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Spinoff Rulings; *Morris Trust* Repeal?

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As most practitioners know, Revenue Procedure 96-30, 1996-1 C.B. 696, gives the current rundown of items that need to be submitted to obtain a ruling under Section 355. A Section 355 ruling is, after all, a pretty important condition to most Section 355 transactions, the "use an opinion of counsel" notion not having become as popular as some once thought it might be. Revenue Procedure 96-30 has a lot of information in it, and is coupled with a useful checklist. It even sets out a business purpose appendix, containing a nonexclusive list of business purposes that are deemed permissible. For details of Revenue Procedure 96-30, see Wood, "Spinoff

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Changes Amounts," Vol. 4, No. 11, *M&A Tax Report* (June 1996), p. 1.

Not too long after the release of Rev. Proc. 96-30, the Service published Revenue Procedure 96-39, 1996-33, I.R.B. 11, also impacting Section 355 rulings. This procedure, dubbed "odious" by *M&A Tax Report* Advisory Board Member Gil Bloom, established an IRS no-ruling category in cases where "there have been negotiations, agreements or arrangements with respect to transactions or events which, if treated as consummated before the [spinoff] would result in the distribution of stock or securities of a corporation which is not controlled by the distributing corporation...."

This "we'll treat it as if it was consummated pursuant to a negotiations even if negotiations are not fruitful" notion understandably has upset some people. See Bloom, "New Odious Rev. Proc. on Spinoffs," Vol. 5, No. 4, *M&A Tax Report*, (Nov. 1996), p. 1. However, according to the IRS, spinoff submissions are actually on the rise. Come again?

More Rulings?

The IRS has indicated in a recent bar association meeting that both the quantity and quality of Section 355 ruling submissions are up this year. Indeed, a couple of Revenue Service officials announced, presumably due to Revenue Procedure 96-30, that there were quite a few more rulings being requested. Furthermore, the generally unpopular Viacom ruling has apparently not prompted the IRS to develop guidelines on the issue of disproportionate debt allocations. (For details about the Viacom ruling, see Wood, "Viacom 355 Ruling Sparks Praise and Criticism," Vol. 5, No. 1, *M&A Tax Report* (Aug. 1996), p. 1.)

For most of us, this is obviously good news. Still, the IRS comments apparently did not note that a lot more rulings are being ***granted***! (For details on the IRS comments, see Stratton, "Spin-off Rulings on the Rise, Officials Say," Vol. 75, No. 1, *Tax Notes* (Apr. 7, 1997), p. 41.)

No to TCI

Actually, one well-publicized transaction has just failed to receive a ruling from the IRS. Tele-Communications, Inc. ("TCI") has announced that it is canceling the plan to spinoff three units because the IRS declined to rule that the transaction would be tax-free to Tele-Communications shareholders. TCI had requested rulings on the distribution of Liberty Media Corp., TCI International, Inc., and Liberty's 9% stake in Time Warner, Inc. According to reports, the reason that the Service refused to rule is that it asked for assurances from the estate of a major shareholder as to the estate's actions after the spinoff. The Service wanted the estate to represent and warrant that it would not turn around and sell TCI stock or stock from any of the spun off units. TCI reported that the estate of the shareholder could not give such assurances to the IRS because the estate had fiduciary duties to its beneficiaries. See "TCI to Cancel Plan to Spin Off Units as IRS Declines to Rule on Tax Status," *Wall Street Journal*, April 10, 1997, p. B16.

Legislative Assault

But what surely is most worth mentioning at this juncture is the seemingly wholesale legislative assault on Section 355. At this writing, the introduction of legislation by both Senate Finance Committee Chairman William D. Roth, Jr. (R-Del) and House Ways and Means Committee Chairman Bill Archer

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(R-Tex), suggests that *Morris Trust* transactions may go the way of the *General Utilities* doctrine. Indeed, the *Wall Street Journal* even referred to these deals as "nonsale sales." See "Top Tax Writers in Congress Take Aim at Closing Popular Corporate Loophole," *Wall Street Journal*, April 18, 1997, p. A4. The *Wall Street Journal* even included a cleverly titled table "In Morris We Trusted" listing the biggest transactions in the past twelve months accomplished under Section 355. See "Closing Loophole Puts a Chill in Tax-Free Deals," *Wall Street Journal*, April 21, 1997, p. A3.

Of course, while Section 355 deals will obviously be dramatically affected, it is not as though Congress is proposing a total repeal of Section 355. Not yet anyway. Instead, the proposals are directed at acquisitions in which one corporation distributes the stock of a subsidiary to its shareholders in a spinoff and, under a pre-arranged plan, either the distributed subsidiary or the old parent corporation is acquired by another, unrelated corporation. Frequently, the corporation that is to be acquired will borrow or assume a large amount of debt incurred before the spinoff, while the proceeds of the indebtedness will be retained by the other corporation. The *Morris Trust* moniker comes from the up until now seemingly sacrosanct case of *Commissioner v. Mary Archer W. Morris Trust*, 367 F.2d 794 (4th Cir. 1966).

The proposals would foist various other restrictions on Section 355 deals, too. If, according to a plan or arrangement that was in existence on the date of the Section 355 distribution, either the controlled or the distributing corporation is acquired, then gain would be recognized by the other corporation as of the date of the distribution. Acquisitions occurring within the four-year period that begins two years *before* the date of the distribution would be presumed to have occurred under such a plan or arrangement. As proposed, it would be possible to rebut this presumption. Thus, a taxpayer would be able to avoid gain recognition (at least theoretically) by showing that an acquisition that occurs during the four-year period was unrelated to the distribution. However, one could expect that there would be a significant *in terrorem* effect to this rule.

One of the more disturbing factors in this particular legislative assault is the effective date of these proposed amendments to Section 355. Far from allowing companies to take advantage of existing law until a certain cutoff date (remember *General Utilities* repeal back in 1986?), the proposed effective date of this set of enormous changes would be retroactive to April 16, 1997. Wall Street has already noted that various potential transactions are likely to be affected, particularly America On Line, Inc.'s talks to acquire H&R Block, Inc.'s CompuServe. That deal was supposedly a few days away from being signed. (For further coverage on the H&R Block deal and this unfortunate timing, see "AOL, CompuServe Pact is Threatened," *Wall Street Journal*, April 21, 1997, p. B2.

Due to the importance of the Congressional proposals, further analysis will be contained in an upcoming issue of *The M&A Tax Report*. ■