plan of reorganization (including in the event of a change in circumstances following adoption of the plan). In proposing this guidance, the Treasury Department and the IRS have endeavored to balance the importance of providing taxpayers with transactional flexibility to effectuate bona fide business transactions with the need to facilitate IRS administration of the reorganization provisions of subchapter C. Accordingly, the Treasury Department and the IRS believe that this guidance would help achieve the compliance, increased certainty, and transaction facilitation objectives of these proposed regulations. (*See* the discussion of the objectives for guidance in part VI of the Background; *see also* the discussion of the TIGTA Report in part IV of the Background.)

2. Proposed Rules Regarding Plan of Reorganization

a. Purpose and Effect of Plan of Reorganization

The Treasury Department and the IRS view a plan of reorganization as serving two related purposes. First, a plan of reorganization serves to identify those transactions to which the definitional and operative provisions of subchapter C apply. Second, a plan of reorganization serves to distinguish transactions the Federal income tax treatment of which is governed by the reorganization provisions of subchapter C from transactions to which the general recognition provisions of the Code (such as section 1001) apply.

However, under the proposed regulations, a taxpayer's failure to set forth a plan of reorganization in a single, comprehensive document neither would be determinative as to the existence or scope of a plan of reorganization for a transaction nor would govern the application of any definitional or operative provision to that transaction. *See* proposed § 1.368–4(a)(3).

b. Determination of Plan of Reorganization

The proposed regulations would permit a plan of reorganization to be determined in several different manners. Under the manner preferred by the Treasury Department and the IRS, a taxpayer would prepare a single, comprehensive document that satisfies all requirements set forth in proposed § 1.368–4(d) and file that document with the IRS as required by proposed § 1.368–3(a)(5) (taxpayer-filed plan of reorganization). *See* proposed § 1.368–4(b)(1). The taxpayer-filed plan of reorganization would contain the information required by prior and current § 1.368–3(a) and incorporate recommendations of the TIGTA Report.

Specifically, proposed § 1.368–4(d) would set forth the following requirements. First, the proposal would require the taxpayer-filed plan of reorganization to identify (i) all parties to the reorganization (as required by current § 1.368–3(a)), (ii) all transactions properly included in the plan of reorganization (as required by prior § 1.368–3(a)), and (iii) all liabilities (including debt) to be assumed by the acquiring corporation and the obligees (or creditors) of those liabilities, and (iv) all debt of the target corporation that will be satisfied with section 361 consideration and the creditors of that debt. Second, the proposal would require such plan to describe the intended Federal income tax treatment of those transactions (which would facilitate implementing the recommendations of the TIGTA Report). Third, the proposal would require such plan to describe the corporate business purpose for each transaction (consistent with current § 1.368–2(g)). Lastly, the proposal would require such plan to establish that each transaction facilitates the continuance of the business of a corporation a party to the reorganization (consistent with current § 1.368–2(g)). *See* proposed § 1.368–4(d)(1).

The proposed regulations would reflect a preference that taxpayers will timely file a complete and accurate plan of reorganization. *See* proposed § 1.368–4(c)(1). Accordingly, the Federal income tax consequences of the subject transactions generally would be determined in accordance with that plan. *See* proposed § 1.368–4(a)(2)(i). Throughout the duration of the transaction or series of transactions, which potentially could span several taxable years, the IRS would possess the ability to monitor the taxpayer's execution of that plan of reorganization (for example, through the taxpayer's annual filing of Form 7216 for divisive transactions). The Treasury Department and the IRS intend the proposed approach (i) to increase taxpayer certainty regarding the Federal income tax treatment of transactions properly included in a plan of reorganization, and (ii) to facilitate IRS administration of the reorganization provisions of subchapter C.

However, if a taxpayer files a plan of reorganization with the IRS that fails to satisfy any requirement set forth in proposed § 1.368–4(d), or if the taxpayer fails to file a plan of reorganization with the IRS in accordance with proposed § 1.368–3(a)(5), proposed § 1.368–4(c)(2)(i) recognizes that the Commissioner may correct or identify a plan of reorganization. Under proposed § 1.368–4(c)(2)(ii), the Commissioner may determine that a transaction or series of transactions should be included in, or excluded from, a plan of reorganization based on (i) all facts and circumstances regarding the transaction or series of transactions, and (ii) all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine.

The proposed approach is consistent with long-standing caselaw indicating that the existence and proper scope of a plan of reorganization can be determined in the absence of formal documentation. *See, for example, Redfield,* 34 B.T.A. at 973 (''It is not necessary, however, that such a plan of reorganization be evidenced by a formal written document, such as a contract or corporate minutes. It is sufficient if the circumstances indicate that the various steps taken were pursuant to a definite plan of reorganization.''); *Fry* v. *Comm'r,* 5 T.C. 1058, 1070 (1945) (similar). The proposed regulations would reflect this long-standing position because conditioning the applicability of the definitional and operative provisions of subchapter C on whether a plan of reorganization formally was prepared and filed would, in particular and contrary to law, make the reorganization regime entirely elective.

Nonetheless, the Treasury Department and the IRS are of the view that formal documentation requirements for taxpayer-filed plans of reorganization are necessary to facilitate the IRS's administration of the reorganization provisions of subchapter C. *See* part III of the Background. Moreover, the preference for complete and accurate taxpayer-filed plans of reorganization under proposed § 1.368–4(c)(1) requires adequate substantiation with the IRS, which would be provided by objectively verifiable, official corporate documents. Accordingly, proposed § 1.368–4(d) would enhance the current reporting requirements for plans of reorganization.

c. Agreement by Parties to Plan of Reorganization; Beginning of Plan of Reorganization

Proposed § 1.368–4(d)(2) would provide that, prior to the first step of a reorganization, the plan of reorganization or an original plan of reorganization that becomes the amended plan of reorganization, as applicable, must be finalized and adopted by the party to the reorganization. Taxpayers would demonstrate satisfaction of this requirement through (i) the acts of duly authorized officers and directors of the corporation, and (ii) the official records of the party to the reorganization.

The Treasury Department and the IRS are of the view that the proposed approach would provide greater taxpayer certainty regarding the means by which parties to a reorganization can adopt a plan of reorganization than current § 1.368–3(a), which provides only that ''[t]he plan of reorganization must be adopted by each of the corporations that are parties thereto.'' As previously discussed in part III.B of this Explanation of Provisions, the current regulations have created significant uncertainty due to the lack of guidance on what constitutes an ''adoption'' by the parties. The proposed regulations would address this uncertainty in a manner consistent with prior § 1.368–3(a) and statutory law. *See* section 806(g)(3) of the Tax Reform Act of 1976 (Public Law 94–455, 90 Stat. 1520, 1606) (describing how a corporation is considered to have adopted a plan of reorganization for purposes of determining the effective date of certain modifications to sections 382 and 383).

In addition, the proposed substantiation requirements would facilitate the IRS's administrative function by marking the beginning of the taxpayer's plan of reorganization—a feature that the Tax Court also views as important. *See Seagram,* 104 T.C. at 98 (emphasizing in its plan of reorganization analysis that the DuPont/Conoco Agreement ''provides a discrete start and finish'').

d. Timing Requirement for Completion of Plan of Reorganization

i. General ''Expeditious Completion'' Requirement

Proposed § 1.368–4(d)(3)(i)(A) and (ii)(A) would require that, taking into account all facts and circumstances (including the one or more corporate

business purposes for a reorganization), all parties to the reorganization must complete the plan of reorganization as expeditiously as practicable, and in the manner described in that plan. The proposed approach takes into account taxpayers' need for transactional flexibility and reflects the long-standing principle that the passage of time is not determinative of whether a transaction is part of a plan of reorganization. *See, for example, Wilson* v. *Comm'r,* T.C. Memo. 1961–135 (''The mere lapse of time is not decisive. The important thing is that the steps which are taken evidence a consistent performance of the reorganization plan and purpose.'').

ii. Presumption of Satisfaction if Completion Within 24 Months

However, the Treasury Department and the IRS are concerned that the lack of a time limitation for completing a plan of reorganization raises administrability concerns for the IRS. Accordingly, the Treasury Department and the IRS are (i) issuing proposed § 1.355–5, and (ii) introducing new Form 7216, to provide the IRS with information regarding divisive transactions that span multiple tax years. *See* part V of the Background.

Additionally, temporal guidelines would provide greater certainty to taxpayers. In this regard, stakeholders have requested the inclusion of safe harbors in these proposed regulations to mitigate uncertainty arising from conceptual rules and facts-and-circumstances determinations. Based on this feedback, proposed § 1.368–4(d)(3)(i)(B) would provide that the ''expeditious completion'' requirement is presumed to be satisfied if all parties to a reorganization complete the plan of reorganization within the 24-month period beginning on the date of the first step of the plan of reorganization. This increased certainty would help achieve the transaction facilitation objective of these proposed regulations, and providing a 24-month safe harbor would help achieve the compliance objective of these proposed regulations.

e. Requirements for Transactions To Be Treated as Properly Included in Plan of Reorganization

i. Overview

Stakeholders have recommended various standards and approaches for determining whether a transaction is properly included in a plan of reorganization. As noted by stakeholders, neither current guidance nor the caselaw regarding the ''plan of reorganization'' requirement adequately addresses this issue. The proposed regulations would synthesize the overarching principles of this caselaw into rules that could be applied by taxpayers and the IRS with significantly greater certainty than under current Treasury guidance and the caselaw.

ii. Definite Intent Requirement

As a threshold requirement, proposed § 1.368–4(e)(1)(i) would require that, prior to the first step of a plan of reorganization or an original plan of reorganization that becomes the amended plan of reorganization, one or more parties to the reorganization must evidence a definite intent to carry out the transaction. This definite intent must be evidenced through a written commitment in one or more official records of the party that substantiate the plan of reorganization. Under this proposal, the existence of contingencies or conditions would not be conclusive in determining whether a party to the reorganization satisfies this requirement.

The ''definite intent'' standard is intended to provide sufficient transactional flexibility to encourage bona fide business transactions in a manner consistent with long-standing caselaw. The origins of the ''definite intent'' standard can be traced back to judicial opinions of the Board of Tax Appeals (BTA), the predecessor to the Tax Court. For example, in *Fry* v. *Commissioner,* the BTA relied on this standard for determining the existence of a plan of reorganization from ''what appear[ed] on the minutes of the meeting of the stockholders and the meeting of the board of directors of the old bank,'' which had articulated the business objectives and transaction steps for the reorganization. 5 T.C. at 1070; *see also Redfield,* 34 B.T.A. at 973 (noting that, although a formal written plan of reorganization is not necessary, the circumstances evidencing that a reorganization occurred need to indicate that the various steps taken in pursuance thereof were taken ''pursuant to a *definite* plan of reorganization'') (emphasis added); *Seagram,* 104 T.C. at 97 (observing that the DuPont/Conoco Agreement ''definitively states the terms for 'the acquisition of [Conoco] by [DuPont Tenderor and]' sets out . . . the series of transactions which in their totality were intended to accomplish a section 368 reorganization'').

In contrast, courts have determined that transactions subject to a lesser degree of intent or predominated by uncertainty are not properly included in a plan of reorganization. For example, in *National Bank of Commerce in Memphis* v. *United States,* 87 F. Supp. 302 (W.D. Tenn. 1949), the court concluded that a transaction contemplated prior to the plan of reorganization was not properly included in that plan because the transaction was uncertain and indefinite as of the time of the first step of the plan of reorganization. 87 F. Supp. at 304. The court emphasized that ''[a]n element in a plan of reorganization that cannot be legally enforced and, in addition is fraught with much uncertainty, is indefinite and not necessary to the reorganization, cannot be considered as one of the steps resulting in the completed transaction.'' *Id.* Accordingly, if the parties did not anticipate or otherwise contemplate a transaction prior to the adoption of the plan of reorganization, that transaction cannot be included in that plan. *See Atwood Grain & Supply Co.* v. *Comm'r,* 60 T.C. 412, 423 (1973) (observing that ''[t]here [wa]s no evidence that issuance of the preferred stock was contemplated either in the merger negotiations or in the merger agreement,'' and reasoning that, ''[i]n order to include events occurring after a merger in the plan of merger there must be some anticipation of the event in the merger'').

Stakeholders have noted that a ''plan of reorganization'' concept that includes every possibility considered by any taxpayer in connection with a reorganization would be overbroad and meaningless. Indeed, a commenter relied upon by the Tax Court for its analysis in *Seagram* noted that ''[t]he contemplated possibility standard is too broad. . . . A more appropriate standard would be to link the later transaction to the earlier one only if there is a firm commitment to consummate it.'' Faber, *The Use and Misuse of the Plan of Reorganization Concept,* 38 Tax L. Rev. at 547. The Treasury Department and the IRS agree that such a standard would not be appropriate for the proposed regulations. Accordingly, proposed § 1.368–4(e)(1)(iii)(A) would provide that mere contemplation that a transaction may be carried out would not be sufficient to satisfy the ''definite intent'' requirement, regardless of whether that contemplated transaction is included in an official record of the party.

However, the Treasury Department and the IRS recognize that the ''contemplated possibility'' standard is relevant for certain plan of reorganization determinations. Accordingly, proposed § 1.368–4(e)(1)(iii)(B) would provide that a party's mere contemplation of a transaction may be relevant for purposes of the correction or identification of a plan of reorganization by the

Commissioner. As previously discussed in part III.C.2.b. of this Explanation of Provisions, the Commissioner's determination under proposed § 1.368–4(c)(2)(ii) would be based on all facts and circumstances pertaining to the transaction and the application of all relevant Code provisions and Federal income tax principles, including the step transaction doctrine.

Permitting the IRS to determine the outer reaches of the scope of transactions potentially includable in a plan of reorganization through an analysis of all facts and circumstances and Federal income tax principles would be consistent with judicial authorities that have applied a ''contemplated possibility'' test. For example, in *Anheuser-Busch, Inc.* v. *Commissioner,* 40 B.T.A. 1100 (1939), the BTA relied on substance-over-form principles to determine the scope of transactions included in a plan of reorganization, based on its determination that a first-step transfer to a parent corporation was ''transitory and without real substance.'' 40 B.T.A. at 1106. As part of its analysis, the court observed that the parent had ''contemplated,'' but was not obligated to carry out, the immediate transfer of the property received to its subsidiary, and the court expanded the scope of the plan of reorganization to include that second-step transfer. *Id.* at 1106–07 (relying on the substance-over-form analysis of *Helvering* v. *Bashford,* 302 U.S. 454, 458 (1938)). Other judicial opinions similarly have used the existence of a contemplated possibility in this manner. *See, for example, Avco Mfg. Corp.* v. *Comm'r,* 25 T.C. 975, 984–85 (1956) (noting that a ''subsequent transfer of the property . . . was a contemplated possibility under the plan that actually eventuated'' and was properly included within the scope of the plan of reorganization under the mutual interdependence test); *Transport Products Corp.* v. *Comm'r,* 25 T.C. 853, 857–58 (1956).

Once a definite intent is established, the existence of contingencies and other conditions that could affect prosecution of the plan of reorganization are not treated as diminishing that level of intent. *See, for example, Seagram,* 104 T.C. at 96 (''DuPont had an indisputable legal obligation to complete the Merger with Conoco, notwithstanding the possibility of intervening legal impediments, or contingencies, which in fact, never materialized''). Accordingly, proposed § 1.368–4(e) would provide that, for purposes of determining whether a party to a reorganization satisfies the ''definite intent'' requirement, the existence of contingencies or conditions is not conclusive.

Section 355 transactions would be subject to a special definite intent requirement under proposed §§ 1.355–4(d)(1)(ii) and 1.368–4(e)(1)(ii). Specifically, if a control distribution occurs in a later taxable year than the first distribution, the distributing corporation would not be treated as establishing a definite intent unless all distributions up to and including the control distribution are effectuated pursuant to a binding commitment. This proposed special ''definite intent'' requirement would reflect the Supreme Court's decision in *Gordon. See also* the discussion in part I.D.2 of the Background.

iii. Proximate Relationship Requirement

(a) Overview

The proposed regulations would set forth standards for determining whether a transaction shares a sufficient relationship with other transactions to which a definitional or operative provision applies. To reflect the distinct purposes for, and requirements of, the definitional provisions and the operative provisions in subchapter C, the proposed regulations would set forth two different sets of proximate relationship requirements.

(b) Necessary or Integral Test for Qualification Under Definitional Provisions

Under proposed § 1.368–4(e)(2)(i)(A), a transaction would be treated as part of the plan of reorganization for a reorganization to which a definitional provision can apply only if, on its own or as part of a series of transactions, the transaction either (i) is necessary to satisfy one or more requirements of the definitional provision, or (ii) is an integral part of a series of transactions carried out to satisfy the requirements of the definitional provision. In practice, the ''integral part'' test generally would be relevant for transactions that are not ''necessary to satisfy'' one or more requirements of a definitional provision. The proposed regulations would require satisfaction of either condition to be evidenced by a written commitment in one or more official records of the party to the reorganization. *See* proposed § 1.368–4(e)(2)(i)(A).

The ''necessary to satisfy'' condition is intended to convey, with more precision, a requirement set forth in current § 1.368–2(g). Section 1.368–2(g) states, in part, that ''[t]he term plan of reorganization has reference to a consummated transaction specifically defined as a reorganization under section 368(a).'' In addition, current § 1.368–2(g) provides that ''[t]he term is not to be construed as broadening the definition of 'reorganization' as set forth in section 368(a).'' The Treasury Department and the IRS view the ''necessary to satisfy'' condition as already clear (given that the definitional provisions in section 368(a)(1) describe the steps necessary for qualification) but have rearticulated this standard to eliminate the circularity and vagueness that courts and stakeholders have identified in current § 1.368–2(g). *See Int'l Telephone,* 77 T.C. at 75 (noting such vagueness); *Seagram,* 104 T.C. at 96 (highlighting the Tax Court's observation in *Int'l Telephone*).

The ''integral part'' condition also is embedded in current § 1.368–2(g), which provides that the term ''plan of reorganization'' is to be taken as limiting the nonrecognition of gain or loss to ''such exchanges or distributions as are *directly a part of the transaction specifically described as a reorganization in section 368(a)*'' (emphasis added). The Treasury Department and the IRS view this ''directly a part'' standard as less stringent than the ''necessary to satisfy'' standard but nonetheless view it as mandating that a transaction must be essential to qualifying a series of transactions as a reorganization. Accordingly, the proposed regulations would replace the phrase ''directly a part of the transaction'' with an ''integral part'' standard.

The proposed ''integral part'' standard is intended to reflect the structure of section 368(a)(1) and the long-standing position of the IRS and the courts. For example, a distributing corporation that retains controlled corporation stock may qualify under section 355—and therefore ultimately may satisfy a condition in section 368(a)(1)(D)—through multiple types of dispositions of controlled corporation stock. In each instance, such disposition may be viewed as integral to section 368(a)(1)(D) qualification. (*See also* the requirements for qualifying retentions previously discussed in part I.C of this Explanation of Provisions.)

The foregoing principle is reflected in Rev. Rul. 57–518, 1957–2 C.B. 253, which addressed whether a transaction satisfied a prior version of section 368(a)(1)(C) that did not yet impose a liquidation requirement. In Rev. Rul. 57–518, a target corporation transferred 70 percent of its assets to an acquiring corporation for acquiring corporation voting stock. The target corporation then disposed of all its remaining assets in recognition transactions (that is, not under the operative nonrecognition

provisions of subchapter C) and liquidated. Although the liquidation was not described in, or required by, that prior version of section 368(a)(1)(C), the IRS concluded that the liquidation was part of the plan of reorganization. Like the disposition by a distributing corporation of retained controlled corporation stock in a transaction to which section 1001 applies, the target corporation liquidation was not necessary to achieve qualification under section 368(a)(1), but it was an integral part of a series of transactions carried out to satisfy the requirements of that definitional provision.

(c) But for, or Integral to, Test for Application of Operative Provision

Under proposed § 1.368–4(e)(2)(i)(B), a transaction would be treated as part of the plan of reorganization to which an operative provision can apply only if, on its own or as part of a series of transactions, the transaction either (i) would not have occurred but for the reorganization that is covered by the plan of reorganization, or (ii) is an integral part of a series of transactions carried out to satisfy the requirements of the definitional provision intended to apply to the reorganization. The proposed regulations would require satisfaction of either condition to be evidenced by a written commitment in one or more official records of the party to the reorganization. Both of these conditions are intended to replace the ''directly a part of'' standard set forth in current § 1.368–2(g) with standards that are clearer and more reflective of the purpose and requirements of the operative provisions in subchapter C.

The proposed ''but for'' condition is embedded within the ''directly a part of'' requirement in current § 1.368–2(g). Among other objectives, this proposed condition is intended to help clarify the determination of whether an operative provision applies to a distribution that occurs within close temporal proximity to one or more transactions that are properly included in a plan of reorganization. For example, in determining whether section 361(b) should apply to a distribution by a distributing corporation to its shareholders in close temporal proximity to a divisive reorganization, the proposed ''but for'' test would clarify that section 361(b) treatment would be applicable only if that distribution would not have occurred ''but for'' the divisive reorganization. *See* the examples in proposed § 1.361–3(f)(2) through (5).

An ''integral part'' standard also would increase taxpayer certainty as compared to the current ''directly a part of'' standard, particularly because courts historically have applied an ''integral part'' standard. For example, in *Sheldon* v. *Commissioner,* 6 T.C. 510 (1946), the Tax Court found that a transaction was integral to a merger even though the transaction was not necessary for qualification for a definitional provision under section 368(a)(1). In *Sheldon,* the Tax Court considered whether a pre-merger distribution should be included in the plan of reorganization for the merger. 6 T.C. at 517–18. The court emphasized that the pre-merger distribution was made to equalize values of the target corporation and the acquiring corporation so that the merger could be one of equals, thereby satisfying a condition for executing the merger. *Id.* In its analysis, the court provided that ''[t]he purpose of this distribution, its place in the sequence of events, and the surrounding circumstances, lead to but one conclusion. They all demonstrate that it was an integral part of the reorganization transaction as a whole and must be treated in connection with it.'' *Id.* at 517. *See also Int'l Telephone,* 77 T.C. at 76 (noting the absence of ''a binding agreement or other factors indicating that conversion [of debentures] was an integral part of the plans of reorganization'').

Additionally, the Treasury Department and the IRS are of the view that replacing the ''directly a part of'' standard in current § 1.368–2(g) with the standards in proposed § 1.368–4(e)(2)(i)(B) would improve taxpayer certainty in determining the applicability of an operative provision of subchapter C. Proposed § 1.368–4(e) would provide additional certainty by requiring the ''but for'' standard to be applied in tandem with the ''definite intent'' requirement set forth in proposed § 1.368–4(e)(1). In other words, a transaction would not be properly included in a plan of reorganization if the party to the reorganization failed to evidence a definite intent to carry out that transaction, regardless of whether the transaction would not have occurred ''but for'' the reorganization.

This implementation of the ''but for'' standard would be consistent with judicial authorities, including those cited by stakeholders. For example, in *International Telephone,* the Tax Court considered exchanges involving debentures that could not have occurred but for the execution of a reorganization that qualified under section 368(a)(1)(C). 77 T.C. at 72–78. Although the court observed the existence of that ''but for'' relationship, the court reasoned that ''[t]he fact that [the acquiring corporation] assumed the conversion obligation as part of the plans of reorganization does not mean . . . that the subsequent conversions and retirement of the debentures were also part of the reorganizations.'' *Id.* at 76. Based on the lack of indicia indicating satisfaction of the proposed ''direct intent'' requirement, the Tax Court concluded that such exchanges were not properly included in the plan of reorganization. *See id.* at 76–77 (noting the lack of any binding agreement, any other type of obligation, or other facts that would indicate satisfaction of the ''direct intent'' requirement). *See also Becher* v. *Comm'r,* 22 T.C. 932 (1954) (treating a distribution as not part of the plan of reorganization under the predecessor to section 368(a)(1)(D), and therefore not ''boot,'' based on an examination of the facts and circumstances of the distribution and the transactions comprising the reorganization).

(d) Independent Legal Significance; Temporal Proximity

Proposed § 1.368–4(e)(2)(ii) would confirm that the independent significance of a transaction (for example, the fact that the transaction has a separate business motive apart from the reorganization) does not preclude satisfaction of the proximate relationship requirements in proposed § 1.368–4(e)(2)(i)(A) and (B). The Treasury Department and the IRS view this approach as consistent with established caselaw (*see Seagram,* 104 T.C. at 91–93) and reflective of the realities of bona fide business transactions. It has long been the understanding of the Treasury Department and the IRS that a transaction could be included in the plan of reorganization even though it may have separate business motives, or separate and permanent legal, economic, and business consequences, apart from the reorganization.

Additionally, proposed § 1.368–4(e)(2)(iii) would provide that a transaction occurring in close temporal proximity to one or more other transactions is not properly included in a plan of reorganization unless Federal income tax principles (including the step transaction doctrine) would apply to determine that the transaction was, in substance, part of the plan of reorganization.

iv. Business Purpose Consistency Requirement

Lastly, in order for a transaction to be treated as properly included in a plan of reorganization, proposed § 1.368–4(e)(3) would require the transaction (on its

own, or as part of a series of transactions) to be consistent with, and directly related to, one or more corporate business purposes for the reorganization (for example, the transaction directly furthers one or more corporate business purposes for the reorganization).

The Treasury Department and the IRS view the proposed corporate business purpose consistency requirement as reflective of established caselaw. *See Seagram,* 104 T.C. at 83, 97 (noting that the tender offer and the merger shared the same corporate business purpose of enabling DuPont to acquire all the stock of Conoco). In addition, the Treasury Department and the IRS view this proposed rule as conceptually grounded in current § 1.368–2(g), which provides that ''the readjustments involved in the exchanges or distributions effected in the consummation [of the reorganization] must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization.''

f. Amended Plan of Reorganization

The Treasury Department and the IRS recognize that, in certain circumstances, taxpayers may need to amend their plans of reorganization. Accordingly, proposed § 1.368–4(f)(1) would provide that, if a taxpayer amends a plan of reorganization after the first step of the original plan (amended plan of reorganization), those amendments do not cause the taxpayer to fail to satisfy the ''plan of reorganization'' requirements set forth in proposed § 1.368–4(d) only if the following requirements are satisfied. First, the amendments to the plan must be in direct response to an identifiable, unexpected, and material change in market or business conditions that occurs after the date on which the original plan of reorganization is adopted by the party to the reorganization. Second, the amendments must be necessary to effectuate the reorganization. Third, the amended plan of reorganization must satisfy all requirements set forth in proposed § 1.368–4(d) to qualify as a plan of reorganization.

If the taxpayer satisfies the requirements in proposed § 1.368–4(f)(1), proposed § 1.368–4(f)(2)(i) would provide that the definitional and operative provisions described in proposed § 1.368–1(c)(2)(i) and (ii) would apply to the transactions identified in, and carried out pursuant to, the amended plan of reorganization. In other words, the proposed regulations would confirm that the Federal income tax consequences of all transactions properly included in the amended plan of reorganization would be determined based on that plan of reorganization (and not on the original plan of reorganization). However, proposed § 1.368–4(f)(2)(ii) would provide that, if the amended plan of reorganization fails to satisfy the requirements in proposed § 1.368–4(f)(1), the Commissioner may correct or identify the amended plan of reorganization.

3. Proposed Rules Regarding Party to a Reorganization

In addition to providing rules regarding the determination, adoption, and prosecution of a plan of reorganization, the proposed regulations would revise current § 1.368–2(f) to further clarify (i) which persons are parties to a reorganization, and (ii) the consequences of determining that a person is (or is not) a party to a reorganization.

Proposed § 1.368–2(f)(1) generally would provide that the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii), respectively, apply solely to a transaction that is carried out by, between, or among one or more parties to a reorganization. For purposes of determining the scope of transactions to which those provisions apply, the term ''party to a reorganization'' would be limited under proposed § 1.368–2(f)(2) through (4) solely to a corporation that (i) engages in a transaction or series of transactions that satisfies a definitional provision set forth in section 368(a)(1), and (ii) is determined to be a party to a reorganization, as further described in the following paragraph.

In general, proposed § 1.368–2(f)(4)(i) would provide that a corporation's status as a party to a reorganization is established solely by the inclusion and identification of the corporation as a party to the reorganization in a plan of reorganization filed with the IRS pursuant to proposed § 1.368–3(a)(5). However, proposed § 1.368–2(f)(4)(ii) would provide that the corporation's status as a party to a reorganization may be determined by the Commissioner based on (i) all facts and circumstances regarding the transaction or series of transactions, and (ii) all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine.

Proposed § 1.368–2(f)(3)(ii) would retain the rules in current § 1.368–2(f) regarding the impact of certain transfers of assets or stock in a reorganization on a person's status as a party to the reorganization.

IV. Application of Substance-Over-Form, Agency, and Other Relevant Theories to Intermediated Exchanges and Direct Issuance Transactions

A. Notice 2024–38

In section 2.02(5) of Notice 2024–38, the Treasury Department and the IRS announced that they are continuing to study the application of the Code, as well as general principles of Federal income tax law (including substance-over-form, agency, or other relevant theories), to monetization transactions involving section 361 consideration. In particular, this study continues to focus on intermediated exchanges, which occur through (i) the acquisition by an intermediary (such as an investment bank) of historical distributing corporation debt from holders of that debt, and (ii) the subsequent satisfaction of that debt by the distributing corporation using section 361 consideration.

As capital market transactions have evolved, this study also has focused increasingly on direct issuance transactions, which typically occur through: (i) the issuance of new debt by a distributing corporation to an intermediary for cash in anticipation of a divisive reorganization; (ii) the use of that cash by the distributing corporation to satisfy historical distributing corporation debt, during a potentially indefinite period; and (iii) the satisfaction of that new debt by the distributing corporation through the transfer of section 361 consideration to the intermediary.

This study reflects the long-standing position of the Treasury Department and the IRS that general principles of Federal income tax law (including substance-over-form, agency, or other relevant theories) apply to determine the Federal income tax consequences of all transactions, including such monetization transactions. *See United States* v. *Fruehauf Corp.,* 577 F.2d 1038, 1068 (6th Cir. 1978) (''The incidence of federal taxation has always depended upon the substance of transactions . . .''). Indeed, this position is consistent with nearly a century of Supreme Court precedent beginning with the Court's decision in *Gregory* v. *Helvering,* which established that the application of the Code to a transaction (or series of transactions) turns on the substance of the transaction. *See Gregory,* 293 U.S. at 467–70 (concluding that the ''reorganization attempted was without substance and must be disregarded [and] [t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose'');

United States v. *Iles,* 906 F.2d 1122, 1127 (6th Cir. 1990) (''The Supreme Court has recognized, at least as far back as *Gregory* v. *Helvering* . . . that substance over form governs federal taxation.'') (citations omitted).

The application of substance-over-form and similar doctrines can affect qualification for nonrecognition treatment under section 361. Notice 2024–38 conveyed the long-standing view of the Treasury Department and the IRS that the application of agency principles to an intermediated exchange involving so-called ''old and cold'' distributing corporation debt could cause that transaction to be recharacterized for Federal income tax purposes such that the distributing corporation would not be treated as transferring section 361 consideration to a creditor in satisfaction of distributing corporation debt. In other words, if the intermediary were found to be acting on behalf of the distributing corporation under agency principles, transfers of section 361 consideration to the intermediary would not satisfy the requirements for nonrecognition under section 361. With respect to a direct issuance transaction in which the distributing corporation issues and redeems the new debt in close temporal proximity, the Treasury Department and the IRS are of the view that the transaction could be recast under general principles of Federal income tax law such that the nonrecognition requirements under section 361 are not satisfied.

B. Stakeholder Input

1. Intermediated Exchanges

Stakeholders have contended that intermediated exchanges should not be subject to recharacterization, provided that the distributing corporation establishes the intermediary's status as a creditor acting for its own account under agency principles. Stakeholders have stated that this approach would be consistent with Rev. Rul. 2017–9, 2017–21 I.R.B. 1244, because intermediated exchanges (i) do not conflict with the underlying policy of section 361(c)(3), (ii) do not avoid the result intended by section 361(c)(3) (that is, the reallocation of historical distributing corporation liabilities to the controlled corporation), and (iii) do not produce results that are inconsistent with the underlying intent of section 361(c)(3). In other words, stakeholders have suggested that, in determining whether an intermediated exchange should be recharacterized, the relevant question is whether the distributing corporation debt acquired by the intermediary was issued with a purpose of avoiding any requirement or limitation under section 361.

In this regard, one stakeholder has requested guidance providing that steps of an intermediated exchange will not be recast under Federal income tax principles if (i) the intermediary acts on its own account in acquiring distributing corporation debt from third parties (that is, the intermediary becomes the owner of such debt for Federal income tax purposes and the acquisition is not funded or guaranteed by the distributing corporation), (ii) the intermediary assumes the risk that the distributing corporation may default on its debt while such debt is held by the intermediary, and (iii) the distributing corporation debt acquired by the intermediary was not issued with a purpose of avoiding the requirements or limitations of section 361.

Another stakeholder has recommended that the Treasury Department and the IRS refrain from issuing substantive guidance given the fact-intensive nature of determining whether an intermediated exchange should be recast. The stakeholder has recommended that the IRS continue to issue private letter rulings on a case-by-case basis to taxpayers that are able to establish an intermediary's status as a creditor acting for its own account by reference to the factors specified in a series of technical advice memoranda previously issued by the IRS. *See* T.A.M. 8815003 (Dec. 11, 1987); T.A.M. 8738003 (May 22, 1987); T.A.M. 8735007 (May 18, 1987); T.A.M. 8735006 (May 18, 1987).

2. Direct Issuances

Stakeholders have provided various recommendations to the Treasury Department and the IRS regarding the treatment of direct issuance transactions. Stakeholders uniformly have contended that the proposed regulations should recast or recharacterize a direct issuance transaction only if the transaction presents an abuse within the meaning of section 361(b)(3). In addition, stakeholders consistently have contended that the policy of section 361 confirms that direct issuance transactions satisfy the requirements for nonrecognition treatment under section 361. Although one stakeholder has acknowledged that, in some circumstances, the Treasury Department and the IRS may have a legitimate concern that a direct issuance transaction should be treated as a sale of controlled corporation stock to the intermediary, the stakeholder has noted that delineating the exact bounds of an abusive transaction as it relates to section 361(b)(3) and (c)(3) would be difficult. Accordingly, stakeholders generally have recommended that the Treasury Department and the IRS continue to address the section 361 qualification of direct issuance transactions through the IRS's private letter ruling program rather than through Treasury regulations.

Alternatively, stakeholders have recommended that the proposed regulations set forth specific safe harbors for direct issuance transactions that, after adequately taking into account commercial considerations (which one stakeholder has referred to as ''commercially grounded carveouts''), clearly would not present evidence of abuse. One stakeholder has recommended that a direct issuance transaction be respected as a borrowing if: (i) the newly issued debt qualifies as debt for Federal income tax purposes; (ii) the new debt issuance and the exchange agreement with the intermediary (regarding satisfaction of the newly issued debt with controlled corporation stock or securities) are pursuant to two legally separate agreements; (iii) the distributing corporation is not under economic compulsion to satisfy the newly issued debt with controlled corporation stock or securities at the time of issuance because the distributing corporation has sufficient other resources to repay the debt; (iv) the newly issued debt is satisfied with controlled corporation stock or securities having a fair market value equal to the principal amount and unpaid interest on the debt; and (v) the distributing corporation retains tax ownership of the controlled corporation stock or securities until the time of repayment.

Another stakeholder has suggested additional factors to be considered, including (i) the number of days the newly issued debt is outstanding before the exchange of that debt for controlled corporation stock or securities, and (ii) whether the intermediary participating in the direct issuance transaction is a member of a syndicate of lenders that has historically provided debt financing to the distributing corporation. Additionally, a stakeholder has recommended (i) limiting permissible direct issuance transactions to situations in which the proceeds of the new debt are used to retire historical debt, and (ii) including a general anti-avoidance rule based on the distributing corporation's business purpose for entering into the direct issuance transaction.

C. Proposed Regulations

1. Overview

The Treasury Department and the IRS continue to be of the view that, under certain circumstances, intermediated exchanges and direct issuance transactions can be recast or otherwise recharacterized under Federal income tax principles. Certain stakeholders have described the aforementioned concerns of the Treasury Department and the IRS with respect to such transactions as new or as deriving primarily from direct issuance transactions or refinancing transactions.

However, these concerns are neither new nor unique. As confirmed almost a century ago by the Supreme Court in *Gregory* v. *Helvering,* the application of substance over form and other general Federal income tax principles is inseparable from the application of the Code itself. *See also Newman* v. *Comm'r,* 894 F.2d 560, 562 (2d Cir. 1990) (emphasizing that, ''in reviewing a transaction for tax consequences, the substance of the agreement takes precedence over its form''). Accordingly, one objective of these proposed regulations is to clarify that general Federal income tax principles apply with regard to the application of section 361 just as such principles would apply with regard to the application of other Code provisions.

With regard to the application of section 361 to intermediated exchanges, the Treasury Department and the IRS note that concerns regarding agency and substance over form date back decades to a series of technical advice memoranda that considered the application of a prior version of section 108 of the Code to conceptually similar intermediated exchanges of stock and securities. *See* T.A.M. 8815003 (Dec. 11, 1987); T.A.M. 8738003 (May 22, 1987); T.A.M. 8735007 (May 18, 1987); T.A.M. 8735006 (May 18, 1987). The so-called ''5/14 standard'' in corporate private letter rulings developed out of concerns similar to those discussed in those memoranda. (Under this standard, rulings generally would be issued by the IRS if: (i) the intermediary purchased distributing corporation debt; (ii) after at least five days, the intermediary and the distributing corporation entered into an agreement to exchange the purchased distributing corporation debt for section 361 consideration; and (iii) the exchange occurred at least 14 days after the intermediary purchased the distributing corporation debt.)

With regard to the application of section 361 to direct issuance transactions, the Treasury Department and the IRS have expressed similar concerns for more than a decade. In particular, the Treasury Department and the IRS ceased considering certain private letter ruling requests under section 361 in part due to this type of section 361 monetization transaction. *See* section 5.01(10) of Rev. Proc. 2013–3, 2013–1 I.R.B. 113. As explained by Treasury Department and IRS officials at that time, these transactions raised issues concerning the application of general principles of Federal income tax, including the substance-over-form doctrine. Stakeholders also raised similar issues at that time.

In addition, certain stakeholders have mischaracterized the concerns of the Treasury Department and the IRS as focused principally on (i) whether the new debt should be respected as a debt instrument for Federal income tax purposes, or (ii) temporal proximity. With regard to the former point, certain stakeholders have provided feedback on Notice 2024–38 emphasizing debt-equity factors or have noted that, outside of Federal income tax (for example, under securities law), new debt issued by a distributing corporation in a direct issuance transaction would be treated as debt.

However, as previously discussed in this part IV.C.1, the Treasury Department and the IRS are concerned with the application of the Code and Federal income tax principles—not commercial law or other non-Federal income tax law—to intermediated exchanges and direct issuance transactions. In particular, as expressed in Notice 2024–38, the concern is not simply the status of the newly issued distributing corporation debt as debt for Federal income tax purposes, but also that the form of those debt-elimination transactions should be respected and not recharacterized under Federal income tax principles.

With regard to the latter point, the Treasury Department and the IRS replaced the 5/14 standard for private letter rulings in Rev. Proc. 2018–53 with a standard based on a facts-and-circumstances analysis. This change was made due to concerns that the 5/14 standard provided a temporal requirement that was indifferent to the particular facts and circumstances of the transaction, including the intermediary's relationship with the distributing corporation. As a consequence, the Treasury Department and the IRS observed that the 5/14 standard created confusion for taxpayers as to whether temporal proximity is the sole consideration with regard to the application of agency or substance-over-form principles to intermediated exchanges and direct issuance transactions.

The Treasury Department and the IRS also continue to be of the view that Rev. Rul. 2017–9 and other revenue rulings mentioned by stakeholders in their submitted feedback do not (and cannot) set forth broadly applicable principles that would dictate the positions set forth in these proposed regulations. One reason is that there are long-established limitations on the precedential value of revenue rulings. Specifically, ''[r]evenue rulings published in the [Internal Revenue] Bulletin do not have the force and effect of Treasury Department regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for that purpose.'' Section 601.601(d)(2)(v)(d) of the Statement of Procedural Rules (codifying section 7.01(4) of Rev. Proc. 89–14, 1989–8 I.R.B. 20). In addition, ''[e]ach revenue ruling represents the conclusion of the Service as to the application of the law to the entire statement of facts involved,'' as opposed to an application outside of that entire statement of relevant facts. Section 601.601(d)(2)(v)(d) (codifying section 7.01(6) of Rev. Proc. 89–14). Based on these limitations, ''taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same.'' Section 601.601(d)(2)(v)(e).

Another reason is that, in almost all instances, the facts and circumstances set forth in the revenue rulings mentioned by stakeholders are not substantially the same as the transaction facts considered by the Treasury Department and the IRS in developing these proposed regulations. *See* Rev. Rul. 2017–9 (providing that ''[t]his revenue ruling provides guidance regarding the federal tax treatment of certain transactions referred to as 'north-south' transactions,'' rather than intermediated exchanges or direct issuance transactions); Rev. Rul. 59–197, 1959–1 C.B. 77 (considering the potential effect of a ''cash sale to the key employee'' of the distributing corporation on section 355 qualification, rather than an intermediated exchange or a direct issuance transaction). Accordingly, those revenue rulings address entirely different provisions of the Code. *See* Rev. Rul. 2017–9 (addressing the application of, and qualification under, sections 301, 351, 355, and 361(b)(1) and (2) (not section 361(b)(3) and (c)(3)); Rev. Rul. 59–197 (addressing the application of the device

and continuity of interest requirements under section 355, not section 361(b)(3) and (c)(3)).

However, the Treasury Department and the IRS are of the view that the facts and analysis set forth in Rev. Rul. 79–258 are relevant for purposes of developing proposed regulations under section 357(b). Accordingly, based on a de novo consideration of the analysis set forth in that revenue ruling, proposed § 1.357–3(d)(4)(ii)(B) would incorporate that analysis into proposed rules regarding the assumption by a controlled corporation of distributing corporation debt issued in close proximity to a divisive reorganization. *See* the discussion in part VIII.C.3.b of this Explanation of Provisions. For the reasons discussed in this part IV.C.1, the Treasury Department and the IRS do not view it as appropriate for these proposed regulations to extend the analysis of Rev. Rul. 79–258 to proposed rules addressing the application of section 361.

2. General Approach of Proposed Regulations

The Treasury Department and the IRS appreciate the feedback received from stakeholders on intermediated exchanges and direct issuance transactions. As emphasized in Notice 2024–38, and consistent with other aspects of these proposed regulations, the proposed rules addressing these topics are intended (i) to be consistent with all relevant provisions of the Code (that is, the compliance objective); (ii) to provide certainty to taxpayers and the IRS regarding the application of all relevant provisions of the Code to purported section 355 transactions (that is, the increased certainty objective); and (iii) to be responsive to the manner in which section 355 transactions are engaged in by taxpayers and reflect current market practices and preferences (that is, the transaction facilitation objective), to the extent that doing so does not conflict with the compliance and increased certainty objectives.

With regard to the increased certainty objective, the Treasury Department and the IRS have leveraged the expertise of IRS audit and examination personnel to develop proposed rules that, to the extent practicable, employ bright-line safe harbors, objectively verifiable conditions for qualification, and other similar architecture that can be readily reflected on Form 7216. These rules reflect the express delegation of authority to the Secretary to prevent avoidance of tax through abuse of section 361(b)(3) or (c)(3). The Treasury Department and the IRS have endeavored to balance this increased certainty objective with the transaction facilitation objective.

3. Specific Aspects of Proposed Regulations

a. General Requirements for Deemed Distribution Treatment

Proposed § 1.361–5 would implement section 361(b)(3) and (c)(3) by setting forth requirements that, if satisfied, would cause a transfer of section 361 consideration by the distributing corporation to its creditor to be treated as a distribution by the distributing corporation to its shareholders pursuant to the plan of reorganization. First, the creditor of the distributing corporation must be a qualifying creditor, as determined under proposed § 1.361–5(b). Second, the distributing corporation debt that is satisfied with section 361 consideration must constitute eligible distributing corporation debt, as determined under proposed § 1.361–5(c)(2). Third, the amount of distributing corporation debt that can be eliminated under the safe harbors of section 361(b)(3) and (c)(3) cannot exceed a maximum amount, as determined under proposed § 1.361–5(d). Lastly, the transfer by the distributing corporation of section 361 consideration in exchange for eligible distributing corporation debt must be carried out as part of a qualifying debt elimination transaction, as determined under proposed § 1.361–5(e).

Notwithstanding the satisfaction of the foregoing requirements, proposed § 1.361–5(f)(1)(i) would provide that the amount of section 361 consideration treated as transferred by the distributing corporation to a creditor of the distributing corporation in a qualifying debt elimination transaction is reduced by the amount of distributing corporation debt that is transitorily eliminated. *See* the discussion in part VII.C of this Explanation of Provisions regarding transitorily eliminated distributing corporation debt.

b. Qualifying Creditors

Proposed § 1.361–5(b)(1) would require each creditor to which the distributing corporation transfers section 361 consideration in a divisive reorganization to be a creditor that holds eligible distributing corporation debt (as described in proposed § 1.361–5(c)). Additionally, proposed § 1.361–5(b)(1) and (b)(2)(i) generally would prohibit the distributing corporation from satisfying eligible distributing corporation debt held by a person related (within the meaning of section 267(b) or section 707(b)(1)) (*see* proposed § 1.361–1(b)(47)) to the distributing corporation (distributing corporation related person), the controlled corporation (controlled corporation related person), or a related person with regard to a distributing corporation related person or a controlled corporation related person (collectively, non-qualifying creditors). Creditors that hold eligible distributing corporation debt, and that are not otherwise disqualified as non-qualifying creditors under proposed § 1.361–5(b)(2), are referred to as ''qualifying creditors.''

Proposed § 1.361–5(b)(2)(ii) would provide an exception to the general related-creditor prohibition in proposed § 1.361–5(b)(2)(i) for a creditor that is a distributing corporation related person or a related person with regard to a distributing corporation related person if three requirements are satisfied. First, as part of the plan of reorganization, proposed § 1.361–5(b)(2)(ii)(A) would provide that the section 361 consideration must be transferred to a creditor that is neither a distributing corporation related person nor a related person with regard to a distributing corporation related person (unrelated ultimate creditor). Specifically, if the section 361 consideration is money or other property, proposed § 1.361–5(b)(2)(ii)(A)(*1*) would provide that it must be transferred to an unrelated ultimate creditor pursuant to the plan of reorganization no later than the end of the 12-month period beginning on the date the distributing corporation receives the money or other property (as appropriate). If the section 361 consideration is qualified property (as defined in proposed § 1.361–1(b)(43)), proposed § 1.361–5(b)(2)(ii)(A)(*2*) would provide that it must be transferred to an unrelated ultimate creditor in an expeditious manner pursuant to the plan of reorganization under proposed § 1.368–4(d)(3). Second, proposed § 1.361–5(b)(2)(ii)(B)(*1*) would provide a general provision that all debt for which section 361 consideration is exchanged must be in existence as of the earliest applicable date. Proposed § 1.361–5(b)(2)(ii)(B)(2) would provide that distributing corporation debt held directly by a distributing corporation related person or a related person with regard to a distributing corporation related person must qualify as historical distributing corporation debt described in proposed § 1.361–5(c)(2)(i). Third, proposed § 1.361–5(b)(2)(ii)(C) would provide that each transaction (including each intermediate and unrelated ultimate creditor transfer), creditor (including the unrelated ultimate

creditor), and debt satisfied with section 361 consideration must be identified and described in the plan of reorganization with regard to the divisive reorganization.

For purposes of the requirements in proposed § 1.361–5(b)(2)(ii)(A), proposed § 1.361–5(b)(2)(ii)(A)(*3*) would permit one or more intermediate transfers of section 361 consideration between or among distributing corporation related persons or related persons with regard to distributing corporation related persons to satisfy debts (including the initial distributing corporation debt) if those intermediate transfers culminate in a transfer of section 361 consideration to an unrelated ultimate creditor. Under proposed § 1.361–5(b)(2)(iii), a person's status as a distributing corporation related person or a controlled related person, or as a related person with regard to any distributing corporation related person or as a related person with respect to any controlled corporation related person, would be determined at the time of that person's receipt of the section 361 consideration in exchange for the satisfaction and retirement of debt in a transfer or series of transfers described in proposed § 1.361–5(b)(2)(ii)(A).

c. Eligible Distributing Corporation Debt

i. In General

Proposed § 1.361–5(c)(1) would provide that distributing corporation debt is not eligible to be satisfied with section 361 consideration under proposed § 1.361–5(a) unless that debt qualifies as eligible distributing corporation debt.

(a) Historical Distributing Corporation Debt

In general, proposed § 1.361–5(c)(2)(i) would provide that distributing corporation debt that qualifies as historical distributing corporation debt is eligible to be satisfied with section 361 consideration. In general, distributing corporation debt qualifies as historical distributing corporation debt if that debt was incurred before the ''earliest applicable date,'' and that debt has an original term that ends after the date of the exchange described in § 1.361–2(a) or 1.361–3(a) and is identified in the plan of reorganization or original plan of reorganization (if amended). The ''earliest applicable date'' is defined in proposed § 1.361–1(b)(27) as the earliest date of three specified events: (i) the date of the first public announcement (as defined in § 1.355–7(h)(10)) of the divisive reorganization or a similar transaction; (ii) the date the distributing corporation entered into a written agreement to effectuate the divisive reorganization or a similar transaction; and (iii) the date the distributing corporation's board of directors approved the divisive reorganization or a similar transaction.

However, the Treasury Department and the IRS are of the view that a debt refinancing exception would be appropriate to help achieve the transaction facilitation objective. Specifically, proposed § 1.361–5(c)(2)(ii) would provide that distributing corporation debt incurred by the distributing corporation after the earliest applicable date is treated as historical distributing corporation debt only if the following four requirements are met. First, proposed § 1.361–5(c)(2)(ii)(A) would provide that the distributing corporation debt must be (i) a refinancing of historical distributing corporation debt, or (ii) a refinancing of refinanced historical distributing corporation debt (that is, the debt must be traced directly through one or more refinancings to debt that qualifies as historical distributing corporation debt). Second, proposed § 1.361–5(c)(2)(ii)(B) would provide that the refinanced historical distributing corporation debt must not have been incurred as part of a plan to incur debt in addition to historical distributing corporation debt determined under proposed § 1.361–5(c)(2)(i) (or an amount of debt in addition to the amount of historical distributing corporation debt determined under paragraph (d) of that section, without regard to proposed § 1.361–5(d)(2)(iv)) in anticipation of the divisive reorganization (for example, the incurrence of the refinanced historical distributing corporation debt would have occurred without regard to the divisive reorganization). Third, proposed § 1.361–5(c)(2)(ii)(C) would provide that the distributing corporation must engage in a qualifying debt elimination transaction solely under proposed § 1.361–5(e)(3) or (4) to eliminate that refinanced historical distributing corporation debt. Fourth, proposed § 1.361–5(c)(2)(ii)(D) would provide that the qualifying debt elimination transaction must be described and identified in the plan of reorganization or original plan of reorganization (if amended) for the divisive reorganization.

Proposed § 1.361–5(c)(2)(iii) would provide that a revolving credit agreement to which the distributing corporation is a debtor qualifies as historical distributing corporation debt only if the following requirements are met. First, the distributing corporation must have entered into the agreement before the earliest applicable date. Second, the agreement does not expire until after the date of the exchange described in proposed § 1.361–2(a) or 1.361–3(a). Third, the agreement is identified in the plan of reorganization or original plan of reorganization (if amended). The Treasury Department and the IRS request comments regarding whether there are other arrangements similar to revolving credit agreements that, based on the same rationale employed by these proposed regulations, should be treated similarly.

(b) Qualifying Trade Payables

Proposed § 1.361–5(c)(2)(iv) would provide that qualifying trade payables are eligible to be satisfied with section 361 consideration. For purposes of that qualification, the following requirements must be met. First, the trade payables must be described in a plan of reorganization or original plan of reorganization (if amended). Second, the trade payables must have been incurred in the ordinary course of business of the distributing corporation. Third, the satisfaction of such trade payables is necessary (A) to ensure the allocation to the controlled corporation of all liabilities properly associated with the business assets transferred to that corporation and (B) to result in the controlled corporation being allocated liabilities in an amount that properly relates to its business operations, the earnings of which will be used to properly satisfy those liabilities.

(c) Direct Issuance Debt

These proposed regulations would also provide that direct issuance debt is eligible to be satisfied with section 361 consideration. Specifically, proposed § 1.361–5(c)(2)(v) would provide that direct issuance debt incurred as part of a direct issuance transaction (as defined in proposed § 1.361–1(b)(17)) satisfying the requirements of proposed § 1.361–5(e)(4) is eligible to be satisfied with section 361 consideration. *See* the discussion in part IV.C.3.d.iv regarding qualifying direct issuance transactions.

ii. Amount of Distributing Corporation Debt Repaid

Under proposed § 1.361–5(d)(1), the maximum amount of distributing corporation debt that can be satisfied with section 361 consideration under proposed § 1.361–5(a) would equal the amount obtained by subtracting the aggregate amount of distributing corporation debt that the controlled corporation assumes (in accordance with proposed §§ 1.357–2 through 1.357–4) pursuant to the plan of reorganization from the lesser of (i) the

aggregate amount of distributing corporation debt (as determined under proposed § 1.361–5(c)(3)), and (ii) the aggregate amount of distributing corporation debt determined under the eight-quarterly-average test set forth in proposed § 1.361–5(d)(2). The Treasury Department and the IRS are of the view that incorporating the IRS's long-standing, quarterly average test for advance ruling purposes (which was expanded to an eight-quarterly-average test in Rev. Proc. 2018–53 to provide a more accurate determination) into this computation would help achieve the increased certainty objective of these proposed regulations.

(a) Aggregate Amount of Distributing Corporation Debt

Under proposed § 1.361–5(c)(3)(ii), the aggregate amount of distributing corporation debt would include solely the amounts described in proposed § 1.361–5(c)(3)(ii)(A) through (E), as applicable, taking into account any reduction required by proposed proposed § 1.361–5(c)(3)(iii) (that is, offsetting debts). Specifically, proposed § 1.361–5(c)(3)(ii)(A) would provide that the aggregate amount of historical distributing corporation debt would equal the aggregate remaining principal amount, as of the earliest applicable date, of all historical distributing corporation debt other than historical distributing corporation debt that is eliminated as part of a qualifying direct issuance transaction. With regard to refinanced distributing corporation debt, proposed § 1.361–5(c)(3)(ii)(B) would provide that, if the distributing corporation relies on the refinancing exception for historical distributing corporatrion debt under proposed § 1.361–5(c)(2)(ii), then the amount of that debt distributing corporation debt would equal the lesser of (i) the original principal amount of the refinanced distributing corporation debt and (ii) the principal amount of the original historical distributing corporation debt (that is, the distributing corporation debt to which the refinanced distributing corporation debt is traced) as of the earliest applicable date. With regard to a revolving credit agreement that satisfies the requirements set forth in § 1.361–5(c)(2)(iii), proposed § 1.361–5(c)(3)(ii)(C) would provide that the amount of that debt would be the lesser of (i) the balance under that agreement as of the earliest applicable date (and not the maximum amount that could be incurred by the distributing corporation under that agreement), and (ii) the lowest balance under the agreement beginning on the earliest applicable date and ending on the control distribution date.

Additionally, proposed § 1.361–5(c)(3)(ii)(D) would provide that the amount of qualifying trade payables would equal the aggregate amount of those payables on the date of the exchange described in proposed § 1.361–2(a) or 1.361–3(a). With regard to direct issuance debt, proposed § 1.361–5(c)(3)(ii)(E) would provide that the amount of that debt would equal the aggregate principal amount of that debt on the date exchange described in proposed § 1.361–2(a) or 1.361–3(a).

Lastly, proposed § 1.361–5(c)(3)(iii) would require the aggregate amount of distributing corporation debt be reduced to reflect certain offsetting debts. That is, if the distributing corporation is a creditor, and if the debtor with respect to that debt is a creditor with respect to distributing corporation debt, the distributing corporation would be required to reduce the aggregate principal amount of its distributing corporation debt by the aggregate principal amount of debt issued to that other person for purposes of the computation under proposed § 1.361–5(c)(3)(ii). This proposed rule also would include reductions to account for revolving credit agreements.

(b) Eight-Quarterly-Average Test

Proposed § 1.361–5(d)(2)(i) would provide that, under the eight-quarterly-average test, the aggregate amount of distributing corporation debt generally would equal the average of the amount of distributing corporation debt owed to persons other than distributing corporation related persons as of the close of each of the eight fiscal quarters that end immediately before the earliest applicable date. Proposed § 1.361–5(d)(2)(ii) and (iii) would provide additional rules to address (i) the calculation of distributing corporation debt at the close of each quarter, and (ii) distributing corporation debt held by distributing corporation related persons.

d. Qualifying Debt Elimination Transactions

i. Overview

The Treasury Department and the IRS are proposing bright-line rules for qualifying debt elimination transactions to achieve the transaction facilitation and increased certainty objectives for these proposed regulations. The determination of whether a debt elimination transaction qualifies under section 361(b)(3) and (c)(3), and the extent of that qualification, has created more uncertainty for taxpayers and the IRS than perhaps any other issue arising from divisive reorganizations. With these proposed rules, the Treasury Department and the IRS are seeking to strike a balance that would facilitate intermediated exchanges and direct issuance transactions in a manner that (i) is consistent with the Code (particularly sections 355, 361, and 368) and underlying legislative history, and (ii) facilitates IRS administration and enforcement.

ii. Section 361 Transactions in Which No Intermediary is Used

Proposed § 1.361–5(e)(2) would set forth rules for qualifying original creditor exchanges. Specifically, proposed § 1.361–5(e)(2) would provide that the satisfaction of distributing corporation debt with section 361 consideration in an exchange not described in proposed § 1.361–5(e)(3) or (4) is treated as a qualifying debt elimination transaction (that is, the exchange will be treated as a nonrecognition transaction for Federal income tax purposes) if all applicable requirements set forth in proposed § 1.361–5(b) through (d) are satisfied. In particular, proposed § 1.361–5(c)(2)(ii)(C) would provide that the refinancing exception set forth in proposed § 1.361–5(c)(2)(ii) would not apply to distributing corporation debt that is refinanced and then eliminated in a qualifying original creditor exchange. In other words, for a distributing corporation to apply that refinancing exception, the distributing corporation would be required to engage in a qualifying intermediated exchange or a qualifying direct issuance transaction (as discussed in parts IV.C.3.d.iii and iv of this Explanation of Provisions).

iii. Qualifying Intermediated Exchanges

Under proposed § 1.361–5(e)(3), an intermediated exchange would not qualify as a qualifying debt elimination transaction unless certain requirements are satisfied. First, proposed § 1.361–5(e)(3)(i)(A) generally would prohibit the holder of historical distributing corporation debt that will be satisfied with section 361 consideration from holding that debt for the benefit of the distributing corporation, the controlled corporation, a distributing corporation related person, or a controlled corporation related person. However, under proposed § 1.361–5(e)(3)(i)(B) this prohibition would not apply to a collateral benefit (such as the efficient purchase by an intermediary of historical distributing debt on the open market) received by a distributing corporation or a distributing corporation related person, from the intermediary's

facilitation of the transfer of section 361 consideration in satisfaction of historical distributing corporation debt.

Second, proposed § 1.361–5(e)(3)(ii) would prohibit the intermediary from acquiring historical distributing corporation debt that is satisfied with section 361 consideration from the distributing corporation, the controlled corporation, or any distributing corporation related person or controlled corporation related person. However, under proposed § 1.361–5(c)(2)(ii)(A) the refinancing exception set forth in proposed § 1.361–5(c)(2)(ii) would be available for distributing corporations that engage in qualifying intermediated exchanges. The Treasury Department and the IRS are of the view that this exception would help achieve the transaction facilitation objective by providing distributing corporations with significant flexibility to engage in debt elimination transactions under section 361 with debt refinanced after the earliest applicable date.

Third, the proposed regulations would impose long-standing requirements consistent with the analysis in the aforementioned technical advice memoranda addressing intermediated exchanges under former section 108. Specifically, proposed § 1.361–5(e)(3)(iii) would require the intermediary and the distributing corporation to effectuate the exchange of section 361 consideration for historical distributing corporation debt based on terms and conditions arrived at by the parties bargaining at arm's length.

Fourth, proposed § 1.361–5(e)(3)(iv) would prohibit the distributing corporation, the controlled corporation, and any distributing corporation related person or controlled corporation related person from (i) participating in any profit gained by the intermediary upon the exchange of section 361 consideration, or (ii) limiting the intermediary's profit by agreement or other arrangement.

Fifth, proposed § 1.361–5(e)(3)(v)(A) and (B) would require the intermediary (i) to act for its own account with regard to all components of the intermediated exchange, and (ii) bear the risk of loss with regard to the historical distributing corporation debt and any subsequent disposition of any section 361 consideration received in the exchange. Accordingly, proposed § 1.361–5(e)(3)(v)(C) would prohibit the intermediary from entering into a variable pricing agreement or similar arrangement with the distributing corporation, the controlled corporation, or any distributing corporation related person or controlled corporation related person (for example, agreements between the intermediary and the distributing corporation requiring ''true-up'' payments would be prohibited).

Finally, proposed § 1.361–5(e)(3)(vi) would require the intermediary to hold the historical distributing corporation debt for a period of not less than 30 days ending on the control distribution date. Based on feedback from stakeholders, the Treasury Department and the IRS are of the view that providing a bright-line rule would help achieve the transaction facilitation and increased certainty objectives of these proposed regulations. The proposed rule would depart from the facts-and-circumstances approach set forth in Rev. Proc. 2018–53.

iv. Qualifying Direct Issuance Transaction

Under proposed § 1.361–5(e)(4), a direct issuance transaction would not qualify as a qualifying debt elimination transaction unless certain requirements are satisfied. For this purpose, proposed § 1.361–1(b)(17) would define the term ''direct issuance transaction'' to mean a transaction, or a series of transactions (or similar transaction or series of transactions), in which (i) the distributing corporation incurs distributing corporation debt with a creditor after the earliest applicable date, (ii) the distributing corporation uses the proceeds of the newly incurred distributing corporation debt (directly or indirectly) to repay historical distributing corporation debt, and (iii) the new creditor exchanges that newly incurred distributing corporation debt for controlled corporation stock or securities held by the distributing corporation.

First, proposed § 1.361–5(e)(4)(i)(A) would require that a direct issuance transaction be determined to comprise a transfer by the distributing corporation of section 361 consideration to the creditor in exchange for the satisfaction of distributing corporation debt held by that creditor (direct issuance debt), and not a sale by the distributing corporation of section 361 consideration to the creditor for the proceeds of that direct issuance debt, for Federal income tax purposes. Proposed § 1.361–5(e)(4)(i)(B) would provide that that determination is made based on all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine. Proposed § 1.361–5(e)(4)(i)(B) also would provide that the substance of the direct issuance transaction must be determined, pursuant to all relevant provisions of the Code and general principles of Federal income tax law, before the requirements of section 361 can be applied.

Second, proposed § 1.361–5(e)(4)(ii)(A) would provide that, unless the transaction satisfies the safe harbor under proposed § 1.361–5(e)(4)(iii), the determination of whether a direct issuance transaction is an exchange under section 361, and not a sale, is made using a facts-and-circumstances test. For this purpose, proposed § 1.361–5(e)(4)(ii)(B) would provide a set of factors to be used in determining whether the direct issuance transaction exchange qualifies as an exchange under section 361. Proposed § 1.361–5(e)(4)(ii)(B) would provide that each of the specified factors represents either evidence of qualification or non-qualification as an exchange. The strength of evidence provided by the factors is determined based on an analysis of all relevant facts and circumstances.

(a) Prescribed Factors for Facts-and-Circumstances Test

First, proposed § 1.361–5(e)(4)(ii)(B)(*1*) would provide that an exchange of section 361 consideration by the distributing corporation with a creditor occurs pursuant to an arrangement that comprises part of a prearranged, integrated plan is substantial evidence of non-qualification, whereas, an exchange that does not occur pursuant to an arrangement that comprises part of a prearranged, integrated plan is evidence of qualification.

Second, proposed § 1.361–5(e)(4)(ii)(B)(*2*)(*i*) would provide that, if any one of the following requirements are not met, the failure of any one requirement is evidence of non-qualification: (1) an exchange of section 361 consideration for refinanced historical distributing corporation debt between the distributing corporation and the creditor must be effectuated based on arm's-length terms and conditions; (2) neither the distributing corporation, controlled corporation, nor any distributing controlled corporation related person or controlled corporation related person participates in any profit gained by the creditor upon the exchange of section 361 consideration, or limits by agreement or other arrangement any profit of the creditor gained upon the exchange of section 361 consideration; (3) the creditor acts for its own account with regard to all components of the direct issuance transaction; and (4) the creditor bears the risk of loss with respect to the refinanced historical distributing corporation debt and any subsequent sale or other disposition of section 361

consideration transferred to the creditor in satisfaction of the refinanced historical distributing corporation debt. However, pursuant to proposed § 1.361–5(e)(4)(ii)(B)(*2*)(*iii*), the satisfaction of all these aforementioned requirements is substantial evidence of qualification.

Third, proposed § 1.361–5(e)(4)(ii)(B)(*3*) would provide that, if the creditor holds the refinanced historical distribution corporation debt for a period of less than 30 days ending on the control distributing date, then that fact is evidence of non-qualification. Conversely, if the creditor holds that debt for a period of at least 30 days ending on control distribution, then that fact is evidence of qualification.

Fourth, proposed § 1.361–5(e)(4)(ii)(B)(*4*) would provide that if the distributing corporation has legal or practical dominion or control over any proceeds of the refinanced historical distributing corporation debt (as determined in accordance with § 1.357–(e)(2)), then that fact is substantial evidence of non-qualification. However, the distributing corporation's lack of legal or practical dominion or control over any of those proceeds is substantial evidence of qualification.

Fifth, proposed § 1.361–5(e)(4)(ii)(B)(*5*) provides that if the distributing corporation issued the refinanced historical distributing corporation debt with a principal purpose of avoiding any of the requirements or limitations of section 361, then that fact is evidence of non-qualification.

(b) Safe Harbor for Direct Issuance Transactions

Proposed § 1.361–5(e)(4)(iii) would provide a safe harbor for direct issuance transactions. A direct issuance transaction would qualify under the safe harbor to be treated as a qualifying debt elimination transaction only if all the following requirements are satisfied: (1) the distributing corporation does not have, at any time, legal or practical dominion or control over any proceeds of the refinanced historical distributing corporation debt, as determined in accordance with § 1.357–(e)(2); (2) the creditor holds the refinanced historical distributing corporation debt for a period of not less than 30 days ending on the control distribution date; (3) each exchange of section 361 consideration for refinanced historical distribution corporation debt between the distributing corporation and the creditor is effectuated on arm's-length terms and conditions; (4) none of the distributing corporation, controlled corporation, or any distributing controlled corporation related person or controlled corporation related person participates in any profit gained by the creditor upon the exchange of section 361 consideration, or limits by agreement or other arrangement any profit gained by the creditor upon the exchange of section 361 consideration; (5) the creditor acts for its own account with regard to all components of the direct issuance transaction; and (6) the creditor bears the risk of loss with respect to the refinanced historical distributing corporation debt and any subsequent sale or other disposition of section 361 consideration transferred to the creditor in satisfaction of the refinanced historical distributing corporation debt. For purposes of the proceeding requirement, proposed § 1.361–5(e)(4)(iv) would provide that the creditor is not treated as bearing the risk of loss with respect to the refinanced historical distributing corporation debt if the creditor enters into a variable pricing or similar arrangement with the distributing corporation (or a controlled corporation, distributing corporation related person, or controlled corporation related person) with regard to any section 361 consideration.

V. Federal Income Tax Treatment and Consequences of Post-Distribution Payments

A. Notice 2024–38

As stated in section 2.02(6) of Notice 2024–38, the Treasury Department and the IRS are considering the application of the Code to post-distribution payments. Proposed § 1.361–1(b)(42) would define a ''post-distribution payment'' as a transfer of money or other property by the controlled corporation to the distributing corporation (or vice versa) after the control distribution date pursuant to the plan of reorganization.

In Notice 2024–38, the Treasury Department and the IRS expressed the view that a post-distribution payment is treated as section 361 consideration only if the taxpayer establishes that (i) the character of the payment for Federal income tax purposes is section 361 consideration, (ii) as of the first distribution date, the fair market value of the distributing corporation's right to receive the payment was not (or will not be) reasonably ascertainable (*see Burnet* v. *Logan,* 283 U.S. 404, 413 (1931)), and (iii) the payment will be properly accounted for when received. For the avoidance of doubt, the Treasury Department and the IRS also expressed the view in Notice 2024–38 that *Arrowsmith* v. *Commissioner,* 344 U.S. 6 (1952), applies solely to the requirement described in clause (i) of the preceding sentence (that is, characterization of the post-distribution payment for Federal income tax purposes).

B. Stakeholder Input

As an initial matter, stakeholders have stated in their feedback that post-distribution payments between the distributing corporation and the controlled corporation in connection with both section 355(c) transactions and divisive reorganizations are subject to different doctrines (for example, *Arrowsmith* or the open transaction doctrine) depending on the facts and circumstances. Due to the variable fact patterns, the non-recurring nature of such payments, and the complex interplay of the legal provisions governing such payments, one stakeholder has contended that additional substantive guidance (for example, in the form of Treasury regulations) would not be appropriate, and that the Treasury Department and the IRS should continue to address this topic through the IRS's private letter ruling program.

Stakeholders also have contended that indemnification payments made under the governing transaction documents, which constitute the overwhelming majority of post-distribution payments, clearly are subject to the *Arrowsmith* doctrine and should be characterized as either (i) a contribution by the distributing corporation to the controlled corporation, or (ii) a payment of section 361 consideration by the controlled corporation to the distributing corporation, unless the transaction documents result in the assumption of a liability under section 357(d). Accordingly, other than limited guidance with respect to the treatment of so-called ''indemnity purges'' (that is, the distributing corporation's satisfaction of a liability with cash on hand and subsequent reimbursement by the controlled corporation), stakeholders have expressed the view that substantive guidance is unnecessary.

With regard to such indemnity purges, stakeholders have recommended different approaches for the proposed regulations. One stakeholder has recommended (i) treating the distributing corporation's receipt of the indemnity payment from the controlled corporation as section 361 consideration, and (ii) treating the distributing corporation's payment of the indemnified liability as a transfer of such section 361 consideration to a creditor in satisfaction of section 361(b)(3) (that is, a post-distribution

payment). Alternatively, other stakeholders have suggested (i) treating the liability giving rise to the indemnity payment as having been assumed by the controlled corporation under the principles of section 357(d), and (ii) treating the distributing corporation as having received payment from, and as making a payment to satisfy the liability as an agent of, the controlled corporation.

C. Proposed Regulations

1. General Treatment of Target Corporations Under Section 361(a)

Consistent with section 361(a), these proposed regulations generally would provide that a target corporation (including a distributing corporation) that is a party to a reorganization does not recognize gain or loss on its transfer of property to an acquiring corporation (including a controlled corporation) if the following three requirements are satisfied. First, proposed § 1.361–2(a)(1) would require that the acquiring corporation (or a corporation controlling the acquiring corporation) must be a party to the reorganization. Second, proposed § 1.361–2(a)(2) would require that the target corporation must receive solely stock or securities of the acquiring corporation (or the corporation controlling the acquiring corporation) in exchange for the transferred property. Third, proposed § 1.361–2(a)(3) would require that the exchange must occur pursuant to the plan of reorganization.

2. Receipt of Money or Other Property

a. In General

If proposed § 1.361–2(a) would apply to an exchange between a target corporation and an acquiring corporation but for the fact that the target corporation receives money or other property in addition to stock and securities of the acquiring corporation (or of a corporation controlling the acquiring corporation), then proposed § 1.361–3 would govern the exchange. *See* §§ 1.361–2(b) and 1.361–3(a)(1).

In general, proposed § 1.361–3(b)(1) and (2) would provide that, in an acquisitive reorganization, the target corporation does not recognize gain on the receipt of money or other property provided that, pursuant to the plan of reorganization, the target corporation distributes the money or other property to its shareholders or transfers that property to a creditor in satisfaction of target corporation debt.

Additional requirements would apply in the case of a divisive reorganization. In that case, proposed § 1.361–3(c)(1) would provide that the distributing corporation does not recognize gain on the exchange if, pursuant to the plan of reorganization, (i) the distributing corporation deposits the money received in the exchange in a segregated account, and (ii) the distributing corporation distributes the money or other property received in the exchange to the distributing corporation's shareholders no later than the end of the 12-month period beginning on the date of the exchange. Under proposed § 1.361–3(c)(2)(i), similar rules would apply with respect to transfers of the money or other property received in the exchange to creditors of the distributing corporation in satisfaction of distributing corporation debt.

However, under proposed § 1.361–3(c)(2)(ii), the aggregate amount of money and the fair market value of other property transferred to creditors that is treated as distributed to shareholders would be limited to the amount by which the aggregate adjusted basis of the assets transferred by the distributing corporation to the controlled corporation exceeds the aggregate amount of distributing corporation liabilities assumed by the controlled corporation. Moreover, transfers to creditors of the distributing corporation would be subject to the requirements set forth in proposed § 1.361–5. *See* the prior discussion in part IV.C.3 of this Explanation of Provisions. Consistent with the Treasury Department's and the IRS's efforts to encourage taxpayers to undertake bona fide corporate reorganizations by providing sufficient transactional flexibility, the proposed regulations governing transfers of section 361 consideration to creditors would be based in part on whether such transfers occur pursuant to a target corporation's (including a distributing corporation's) plan of reorganization. *See* the prior discussion in part III.C of this Explanation of Provisions.

Under proposed § 1.361–3(d), the failure to distribute the money or other property received in the exchange in the manner set forth in proposed § 1.361–3(b) or (c) would result in the recognition of gain by the target corporation. The amount of gain recognized would not exceed the sum of (i) the amount of money received but not distributed, and (ii) the fair market value of the other property received but not distributed. Consistent with section 361(b)(2), proposed § 1.361–3(e) would provide that the target corporation does not recognize a loss if it receives money or other property in addition to stock or securities of the acquiring corporation.

b. Treatment of Post-Distribution Payments

i. In General

Proposed § 1.361–3(c)(3) would provide that, in a divisive reorganization in which the distributing corporation receives a post-distribution payment, the distributing corporation does not recognize any gain under proposed § 1.361–3(c)(1) or (2) only if three conditions are satisfied. First, the post-distribution payment constitutes section 361 consideration for Federal income tax purposes. Second, the distributing corporation places the post-distribution payment in a segregated account pursuant to the plan of reorganization. Third, pursuant to the plan of reorganization, the distributing corporation distributes the post-distribution payment to its shareholders or to its creditors (in satisfaction of distributing corporation debt in a transfer meeting the requirements set forth in proposed § 1.361–5) by the later of (i) 90 days after the date on which the distributing corporation receives the post-distribution payment, or (ii) the end of the 12-month period beginning on the date of the exchange described in proposed § 1.361–3(a)(1).

For purposes of proposed § 1.361–3(c)(3), a post-distribution payment would constitute section 361 consideration (and not, for example, a separate payment for goods or services) for Federal income tax purposes only if the three requirements in proposed § 1.361–3(c)(3)(i) are satisfied. First, the payment must properly be characterized for Federal income tax purposes as consideration that the distributing corporation receives in the exchange described in proposed § 1.361–3(a)(1). *See generally Arrowsmith,* 344 U.S. 6. Second, the fair market value of the distributing corporation's right to receive the post-distribution payment must not be reasonably ascertainable as of the exchange date. *See generally Burnet,* 283 U.S. 404. Third, the distributing corporation must properly account for the payment upon receipt, in accordance with the plan of reorganization.

Similar rules would apply to the receipt of a post-distribution payment by a controlled corporation. In this respect, proposed § 1.361–3(c)(4) would provide that, if a controlled corporation receives a post-distribution payment, the aggregate adjusted basis of the assets transferred by the distributing corporation to the controlled corporation is increased for purposes of proposed § 1.361–3(c)(2)(ii) only if three requirements similar to those described in the prior paragraph are satisfied.

ii. Treatment of Payments Under Indemnification Agreements

These proposed regulations would not treat payments made in respect of indemnification agreements as post-distribution payments in certain circumstances. Instead, proposed § 1.357–2(e)(2)(iii)(A) would treat (i) the underlying liability as having been assumed by the controlled corporation, and (ii) the receipt of the indemnification payment as not within the legal or practical dominion or control of the distributing corporation for purposes of proposed § 1.357–2(e)(1). *See* the discussion in part VIII.B.3.b of this Explanation of Provisions.

3. Treatment of Distributions

a. Qualified Property

Consistent with section 361(c)(1), proposed § 1.361–4(a)(1) generally would provide that a target corporation (including a distributing corporation) recognizes no gain or loss on a distribution of qualified property to its shareholders pursuant to a plan of reorganization. Proposed § 1.361–4(a)(2)(i) would provide that the target corporation in an acquisitive reorganization is treated as distributing qualified property to its shareholders for purposes of proposed § 1.361–4(a)(1) if the target corporation transfers qualified property to a creditor pursuant to the plan of reorganization and in satisfaction of target corporation debt. To obtain similar treatment in the case of a divisive reorganization, proposed § 1.361–4(a)(2)(ii) would provide that the distributing corporation's transfer of qualified property to a creditor in satisfaction of distributing corporation debt also must meet the requirements in § 1.361–5.

b. Appreciated Nonqualified Property

Under proposed § 1.361–4(b)(1) and (c), if a target corporation distributes appreciated nonqualified property to its shareholders pursuant to a plan of reorganization, the target corporation would recognize gain (but not loss) as if it sold the property to its shareholders at the property's fair market value. Proposed § 1.361–4(b)(2) would provide that, if such property is subject to a liability, or if a shareholder assumes a liability of the target corporation in connection with the distribution, the fair market value of that property for purposes of proposed § 1.361–4(b)(1) is treated as an amount not less than the amount of that liability.

For this purpose, proposed § 1.361–1(b)(4) would define ''appreciated nonqualified property'' as property other than qualified property that, at the time of the distribution of that property, has a fair market value that exceeds its adjusted basis in the hands of the target corporation. For example, appreciated nonqualified property would include controlled corporation stock or securities held by the distributing corporation prior to the exchange under section 361. The definition in proposed § 1.361–1(b)(4) also would include all controlled corporation stock or securities that (i) is treated as other property under section 355(a)(3)(B), (ii) is distributed in a disqualified distribution (as defined in section 355(d)(2)), or (iii) is distributed by a distributing corporation pursuant to an acquisition described in section 355(e)(2).

VI. Effect of Transaction Related to Divisive Reorganization on Controlled Securities

A. Notice 2024–38

As stated in section 2.02(7) of Notice 2024–38, the Treasury Department and the IRS are considering the impact of the application of general Federal income tax principles (including the substance-over-form doctrine and other relevant theories) to acquisitions of a controlled corporation following the control distribution date that result in a modification of the controlled corporation's securities. For example, the Treasury Department and the IRS are considering whether general Federal income tax principles could preclude qualification under section 361(c)(3) if (i) the controlled corporation issued securities that were treated by the distributing corporation as section 361 consideration that could be used to satisfy its creditors, and (ii) the controlled corporation subsequently merged into an acquiring corporation in a transaction resulting in the modification of those securities. In response to feedback received following the publication of Rev. Proc. 2018–53, Notice 2024–38 stated the view of the Treasury Department and the IRS that Rev. Rul. 98–27, 1998–1 C.B. 1159, is not relevant for determining whether any such transaction or series of transactions should cause the divisive reorganization to be recast, because that revenue ruling addresses solely whether the controlled corporation was a ''controlled corporation'' under section 355(a) immediately before the distribution. *See also generally* Rev. Rul. 98–44, 1998–2 C.B. 315.

B. Stakeholder Input

Stakeholders have suggested that the focus on debt instrument modifications in Notice 2024–38 is directed toward transactions involving a post-distribution merger of a controlled corporation into a third-party corporation and whether the purported controlled corporation debt should be treated as qualified property for purposes of section 361(c)(2)(B). Stakeholders have requested clarification that controlled corporation debt will not be treated as non-qualified property to the extent that (i) modifications of such debt are not ''significant modifications'' within the meaning of § 1.1001–3 (disregarded modifications), or (ii) the modifications are a ''significant modification'' under § 1.1001–3 as a result of which the holder of such debt is treated as receiving a new debt instrument in a nonrecognition transaction (nonrecognition modifications).

Stakeholders also have recommended that a deemed or unplanned transaction occurring after the distribution should not cause the controlled corporation's debt to be treated as something other than controlled corporation debt for purposes of section 361(c). Additionally, stakeholders have asserted that (i) step transaction principles should not be applied to the extent the result of the transaction is consistent with the policies of section 361, and (ii) a recast of the transaction would be at odds with the provisions of § 1.1001–3 applicable to nonrecognition modifications.

Stakeholders have recommended that, if guidance is issued on this topic, safe harbors should be provided with respect to both disregarded modifications and nonrecognition modifications to allow controlled corporation debt to be treated as qualified property under section 361(c).

C. Proposed Regulations

The Treasury Department and the IRS anticipate providing proposed guidance on this topic as part of a guidance package that includes the finalization of these proposed regulations. The Treasury Department and the IRS believe that additional study and stakeholder feedback would be appropriate, rather than the publication of proposed rules at this time. It is the position of the Treasury Department and the IRS that the series of transactions described in section 2.02(7) of Notice 2024–38 merit additional scrutiny but, until the completion of this study, should be addressed by the IRS on a case-by-case basis. With regard to additional stakeholder feedback on this topic, the Treasury Department and the IRS particularly would welcome suggestions on appropriate bright-line

rules or safe harbors, as well as supporting analysis that discusses how those suggestions would balance the compliance, increased certainty, and transaction facilitation objectives that guide these proposed regulations.

As set forth in section 2.02(7) of Notice 2024–38, the Treasury Department and the IRS do not view Rev. Rul. 98–27 and Rev. Rul. 98–44 as determinative for questions regarding the impact of the application of general Federal income tax principles to acquisitions of a controlled corporation following the control distribution date that result in a modification of the controlled corporation's securities. For the avoidance of doubt, and consistent with the discussion in part IV.C.1 of this Explanation of Provisions, this view of the Treasury Department and the IRS also directly extends to Rev. Rul. 2003–79, 2003–29 I.R.B. 80. None of Rev. Rul. 98–27, Rev. Rul. 98–44, or Rev. Rul. 2003–79 sets forth broadly applicable principles regarding the application of the step transaction or substance-over-form doctrines beyond the fact patterns directly addressed by those rulings.

VII. Replacement of Distributing Debt

A. Notice 2024–38

As stated in section 2.02(8) of Notice 2024–38, the Treasury Department and the IRS are considering the application of the Code to borrowings by a distributing corporation that replace distributing corporation debt satisfied with section 361 consideration in a divisive reorganization. The Treasury Department and the IRS are concerned that, in certain circumstances, the replacement of distributing corporation debt that was satisfied with section 361 consideration could be used as an artifice for increasing the aggregate debt and other liabilities of the distributing corporation and the controlled corporation.

As one example, the Treasury Department and the IRS have considered situations in which, as of the date on which assets are contributed to a controlled corporation in a divisive reorganization, the distributing corporation anticipates entering into a borrowing that effectively reverses the de-leveraging achieved through the distribution of section 361 consideration pursuant to the plan of reorganization. Such a borrowing would render the de-leveraging merely transitory and without real economic effect. As emphasized in Notice 2024–38, the Treasury Department and the IRS are concerned that this result resembles a partial sale of the controlled corporation that would not qualify for nonrecognition treatment under section 361.

B. Stakeholder Input

Stakeholders have acknowledged the aforementioned potential for abuse and the potential treatment of such transactions as partial sales. However, stakeholders have contended that distributing corporations generally do not plan to replace historical debt satisfied in the section 355 transaction. Accordingly, stakeholders have suggested that any substantive guidance on this issue (i) should be narrowly tailored to address abusive structures that do not reflect the policies of section 361, and (ii) should take into account distributing corporations' need to borrow in the ordinary course of business and obtain funding for circumstances unrelated to the section 355 transaction. Stakeholders also have suggested that the main difficulty in issuing guidance will be identifying clear anti-abuse principles that sufficiently differentiate between artificial post-distribution re-leveraging transactions (which should be disallowed) and genuine post-distribution re-leveraging transactions with a bona fide commercial purpose unrelated to the divisive transaction (which should be allowed).

One stakeholder has recommended providing a safe harbor for transactions that do not raise debt replacement concerns, in order to increase certainty for taxpayers pursuing bona fide transactions. According to the stakeholder, the common factors in those transactions that should be included in such a safe harbor are: (i) a genuine non-tax business purpose for the re-leveraging transaction; (ii) use of the re-leveraging proceeds in a manner consistent with such business purpose; and (iii) a non-tax economic effect of the re-leveraging transaction.

The stakeholder has further recommended evaluating re-leveraging transactions that fall outside the aforementioned safe harbor based on all facts and circumstances. According to the stakeholder, factors that would support respecting the re-leveraging as a new borrowing for Federal income tax purposes include: (i) the existence of a non-tax business purpose supporting the re-leveraging transaction; (ii) the use of re-leveraging proceeds in a manner consistent with such business purpose; (iii) the absence of a plan to enter into the re-leveraging transaction at the time of the distribution; (iv) the passage of time between the distributing corporation's satisfaction of debt with section 361 consideration and the re-leveraging transaction; (v) the occurrence of the re-leveraging transaction in the ordinary course of business and/or the consistency of the transaction with historical practices; and (vi) evidence that, as a result of the de-leveraging transaction, the distributing corporation was appropriately leveraged from a capital markets perspective.

In contrast, according to the stakeholder, the following factors would not support respecting the re-leveraging as a new borrowing. First, the lenders with regard to the re-leveraging transaction are the same as those with regard to the distributing corporation debt satisfied in the de-leveraging transaction. Second, the terms of the new distributing corporation debt are the same as (or substantially similar to) the terms of the distributing corporation debt satisfied in the de-leveraging transaction. Third, the proceeds of the re-leveraging transaction are retained (unless such retention is consistent with the business purpose for the re-leveraging). Finally, the de-leveraging transaction, when taken together with the re-leveraging transaction, has little or no economic effect.

C. Proposed Regulations

1. Overview

The Treasury Department and the IRS appreciate the feedback provided by stakeholders regarding transitory borrowings. In developing these proposed regulations, the Treasury Department and the IRS have attempted to balance the compliance and increased certainty objectives with the understanding that distributing corporations should be able to borrow in the ordinary course of business and obtain financing for circumstances demonstrably unrelated to the divisive reorganization (that is, the transaction facilitation objective).

2. General Rule

Proposed § 1.361–5(f)(1) generally would reduce the amount of section 361 consideration that the distributing corporation is treated as transferring to a creditor in a qualifying debt elimination transaction by the amount of eligible distributing corporation debt that is ''transitorily eliminated.'' Proposed § 1.361–5(f)(2)(i) would treat a distributing corporation as transitorily eliminating an amount of eligible distributing corporation debt equal to the amount of such debt that the distributing corporation or a distributing corporation related person replaces after the earliest applicable date, directly or indirectly, with borrowing that the distributing corporation or any

distributing corporation related person expects or is committed to, directly or indirectly, before that date. For this purpose, relatedness to the distributing corporation would be determined by examining all relevant relationships immediately after the earliest applicable date.

The proposed regulations would set forth the earliest applicable date as the relevant date for examining the issuance of distributing debt that potentially could give rise to a transitory elimination of eligible distributing corporation debt. Principally, the Treasury Department and the IRS have selected the earliest applicable date as the relevant date for purposes of these proposed rules because that date also would serve generally under these proposed regulations as the bright line for determining whether distributing corporation debt qualifies as historical distributing corporation debt. Therefore, a proposed rule that focused on distributing corporation borrowings after that date, and which the distributing corporation expected or was committed to before that date, would connect logically to the proposed earliest applicable date for determining historical distributing corporation debt. Connecting such proposed rules to a single relevant date (that is, the earliest applicable date) is intended to help achieve the increased certainty objective of these proposed regulations, and consequently the compliance and transaction facilitation objectives as well.

3. Exceptions to General Transitory Debt Elimination Rule

Based on feedback from stakeholders, proposed § 1.361–5(f)(2)(ii) and (iii) would provide exceptions to the general transitory debt elimination rule for ordinary course borrowings and borrowings resulting from unexpected events. With regard to each of these exceptions, the intent of the Treasury Department and the IRS is to provide safe harbors for borrowings that could not have had any connection to the distributing corporation's elimination of eligible distributing corporation debt because such borrowings would have occurred regardless of the occurrence of the divisive reorganization. In proposing these exceptions, the Treasury Department and the IRS are guided conceptually by existing regulations under section 355(e) (section 355(e) regulations) addressing non-plan factors for determining the existence of a plan. The intent of extending those principles to these proposed regulations is to increase certainty for taxpayers and the IRS by providing rules based on long-standing Treasury regulations.

a. Ordinary Course Borrowings

The Treasury Department and the IRS have proposed an ordinary course borrowing exception in proposed § 1.361–5(f)(2)(iii) to help achieve the increased certainty and transaction facilitation goals of these proposed regulations. Specifically, the Treasury Department and the IRS do not intend for the safeguards against transitorily eliminated distributing corporation debt to prevent the distributing corporation from engaging in its ordinary course business activities. Although the Treasury Department and the IRS agree with stakeholders that proposed rules on this issue would be challenging to provide in bright-line form, the purpose of these proposed rules is to reduce uncertainty by removing from consideration of the general rule those borrowings that the distributing corporation readily could identify as part of its ordinary course business operations.

Consequently, the proposed regulations would provide that a replacement borrowing is not treated as transitorily eliminating eligible distributing corporation debt if the replacement borrowing (i) is incurred in the ordinary course of business of the distributing corporation or distributing corporation related person, and (ii) would have been incurred without regard to the divisive reorganization (or any transaction related to the divisive reorganization). *See* proposed § 1.361–5(f)(2)(iii). The Treasury Department and the IRS based this proposed rule conceptually on § 1.355–7(b)(4)(vi) (''In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition.'').

b. Unexpected Borrowings

In addition, proposed § 1.361–5(f)(2)(ii) would provide that certain borrowings are not treated as expected (or otherwise committed) borrowings and, therefore, are not within the scope of the general rule of proposed § 1.361–5(f)(2)(i) if two conditions are met. First, proposed § 1.361–5(f)(2)(ii)(A) would require that a borrowing after the earliest applicable date must result from an event unrelated to the divisive reorganization and not in the ordinary course of business of the distributing corporation. Second, proposed § 1.361–5(f)(2)(ii)(B) would require that the borrowing must result from changed circumstances not expected prior to the control distribution date. The Treasury Department and the IRS are proposing this exception to provide increased certainty and facilitate bona fide transactions by reinforcing that a borrowing not in the ordinary course of business also should be excepted from application of the general rule, provided that the distributing corporation establishes that such borrowing results from an event that could not have been related to the divisive reorganization.

In formulating the foregoing proposed rules, the Treasury Department and the IRS have relied on the same standard employed by the section 355(e) regulations for determining the existence of a plan. *See* § 1.355–7(b)(4)(ii) (''In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.'') and (iv) (''In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.''). It is the intent of the Treasury Department and the IRS that exceptions based on the established section 355(e) regulations would facilitate bona fide transactions in the same manner that the section 355(e) regulations facilitate such transactions while addressing the challenging issue of determining the existence of a plan.

VIII. Application of Section 357 to Assumptions of Liabilities

A. Overview of Proposed Regulations

The Treasury Department and IRS appreciate the feedback received from stakeholders addressing the interaction and separate operation of sections 357 and 361. From the perspective of the Treasury Department and the IRS, such feedback was insightful and has been helpful in the development these proposed regulations, particularly in achieving the three objectives discussed in section 2.01 of Notice 2024–38. Leveraging this feedback, the Treasury Department and IRS have attempted to balance the objectives of (i) facilitating compliance with sections 357 and 361, (ii) providing certainty to taxpayers and the IRS, and (iii) permitting bona-fide corporate readjustments with respect to the assumption of liabilities (including assuming refinanced distributing corporation debt) and the satisfaction of debt with section 361 consideration. In other words, in these proposed regulations, the Treasury Department

and IRS have attempted to provide taxpayers with an appropriate level of transactional flexibility that is consistent, and therefore compliant, with the operation of sections 357 and 361.

B. Liability Assumptions Under Section 357

1. General Rules

Consistent with section 357(a), proposed § 1.357–2(a) generally would provide that, if a transferor receives property that would be permitted to be received under section 351 or 361 without the recognition of gain to the transferor if that property were the sole consideration received by the transferor, and if, as part of the consideration, the transferee corporation assumes a liability of the transferor, then the transferee corporation's assumption of that liability (i) will not be treated as the receipt of money or other property by the transferor, and (ii) will not prevent the exchange from being within the provisions of section 351 or 361. Under proposed § 1.357–2(b), this general rule would not preclude any liability of a transferor that is assumed by a transferee corporation from being taken into account for purposes of computing the amount of gain or loss realized to the transferor under section 1001 resulting from the exchange.

2. Amount of Liability Assumed

Proposed § 1.357–2(c) would provide that, if the transferor issues a debt that converts, pursuant to its terms, into a debt of the transferee corporation (traveling note), the transferee corporation is treated as assuming that traveling note at the time at which the debtor on that debt converts from the transferor to the transferee corporation under the terms of the note. Proposed § 1.357–2(d) also would provide general rules for determining the amount of recourse and nonrecourse liabilities assumed by a transferee corporation for purposes of §§ 1.357–2, 1.357–3, 1.357–4, 1.358–3, 1.358–5, 1.358–7, 1.361–3(c)(2), and 1.368–2(d).

The Treasury Department and the IRS are considering additional rules regarding the amount of a liability a transferee corporation is treated as assuming in connection with a transfer of property and certain tax consequences that result from such an assumption. The Treasury Department and the IRS request comments regarding these issues and rules. *See* REG–100818–01, *Liabilities Assumed in Certain Transactions,* 68 FR 23931 (May 6, 2003).

a. Recourse Liabilities

Proposed § 1.357–2(d)(1)(i) would provide that a recourse liability (or portion thereof) of a transferor is treated as having been assumed by the transferee corporation if, as determined based on all facts and circumstances, the transferee corporation has agreed to, and is expected to, satisfy the liability (or portion thereof), whether or not the transferor has been relieved of the liability (or portion thereof).

b. Nonrecourse Liabilities

Proposed § 1.357–2(d)(1)(ii)(A) generally would provide that a nonrecourse liability of a transferor is treated as having been assumed by the transferee corporation to which any asset subject to that liability is transferred. However, proposed § 1.357–2(d)(1)(ii)(B) would provide that the amount of any nonrecourse liability of a transferor treated as assumed is reduced by the lesser of (i) the amount of that liability that an owner of other assets not transferred to the transferee corporation and also subject to that liability has agreed with the transferee corporation to, and is expected to, satisfy, or (ii) the fair market value of such other assets (determined without regard to section 7701(g) of the Code).

3. Legal or Practical Dominion or Control Over Payment of Assumed Liability

a. General Rule

Proposed § 1.357–2(e)(1) would apply if a transferee corporation (or, in the case of a divisive reorganization, a member of the CSAG) makes a payment to satisfy an assumed liability, and if the transferor (or, in the case of a divisive reorganization, a member of the DSAG) has legal or practical dominion or control over any part of the payment. If proposed § 1.357–2(e)(1) applies, then (i) that part of the payment is treated as money or other property received by the transferor, (ii) the rules in section 351(b) or 361(b) (as applicable) apply to determine the Federal income tax consequences of the receipt of that money or other property by the transferor, and (iii) the rules in proposed §§ 1.357–2 through 1.357–4 (*see* the discussion in part VIII.C and D of this Explanation of Provisions) do not apply (that is, the Federal income tax consequences of the payment are not determined under section 357).

Proposed § 1.357–2(e)(2)(i) would provide that the determination of whether a payment is within the transferor's legal or practical dominion or control generally is made based on all facts and circumstances. However, proposed § 1.357–2(e)(2)(ii) would treat a payment as within a transferor's legal or practical dominion or control if that payment is made to (i) a segregated account of the transferor (or, in the case of a divisive reorganization, a member of the DSAG), or (ii) any person through which the transferor (or, in the case of a divisive reorganization, a member of the DSAG) can direct the treatment or disposition of the payment, regardless of the brevity or transitory nature of the period in which the payment is in such an account.

b. Exceptions for Indemnification Agreements and Other Payments

These proposed regulations also would except from the general facts-and-circumstances determination certain payments that otherwise would result in the transferor having legal or practical dominion or control over the payment. Under proposed § 1.357–2(e)(2)(iii)(A), payments made pursuant to an indemnification agreement would not be treated as within the transferor's legal or practical dominion or control (and, thus, would not be treated as money or other property received by the transferor) if three requirements are satisfied. First, the transferee corporation must be legally prohibited from assuming the liability. Second, the indemnification agreement must require the transferor to first satisfy the obligation that is the subject of the indemnification before seeking payment from the transferee corporation. Third, the transferor must be in the same net economic position as it would have been had the transferee corporation legally assumed the liability.

Under proposed § 1.357–2(e)(2)(iii)(B), a payment not made pursuant to an indemnification agreement would not be treated as within the transferor's legal or practical dominion or control if (i) the payment is dedicated to the satisfaction of a liability of the transferor that is identified in an agreement or the plan of reorganization, (ii) the payment is made to an independent trustee or escrow agent that is not affiliated with the transferor, (iii) the payment is not made to any account of the transferor (or, in the case of a divisive reorganization, a member of the DSAG) or any person through which the transferor (or, in the case of a divisive reorganization, a member of the DSAG) could direct the payment, (iv) the transferor and transferee corporation treat any income, gain, or loss on the payment proceeds as income, gain, or loss of the transferee corporation, and (v) any excess of the payment account (and any income or gain thereon) over

the amount paid in satisfaction of the liability reverts to the transferee corporation.

C. Tax Avoidance Purpose Under Section 357(b)

1. Principal Purpose Standard

These proposed regulations would revise and redesignate current § 1.357–1(c) (concerning tax avoidance purpose) as proposed § 1.357–3(a) through (c). Consistent with section 357(b), proposed § 1.357–3(a)(1) would provide that § 1.357–2(a) does not apply to any exchange involving the assumption of a liability if the principal purpose of the transferor with respect to the assumption is either (i) to avoid Federal income tax on the exchange, or (ii) not a bona fide business purpose. In accordance with caselaw and the long-standing view of the Treasury Department and the IRS, proposed § 1.357–3(a)(2) also would clarify that a principal purpose described in proposed § 1.357–3(a)(1) is presumed to exist if the transferee corporation assumes a liability of the transferor that was not incurred in the ordinary course of a business of the transferor. *See Bryan* v. *Comm'r,* 281 F.2d 238 (4th Cir. 1960); Rev. Proc. 96–30, 1996–1 C.B. 696, *superseded by* Rev. Proc. 2024–24 (continuing to require a similar representation); Rev. Proc. 83–59, 1983–2 C.B. 575.

Consistent with section 357(b)(1) and current § 1.357–1(c), proposed § 1.357–3(b) would provide that, for purposes of determining the amount of gain recognized upon an exchange described in proposed § 1.357–3(a)(1), the total amount of liabilities assumed or acquired pursuant to the exchange (and not merely a particular liability with respect to which the tax avoidance or non-business purpose existed) is treated as money or other property received by the transferor upon the exchange. Consistent with section 357(b)(2) and current § 1.357–1(c), proposed § 1.357–3(c) would provide that, if the Commissioner determines that the transferor's principal purpose with respect to the assumption of a liability was to avoid Federal income tax on the exchange or was not a bona fide business purpose, the burden is on the transferor to prove by a clear preponderance of the evidence that the liability assumption should not be treated as the receipt of money or other property.

2. Eligible Distributing Corporation Liabilities

With respect to divisive reorganizations, the Treasury Department and the IRS view the allocation of distributing corporation liabilities as a fundamental aspect of separating one or more businesses. These proposed regulations are intended to facilitate the assumption of a distributing corporation's liabilities in bona-fide divisive reorganizations in a manner that balances the objectives of complying with section 357 while providing certainty to taxpayers and the IRS.

Accordingly, as a threshold matter, proposed § 1.357–3(d)(2) generally would permit solely eligible distributing corporation liabilities to be assumed. In other words, these proposed regulations would provide that a distributing corporation is presumed to have hade a principal purpose described in proposed § 1.357–3(a)(1) (and, as a result, is presumed to be treated as recognizing an amount of gain determined under proposed § 1.357–3(b)) if the controlled corporation assumes a distributing corporation liability that is not eligible to be assumed under proposed § 1.357-(d)(3). Liabilities of a distributing corporation would be eligible to be assumed under proposed § 1.357–3(d)(3) if (i) the liabilities are described in a plan of reorganization or original plan of reorganization (if amended), (ii) the liabilities were incurred in the ordinary course of business of the distributing corporation, and (iii) the assumption of the liabilities is necessary (A) to ensure the transfer to the controlled corporation of all liabilities properly associated with the business assets transferred to that corporation, and (B) to result in the controlled corporation assuming liabilities in an amount that properly relates to its business operations, the earnings of which will be used to properly satisfy those liabilities.

3. Eligible Distributing Corporation Debt

a. In General

Proposed § 1.357–3(d)(4) would provide additional requirements if the distributing corporation liabilities to be assumed are debt. The general rule in proposed § 1.357–3(d)(4)(i) would provide that distributing corporation debt generally is eligible to be assumed if such debt qualifies as historical distributing corporation debt (as defined in proposed § 1.357–1(b)(13)) (certain exceptions to the general rule are provided in proposed § 1.357–3(d)(4)(ii)).

b. Exceptions to Requirement That Eligible Distributing Corporation Debt be Historical

To facilitate the bona-fide allocation of distributing corporation debt in divisive reorganizations and to provide certainty to taxpayers and the IRS, proposed § 1.357–3(d)(4)(ii) would provide several exceptions to the requirement that the distributing corporation debt must qualify as historical distributing corporation debt. First, proposed § 1.357–3(d)(4)(ii)(A) would provide that any trade payables (as defined in proposed § 1.357–1(b)(19)) of the distributing corporation that meet the requirements set forth in proposed § 1.357–3(d)(3) (that is, the general requirements for distributing corporation liabilities eligible to be assumed) are not required to qualify as historical distributing corporation debt.

Second, proposed § 1.357–3(d)(4)(ii)(B) would provide that, if a controlled corporation assumes refinanced distributing corporation debt (as defined in proposed § 1.357–1(b)(17)), that refinanced distributing corporation debt is treated as historical distributing corporation debt if all the following requirements are met: (i) the distributing corporation has a direct business purpose for the controlled corporation's assumption of the refinanced distributing corporation debt; (ii) the distributing corporation's refinancing of its historical distributing corporation debt is completed before the controlled corporation's assumption of that refinanced distributing corporation debt; (iii) following the controlled corporation's assumption of the refinanced distributing corporation debt, the distributing corporation and the controlled corporation are in the same net economic position as each corporation would have been had the controlled corporation assumed the historical distributing corporation debt; (iv) the distributing corporation's refinancing of its historical distributing corporation debt and the subsequent assumption of that refinanced debt are included in the plan of reorganization for the divisive reorganization; (v) there is no untaxed gain or other Federal income tax benefit to the distributing corporation or the controlled corporation resulting from the distributing corporation's refinancing of a historical distributing corporation debt and the assumption by the controlled corporation of that refinanced distributing corporation debt; (vi) the business assets transferred by the distributing corporation to the controlled corporation in the section 361(a) exchange are associated with the

refinanced distributing corporation debt assumed by the controlled corporation; and (vii) the refinancing of historical distributing corporation debt by the distributing corporation and the subsequent assumption of that refinanced distributing corporation debt by the controlled corporation result in the controlled corporation assuming liabilities in an amount that properly relates to its business operations and will be properly satisfied with earnings generated by those operations. The foregoing requirements are derived directly from Rev. Rul. 79–258, which provides long-standing IRS guidance on the treatment of an assumption of a refinanced historical distributing corporation debt.

Third, proposed § 1.357–3(d)(4)(ii)(C) would provide that a controlled corporation's assumption of a traveling note issued to refinance a historical distributing corporation debt is treated as an assumption of historical distributing corporation debt if the requirements with respect to refinanced distributing corporation debt described in the foregoing paragraph are met. Because the issuance of a traveling note resembles the issuance and assumption of refinanced debt, the Treasury Department and IRS are of the view that traveling notes should be subject to the same degree of scrutiny as the issuance and assumption of refinanced debt.

Fourth, proposed § 1.357–3(d)(4)(ii)(D) would provide that a revolving credit agreement to which the distributing corporation is a debtor qualifies as historical distributing corporation debt only if the distributing corporation entered into the agreement before the earliest applicable date, the agreement does not expire until after the date of the exchange described in proposed § 1.361–2(a) or 1.361–3(a), and that agreement is identified in the plan of reorganization or original plan of reorganization (if amended).

D. Liabilities in Excess of Basis Under Section 357(c)

Consistent with section 357(c) and current § 1.357–2(a), proposed § 1.357–4(a)(1) generally would provide that, in an exchange described in section 351 or in section 361 (by reason of a divisive reorganization that qualifies under sections 355 and 368(a)(1)(D)), the excess of (i) the sum of the amount of liabilities of the transferor assumed by the transferee corporation, over (ii) the total adjusted basis of the property transferred by the transferor pursuant tothe exchange, is treated as gain from the sale or exchange of a capital asset or of property that is not a capital asset, as applicable. The determination of whether gain resulting from the transfer of capital assets is long-term or short-term capital gain would be made under proposed § 1.357–4(b) by reference to the transferor's holding period for the transferred assets, based on the proportionate fair market value of the transferor's long-term assets to its short-term assets.

Under proposed § 1.357–4(a)(2), the general rule in proposed § 1.357–4(a)(1) would not apply to any exchange (i) to which proposed § 1.357–3(a) applies, (ii) that is pursuant to a plan of reorganization for a reorganization described in section 368(a)(1)(G) in which no former shareholder of the transferor corporation receives any consideration for the shareholder's stock, or (iii) to which section 351 applies if that exchange also (A) qualifies as part of a reorganization described in section 368(a)(1)(A), (C), or (D) or (G) (provided the requirements of section 354(b)(1) of the Code are satisfied), and (B) is described as a reorganization in a filing with the IRS under § 1.368–3.

In addition, the following liabilities generally would be excluded under proposed § 1.357–4(a)(3)(i) for purposes of applying the general rule in proposed § 1.357–4(a)(1): (i) a liability the payment of which would give rise to a deduction; (ii) a liability the payment of which would give rise to the creation of, or increase in, the basis of any property; and (iii) a liability the payment of which would be described in section 736(a) of the Code. However, such liabilities would not be excluded under proposed § 1.357–4(a)(3)(i) to the extent (i) the incurrence of the liability resulted in a deduction, (ii) the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property, or (iii) the liability is not incurred in the ordinary course of business or associated with any assets transferred.

IX. Solvency and Continued Viability of Distributing Corporation and Controlled Corporation

A. Notice 2024–38

Section 2.02(3) of Notice 2024–38 stated the view of the Treasury Department and the IRS that qualification under section 355 is limited to transactions after which the distributing corporation and the controlled corporation are capable of carrying on sustained businesses. In this regard, section 355 and related Code provisions were not enacted to provide nonrecognition treatment for section 355 transactions that burden the distributing corporation or the controlled corporation with excessive leverage, thereby jeopardizing their ability to continue as a viable going concern. *See, for example,* S. Rep. No. 82–781, at 58 (1951) (providing, in relevant part, that the predecessor statute to section 355 was drafted ''so as to limit its benefits to reorganizations in which all of the new corporations as well as the parent are intended to carry on a business after the reorganization'').

B. Stakeholder Input

Stakeholders have contended that substantive guidance under section 355, 357, or 361 is not appropriate to address the foregoing solvency concern and that additional rules to address this concern are unnecessary. First, stakeholders have asserted that section 355 already provides safeguards to prevent an abusive transaction (such as a transaction involving the allocation of excess liabilities to the controlled corporation) from qualifying under sections 355 and 361. Those safeguards include the active trade or business requirement (*see* section 355(b)), the corporate business purpose requirement (*see* § 1.355–2(b)), and the device prohibition (*see* section 355(a)(1)(B) and § 1.355–2(d)). Second, stakeholders have noted that, if a taxpayer's principal purpose with respect to a liability assumption is to avoid Federal income tax on the exchange or is not a bona fide business purpose, the total amount of liabilities assumed is treated as money received by the taxpayer in the exchange (that is, as taxable boot). *See* section 357(b)(1). Third, stakeholders have contended that, if the controlled corporation is not expected to have the capacity to repay the assumed debt, that debt would not be respected as debt for Federal income tax purposes (and would be recharacterized as non-voting equity). Finally, stakeholders have contended that non-tax safeguards, including commercial constraints on capital allocation and structuring, State law restrictions (such as voidable transfers or fraudulent transfers), bankruptcy law, and third-party evaluations (including credit agency ratings), operate as limitations on the assumption of excessive liabilities by the controlled corporation and, thus, obviate the need for a solvency requirement under section 355.

C. Proposed Regulations

The Treasury Department and the IRS disagree that the foregoing safeguards obviate the need for additional guidance to address the solvency concern. As acknowledged by stakeholders, some distributing corporations facing substantial contingent liabilities have separated those liabilities from the

corporations' primary assets through divisive reorganizations. In numerous instances, the controlled corporation has been unable to support those liabilities through operation of the transferred business and consequently became financially unviable, notwithstanding the safeguards mentioned by stakeholders. Such separations have been successfully challenged as fraudulent transfers. *See, for example, In re Tronox Inc.,* 503 B.R. 239 (Bankr. S.D.N.Y. 2013).

The Treasury Department and the IRS view the aforementioned transactions and resulting outcomes as inconsistent with Congress's intent that section 355 ''limit its benefits to reorganizations in which all of the new corporations as well as the parent are intended to carry on a business after the reorganization.'' S. Rep. No. 82–781, at 58 (1951). For example, the Treasury Department and the IRS are of the view that so-called ''spin-to-bankruptcy'' transactions, in certain situations, would fail to evidence an intent for the continued conduct of the business following the divisive reorganization.

Accordingly, the Treasury Department and the IRS intend to address these issues in forthcoming guidance concerning the active trade or business requirement under section 355(b). It is the position of the Treasury Department and the IRS that, while such guidance is pending, solvency and financial viability considerations continue to be relevant for purposes of the IRS's private letter ruling program, as reflected in Rev. Proc. 2024–24. The Treasury Department and the IRS request additional comments on this issue, taking into account the views described in this part IX.C.

Proposed Applicability Dates

Each provision of the regulations contained in this notice of proposed rulemaking is proposed to apply to transactions occurring after the date of publication of final regulations in the **Federal Register** (publication date), but only if the earliest of the following dates with respect to the transaction occurs after the publication date (general applicability date): (1) the date of the first public announcement; (2) the date of entry by the taxpayer into a written agreement; (3) the date of approval by the board of directors of the taxpayer; (4) the date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case, only if the taxpayer was a debtor in a case before such court; or (5) the date a ruling request is submitted to the IRS.

Proposed §§ 1.355–2(e), 1.355–4, and 1.355–10 would be applicable to section 355 transactions occurring after the general applicability date. Proposed §§ 1.357–1 through 1.357–4 would be applicable to assumptions of liabilities in transactions intended to qualify under section 351 or section 361 occurring after the general applicability date. Proposed §§ 1.361–1 through 1.361–5 would be applicable to exchanges under section 361 occurring after the general applicability date. Proposed §§ 1.368–1(c), 1.368–2(f), 1.368–3(a)(5), and 1.368–4 would be applicable to transactions occurring after the general applicability date.

Effect on Other Documents

The following revenue rulings are proposed to be obsoleted for transactions occurring after the date of publication of final regulations in the **Federal Register**: Rev. Rul. 2007–8, 2007–1 C.B. 469; Rev. Rul. 95–74, 1995–2 C.B. 36; Rev. Rul. 79–258, 1979–2 C.B. 143; Rev. Rul. 75–469, 1975–2 C.B. 126; Rev. Rul. 75–321, 1975–2 C.B. 123; Rev. Rul. 57–518, 1957–2 C.B. 253.

Special Analyses

I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA) generally requires that a Federal agency obtain the approval of the Office of Management and Budget (OMB) before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The general recordkeeping requirements mentioned within these proposed regulations are considered general tax records under § 1.6001–1(e). In connection with a reorganization, these records should include information regarding the amount, basis, and fair market value of all transferred property, and relevant facts regarding any liabilities assumed or extinguished as part of such reorganization. For PRA purposes, these general tax records are already approved under OMB control number 1545–0123.

The reporting requirements set forth in proposed §§ 1.355–5(a)(2) and 1.368–3(a)(5) require parties to a section 355(c) distribution or a corporate reorganization to attach a statement to their return that includes a copy of the plan of distribution or the plan of reorganization satisfying the requirements set forth in proposed §§ 1.355–4 or 1.368–4, respectively. The burden for these requirements will be approved by OMB, in accordance with 5 CFR 1320.10, under OMB control number 1545–0123 for business entities.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the situations to which these proposed regulations would apply are primarily section 355 transactions and acquisitive reorganizations. Such transactions primarily are engaged in by publicly traded corporations, which tend to be larger businesses. Specifically, the Research, Applied Analytics, and Statistics Division of the IRS estimates that, based on the most recent complete data available, fewer than one percent of small businesses with gross receipts under $25 million would be subject to the requirements of these regulations annually. To the extent that transactions qualifying under section 351 or 368(a)(1) also are included, the percentage of small businesses impacted remains fewer than one percent of small businesses with gross receipts under $25 million. In addition, the reporting burden in these proposed regulations is an incremental, additional obligation on small entities to a currently existing collection of information. Moreover, the economic impact of these proposed regulations will not be significant.

Therefore, these proposed regulations would not create significant additional obligations for, or impose any meaningful economic impact on, a substantial number of small entities. Accordingly, the Secretary certifies that the proposed regulations would not have a significant economic impact on a substantial number of small entities and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. Section 7805(f)

Pursuant to section 7805(f) of the Code, the proposed regulations have been submitted to the Chief Counsel for the Office of Advocacy of the Small

Business Administration for comment on its impact on small business.

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation.

These proposed regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector, in excess of that threshold.

VI. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in the preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All commenters are strongly encouraged to submit comments electronically. The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket on *https://www.regulations.gov.*

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing also are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**.

Statement of Availability of IRS Documents

Guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov.*

Drafting Information

The principal author of these proposed regulations is Justin R. Du Mouchel of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding entries in numerical order for §§ 1.355–2(e), 1.355–4, 1.355–5, 1.355–10, 1.361–1 through 1.361–5, and 1.368–1 through 1.368–4, and removing the entry for § 1.355–2T(g) and (i) to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Section 1.355–2(e) also issued under 26 U.S.C. 337(d).

* * * * *

Section 1.355–4 also issued under 26 U.S.C. 337(d).

Section 1.355–5 also issued under 26 U.S.C. 337(d).

* * * * *

Section 1.355–10 also issued under 26 U.S.C. 337(d).

* * * * *

Section 1.361–1 also issued under 26 U.S.C. 337(d).

Section 1.361–2 also issued under 26 U.S.C. 337(d).

Section 1.361–3 also issued under 26 U.S.C. 337(d) and 361(b)(3).

Section 1.361–4 also issued under 26 U.S.C. 337(d) and 361(b)(3).

Section 1.361–5 also issued under 26 U.S.C. 337(d) and 361(b)(3).

* * * * *

Section 1.368–1 also issued under 26 U.S.C. 337(d).

Section 1.368–2 also issued under 26 U.S.C. 337(d).

Section 1.368–3 also issued under 26 U.S.C. 337(d).

Section 1.368–4 also issued under 26 U.S.C. 337(d).

* * * * *

■ **Par. 2.** Section 1.355–1 is revised and republished to read as follows:

§ 1.355–1 Distribution of stock and securities of a controlled corporation.

(a) *Application of section 355*—(1) *Overview*—(i) *In general.* Section 355 of the Code provides for the separation, without recognition of gain or loss to (or the inclusion in income of) the shareholders and security holders, of one or more existing businesses formerly operated, directly or indirectly, by a single distributing corporation. Section 355 applies only to the separation of existing businesses that have been in active operation for at least five years (or to the division of a business that has been in active operation for at least five years into separate businesses), and that, in general, have been owned, directly or indirectly, for at least five years by the distributing corporation. A separation is achieved through the distribution by the distributing corporation of stock, or of stock and securities, of one or more controlled corporations (which may be pre-existing or newly created subsidiaries) to the distributing corporation's shareholders with respect to its stock or to its security holders in exchange for its securities. Section 355 contemplates the continued operation of the business or businesses existing prior to the separation.

(ii) *Scope.* Paragraph (a)(2) of this section provides general definitions that apply for purposes of the section 355 regulations. Paragraph (b) of this section describes types of distributions that may qualify under section 355, including pro rata distributions and non pro rata distributions. Paragraphs (c) and (d) of this section provide rules regarding stock rights and nonqualified preferred stock, respectively. Paragraph (e) of this section provides applicability dates for certain sections of the section 355 regulations.

(2) *Definitions.* Except as otherwise provided in the section 355 regulations, the following definitions apply for purposes of the section 355 regulations:

(i) *Code.* The term *Code* means the Internal Revenue Code of 1986, as amended.

(ii) *Commissioner.* The term *Commissioner* means the Commissioner of Internal Revenue.

(iii) *Control distribution.* The term *control distribution* means a distribution of controlled corporation stock, or of controlled corporation stock and securities, that results in the distribution by the distributing

corporation of an amount of controlled corporation stock constituting control (within the meaning of section 368(c) of the Code).

(iv) *Control distribution date.* The term *control distribution date* means the date of the control distribution.

(v) *Controlled corporation.* The term *controlled corporation* means the controlled corporation described in section 355(a)(1)(A).

(vi) *Distributing corporation.* The term *distributing corporation* means the distributing corporation described in section 355(a)(1)(A).

(vii) *Distribution.* Unless the context indicates otherwise, the term *distribution* means—

(A) With regard to a section 355(c) distribution, a single distribution or series of distributions of controlled corporation stock and securities (if any) carried out pursuant to a plan of distribution to qualify the distribution or series of distributions under section 355; or

(B) With regard to a divisive reorganization, a single distribution or series of distributions of controlled corporation stock and securities (if any) carried out pursuant to a plan of reorganization to qualify the distribution or series of distributions under section 355.

(viii) *Divisive reorganization.* The term *divisive reorganization* means a series of transactions carried out pursuant to a plan of reorganization that qualify as a reorganization described in sections 355 and 368(a)(1)(D) or (G).

(ix) *Final distribution.* The term *final distribution* means, with respect to a series of distributions, the last distribution that is made by the distributing corporation pursuant to the plan of distribution or plan of reorganization (as appropriate).

(x) *First distribution.* The term *first distribution* means, with respect to a series of distributions, the earliest distribution that is made by the distributing corporation pursuant to the plan of distribution or plan of reorganization (as appropriate).

(xi) *First distribution date.* The term *first distribution date* means the date of the first distribution.

(xii) *IRS.* The term *IRS* means the Internal Revenue Service.

(xiii) *Plan of distribution.* The term *plan of distribution* has the meaning provided in § 1.355–4.

(xiv) *Plan of reorganization.* The term *plan of reorganization* has the meaning provided in § 1.368–4.

(xv) *SEC.* The term *SEC* means the U.S. Securities and Exchange Commission.

(xvi) *Section 355 regulations.* The term *section 355 regulations* means this section and §§ 1.355–2 through 1.355–10.

(xvii) *Section 355 transaction.* The term *section 355 transaction* means either a section 355(c) distribution or a divisive reorganization.

(xviii) *Section 355(c) distribution.* The term *section 355(c) distribution* means a distribution that qualifies under section 355(a) (or so much of section 356 of the Code as relates to section 355) and section 355(c).

(b) *Non pro rata distributions*—(1) *In general.* Section 355 provides for nonrecognition of gain or loss with respect to a distribution whether or not—

(i) The distribution is pro rata with respect to all shareholders of the distributing corporation;

(ii) The distribution is pursuant to a plan of reorganization within the meaning of section 368(a)(1)(D); or

(iii) The shareholders surrender stock in the distributing corporation.

(2) *Controlled corporation stock.* Under section 355, the stock of a controlled corporation may consist of common stock or preferred stock. (*See,* however, section 306 of the Code and the regulations under section 306.)

(3) *Section 355 not applicable to mere exchanges of stock or securities.* Section 355 does not apply if the substance of a transaction is merely an exchange between shareholders or security holders of stock or securities in one corporation for stock or securities in another corporation. For example, if two individuals, A and B, each own directly 50 percent of the stock of corporation X and 50 percent of the stock of corporation Y, section 355 would not apply to a transaction in which A and B transfer all of their stock of X and Y to a new corporation Z for all of the stock of Z, and Z then distributes the stock of X to A and the stock of Y to B.

(c) *Stock rights.* Except as provided in § 1.356–6, for purposes of section 355, the term *securities* includes rights issued by the distributing corporation or the controlled corporation to acquire the stock of that corporation. For purposes of this section and section 356(d)(2)(B), a right to acquire stock has no principal amount. For this purpose, the term *rights to acquire stock* has the same meaning as it does under sections 305 and 317(a) of the Code. Other Code provisions governing the treatment of rights to acquire stock also may apply to certain distributions occurring in connection with a transaction described in section 355. *See, for example,* sections 83 and 421 through 424 of the Code and the regulations under sections 83 and 421 through 424.

(d) *Nonqualified preferred stock. See* § 1.356–7(a) and (b) for the treatment of nonqualified preferred stock (as defined in section 351(g)(2) of the Code) received in certain exchanges for (or in certain distributions with respect to) nonqualified preferred stock or preferred stock. *See* § 1.356–7(c) for the treatment of the receipt of preferred stock in certain exchanges for (or in certain distributions with respect to) common or preferred stock described in section 351(g)(2)(C)(i)(II).

(e) *Applicability dates*—(1) *Section 1.355–1*—(i) *In general.* This section applies to section 355 transactions for which the earliest of the following dates occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**] (general applicability date):

(A) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the section 355 transaction.

(B) The date of entry by the distributing corporation into a written agreement to engage in the section 355 transaction.

(C) The date of approval of the section 355 transaction by the board of directors of the distributing corporation.

(D) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A)), but only if the taxpayer was a debtor in a case before such court.

(E) The date a ruling request for the section 355 transaction is submitted to the IRS.

(ii) *Transactions occurring on or before general applicability date.* For section 355 transactions occurring on or before the general applicability date, *see* 26 CFR 1.355–1 and 1.355–4 (revised as of April 1, 2024).

(2) *Sections 1.355–2 and 1.355–3*—(i) *In general.* Except as otherwise provided in this paragraph (e)(2), §§ 1.355–2 and 1.355–3 apply to section 355 transactions occurring after February 6, 1989. For section 355 transactions occurring on or before that date, *see* 26 CFR 1.355–2 and 1.355–3 (revised as of April 1, 1988).

(ii) *Section 1.355–2(e).* Section 1.355–2(e) applies to section 355 transactions for which the earliest of the dates listed in paragraphs (e)(1)(i)(A) through (E) of this section occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**].

(iii) *Section 1.355–2(g).* Sections 1.355–2(g) applies to section 355 transactions occurring after October 20, 2011. For rules regarding section 355

transactions occurring on or before October 20, 2011, *see* § 1.355–2T(i), as contained in 26 CFR part 1, revised as of April 1, 2011.

(3) *Section 1.355–4.* Section 1.355–4 applies to section 355 transactions for which the earliest of the dates listed in paragraphs (e)(1)(i)(A) through (E) of this section occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**].

(4) [Reserved]

(5) *Section 1.355–10.* Section 1.355–10 applies to section 355 transactions for which the earliest of the dates listed in paragraphs (e)(1)(i)(A) through (E) of this section occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**].

■ **Par. 3.** Section 1.355–2 is amended by:

■ 1. Revising paragraph (e); and

■ 2. Removing paragraph (i).

The revision reads as follows:

§ 1.355–2 Limitations.

* * * * *

(e) *Stock and securities distributed*—(1) *Overview.* To qualify under section 355, a distributing corporation, as part of the distribution (within the meaning of section 355(a)(1)(D)), must distribute stock, or stock and securities, of the controlled corporation.

(2) *Requirements.* A distribution does not qualify under section 355 unless, pursuant to a plan of distribution (as described in § 1.355–4) or a plan of reorganization (within the meaning of § 1.368–4), the distributing corporation satisfies the requirements set forth in either paragraph (e)(2)(i) or (ii) of this section in addition to satisfying the requirements set forth in paragraph (e)(2)(iii) of this section.

(i) The distributing corporation distributes at least an amount of stock of the controlled corporation that constitutes a control distribution within a single taxable year of the distributing corporation.

(ii) The distributing corporation distributes stock of the controlled corporation as part of a control distribution during two taxable years of the distributing corporation, but only if all distributions up to and including the control distribution are made pursuant to a binding commitment that is described in, as appropriate—

(A) The plan of distribution; or

(B) The plan of reorganization.

(iii) Any stock of the controlled corporation not distributed as part of the first distribution satisfies all requirements for a qualifying retention (as described in § 1.355–10(c)).

* * * * *

■ **Par. 4.** Section 1.355–4 is revised to read as follows:

§ 1.355–4 Plan of distribution.

(a) *Plan of distribution*—(1) *Scope and purpose.* This section sets forth requirements and procedures for the determination of a plan of distribution, including the scope of distributions properly included within that plan. This section applies solely to a section 355(c) distribution. Accordingly, this section does not apply to a reorganization described in section 368(a)(1)(D) or (G) of the Code.

(2) *Definition.* For purposes of section 355 of the Code and the section 355 regulations, the term *plan of distribution* means—

(i) A plan of distribution of the distributing corporation that—

(A) Satisfies all requirements set forth in paragraph (c) of this section; and

(B) Is filed with the IRS pursuant to § 1.355–5(a)(2);

(ii) A plan of distribution of the distributing corporation that results from the Commissioner correcting a plan of distribution of a distributing corporation; or

(iii) A plan of distribution of the distributing corporation that results from the Commissioner identifying a plan of distribution for a distributing corporation (in the event of a failure to file a plan of distribution with the IRS pursuant to § 1.355–5(a)(2)).

(3) *Failure to satisfy requirements.* The failure of a distributing corporation to comply with any particular requirement or procedure set forth in this section (including the failure to file a plan of distribution with the IRS pursuant to § 1.355–5(a)(2)) does not, on its own, prevent a transaction or series of transactions from being considered part of the plan of distribution.

(b) *Determination of plan of distribution*—(1) *Status generally based on plan of distribution filed by distributing corporation.* Except as provided in paragraph (b)(2) of this section, a distributing corporation establishes the plan of distribution for a transaction or series of transactions solely by—

(i) Satisfying all requirements set forth in paragraph (c) of this section; and

(ii) Filing the plan of distribution with the IRS pursuant to § 1.355–5(a)(2).

(2) *Correction or identification of plan of distribution due to distributing corporation's failure to file a complete plan of distribution*—(i) *In general.* If a distributing corporation files a plan of distribution with the IRS that fails to satisfy any requirement set forth in paragraph (c) of this section, or if the distributing corporation fails to file any plan of distribution with the IRS, the Commissioner may correct or identify a plan of distribution in accordance with paragraph (b)(2)(ii) of this section.

(ii) *Status of distributions as part of a plan of distribution.* The Commissioner may determine that a distribution or series of distributions should be included in, or excluded from, a plan of distribution described in paragraph (b)(2)(i) of this section based on—

(A) All facts and circumstances regarding the distribution or series of distributions; and

(B) All relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine.

(c) *Requirements for a plan of distribution.* To qualify as a plan of distribution described in paragraph (a)(2)(i) of this section, the distributing corporation must satisfy all requirements set forth in paragraphs (c)(1) through (3) of this section. For purposes of this paragraph (c) and paragraph (d) of this section, the term *official records* includes a contract or other agreement to which the distributing corporation is a party, a resolution or other document authorized by the distributing corporation's board of directors, or other document filed with the SEC or other Federal regulatory agency.

(1) *Documentation requirement.* The plan of distribution is provided in a single, comprehensive document that—

(i) Identifies the distributing corporation and each controlled corporation;

(ii) Identifies all distributions properly included in the plan of distribution (as determined pursuant to paragraph (d) of this section);

(iii) Describes the intended Federal income tax treatment of the distributions described in paragraph (c)(1)(ii) of this section; and

(iv) Describes the corporate business purpose for each distribution.

(2) *Adoption of plan of distribution.* Prior to the first distribution, the plan of distribution described in paragraph (a)(2)(i) of this section or an original plan of distribution that becomes the amended plan of distribution (within the meaning of paragraph (e) of this section), as applicable, is finalized and adopted by the distributing corporation, as established by—

(i) The acts of the distributing corporation's duly authorized officers and directors; and

(ii) The distributing corporation's official records.

(3) *Completion of plan of distribution*—(i) *Expeditious prosecution of plan of distribution*—(A) *General rule.* In accordance with paragraph (c)(3)(ii) of this section, taking into account all facts and circumstances (including the one or more corporate business purposes for each distribution), the distributing corporation completes the plan of distribution as expeditiously as practicable.

(B) *24-month presumption.* The requirement in paragraph (c)(3)(i)(A) of this section is presumed to be satisfied if, in accordance with paragraph (c)(3)(ii) of this section, the distributing corporation completes the plan of distribution within the 24-month period beginning on the first distribution date.

(ii) *Completion of entire plan of distribution*—(A) *General rule.* All distributions included in a plan of distribution must be carried out in the manner described in the plan of distribution.

(B) *Failure to complete entire plan of distribution.* Except as provided in paragraph (e) of this section, if the requirement of paragraph (c)(3)(ii)(A) of this section is not satisfied, section 355 does not apply to any distribution unless the Commissioner determines the existence of a plan of distribution.

(d) *Requirements for distributions to be treated as properly included in plan of distribution.* The requirements set forth in this paragraph (d) must be satisfied for a distribution to be treated as properly included in a plan of distribution. The existence of contingencies or conditions is not conclusive in determining whether a requirement of this paragraph (d) is satisfied.

(1) *Definite intent requirement*—(i) *General rule.* Prior to the first step of the plan of distribution or of an original plan of distribution that becomes the amended plan of distribution (within the meaning of paragraph (e) of this section), the distributing corporation evidences a definite intent to carry out the distribution through a written commitment in one or more official records of the distributing corporation that substantiate the plan of distribution.

(ii) *Section 355 transactions.* With regard to a control distribution that occurs in the next taxable year after the first distribution, the distributing corporation does not establish a definite intent under paragraph (d)(1)(i) of this section unless all distributions up to and including the control distribution are effectuated pursuant to a binding commitment of the distributing corporation. *See* § 1.355–2(e)(2)(ii).

(iii) *Relevancy of contemplated possibilities*—(A) *Contemplation irrelevant to distributing corporation's determination.* The contemplation by the distributing corporation that it may carry out a distribution is not sufficient for the distributing corporation to establish a definite intent to carry out that distribution, regardless of whether that contemplated distribution is included in an official record.

(B) *Contemplation relevant to Commissioner's determination.* The distributing corporation's contemplation of a distribution may be relevant for purposes of the correction or identification of a plan of distribution by the Commissioner pursuant to paragraph (b)(2) of this section.

(2) *Proximate relationship requirement*—(i) *General rule.* Taking into account paragraphs (d)(2)(ii) and (iii) of this section, a distribution is part of the plan of distribution to which the provisions of section 355 apply only if, on its own or as part of a series of distributions, the distribution is necessary to satisfy one or more requirements of section 355, or is an integral part of a series of distributions carried out to satisfy the requirements of section 355, as evidenced by a written commitment in one or more official records of the distributing corporation.

(ii) *Existence of independent significance not determinative.* The independent significance of a distribution (for example, the fact that a distribution has a separate business motive apart from one or more other distributions) does not preclude the satisfaction of the requirements under paragraph (d)(2)(i) of this section.

(iii) *Temporal proximity.* A distribution that takes place in close temporal proximity to one or more other distributions is not properly included in a plan of distribution under paragraph (d)(2)(i) of this section unless Federal income tax principles (including the step transaction doctrine) would apply to determine that the distribution was in substance part of the plan of distribution.

(3) *Corporate business purpose consistency requirement.* A distribution, on its own or as part of a series of distributions, is consistent with, and directly related to, one or more corporate business purposes for the one or more other distributions (for example, the distribution directly furthers one or more corporate business purposes for the one or more other distributions).

(e) *Amended plan of distribution*—(1) *Conditions.* If the distributing corporation amends a plan of distribution described in paragraph (a)(2)(i) of this section (original plan of distribution) after the first step of the original plan of distribution (amended plan of distribution), those amendments will not cause the distributing corporation to fail to satisfy the requirements set forth in paragraph (c) of this section only if—

(i) Those amendments are in direct response to an identifiable, unexpected, and material change in market or business conditions that occurs after the date on which the original plan of distribution is adopted by the distributing corporation in the manner described in paragraph (c)(2) of this section;

(ii) Those amendments are necessary to achieve the one or more corporate business purposes for the distribution; and

(iii) The amended plan of distribution satisfies all requirements set forth in paragraph (c) of this section.

(2) *Consequences of plan of distribution amended due to changed circumstances*—(i) *Qualifying amended plan of distribution.* If the requirements set forth in paragraph (e)(1) of this section are satisfied, the provisions set forth in section 355 will apply to distributions identified in, and carried out pursuant to, the amended plan of distribution. That is, the Federal income tax consequences of all distributions included in the amended plan of distribution will be determined based on that plan of distribution (and not on the original plan of distribution).

(ii) *Non-qualifying amended plan of distribution.* If an amended plan of distribution fails to satisfy all requirements set forth in paragraph (e)(1) of this section, the Commissioner may correct the amended plan of distribution or may identify an amended plan of distribution.

(f) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples, unless otherwise provided: a distributing corporation (Distributing) owns all the stock of an existing controlled corporation (Controlled); Distributing properly files a plan of distribution with the IRS pursuant to § 1.355–5 that satisfies all requirements set forth in paragraph (c) of this section, including providing the corporate business purpose for each distribution and the intended Federal income tax treatment of those distributions (that is, a section 355(c) distribution, as defined in § 1.355–1(a)(2)(xviii)) and completing the plan of distribution as expeditiously as practicable; Distributing satisfies all requirements for qualification under

section 355; and with regard to any retained controlled corporation stock (as defined in § 1.355–10(b)(7)), the requirements set forth in § 1.355–10(c) are satisfied.

(1) *Example 1: Status of distributions as part of the plan of distribution*—(i) *Facts.* Official records of Distributing provide that Distributing will distribute, in a single distribution, an amount of Controlled stock constituting control (control distribution) to Distributing's shareholders during Distributing's 2025 taxable year. Such records also provide that, during Distributing's 2026 taxable year, Distributing will distribute, in a single distribution, the remaining 20 percent of Controlled stock to Distributing's shareholders (the final distribution; together with the control distribution, the separation). Official records of Distributing also provide that, during Distributing's 2026 taxable year, Distributing will distribute an appreciated asset (Asset 1) to its shareholders (Asset 1 distribution). However, the official records express only a contemplated possibility that Distributing will distribute another appreciated asset (Asset 2) to its shareholders during Distributing's 2026 taxable year (Asset 2 distribution). As reflected in official records of Distributing, the control and final distributions, and the Asset 1 and Asset 2 distributions, will enable Distributing to focus on its retained, core businesses (that is, a fit-and-focus corporate business purpose).

(ii) *Analysis*—(A) *Distribution of Controlled stock.* Each of the control distribution and the final distribution is properly included in the plan of distribution for the separation. First, as reflected in official records, Distributing evidences a definite intent, prior to the first step of the plan of distribution, to carry out, through a written commitment in those official records, the control distribution and the final distribution. *See* paragraph (d)(1)(i) of this section. Second, each of these distributions is necessary to satisfy the requirements for qualification under section 355, as evidenced by the official records of Distributing, which impose a written commitment on Distributing to make both distributions. *See* paragraph (d)(2)(i) of this section. Third, the control distribution and the final distribution are consistent with, and directly relate to, the fit-and-focus corporate business purpose for the distributions. *See* paragraph (d)(3) of this section. Accordingly, based on the correct and properly filed plan of distribution, the Federal income tax consequences of the control and final distributions are determined under section 355.

(B) *Distribution of Asset 1.* The analysis is the same as in paragraph (f)(1)(ii)(A) of this section. Accordingly, because the Asset 1 distribution is properly included in the plan of distribution for the separation, Distributing recognizes gain on its distribution of Asset 1 under section 355(c)(2) (as opposed to section 311(b) of the Code).

(C) *Distribution of Asset 2.* The Asset 2 distribution is not properly included in the plan of distribution for the separation because not all requirements set forth in paragraph (d) of this section are satisfied. Specifically, as evidenced by official records of Distributing, Distributing treats the Asset 2 distribution as a contemplated possibility, thereby failing to evidence a definite intent to carry out the transaction. *See* paragraph (d)(1)(iii)(A) of this section. Accordingly, Distributing recognizes gain on its distribution of Asset 2 under section 311(b) (as opposed to section 355(c)(2)).

(2) *Example 2: Identifiable, unexpected change in market or business conditions*—(i) *Facts.* The facts are the same as in paragraph (f)(1)(i) of this section (*Example 1*), except for the following. Following the date of adoption of Distributing's plan of distribution for the separation, and before the intended date of the final distribution, market conditions unexpectedly deteriorate to such an extent that, in the judgment of Distributing and its advisors, the final distribution should be postponed. In response, Distributing amends its plan of distribution during its 2026 taxable year to reflect Distributing's definite intent to make the final distribution when market conditions sufficiently improve, in the judgment of Distributing and its advisors. During Distributing's 2027 taxable year, market conditions improve sufficiently to permit the final distribution, and Distributing accordingly makes the final distribution during that taxable year.

(ii) *Analysis.* The final distribution is properly included in the plan of distribution for the separation. *See* the analysis in paragraph (f)(1)(ii)(A) of this section (*Example 1*). Distributing's amendment of its original plan of distribution (amended plan of distribution) does not cause Distributing to fail to satisfy the requirements under paragraph (c) of this section for the following reasons. First, the amendments are in direct response to an identifiable, unexpected, and material change in market or business conditions that occurs after the date of adoption of the original plan of reorganization. *See* paragraph (e)(1)(i) of this section. Second, those amendments are necessary to achieve the fit-and-focus corporate business purpose for the separation. *See* paragraph (e)(1)(ii) of this section. Third, Distributing's amended plan of distribution satisfies all other requirements set forth in paragraph (c) of this section. *See* paragraph (e)(1)(iii) of this section. Consequently, all the requirements set forth in paragraph (e)(1) of this section are satisfied and therefore the final distribution will be treated as carried out pursuant to the amended plan of distribution. That is, the Federal income tax consequences of the control distribution and final distribution, which are included in the amended plan of distribution, will be determined based on that amended plan of distribution (and not on the original plan of distribution). *See* paragraph (e)(2)(i) of this section.

■ **Par. 5.** Section 1.355–5 is revised to read as follows:

§ 1.355–5 Information reporting and record retention requirements.

(a) *Reporting of transaction information*—(1) [Reserved]

(2) *Plan of distribution.* With regard to a section 355(c) distribution, the distributing corporation must include, with its return for the taxable year of the first distribution, a copy of its plan of distribution for the section 355(c) distribution satisfying the requirements of § 1.355–4.

(3) *Plan of reorganization.* With regard to a divisive reorganization, *see* § 1.368–3(a).

(b) [Reserved]

(c) [Reserved]

(d) *Applicability date*—(1) [Reserved]

(2) *Paragraphs (a)(2) and (3).* Paragraphs (a)(2) and (3) of this section apply to section 355 transactions for which the earliest of the following dates occurs after [date of publication of final regulations in the **Federal Register**]:

(i) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the section 355 transaction.

(ii) The date of entry by the distributing corporation into a written agreement to engage in the section 355 transaction.

(iii) The date of approval of the section 355 transaction by the board of directors of the distributing corporation.

(iv) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(v) The date a ruling request for the section 355 transaction is submitted to the IRS.

■ **Par. 6.** Section 1.355–10 is added to read as follows:

§ 1.355–10 Qualifying retentions of controlled corporation stock or securities.

(a) *Overview.* For a distribution to qualify as a section 355 transaction, there must be a genuine separation of the DSAG and the CSAG. In the case of a retention, the distributing corporation must establish to the satisfaction of the Commissioner that the retention was not pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *CSAG*—(i) *In general.* Except as provided in paragraph (b)(1)(ii) of this section, the term *CSAG* means the separate affiliated group (as defined in section 355(b)(3)(B) of the Code) of which the controlled corporation is the common parent.

(ii) *Controlled corporation not common parent.* If the controlled corporation is not the common parent of a separate affiliated group, the term *CSAG* refers to the controlled corporation.

(2) *Distributing corporation related person.* The term *distributing corporation related person* means a person that is related to a distributing corporation within the meaning of section 267(b) or 707(b)(1) of the Code, determined immediately before the control distribution date.

(3) *DSAG*—(i) *In general.* The term *DSAG* means the separate affiliated group (as defined in section 355(b)(3)(B)) of which the distributing corporation is the common parent.

(ii) *Distributing corporation not common parent.* If the distributing corporation is not the common parent of a separate affiliated group, the term *DSAG* means the distributing corporation.

(4) *Key employee.* The term *key employee* means, with regard to a business of the DSAG or CSAG, an employee—

(i) Who possesses specialized and unique expertise with regard to that business and applies that expertise in a manner that significantly preserves or improves the strength of that business (for example, through innovation or other advancement of the business);

(ii) Whose departure would be significantly detrimental to that business; and

(iii) Who would be difficult to replace due to the attributes described in paragraph (b)(4)(i) of this section.

(5) *Option.* The term *option* means a call option, a warrant, a convertible obligation, a conversion feature of convertible stock, a put option, a redemption agreement (including the right to cause the redemption of stock), any other instrument that provides for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interest.

(6) *Qualifying retention.* The term *qualifying retention* means a retention described in paragraph (c)(2) of this section.

(7) *Retained controlled corporation stock (or securities).* The term *retained controlled corporation stock (or securities)* means the following instruments that the distributing corporation continues to hold after the first distribution date:

(i) Stock or securities in a controlled corporation or another member of the CSAG.

(ii) Options to acquire stock or securities in a controlled corporation or another member of the CSAG.

(iii) Stock or securities in a controlled corporation or another member of the CSAG acquired upon the exercise of an option.

(8) *Retention.* The term *retention* means the continued ownership of retained controlled corporation stock (or securities) by a distributing corporation after the first distribution date.

(c) *General rule*—(1) *Presumption of tax avoidance.* A retention is treated as pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax unless the retention is a qualifying retention.

(2) *Qualifying retention*—(i) *In general.* A *qualifying retention* is a retention that—

(A) Satisfies all requirements set forth in paragraphs (c)(2)(ii) and (iii) of this section; or

(B) Satisfies the requirements set forth in paragraph (c)(2)(iii) of this section and meets the safe harbor set forth in paragraph (c)(3) of this section.

(ii) *Facts-and-circumstances test.* A distributing corporation establishes to the satisfaction of the Commissioner, based on all facts and circumstances (including the extent to which the safe harbor requirements described in paragraph (c)(3) of this section are satisfied), that the requirements set forth in each of paragraphs (c)(2)(ii)(A) through (E) of this section are satisfied.

(A) The distribution resulted in a genuine separation of the DSAG and the CSAG.

(B) The retention does not allow the DSAG to retain any practical control over the CSAG.

(C) There is a sufficient corporate business purpose for the retention as of the date on which the plan of distribution or the plan of reorganization (as applicable) is adopted in accordance with § 1.355–4(c)(2) or 1.368–4(d)(2), respectively.

(D) There is a sufficient corporate business purpose for the retention at all times during the period of retention.

(E) The disposition of retained controlled corporation stock (or securities) would not result in less Federal income tax to the distributing corporation (determined based on the fair market value and adjusted basis of such stock or securities on the first distribution date) than if that retained controlled corporation stock (or securities) had been distributed in the first distribution.

(iii) *Proportionate voting requirement.* The DSAG votes any retained controlled corporation stock in proportion to the votes cast by the controlled corporation's other shareholders (other than distributing corporation related persons).

(3) *Safe harbor for rebutting tax avoidance presumption*—(i) *General rule.* A distributing corporation is considered to have met the requirements of the facts-and-circumstances test set forth in paragraph (c)(2)(ii) of this section if the distributing corporation satisfies all requirements described in paragraphs (c)(3)(ii) through (vii) of this section and either—

(A) With regard to a section 355(c) distribution, includes in its plan of distribution a description of each agreement and transaction that establishes the satisfaction of the requirements described in paragraphs (c)(3)(ii) through (vii) of this section; or

(B) With regard to a divisive reorganization, includes in its plan of reorganization a description of each agreement and transaction that establishes the satisfaction of the requirements described in paragraphs (c)(3)(ii) through (vii) of this section.

(ii) *Corporate business purpose.* The distributing corporation has a specific corporate business purpose for the retention—

(A) As of the date on which the plan of distribution or the plan of reorganization (as applicable) is adopted in accordance with § 1.355–4(c)(2) or 1.368–4(d)(2), respectively; and

(B) At all times during the period of retention.

(iii) *Controlled corporation stock is widely held.* Stock of the controlled corporation (including a successor to the controlled corporation (within the meaning of § 1.355–8(c)(2))) is widely

held during the period of retention after the first distribution date. For example, stock of the controlled corporation is considered to be widely held if it is traded on an established securities market (within the meaning of § 1.7704–1(b)).

(iv) *Overlapping officers, directors, or key employees.* No officers, directors, or key employees of a member of the DSAG serve as an officer, a director, or a key employee of a member of the CSAG during the period of retention, unless—

(A) The officer, director, or key employee of a member of the DSAG serves as an officer, a director, or a key employee of a member of the CSAG solely to accommodate the CSAG's business needs;

(B) The overlapping directors do not constitute a majority of the CSAG member's board; and

(C) The duration of the overlap for officers, directors, and key employees is for an identified, limited period of time, not in excess of two years after the first distribution date.

(v) *Continuing arrangements.* Any continuing arrangement between the distributing corporation and the controlled corporation during the period of retention—

(A) Is negotiated on, and reflects, arm's-length terms; or

(B) If the arrangement is not described in paragraph (c)(3)(v)(A) of this section, is—

(*1*) Terminated within two years after the first distribution date; or

(*2*) Renegotiated within two years after the first distribution date to reflect arm's-length terms.

(vi) *Disposition of retained controlled corporation stock (or securities).* The plan of distribution or plan of reorganization, as appropriate, reflects a definite intent in the official records of the distributing corporation that the distributing corporation will dispose of all retained controlled corporation stock (or securities) by not later than the end of the five-year period beginning on the first distribution date. For purposes of this paragraph (c)(3)(vi) and paragraph (d) of this section, the term *official records* includes a contract or other agreement to which the distributing corporation is a party, a resolution or other document authorized by the distributing corporation's board of directors, or other document filed with the SEC or other Federal regulatory agency.

(vii) *Disposition of retained controlled corporation stock does not result in less Federal income tax.* The disposition of retained controlled corporation stock (or securities) would not result in less Federal income tax to the distributing corporation (determined based on the fair market value and adjusted basis of such stock or securities on the first distribution date) than if that controlled corporation stock (or securities) had been distributed in the first distribution.

(d) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples: a distributing corporation (Distributing) is the common parent of a separate affiliated group of corporations (DSAG); the DSAG includes an existing, wholly owned controlled corporation (Controlled) with a single class of outstanding stock that is directly owned by Distributing; and the DSAG operates a banking business and a title insurance business, with Controlled operating the banking business, and the remaining DSAG members (including Distributing) operating the title insurance business.

(1) *Example 1: Not a qualifying retention*—(i) *Facts.* Distributing distributes 80 percent of Controlled's stock to Distributing's shareholders in a single distribution on a pro rata basis during Distributing's 2025 taxable year (first distribution). Distributing retains the remaining 20 percent of the Controlled stock (retention). Distributing does not evidence any definite intent in its official records to dispose of the retained Controlled stock within the five-year period beginning on the first distribution date. The directors of Distributing will serve as half of the directors of Controlled for a four-year period after the first distribution date, after which time they can seek reelection. One of Distributing's purposes for the retention is to reduce the likelihood that new minority investors could acquire a substantial ownership interest in Controlled, thereby reducing Distributing's continued effective control over Controlled. Apart from whether the retention is a qualifying retention, the distribution satisfies all requirements to qualify under section 355.

(ii) *Analysis.* The retention is treated as pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax unless the retention is a qualifying retention. *See* paragraph (c)(1) of this section. To be a qualifying retention, the retention must satisfy the requirements under either the facts-and-circumstances test set forth in paragraph (c)(2)(ii) of this section or the safe harbor set forth in paragraph (c)(3) of this section, among other requirements. *See* paragraph (c)(2)(i) of this section. Distributing does not satisfy the requirements for the safe harbor set forth in paragraph (c)(3) of this section because directors of Distributing will serve as directors of Controlled for a period that is not limited to two years after the first distribution date, and Distributing does not evidence any definite intent in its official records to dispose of the retained Controlled stock within the five-year period beginning on the first distribution date. *See* paragraphs (c)(3)(iv) and (vi) of this section. Distributing also fails the facts-and-circumstances test set forth in paragraph (c)(2)(ii) of this section because the control distribution does not result in a genuine separation, Distributing retains practical control over Controlled, and there is not a sufficient corporate business purpose for the retention. *See* paragraphs (c)(2)(ii)(A) through (D) of this section. Accordingly, Distributing's retention is not a qualifying retention. Consequently, the first distribution (and any subsequent distribution of Controlled stock) does not qualify under section 355. *See* paragraphs (a) and (c)(1) of this section and § 1.355–2(e)(2)(iii).

(2) *Example 2: Safe harbor*—(i) *Facts.* Distributing distributes 95 percent of Controlled's stock to Distributing's shareholders in a single distribution on a pro rata basis during Distributing's 2025 taxable year (first distribution) and retains 5 percent of Controlled stock (retention). The corporate business purpose for the retention, as of the date on which the plan of distribution is adopted in accordance with § 1.355–4(c)(2) and throughout the period of retention, is to enable Distributing to have assets of sufficient value (which otherwise would not be available absent the retention) to serve as collateral for needed short-term financing for Distributing's remaining business enterprise. The stock of Controlled is traded on an established securities market (within the meaning of § 1.7704–1(b)) throughout the period of retention. The plan of distribution reflects a definite intent in the official records of Distributing that Distributing will dispose of the retained Controlled stock within five years after the first distribution date. No officers, directors, or key employees of a member of the DSAG will serve as an officer, a director, or a key employee of a member of the CSAG during the period of retention. Any continuing arrangements between Distributing and Controlled during the period of retention either are negotiated on arm's-length terms or will terminate within two years after the first distribution date. The disposition of retained Controlled stock will not result in less Federal income tax to

Distributing (determined based on the fair market value and adjusted basis of such stock on the first distribution date) than if that Controlled stock had been distributed in the first distribution. The plan of distribution describes each of the foregoing agreements and transactions. Apart from whether the retention is a qualifying retention, the distribution satisfies all requirements to qualify under section 355.

(ii) *Analysis.* Distributing satisfies all requirements for the safe harbor set forth in paragraph (c)(3) of this section. However, to have a qualifying retention, Distributing also must meet the requirement set forth in paragraph (c)(2)(iii) of this section. *See* paragraph (c)(2)(i)(B) of this section.

(3) *Example 3: Overlapping directors*—(i) *Facts.* The facts are the same as in paragraph (d)(2)(i) of this section (*Example 2*), except that directors of Distributing that are recognized as experts in the banking industry will serve as two of the six directors of Controlled after the first distribution date. Their presence on the Controlled board is intended to reassure the financial markets by providing a sense of continuity. Their terms will expire after two years, at which point they cannot seek reelection during the period of retention.

(ii) *Analysis.* The two directors of Distributing that will serve as directors of Controlled do so solely to accommodate Controlled's business needs, do not constitute a majority of Controlled's board, and will not serve as directors of Controlled's board for more than two years after the first distribution date. *See* paragraph (c)(3)(iv) of this section. Accordingly, Distributing satisfies all requirements for the safe harbor set forth in paragraph (c)(3) of this section. However, to have a qualifying retention, Distributing also must meet the requirement set forth in paragraph (c)(2)(iii) of this section. *See* paragraph (c)(2)(i)(B) of this section.

(iii) *Ability to seek reelection during retention period.* The facts are the same as in paragraph (d)(3)(i) of this section (*Example 3*), except that the two directors of Distributing that will serve as directors of Controlled after the first distribution date may seek reelection after their two-year term expires. Distributing does not satisfy all requirements for the safe harbor set forth in paragraph (c)(3) of this section. *See* paragraph (c)(3)(iv)(C) of this section.

(4) *Example 4: Safe harbor is not met but facts-and-circumstances test is met*—(i) *Facts.* The facts are the same as in paragraph (d)(2)(i) of this section (*Example 2*), except that Distributing must retain the Controlled stock (to meet collateral requirements) for at least six years after the first distribution date, as reflected in the plan of distribution and the official records of Distributing.

(ii) *Analysis*—(A) *Safe harbor requirements not satisfied.* Distributing's retention of Controlled stock does not qualify for the safe harbor set forth in paragraph (c)(3) of this section because the plan of distribution does not reflect a definite intent in the official records of Distributing that Distributing will dispose of all retained Controlled stock within five years of the first distribution date. *See* paragraph (c)(3)(vi) of this section.

(B) *Facts-and-circumstances test satisfied.* The facts-and-circumstances test set forth in paragraph (c)(2)(ii) of this section is satisfied because the control distribution results in a genuine separation of Distributing and Controlled, the retention does not allow Distributing to retain any practical control over Controlled, there is a sufficient corporate business purpose for the retention as of the date on which the plan of distribution is adopted in accordance with § 1.355–4(c)(2), there is a sufficient corporate business purpose for the retention at all times during the period of retention, and the disposition of the retained Controlled stock will not result in less Federal income tax to Distributing than if Distributing had distributed the Controlled stock in the first distribution. Accordingly, provided Distributing also meets the requirement set forth in paragraph (c)(2)(iii) of this section, the retention is a qualifying retention under paragraph (c)(2)(i)(A) of this section.

(5) *Example 5: Not a qualifying retention*—(i) *Facts.* The facts are the same as in paragraph (d)(2)(i) of this section (*Example 2*), except that Distributing owns multiple blocks of Controlled stock and the shares of retained Controlled stock are specifically designated for retention because the adjusted basis of that stock exceeds its fair market value as of the first distribution date. Distributing subsequently sells the retained Controlled stock in a transaction in which Distributing recognizes a loss for Federal income tax purposes.

(ii) *Analysis.* The retention is treated as pursuant to a plan having as one of its principal purposes the avoidance of Federal income tax unless the retention is a qualifying retention. *See* paragraph (c)(1) of this section. Distributing does not satisfy the requirements for the safe harbor set forth in paragraph (c)(3) of this section, because the disposition of the retained Controlled stock results in less Federal income tax to Distributing than if that Controlled stock had been distributed in the first distribution. *See* paragraph (c)(3)(vii) of this section. For the same reason, the retention does not satisfy the facts-and-circumstances test set forth in paragraph (c)(2)(ii) of this section. *See* paragraph (c)(2)(ii)(E) of this section. Accordingly, the retention is not a qualifying retention. *See* paragraph (c)(2)(i) of this section. Consequently, the distribution does not qualify under section 355. *See* paragraphs (a) and (c)(1) of this section and § 1.355–2(e)(2)(iii).

■ **Par. 7.** Section 1.357–0 is added to read as follows:

§ 1.357–0 Table of contents.

This section lists the major captions that appear in §§ 1.357–1 through 1.357–5.

§ 1.357–1 Assumption of liability.

(a) Overview.
(b) Definitions.
(1) Code.
(2) Commissioner.
(3) Contingent liability.
(4) Controlled corporation.
(5) CSAG.
(i) In general.
(ii) Controlled corporation not a common parent.
(6) Debt.
(7) Distributing corporation.
(8) Distributing corporation debt.
(i) In general.
(ii) Section 381(a) transactions.
(9) Distributing corporation liability.
(10) Divisive reorganization.
(11) DSAG.
(i) In general.
(ii) Distributing corporation not a common parent.
(12) Earliest applicable date.
(i) In general.
(ii) Similar transaction.
(13) Historical distributing corporation debt.
(14) IRS.
(15) Liability.
(i) In general.
(ii) Certain obligations incurred in the ordinary course of business.
(16) Plan of reorganization.
(17) Refinanced distributing corporation debt.
(18) Section 357 regulations.
(19) Trade payable.
(20) Transferee corporation.
(21) Transferor.
(22) Traveling note.

§ 1.357–2 Application of section 357(a).

(a) In general.
(b) Amount realized.
(c) Treatment of traveling notes.
(d) Determination of amount of liability assumed.
(1) In general.
(i) Recourse liability.
(ii) Nonrecourse liability.
(2) [Reserved]
(e) Dominion or control over payment of assumed liability.

(1) General rule.
(2) Dominion or control.
(i) In general.
(ii) Segregated account; related person.
(iii) No legal or practical dominion or control.
(f) Examples.
(1) Example 1: Application of general rule.
(2) Example 2: Dominion or control.
(3) Example 3: Exception to dominion or control.

§ 1.357–3 Application of section 357(b).

(a) Principal purpose standard.
(1) General rule.
(2) Ordinary course of business requirement.
(b) Amount of gain recognized.
(c) Burden of proof.
(d) Eligible distributing corporation liabilities.
(1) Scope.
(2) In general.
(3) Eligible assumptions of Distributing corporation liabilities.
(4) Distributing corporation debt.
(i) In general.
(ii) Exceptions.
(e) Examples.
(1) Example 1: Application of general rule.
(2) Example 2: Refinanced distributing corporation debt.
(3) Example 3: Traveling note.
(4) Example 4: Trade payables.
(5) Example 5: Assumption to avoid Federal income tax in a divisive reorganization.
(6) Example 6: Assumption to avoid Federal income tax in a section 351 exchange.

§ 1.357–4 Application of section 357(c).

(a) Liabilities in excess of adjusted basis.
(1) General rule.
(2) Exceptions.
(3) Certain liabilities excluded.
(i) General rule.
(ii) Exceptions.
(b) Determination of character of gain of multiple capital assets.
(c) Examples.
(1) Example 1: Determination of character of gain.
(2) Example 2: Capital and non-capital assets.
(3) Example 3: Liabilities in excess of adjusted basis.

§ 1.357–5 Applicability date.

(a) Applicability date.

■ **Par. 8.** Section 1.357–1 is revised to read as follows:

§ 1.357–1 Assumption of liability.

(a) *Overview.* The section 357 regulations apply to the assumption by a transferee corporation of a liability of a transferor pursuant to an exchange between the transferor and the transferee corporation in a transaction qualifying under section 351 of the Code (relating to a transfer of property to a corporation controlled by the transferor) or section 361 of the Code (relating to the nonrecognition of gain or loss to a corporation upon the exchange of property pursuant to a plan of reorganization).

(b) *Definitions.* The following definitions apply for purposes of the section 357 regulations:

(1) *Code.* The term *Code* means the Internal Revenue Code of 1986, as amended.

(2) *Commissioner.* The term *Commissioner* means the Commissioner of Internal Revenue.

(3) *Contingent liability.* The term *contingent liability* means a liability (other than a debt) that includes one or more contingent payments.

(4) *Controlled corporation.* The term *controlled corporation* means the controlled corporation described in section 355(a)(1)(A) of the Code.

(5) *CSAG*—(i) *In general.* Except as provided in paragraph (b)(5)(ii) of this section, the term *CSAG* means the separate affiliated group (as defined in section 355(b)(3)(B)) of which a controlled corporation is the common parent.

(ii) *Controlled corporation not a common parent.* If the controlled corporation is not the common parent of a separate affiliated group, the term *CSAG* refers to the controlled corporation.

(6) *Debt.* The term *debt* means a liability pursuant to an instrument or a contractual arrangement that constitutes debt under general principles of Federal income tax law. *See* § 1.1275–1(d).

(7) *Distributing corporation.* The term *distributing corporation* means the distributing corporation described in section 355(a)(1)(A).

(8) *Distributing corporation debt*—(i) *In general.* The term *distributing corporation debt* means debt for which the distributing corporation is the obligor.

(ii) *Section 381(a) transactions.* The term *distributing corporation debt* includes a debt that satisfies both of the following requirements:

(A) The distributing corporation assumed the debt in a transaction to which section 381(a) of the Code applies; and

(B) The debt assumed in the transaction was incurred prior to the earliest applicable date.

(9) *Distributing corporation liability.* The term *distributing corporation liability* means a liability for which the distributing corporation is the obligor.

(10) *Divisive reorganization.* The term *divisive reorganization* means a series of transactions carried out pursuant to a plan of reorganization that qualify as a reorganization described in sections 355 and 368(a)(1)(D) or (G) of the Code.

(11) *DSAG*—(i) *In general.* Except as provided in paragraph (b)(11)(ii) of this section, the term *DSAG* means the separate affiliated group (as defined in section 355(b)(3)(B)) of which the distributing corporation is the common parent.

(ii) *Distributing corporation not a common parent.* If the distributing corporation is not the common parent of a separate affiliated group, the term *DSAG* means the distributing corporation.

(12) *Earliest applicable date*—(i) *In general.* The term *earliest applicable date* means the date that is the earliest of—

(A) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the divisive reorganization or a similar transaction;

(B) The date of entry by the distributing corporation into a written agreement to engage in the divisive reorganization or a similar transaction; and

(C) The date of approval of the divisive reorganization or a similar transaction by the board of directors of the distributing corporation.

(ii) *Similar transaction.* For purposes of paragraph (b)(12)(i) of this section, the term *similar transaction* means a similar acquisition within the meaning of § 1.355–7(h)(12) and (13).

(13) *Historical distributing corporation debt.* The term *historical distributing corporation debt* means a debt of the distributing corporation that was in existence as of the earliest applicable date, has an original term that ends after the date of the exchange described in § 1.361–2(a) or 1.361–3(a), and is identified in the plan of reorganization or original plan of reorganization (if amended).

(14) *IRS.* The term *IRS* means the Internal Revenue Service.

(15) *Liability*—(i) *In general.* The term *liability* means a debt, a contingent liability, or any other fixed or contingent obligation, without regard to whether the obligation otherwise has been taken into account for Federal income tax purposes.

(ii) *Certain obligations incurred in the ordinary course of business*—(A) *In general.* Except as provided in paragraph (b)(15)(ii)(B) of this section, an obligation incurred in the ordinary course of business pursuant to a bilateral contract is not a liability.

(B) *Exception regarding financial statements.* An obligation described in paragraph (b)(15)(ii)(A) of this section is a liability, in whole or in part, to the extent the obligation is reflected in one or more financial statements of the obligor as a liability, reserve, or similar item.

(16) *Plan of reorganization.* The term *plan of reorganization* has the meaning provided in § 1.368–4.

(17) *Refinanced distributing corporation debt.* The term *refinanced distributing corporation debt* means debt of a distributing corporation—

(i) That is incurred on or after the earliest applicable date; and

(ii) The proceeds of which are used to satisfy a historical distributing corporation debt.

(18) *Section 357 regulations.* The term *section 357 regulations* means this section and §§ 1.357–2 through 1.357–5.

(19) *Trade payable.* The term *trade payable* means debt arising in the ordinary course of a business from sales, leases, licenses, or the rendition of services provided to or for the distributing corporation.

(20) *Transferee corporation.* The term *transferee corporation* means a corporation to which property is transferred pursuant to an exchange described in section 351 or 361.

(21) *Transferor.* The term *transferor* means the person that transfers property to a transferee corporation pursuant to an exchange described in section 351 or 361.

(22) *Traveling note.* The term *traveling note* means, with regard to an exchange described in section 351 or 361, a debt of the transferor that converts, pursuant to its terms, into a debt of the transferee corporation.

■ **Par. 9.** Section 1.357–2 is revised to read as follows:

§ 1.357–2 Application of section 357(a).

(a) *In general.* Except as provided in §§ 1.357–3 and 1.357–4, and subject to the requirements set forth in paragraph (e) of this section, the assumption by a transferee corporation of a liability of a transferor will not be treated as money or other property received by the transferor, and will not prevent an exchange between the transferee corporation and the transferor from being within the provisions of section 351 or 361 of the Code, if—

(1) The transferor receives property that would be permitted to be received under section 351 or 361 without the recognition of gain to the transferor if that property were the sole consideration received by the transferor; and

(2) As part of the consideration, the transferee corporation assumes a liability of the transferor.

(b) *Amount realized.* Neither section 357(a) of the Code nor this section precludes any liability of a transferor that is assumed by a transferee corporation from being taken into account for purposes of computing the amount of gain or loss realized to the transferor under section 1001 of the Code resulting from the exchange between the transferor and the transferee corporation.

(c) *Treatment of traveling notes.* A transferee corporation is treated as assuming a traveling note with respect to which the transferor is the debtor at the time at which the debtor on the traveling note converts from the transferor to the transferee corporation under the terms of the note.

(d) *Determination of amount of liability assumed*—(1) *In general.* For purposes of this section and §§ 1.357–3, 1.357–4, 1.358–3, 1.358–5, 1.358–7, 1.361–3(c)(2), and 1.368–2(d), the rules of this paragraph (d) apply in determining the amount of liabilities assumed by a transferee corporation.

(i) *Recourse liability.* A recourse liability (or portion thereof) of a transferor is treated as having been assumed by the transferee corporation if, as determined based on all facts and circumstances, the transferee corporation has agreed to, and is expected to, satisfy or indemnify the transferor for the liability (or portion thereof), whether or not the transferor has been relieved of the liability (or portion thereof).

(ii) *Nonrecourse liability*—(A) *In general.* A nonrecourse liability of a transferor is treated as having been assumed by the transferee corporation to which any asset subject to that liability is transferred.

(B) *Limitation on amount of nonrecourse liability treated as assumed.* The amount of any nonrecourse liability of a transferor treated as assumed under paragraph (d)(1)(ii)(A) of this section is reduced by the lesser of—

(*1*) The amount of that liability that an owner of other assets not transferred to the transferee corporation and also subject to that liability has agreed with the transferee corporation to, and is expected to, satisfy; or

(*2*) The fair market value of the assets described in paragraph (d)(1)(ii)(B)(*1*) of this section (determined without regard to section 7701(g) of the Code).

(2) [Reserved]

(e) *Dominion or control over payment of assumed liability*—(1) *General rule.* If the transferee corporation (or, in the case of a divisive reorganization, a member of the CSAG) makes a payment to satisfy an assumed liability that results in the transferor (or, in the case of a divisive reorganization, a member of the DSAG) having legal or practical dominion or control over any part of the payment—

(i) That part of the payment is treated as money or other property received by the transferor;

(ii) The rules in section 351(b) or 361(b) (as applicable) apply to determine the Federal income tax consequences of the receipt by the transferor of the money or other property; and

(iii) The rules in this section and §§ 1.357–3 and 1.357–4 do not apply (that is, the Federal income tax consequences of the payment are not determined under section 357).

(2) *Dominion or control*—(i) *In general.* Except as provided in paragraph (e)(2)(ii) or (iii) of this section, the determination of whether a payment is within a transferor's legal or practical dominion or control is made based on all facts and circumstances.

(ii) *Segregated account; related person.* For purposes of this paragraph (e), a payment is treated as within a transferor's legal or practical dominion or control if made to a segregated account of the transferor (or, in the case of a divisive reorganization, a member of the DSAG) or any person through which the transferor (or, in the case of a divisive reorganization, a member of the DSAG) can direct the treatment or disposition of the payment, regardless of the brevity or transitory nature of the period in which the payment is in such an account.

(iii) *No legal or practical dominion or control.* For purposes of this paragraph (e), a payment is treated as not within the legal or practical dominion or control of a transferor if all conditions set forth in paragraph (e)(2)(iii)(A) or (B) of this section (as appropriate) are satisfied.

(A) *Indemnification agreements.* For payments made pursuant to an indemnification agreement:

(*1*) The transferee corporation is legally prohibited from assuming the liability (for example, because the transferor is prohibited from causing any other person to assume the liability).

(*2*) The indemnification agreement requires the transferor to first satisfy the obligation that is the subject of the indemnification agreement before the transferor is permitted to receive payment from the transferee corporation.

(*3*) The transferor is in the same net economic position it would have been in if the transferee corporation legally were allowed to assume the liability.

(B) *Other payments.* For any payment not made pursuant to an indemnification agreement:

(*1*) The payment is dedicated to the satisfaction of a liability of the transferor

identified in an agreement or the plan of reorganization.

(*2*) The payment is made to an independent trustee or escrow agent that is not affiliated with the transferor.

(*3*) The payment is not made to any account of the transferor (or, in the case of a divisive reorganization, a member of the DSAG) or any person through which the transferor (or, in the case of a divisive reorganization, a member of the DSAG) could direct the payment.

(*4*) The transferor and the transferee corporation treat any income, gain, or loss on the payment proceeds as income, gain, or loss to the transferee corporation.

(*5*) Any excess of the payment amount (and any income or gain thereon) over the amount paid to satisfy the liability reverts to the transferee corporation.

(f) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples: the principal purpose of the transferor with respect to the assumption of liabilities is not to avoid Federal income tax on the exchange; there is a bona fide business purpose for the assumption of liabilities; the amount of liabilities assumed by the transferee corporation does not exceed the adjusted basis of the assets transferred to the transferee corporation in the exchange; and any liability assumption is provided for in an agreement or a plan of reorganization entered into between the transferor and the transferee corporation before the date of the exchange.

(1) *Example 1: Application of general rule*—(i) *Facts.* In an exchange that qualifies under section 351, Individual A transfers to a transferee corporation property with an adjusted basis of $10,000x in exchange for stock of the corporation with a fair market value of $8,000x, money amounting to $3,000x, and the assumption by the corporation of a liability of Individual A amounting to $4,000x.

(ii) *Analysis.* Individual A's realized gain is $5,000x, computed as follows:

TABLE 1 TO PARAGRAPH (f)(1)(ii)

Stock received, fair market value	$8,000x
Money received	3,000x
Liability assumed by transferee corporation	4,000x
Total consideration received	15,000x
Less: Adjusted basis of property transferred	10,000x
Gain realized	5,000x

The gain recognized to Individual A is limited to the $3,000x of money received, because the assumption of the $4,000x liability does not constitute money or other property. *See* paragraph (a) of this section and section 351(b).

(2) *Example 2: Dominion or control*—(i) *Facts.* A distributing corporation (Distributing) transfers one of its businesses to a newly formed controlled corporation (Controlled) in exchange for Controlled stock (contribution). Distributing distributes all the Controlled stock to its shareholders (distribution; together with the contribution, the separation). As part of the contribution, Controlled agrees to assume a contingent liability of Distributing. The separation satisfies all requirements to qualify as a divisive reorganization. In a taxable year following the year of the distribution, the contingent liability becomes fixed and determinable. To satisfy the liability, Controlled makes a $200x payment to a segregated account maintained by Distributing, and Distributing uses the $200x in the segregated account to make payment to the obligee.

(ii) *Analysis.* Distributing is treated as having dominion or control over the $200x payment despite its receipt of the payment in a segregated account. *See* paragraphs (e)(2)(i) and (ii) of this section. Accordingly, the $200x payment is treated as money received by Distributing in the contribution, and the rules in section 361(b) apply. *See* paragraph (e)(1) of this section.

(3) *Example 3: Exception to dominion or control*—(i) *Facts.* The facts are the same as in paragraph (f)(2)(i) of this section (*Example 2*), except that, as part of the contribution, Distributing and Controlled enter into an indemnity agreement with respect to a contingent liability of Distributing that Controlled cannot assume in form under State law. Pursuant to the indemnity agreement, Distributing remains the primary obligor for State law purposes, but Controlled must reimburse Distributing for any payment that Distributing is required to make to satisfy the contingent liability. The indemnity agreement is treated as an assumption by Controlled of the contingent liability under paragraph (d) of this section. In a taxable year following the year of the distribution, the contingent liability becomes fixed and determinable, and Distributing makes a $200x payment to the obligee to satisfy the liability. Pursuant to the terms of the indemnity agreement, Controlled transfers to Distributing $200x, which Distributing retains. The $200x payment from Controlled to Distributing places Distributing in the same net economic position it would have been in if Controlled were allowed to assume the contingent liability under State law.

(ii) *Analysis.* For purposes of paragraph (e)(1) of this section, Distributing is treated as not having dominion or control over the $200x payment despite its receipt of the payment. *See* paragraph (e)(2)(iii)(A) of this section. Accordingly, the $200x payment is not treated as money received by Distributing in the contribution. *See* paragraph (a) of this section.

■ **Par. 10.** Sections 1.357–3 through 1.357–5 are added to read as follows:

§ 1.357–3 Application of section 357(b).

(a) *Principal purpose standard*—(1) *General rule.* Section 1.357–2(a) does not apply to any exchange involving the assumption by a transferee corporation of a liability of a transferor if the principal purpose of the transferor with respect to that assumption is either—

(i) To avoid Federal income tax on the exchange; or

(ii) Not a bona fide business purpose.

(2) *Ordinary course of business requirement.* With regard to an assumption by a transferee corporation of a liability described in paragraph (a)(1) of this section, a principal purpose is presumed to exist if the liability was not incurred in the ordinary course of a business of the transferor.

(b) *Amount of gain recognized.* For purposes of determining the amount of gain recognized upon an exchange described in paragraph (a) of this section, the total amount of liabilities assumed or acquired pursuant to that exchange (and not merely a particular liability with respect to which the tax avoidance or non-business purpose existed) is treated as money or other property received by the transferor under section 351(b) or 361(b) (as applicable) of the Code upon the exchange.

(c) *Burden of proof.* If the Commissioner determines that the transferor's principal purpose with respect to the assumption of a liability by a transferee corporation was to avoid Federal income tax on the exchange or was not a bona fide business purpose, and if the transferor contests that determination, the burden is on the transferor to prove by a clear preponderance of the evidence that the liability assumption should not be treated as the receipt of money or other property. Therefore, the transferor must prove by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

(d) *Eligible distributing corporation liabilities*—(1) *Scope.* The rules of this

paragraph (d) apply solely to divisive reorganizations.

(2) *In general.* A distributing corporation is presumed to have the principal purpose described in paragraph (a) of this section (and, as a result, is presumed to be treated as recognizing an amount of gain determined under paragraph (b) of this section) if the controlled corporation assumes a distributing corporation liability that is not eligible to be assumed under paragraph (d)(3) of this section.

(3) *Eligible assumptions of Distributing corporation liabilities.* Distributing corporation liabilities are eligible to be assumed under § 1.357–2(a) in a divisive reorganization if—

(i) The distributing corporation liabilities to be assumed are described in a plan of reorganization or original plan of reorganization (if amended);

(ii) The distributing corporation liabilities were incurred in the ordinary course of business of the distributing corporation; and

(iii) The assumption of such distributing corporation liabilities is necessary—

(A) To ensure the transfer to the controlled corporation of all liabilities properly associated with the business assets transferred to that corporation; and

(B) To result in the controlled corporation assuming liabilities in an amount that properly relates to its business operations, the earnings of which will be used to properly satisfy those liabilities.

(4) *Distributing corporation debt*—(i) *In general.* Except as provided in paragraph (d)(4)(ii) of this section, distributing corporation debt eligible to be assumed under paragraph (d)(3) of this section must qualify as historical distributing corporation debt.

(ii) *Exceptions.* The following exceptions apply to the general rule in paragraph (d)(4)(i) of this section:

(A) *Qualifying trade payables.* For purposes of paragraph (d)(4)(i) of this section, solely trade payables of the distributing corporation that meet the requirements set forth in paragraph (d)(3) of this section are not required to qualify as historical distributing corporation debt.

(B) *Assumptions of refinanced distributing corporation debt.* For purposes of paragraph (d)(4)(i) of this section, refinanced distributing corporation debt is treated as historical distributing corporation debt if all the following requirements are met:

(*1*) The distributing corporation has a direct business purpose for the controlled corporation's assumption of the refinanced distributing corporation debt. For purposes of this paragraph (d)(4)(ii)(B)(*1*), the modification of the capital structure of the distributing corporation or the controlled corporation is not a direct business purpose unless that modification directly accomplishes a corporate business purpose of the distributing corporation.

(*2*) The distributing corporation's refinancing of its historical distributing corporation debt is completed before the controlled corporation's assumption of that refinanced distributing corporation debt.

(*3*) Following the controlled corporation's assumption of the refinanced distributing corporation debt, the distributing corporation and the controlled corporation are in the same net economic position as each corporation would have been had the controlled corporation assumed the historical distributing corporation debt.

(*4*) The distributing corporation's refinancing of its historical distributing corporation debt and the subsequent assumption of that refinanced distributing corporation debt are included in the plan of reorganization for the divisive reorganization.

(*5*) There is no untaxed gain or other Federal income tax benefit resulting to the distributing corporation or the controlled corporation from the distributing corporation's refinancing of a historical distributing corporation debt and the assumption by the controlled corporation of that refinanced distributing corporation debt.

(*6*) The business assets transferred by the distributing corporation to the controlled corporation in the exchange described in section 361(a) are associated with the refinanced distributing corporation debt assumed by the controlled corporation.

(*7*) The refinancing of a historical distributing corporation debt by the distributing corporation and the subsequent assumption of that refinanced distributing corporation debt by the controlled corporation result in the controlled corporation assuming liabilities in an amount that properly relates to its business operations and will be properly satisfied with earnings generated by those operations.

(C) *Qualifying assumption of a traveling note.* For purposes of paragraph (d)(4)(i) of this section, a controlled corporation's assumption of a traveling note (within the meaning of § 1.357–2(c)) issued to refinance a historical distributing corporation debt will be treated as historical distributing corporation debt only if all requirements set forth in paragraph (d)(4)(ii)(B) of this section are satisfied.

(D) *Revolving credit agreements.* For purposes of paragraph (d)(4)(i) of this section, a revolving credit agreement to which the distributing corporation is a debtor qualifies as historical distributing corporation debt only if—

(*1*) The distributing corporation entered into the agreement before the earliest applicable date;

(*2*) That agreement does not expire until after the date of the exchange described in § 1.361–2(a) or 1.361–3(a); and

(*3*) That agreement is identified in the plan of reorganization or original plan of reorganization (if amended).

(e) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples: any liability assumption is provided for in an agreement or a plan of reorganization entered into between the transferor and transferee corporation before the date of the exchange; and the amount of liabilities assumed by the transferee corporation does not exceed the adjusted basis of the assets transferred to the transferee corporation in the exchange.

(1) *Example 1: Application of general rule*—(i) *Facts.* In an exchange that qualifies under section 351, Individual A transfers to a transferee corporation property with an adjusted basis of $10,000x in exchange for stock of the corporation with a fair market value of $8,000x, money amounting to $3,000x, and the assumption by the corporation of debt of Individual A amounting to $4,000x. Individual A's principal purpose for causing the transferee corporation to assume the $4,000x liability is to avoid Federal income tax on the exchange.

(ii) *Analysis.* Individual A's realized gain is $5,000x, computed as follows:

TABLE 1 TO PARAGRAPH (e)(1)(ii)

Stock received, fair market value	$8,000x
Money received	3,000x
Liability assumed by transferee corporation	4,000x
Total consideration received	15,000x
Less: Adjusted basis of property transferred	10,000x
Gain realized	5,000x

Because Individual A's principal purpose for the assumption of the $4,000x liability is to avoid Federal income tax on the exchange, the amount of gain recognized is $5,000x. *See* paragraphs (a) and (b) of this section and section 351(b).

(2) *Example 2: Refinanced distributing corporation debt*—(i)

Facts—(A) In general. A distributing corporation (Distributing) transfers one of its businesses to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and Controlled's assumption of liabilities of Distributing (contribution). Distributing distributes all the Controlled stock to its shareholders (distribution; together with the contribution, the separation). The separation satisfies all requirements to qualify as a divisive reorganization.

(B) *Refinanced debt.* One liability that Distributing intended Controlled to assume in the contribution is a $4,000x portion of a $25,000x historical Distributing debt to a creditor that Distributing incurred in connection with the transferred business. However, Distributing is unable to apportion this historical debt with Controlled because the creditor refuses to relieve Distributing of its primary liability for repayment of the debt. Therefore, unless Distributing refinances that portion of its historical debt, Distributing will be unable to have Controlled assume an amount of existing historical debt that properly relates to, and to have that debt properly be satisfied with earnings from, the transferred business. Accordingly, pursuant to the plan of reorganization for the separation, Distributing obtains from a bank a new long-term $4,000x loan on which Distributing is primarily liable (New Loan), Distributing uses the proceeds from the New Loan to repay $4,000x of the $25,000x historical debt, Controlled then assumes the New Loan in the contribution (Controlled refinanced debt assumption), and the bank relieves Distributing of its primary liability for repayment of the New Loan.

(ii) *Analysis.* The Controlled refinanced debt assumption satisfies all requirements set forth in paragraph (d)(4)(ii)(B) of this section and, therefore, is treated under paragraph (d)(3) of this section as an eligible assumption by Controlled to which § 1.357–2(a) applies. Distributing has a direct business purpose for Controlled's assumption of the New Loan. *See* paragraph (d)(4)(ii)(B)(*1*) of this section. Distributing's refinancing of its historical debt is completed before Controlled's assumption of the New Loan. *See* paragraph (d)(4)(ii)(B)(*2*) of this section. Following the Controlled refinanced debt assumption, Distributing and Controlled are in the same net economic position as they would have been had Controlled assumed an equivalent portion of Distributing's historical debt. *See* paragraph (d)(4)(ii)(B)(*3*) of this section. Distributing's refinancing of historical debt and the Controlled refinanced debt assumption occur pursuant to the plan of reorganization for the separation. *See* paragraph (d)(4)(ii)(B)(*4*) of this section. No untaxed gain or other Federal income tax benefit results to Distributing or Controlled from Distributing's refinancing of historical Distributing debt and the Controlled refinanced debt assumption. *See* paragraph (d)(4)(ii)(B)(*5*) of this section. The business assets transferred by Distributing to Controlled in the section 361 exchange are associated with the New Loan. *See* paragraph (d)(4)(ii)(B)(*6*) of this section. Lastly, the Distributing refinancing of historical debt and the Controlled refinanced debt assumption result in Controlled assuming liabilities in an amount that properly relates to, and that properly will be satisfied with earnings generated by, its business operations. *See* paragraph (d)(4)(ii)(B)(*7*) of this section.

(3) *Example 3: Traveling note*—(i) *Facts.* The facts are the same as in paragraph (e)(2)(i) of this section (*Example 2*), except that, pursuant to the terms of the New Loan, Controlled replaces Distributing as the debtor on the New Loan upon the contribution.

(ii) *Analysis.* The New Loan is treated as a traveling note. *See* § 1.357–1(b)(22). Therefore, Controlled is treated as assuming the New Loan at the time Controlled becomes the debtor on the New Loan (that is, upon the contribution). *See* § 1.357–2(c). The analysis is the same as in paragraph (e)(2)(ii) of this section (*Example 2*).

(4) *Example 4: Trade payables*—(i) *Facts*—(A) *In general.* Pursuant to a plan of reorganization, a distributing corporation (Distributing) transfers one of its two operating divisions (Business B) to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and the assumption of $20,000x of Distributing liabilities (contribution), and Distributing distributes all the Controlled stock to its shareholders on a pro rata basis (distribution; together with the contribution, the separation). The separation satisfies all requirements to qualify as a divisive reorganization.

(B) *Liabilities assumed.* The $20,000x of liabilities assumed by Controlled arose in the ordinary course of Business B's operations from the rendition of services to or for Distributing. The liabilities were incurred after the earliest applicable date, but before the contribution date identified in the plan of reorganization for the separation. The assumption of those liabilities is necessary to ensure the transfer to Controlled of all liabilities properly associated with Business B and to result in Controlled assuming an amount of Distributing liabilities that properly relates to, and that will be properly satisfied with earnings from, Business B.

(ii) *Analysis.* The $20,000x of liabilities assumed by Controlled are trade payables because they constitute debt that arose in the ordinary course of Business B's operations from the rendition of services to or for Distributing. *See* § 1.357–1(b)(19). Accordingly, these liabilities are not required to qualify as historical distributing corporation debt to be eligible for assumption by Controlled. *See* paragraph (d)(4)(ii)(A) of this section. Consequently, all $20,000x of trade payables are eligible to be assumed by Controlled under paragraph (d)(3) of this section. *See* paragraph (d)(4)(i) of this section. Therefore, Distributing is not treated as having the principal purpose described in paragraph (a)(1) of this section for Controlled's assumption of the $20,000x of liabilities, and, consequently, those liabilities are not treated as money received by Distributing in the contribution. *See* paragraphs (a) and (d)(2) of this section.

(5) *Example 5: Assumption to avoid Federal income tax in a divisive reorganization*—(i) *Facts.* A distributing corporation (Distributing) transfers one of its businesses (Business A) to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and Controlled's assumption of historical Distributing debt (contribution). The historical Distributing debt consists of two loans (Loan 1 and Loan 2) that were incurred by Distributing prior to the earliest applicable date and have an original term that ends after the date of the contribution. Loan 1 was incurred in the ordinary course of business and is associated with Business A. Loan 2 was not incurred in the ordinary course of business and is not associated with Business A. Distributing distributes all the Controlled stock to its shareholders (distribution; together with the contribution, the separation). The separation satisfies all requirements to qualify as a divisive reorganization.

(ii) *Analysis.* Because Loan 2 was not incurred in the ordinary course of business and the assumption of that debt is not necessary to ensure the transfer to Controlled of all liabilities properly associated with Business A, Loan 2 is presumed to have been assumed for a principal purpose described in paragraph (a) of this section. *See* paragraphs (d)(2) and (3) of this section. Accordingly, Controlled's assumption of the historical Distributing debt (that is, both Loan 1 and Loan 2) is presumed to be treated as money received by Distributing in the

exchange. *See* paragraphs (a) and (b) of this section and § 1.357–2(a). However, Distributing would recognize no gain on the exchange if, pursuant to the plan of reorganization, Distributing distributes to its shareholders an amount of money equivalent to the amount it is treated as having received in the contribution or transfers an equivalent amount of money to its creditors in satisfaction of Distributing debt in a distribution or transfer meeting the requirements set forth in § 1.361–3(b)(2).

(6) *Example 6: Assumption to avoid Federal income tax in a section 351 exchange*—(i) *Facts.* In a transaction that qualifies as a section 351 exchange, Corporation A contributes one of its two businesses to newly formed Corporation B in exchange for all of B's stock and B's assumption of liabilities of A. One of the liabilities assumed by B was not incurred in the ordinary course of A's business.

(ii) *Analysis.* Because the liability assumed by B was not incurred in the ordinary course of business, the liability is presumed to have been assumed for a principal purpose described in paragraph (a)(1) of this section. *See* paragraph (a)(2) of this section. Accordingly, B's assumption of liabilities is presumed to be treated as money received by A on the exchange. For purposes of determining the amount of gain A recognizes on the exchange under section 351(b), the total amount of liabilities assumed by B would be treated as money received by A. *See* paragraph (b) of this section.

§ 1.357–4 Application of section 357(c).

(a) *Liabilities in excess of adjusted basis*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, in an exchange to which section 351 of the Code is applicable, or to which section 361 of the Code is applicable by reason of a divisive reorganization that qualifies under sections 355 and 368(a)(1)(D) of the Code, a transferor is treated as recognizing gain from the sale or exchange of a capital asset or of property that is not a capital asset, as applicable, in an amount equal to the excess of—

(i) The sum of the amount of liabilities of the transferor assumed by the transferee corporation; over

(ii) The total adjusted basis of the property transferred by the transferor pursuant to the exchange.

(2) *Exceptions.* Paragraph (a)(1) of this section does not apply to any exchange—

(i) To which § 1.357–3(a) applies;

(ii) That is pursuant to a plan of reorganization for a transaction that qualifies as a reorganization under section 368(a)(1)(G) in which no former shareholder of the transferor corporation receives any consideration for the shareholder's stock; or

(iii) To which section 351 applies if the exchange—

(A) Also qualifies as part of a reorganization described in section 368(a)(1)(A), (C), (D) (provided the requirements of section 354(b)(1) of the Code are satisfied), or (G) (provided the requirements of section 354(b)(1) are satisfied); and

(B) Is described as a reorganization pursuant to a filing with the IRS under § 1.368–3.

(3) *Certain liabilities excluded*—(i) *General rule.* Except as provided in paragraph (a)(3)(ii) of this section, the following liabilities are excluded for purposes of applying paragraph (a)(1) of this section:

(A) A liability the payment of which would give rise to a deduction.

(B) A liability the payment of which would give rise to the creation of, or increase in, the basis of any property.

(C) A liability the payment of which would be described in section 736(a) of the Code.

(ii) *Exceptions.* Paragraph (a)(3)(i) of this section does not apply to any liability to the extent that—

(A) The incurrence of the liability resulted in a deduction;

(B) The incurrence of the liability resulted in the creation of, or an increase in, the basis of any property; or

(C) The liability is not—

(*1*) Incurred in the ordinary course of business; or

(*2*) Associated with any assets transferred.

(b) *Determination of character of gain of multiple capital assets.* The determination of whether gain resulting from the transfer of capital assets is long-term or short-term capital gain is made by reference to the transferor's holding period for the transferred assets, based on the proportionate fair market value of the transferor's long-term assets to its short-term assets.

(c) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples: no exchange is described in paragraph (a)(2) of this section; any liability assumption is provided for in an agreement or a plan of reorganization entered into between the transferor and the transferee corporation before the date of the exchange; no liability is described in paragraph (a)(3)(i) of this section; all liabilities were incurred in the ordinary course of business and are associated with the assets transferred; the transferor's principal purpose with respect to the assumption of liabilities is not to avoid Federal income tax on the exchange; and there is a bona fide business purpose for the assumption of liabilities.

(1) *Example 1: Determination of character of gain*—(i) *Facts.* In an exchange that qualifies under section 351, Individual A transfers to a transferee corporation property with an adjusted basis of $1,000x in exchange for stock of the transferee corporation with a fair market value of $8,000x and the assumption by the transferee corporation of Individual A debt amounting to $4,000x. All assets transferred by Individual A to the transferee corporation are capital assets. By reference to Individual A's holding period at the time of the exchange, one half of the assets transferred (with a fair market value of $4,000x and an adjusted basis of $500x) have a long-term holding period, and the other half of the assets transferred (with a fair market value of $4,000x and an adjusted basis of $500x) have a short-term holding period.

(ii) *Analysis.* The excess of the amount of liabilities assumed over the adjusted basis of the assets transferred ($4,000x − $1,000x = $3,000x) is treated as gain from the sale or exchange of a capital asset. *See* paragraph (a)(1) of this section. Half of Individual A's capital gain resulting from the deemed sale or exchange of a capital asset (that is, $1,500x) is long-term capital gain, and the other half is short-term capital gain. *See* paragraph (b) of this section.

(2) *Example 2: Capital and non-capital assets*—(i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*), except that the long-term assets transferred are capital assets, and the short-term assets are other than capital assets.

(ii) *Analysis.* Half of the gain recognized by Individual A is treated as capital gain, and the other half of the gain recognized by Individual A is treated as gain from the sale or exchange of assets other than capital assets. *See* paragraph (a)(1) of this section.

(3) *Example 3: Liabilities in excess of adjusted basis*—(i) *Facts.* Pursuant to a plan of reorganization, a distributing corporation (Distributing) transfers one of its businesses (Business A) to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and Controlled's assumption of a historical Distributing debt (contribution), and Distributing distributes all the Controlled stock to its shareholders (distribution; together with the contribution, the separation). The separation satisfies all requirements to qualify as a divisive reorganization. At the time of the contribution,

Distributing has an aggregate adjusted basis of $5,000x in the Business A assets, which are the only assets subject to a nonrecourse loan of $10,000x.

(ii) *Analysis.* Under paragraph (a) of this section, Controlled's assumption of Distributing's Business A loan causes Distributing to recognize gain on the transfer of Business A to Controlled as though Distributing had sold or exchanged the Business A assets to Controlled. Specifically, because the amount of the loan ($10,000x) exceeds the total adjusted basis of the Business A assets ($5,000x), Distributing recognizes gain of $5,000x ($10,000x − $5,000x) on the exchange. *See* paragraph (a)(1) of this section. The character of that gain depends on the character of the assets transferred in the exchange. *See* paragraph (b) of this section.

§ 1.357–5 Applicability date.

(a) *Applicability date.* The rules of §§ 1.357–1 through 1.357–4 apply to transactions intended to qualify under section 351 or 361 of the Code for which the earliest of the following dates occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**]:

(1) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(2) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(3) The date of approval of the transaction by the board of directors of the taxpayer.

(4) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(5) The date a ruling request for the transaction is submitted to the IRS.

■ **Par. 11.** Section 1.361–0 is added to read as follows:

§ 1.361–0 Table of contents.

This section lists the major captions that appear in §§ 1.361–1 through 1.361–6.

§ 1.361–1 Nonrecognition of gain or loss to corporations under section 361.

(a) Overview.
(1) In general.
(2) Scope.
(b) Definitions.
(1) Acquiring corporation.
(2) Acquisitive reorganization.
(3) Amount.
(4) Appreciated nonqualified property.
(i) In general.
(ii) Inclusions.
(5) Assume; assumption.
(6) Code.
(7) Contingent liability.
(8) Control distribution.
(9) Control distribution date.
(10) Controlled corporation.
(11) Controlled corporation contingent liability.
(12) Controlled corporation debt.
(13) Controlled corporation related person.
(14) Covered convertible debt.
(15) CSAG.
(i) In general.
(ii) Controlled corporation not a common parent.
(16) Debt.
(17) Direct issuance transaction.
(18) Distributing corporation.
(19) Distributing corporation contingent liability.
(20) Distributing corporation debt.
(i) In general.
(ii) Section 381(a) transactions.
(21) Distributing corporation liability.
(22) Distributing corporation related person.
(23) Distribution.
(24) Distribution date.
(25) Distribution period.
(26) Divisive reorganization.
(27) DSAG.
(i) In general.
(ii) Distributing corporation not a common parent.
(28) Earliest applicable date.
(i) In general.
(ii) Similar transaction.
(29) Final distribution.
(30) Final distribution date.
(31) First distribution.
(32) First distribution date.
(33) Historical distributing corporation debt.
(34) Intermediary.
(i) In general.
(ii) Inclusion.
(35) Intermediated exchange.
(36) Liability.
(i) In general.
(ii) Certain obligations incurred in the ordinary course of business.
(37) Non-qualifying creditor.
(38) Obligor.
(39) Other property.
(40) Party to a reorganization.
(41) Plan of reorganization.
(42) Post-distribution payment.
(43) Qualified property.
(44) Qualifying creditor.
(45) Qualifying debt elimination transaction.
(46) Refinanced historical distributing corporation debt.
(47) Related person.
(48) Revolving credit agreement.
(49) Section 361 consideration.
(i) In general.
(ii) Inclusions.
(iii) Exclusion.
(50) Section 361 regulations.
(51) Target corporation.
(i) In general.
(ii) Inclusions.
(52) Trade payable.
(53) True-up payment.
(54) Unrelated ultimate creditor.

§ 1.361–2 Exchanges solely for stock or securities under section 361(a).

(a) General rule.
(b) Exchanges not solely for stock or securities.
(c) Example.

§ 1.361–3 Exchanges not solely for stock or securities under section 361(b).

(a) Scope.
(1) In general.
(2) Exception.
(b) Money or other property distributed in acquisitive reorganizations.
(1) Distributions to shareholders.
(2) Transfers to creditors.
(c) Money or other property distributed in divisive reorganizations.
(1) Distributions to shareholders.
(2) Transfers to creditors.
(i) In general.
(ii) Application of adjusted basis limitation to divisive reorganizations described in sections 355 and 368(a)(1)(D).
(3) Post-distribution payments received by a distributing corporation.
(i) Treatment as section 361 consideration.
(ii) Segregated account requirement.
(iii) Disposition requirement.
(4) Post-distribution payments received by a controlled corporation.
(i) Characterization as contribution in the reorganization exchange.
(ii) Value not reasonably ascertainable.
(iii) Proper accounting.
(d) Money or other property not distributed.
(e) No recognition of loss.
(f) Examples.
(1) Example 1: Acquisitive reorganization.
(2) Example 2: Divisive reorganization with money or other property distributed pursuant to plan of reorganization.
(3) Example 3: Ordinary course distribution.
(4) Example 4: Special stock repurchase program.
(5) Example 5: Existing stock repurchase program.
(6) Example 6: Divisive reorganization with money or other property not distributed within the 12-month period.
(7) Example 7: Post-distribution payments from a distributing corporation to a controlled corporation.
(8) Example 8: Post-distribution payment from a controlled corporation to a distributing corporation.

§ 1.361–4 Distributions of property under section 361(c).

(a) Distributions of qualified property.
(1) Distributions to shareholders.
(2) Treatment of certain transfers to creditors.
(i) Acquisitive reorganizations.
(ii) Divisive reorganizations.
(b) Distributions of appreciated nonqualified property.
(1) Deemed sale treatment.
(2) Treatment of liabilities.
(c) No recognition of loss.
(d) Coordination with other provisions; cross-references.
(e) Examples.
(1) Example 1: Distribution of qualified property.
(2) Example 2: Distribution timing requirement.

(3) Example 3: Distribution of nonqualified property.
§ 1.361–5 Transfers to creditors of distributing corporation in divisive reorganizations under section 361(b)(3) and (c)(3).
(a) General rule.
(b) Qualifying creditor.
(1) General status as a creditor with regard to distributing corporation debt.
(2) Related-creditor prohibition.
(i) General rule.
(ii) Exception for certain distributing corporation related persons.
(iii) Determination of related-person status.
(c) Eligible distributing corporation debt.
(1) Overview.
(2) Qualification as eligible distributing corporation debt.
(i) Historical distributing corporation debt.
(ii) Refinancing exception for historical distributing corporation debt.
(iii) Revolving credit agreements.
(iv) Qualifying trade payables.
(v) Direct issuance debt.
(3) Determination of amount of distributing corporation debt.
(i) Purpose.
(ii) Aggregate amount of distributing corporation debt.
(iii) Offsetting debts taken into account.
(d) Maximum amount of distributing corporation debt.
(1) General calculation.
(2) Eight-quarterly-average test.
(i) Determination.
(ii) Calculation of distributing corporation debt at the close of each quarter.
(iii) Distributing corporation debt held by distributing corporation related person.
(e) Qualifying debt elimination transactions.
(1) Overview.
(2) Qualifying original creditor exchanges.
(3) Qualifying intermediated exchanges.
(i) Prohibition on intermediary benefits.
(ii) Prohibition on acquiring debt from distributing corporation.
(iii) Arm's-length bargaining required.
(iv) Prohibition on profit-sharing or limitation.
(v) Independence requirement.
(vi) Minimum temporal requirement.
(4) Qualifying direct issuance transactions.
(i) Overview.
(ii) Facts-and-circumstances test.
(iii) Safe harbor for direct issuance transactions.
(iv) Prohibition regarding variable pricing and similar agreements.
(f) Transitorily eliminated distributing corporation debt.
(1) Overview.
(2) Transitory elimination.
(i) General rule.
(ii) Borrowings not in the ordinary course.
(iii) Borrowings in the ordinary course.
(g) Examples.
(1) Example 1: Transfer of money or other property to related creditor.
(2) Example 2: Refinancing of historical distributing corporation debt.
(3) Example 3: Eight-quarterly-average test.
(4) Example 4: Amount of distributing corporation debt under revolving credit agreement.
(5) Example 5: Effect of offsetting debts on amount of distributing corporation debt.
(6) Example 6: Qualifying original creditor exchange.
(7) Example 7: Not a qualifying direct issuance transaction.
(8) Example 8: Qualifying intermediated exchange.
§ 1.361–6 Applicability date.
(a) Applicability date.

■ **Par. 12.** Section 1.361–1 is revised to read as follows:

§ 1.361–1 Nonrecognition of gain or loss to corporations under section 361.

(a) *Overview*—(1) *In general.* The section 361 regulations apply—

(i) To exchanges of property by a target corporation pursuant to a plan of reorganization for property from an acquiring corporation that is a party to the reorganization; and

(ii) To distributions by the target corporation to its shareholders of property pursuant to a plan of reorganization (including transfers by the target corporation treated as such distributions).

(2) *Scope.* Paragraph (b) of this section provides definitions for purposes of the regulations under section 361 of the Code. Section 1.361–2 provides rules regarding exchanges in which a target corporation receives solely stock or securities in an acquiring corporation. Section 1.361–3 provides rules regarding exchanges in which a target corporation receives money or other property in addition to stock or securities in an acquiring corporation. Section 1.361–4 provides rules regarding distributions of property received by a target corporation in the exchange. Section 1.361–5 provides rules regarding transfers of section 361 consideration to creditors of a distributing corporation in a divisive reorganization. Section 1.361–6 provides the applicability date.

(b) *Definitions.* The following definitions apply for purposes of the section 361 regulations:

(1) *Acquiring corporation.* The term *acquiring corporation* means a corporation (including a controlled corporation) that receives property transferred by a target corporation in an exchange to which section 361(a) applies.

(2) *Acquisitive reorganization.* The term *acquisitive reorganization* means a transaction that qualifies as a reorganization under—

(i) Section 368(a)(1)(A) of the Code (including by reason of section 368(a)(2)(D) or section 368(a)(2)(E));

(ii) Section 368(a)(1)(C);

(iii) Section 368(a)(1)(D) (provided the requirements of section 354(b)(1) of the Code are satisfied);

(iv) Section 368(a)(1)(F); or

(v) Section 368(a)(1)(G) (provided the requirements of section 354(b)(1) are satisfied).

(3) *Amount.* The term *amount* means:

(i) With respect to liabilities, except as provided under paragraph (b)(3)(ii) or (iii) of this section, the amount of cash that a willing assignor would pay to a willing assignee to assume the liability in an arm's-length transaction.

(ii) With respect to debt, except as provided in paragraph (b)(3)(iii) of this section, the adjusted issue price (as defined in § 1.1275–1(b)) of the debt.

(iii) With respect to covered convertible debt, the fair market value of the covered convertible debt as of the earliest applicable date.

(4) *Appreciated nonqualified property*—(i) *In general.* The term *appreciated nonqualified property* means property distributed by a target corporation under § 1.361–4(b) that—

(A) Is property other than qualified property; and

(B) At the time of the distribution of that property under section 361(c), has a fair market value that exceeds the adjusted basis of that property in the hands of the target corporation.

(ii) *Inclusions.* The term *appreciated nonqualified property* includes all controlled corporation stock or securities—

(A) Treated as other property under section 355(a)(3)(B) of the Code;

(B) Distributed in a disqualified distribution, as defined in section 355(d)(2); or

(C) Distributed by a distributing corporation pursuant to an acquisition described in section 355(e)(2).

(5) *Assume; assumption.* With respect to a liability, the terms *assume, assumption,* and similar terms have the meaning of ''assumed'' as set forth in § 1.357–2(d).

(6) *Code.* The term *Code* means the Internal Revenue Code of 1986, as amended.

(7) *Contingent liability.* The term *contingent liability* means a liability (other than a debt) that includes one or more contingent payments.

(8) *Control distribution.* The term *control distribution* means a distribution of controlled corporation stock, or of controlled corporation stock and securities, that results in the distribution by the distributing corporation of an amount of controlled corporation stock constituting control (within the meaning of section 368(c) of the Code).

(9) *Control distribution date.* The term *control distribution date* means the date of the control distribution.

(10) *Controlled corporation.* The term *controlled corporation* means the

controlled corporation described in section 355(a)(1)(A).

(11) *Controlled corporation contingent liability.* The term *controlled corporation contingent liability* means a contingent liability for which a controlled corporation is the obligor.

(12) *Controlled corporation debt.* The term *controlled corporation debt* means debt for which a controlled corporation is the obligor.

(13) *Controlled corporation related person.* The term *controlled corporation related person* means a related person with respect to a controlled corporation.

(14) *Covered convertible debt.* The term *covered convertible debt* means debt with a conversion option described in § 1.1275–4(a)(4) that is reasonably certain to be exercised as of the earliest applicable date based on all facts and circumstances—

(i) Taking into account § 1.1504–4(g) (to the extent relevant); but

(ii) Not taking into account the safe harbors described in § 1.1504–4(g)(3).

(15) *Debt.* The term *debt* means a liability pursuant to an instrument or a contractual arrangement that constitutes debt under general principles of Federal income tax law. *See* § 1.1275–1(d).

(16) *Direct issuance debt.* The term *direct issuance debt* means the newly incurred debt a distributing corporation incurs with a creditor as part of a direct issuance transaction and the proceeds of which are used to repay historical distributing corporation debt.

(17) *Direct issuance transaction.* The term *direct issuance transaction* means a transaction, or a series of transactions (or similar transaction or series of transactions), in which—

(i) The distributing corporation incurs distributing corporation debt with a creditor after the earliest applicable date;

(ii) The distributing corporation uses the proceeds of the newly incurred distributing corporation debt (directly or indirectly) to repay historical distributing corporation debt; and

(iii) The new creditor exchanges that newly incurred distributing corporation debt for controlled corporation stock or securities held by the distributing corporation.

(18) *Distributing corporation.* The term *distributing corporation* means the distributing corporation described in section 355(a)(1)(A).

(19) *Distributing corporation contingent liability.* The term *distributing corporation contingent liability* means a contingent liability for which the distributing corporation is the obligor.

(20) *Distributing corporation debt*—(i) *In general.* The term *distributing corporation debt* means debt for which the distributing corporation is the obligor.

(ii) *Section 381(a) transactions.* The term *distributing corporation debt* includes a debt that satisfies the following requirements:

(A) The distributing corporation assumed the debt in a transaction to which section 381(a) of the Code applies; and

(B) The debt assumed in the transaction was incurred prior to the earliest applicable date.

(21) *Distributing corporation liability.* The term *distributing corporation liability* means a liability for which the distributing corporation is the obligor.

(22) *Distributing corporation related person.* The term *distributing corporation related person* means a related person with respect to the distributing corporation.

(23) *Distribution.* The term *distribution* means a single distribution, or one of a series of distributions, of controlled corporation stock, or of controlled corporation stock and securities—

(i) Intended to qualify as a divisive reorganization; and

(ii) Made by the distributing corporation pursuant to the plan of reorganization.

(24) *Distribution date.* If all distributions comprising an intended divisive reorganization take place on one date—

(i) The term *distribution date* means that date; and

(ii) Each of the terms *first distribution date, control distribution date,* and *final distribution* date refers to the distribution date.

(25) *Distribution period.* The term *distribution period* means the period of time that—

(i) Begins at the time of the first distribution; and

(ii) Ends at the time of the final distribution.

(26) *Divisive reorganization.* The term *divisive reorganization* means a series of transactions carried out pursuant to a plan of reorganization that qualify as a reorganization under sections 355 and 368(a)(1)(D) or (G).

(27) *Earliest applicable date*—(i) *In general.* The term *earliest applicable date* means the date that is the earliest of—

(A) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the divisive reorganization or a similar transaction;

(B) The date of entry by the distributing corporation into a written agreement to engage in the divisive reorganization or a similar transaction; and

(C) The date of approval of the divisive reorganization or a similar transaction by the board of directors of the distributing corporation.

(ii) *Similar transaction.* For purposes of paragraph (b)(27)(i) of this section, the term *similar transaction* means a similar acquisition within the meaning of § 1.355–7(h)(12) and (13).

(28) *Eligible distributing corporation debt.* The term *eligible distributing corporation debt* means distributing corporation debt described in § 1.361–5(c).

(29) *Final distribution.* The term *final distribution* means, with respect to a series of distributions, the last distribution that is made by the distributing corporation pursuant to the plan of reorganization.

(30) *Final distribution date.* The term *final distribution date* means the date of the final distribution.

(31) *First distribution.* The term *first distribution* means, with respect to a series of distributions, the earliest distribution that is made by the distributing corporation pursuant to the plan of reorganization.

(32) *First distribution date.* The term *first distribution date* means the date of the first distribution.

(33) *Historical distributing corporation debt.* The term *historical distributing corporation debt* means distributing corporation debt described in § 1.361–5(c)(2).

(34) *Intermediary*—(i) *In general.* The term *intermediary* means an investment bank or other person that—

(A) Is not a distributing corporation related person or a controlled corporation related person, at any time during the period beginning on the earliest applicable date and ending on the date of completion of the plan of reorganization; and

(B) Provides capital or financial services to the distributing corporation or the controlled corporation, directly or indirectly, to facilitate the divisive reorganization.

(ii) *Inclusion.* The term *intermediary* includes a related person of the intermediary.

(35) *Intermediated exchange.* The term *intermediated exchange* means a transaction, or a series of transactions (or similar transaction or series of transactions), in which an intermediary—

(i) Acquires historical distributing corporation debt on a secondary market from the holders of that debt; and

(ii) Exchanges that historical distributing corporation debt for controlled corporation stock or securities held by the distributing corporation.

(36) *Liability*—(i) *In general.* The term *liability* means a debt, a contingent liability, or any other fixed or contingent obligation, without regard to whether the obligation otherwise has been taken into account for Federal income tax purposes.

(ii) *Certain obligations incurred in the ordinary course of business*—(A) *In general.* Except as provided in paragraph (b)(36)(ii)(B) of this section, an obligation incurred in the ordinary course of business pursuant to a bilateral contract is not a liability.

(B) *Exception regarding financial statements.* An obligation described in paragraph (b)(36)(ii)(A) of this section is a liability, in whole or in part, to the extent the obligation is reflected in one or more financial statements of the obligor as a liability, reserve, or similar item.

(37) *Non-qualifying creditor.* The term *non-qualifying creditor* has the meaning provided in § 1.361–5(b)(2)(i).

(38) *Obligor.* With regard to a liability, the term *obligor* means the person that has agreed and is expected (as determined based on all facts and circumstances) to satisfy the liability, taking into account—

(i) All relevant provisions of the Code (including the principles of section 357(d) (liability treated as assumed));

(ii) Treasury regulations (26 CFR chapter I); and

(iii) General principles of Federal income tax law, including the substance-over-form doctrine.

(39) *Other property.* The term *other property* means section 361 consideration other than money, acquiring corporation stock or securities, and stock of a corporation controlling the acquiring corporation (within the meaning of section 368(c)).

(40) *Party to a reorganization.* The term *party to a reorganization* has the meaning provided in § 1.368–2(f).

(41) *Plan of reorganization.* The term *plan of reorganization* has the meaning provided in § 1.368–4.

(42) *Post-distribution payment.* The term *post-distribution payment* means a transfer of money or other property by the controlled corporation to the distributing corporation or by the distributing corporation to the controlled corporation—

(i) Pursuant to the plan of reorganization; and

(ii) Subsequent to the control distribution date.

(43) *Qualified property.* The term *qualified property* means any stock in (or right to acquire stock in), or obligation of—

(i) The target corporation;

(ii) The acquiring corporation, if that stock (or right) or obligation is received by the target corporation in an exchange described in § 1.361–2 or § 1.361–3; or

(iii) A corporation controlling the acquiring corporation (within the meaning of section 368(c)), if—

(A) The controlling corporation is a party to the reorganization; and

(B) That stock (or right) or obligation is received by the target corporation in an exchange described in in § 1.361–2 or § 1.361–3.

(44) *Qualifying creditor.* The term *qualifying creditor* means a creditor described in § 1.361–5(b).

(45) *Qualifying debt elimination transaction.* The term *qualifying debt elimination transaction* means a transaction described in § 1.361–5(e).

(46) *Refinanced historical distributing corporation debt.* The term *refinanced historical distributing corporation debt* has the meaning provided in § 1.361–5(c)(2)(ii).

(47) *Related person.* The term *related person* means a person related within the meaning of section 267(b) or section 707(b)(1) of the Code.

(48) *Revolving credit agreement.* The term *revolving credit agreement* means a loan structure that—

(i) Permits the borrower to make multiple borrowings and re-borrowings during the term of the revolving credit facility;

(ii) Limits the aggregate borrowings to a pre-determined maximum amount that the one or more lenders agree to fund; and

(iii) May, or may not, require the borrower to pledge any of its assets as security for the loan (that is, it may be a secured or unsecured loan structure).

(49) *Section 361 consideration*—(i) *In general.* The term *section 361 consideration* means, with regard to an exchange to which § 1.361–2 or § 1.361–3 applies, the consideration received by a target corporation from an acquiring corporation in exchange for property transferred by the target corporation to the acquiring corporation pursuant to the plan of reorganization.

(ii) *Inclusions.* The term *section 361 consideration* includes—

(A) Acquiring corporation stock or stock of a corporation controlling the acquiring corporation (within the meaning of section 368(c));

(B) Acquiring corporation securities;

(C) Acquiring corporation non-security debt;

(D) Money transferred by the acquiring corporation; and

(E) Other property (other than acquiring corporation non-security debt) transferred by the acquiring corporation.

(iii) *Exclusion.* The term *section 361 consideration* does not include an assumption of a liability described in § 1.357–2(a).

(50) *Section 361 regulations.* The term *section 361 regulations* means this section and §§ 1.361–2 through 1.361–6.

(51) *Target corporation*—(i) *In general.* The term *target corporation* means the corporation that is treated under section 361(a) or (b) as exchanging its property pursuant to a plan of reorganization for section 361 consideration.

(ii) *Inclusions.* The term *target corporation* includes solely—

(A) A corporation that is acquired in an acquisitive reorganization; and

(B) A distributing corporation in a divisive reorganization.

(52) *Trade payable.* The term *trade payable* means debt arising in the ordinary course of a business from sales, leases, licenses, or the rendition of services provided to or for the distributing corporation.

(53) *True-up payment.* The term *true-up payment* means, with respect to an exchange of controlled corporation stock or securities, or controlled corporation non-security debt, for distributing corporation debt pursuant to a plan of reorganization of a divisive reorganization, a payment—

(i) Under an agreement entered into between the distributing corporation (including any distributing corporation related person) and an intermediary (including any related person with regard to the intermediary); and

(ii) Made pursuant to that agreement by—

(A) The distributing corporation to the intermediary as the result of a decrease in value of any controlled corporation stock or securities or controlled corporation non-security debt (as applicable) between an initial valuation date and a subsequent valuation date; or

(B) The intermediary to the distributing corporation as the result of an increase in value of any controlled corporation stock or securities or controlled corporation non-security debt (as applicable) between an initial valuation date and a subsequent valuation date.

(54) *Unrelated ultimate creditor.* The term *unrelated ultimate creditor* means a creditor that is not—

(i) A distributing corporation related person; or

(ii) A related person with regard to a distributing corporation related person.

■ **Par. 13.** Sections 1.361–2 through 1.361–6 are added to read as follows:

§ 1.361–2 Exchanges solely for stock or securities under section 361(a).

(a) *General rule.* A target corporation that is a party to a reorganization does not recognize any gain or loss on a transfer of property by that corporation to an acquiring corporation if—

(1) The acquiring corporation or a corporation controlling the acquiring corporation is a party to the reorganization;

(2) The target corporation receives solely stock or securities of—

(i) The acquiring corporation in exchange for the transferred property; or

(ii) The corporation controlling the acquiring corporation in exchange for the transferred property; and

(3) The exchange occurs pursuant to the plan of reorganization.

(b) *Exchanges not solely for stock or securities.* With regard to an exchange to which paragraph (a) of this section would apply but for the fact that the target corporation receives money or other property in addition to stock and securities of an acquiring corporation or a corporation controlling the acquiring corporation, *see* § 1.361–3.

(c) *Example*—(1) *Facts.* Pursuant to a plan of reorganization for a transaction that qualifies as a reorganization described in section 368(a)(1)(C), a target corporation (Target) transfers all its property to an acquiring corporation (Acquiring) solely in exchange for Acquiring stock, which Target distributes to its shareholders in complete liquidation of Target. Target properly files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) that satisfies all requirements set forth in § 1.368–4, including properly including and identifying Target and Acquiring as parties to the reorganization.

(2) *Analysis.* Target recognizes no gain or loss on the transfer of its property to Acquiring solely in exchange for Acquiring stock because Target and Acquiring are parties to the reorganization, Target receives solely Acquiring stock in exchange for Target's property, and the exchange occurs pursuant to the plan of reorganization. *See* paragraph (a) of this section.

§ 1.361–3 Exchanges not solely for stock or securities under section 361(b).

(a) *Scope*—(1) *In general.* If § 1.361–2(a) would apply to an exchange between a target corporation and an acquiring corporation but for the fact that the target corporation receives money or other property, in addition to stock and securities of the acquiring corporation or stock of the corporation controlling the acquiring corporation, the exchange is governed by paragraphs (b) through (e) this section.

(2) *Exception.* If the exchange is pursuant to a reorganization that qualifies under section 368(a)(1)(F) of the Code, the exchange is not governed by paragraphs (b) through (e) of this section. *See* § 1.368–2(m)(3)(iii).

(b) *Money or other property distributed in acquisitive reorganizations*—(1) *Distributions to shareholders.* In an acquisitive reorganization, the target corporation recognizes no gain from an exchange described in paragraph (a)(1) of this section if the target corporation distributes the money or other property received in the exchange to its shareholders pursuant to the plan of reorganization.

(2) *Transfers to creditors.* In an acquisitive reorganization, if a target corporation receives money or other property in an exchange described in paragraph (a)(1) of this section, the target corporation is treated as distributing the money or other property to its shareholders for purposes of paragraph (b)(1) of this section if the target corporation transfers that money or other property to a creditor—

(i) Pursuant to the plan of reorganization; and

(ii) In satisfaction of debt of the target corporation.

(c) *Money or other property distributed in divisive reorganizations*—(1) *Distributions to shareholders.* In a divisive reorganization, the distributing corporation recognizes no gain from an exchange described in paragraph (a)(1) of this section if, pursuant to the plan of reorganization, the distributing corporation—

(i) Deposits the money received in the exchange in a segregated account; and

(ii) Distributes the money or other property received in the exchange to its shareholders no later than the end of the 12-month period beginning on the date of the exchange.

(2) *Transfers to creditors*—(i) *In general.* Subject to the adjusted basis limitation set forth in paragraph (c)(2)(ii) of this section, in a divisive reorganization, if a distributing corporation receives money or other property in an exchange described in paragraph (a)(1) of this section, the distributing corporation is treated as distributing the money or other property to its shareholders for purposes of paragraph (c)(1) of this section if, pursuant to the plan of reorganization, the distributing corporation—

(A) Deposits the money received in the exchange in a segregated account; and

(B) Transfers that money or other property to a creditor—

(*1*) In satisfaction of distributing corporation debt in a transfer meeting the requirements set forth in § 1.361–5; and

(*2*) Within the period described in paragraph (c)(1)(ii) of this section.

(ii) *Application of adjusted basis limitation to divisive reorganizations described in sections 355 and 368(a)(1)(D).* The aggregate amount of money and the fair market value of any other property transferred to a creditor that is treated as a distribution under paragraph (c)(1) of this section is limited to the amount by which the aggregate adjusted basis of the assets transferred by a distributing corporation to a controlled corporation in a divisive reorganization described in sections 355 and 368(a)(1)(D) exceeds the aggregate amount of distributing corporation liabilities assumed by the controlled corporation.

(3) *Post-distribution payments received by a distributing corporation.* Paragraphs (c)(1) and (2) of this section (without regard to paragraph (c)(1)(ii) of this section) apply to any post-distribution payment received by a distributing corporation only if all the following requirements are satisfied:

(i) *Treatment as section 361 consideration.* The post-distribution payment constitutes section 361 consideration for Federal income tax purposes. For purposes of this paragraph (c)(3), a post-distribution payment constitutes section 361 consideration for Federal income tax purposes (and not, for example, a payment for goods or services separate from and, therefore, not pursuant to the plan of reorganization for the divisive reorganization) only if all the following requirements are satisfied:

(A) *Characterization as section 361 consideration.* The post-distribution payment properly is characterized for Federal income tax purposes as consideration that the distributing corporation receives in the exchange described in § 1.361–3(a).

(B) *Value not reasonably ascertainable.* As of the date of the exchange described in § 1.361–3(a), the fair market value of the distributing corporation's right to receive the post-distribution payment is not reasonably ascertainable.

(C) *Proper accounting.* In accordance with the plan of reorganization, the distributing corporation properly accounts for the post-distribution payment as part of the contribution when the distributing corporation receives that payment.

(ii) *Segregated account requirement.* The distributing corporation deposits the post-distribution payment in a segregated account pursuant to the plan of reorganization.

(iii) *Disposition requirement.* By the later of 90 days after the date on which the distributing corporation receives the post-distribution payment or the date

specified in paragraph (c)(1)(ii) of this section, the distributing corporation, pursuant to the plan of reorganization—

(A) Distributes that post-distribution payment to the distributing corporation's shareholders; or

(B) Transfers that post-distribution payment to the distributing corporation's creditors in satisfaction of distributing corporation debt in a transfer meeting the requirements set forth in § 1.361–5.

(4) *Post-distribution payments received by a controlled corporation.* For purposes of the adjusted basis limitation set forth in paragraph (c)(2)(ii) of this section, any post-distribution payment received by the controlled corporation from the distributing corporation will increase the aggregate adjusted basis of the assets transferred by the distributing corporation to the controlled corporation only if all the following requirements are satisfied:

(i) *Characterization as contribution in the reorganization exchange.* The post-distribution payment properly is characterized for Federal income tax purposes as consideration that the controlled corporation receives in the exchange described in § 1.361–3(a).

(ii) *Value not reasonably ascertainable.* As of the date of the exchange described in § 1.361–3(a), the fair market value of the controlled corporation's right to receive the post-distribution payment is not reasonably ascertainable.

(iii) *Proper accounting.* In accordance with the plan of reorganization, the controlled corporation properly accounts for the post-distribution payment as part of the contribution when the controlled corporation receives that payment.

(d) *Money or other property not distributed.* If a target corporation does not satisfy the requirements set forth in paragraph (b) or (c) of this section with respect to an exchange described in paragraph (a)(1) of this section, the target corporation recognizes gain (if any) from the exchange in an amount that does not exceed the sum of—

(1) The amount of money received but not distributed; and

(2) The fair market value of other property received but not distributed.

(e) *No recognition of loss.* A target corporation does not recognize any loss on an exchange described in paragraph (a)(1) of this section.

(f) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples: Distributing is a distributing corporation, and Controlled is a controlled corporation, in a divisive reorganization; Target is a target corporation, and Acquiring is an acquiring corporation, in an acquisitive reorganization; all taxpayers are calendar-year taxpayers; and for each transaction, a plan of reorganization has been properly filed with the IRS pursuant to § 1.368–3(a)(5) that satisfies all requirements set forth in § 1.368–4, including identifying all parties to the reorganization, identifying all transactions included in the plan of reorganization, and describing the intended Federal income tax treatment of the transaction.

(1) *Example 1: Acquisitive reorganization*—(i) *Facts.* Pursuant to a plan of reorganization for a transaction that qualifies as a reorganization described in section 368(a)(1)(C), Target transfers all its property to Acquiring in exchange for Acquiring stock and money (exchange), and Target distributes the Acquiring stock and money to Target's shareholders in complete liquidation of Target.

(ii) *Analysis.* Target recognizes no gain on the exchange because Target distributes the money received in the exchange to its shareholders pursuant to the plan of reorganization. *See* paragraph (b)(1) of this section.

(2) *Example 2: Divisive reorganization with money or other property distributed pursuant to plan of reorganization*—(i) *Facts*—(A) *In general.* On June 1, 2025, pursuant to a plan of reorganization for a transaction that qualifies as a divisive reorganization, Distributing transfers one of its businesses (Business B) to newly formed Controlled in exchange for $10,000x of Controlled stock and $10,000x of cash (contribution) and distributes all the Controlled stock to Distributing's shareholders (distribution). The Business B assets have an aggregate adjusted basis of $10,000x. Pursuant to its plan of reorganization, Distributing will deposit the $10,000x of cash received in the contribution in a segregated account.

(B) *Special distribution.* On December 1, 2025, Distributing distributes the $10,000x of cash received to Distributing's shareholders in a special distribution (special dividend) pursuant to the plan of reorganization. A separation and distribution agreement filed by Distributing with the U.S. Securities and Exchange Commission (SEC), a resolution by Distributing's board of directors, and other official records of Distributing collectively evidence a definite intent, prior to the first step of the transaction, to have Distributing distribute the $10,000x of cash pursuant to the special dividend. Specifically, those documents provide that the special dividend is in addition to any regularly occurring dividends distributed to Distributing's shareholders pursuant to Distributing's dividend payment policy (as reflected in documents filed by Distributing with the SEC).

(ii) *Analysis.* The special dividend satisfies all requirements set forth in § 1.368–4(e). Accordingly, the special dividend is properly included in the plan of reorganization for the divisive reorganization. Distributing recognizes no gain on the contribution because, pursuant to the plan of reorganization, Distributing deposits the money received in the contribution in a segregated account, and it distributes the money received in the contribution to its shareholders no later than the end of the 12-month period beginning on the date of the contribution. *See* paragraph (c)(1) of this section.

(3) *Example 3: Ordinary course distribution*—(i) *Facts.* The facts are the same as in paragraph (f)(2)(i) of this section (*Example 2*), except that Distributing provides in the separation and distribution agreement, or in Distributing's other official records, that Distributing will distribute the $10,000x of cash received from Controlled to Distributing's shareholders through an ordinary course dividend pursuant to Distributing's dividend payment policy (as reflected in documents filed by Distributing with the SEC). Distributing distributes the cash in an ordinary course dividend on November 1, 2025.

(ii) *Analysis.* The ordinary course dividend is not properly included in the plan of reorganization for the divisive reorganization because the dividend does not satisfy the requirements set forth in § 1.368–4(e)(2)(i)(B) (that is, the dividend would have occurred regardless of the divisive reorganization). Because the $10,000x of cash received from Controlled is not distributed to Distributing's shareholders pursuant to the plan of reorganization, Distributing recognizes gain (but not loss) on the exchange in an amount that does not exceed the amount of money received (that is, $10,000x). *See* paragraphs (c)(1), (d), and (e) of this section. The Federal income tax consequences of the ordinary course dividend are determined under section 301 of the Code.

(4) *Example 4: Special stock repurchase program*—(i) *Facts.* The facts are the same as in paragraph (f)(2)(i) of this section (*Example 2*), except that, pursuant to the plan of reorganization, and as reflected in the official records of Distributing and Controlled, Distributing uses the $10,000x of cash received from

Controlled to fund a special repurchase of Distributing stock (and, accordingly, is not part of an existing stock repurchase program approved by Distributing's board of directors). The redemptions occur on February 1, 2026, and March 1, 2026.

(ii) *Analysis.* The analysis is the same as in paragraph (f)(2)(ii) of this section (*Example 2*).

(5) *Example 5: Existing stock repurchase program*—(i) *Facts.* The facts are the same as in paragraph (f)(4)(i) of this section (*Example 4*), except that Distributing uses the $10,000x of cash received from Controlled to fund a repurchase of Distributing stock pursuant to an existing stock repurchase program approved by Distributing's board of directors.

(ii) *Analysis.* The analysis is the same as in paragraph (f)(3)(ii) of this section (*Example 3*). Accordingly, the Federal income tax consequences of the ordinary course stock repurchase are determined under section 301 or 302 of the Code.

(6) *Example 6: Divisive reorganization with money or other property not distributed within the 12-month period*—(i) *Facts.* The facts are the same as in paragraph (f)(2)(i)(A) of this section (*Example 2*), except that Distributing distributes the $10,000x of cash received from Controlled to Distributing's shareholders on July 1, 2026, and, therefore, after the end of the 12-month period beginning on June 1, 2025.

(ii) *Analysis.* Distributing recognizes gain (but not loss) on the exchange in an amount that does not exceed the amount of money received (that is, $10,000x). *See* paragraphs (c)(1), (d), and (e) of this section.

(7) *Example 7: Post-distribution payments from a distributing corporation to a controlled corporation*—(i) *Facts.* The facts are the same as in paragraph (f)(2)(i)(A) of this section (*Example 2*), except that Distributing and Controlled enter into a capital contribution agreement, which is identified and properly included in the plan of reorganization, under which Distributing will make one or more transfers of working capital to Controlled after the contribution to fund Business B's post-distribution operations. Distributing's obligation to make any such transfer, and the amount of any such transfer (if required to be made), is subject to certain conditions such that, as of the date of the contribution, the fair market value of Controlled's right to receive any one or more post-distribution payments is not reasonably ascertainable. On September 30, 2025, it is determined that Distributing must transfer $200x to Controlled under this agreement. Distributing and Controlled both treat the $200x payment as part of the contribution.

(ii) *Analysis.* The $200x payment is treated as increasing the aggregate adjusted basis of the assets transferred by Distributing to Controlled in the contribution. *See* paragraph (c)(4) of this section. First, the $200x is a post-distribution payment because the transfer of $200x from Distributing to Controlled occurs pursuant to the plan of reorganization and after the control distribution date. *See* § 1.361–1(b)(42). Based on all facts and circumstances, including because the capital contribution agreement is identified and properly included in the plan of reorganization, the $200x properly is characterized for Federal income tax purposes as consideration that Controlled receives in an exchange described in paragraph (a)(1) of this section (that is, the contribution). *See* paragraph (c)(4)(i) of this section. In addition, Controlled's right to receive the post-distribution payment is not reasonably ascertainable as of the contribution date, and, in accordance with the plan of reorganization, Controlled properly accounts for the post-distribution payment as part of the contribution when Controlled receives that payment. *See* paragraphs (c)(4)(ii) and (iii) of this section.

(8) *Example 8: Post-distribution payment from a controlled corporation to a distributing corporation*—(i) *Facts*—(A) *In general.* The facts are the same as in paragraph (f)(7)(i) of this section (*Example 7*), except for the following. Distributing transferred $10,000x received from Controlled in the contribution to a qualifying creditor in a transfer meeting the requirements set forth in paragraph (c)(3) of this section and § 1.361–5. Distributing and Controlled also enter into an indemnification agreement whereby Controlled agrees to satisfy a contingent liability (Liability) that is associated with Business B but that Controlled cannot assume under State law. Under the indemnification agreement, Distributing may demand payment from Controlled once the amount of the Liability becomes fixed and determinable, without regard to whether Distributing has satisfied the Liability. The fair market value of Distributing's right to receive any such payment, and the amount of any such payment (if required to be made), is not reasonably ascertainable at the time of the contribution. On November 1, 2026, the Liability becomes fixed and determinable in the amount of $300x.

(B) *Payment under indemnification agreement.* After November 1, 2026, Distributing seeks payment from Controlled under the indemnification agreement without first satisfying the Liability with Distributing's own funds. Upon receiving the $300x payment from Controlled, Distributing properly accounts for the payment as section 361 consideration and deposits the $300x in a segregated account pursuant to the plan of reorganization. Not later than 90 days after the date on which Distributing receives the $300x from Controlled, pursuant to the plan of reorganization, Distributing transfers the $300x to a qualifying creditor in satisfaction of Distributing debt in a manner that satisfies all requirements set forth in § 1.361–5.

(ii) *Analysis*—(A) *Post-distribution payment; section 361 consideration; treatment as distribution to shareholders.* The $300x that Distributing receives from Controlled is a post-distribution payment because that transfer occurs pursuant to the plan of reorganization and after the control distribution date. *See* § 1.361–1(b)(42). Based on all facts and circumstances, including because the indemnification agreement is identified and properly included in the plan of reorganization, the $300x payment properly is characterized for Federal income tax purposes as consideration that Distributing receives in an exchange described in paragraph (a)(1) of this section (that is, the contribution). *See* paragraph (c)(3)(i)(A) of this section. In addition, the fair market value of Distributing's right to receive the post-distribution payment is not reasonably ascertainable as of the contribution date, and, in accordance with the plan of reorganization, Distributing properly accounts for the post-distribution payment as part of the contribution when Distributing receives that payment. *See* paragraphs (c)(3)(i)(B) and (C) of this section. Paragraph (c)(2) of this section applies to Distributing's receipt and transfer of the $300x payment because the payment constitutes section 361 consideration and, pursuant to the plan of reorganization, Distributing deposits the payment in a segregated account and transfers the $300x to a qualifying creditor in satisfaction of Distributing debt in a transfer meeting the requirements set forth in § 1.361–5 not later than 90 days after the date on which Distributing receives the payment. *See* paragraph (c)(2) of this section. Accordingly, and subject to the adjusted basis limitation set forth in

paragraph (c)(2)(ii) of this section, Distributing would be treated as distributing to its shareholders for purposes of paragraph (c)(1) of this section the $300x post-distribution payment. *See* paragraph (c)(2)(i) of this section.

(B) *Adjusted basis limitation.* The aggregate amount of money and the fair market value of any other property that Distributing may transfer to a creditor under paragraph (c)(2)(i) of this section that is treated as a distribution under paragraph (c)(1) of this section is limited to the amount by which the aggregate adjusted basis of the Business B assets transferred by Distributing to Controlled in the contribution ($10,200x) exceeds the sum of the aggregate amount of Distributing liabilities assumed by Controlled ($0), as further reduced by the $10,000x that Distributing had transferred to a qualifying creditor. *See* paragraph (c)(2)(ii) of this section. Therefore, Distributing has $200x remaining in its adjusted basis limitation ($10,200x − $10,000x) under paragraph (c)(2)(ii) of this section. As a result, $100x of the post-distribution payment ($300x − $200x) is treated as money not distributed to Distributing's shareholders for purposes of paragraph (c)(1) of this section. *See* paragraph (c)(2)(i) of this section. Therefore, Distributing recognizes $100x of gain (that is, an amount that does not exceed the sum of the money received but not distributed and the fair market value of other property received but not distributed). *See* paragraph (d) of this section.

§ 1.361–4 Distributions of property under section 361(c).

(a) *Distributions of qualified property*—(1) *Distributions to shareholders.* A target corporation recognizes no gain or loss on a distribution of qualified property received in an exchange described in § 1.361–2(a) or § 1.361–3(a) to the target corporation's shareholders pursuant to a plan of reorganization.

(2) *Treatment of certain transfers to creditors*—(i) *Acquisitive reorganizations.* In an acquisitive reorganization, if a target corporation receives qualified property in an exchange described in § 1.361–2(a) or § 1.361–3(a), the target corporation is treated as distributing the qualified property to its shareholders for purposes of paragraph (a)(1) of this section if the target corporation transfers that qualified property to a creditor—

(A) Pursuant to the plan of reorganization; and

(B) In satisfaction of target corporation debt.

(ii) *Divisive reorganizations.* In a divisive reorganization, if a distributing corporation receives qualified property in an exchange described in § 1.361–2(a) or § 1.361–3(a), the distributing corporation is treated as distributing the qualified property to its shareholders for purposes of paragraph (a)(1) of this section if the distributing corporation transfers that qualified property to a creditor—

(A) Pursuant to a plan of reorganization; and

(B) In satisfaction of distributing corporation debt in a transfer meeting the requirements set forth in § 1.361–5.

(b) *Distributions of appreciated nonqualified property*—(1) *Deemed sale treatment.* If a target corporation distributes appreciated nonqualified property received in an exchange described in § 1.361–3(a) to its shareholders pursuant to a plan of reorganization, the target corporation recognizes gain as if the target corporation had sold that property to its shareholders at the property's fair market value.

(2) *Treatment of liabilities.* If a target corporation distributes appreciated nonqualified property subject to a liability to its shareholders pursuant to a plan of reorganization, or if a shareholder assumes a liability of the target corporation pursuant to the plan of reorganization, the fair market value of that appreciated nonqualified property for purposes of paragraph (b)(1) of this section is treated as not less than the amount of that liability.

(c) *No recognition of loss.* If a target corporation distributes property received in an exchange described in described in § 1.361–2(a) or § 1.361–3(a) to its shareholders pursuant to a plan of reorganization, the target corporation does not recognize loss.

(d) *Coordination with other provisions; cross-references.* Sections 311 and 336 through 338 of the Code do not apply to a target corporation's distribution of property described in paragraph (a) or (b) of this section. *See* sections 355(a)(3)(B), (d), and (e) of the Code for purposes of determining whether a distributing corporation recognizes gain on a distribution of controlled corporation stock or securities.

(e) *Examples.* The following examples illustrate the application of the rules of this section.

(1) *Example 1: Distribution of qualified property*—(i) *Facts.* On June 1, 2025, a calendar-year distributing corporation (Distributing) transfers one of its businesses to a newly formed controlled corporation (Controlled) in exchange for Controlled stock (contribution). On June 2, 2025, Distributing distributes 80 percent of the Controlled stock to Distributing's shareholders on a pro rata basis (control distribution). As reflected in the separation and distribution agreement between Distributing and Controlled filed by Distributing with the U.S. Securities and Exchange Commission, Distributing evidences a definite intent to distribute the Controlled stock not distributed in the control distribution (retained Controlled stock) in 2026 pursuant to, and in completion of, the plan of reorganization (final distribution; together with the contribution and the control distribution, the separation). The retention of the retained Controlled stock is a qualifying retention within the meaning of § 1.355–10(c). Distributing properly files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) satisfying all requirements set forth in § 1.368–4, including identifying Distributing and Controlled as parties to the reorganization, determining that the contribution and each distribution are properly included in the plan of reorganization, and describing the intended Federal income tax treatment of the contribution and each distribution. The separation qualifies as a divisive reorganization.

(ii) *Analysis.* The Controlled stock Distributing receives in the contribution is qualified property. *See* § 1.361–1(b)(43). The contribution is an exchange described in § 1.361–2(a), because Controlled is a party to the reorganization, Distributing receives solely Controlled stock in the contribution, and the contribution and each distribution of Controlled stock occurs pursuant to the plan of reorganization. Consequently, Distributing recognizes no gain or loss on the control distribution or the final distribution. *See* paragraph (a)(1) of this section.

(2) *Example 2: Distribution timing requirement*—(i) *Facts.* The facts are the same as in paragraph (e)(1)(i) of this section (*Example 1*), except that the plan of reorganization evidences a definite intent to distribute the retained Controlled stock three years after the date of the first step of the plan of reorganization.

(ii) *Analysis.* The 24-month presumption for the expeditious prosecution of the plan of reorganization requirement is not satisfied. *See* § 1.368–4(d)(3)(i)(B). However, if Distributing demonstrates, based on all facts and circumstances, that Distributing has transferred the retained Controlled stock to its shareholders as expeditiously as

practicable in completion of the plan of reorganization, Distributing recognizes no gain or loss on the control distribution or final distribution. *See* § 1.368–4(d)(3)(i)(A) and paragraph (a)(1) of this section.

(3) *Example 3: Distribution of nonqualified property*—(i) *Facts.* Pursuant to a plan of reorganization for a transaction that qualifies as a reorganization under section 368(a)(1)(C), a target corporation (Target) transfers all its property other than an appreciated asset (Asset) to an acquiring corporation (Acquiring) solely in exchange for Acquiring voting stock, which Target distributes, along with Asset, to its shareholders in complete liquidation of Target. Asset has a fair market value of $100x and an adjusted basis of $50x and is subject to a $130x nonrecourse liability. Target properly files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) satisfying all requirements set forth in § 1.368–4, including identifying Target and Acquiring as parties to the reorganization, determining that the distribution of Asset is properly included in the plan of reorganization, and describing the intended Federal income tax treatment of the reorganization.

(ii) *Analysis*—(A) *In general.* The Acquiring stock Target receives in the exchange is qualified property. *See* § 1.361–1(b)(43). The exchange of Target assets for Acquiring stock is described in § 1.361–2(a), because the exchange occurs pursuant to a plan of reorganization, Target and Acquiring are parties to the reorganization, and Target receives solely Acquiring stock in the exchange. Accordingly, Target recognizes no gain on the distribution of Acquiring stock to Target shareholders. *See* paragraph (a)(1) of this section.

(B) *Asset distribution.* Asset is appreciated nonqualified property. *See* § 1.361–1(b)(4). Accordingly, Target recognizes gain on the distribution of Asset to its shareholders pursuant to the plan of reorganization as if Target had sold Asset to its shareholders at Asset's fair market value. *See* paragraph (b)(1) of this section. Because Target distributed Asset to its shareholders subject to the $130 nonrecourse liability, the fair market value of Asset is treated as not less than the amount of that liability. *See* paragraph (b)(2) of this section. Accordingly, the amount of gain Target recognizes on the distribution is $80x ($130x fair market value − $50x adjusted basis).

§ 1.361–5 Transfers to creditors of distributing corporation in divisive reorganizations under section 361(b)(3) and (c)(3).

(a) *General rule.* The transfer of section 361 consideration by a distributing corporation to a creditor of the distributing corporation under § 1.361–3(c)(2) or 1.361–4(a)(2)(ii) (as appropriate) in a divisive reorganization is not treated as a distribution by the distributing corporation to its shareholders pursuant to the plan of reorganization unless the transfer is—

(1) To a qualifying creditor of the distributing corporation, as determined under paragraph (b) of this section;

(2) In satisfaction of eligible distributing corporation debt, as determined under paragraph (c) of this section;

(3) In an amount not greater than the maximum amount of distributing corporation debt, as determined under paragraph (d) of this section; and

(4) Part of a qualifying debt elimination transaction, as determined under paragraph (e) of this section.

(b) *Qualifying creditor*—(1) *General status as a creditor with regard to distributing corporation debt.* Each creditor to which the distributing corporation transfers section 361 consideration must be a creditor (qualifying creditor) that—

(i) Holds historical distributing corporation debt, qualifying trade payables, or direct issuance debt; and

(ii) Satisfies the requirements set forth in paragraph (b)(2) of this section.

(2) *Related-creditor prohibition*—(i) *General rule.* Except as provided in paragraph (b)(2)(ii) of this section, the following persons are not qualifying creditors of the distributing corporation (non-qualifying creditors):

(A) A distributing corporation related person.

(B) A controlled corporation related person.

(C) A related person with respect to a distributing corporation related person.

(D) A related person with respect to a controlled corporation related person.

(ii) *Exception for certain distributing corporation related persons.* A distributing corporation related person or a related person with respect to a distributing corporation related person (each as determined in accordance with paragraph (b)(2)(iii) of this section) is a qualifying creditor of the distributing corporation only if the following requirements are satisfied:

(A) *Transfer to unrelated ultimate creditor*—(*1*) *Money or other property.* No later than the end of the 12-month period beginning on the date the distributing corporation receives the money or other property, the section 361 consideration composed of money or other property is transferred to an unrelated ultimate creditor pursuant to the plan of reorganization to satisfy debt owed by the distributing corporation related person or the related person with regard to a distributing corporation related person, respectively, to the unrelated ultimate creditor.

(*2*) *Qualified property.* The section 361 consideration composed of qualified property is transferred pursuant to the plan of reorganization to an unrelated ultimate creditor to satisfy debt owed by the distributing corporation related person or the related person with regard to a distributing corporation related person, respectively, to the unrelated ultimate creditor. For rules regarding the expeditious completion of the plan of reorganization, *see* § 1.368–4(d)(3).

(*3*) *Intermediate transfers.* For purposes of paragraph (b)(2)(ii)(A)(*1*) and (*2*) of this section, one or more intermediate transfers of section 361 consideration between or among distributing corporation related persons or related persons with regard to distributing corporation related persons to satisfy debts (including the initial distributing corporation debt) are permissible if those intermediate transfers culminate in a transfer of section 361 consideration to an unrelated ultimate creditor.

(B) *Debt in existence as of earliest applicable date*—(*1*) *In general.* Except as provided in paragraph (b)(2)(ii)(B)(*2*) of this section, all debt for which section 361 consideration is exchanged pursuant to the transfers described in paragraph (b)(2)(ii)(A) of this section is in existence as of the earliest applicable date.

(*2*) *Distributing corporation debt directly held by internal creditor.* Distributing corporation debt held directly by a distributing corporation related person or a related person with regard to a distributing corporation related person qualifies as historical distributing corporation debt described in paragraph (c)(2)(i) of this section.

(C) *Transactions, debts, and creditors identified in plan of reorganization.* Each transaction (including each intermediate and unrelated ultimate creditor transfer), creditor (including the unrelated ultimate creditor), and debt referenced in paragraph (b)(2)(ii)(A) of this section is identified and described in the plan of reorganization with regard to the divisive reorganization.

(iii) *Determination of related-person status.* For purposes of paragraph (b)(2) of this section, the status of a person as a distributing corporation related person

or a controlled related person, or as a related person with regard to any distributing corporation related person or as a related person with respect to any controlled corporation related person, is determined as of the date on which that person receives section 361 consideration in a transfer or series or transfers described in paragraph (b)(2)(ii)(A) of this section.

(c) *Eligible distributing corporation debt*—(1) *Overview.* Distributing corporation debt is not eligible to be satisfied with section 361 consideration under paragraph (a) of this section unless that debt qualifies under paragraph (c)(2) of this section.

(2) *Qualification as eligible distributing corporation debt*—(i) *Historical distributing corporation debt.* Historical distributing corporation debt is eligible to be satisfied with section 361 consideration under paragraph (c)(1) of this section. Except as provided in paragraph (c)(2)(ii) or (iii) of this section, for a distributing corporation debt to qualify as historical distributing corporation debt—

(A) The distributing corporation must have incurred the distributing corporation debt before the earliest applicable date;

(B) That debt must have an original term that ends after the date of the exchange described in § 1.361–2(a) or 1.361–3(a); and

(C) That debt must be identified in the plan of reorganization or original plan of reorganization (if amended).

(ii) *Refinancing exception for historical distributing corporation debt.* Distributing corporation debt incurred by the distributing corporation after the earliest applicable date is treated as historical distributing corporation debt only if—

(A) The distributing corporation debt is—

(*1*) A refinancing of historical distributing corporation debt (refinanced historical distributing corporation debt); or

(*2*) A refinancing of refinanced historical distributing corporation debt (that is, the debt is traced directly through one or more refinancings to debt that qualifies as historical distributing corporation debt pursuant to this paragraph (c)(2)(ii);

(B) The incurrence of the refinanced historical distributing corporation debt described in paragraph (c)(2)(ii)(A) of this section is not part of a plan to incur debt in addition to historical distributing corporation debt determined under paragraph (c)(2)(i) of this section (or an amount of debt in addition to the amount of historical distributing corporation debt determined under paragraph (d) of this section, without regard to paragraph (d)(2)(iv) of this section) in anticipation of the divisive reorganization (for example, the incurrence of the refinanced historical distributing corporation debt would have occurred without regard to the divisive reorganization);

(C) The distributing corporation engages in a qualifying debt elimination transaction solely under paragraph (e)(3) or (4) of this section to eliminate that refinanced historical distributing corporation debt; and

(D) The qualifying debt elimination transaction described in paragraph (c)(2)(ii)(C) of this section is described and identified in the plan of reorganization or original plan of reorganization (if amended) for the divisive reorganization.

(iii) *Revolving credit agreements.* A revolving credit agreement to which the distributing corporation is a debtor qualifies as historical distributing corporation debt only if—

(A) The distributing corporation entered into the agreement before the earliest applicable date;

(B) That agreement does not expire until after the date of the exchange described in § 1.361–2(a) or 1.361–3(a); and

(C) That agreement is identified in the plan of reorganization or original plan of reorganization (if amended).

(iv) *Qualifying trade payables.* Trade payables of the distributing corporation that meet the following requirements are eligible to be satisfied with section 361 consideration under paragraph (c)(1) of this section:

(A) The trade payables are described in a plan of reorganization or original plan of reorganization (if amended).

(B) The trade payables were incurred in the ordinary course of business of the distributing corporation.

(C) The satisfaction such trade payables is necessary—

(*1*) To ensure the allocation to the controlled corporation of all liabilities properly associated with the business assets transferred to that corporation; and

(*2*) To result in the controlled corporation being allocated liabilities in an amount that properly relates to its business operations, the earnings of which will be used to properly satisfy those liabilities.

(v) *Direct issuance debt.* Direct issuance debt incurred as part of a direct issuance transaction satisfying the requirements of paragraph (e)(4) of this section is eligible to be satisfied with section 361 consideration under paragraph (c)(1) of this section.

(3) *Determination of amount of distributing corporation debt*—(i) *Purpose.* The rules in this paragraph (c)(3) apply to determine the aggregate amount of distributing corporation debt. For rules to determine the maximum amount of distributing corporation debt that can be satisfied with section 361 consideration under paragraph (a) of this section, *see* paragraph (d) of this section.

(ii) *Aggregate amount of distributing corporation debt.* The aggregate amount of distributing corporation debt includes solely the amounts described in paragraphs (c)(3)(ii)(A) through (E) of this section, as applicable, taking into account any reduction required by paragraph (c)(3)(iii) of this section.

(A) *Historical distributing corporation debt.* The aggregate amount of historical distributing corporation debt equals the aggregate remaining principal amount, as of the earliest applicable date, of all historical distributing corporation debt other than historical distributing corporation debt that is eliminated as part of a qualifying direct issuance transaction under paragraph (e)(4) of this section.

(B) *Refinanced distributing corporation debt.* If the distributing corporation relies on the exception set forth in paragraph (c)(2)(ii) of this section (that is, the refinancing exception for historical distributing corporation debt) with regard to any distributing corporation debt, the amount of that distributing corporation debt equals the lesser of—

(*1*) The original principal amount of the refinanced distributing corporation debt; and

(*2*) The principal amount of the original historical distributing corporation debt (that is, the distributing corporation debt to which the refinanced distributing corporation debt is traced) as of the earliest applicable date.

(C) *Revolving credit agreements.* With regard to a revolving credit agreement that satisfies the requirements set forth in paragraph (c)(2)(iii) of this section, the amount of that revolving credit agreement equals the lesser of—

(*1*) The balance under that agreement as of the earliest applicable date (and not the maximum amount that could be incurred by the distributing corporation under that agreement); and

(*2*) The lowest balance under that agreement beginning on the earliest applicable date and ending on the control distribution date.

(D) *Qualifying trade payables.* With regard to trade payables of the distributing corporation that satisfy the requirements set forth in paragraph

(c)(2)(iv) of this section, the amount of those payables equals the aggregate amount of those payables on the date of the exchange described in § 1.361–2(a) or 1.361–3(a).

(E) *Direct issuance debt.* With regard to direct issuance debt that satisfies the requirements set forth in paragraph (c)(2)(v) of this section, the amount of that debt equals the aggregate principal amount of that debt on the date of the exchange described in § 1.361–2(a) or 1.361–3(a).

(iii) *Offsetting debts taken into account.* The aggregate amount of distributing corporation debt determined under paragraph (c)(3)(ii) of this section must be reduced by the aggregate principal amount (or the balance, in the case of a revolving credit agreement) of any debt for which—

(A) The distributing corporation is a creditor; and

(B) The debtor of that debt is a creditor with respect to distributing corporation debt described in paragraph (c)(3)(ii) of this section.

(d) *Maximum amount of distributing corporation debt*—(1) *General calculation.* The maximum amount of distributing corporation debt that can be satisfied with section 361 consideration under paragraph (a) of this section equals the amount obtained by subtracting the aggregate amount of distributing corporation debt that the controlled corporation assumes pursuant to the plan of reorganization from the lesser of—

(i) The aggregate amount of distributing corporation debt (as determined under paragraph (c)(3) of this section); and

(ii) The aggregate amount of distributing corporation debt determined under the eight-quarterly-average test (as set forth in paragraph (d)(2) of this section).

(2) *Eight-quarterly-average test*—(i) *Determination.* In accordance with paragraphs (d)(2)(ii) and (iii) of this section, the aggregate amount of distributing corporation debt under the eight-quarterly-average test, measured as of the close of each of the eight fiscal quarters that end immediately before the earliest applicable date, equals the average of the amount of distributing corporation debt owed to persons other than distributing corporation related persons.

(ii) *Calculation of distributing corporation debt at the close of each quarter.* The methodology for determining the maximum amount of distributing corporation debt under paragraph (c)(3) of this section must be used to determine the amount of distributing corporation debt at the close of each quarter for purposes of paragraph (d)(2)(i) of this section.

(iii) *Distributing corporation debt held by distributing corporation related person.* If the distributing corporation relies on the exception set forth in paragraph (b)(2)(ii) of this section (that is, the related-creditor exception), the amount determined under paragraph (d)(2)(i) of this section includes an amount equal to the least of—

(A) The amount of distributing corporation debt directly held by distributing corporation related persons or related persons with respect to distributing corporation related persons (each, a related person);

(B) The amount of debt of a related person (related person debt) held by any other related person; and

(C) The amount of related person debt held by the unrelated ultimate creditor.

(e) *Qualifying debt elimination transactions*—(1) *Overview.* A transaction that satisfies the requirements set forth in this paragraph (e) qualifies as a qualifying debt elimination transaction for purposes of paragraph (a) of this section.

(2) *Qualifying original creditor exchanges.* The satisfaction of distributing corporation debt with section 361 consideration in an exchange not described in paragraph (e)(3) or (4) of this section (original creditor exchange) qualifies as a qualifying debt elimination transaction if all applicable requirements set forth in paragraphs (b) through (d) of this section (without regard to paragraph (c)(2)(ii)(A) of this section) are satisfied.

(3) *Qualifying intermediated exchanges.* An intermediated exchange qualifies as a qualifying debt elimination transaction if all applicable requirements set forth in paragraphs (b) through (d) and (e)(3)(i) through (vi) of this section are satisfied.

(i) *Prohibition on intermediary benefits*—(A) *In general.* Except as provided in paragraph (e)(3)(i)(B) of this section, no holder of a distributing corporation debt satisfied with section 361 consideration holds the distributing corporation debt for the benefit of—

(*1*) The distributing corporation;

(*2*) The controlled corporation;

(*3*) A distributing corporation related person; or

(*4*) A controlled corporation related person.

(B) *Exception.* The prohibition described in paragraph (e)(3)(i)(A) of this section does not apply to the collateral benefit received by a distributing corporation, or a distributing corporation related person, from the intermediary's facilitation of the transfer of section 361 consideration in satisfaction of historical distributing corporation debt.

(ii) *Prohibition on acquiring debt from distributing corporation.* The intermediary does not acquire historical distributing corporation debt satisfied with section 361 consideration from the distributing corporation, the controlled corporation, or any distributing corporation related person or controlled corporation related person.

(iii) *Arm's-length bargaining required.* Each exchange of section 361 consideration for historical distributing corporation debt between the distributing corporation and the intermediary is effectuated based on terms and conditions arrived at by the parties bargaining at arm's length.

(iv) *Prohibition on profit-sharing or limitation.* None of the distributing corporation, the controlled corporation, or any distributing corporation related person or controlled corporation related person—

(A) Participates in any profit gained by the intermediary upon an exchange of section 361 consideration; or

(B) Limits by agreement or other arrangement any profit described in paragraph (e)(3)(iv)(A) of this section.

(v) *Independence requirement*—(A) *General rule.* The intermediary acts for its own account with regard to all components of the intermediated exchange.

(B) *Risk of loss.* The intermediary bears the risk of loss with respect to—

(*1*) The historical distributing corporation debt; and

(*2*) Any subsequent sale or other disposition of section 361 consideration transferred to the intermediary to satisfy the historical distributing corporation debt.

(C) *Prohibition regarding variable pricing and similar agreements.* The requirement set forth in paragraph (e)(3)(v)(B) of this section is not satisfied if the intermediary enters into a variable pricing agreement or similar arrangement with the distributing corporation (or a controlled corporation, distributing corporation related person, or controlled corporation related person) with regard to any section 361 consideration, including—

(*1*) True-up payments;

(*2*) Forward exchange agreements; and

(*3*) Any similar agreement or arrangement.

(vi) *Minimum temporal requirement.* The intermediary holds the historical distributing corporation debt for a period of not less than 30 days ending on the control distribution date.

(4) *Qualifying direct issuance transactions*—(i) *Overview*—(A) *In general.* To qualify as a qualifying debt

elimination transaction, a direct issuance transaction must be determined to comprise a transfer by the distributing corporation of section 361 consideration to the creditor in exchange for the satisfaction of the distributing corporation debt held by the creditor (direct issuance debt), and not a sale by the distributing corporation of section 361 consideration to the creditor for the proceeds of that direct issuance debt, for Federal income tax purposes.

(B) *Application of Code and general principles of Federal income tax law.* The determination under paragraph (e)(4)(i)(A) of this section is made based on all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine. Specifically, the substance of the direct issuance transaction must be determined under all relevant provisions of the Code and general principles of Federal income tax law before the requirements under section 361 can be applied to determine whether the transaction qualifies for nonrecognition treatment under that section.

(ii) *Facts-and-circumstances test*—(A) *In general.* The determination of whether a direct issuance transaction qualifies as an exchange under section 361 (and not as a sale under section 1001) is made based on the factors specified in paragraph (e)(4)(ii)(B) of this section, each of which provides evidence of qualification or non-qualification as an exchange under section 361 as set forth in paragraph (e)(4)(ii)(B) of this section, unless the transaction satisfies the safe harbor under paragraph (e)(4)(iii) of this section. The strength of the evidence provided by those factors is determined based on an analysis of all relevant facts and circumstances.

(B) *Factors*—(*1*) *Exchange part of prearranged, integrated plan*—(*i*) *Substantial evidence of non-qualification.* An exchange of section 361 consideration by the distributing corporation with the creditor pursuant to an arrangement that comprises part of a prearranged, integrated plan is substantial evidence of non-qualification.

(*ii*) *Evidence of qualification.* An exchange of section 361 consideration by the distributing corporation with the creditor that is not pursuant to an arrangement that comprises part of a prearranged, integrated plan is evidence of qualification.

(*2*) *Specified agency and substance-over-form requirements*—(*i*) *Evidence of non-qualification.* The failure to satisfy one or more requirements set forth in paragraphs (e)(4)(iii)(C) through (F) of this section is evidence of non-qualification.

(*ii*) *Substantial evidence of non-qualification.* Substantial failure to satisfy any of the requirements set forth in paragraphs (e)(4)(iii)(C) through (F) of this section, as determined based on all relevant facts and circumstances, or any failure to satisfy a substantial number of those requirements, is substantial evidence of non-qualification.

(*iii*) *Substantial evidence of qualification.* The satisfaction of all requirements set forth in paragraphs (e)(4)(iii)(C) through (F) of this section is substantial evidence of qualification.

(*3*) *Temporal proximity*—(*i*) *Evidence of non-qualification.* The fact that the creditor holds the refinanced historical distributing corporation debt for a period of less than 30 days ending on the control distribution date is evidence of non-qualification.

(*ii*) *Evidence of qualification.* The fact that the creditor holds the refinanced historical distributing corporation debt for a period of at least 30 days ending on the control distribution date is evidence of qualification.

(*4*) *Dominion or control of cash proceeds of refinanced distributing corporation debt*—(*i*) *Substantial evidence of non-qualification.* The distributing corporation's legal or practical dominion or control over any proceeds of the refinanced historical distributing corporation debt (as determined in accordance with § 1.357–2(e)(2)) is substantial evidence of non-qualification.

(*ii*) *Substantial evidence of qualification.* The distributing corporation's lack of legal or practical dominion or control over any proceeds of the refinanced historical distributing corporation debt (as determined in accordance with § 1.357–2(e)(2)) is substantial evidence of qualification.

(*5*) *Purpose of avoiding requirements or limitations of section 361.* The distributing corporation's issuance of the refinanced historical distributing corporation debt with a principal purpose of avoiding any of the requirements or limitations of section 361 is evidence of non-qualification.

(iii) *Safe harbor for direct issuance transactions.* A direct issuance transaction is treated as a qualifying debt elimination transaction under this paragraph (e)(4)(iii) only if all the following requirements are satisfied:

(A) The distributing corporation does not have, at any time, legal or practical dominion or control over any proceeds of the refinanced historical distributing corporation debt, as determined in accordance with § 1.357–2(e)(2).

(B) The creditor holds the refinanced historical distributing corporation debt for a period of not less than 30 days ending on the control distribution date.

(C) Each exchange of section 361 consideration for refinanced historical distributing corporation debt between the distributing corporation and the creditor is effectuated based on terms and conditions arrived at by the parties bargaining at arm's length.

(D) None of the distributing corporation, the controlled corporation, or any distributing corporation related person or controlled corporation related person—

(*1*) Participates in any profit gained by the creditor upon an exchange of section 361 consideration; or

(*2*) Limits by agreement or other arrangement any profit of the creditor described in paragraph (e)(4)(iii)(D)(*1*) of this section.

(E) The creditor acts for its own account with regard to all components of the direct issuance transaction.

(F) The creditor bears the risk of loss with respect to—

(*1*) The refinanced historical distributing corporation debt; and

(*2*) Any subsequent sale or other disposition of section 361 consideration transferred to the creditor to satisfy the refinanced historical distributing corporation debt.

(iv) *Prohibition regarding variable pricing and similar agreements.* The requirement set forth in paragraph (e)(4)(iii)(F) of this section is not satisfied if the creditor enters into a variable pricing agreement or similar arrangement with the distributing corporation (or a controlled corporation, distributing corporation related person, or controlled corporation related person) with regard to any section 361 consideration, including—

(A) True-up payments;

(B) Forward exchange agreements; and

(C) Any similar agreement or arrangement.

(f) *Transitorily eliminated eligible distributing corporation debt*—(1) *Overview.* The amount of section 361 consideration treated as transferred by a distributing corporation to a creditor of the distributing corporation in a qualifying debt elimination transaction (and, therefore, treated as distributed to shareholders pursuant to the plan of reorganization under section 361(b)(3) or (c)(3), as appropriate) is reduced by the amount of eligible distributing corporation debt that is transitorily eliminated pursuant to paragraph (f)(2)(i) of this section.

(2) *Transitory elimination*—(i) *General rule.* Unless the exception

described in paragraph (f)(2)(iii) of this section applies, a distributing corporation is treated as transitorily eliminating an amount of eligible distributing corporation debt equal to the amount of such debt that the distributing corporation or a distributing corporation related person (determined immediately after the earliest applicable date) replaces after the earliest applicable date, directly or indirectly, with borrowing that the distributing corporation or any distributing corporation related person (determined immediately after the earliest applicable date) expects or is committed to, directly or indirectly, before that date.

(ii) *Borrowings not in the ordinary course.* For purposes of paragraph (f)(2)(i) of this section, a borrowing is not treated as expected if the borrowing results from—

(A) An event unrelated to the divisive reorganization and not in the ordinary course of business of the distributing corporation; and

(B) Changed circumstances that were not expected prior to the control distribution date (therefore, the borrowing is unrelated to, and demonstrably independent of, the divisive reorganization or any transaction related to the divisive reorganization).

(iii) *Borrowings in the ordinary course.* A borrowing described in paragraph (f)(2)(i) of this section is not treated as transitorily eliminating eligible distributing corporation debt if the borrowing—

(A) Is incurred in the ordinary course of business of the distributing corporation or distributing corporation related person (as appropriate); and

(B) Would have been incurred by the distributing corporation or distributing corporation related person (as appropriate) without regard to the divisive reorganization or any transaction related to the divisive reorganization (that is, the borrowing is unrelated to, and demonstrably independent of, any such transaction).

(g) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples, the following facts apply: A distributing corporation (Distributing) transfers one of its businesses to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and other section 361 consideration (contribution); Distributing distributes all the Controlled stock to its shareholders on a pro rata basis (distribution); Distributing transfers the other section 361 consideration to holders of Distributing debt (together with the contribution and the distribution, the separation); Distributing properly files a plan of reorganization for the separation with the IRS pursuant to § 1.368–3(a)(5) that satisfies all requirements set forth in § 1.368–4; the separation qualifies as a divisive reorganization under sections 355 and 368(a)(1)(D); and the aggregate amount of adjusted basis of the assets transferred in the contribution exceeds the sum of the aggregate amount of liabilities assumed by Controlled plus the amount of money and the fair market value of any other property received by Distributing. Unless otherwise provided, no Distributing debt was transitorily eliminated within the meaning of paragraph (f) of this section.

(1) *Example 1: Transfer of money or other property to related creditor*—(i) *Facts.* The section 361 consideration received by Distributing in the contribution consists of Controlled stock and $100x of cash. Distributing has an outstanding debt of $100x owed to a wholly owned subsidiary that is a Distributing related person (Subsidiary, and such debt, Internal Debt). Subsidiary has an outstanding debt of $100x owed to an unrelated ultimate creditor (External Debt). The External Debt was incurred prior to the earliest applicable date. The Internal Debt qualifies as historical Distributing debt described in paragraph (c)(2)(i) of this section. The maximum amount of Distributing debt that can be satisfied with section 361 consideration, as determined under paragraph (d) of this section, is $100x. Pursuant to the plan of reorganization, Distributing deposits the $100x of cash received in the contribution in a segregated account. Subsequently, Distributing, pursuant to the plan of reorganization, transfers the $100x of cash to Subsidiary in satisfaction of the Internal Debt (which Subsidiary deposits into a segregated account), and Subsidiary transfers the $100x of cash to the unrelated ultimate creditor in satisfaction of the External Debt. The transfers from Distributing to Subsidiary, and from Subsidiary to the unrelated ultimate creditor, occur no later than the end of the 12-month period beginning on the date that Distributing receives the $100x of cash from Controlled. Each transaction, creditor (Subsidiary and unrelated ultimate creditor), and debt (Internal Debt and External Debt) is identified and described in the plan of reorganization with regard to the separation.

(ii) *Analysis.* Distributing's transfer of the $100x of cash to Subsidiary satisfies all requirements under this section and § 1.361–3(c)(2)(i) to be treated as a distribution to Distributing's shareholders pursuant to the plan of reorganization for purposes of § 1.361–3(c)(1). *See* paragraph (a) of this section. First, each of Distributing and Subsidiary deposits the $100x of cash they received into a segregated account. *See* § 1.361–3(c)(2)(i)(A). Second, Distributing's transfer of the $100x of cash to Subsidiary is a transfer to a qualifying creditor because, pursuant to the plan of reorganization, Subsidiary transfers the $100x of cash to an unrelated ultimate creditor by no later than the end of the 12-month period beginning on the date Distributing receives the $100x of cash from Controlled (*see* paragraph (b)(2)(ii)(A)(*1*) of this section), the Internal Debt qualifies as historical distributing corporation debt and therefore is eligible distributing corporation debt, the External Debt is in existence as of the earliest applicable date (*see* paragraphs (a)(2) and (b)(2)(ii)(B) of this section), and each transfer of the $100x provided by Controlled, each of the Internal Debt and External Debt, and each of Subsidiary and the unrelated ultimate creditor, is identified and described in the plan of reorganization (*see* paragraph (b)(2)(ii)(C) of this section). Second, the amount of historical distributing corporation debt satisfied by Distributing (that is, $100x) does not exceed the maximum amount of distributing corporation debt determined under paragraph (d) of this section (that is, $100x). *See* paragraph (a)(3) of this section. Lastly, the transfer of the $100x of cash by Distributing to Subsidiary in satisfaction of the Internal Debt is a qualifying original creditor exchange under paragraph (e)(2) of this section. *See* paragraph (a)(4) of this section.

(2) *Example 2: Refinancing of historical distributing corporation debt*—(i) *Facts.* The section 361 consideration received by Distributing in the contribution consists of Controlled stock and $100x of cash. Distributing has an outstanding $100x debt owed to an unrelated creditor that is a qualifying creditor (Distributing debt). The Distributing debt was incurred before the earliest applicable date and has an original term that ends after the date of the contribution. This debt was identified in the plan of reorganization. Before the date of the contribution, but after the earliest applicable date, Distributing refinances the Distributing debt with a bank that is a qualifying creditor (refinanced Distributing debt). The incurrence of the refinanced Distributing debt is not part of a plan to incur additional debt

prohibited by paragraph (c)(2)(ii)(B) of this section, because Distributing needed to refinance the Distributing debt in response to an identifiable, material, and unexpected delay in the date of the contribution. Thereafter, Distributing satisfies the refinanced Distributing debt through an intermediated exchange that is a qualifying debt elimination transaction under paragraph (e)(3) of this section (Distributing intermediated exchange). The Distributing debt refinancing and the Distributing intermediated exchange are described and identified in the amended plan of reorganization for the separation.

(ii) *Analysis.* The refinanced Distributing debt is treated as historical distributing corporation debt because it satisfies the requirements for the refinancing exception set forth in paragraph (c)(2)(ii) of this section. First, the refinanced Distributing debt is a refinancing of historical distributing corporation debt (that is, the original Distributing debt). *See* paragraph (c)(2)(ii)(A)(*1*) of this section. Second, Distributing did not refinance the Distributing debt as part of a plan to incur additional debt prohibited by paragraph (c)(2)(ii)(B) of this section. Third, the refinanced Distributing debt was eliminated by Distributing through a qualifying debt elimination transaction under paragraph (e)(3) of this section. *See* paragraph (c)(2)(ii)(C) of this section. Lastly, the qualifying debt elimination transaction and the refinancing of the Distributing debt are described and identified in the amended plan of reorganization for the separation. *See* paragraph (c)(2)(ii)(D) of this section and proposed § 1.368–4(d)(1)(iv). Accordingly, the refinanced Distributing debt is eligible to be satisfied with section 361 consideration under paragraph (a) of this section. *See* paragraph (c)(1) of this section.

(3) *Example 3: Eight-quarterly-average test*—(i) *Facts.* The section 361 consideration received by Distributing in the contribution consists of Controlled stock and $100x of cash. As of the earliest applicable date (July 10, 2025), Distributing has outstanding debt of $180x owed to an unrelated creditor that is a qualifying creditor (Distributing debt). The $180x of Distributing debt consists of three loans: a $100x loan incurred in the eighth fiscal quarter that ended immediately before the earliest applicable date (September 30, 2023); a $60x loan incurred in the first fiscal quarter that ended immediately before the earliest applicable date (June 30, 2025); and a $20x loan incurred in the first fiscal quarter that ended immediately before the earliest applicable date (June 30, 2025). The three loans that comprise the $180x of Distributing debt have an original term that ends after the date of the contribution, as identified in the plan of reorganization. Controlled assumes the $20x loan in the contribution.

(ii) *Analysis.* All $180x of the Distributing debt qualifies as historical Distributing debt, and therefore eligible Distributing debt, because Distributing incurred each of the debts before the earliest applicable date and each of the debts has an original term that ends after the date of the contribution and is identified in the plan of reorganization. *See* paragraph (c)(2)(i) of this section. However, the maximum amount of eligible Distributing debt that Distributing can satisfy with section 361 consideration is limited under paragraphs (c)(3) and (d) of this section. The aggregate amount of Distributing debt is equal to $180x (that is, the remaining principal amount of all historical Distributing debt as of the earliest applicable date). *See* paragraph (c)(3)(ii)(A) of this section. The aggregate amount of Distributing debt determined under the eight-quarterly-average test is equal to $110x (that is, the eight quarterly average of $880x—the $180x of Distributing debt outstanding at the close of the first fiscal quarter ending immediately before the earliest applicable date and the $100x of Distributing debt outstanding at the close of each of the preceding seven fiscal quarters ((($180x × 1) + ($100x × 7))/8 = $110x)). *See* paragraph (d)(2) of this section. Accordingly, the maximum amount of eligible Distributing debt that Distributing can satisfy with the section 361 consideration received from Controlled is $90x (that is, the lesser of the $180x of eligible Distributing debt and the $110x of Distributing debt determined under the eight-quarterly-average test, reduced by the $20x of Distributing debt assumed by Controlled in the contribution). *See* paragraph (d)(1) of this section.

(4) *Example 4: Amount of distributing corporation debt under revolving credit agreement*—(i) *Facts.* Distributing is the debtor under a revolving credit agreement entered into before the earliest applicable date with an unrelated creditor that is a qualifying creditor. The revolving credit agreement does not expire until after the date of the contribution, and the agreement is identified in the plan of reorganization for the separation. Distributing's credit limit under the agreement is $100x. As of the earliest applicable date, Distributing's outstanding balance under the agreement is $50x. After that date, but prior to the control distribution date, Distributing's outstanding balance under the agreement decreases to $40x and then subsequently increases to $80x.

(ii) *Analysis.* The revolving credit agreement qualifies as historical distributing corporation debt because Distributing entered into the agreement before the earliest applicable date, the agreement does not expire until after the date of the contribution, and the agreement is identified in the plan of reorganization for the separation. *See* paragraph (c)(2)(iii) of this section. Although Distributing's credit limit under the revolving credit agreement is $100x, the maximum amount under the agreement that Distributing can satisfy with section 361 consideration is $40x (that is, the lesser of the outstanding balance as of the earliest applicable date ($50x) and the lowest balance under the agreement beginning on the earliest applicable date and ending on the control distribution date ($40x). *See* paragraph (c)(3)(ii)(C) of this section.

(5) *Example 5: Effect of offsetting debts on amount of historical distributing corporation debt*—(i) *Facts.* As of the earliest applicable date, Distributing has an outstanding $100x debt owed to an unrelated creditor (Creditor) that is a qualifying creditor (Distributing debt). The Distributing debt is historical Distributing debt under paragraph (c)(2)(i) of this section, and therefore qualifies as Distributing debt eligible to be satisfied with section 361 consideration under paragraph (a)(2) of this section. *See* paragraphs (c)(1) and (2) of this section. As of the earliest applicable date, Creditor also has an outstanding $50x debt owed to Distributing (Creditor debt).

(ii) *Analysis.* In determining the aggregate amount of eligible Distributing debt under paragraph (c)(3) of this section, the amount of eligible Distributing debt must be reduced by the aggregate principal amount of any debt for which Distributing is a creditor and the debtor is the Creditor with respect to that Distributing debt. *See* paragraph (c)(3)(iii) of this section (requiring offsetting debts to be taken into account). Accordingly, the aggregate amount of eligible Distributing debt is $50x (that is, the $100x of Distributing debt reduced by the $50x of Creditor debt).

(6) *Example 6: Qualifying original creditor exchange*—(i) *Facts.* The section 361 consideration received by Distributing in the contribution consists of Controlled stock and $100x of Controlled securities. As of the earliest applicable date, Distributing has an outstanding $100x debt owed to an unrelated creditor (Creditor) that is a

qualifying creditor (Distributing debt). The Distributing debt has an original term that ends after the date of the contribution and is identified in the plan of reorganization. The maximum amount of Distributing debt determined under paragraph (d) of this section that can be satisfied with section 361 consideration is $100x. Pursuant to the plan of reorganization for the separation, Distributing transfers the $100x of Controlled securities received from Controlled directly to Creditor in satisfaction of the Distributing debt. This transfer does not qualify as a qualifying intermediated exchange under paragraph (e)(3) of this section or as a qualifying direct issuance transaction under paragraph (e)(4) of this section.

(ii) *Analysis.* The Distributing debt qualifies as historical distributing corporation debt because Distributing incurred the debt before the earliest applicable date and that debt has an original term that ends after the date of the contribution and is identified in the plan of reorganization. *See* paragraph (c)(2)(i) of this section. Creditor is a qualifying creditor because Creditor holds historical distributing corporation debt and does not run afoul of the related-creditor prohibition under paragraph (b)(2)(i) of this section. *See* paragraph (b)(1) of this section. The amount of Distributing debt satisfied in the transaction (that is, $100x) does not exceed the maximum amount determined under paragraph (d) of this section (that is, $100x). Distributing's transfer of the $100x of Controlled securities directly to Creditor in satisfaction of Distributing debt is a qualifying original creditorexchange, and therefore is a qualifying debt elimination transaction. *See* paragraph (e)(2) of this section. Accordingly, the transfer of $100x of Controlled securities to Creditor in satisfaction of Distributing debt is treated as a distribution by Distributing to its shareholders pursuant to the plan of reorganization. *See* paragraph (a) of this section.

(7) *Example 7: Not a qualifying direct issuance transaction*—(i) *Facts.* The facts are the same as in paragraph (g)(6)(i) of this section (*Example 6*), except for the following. In anticipation of the divisive reorganization, Distributing intends to issue new debt to Creditor and use the proceeds to satisfy historical Distributing debt on a date following the contribution date. Accordingly, after the earliest applicable date, and as part of a prearranged, integrated plan with Creditor, Distributing carries out the following transactions. First, Distributing directly issues new debt to Creditor (new Distributing debt) in exchange for $100x. Distributing intends to transfer to Creditor the Controlled securities Distributing receives in the contribution to satisfy the new Distributing debt (collectively, the direct issuance transaction). On a date following the contribution, Distributing uses the $100x of proceeds from the new Distributing debt to repay the historical Distributing debt. Also following the date of the contribution, Distributing transfers the Controlled securities to Creditor in exchange for the refinanced Distributing debt (securities-for-debt exchange).

(ii) *Analysis.* The securities-for-debt exchange is not carried out through a qualifying debt elimination transaction. Distributing incurred the refinanced Distributing debt after the earliest applicable date and does not satisfy the requirements for the refinancing exception in paragraph (c)(2)(ii) of this section. The direct issuance transaction fails to qualify for the safe harbor for qualifying direct issuance transactions under paragraph (e)(4)(iii) of this section because Distributing had dominion and control over the direct issuance proceeds. *See* paragraph (e)(4)(iii)(A) of this section. In addition, the dominion and control that Distributing had over the direct issuance proceeds provides substantial evidence that the direct issuance transaction fails to qualify as a qualifying debt elimination transaction under the facts-and-circumstances test set forth in paragraph (e)(4)(ii) of this section. *See* paragraph (e)(4)(ii)(B)(*4*) of this section. In addition, the securities-for-debt exchange was carried out pursuant to an arrangement that comprises part of a prearranged, integrated plan, and therefore also provides substantial evidence that the direct issuance transaction fails to qualify as a qualifying debt elimination transaction. *See* paragraph (e)(4)(ii)(B)(*1*) of this section. Accordingly, the exchange with Creditor is not a qualifying original creditorexchange, a qualifying intermediated exchange, or a qualifying direct issuance transaction. *See* paragraphs (e)(2), (3), and (4) of this section. As a result, Distributing's transfer of the Controlled securities to Creditor is not treated as a distribution to its shareholders pursuant to the plan of reorganization under § 1.361–4(a)(2)(ii). *See* paragraph (a) of this section.

(8) *Example 8: Qualifying intermediated exchange*—(i) *Facts*—(A) *Historical Distributing debt.* The section 361 consideration received by Distributing in the contribution consists of Controlled stock and $100x of Controlled securities. As of the earliest applicable date, Distributing has outstanding debt of $100x owed to an unrelated creditor that is a qualifying creditor (Distributing debt). Furthermore, that debt has an original term that ends after the date of the contribution and is identified in the plan of reorganization.

(B) *Intermediated exchange.* Pursuant to the plan of reorganization for the separation, Distributing engages an intermediary to facilitate the transfer of the $100x of Controlled securities in satisfaction of the Distributing debt (intermediated exchange). As described in the plan of reorganization, the intermediary will acquire the $100x of Distributing debt directly from the creditor (and not from Distributing, Controlled, or any Distributing related person or Controlled related person). The intermediary will not hold that debt for the benefit of Distributing, Controlled, or any Distributing related person or Controlled related person. All exchanges of Controlled securities for Distributing debt between Distributing and the intermediary are effectuated based on terms and conditions arrived at by the parties bargaining at arm's length. None of Distributing, Controlled, or any Distributing related person or Controlled related person participates in any profit gained by the intermediary upon an exchange of Controlled securities or limits by agreement or other arrangement any such profit. The intermediary acts for its own account with regard to all components of the intermediated exchange, bears the risk of loss with respect to the Distributing debt and any subsequent sale or other disposition of the Controlled securities, and does not enter into a variable pricing or similar agreement with Distributing, Controlled, or any Distributing related person or Controlled related person with regard to the Controlled securities. The intermediary holds the Distributing debt for a period of not less than 30 days ending on the distribution date. All applicable requirements set forth in paragraphs (b) through (d) of this section are satisfied.

(ii) *Analysis.* The intermediated exchange satisfies all requirements set forth in paragraph (e)(3) of this section to qualify as a qualifying debt elimination transaction. *See* paragraphs (b) through (d) and (e)(3) of this section.

§ 1.361–6 Applicability date.

(a) *Applicability date.* The rules of §§ 1.361–1 through 1.361–5 apply to transactions intended to qualify under section 361 of the Code for which the

earliest of the following dates occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**]:

(1) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(2) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(3) The date of approval of the transaction by the board of directors of the taxpayer.

(4) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(5) The date a ruling request for the transaction is submitted to the IRS.

■ **Par. 14.** Section 1.368–1 is amended by revising paragraph (c) to read as follows:

§ 1.368–1 Purpose and scope of exception of reorganization exchanges.

* * * * *

(c) *Scope of exception for reorganization exchanges*—(1) *Overview.* The reorganization provisions of part III of subchapter C of chapter 1 of the Code (part III) consist of the following categories of rules:

(i) Definitional provisions (as described in paragraph (c)(2)(i) of this section), the satisfaction of which qualify persons for potential nonrecognition treatment under the Code. The purpose of these definitional provisions is to limit the scope of transactions, and therefore the parties to such transactions (and other relevant persons, such as shareholders of a party to a reorganization), to which certain operative provisions apply.

(ii) Operative provisions (certain of which are described in greater detail in paragraph (c)(2)(ii) of this section), the satisfaction of which qualify a party for partial or complete nonrecognition treatment under part III. The purpose of these operative provisions is to further limit the scope of transactions, and therefore the parties to such transactions (and other relevant persons, such as shareholders of a party to a reorganization), that qualify for nonrecognition treatment (in whole or in part) under part III.

(2) *Definitional and operative provisions.* The definitional and operative provisions referred to in paragraph (c)(1) of this section include the following:

(i) *Definitional provision.* Section 368(a)(1) limits the definition of the term *reorganization* to seven types of transactions (including triangular reorganizations, which are variants of such transactions). All transactions and series of transactions that do not satisfy any of the definitional provisions under section 368(a)(1) are excluded from treatment as a reorganization under part III.

(ii) *Operative provisions for transactions that qualify as reorganizations*—(A) *Section 354.* Section 354 generally provides that a shareholder or security holder of a target corporation recognizes no gain or loss if the target corporation is a party to a reorganization and the shareholder or security holder exchanges solely stock or securities of the target corporation for the stock or securities of an acquiring corporation pursuant to the plan of reorganization.

(B) *Section 355.* Section 355 generally provides that, if all requirements are satisfied, shareholders and security holders of a distributing corporation recognize no gain or loss (and do not include any amount in income) on the receipt of controlled corporation stock or securities with respect to, or in exchange for, their distributing corporation stock.

(C) *Section 356.* Section 356 of the Code generally provides that, if a shareholder of a target corporation receives stock or securities of the corporation in an exchange to which section 354 or 355 otherwise would apply, and also receives money or other property, then that shareholder recognizes gain or income (as determined pursuant to the gain calculation and characterization rules under section 356).

(D) *Section 357.* Section 357 of the Code generally provides that an assumption by an acquiring corporation of a liability of a target corporation is not treated as money received by the target corporation (and, therefore, the target corporation recognizes no gain or loss as a result of the liability assumption).

(E) *Section 361(a) and (b)—Transfers of stock or securities.* Section 361(a) and (b) of the Code generally provide that a target corporation recognizes no gain or loss if that corporation is a party to a reorganization and exchanges property, pursuant to the plan of reorganization, solely for stock or securities in an acquiring corporation that is a party to the reorganization.

(F) *Section 361(c)—Distributions of qualified property by target corporation.* Section 361(c) generally provides that a target corporation recognizes no gain or loss on the distribution to its shareholders or transfer to its creditors of qualified property (as defined in section 361(c)(2)(B)) pursuant to the plan of reorganization.

(3) *Applicability date.* This paragraph (c) applies to transactions intended to qualify under section 368 of the Code for which the earliest of the following dates occurs after [DATE OF PUBLICATION OF FINAL REGULATIONS IN THE **FEDERAL REGISTER**]:

(i) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(ii) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(iii) The date of approval of the transaction by the board of directors of the taxpayer.

(iv) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(v) The date a ruling request for the transaction is submitted to the IRS.

* * * * *

■ **Par. 15.** Section 1.368–2 is amended by revising paragraphs (f) and (g) to read as follows:

§ 1.368–2 Definitions of terms and operative rules.

* * * * *

(f) *Party to a reorganization*—(1) *Overview.* The provisions described in § 1.368–1(c)(2)(i) and (ii) apply solely to a transaction that is carried out by, between, or among one or more parties to a reorganization.

(2) *Scope of party to a reorganization.* For purposes of determining the scope of the transaction or series of transactions to which the provisions described in § 1.368–1(c)(2)(i) and (ii) apply, the term *party to a reorganization* is limited solely to a corporation that—

(i) Is described in paragraph (f)(3) of this section; and

(ii) Is determined to be a party to a reorganization pursuant to paragraph (f)(4) of this section.

(3) *Definition*—(i) *In general.* The term *party to a reorganization* includes—

(A) A corporation resulting from a transaction that qualifies as a reorganization;

(B) Both corporations, in a transaction that qualifies as a reorganization in which one corporation acquires stock or properties of another corporation; and

(C) A corporation controlling an acquiring corporation in a transaction that qualifies as a triangular reorganization (as defined in § 1.358–6(b)(2)) if stock of the controlling corporation is used in the acquisition of stock or properties.

(ii) *Certain transfers of assets or stock in reorganizations*—(A) *In general.* If a transaction otherwise qualifies as a reorganization, a corporation remains a party to the reorganization even though stock or assets acquired by the acquiring corporation pursuant to the plan of reorganization are transferred in a transaction described in paragraph (k) of this section. For example, a corporation does not cease to be a party to the reorganization solely because part or all of the assets acquired pursuant to the plan of reorganization are transferred to a partnership in which the transferor is a partner, so long as the continuity of business enterprise requirement is satisfied. *See* § 1.368–1(d).

(B) *Triangular reorganizations.* If a transaction otherwise qualifies as a reorganization under section 368(a)(1)(B) or as a reverse triangular merger (as defined in § 1.358–6(b)(2)(iii)), the target corporation (in the case of a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(B)) or the surviving corporation (in the case of a transaction that otherwise qualifies as a reverse triangular merger) remains a party to the reorganization even though its stock or assets acquired pursuant to the plan of reorganization are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a forward triangular merger (as defined in § 1.358–6(b)(2)(i)), a triangular B reorganization (as defined in § 1.358–6(b)(2)(iv)), a triangular C reorganization (as defined in § 1.358–6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), the acquiring corporation remains a party to the reorganization even though its stock is transferred in a transaction described in paragraph (k) of this section.

(4) *Determination of party to the reorganization*—(i) *Status generally based on plan of reorganization.* Subject to paragraph (f)(4)(ii) of this section, the status of a corporation as a party to a reorganization is established solely by the inclusion and identification of that corporation as a party to the reorganization in a plan of reorganization (as defined in § 1.368–4) that is filed with the IRS pursuant to § 1.368–3(a)(5).

(ii) *Status determined by Commissioner based on Federal income tax principles.* Notwithstanding the inclusion or omission of a corporation as a party to a reorganization in a plan of reorganization filed by the taxpayer with the IRS pursuant to § 1.368–3(a)(5), the status of a corporation as a party to the reorganization may be determined by the Commissioner based on the correction of that plan of reorganization in accordance with § 1.368–4(c)(2), taking into account—

(A) All facts and circumstances regarding the transaction or series of transactions; and

(B) All relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine.

(5) *Examples.* The following examples illustrate the application of the rules of this paragraph (f).

(i) *Example 1: Statutory merger*—(A) *Facts.* Pursuant to State law, Corporation A merges into Corporation B in a transaction qualifying as a reorganization under section 368(a)(1)(A). A plan of reorganization is filed with the IRS pursuant to § 1.368–3(a)(5) that identifies A and B as parties to the reorganization.

(B) *Analysis.* A and B are both described in paragraph (f)(3)(i)(B) of this section. Further, the status of both A and B as parties to the reorganization is established by their identification in the plan of reorganization. *See* paragraph (f)(4)(i) of this section. Accordingly, each of A and B is a party to a reorganization for purposes of determining the scope of the transactions to which the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply. *See* paragraph (f)(2) of this section.

(ii) *Example 2: B reorganization*—(A) *Facts.* Corporation C owns all the stock of Corporation D. D acquires all the stock of Corporation E solely in exchange for voting stock of D in a transaction qualifying as a reorganization under section 368(a)(1)(B). A plan of reorganization is filed with the IRS pursuant to § 1.368–3(a)(5) that identifies D and E as parties to the reorganization.

(B) *Analysis.* With respect to D and E, the analysis is the same as in paragraph (f)(5)(i)(B) of this section (*Example 1*). C is not described in paragraph (f)(3) of this section. Accordingly, C is not a party to the reorganization.

(iii) *Example 3: Triangular C reorganization*—(A) *Facts.* The facts are the same as in paragraph (f)(5)(ii)(A) of this section (*Example 2*), except that D acquires all the assets of E solely in exchange for voting stock of C, and E distributes the stock of C received in the exchange to E's shareholders, in a transaction that qualifies as a reorganization under section 368(a)(1)(C). A plan of reorganization is filed with the IRS pursuant to § 1.368–3(a)(5) that identifies C, D, and E as parties to the reorganization.

(B) *Analysis.* With respect to D and E, the analysis is the same as in paragraph (f)(5)(i)(B) of this section (*Example 1*). C is described in paragraph (f)(3)(i)(C) of this section and is identified as a party to the reorganization in the plan of reorganization. Accordingly, C also is a party to a reorganization for purposes of determining the scope of the transactions to which the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply. *See* paragraph (f)(2) of this section.

(iv) *Example 4: Transfer of assets acquired in a reorganization*—(A) *Facts.* The facts are the same as in paragraph (f)(5)(iii)(A) of this section (*Example 3*), except that, after the reorganization, D transfers all the assets of E received in the exchange to a partnership in which D owns a significant interest. The partnership continues E's historic business.

(B) *Analysis.* The continuity of business enterprise requirement continues to be satisfied after D's transfer of the E assets to the partnership. *See* § 1.368–1(d)(4)(iii). Consequently, none of C, D, or E ceases to be a party to the reorganization. *See* paragraph (f)(3)(ii)(B) of this section.

(v) *Example 5: Transfer of stock acquired in a triangular reorganization.* The facts are the same as in paragraph (f)(5)(iii)(A) of this section (*Example 3*), except that E merges into D under State law solely in exchange for C stock in a transaction qualifying as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). After the reorganization, C transfers all the stock of D to newly formed Corporation G in exchange for all the stock of G.

(B) *Analysis.* The analysis is the same as in paragraph (f)(5)(iii)(B) of this section. Additionally, the continuity of business enterprise requirement continues to be satisfied after C's transfer of the D stock to G. *See* § 1.368–1(d)(4)(iii). Accordingly, D does not cease to be a party to the reorganization by reason of the transfer. *See* paragraph (f)(3)(ii) of this section.

(vi) *Example 6: Divisive reorganization*—(A) *Facts.* Pursuant to a plan of reorganization for a transaction that qualifies as a reorganization under sections 368(a)(1)(D) and 355, Corporation F transfers one of its businesses to newly formed Corporation G in exchange for all the stock of G and then distributes all the G stock to F's shareholders. The plan of reorganization, which is filed with the IRS pursuant to § 1.368–3(a)(5), identifies F and G as parties to the reorganization.

(B) *Analysis.* The analysis is the same as in paragraph (f)(5)(i)(B) of this section (*Example 1*).

(6) *Applicability date.* The rules of this paragraph (f) apply to transactions intended to qualify under section 368 of the Code for which the earliest of the following dates occurs after [date of publication of final regulations in the **Federal Register**]:

(i) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(ii) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(iii) The date of approval of the transaction by the board of directors of the taxpayer.

(iv) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(v) The date a ruling request for the transaction is submitted to the IRS.

(g) [Reserved]

* * * * *

■ **Par. 16.** Section 1.368–3 is amended by:

■ a. Revising paragraphs (a)(3)(iv) and (4);

■ b. Adding paragraph (a)(5) and

■ c. Revising paragraph (e).

The revisions and addition read as follows:

§ 1.368–3 Records to be kept and information to be filed with returns.

(a) * * *

(3) * * *

(iv) Property not described in paragraph (a)(3)(i), (ii), or (iii) of this section;

(4) The date and control number of any private letter ruling(s) issued by the Internal Revenue Service in connection with this reorganization; and

(5) A copy of the plan of reorganization satisfying the requirements set forth in § 1.368–4(d).

* * * * *

(e) *Applicability date*—(1) *In general.* This section applies to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, *see* § 1.368–3 as contained in 26 CFR part 1 in effect on April 1, 2006.

(2) *Paragraphs (a)(3) and (b)(3).* Paragraphs (a)(3) and (b)(3) of this section apply with respect to reorganizations occurring on or after March 28, 2016, and also with respect to reorganizations occurring before such date as a result of an entity classification election under § 301.7701–3 of this chapter filed on or after March 28, 2016, unless such reorganization is pursuant to a binding agreement that was in effect prior to March 28, 2016 and at all times thereafter.

(3) *Paragraph (a)(5).* Paragraph (a)(5) of this section applies to transactions intended to qualify under section 368 of the Code for which the earliest of the following dates occurs after [date of publication of final regulations in the **Federal Register**]:

(i) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(ii) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(iii) The date of approval of the transaction by the board of directors of the taxpayer.

(iv) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(v) The date a ruling request for the transaction is submitted to the IRS.

■ **Par. 17.** Section 1.368–4 is added to read as follows:

§ 1.368–4 Plan of reorganization.

(a) *Plan of reorganization*—(1) *Scope and purpose.* This section sets forth requirements and procedures for the determination of a plan of reorganization, including the scope of transactions properly included within that plan. The plan of reorganization serves to identify solely those transactions to which the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply. The plan of reorganization also serves to distinguish those qualifying transactions described in § 1.368–1(c)(2)(i) and (ii) from transactions to which the general recognition provisions of the Code (such as section 1001 of the Code) apply. The plan of reorganization is not to be construed as broadening the definition of a *reorganization* as set forth in section 368(a) of the Code.

(2) *Plan of reorganization to which definitional and operative provisions apply.* The provisions described in § 1.368–1(c)(2)(i) and (ii) apply solely to a transaction that is identified in, and carried out pursuant to—

(i) A plan of reorganization of a taxpayer described in paragraph (b)(1) or an amended plan of reorganization described in paragraph (f) of this section;

(ii) A plan of reorganization of a taxpayer that is corrected by the Commissioner under paragraph (b)(2)(i) of this section; or

(iii) A plan of reorganization that is identified by the Commissioner under paragraph (b)(2)(ii) of this section.

(3) *Failure to satisfy requirements.* The failure of a taxpayer to comply with any particular requirement or procedure set forth in this section (including the failure to file a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5)) does not, on its own, prevent a transaction or series of transactions from being considered part of the plan of reorganization, qualifying as a reorganization under a definitional provision, or qualifying for nonrecognition treatment (in whole or in part) under an operative provision.

(b) *Definition.* The term *plan of reorganization* means—

(1) A plan of reorganization of a taxpayer that—

(i) Satisfies all requirements set forth in paragraph (d) of this section; and

(ii) Is filed with the IRS pursuant to § 1.368–3(a)(5); or

(2) A plan of reorganization that results from—

(i) The Commissioner correcting a plan of reorganization of a taxpayer; or

(ii) The Commissioner identifying a plan of reorganization for a taxpayer (in the event of a failure to file a plan of reorganization with the IRS pursuant to § 1.355–5(a)(2)).

(c) *Determination of plan of reorganization*—(1) *Status generally based on plan of reorganization filed by taxpayer.* Except as provided in paragraph (c)(2) of this section, a taxpayer establishes the plan of reorganization for a transaction or series of transactions solely by—

(i) Satisfying all requirements set forth in paragraph (d) of this section; and

(ii) Filing the plan of reorganization with the IRS pursuant to § 1.368–3(a)(5).

(2) *Correction or identification of plan of reorganization due to taxpayer's failure to file a complete plan of reorganization*—(i) *In general.* If a taxpayer files a plan of reorganization with the IRS that fails to satisfy any requirement set forth in paragraph (d) of this section, or if the taxpayer fails to file any plan of reorganization with the IRS, the Commissioner may correct or identify a plan of reorganization in accordance with paragraph (c)(2)(ii) of this section.

(ii) *Status of transactions as part of a plan of reorganization.* The Commissioner may determine that a transaction or series of transactions should be included in, or excluded from, a plan of reorganization described in paragraph (c)(2)(i) of this section based on—

(A) All facts and circumstances regarding the transaction or series of transactions; and

(B) All relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine.

(d) *Requirements for a plan of reorganization.* To qualify as a plan of reorganization described in paragraph (b)(1) of this section, the taxpayer must satisfy all requirements set forth in paragraphs (d)(1) through (3) of this section. For purposes of this paragraph (d) and paragraph (e) of this section, the term *official records* includes a contract or other written agreement to which the taxpayer is a party, a resolution or other document authorized by the taxpayer's board of directors, or other document filed with the U.S. Securities and Exchange Commission (SEC) or other Federal regulatory agency.

(1) *Documentation requirement.* The plan of reorganization is provided in a single, comprehensive document that—

(i) Identifies all parties to the reorganization (as determined pursuant to § 1.368–2(f));

(ii) Identifies all transactions properly included in the plan of reorganization (as determined pursuant to paragraph (e) of this section);

(iii) Identifies all liabilities (including debt) to be assumed by the acquiring corporation and the obligees (or creditors) of those liabilities;

(iv) Identifies all debt of the target corporation that will be satisfied with section 361 consideration (as defined in § 1.361–1(b)(49)) (including all debt intended to qualify for the refinancing exception for historical distributing corporation debt under § 1.361–5(c)) and the creditors of that debt;

(v) Describes the intended Federal income tax treatment of the transactions described in paragraph (d)(1)(ii) of this section;

(vi) Describes the business purpose for each transaction described in paragraph (d)(1)(ii) of this section; and

(vii) Establishes that the readjustments involved in transactions described in paragraph (d)(1)(ii) of this section are undertaken to facilitate the continuance of the business of a corporation a party to the reorganization.

(2) *Adoption of plan of reorganization.* Prior to the first step of the reorganization, a plan of reorganization described in paragraph (b)(1)(i) of this section or an original plan of reorganization that becomes the amended plan of reorganization (within the meaning of paragraph (f) of this section), as applicable, is finalized and adopted by the party to the reorganization, as established by—

(i) The acts of the party's respective duly authorized officers and directors; and

(ii) The official records of the party to the reorganization.

(3) *Completion of plan of reorganization*—(i) *Expeditious prosecution of plan of reorganization*—(A) *General rule.* In accordance with paragraph (d)(3)(iii) of this section, taking into account all facts and circumstances (including the one or more business purposes for the reorganization), all parties to the reorganization complete the plan of reorganization as expeditiously as practicable.

(B) *24-month presumption.* The requirement in paragraph (d)(3)(i)(A) of this section is presumed to be satisfied if, in accordance with paragraph (d)(3)(ii) of this section, all parties to the reorganization complete the plan of reorganization within the 24-month period beginning on the date of the first step of the plan of reorganization.

(ii) *Completion of entire plan of reorganization*—(A) *General rule.* All transactions included in a plan of reorganization must be carried out in the manner described in the plan of reorganization.

(B) *Failure to complete entire plan of reorganization.* Except as provided in paragraph (f) of this section, if the requirement of paragraph (d)(3)(ii)(A) of this section is not satisfied, the provisions described in § 1.368–1(c)(2)(i) and (ii) do not apply to the transaction (or series of transactions) unless the Commissioner determines the existence of a plan of reorganization.

(e) *Requirements for transactions to be treated as properly included in plan of reorganization.* The requirements set forth in this paragraph (e) must be satisfied for a transaction to be treated as properly included in a plan of reorganization. The existence of contingencies or conditions is not conclusive in determining whether a requirement of this paragraph (e) is satisfied.

(1) *Definite intent requirement*—(i) *General rule.* Prior to the first step of the plan of reorganization or an original plan of reorganization that becomes the amended plan of reorganization (within the meaning of paragraph (f) of this section), one or more parties to the reorganization evidences a definite intent to carry out the transaction through a written commitment in one or more official records of the party that substantiate the plan of reorganization.

(ii) *Section 355 transactions.* With regard to a control distribution (as defined in § 1.355–1(a)(2)(iii)) that occurs in the next taxable year after the first distribution, the distributing corporation does not establish a definite intent under paragraph (e)(1)(i) of this section unless all distributions up to and including the control distribution are effectuated pursuant to a binding commitment of the distributing corporation. *See* § 1.355–2(e)(2)(ii).

(iii) *Relevancy of contemplated possibilities*—(A) *Contemplation irrelevant to taxpayer's determination.* The contemplation by a party that the party may carry out a transaction is not sufficient for the party to establish a definite intent to carry out that transaction, regardless of whether that contemplated transaction is included in an official record of a party.

(B) *Contemplation relevant to Commissioner's determination.* A party's contemplation of a transaction may be relevant for purposes of the correction or identification of a plan of reorganization by the Commissioner pursuant to paragraph (c)(2) of this section.

(2) *Proximate relationship requirement*—(i) *General rules.* Taking into account paragraphs (e)(2)(ii) and (iii) of this section:

(A) *Necessary or integral test for application of definitional provision.* A transaction is part of the plan of reorganization for a reorganization to which the provisions described in § 1.368–1(c)(2)(i) apply only if, on its own or as part of a series of transactions, the transaction is necessary to satisfy one or more requirements of a definitional provision described in § 1.368–1(c)(2)(i), or is an integral part of a series of transactions carried out to satisfy the requirements of the definitional provision intended to apply to the reorganization, as evidenced by a written commitment in one or more official records of the party to the reorganization.

(B) *But for, or integral to, test for application of operative provision.* A transaction is part of the plan of reorganization to which the provisions described in § 1.368–1(c)(2)(ii) apply only if, on its own or as part of a series of transactions, the transaction would not occur but for the reorganization that is covered by the plan of reorganization, or is an integral part of a series of transactions carried out to satisfy the requirements of the definitional provision intended to apply to the reorganization, as evidenced by a written commitment in one or more official records of the party to the reorganization.

(ii) *Existence of independent significance not determinative.* The

independent significance of a transaction (for example, the fact that the transaction has a separate business motive apart from the reorganization) does not preclude the satisfaction of the requirements under paragraph (e)(2)(i) of this section.

(iii) *Temporal proximity.* A transaction that takes place in close temporal proximity to one or more other transactions is not properly included in a plan of reorganization under paragraph (e)(2)(i) of this section unless Federal income tax principles (including the step transaction doctrine) would apply to determine that the transaction was in substance part of the plan of reorganization.

(3) *Business purpose consistency requirement.* A transaction, on its own or as part of a series of transactions is consistent with, and directly related to, one or more business purposes for the reorganization (for example, the transaction directly furthers one or more business purposes for the reorganization).

(f) *Amended plan of reorganization*—(1) *Conditions.* If a taxpayer amends a plan of reorganization described in paragraph (b)(1) of this section (original plan of reorganization) after the first step of the original plan of reorganization (amended plan of reorganization), those amendments will not cause the taxpayer to fail to satisfy the requirements set forth in paragraph (d) of this section only if—

(i) Those amendments are in direct response to an identifiable, unexpected, and material change in market or business conditions that occurs after the date on which the original plan of reorganization is adopted by the party to the reorganization in the manner described in paragraph (d)(2) of this section;

(ii) The amendments are necessary to achieve the one or more business purposes for the reorganization; and

(iii) The amended plan of reorganization satisfies all requirements set forth in paragraph (d) of this section.

(2) *Consequences of plan of reorganization amended due to changed circumstances*—(i) *Qualifying amended plan of reorganization.* If the requirements set forth in paragraph (f)(1) of this section are satisfied, the provisions described in § 1.368–1(c)(2)(i) and (ii) will apply to transactions identified in, and carried out pursuant to, the amended plan of reorganization. That is, the Federal income tax consequences of all transactions included in the amended plan of reorganization will be determined based on that plan of reorganization (and not on the original plan of reorganization).

(ii) *Non-qualifying amended plan of reorganization.* If an amended plan of reorganization fails to satisfy all requirements set forth in paragraph (f)(1) of this section, the Commissioner may correct or identify the amended plan of reorganization.

(g) *Examples.* The following examples illustrate the application of the rules of this section. For purposes of these examples, unless otherwise stated: terms defined in § 1.361–1(b) and used in these examples have the meaning given such terms in § 1.361–1(b); all transactions are completed within the 24-month period beginning on the date of the first transaction; all transactions qualify for the Federal income tax treatment intended by the taxpayers, as described in the facts of each example; and all corporations are calendar-year taxpayers.

(1) *Example 1: Creation of plan of reorganization*—(i) *Facts.* A target corporation (Target) transfers all its assets to an acquiring corporation (Acquiring) solely in exchange for stock of Acquiring and Acquiring's assumption of Target liabilities. Target distributes all the Acquiring stock to Target's shareholders. The transaction is intended to qualify as a reorganization under section 368(a)(1)(C). Target fails to file a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5).

(ii) *Analysis.* Target's failure to file a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) does not, on its own, prevent the series of transactions from qualifying as a reorganization under section 368(a)(1)(C). *See* paragraph (a)(3) of this section. The Commissioner may identify a plan of reorganization for the series of transactions based on all facts and circumstances and all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine. *See* paragraphs (b)(2)(ii) and (c)(2) of this section. The definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply to the series of transactions identified in, and carried out pursuant to, the plan of reorganization identified by the Commissioner. *See* paragraph (a)(2)(iii) of this section.

(2) *Example 2: Correction of taxpayer's plan of reorganization*—(i) *Facts.* An acquiring corporation (Acquiring) acquires a target corporation (Target) through the following series of transactions. Acquiring first effectuates a tender offer for 51 percent of Target stock from Target shareholders solely for Acquiring voting stock (tender offer). A subsidiary of Acquiring (Merger Sub) then merges into Target (statutory merger) in a transaction intended to qualify as a reverse subsidiary merger under section 368(a)(2)(E). In the statutory merger, Acquiring's Merger Sub stock is converted into Target stock, and each Target shareholder holding shares of the remaining 49 percent of Target stock exchanges its shares of Target stock for a combination of consideration, two-thirds of which is Acquiring stock and one-third of which is cash. Under general principles of Federal income tax law, including the step transaction doctrine, the tender offer and the statutory merger are treated as an integrated acquisition by Acquiring of all the Target stock. Target files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) that satisfies all requirements set forth in paragraph (d) of this section, except that the plan of reorganization does not mention the tender offer.

(ii) *Analysis.* To determine whether the tender offer should be included in the plan of reorganization for the statutory merger, the Commissioner may examine all facts and circumstances regarding the series of transactions and apply all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine. *See* paragraph (c)(2)(ii) of this section. Because the tender offer and the statutory merger are treated as an integrated series of transactions for Federal income tax purposes, the tender offer and the statutory merger are treated as an integrated acquisition for purposes of determining whether the transaction qualifies as a reverse subsidiary merger under section 368(a)(2)(E). Accordingly, the Commissioner may correct Target's plan of reorganization by including the tender offer. *See* paragraph (c)(2)(i) of this section. The definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply to the transactions identified in, and carried out pursuant to, the plan of reorganization as corrected by the Commissioner. *See* paragraph (a)(2)(ii) of this section.

(3) *Example 3: Scope of plan of reorganization—distribution to equalize values*—(i) *Facts.* On June 30, 2025, Corporation X and Corporation Y decide to merge into newly formed Corporation Z. As reflected in a single, comprehensive document that satisfies the requirements set forth in paragraph (d)(1) of this section, the board of directors of each of X and Y approves the transaction pursuant to paragraph (d)(2) of this section, with the agreement that X and Y must be of equal value

when merged into Z. Consequently, to equalize the amount of its assets and Y's assets, and pursuant to a board resolution, X distributes $100x in cash to its shareholders on September 30, 2025 (equalizing distribution). On October 31, 2025, X and Y consolidate under State law (X/Y consolidation) in a transaction intended to qualify as a reorganization described in section 368(a)(1)(A).

(ii) *Analysis.* The board resolution pursuant to which the equalizing distribution was made, and the single, comprehensive document that reflects the decision of both boards of directors that X and Y be of equal value when combined in the X/Y consolidation, evidence a definite intent, prior to the first step of the plan of reorganization, for X to make the equalizing distribution. *See* paragraph (e)(1) of this section. The equalizing distribution is an integral part of the X/Y consolidation because the equalizing distribution satisfies a condition identified by the boards of directors of X and Y for executing the X/Y consolidation (that is, to equalize the values of X and Y prior to the X/Y consolidation). *See* paragraph (e)(2)(i)(B) of this section. The equalizing distribution is consistent with, directly relates to, and therefore directly furthers the business purpose for the X/Y consolidation, because the X/Y consolidation is intended to effectuate a merger of equals. *See* paragraph (e)(3) of this section. Accordingly, the equalizing distribution is properly included in the plan of reorganization for the X/Y consolidation. *See* paragraph (e) of this section. Consequently, the Federal income tax consequences of the equalizing distribution and the X/Y consolidation are determined under the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii). *See* paragraph (a)(2)(i) of this section.

(4) *Example 4: Scope of plan of reorganization—pre-merger stock acquisition*—(i) *Facts.* Two potential acquiring corporations (X and Y) engage in competing tender offers to acquire 100 percent of the stock of a target corporation (Target). X and Y carry out the tender offers through their respective subsidiary corporations. On June 30, 2025, before acquiring any shares in Target, X subsidiary signs an agreement with Target (X/Target agreement) providing that, among other conditions (including regulatory approval and approval by the shareholders of X and Target), if X subsidiary successfully acquires at least 51 percent of Target's outstanding stock through its tender offer, X will acquire all remaining Target stock by causing Target to merge into X subsidiary in a transaction intended to qualify as a reorganization under section 368(a)(2)(D) (subsidiary merger). As of September 30, 2025, X subsidiary has been tendered 51 percent of Target's outstanding stock. On October 15, 2025, Y subsidiary tenders to X subsidiary all of Y subsidiary's Target shares received in Y subsidiary's tender offer (30 percent of Target's outstanding stock) in exchange for X stock (Y share exchange). On November 1, 2025, pursuant to the X/Target agreement, X causes Target to merge into X subsidiary (that is, the subsidiary merger). The subsidiary merger satisfies the requirements of a definitional provision described in § 1.368–1(c)(2)(i) regardless of whether X subsidiary's tender offer (including the Y share exchange) is included in the plan of reorganization for the subsidiary merger.

(ii) *Analysis.* The X/Target agreement imposes a legal obligation on X subsidiary to carry out the subsidiary merger if X subsidiary's tender offer is successful. Therefore, this agreement evidences a definite intent, prior to the first step of the plan of reorganization, for X subsidiary to carry out both of those transactions as part of a plan of reorganization. *See* paragraph (e)(1) of this section. Satisfaction of this requirement is not affected by the fact that the subsidiary merger is subject to significant conditions, including a successful X subsidiary tender offer, regulatory approval, and X and Target shareholder approvals. *See* paragraph (e) of this section. The X/Target agreement establishes that X subsidiary's tender offer is an integral part of a series of transactions carried out to satisfy the requirements of section 368(a)(2)(D). *See* paragraph (e)(2) of this section. Satisfaction of this requirement is not affected by the fact that X subsidiary's tender offer has a degree of economic significance independent of the subsidiary merger. *See* paragraph (e)(2)(ii) of this section. X's business purpose for the merger is to acquire all the remaining outstanding stock of Target, as established through the X/Target agreement. The tender offer is consistent with, directly relates to, and therefore directly furthers that business purpose. *See* paragraph (e)(3) of this section. Accordingly, X subsidiary's tender offer and the Y share exchange are properly included in the plan of reorganization for the subsidiary merger. Consequently, the Federal income tax consequences of both X subsidiary's tender offer and the subsidiary merger are determined under the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii). *See* paragraph (a)(2) of this section.

(5) *Example 5: Scope of plan of reorganization—multiple distributions of controlled corporation stock to constitute a control distribution*—(i) *Facts.* On June 30, 2025, a distributing corporation (Distributing) contributes property to a newly formed controlled corporation (Controlled) in exchange for Controlled stock (contribution). On September 30, 2025, Distributing distributes 57 percent of the Controlled stock to Distributing's shareholders (first distribution). On January 1, 2026, Distributing distributes the remaining 43 percent of Controlled stock to Distributing's shareholders (final distribution; together with the contribution and the first distribution, the separation). The separation and distribution agreement provides that Distributing will distribute 57 percent of Controlled stock during Distributing's 2025 taxable year, but only expresses a contemplated possibility that Distributing will distribute the remaining 43 percent of Controlled stock. Distributing files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) with its Federal income tax return for the 2025 taxable year that includes the first distribution and the final distribution as part of the plan of reorganization for the separation.

(ii) *Analysis.* If a taxpayer files a plan of reorganization with the IRS that fails to satisfy any requirement set forth in paragraph (d) of this section, the Commissioner may correct the plan of reorganization. *See* paragraph (c)(2)(i) of this section. The Commissioner may correct the plan of reorganization to exclude a transaction based on an examination of all facts and circumstances and consideration of all relevant provisions of the Code and general principles of Federal income tax law, including the step transaction doctrine. *See* paragraph (c)(2)(ii) of this section. The final distribution is properly excluded from the plan of reorganization for the separation because Distributing fails to satisfy the definite intent requirement with respect to the final distribution. *See* paragraph (e)(1)(i) and (iii) of this section. Specifically, because the distribution of control (that is, the final distribution) occurs in the next taxable year after the first distribution and is not pursuant to a binding commitment, Distributing does not establish a definite intent under paragraph (e)(1)(i) of this section. *See* paragraph (e)(1)(ii) of this section. The definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) apply solely to the transactions identified in, and carried

out pursuant to, the plan of reorganization as corrected by the Commissioner (that is, the contribution and first distribution). *See* paragraph (a)(2) of this section. Accordingly, the transaction would fail to meet the definitional requirement under section 368(a)(1)(D) because the first distribution, by itself, does not meet the requirement set forth in § 1.355–2(e)(2)(i).

(6) *Example 6: Scope of plan of reorganization—qualifying distribution of amount of controlled corporation stock constituting section 368(c) control*—(i) *Facts.* The facts are the same as in paragraph (g)(5)(i) of this section (*Example 5*), except for the following. First, Distributing provides in its separation and distribution agreement with Controlled that Distributing will distribute the remaining 43 percent of Controlled stock during 2026. Second, for its Federal income tax return for the 2025 taxable year, Distributing files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) that satisfies all requirements set forth in paragraph (d) of this section, including the establishment, by reference to the separation and distribution agreement, that Distributing will distribute to its shareholders pursuant to a binding commitment 57 percent of Controlled stock during 2025 and the remaining 43 percent of Controlled stock during 2026.

(ii) *Analysis.* The final distribution is properly included in the plan of reorganization for the separation because Distributing satisfies the definite intent requirement to make the final distribution. *See* paragraph (e)(1)(ii) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the contribution and both the first distribution and the final distribution are determined under the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii). *See* paragraph (a)(2)(i) of this section.

(7) *Example 7: Scope of plan of reorganization—contribution and distribution in divisive reorganization*—(i) *Facts.* On June 1, 2025, a distributing corporation (Distributing) contributes property to a newly formed controlled corporation (Controlled) in exchange for Controlled stock and Controlled's assumption of Distributing liabilities related to the contributed business (contribution). On September 1, 2025, Distributing distributes all Controlled stock to Distributing's shareholders (distribution; together with the contribution, the separation). A separation and distribution agreement between Distributing and Controlled, filed by Distributing with the SEC, evidences a definite intent, prior to the first step of the separation, to carry out each of these transactions comprising the separation. Additional official records of Distributing provide that the separation is carried out to sharpen management focus on, and reduce competition for capital between, the retained and contributed businesses, which includes ensuring that earnings of each business are used to pay liabilities arising solely from that business. Distributing files a plan of reorganization with the IRS pursuant to § 1.368–3(a)(5) with its Federal income tax return for the 2025 taxable year.

(ii) *Analysis*—(A) *Contribution.* The contribution is properly included in the plan of reorganization for the separation. *See* paragraph (e) of this section. First, as substantiated by the separation and distribution agreement, Distributing and Controlled evidence a definite intent, prior to the first step of the plan of reorganization, to carry out the contribution. *See* paragraph (e)(1)(i) of this section. Second, the contribution is necessary to satisfy the requirements of section 368(a)(1)(D). *See* paragraph (e)(2)(i)(A) of this section. Lastly, the contribution is consistent with, is directly related to, and therefore directly furthers, the business purpose for the reorganization. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the contribution are determined under a definitional provision described in § 1.368–1(c)(2)(i) (that is, section 368(a)(1)(D)). *See* paragraph (a)(2) of this section.

(B) *Controlled liability assumption.* Controlled's liability assumption is properly included in the plan of reorganization for the separation. *See* paragraph (e) of this section. First, as substantiated by the separation and distribution agreement, Distributing and Controlled evidence a definite intent, prior to the first step of the plan of reorganization, for the liability assumption to occur. *See* paragraph (e)(1)(i) of this section. Second, the liability assumption would not have occurred but for, and is integral to, the separation, because the assumption ensures that the respective liabilities of the retained and contributed businesses continue to be associated with those businesses. *See* paragraph (e)(2)(i)(B) of this section. Lastly, the Controlled liability assumptionis consistent with, is directly related to, and therefore directly furthers the business purpose for the reorganization by ensuring that the earnings of each business are used to pay liabilities arising solely from that business (in other words, furthering Distributing's fit-and-focus corporate business purpose). *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the liability assumption are determined under an operative provision described in § 1.368–1(c)(2)(ii) (that is, section 357). *See* paragraph (a)(2) of this section.

(C) *Distribution.* The distribution is properly included in the plan of reorganization for the separation. *See* paragraph (e) of this section. First, as substantiated by the separation and distribution agreement, Distributing and Controlled evidence a definite intent, prior to the first step of the plan of reorganization, for Distributing to make the distribution. *See* paragraph (e)(1)(i) of this section. Second, the distribution is necessary to satisfy the requirements of section 368(a)(1)(D). *See* paragraph (e)(2)(i)(A) of this section. Lastly, the distribution is consistent with, is directly related to, and therefore directly furthers, the fit-and-focus corporate business purpose for the reorganization. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the distribution are determined under the definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii) (that is, sections 355 and 368(a)(1)(D)). *See* paragraph (a)(2) of this section.

(8) *Example 8: Scope of plan of reorganization—boot purge through special dividend*—(i) *Facts.* The facts are the same as in paragraph (g)(7)(i) of this section (*Example 7*), except for the following. As part of the contribution, Distributing receives cash from Controlled in partial exchange for the assets contributed by Distributing to Controlled. Distributing distributes that cash to its shareholders pursuant to a special dividend declared by Distributing's board of directors (special dividend boot purge) that is intended to facilitate an appropriate post-separation capital structure for the retained and contributed businesses. The separation and distribution agreement, a resolution adopted by Distributing's board of directors, and other official records of Distributing collectively evidence a definite intent, prior to the first step of the separation, to carry out the transactions comprising the separation (including the special dividend boot purge). In particular, those documents provide that the special dividend is in addition to any regularly occurring

dividends distributed to Distributing's shareholders pursuant to Distributing's dividend payment policy (as reflected in documents filed by Distributing with the SEC).

(ii) *Analysis.* The special dividend boot purge is properly included in the plan of reorganization for the separation. *See* paragraph (e) of this section. First, as substantiated by the separation and distribution agreement and other official records of Distributing, Distributing and Controlled evidence a definite intent, prior to the first step of the plan of reorganization, for Distributing to make the special dividend boot purge. *See* paragraph (e)(1)(i) of this section. Second, the special dividend boot purge would not occur but for the separation, as evidenced by the separation and distribution agreement and other official records of Distributing, and by the fact that the special dividend is in addition to any regularly occurring dividends made pursuant to Distributing's dividend payment policy. *See* paragraph (e)(2)(i)(B) of this section. Lastly, the special dividend boot purge is consistent with, directly relates to, and therefore directly furthers the business purpose for the separation because the special dividend boot purge facilitates an appropriate post-separation capital structure for the retained and contributed businesses (thereby facilitating Distributing's fit-and-focus corporate business purpose). *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the special dividend boot purge are determined under an operative provision described in § 1.368–1(c)(2)(ii) (that is, section 361). *See* paragraph (a)(2) of this section.

(9) *Example 9: Scope of plan of reorganization—boot purge through special stock repurchase*—(i) *Facts.* The facts are the same as in paragraph (g)(8)(i) of this section (*Example 8*), except that Distributing uses the Controlled cash to fund a special repurchase of Distributing stock (and, accordingly, is not part of an existing stock repurchase program approved by Distributing's board of directors).

(ii) *Analysis.* The analysis is the same as in paragraph (g)(8)(ii) of this section (*Example 8*).

(10) *Example 10: Scope of plan of reorganization—boot purge through ordinary course dividend*—(i) *Facts.* The facts are the same as in paragraph (g)(8)(i) of this section (*Example 8*), except for the following. Distributing provides in the separation and distribution agreement, or other official records of Distributing, that Distributing will distribute the Controlled cash to Distributing's shareholders through an ordinary course dividend made pursuant to Distributing's dividend payment policy. After the distribution date, Distributing pays an ordinary course dividend that is funded with the cash received from Controlled in the contribution (that is, the Controlled cash).

(ii) *Analysis.* The ordinary course dividend is properly excluded from the plan of reorganization for the separation because the dividend would have occurred regardless of the separation. Therefore, the ordinary course dividend fails the ''but for, or integral to, test'' for application of operative provision. *See* paragraph (e)(2)(i)(B) of this section. Accordingly, the Federal income tax consequences of the ordinary course dividend are determined under section 301 of the Code, not an operative provision described in § 1.368–1(c)(2)(ii). *See* paragraph (a)(2) of this section.

(11) *Example 11: Scope of plan of reorganization—boot purge through existing stock repurchase program*—(i) *Facts.* The facts are the same as in paragraph (g)(10)(i) of this section (*Example 10*), except that Distributing uses the Controlled cash to fund a repurchase of Distributing stock pursuant to an existing stock repurchase program approved by Distributing's board of directors.

(ii) *Analysis.* The analysis is the same as in paragraph (g)(10)(ii) of this section (*Example 10*). Accordingly, the Federal income tax consequences of the ordinary course stock repurchase are determined under section 301 or 302 of the Code, and not an operative provision described in § 1.368–1(c)(2)(ii). *See* paragraph (a)(2) of this section.

(12) *Example 12: Scope of plan of reorganization—securities-for-debt exchange*—(i) *Facts.* The facts are the same as in paragraph (g)(7)(i) of this section (*Example 7*), except for the following. As part of the contribution, Distributing receives securities from Controlled in partial exchange for the assets contributed by Distributing to Controlled. Distributing transfers those Controlled securities to a creditor of Distributing in a series of transactions that satisfies all the requirements set forth in § 1.361–5(a) (securities-for-debt exchange). The separation and distribution agreement, a resolution adopted by Distributing's board of directors, and other official records of Distributing, collectively evidence a definite intent, prior to the first step of the separation, to carry out each of the transactions comprising the securities-for-debt exchange. Consistent with the requirements set forth in §§ 1.361–5(a) and 1.368–3(a)(5), Distributing identifies the historical Distributing debt and the qualifying creditor with regard to that historical Distributing debt, prior to the first step of the plan of reorganization that includes the separation.

(ii) *Analysis.* The securities-for-debt exchange is properly included in the plan of reorganization for the separation because the exchange satisfies all conditions required by paragraph (e) of this section. First, as substantiated by the separation and distribution agreement and other official records of Distributing, Distributing evidences a definite intent, prior to the first step of the plan of reorganization, to carry out the securities-for-debt exchange. *See* paragraph (e)(1)(i) of this section. Second, the securities-for-debt exchange would not occur but for the separation, as evidenced by the separation and distribution agreement and other official records of Distributing. *See* paragraph (e)(2)(i)(B) of this section. Lastly, the securities-for-debt exchange is consistent with, and directly relates to, the fit-and-focus corporate business purpose for the separation, because it facilitates the elimination of competition for capital between the retained and contributed businesses through the establishment of an appropriate post-separation capital structure for each of those businesses. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the securities-for-debt exchange are determined under an operative provision described in § 1.368–1(c)(2)(ii). *See* paragraph (a)(2) of this section.

(13) *Example 13: Scope of plan of reorganization—dispositions of retained stock*—(i) *Facts.* The facts are the same as in paragraph (g)(7)(i) of this section (*Example 7*), except for the following. On September 30, 2025, Distributing distributes to its shareholders 80 percent of the outstanding Controlled stock, constituting a control distribution. With regard to the retained stock, the separation and distribution agreement and other official records of Distributing provide that Distributing will transfer the retained stock to a creditor of Distributing in a stock-for-debt exchange that satisfies the requirements set forth in §§ 1.361–5(a) and 1.368–3(a)(5) (stock-for-debt exchange). The separation and distribution agreement and those other

official records also provide that, to the extent the retained stock is not disposed of in the stock-for-debt exchange, Distributing will distribute that retained stock to Distributing's shareholders (follow-on spin-off). Lastly, the separation and distribution agreement provides that, to the extent the retained stock is not disposed of after Distributing succeeds or fails in completing the stock-for-debt exchange and follow-on spin-off, Distributing will sell the retained stock on the open market by not later than five years after the first distribution date (open-market sale). Distributing describes these contingent commitments in its plan of reorganization filed with the IRS pursuant to § 1.368–3(a)(5).

(ii) *Analysis*—(A) *Stock-for-debt exchange.* The stock-for-debt exchange is properly included in the plan of reorganization for the separation because the exchange satisfies all conditions required by paragraph (e) of this section. First, as substantiated in the separation and distribution agreement, in which Distributing expresses that it will carry out the stock-for-debt exchange, Distributing evidences a definite intent, prior to the first step of the plan of reorganization, to carry out the stock-for-debt exchange. *See* paragraph (e)(1) of this section. The satisfaction of this requirement is not affected by the fact that Distributing might engage in the follow-on spin-off or the open-market sale to dispose of all the retained stock in the event that the stock-for-debt exchange does not result in a total disposition of that stock, because Distributing is committed in writing in one or more of its official records to attempt to complete the exchange. *See* paragraph (e) of this section. Second, the stock-for-debt exchange would not occur but for the separation, as evidenced by the separation and distribution agreement. *See* paragraph (e)(2)(i)(B) of this section. Lastly, the stock-for-debt exchange is consistent with, and directly relates to, the fit-and-focus corporate business purpose for the separation, because it facilitates the elimination of competition for capital between the retained and contributed businesses through the establishment of an appropriate post-separation capital structure for each of those businesses. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the securities-for-debt exchange are determined under an operative provision described in § 1.368–1(c)(2)(ii). *See* paragraph (a)(2) of this section.

(B) *Follow-on spin-off.* The follow-on spin-off is properly included in the plan of reorganization for the separation because that distribution satisfies all conditions required by paragraph (e) of this section. First, as substantiated by the separation and distribution agreement, in which Distributing expresses that it will carry out the follow-on spin-off, Distributing evidences a definite intent, prior to the first step of the plan of reorganization, to carry out the follow-on spin-off. *See* paragraph (e)(1) of this section. The satisfaction of this requirement is not affected by the contingency arising from the fact that Distributing commits to first attempt to carry out the stock-for-debt exchange, because Distributing commits in writing in one or more of its official records to carry out the follow-on spin-off in the event that the stock-for-debt exchange does not occur or does not result in the disposition by Distributing of all the retained stock. *See* paragraph (e) of this section. For the same reason, the satisfaction of this requirement is not affected by the fact that Distributing ultimately might engage in the open-market sale to dispose of all the retained stock, in the event that the follow-on spin-off does not result in a total disposition of that stock. *See* paragraph (e) of this section. In addition, the follow-on spin-off would not occur but for the separation, as evidenced by the separation and distribution agreement. *See* paragraph (e)(2)(i) of this section. Lastly, the follow-on spin-off is consistent with, and directly relates to, the fit-and-focus corporate business purpose for the separation because it would further the separation of the retained and contributed businesses. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the Federal income tax consequences of the follow-on spin-off are determined under an operative provision described in § 1.368–1(c)(2)(ii) (that is, section 361). *See* paragraph (a)(2) of this section.

(C) *Open-market sale.* The open-market sale is properly included in the plan of reorganization for the separation because that sale satisfies all conditions required by paragraph (e) of this section. First, as evidenced by the separation and distribution agreement and other official records of Distributing, in which Distributing expresses that it will carry out the open-market sale, Distributing evidences a definite intent, prior to the first step of the plan of reorganization, to carry out the open-market sale. *See* paragraph (e)(1) of this section. The satisfaction of this requirement is not affected by the contingency that Distributing commits to first attempt to carry out the stock-for-debt exchange and then the follow-on spin-off, because Distributing commits in writing in one or more of its official records to carry out the open-market sale in the event that the stock-for-debt exchange and the follow-on spin-off, taken together or on their own, do not occur or do not result in the disposition by Distributing of all the retained stock. *See* paragraph (e) of this section. In addition, the open-market sale is necessary to satisfy one or more of the requirements of a definitional provision described in § 1.368–1(c)(2)(i) intended to apply to the reorganization. *See* paragraph (e)(2)(i)(A) of this section. Lastly, the open-market sale is consistent with, and directly relates to, the fit-and-focus corporate business purpose for the separation because it would further the separation of the retained and contributed businesses. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the open-market sale is taken into account along with the contribution and distribution for determining the Federal income tax consequences of the separation under sections 355 and 368(a)(1)(D) (that is, the relevant definitional and operative provisions described in § 1.368–1(c)(2)(i) and (ii)). *See* paragraph (a)(2) of this section.

(14) *Example 14: Scope of plan of reorganization—dispositions of retained stock*—(i) *Facts.* The facts are the same as in paragraph (g)(13)(i) of this section (*Example 13*), except for the following. With regard to the retained stock, the separation and distribution agreement and other official records of Distributing provide that Distributing might transfer the retained stock to a creditor of Distributing in a stock-for-debt exchange that satisfies the requirements set forth in §§ 1.361–5(a) and 1.368–3(a)(5) (stock-for-debt exchange). The separation and distribution agreement and other official records of Distributing also provide that Distributing might distribute that retained stock to Distributing's shareholders (follow-on spin-off). Lastly, those documents provide that, to the extent the retained stock is not disposed of after Distributing succeeds or fails in completing the stock-for-debt exchange and follow-on spin-off, Distributing will sell the retained stock on the open market by not later than five years after the first distribution date (open-market sale). Distributing describes these

contemplated possibilities of carrying out the stock-for-debt exchange and follow-on spin-off, as well as its written commitment to carry out the open-market sale, in its plan of reorganization filed with the IRS pursuant to § 1.368–3(a)(5).

(ii) *Analysis*—(A) *Stock-for-debt exchange.* The stock-for-debt exchange is properly excluded from the plan of reorganization for the separation because the exchange fails to satisfy all conditions required by paragraph (e) of this section. Specifically, as evidenced by the separation and distribution agreement and other official records of Distributing, Distributing treats the occurrence of the stock-for-debt exchange as a contemplated possibility, thereby failing to evidence a definite intent to carry out the transaction. *See* paragraph (e)(1)(iii) of this section. Accordingly, as corrected by the Commissioner, the securities-for-debt exchange is excluded from the taxpayer's plan of reorganization (and therefore section 361(c), the otherwise relevant operative provision described in § 1.368–1(c)(2)(ii), does not apply). *See* paragraph (a)(2)(ii) of this section.

(B) *Follow-on spin-off.* The analysis is the same as in paragraph (g)(14)(ii)(A) of this section (*Example 14*). Therefore section 361(c), the otherwise relevant operative provision described in § 1.368–1(c)(2)(ii), does not apply.

(C) *Open-market sale.* The open-market sale is properly included in the plan of reorganization for the separation because the sale satisfies all conditions required by paragraph (e) of this section. First, as substantiated by the separation and distribution agreement, in which Distributing expresses that it will carry out the open-market sale, Distributing evidences a definite intent, prior to the first step of the plan of reorganization, to carry out the open-market sale. *See* paragraph (e)(1) of this section. The satisfaction of this requirement is not affected by the contingency created by Distributing's contemplation of carrying out the stock-for-debt exchange and the follow-on spin-off, because Distributing commits in writing in one or more of its official records to carry out the open-market sale in the event that the stock-for-debt exchange and the follow-on spin-off, taken together or on their own, do not occur or do not result in the disposition by Distributing of all the retained stock. *See* paragraph (e) of this section. In addition, the open-market sale is necessary to satisfy one or more of the requirements of a definitional provision described in § 1.368–1(c)(2)(i) intended to apply to the reorganization. *See* paragraph (e)(2)(i)(A) of this section. Lastly, the open-market sale is consistent with, and directly relates to, the fit-and-focus corporate business purpose for the separation because it would further the separation of the retained and contributed businesses. *See* paragraph (e)(3) of this section. Accordingly, based on the correct and properly filed plan of reorganization pursuant to § 1.368–3(a)(5), the open-market sale is taken into account along with the contribution and distribution for determining the Federal income tax consequences of the separation under the relevant definitional provisions described in § 1.368–1(c)(2)(i). *See* paragraph (a)(2) of this section.

(15) *Example 15: Scope of plan of reorganization—dispositions of retained stock*—(i) *Facts.* The facts are the same as in paragraph (g)(14)(i) of this section (*Example 14*), except for the following. With regard to the retained stock, the separation and distribution agreement and other official records of Distributing provide that the open-market sale also is a contemplated possibility, rather than subject to a written commitment by Distributing.

(ii) *Analysis*—(A) *Stock-for-debt exchange.* The analysis is the same as in paragraph (g)(14)(ii)(A) of this section (*Example 14*).

(B) *Follow-on spin-off.* The analysis is the same as in paragraph (g)(14)(ii)(B) of this section (*Example 14*).

(C) *Open-market sale.* The open-market sale is properly excluded from the plan of reorganization for the separation because the open-market sale fails to satisfy all conditions required by paragraph (e) of this section. Specifically, as evidenced by the separation and distribution agreement and other official records of Distributing, Distributing treats the occurrence of the open-market sale as a contemplated possibility, thereby failing to evidence a definite intent to carry out the transaction. *See* paragraph (e)(1)(iii) of this section. Accordingly, the open-market sale is not taken into account for purposes of satisfying the relevant definitional provision described in § 1.368–1(c)(2)(i), pursuant to a plan of reorganization corrected by the Commissioner. *See* paragraph (a)(2)(ii) of this section.

(h) *Applicability date.* This section applies to transactions intended to qualify under section 368 of the Code for which the earliest of the following dates occurs after [date of publication of final regulations in the **Federal Register**]:

(1) The date of the first public announcement (as defined in § 1.355–7(h)(10)) of the transaction.

(2) The date of entry by the taxpayer into a written agreement to engage in the transaction.

(3) The date of approval of the transaction by the board of directors of the taxpayer.

(4) The date of a court order (or a plan confirmed, or a sale approved, by order of a court) in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Code), but only if the taxpayer was a debtor in a case before such court.

(5) The date a ruling request for the transaction is submitted to the IRS.

Douglas W. O'Donnell,

Deputy Commissioner.

[FR Doc. 2025–00321 Filed 1–13–25; 4:15 pm]

BILLING CODE 4830–01–P