

# Spin Cycle

By Robert W. Wood · San Francisco

Although we may be used to the legal niceties of worrying about whether spin-offs meet the requirements of Code Sec. 355 (particularly the business purpose and device notions), there are occasionally basic number-crunching issues that someone has to deal with. For example, SBC Communications, Inc.'s proposal to buy AT&T made news as possibly the ultimate tax preparation nightmare. Given the complexity of AT&T's restructuring efforts, acquisitions, spin-offs and stock splits, this is hardly a simple determination.

Indeed, many of the 2.7 million shareholders holding AT&T shares have little idea of the initial value or basis of their shares. Suppose someone bought shares in AT&T before 1984 when the monopoly was broken up by the government; such an investor held onto their shares and may have owned, at one time or another, shares of 20 different companies. [See Kim, *AT&T Investors Face Tax Headache*, WALL ST. J., Feb. 3, 2005, at D-1.]

Some of those companies ended up gobbling up each other and/or spun-off their own companies, leading to a kind of chain letter effect. Understanding the basis of an original investment here would require investors not only to calculate their AT&T cost basis, but also to factor in all of the spun-off companies, *etc.*

## Cost Savings, Fit & Focus

Elsewhere in the world, spin-offs are still in the news. For example, Sara Lee has announced

plans to spin-off its U.S. and Asia apparel businesses. [See Grant, *Sara Lee Unveils Spin-Off Revamp*, FINANCIAL TIMES, Feb. 11, 2005, at 24. This is seen as yet another in a line of big food company spin-offs. Dean Foods Co. announced in January that it would spin-off its \$700,000 million pickle and private label food business, focusing on its milk and dairy product lines. Sara Lee's plans to spin-off its apparel operations rather than sell it—guess what—save shareholders a tax burden. After the spin, Sara Lee is to be a slimmer operation. [See Adamy, *Sara Lee to Spinoff Apparel Arm*, WALL ST. J., Feb. 11, 2005, at A-5.]

Thinking about the Sara Lee transaction makes me wonder about our old friend the business purpose requirement. Presumably, Sara Lee will justify its contemplated transaction by reference to the fit and focus of the business. Or, Sara Lee may try to spin this as a tale of cost savings.

Not too many years ago, I viewed the blossoming "cost savings" business purpose as perhaps the be-all and end-all. Economists sometimes refer to it with a more exotic moniker of "economies of scale," but it may not matter exactly how savings arise as long as—one way or the other—they are attributable to the corporate separation.

Once upon a time, the IRS would provide taxpayers a ruling that taxpayers had a valid business purpose. [See Rev. Proc. 96-30, 1996-1

CB 696.] Those days, alas, are no more. The IRS hinted at changes to its operating procedures at the annual ABA Tax Section meeting in Washington in May 2003. There, then-IRS Chief Counsel B. John Williams indicated that regarding Code Sec. 355, the future of IRS guidance would be to address common questions that affect many taxpayers in a generic way, rather than providing guidance to individual taxpayers.

In other words, Williams was saying that the IRS was shifting focus away from issuing private rulings in this area. Generic every-man advice was better. According to Williams, this general guidance simply uses IRS resources more effectively and serves the public in a more egalitarian way. Of course, I would think taxpayers would be pleased to be able to more effectively rely on such guidance (rather than attempting to rely on someone else's individual private letter rulings that are prominently stamped "Don't Rely On This!").

### **No More Business Purpose Rulings**

The IRS wasted no time in issuing Rev. Proc. 2003-48 [1996-1 CB 696] in July 2003. Rev. Proc. 2003-48 provided that the IRS would no longer issue rulings under Code Sec. 355 to determine whether a proposed or completed distribution of stock of a controlled corporation was being carried out for one or more business purposes.

Rather, this determination would now be made based upon an examination of a taxpayer's return. Indeed, under Rev. Proc. 2003-48, taxpayers requesting a ruling under Code Sec. 355 must only represent to having a valid business purpose. The IRS expressly provided that it did not want to review any documentation or substantiation regarding business purpose in the ruling request.

Rev. Proc. 2003-48 effectively deleted all of the business purpose language in Rev. Proc. 96-30 that taxpayers had been using as guidance. Nothing in Rev. Proc. 2003-48 suggested, however, that the analysis previously required by Rev. Proc. 96-30 to determine whether a valid business purpose exists has really changed. After all, that kind of analysis was hardly out of left field.

Thus, even though Rev. Proc. 2003-48 expressly deleted all of the business purpose language from Rev. Proc. 96-30, it behooves taxpayers to continue to analyze any particular scenario under the now-deleted language. And, even though taxpayers need only represent to a valid business purpose to obtain a ruling these days, it also behooves taxpayers to prepare this analysis contemporaneously. Really, if all of the chips were to fall one day, and upon audit, an agent asks for details about the business purpose of a spin done years before, where do you think the IRS is going to start its own analysis?

I really can't imagine that the IRS's positions, as expressed in countless private rulings over the years which were based on Rev. Proc. 96-30, have changed all that much. Obviously, the IRS decided to stop blessing taxpayer's business purpose in advance. Yet, from what I can tell, so far, the IRS's positions on the nitty-gritty of business purpose generally haven't changed.

### **Last Word**

Rev. Proc. 2003-48 was issued as a pilot program intended to apply for at least one year. It has been over one and a half years now, and it does not appear that the IRS is going back to its old ways of issuing rulings for business purpose. Regardless, savvy tax practitioners still should keep Rev. Proc. 96-30 in their back pocket, as it seems to continue to represent the underpinnings of current IRS positions.

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