

## IRS Distributes New Ruling Requirements for Corporate Spin-Off Transactions



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On May 1, 2024, the IRS released [Revenue Procedure 2024-24](#), which sets forth new requirements for requests for private letter rulings (PLRs) on corporate spin-off and split-off transactions. (Both spin-offs (transactions in which a corporation (“Remainco”) distributes stock of a subsidiary (“Spinco”) to its shareholders as a dividend in kind) and split-offs (transactions in which the stock of the subsidiary is exchanged for outstanding Remainco stock) are generally subject to the same tax rules, and this article refers to both types of transactions as spin-offs.) This month’s [long-anticipated](#) Revenue Procedure represents the first systematic guidance on spin-off and split-off transactions since the IRS’s release of [Revenue Procedure 2017-52](#) and reaffirms the IRS’s stated intention, first announced in the 2017 Revenue Procedure as a pilot program, to provide comprehensive rulings that address as many legal aspects of a spin-off transaction as possible. (To conserve resources, between 2013 and 2017, the [IRS would provide rulings only on so-called significant issues](#) in spin-off transactions.) The Revenue Procedure updates or expands representations that taxpayers must provide in a number of areas, and it represents an important shift in IRS policy in a few particular areas.

### Debt-for-Debt and Debt-for-Equity Exchanges

In many spin-off transactions, a Remainco is permitted not only to distribute Spinco stock to its shareholders, but also to distribute either stock or newly issued debt of Spinco to its creditors—effectively repaying its existing debt with Spinco stock or debt. While this exchange of Remainco debt for Spinco debt (a debt-for-debt or “D4D Exchange”) or equity (a debt-for-equity or “D4E Exchange”) can be effected via private negotiation with or tender offers to existing creditors, Remaincos have generally found it easier to adopt either an “intermediated” exchange (where an intermediary, generally a financial institution, acquires Remainco’s existing debt in anticipation of exchanging it for Spinco stock or debt) or a “direct issuance” transaction (where Remainco issues new debt, repaying existing indebtedness with the proceeds, and shortly thereafter agrees to exchange the new debt for Spinco stock or debt).

The new Revenue Procedure addresses both structures. “Intermediated” transactions are largely approved, although the IRS requires a number of specific representations, as well as a detailed description of Remainco’s relationship with any intermediary in order to ensure that the intermediary will be respected for tax

purposes as a creditor of Remainco, rather than as its agent. (If the intermediary is not treated as holding Remainco's debt for its own account, the exchange of Remainco debt for Spinco debt or equity could be recast as a transaction that is taxable to Remainco.) By contrast, the "direct issuance" model is effectively prohibited: any Remainco debt that is repaid in a D4D or D4E Exchange, whether held by an intermediary or a longstanding creditor, must be "old and cold" debt that was issued at least 60 days before the spin-off was announced, agreed to or approved by Remainco's board of directors.

### **Delayed Distribution vs. Retention**

In order for a spin-off to qualify as tax-free, Remainco must distribute stock constituting "control" of Spinco—broadly speaking, 80% of Spinco's stock. In the most straightforward variation of a spin-off, Remainco simply distributes 100% of the stock of Spinco to its shareholders at once. In some cases, however, Remainco may wish to distribute some Spinco stock up front, but keep the rest for a period of time. The tax rules permit this to occur in two different ways—and with the new Revenue Procedure, the IRS is now making taxpayers choose between them up front.

*Delayed Distribution.* In cases where Remainco wishes to hold back a portion of the Spinco stock for a short period of time before distributing the remainder, the tax rules permit the subsequent distributions to occur tax-free and to count toward the 80% distribution requirement, effectively treating all phases as part of a single distribution. For example, in a D4E Exchange, Remainco may distribute some Spinco stock to its shareholders in the form of a dividend, then wait for a period while trading in the Spinco stock settles before entering into a D4E exchange, paying off some of its indebtedness with its remaining Spinco stock at then-prevailing prices. Under the new Revenue Procedure, this is generally permitted so long as all distributions occur within 12 months, although the guidance indicates that delayed distributions that occur more than 90 days after the first distribution will be subject to additional scrutiny.

*Retention.* By contrast, because Remainco is required to distribute only 80% of Spinco stock, it could retain up to 20% of Spinco stock for an extended period of time. For example, Remainco may wish to distribute Spinco's stock to its shareholders but needs to retain some Spinco stock to serve as collateral securing its debt. The Internal Revenue Code permits this, but only if the taxpayer requests a PLR and establishes that this retention is not being done with a tax avoidance purpose. The new Revenue Procedure provides enhanced guidance on how the IRS will make that determination, setting out the criteria it will use and requiring taxpayers to explain the business purpose for retaining the stock, describe the period for which the stock will be retained and any overlap between the officers, directors and key employees of Spinco and Remainco, and promise to vote any retained shares in the same proportion as the votes cast by unrelated shareholders. Remainco will be required to dispose of any retained stock no later than five years after the initial distribution (at which point, the disposition will be taxable).

...*But not both.* In recent years, the IRS has given "backstop" rulings allowing for retained stock to potentially qualify as *either* a delayed distribution or a true retention, depending on future events. For example, Remainco may distribute less than 100% of the stock of Spinco intending to engage in a tax-free D4E exchange

with the remainder, but if it is unable to complete the D4E Exchange within 12 months due to market conditions, a “backstop” ruling would have allowed it to continue to retain the Spinco stock to dispose of in some other way during the next four years (albeit taxably). Under the new Revenue Procedure, “backstop” rulings will no longer be available—taxpayers must choose at the time they seek rulings whether any retained Spinco stock will be distributed within 12 months in a delayed tax-free distribution or retained for a longer period and disposed of in a taxable transaction within five years.

This requirement potentially presents taxpayers with a dilemma: if a Remainco wants to secure a ruling for a transaction that requires a delayed distribution (such as a D4E Exchange), it must be confident that it can distribute all of its Spinco stock (whether to creditors or shareholders) within 12 months. If it fails to do so, then it has arguably retained Spinco stock without the IRS permission required by the statute, meaning that it would be taxed not only when it disposes of the retained stock, but also on the stock distributions that it was able to complete within the allotted time. This apparent “hell or high water” distribution requirement may deter some taxpayers from seeking to engage in D4E Exchanges and similar transactions in the first place.

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The Revenue Procedure also contains important updates or expansions to representations involved in cases where Spinco assumes debt of Remainco or where Spinco may be required to make post-spinoff payments to Remainco. At the same time it released the Revenue Procedure, the IRS also released [Notice 2024-38](#), requesting further public comment with respect to many of the issues underlying the changes in Revenue Procedure 2024-24, suggesting that it is unlikely that this is the final word on spinoffs and PLRs.