

M&A Update

IRS Mulls Change to Spinoff Rules

May 27, 2015

In a statement that would mark a stark change in approach, an IRS official recently indicated that the IRS may begin requiring that companies seeking to effect tax-free spinoffs conduct active businesses that represent a minimum percentage of the companies' assets. The official noted that the IRS may hold future requests by taxpayers for guidance on this issue in abeyance. Although some linked this statement to Yahoo's planned spinoff of a company holding stock in Alibaba, the Chinese e-commerce company, and the Yahoo Small Business unit, the official indicated that, for the moment, pending ruling requests (presumably including Yahoo's) would not be affected.

This new approach would reverse published IRS guidance dating back over 40 years stating that there is no "minimum size" requirement for an active business. Over a decade ago, the IRS also eliminated any minimum size requirement for taxpayers seeking a private ruling confirming a spinoff's tax-free treatment. Since then, senior IRS officials have publicly disavowed a minimum size requirement on several occasions.

Takeaways

This development continues the recent IRS trend limiting taxpayers' ability to obtain private rulings on spinoffs. While the importance of IRS rulings has waned now that such rulings are limited to single issues, a qualifying active business remains particularly important to spinoffs of real estate investment trusts (REITs) and portfolio companies and to "cash-rich" splitoffs. For example, after a spinoff, a REIT may appropriately rely on a relatively small ancillary business where its principal leasing business might not satisfy the spinoff rules.

While we expect the IRS to give particularly careful thought to changing course on this issue in light of its published guidance and consistent public statements to the contrary, we and taxpayers will be closely monitoring future developments.

* * * * *

If you have any questions, please contact any of the following attorneys or your Cadwalader contacts:

Linda Z. Swartz	+1 212 504 6062	linda.swartz@cwt.com
William P. Mills	+1 212 504 6436	william.mills@cwt.com
Richard M. Nugent	+1 212 504 6499	richard.nugent@cwt.com