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Clarifying Devices and Active Businesses Under Code Sec. 355

By Donald P. Board • Wood LLP

Corporate spin-offs and their tax travails may not stir up all of the political fervor of inversions, but they continue to make news. A dramatic recent example was Yahoo's ill-fated plan to spin off its \$35 billion stake in Alibaba, the Chinese e-commerce giant. Yahoo asked the IRS for a private letter ruling that the transaction would qualify for tax-free treatment under Code Sec. 355.

Without a ruling, there was no guaranty that Yahoo's distribution of its Alibaba stake would not turn out to be a taxable dividend to its shareholders under Code Sec. 301(b). The spin-off could also have left Yahoo facing a \$12 billion tax bill under Code Sec. 311(b). Unfortunately, for Yahoo and its shareholders, the IRS declined to provide the requested ruling.

The company bravely but briefly considered going ahead with the spin-off without the IRS's blessing. An opinion letter might have been just fine, but writing an opinion on a potential \$12 billion tax bill could have been unsettling for everyone. So on December 9, 2015, Yahoo announced that the deal was off.

Yahoo's shareholders were no doubt frustrated that all those Alibaba shares remained just out of reach. They might have been surprised—though probably not much comforted—to learn that their 21st century tax problem was not all that new. Shareholders, corporations, Congress and the U.S. Treasury have now been wrestling with the taxation of spin-offs for more than a *century*.

From Rockefeller to Gregory

Back in 1915, the shareholders of the Ohio Oil Company, led by John D. Rockefeller, were facing a regulatory dilemma. The Supreme Court had recently held that the Ohio Oil Company was a common carrier and that its oil pipeline business was subject to regulation by the Interstate Commerce Commission. [*The Pipe Line Cases*, S Ct, 234 US 548 (1914).] Not to be outdone, Congress immediately put the company's petroleum manufacturing business under the jurisdiction of the Federal Trade Commission.

To avoid regulatory conflicts, the shareholders decided to separate the two businesses. The Ohio Oil Company kept the manufacturing operation, but it contributed its pipeline assets to a new subsidiary.

The pipeline company's shares were then distributed, *pro rata*, to Mr. Rockefeller and his fellow investors.

Behold the classical spin-off! After the distribution, the shareholders continued to own exactly the same oil and pipeline businesses as before, in precisely the same proportions. The only difference was that they now operated their two businesses through a pair of brother-sister corporations.

The spin-off may have solved their regulatory problem, but Mr. Rockefeller and the other shareholders still ended up fighting with the government. Now, the problem was the new-fangled Revenue Act of 1913, the direct ancestor of today's individual income tax. According to the Collector of Internal Revenue, the shareholders' receipt of the pipeline company shares had been a taxable dividend.

The dispute reached the Supreme Court in *J.D. Rockefeller* [Sct, 1 USTC ¶155, 257 US 176, 42

SCt 68 (1921)]. Mr. Rockefeller's counsel, the formidable Harrison Tweed, argued that his client could not be taxed under the Revenue Act or the Sixteenth Amendment because the distribution of the pipeline shares was not a true dividend. As anyone could see, the spin-off had done nothing more than adjust the *form* of John D.'s massive investment.


Mr. Tweed had substance on his side, but he argued in vain. It took the Supreme Court only a couple of paragraphs to conclude that the distribution of the pipeline company shares was a dividend to Mr. Rockefeller. The richest man in the world would have to pay tax on the value of his pipeline shares at the top rate for 1915—a confiscatory seven percent.

Congress overturned the result in *Rockefeller* in 1924, when it authorized tax-free spin-offs pursuant to a plan of reorganization. No doubt the legislators assumed that they were just letting shareholders move their existing operations into new corporate shells to deal with business or regulatory exigencies. Mr. Rockefeller's spin-off would have been a case in point.

It was not long, however, before shareholders had devised a way to use the new law to bail out corporate earnings and profits at capital-gain rates. The corporation with the E & P (Distributing) would contribute cash or liquid assets to a newly formed subsidiary (Controlled) and then distribute the shares of Controlled on a tax-free basis. The shareholders of Distributing could then sell or otherwise realize on the value of the Controlled shares without triggering anything worse than a capital gain.

Everybody in the tax trade or business knows what happened next. In *E. Gregory* [Sct, 35-1 USTC ¶9043, 293 US 465, 55 SCt 266 (1935)], the Supreme Court held that complying with the letter of the statute was not enough to immunize a spin-off from tax. If the transaction lacked a business purpose or was "a mere device" to conceal a bailout of Distributing's E & P, the shareholders' receipt of the shares of Controlled would be taxed as a dividend.

Congress, however, was in no mood to take chances. In 1934, before the Supreme Court even decided *Gregory*, Congress simply *repealed* the spin-off provision. For the next 17 years, American capitalism lived under the unforgiving rule of the *Rockefeller* case.



The M&A Tax Report
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Modern Times

The modern era dawned in 1951, when Congress enacted another statute permitting tax-free spin-offs. But this time it tried to distinguish between Mr. Rockefeller's merely formal adjustment and Mrs. Gregory's barefaced bailout. These provisions were codified in 1954 and are the progenitors of today's Code Sec. 355(a)(1)(B) and 355(b).

Under Code Sec. 355(a)(1)(B), a spin-off will not qualify for tax-free treatment if it is used "principally as a device" for distributing the earnings and profits of Distributing or Controlled. Similarly, under Code Sec. 355(b), the transaction will be taxable unless both Distributing and Controlled are engaged in the "active conduct of a trade or business" after the spin-off.

Over the intervening six decades, the Treasury and the IRS have worked and re-worked the criteria for deciding what constitutes a prohibited device and what qualifies as an active trade or business. The latest installment is an important set of proposed regulations released on July 14, 2016. [REG-134016-15; 2016-IRB 205.]

They have been popularly dubbed the "hot dog stand" regulations. The new rules are directed against spin-offs in which either Distributing or Controlled ends up with nonbusiness assets that are disproportionately large in comparison with its business assets. Yahoo's Alibaba spin-off would have been a perfect target.

Yahoo's tax planners had made sure that Controlled would have more to do after the spin-off than just keep an eye on \$35 billion in Alibaba stock. Controlled would also conduct an active trade or business described in Code Sec. 355(b). But there was a quantitative issue.

This active business would have represented just 0.2 percent of the total value of Controlled. Of course, \$70 million is hardly peanuts. But Controlled's active business would still have been just a fancy hot dog stand compared with its portfolio of Alibaba shares.

It is notable that Yahoo asked the IRS for a ruling even though Controlled's ratio of nonbusiness assets to business assets was almost 500 to 1. Also notable is the fact that Yahoo's tax counsel reportedly stood ready to provide a "will" opinion on the spin-off—even after the IRS refused to rule on the transaction! \$12 billion in potential tax be damned?

Given the magnitude of the disconnect, the Treasury and the IRS clearly owed taxpayers and their counsel some new guidance on the device and active trade of business requirements. The 2016 proposed regulations, if adopted in their current form, will greatly clarify the limits.

Active Trade or Business

Code Sec. 355(b) says that both Distributing and Controlled must be engaged in the active conduct of a trade or business following the spin-off. Complicated rules regulate what activities will or will not qualify. However, Code Sec. 355(b) never gets around to saying that a qualifying trade or business must be any specific *size*. Historically, the same has been true of the regulations.

The IRS's position on how much is enough has varied over time. In Rev. Rul. 73-44, it held that a spin-off in which Controlled's active trade or business represented less than 50 percent of the value of its total assets could still satisfy Code Sec. 355(b). But Rev. Rul. 73-44 provided no real guidance on just how low the percentage could go. The IRS was content to leave the matter open, stating only that Controlled's trade or business was "substantial."

Two decades' worth of letter rulings later, the Treasury and the IRS decided to provide more explicit guidance on the low end. Rev. Proc. 96-43 announced that the IRS would not rule on a proposed spin-off unless Distributing and Controlled were both conducting an active trade or business representing at least *five percent* of the total value of their respective assets.

After a few years, however, the IRS revoked its no-rule position. [Rev. Proc. 2003-48, 2003-2 CB 86.] The IRS then issued a series private rulings approving transactions in which the active trade or business of either Distributing or Controlled was plainly *de minimis* compared with its nonqualifying assets—the proverbial hot dog stand. Yahoo was likely banking on these permissive rulings when it asked the IRS to approve its 500-to-1 Alibaba spin-off.

Shortly after the IRS told Yahoo that it would not rule on the deal, the Treasury and the IRS publicly announced their change of course. On September 14, 2015, Rev. Proc. 2015-43 re-imposed a five-percent requirement to get a ruling on a spin-off.

At the same time, Notice 2015-59 informed taxpayers and their counsel that the Treasury and the IRS had the whole area under study. The proposed regulations issued in July 2016 are a product of that review.

Five-Percent Requirement

The proposed regulations roll over the hot dog stand like a juggernaut. They declare that Code Sec. 355(b) is not satisfied unless both Distributing and Controlled have a Five-Year-Active-Business Asset Percentage of at least five percent. [Proposed Reg. §1.355-9(b).]

As one would expect, a corporation's "Five-Year-Active-Business Asset Percentage" means the percentage of its total assets that qualify as Five-Year-Active-Business Assets. [Proposed Reg. §1.355-9(a)(6).] "Five-Year-Active-Business Assets" are assets used in the active conduct of one or more trades or businesses within the meaning of Code Sec. 355(b). In keeping with their name, they must satisfy the usual five-year requirements of Code Sec. 355(b)(2)(B), (C) and (D). [Proposed Reg. §1.355-9(a)(2).]

Sensibly enough, Five-Year-Active-Business Assets include cash and cash equivalents if they are held as a reasonable amount of working capital for the business in question. Assets that the corporation is required (by law or by binding legal commitment) to hold to provide for exigencies of the business or for regulatory purposes can also qualify as Five-Year-Active-Business Assets. [Proposed Reg. §1.355-9(a)(3).]

For much of the history of Code Sec. 355(b), Distributing and Controlled usually got credit only for trades or businesses that they conducted *directly*. Congress changed this in 2006. Now, a corporation is treated as conducting any trade or business conducted by a member of its "separate affiliated group" (SAG).

A corporation's SAG, as defined in Code Sec. 355(b)(3)(B), is the affiliated group that would be determined under Code Sec. 1504(a) if the corporation were the common parent. Of course, when the corporation is Distributing, its SAG does not include Controlled and its SAG. The point, after all, is to evaluate the activities of Distributing and the other members of its SAG *after* the spin-off.

Partnership interests do not generally qualify as Five-Year-Active-Business Assets. [Proposed Reg. §1.355-9(c)(3)(i).]

However, there can be situations in which a corporation's ownership and management of a partnership are so extensive that the IRS is willing to treat the corporation as engaged in a Five-Year Active Business conducted by the partnership. [See, e.g., Rev. Rul. 92-17 and Rev. Rul. 2002-49.]

In those cases, a proportional look-through rule applies. The value of the partnership interest is allocated to the corporation's Five-Year-Active-Business Assets in the same proportion that the value of the partnership's Five-Year-Active-Business Assets bears to the partnership's total assets. [Proposed Reg. §1.355-9(c)(3)(ii).]

Device

Under Code Sec. 355(a)(1)(B), a spin-off is taxable if it is "used principally as a device" for the distribution of the earnings and profits of either Distributing or Controlled. Since 1989, the regulations have also stated that a device can include a transaction that allows for basis recovery. [Reg. §1.355-2(d)(1).] The fact that dividends and capital gains are currently taxed to individuals at the same rate does not obviate the device inquiry.

The current regulations provide an elaborate apparatus to help decide whether a spin-off is being used principally as a device to bail out E & P. The regulations look to all the facts and circumstances surrounding the spin-off. These include the presence (or absence) of the "device factors" listed in Reg. §1.355-2(d)(2) and the "nondevice factors" listed in Reg. §1.355-2(d)(3).

The proposed regulations make three major changes to the current regime:

- The "nature and use of assets" device factor in current Reg. §1.355-2(d)(2)(iv) is revised to include a safe harbor for spin-offs in which the percentage of nonbusiness assets held by each of Distributing and Controlled does not exceed 20 percent.
- Some business purposes are disregarded as nondevice factors under current Reg. §1.355-2(d)(3)(ii) unless there are exigent circumstances requiring the separation of business from nonbusiness assets.
- A new "*per se* device" test is triggered if one of the corporations holds a large percentage of nonbusiness assets (66 2/3 percent or

more), and if this figure is also much *higher* than the percentage of nonbusiness assets held by the other corporation.

Ownership of Nonbusiness Assets

Whether a spin-off is being used principally as a device depends, in part, on the “nature, kind, amount, and use” of the assets of Distributing and Controlled. [Reg. §1.355-2(d)(2)(iv)(A).] If either corporation owns assets that are not used in an active trade or business meeting the requirements of Code Sec. 355(b), that is a sign of device. §1.355-2(d)(2)(iv) device. [Reg. §1.355-2(d)(2)(iv)(B)].

The proposed regulations continue to focus on whether assets are used in an active trade or business. The new term “Business Assets” is defined to mean assets used in the active conduct of a trade or business within the meaning of Code Sec. 355(b). [Proposed Reg. §1.355-2(d)(2)(iv)(B)(2).]

However, in a significant innovation, the proposed regulation states that Code Sec. 355(b) is to be applied without regard to the “five-year” requirements of Code Sec. 355(b)(2)(B), (C) and (D). [Proposed Reg. §1.355-2(d)(2)(iv)(B)(1).] Business Assets, in other words, must be active, but they do not have to be Five-Year-Active-Business Assets.

The proposed regulations treat a corporation and its SAG as a single corporation for purposes of determining its Business Assets. [Proposed Reg. §1.355-2(d)(2)(iv)(D)(2).] Proportional look-through rules provide partial credit for Business Assets held by certain partnerships and corporations that would be members of the SAG if a 50-percent ownership threshold applied (rather than the usual 80 percent). [Proposed Reg. §1.355-2(d)(2)(iv)(D)(6) and (7).]

“Nonbusiness Assets” are defined as all assets that are not Business Assets. This prepares the way for the definition of the key term in the proposed device regulations. A corporation’s “Nonbusiness Asset Percentage” is the percentage of the corporation’s total assets that are Nonbusiness Assets. [Proposed Reg. §1.355-2(d)(2)(iv)(B)(3) and (5).]

Twenty-Percent Safe Harbor

While the ownership of Nonbusiness Assets by either Distributing or Controlled is evidence of device, *how strong* the evidence is depends on all the facts and circumstances. As under

current law, the larger the Nonbusiness Asset Percentage, the stronger the evidence of device. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(1).]

But the proposed regulations also provide that ownership of Nonbusiness Assets will ordinarily *not* be evidence of device if both Distributing and Controlled have a Nonbusiness Asset Percentage of *less* than 20 percent. [*Id.*] To put it more positively, a spin-off in which Business Assets represent at least 80 percent of the value of both Distributing and Controlled is unlikely to constitute a device.

No Five-Year Requirement?

As noted above, the proposed regulations specify that Business Assets do not have to satisfy the several “five-year” requirements of Code Sec. 355(b). This should be a welcome change, but its rationale is not clear. The preamble says only that the Treasury and the IRS have determined that the presence of Business Assets that do not meet the five-year requirement “generally does not raise any more device concerns than the presence of assets used in a Five-Year-Active Business.”

Why not? It is not difficult, after all, for Distributing to convert cash into Business Assets before contributing them to Controlled. That is why the active trade of business requirement imposes all those five-year tests.

Is there some reason to think that it would be difficult for Controlled to convert its new Business Assets *back to cash* following the spin-off? Of course, it might want to wait a decent interval before selling the Business Assets. But, if the shareholders are patient, they still end up holding shares of a pot of cash that would have flunked the device test.

The IRS could certainly challenge the spin-off under the step-transaction doctrine. But the IRS cannot challenge what it does not see. Are the Treasury and the IRS really so confident that the IRS will be able to track and police post-spin asset sales? And do they really want to devote resources to fighting about whether Controlled’s ownership of the Business Assets should be disregarded?

The five-year requirements of Code Sec. 355(b) may well be excessive. If so, it might be better to *reduce* the “holding period” for device purposes to something more reasonable, *e.g.*, 18 months. Jettisoning the requirement *in toto* is simply asking for trouble.

Ten-Percentage-Point Safe Harbor

What if Distributing emerges from the spin-off with a Nonbusiness Asset Percentage of 20 percent, while Controlled comes out at 50 percent? As under the current regulations, a *difference* in the Nonbusiness Asset Percentage of the two corporations is itself treated as evidence of device. The larger the difference, the stronger the evidence. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(2).]

The proposed regulations preserve the current exception for a difference in Nonbusiness Asset Percentages following a distribution that is not *pro rata*, e.g., in a split-off. If the difference is attributable to the need to equalize the value of the stock and securities of Controlled that are distributed and the value of the stock and securities of Distributing that are given up in exchange, the difference will not ordinarily be viewed as evidence of device. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(2)(ii).]

But the proposed regulations do break some new ground. If the difference between the Nonbusiness Asset Percentages of Distributing and Controlled is *less* than 10 percentage points, even after a *pro rata* distribution, the difference will ordinarily not be considered evidence of device. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(2)(i).] Although this probably does not represent a major change in substantive IRS policy, tax practitioners will still appreciate a rule that facilitates planning in this area.

Corporate Business Purpose

Gregory famously insisted that a spin-off must have a business purpose independent of federal taxes. That requirement continues in current Reg. §1.355-2(b), which says that the transaction must be carried out for one or more nontax corporate business purposes.

However, corporate business purpose also plays a role as a potential nondevice factor. Current Reg. §1.355-2(d)(3)(ii) indicates that a “strong” corporate purpose may be able to overcome even substantial evidence of device—for example, Distributing’s disproportionate transfer or retention of assets not used in a trade or business.

The preamble to the proposed regulations observes that some taxpayers have taken the position that even a relatively *weak* corporate business purpose can overcome substantial evidence of device if other nondevice factors are present. Yahoo, for example, might have pointed to the fact that it is publicly traded and

has no greater-than-five-percent shareholders. Under the current regulations, these are both evidence of nondevice. [Reg. §1.355-2(d)(3)(iii).]

The proposed regulations accept that a corporate business purpose can outweigh the ownership of Nonbusiness Assets or the existence of a substantial difference in the Nonbusiness Asset Percentages of Distributing and Controlled. However, they impose a more restrictive rule when the corporate business purpose relates to the separation of Nonbusiness Assets from one or more Businesses or Business Assets. Such a purpose will not be considered evidence of nondevice unless there is “an exigency that requires an investment or other use of the Nonbusiness Assets” in one or more businesses of Distributing or Controlled. [Proposed Reg. §1.355-2(d)(3)(ii).]

The proposed regulations offer two examples to illustrate what will or will not count as an “exigency.” Example 2 of Proposed Reg. §1.355-2(d)(4) imagines two corporations, Distributing and Controlled, whose Business Assets are worth \$100 and \$105, respectively.

Distributing owns all the stock of Controlled. Both companies operate fast-food restaurants, but they hold their franchises from competing franchisors. This becomes a problem when Controlled’s franchisor sends notice that it will terminate the franchise if Controlled remains a subsidiary of Distributing.

The franchisor’s threat would normally constitute a fine corporate business purpose for Distributing to spin off Controlled. However, the analysis in Example 2 is complicated by the fact that Distributing holds \$195 of cash as a Nonbusiness Asset.

Distributing’s lease for its restaurant will expire in 24 months, and Distributing thinks that it may want to purchase a building as its future home. Distributing therefore contributes *only* \$45 of its \$195 cash to Controlled and retains \$150 so that it will have funds available if it decides to purchase a building.

Thus, Distributing emerges from the spin-off with total assets worth \$250 (\$100 in Business Assets plus \$150 in cash). Its Nonbusiness Asset Percentage is 60 percent. Controlled, on the other hand, comes away with Business Assets worth \$105 and \$45 in cash. Its Nonbusiness Asset Percentage is only 30 percent.

Both corporations hold more than 20 percent

of their total value in the form of Nonbusiness Assets, which is evidence of device. There is also a 30-percentage-point *difference* between their Nonbusiness Asset Percentages—further evidence of device, particularly when a distribution is *pro rata*.

Appeasing Controlled's franchisor is a good reason for executing *some* kind of spin-off. But nothing about responding to the franchisor's threat requires Distributing to come away with 60 percent of its assets in the form of cash while Controlled's figure is only 30 percent.

Distributing might nonetheless point to its plan to use the extra cash to purchase a building when its lease expires in 24 months. The proposed regulations, however, say that Distributing's need to relocate in 24 months is not a good corporate business purpose because "it is not required by any exigency." Example 2 therefore concludes that the spin-off flunks the device requirement.

Example 4 of Proposed Reg. §1.355-2(d)(4) varies the facts slightly. Now Distributing's lease is going to expire in *six* months, and Distributing has apparently decided to use \$80 of the \$150 in cash it retains to buy a building. The proposed regulations find that Distributing's retention of the \$80 "is required by business exigencies" and that, under all the facts and circumstances, the spin-off is not being used principally as a device.

The proposed regulations do not explain how the competing device and nondevice factors were weighed against each other. That is a question of judgment, which by nature is a hard matter to pin down. However, once one accepts that Distributing's retention of the \$80 in cash is a legitimate business purpose, one might recalculate Distributing's Nonbusiness Asset Percentage treating the \$80 as a Business Asset—just as an actual building would be if it were being used to house the restaurant.

In that case, Distributing's Nonbusiness Asset Percentage would drop from 60 percent to 28 percent. While still evidence of device, that figure would not be grossly in excess of the 20-percent cut-off for the safe harbor. So, the evidence of device would be relatively weak. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(1).]

Distributing's recalculated Nonbusiness Asset Percentage would also be well within 10 percentage points of Controlled's (30 percent). This means the difference in percentages would

not even be considered evidence of a device. [Proposed Reg. §1.355-2(d)(2)(iv)(C)(2)(ii).]

Government officials have acknowledged that Examples 2 and 4 leave plenty of questions about what will count as a business exigency. So, on August 26, 2016, the IRS amended its "no-rule" list to permit letter rulings on corporate business purpose and device. [Rev. Proc. 2016-45, IRB 2016-37, 344.] This should help create, as one Treasury official put it, "a body of law and lore" that taxpayers and the IRS can use to evaluate claims of business exigency.

Per Se Device

The proposed regulations provide Distributing and Controlled with a measure of assurance that their ownership of Nonbusiness Assets is *not* evidence of device if their respective Nonbusiness Asset Percentages meet certain tests. How about on the other end of the spectrum? Is there a line that Distributing and Controlled must *not* cross?

Historically, the answer has been no. All the facts and circumstances must be taken into account, including the various device and nondevice factors. The Treasury and the IRS, however, have decided it is time to draw some brighter lines in Proposed Reg. §1.355-2(d)(5). The basic idea is straightforward.

If the Nonbusiness Asset Percentage of Distributing or Controlled is high enough (at least 66 2/3 percent), and the difference between the two companies' Nonbusiness Asset Percentages is large enough (about 40 percentage points), the spin-off will be considered a device regardless of any nondevice factors that may be present. However, the proposed regulations are designed to avoid or limit disputes about Nonbusiness Asset Percentages.

The actual rule therefore operates in terms of "bands" of values, so that a disagreement involving a few percentage points will generally not affect the outcome. The first step is to identify the corporation whose Nonbusiness Asset Percentage is at least 66 2/3 percent ("HighCo"). HighCo is then assigned to one of three bands based on its percentage:

- Band 1: At least 66 2/3 percent but less than 80 percent
- Band 2: At least 80 percent but less than 90 percent
- Band 3: 90 percent and above

Attention then shifts to the other corporation (“LowCo”). The spin-off will be considered a *per se* device if LowCo’s Nonbusiness Asset Percentage is *too low*:

- Less than 30 percent (if HighCo is in Band 1)
- Less than 40 percent (if HighCo is in Band 2)
- Less than 50 percent (if HighCo is in Band 3)

The point of the shifting threshold is to maintain a reasonably constant test for how big the *difference* between the two corporations’ Nonbusiness Asset Percentages is. If HighCo is in Bands 2 or 3, there is a *per se* device only if the intercorporate delta is least 40 percentage points.

If HighCo is in Band 1, there is a *per se* device only if the delta is at least 36 2/3 percentage points. This deviation does not reflect any real policy distinction. It is simply an artifact of the decision to use 66 2/3 percent as the threshold for entry into Band 1. If Band 1 had started at 70 percent, the 30-percent requirement for LowCo would have ensured that the delta was at least 40 percentage points—the same as when HighCo is in Bands 2 or 3.

Conclusion

It has been more than 100 years since the Ohio Oil Company spun off its pipeline business to Mr. Rockefeller and friends. It has been more than 80

years since the Supreme Court decided *Gregory*. But the problem of distinguishing legitimate spin offs from abusive bailouts is still with us.

The 2016 proposed regulations do not claim to have all the answers. But they provide important guidance at both ends of the spin-off spectrum. The revived five-percent active trade or business test and the new *per se* device test should reorient practitioners whose natural exuberance may have carried them away.

If they find themselves on the wrong side of either line, they will know that they need to dial it back. Or, as Yahoo has been doing, look for an alternative to a spin-off. You can’t have everything, after all.

Conversely, tax planners who tend to worry and need certainty should take considerable comfort in both the five-percent test for active trade or business and the new 20-percent safe harbor for device. The proposed regulations’ clear focus on fighting *Gregory*-style bailouts should buck up their courage when planning a *bona fide* division of one or more active trades or businesses.

That is good, because many tax practitioners may never have dared to orchestrate a spin-off. The proposed regulations, when finalized, may give us all a chance to make Mr. Rockefeller proud.

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