consequently the loss of control of the airplane.

(d) *What actions must I accomplish to address this problem?* To address this problem, you must do the following:

Actions	Compliance	Procedures
(1) Apply Loctite on attaching bolt threads of inboard, central, and outboard carriages; increase tightening torques; and replace central carriage attaching bolts with new bolts, part number Z00.N5109337315.	Within the next 25 hours time-in-service (TIS) after the effective date of this AD, if not already done.	Do this action following the ACCOMPLISHMENT INSTRUCTIONS paragraph in Socata Service Bulletin SB 70–087, dated September 2000 and the applicable maintenance manual.
(2) Do not install any central carriage attaching bolts that are not part number Z00.N5109337315 (or FAA-approved equivalent part number).	As of the effective date of this AD	Not Applicable.

(e) *Can I comply with this AD in any other way?* You may use an alternative method of compliance or adjust the compliance time if:

(1) Your alternative method of compliance provides an equivalent level of safety; and

(2) The Manager, Small Airplane Directorate, approves your alternative. Submit your request through an FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Small Airplane Directorate.

Note 1: This AD applies to each airplane identified in paragraph (a) of this AD, regardless of whether it has been modified, altered, or repaired in the area subject to the requirements of this AD. For airplanes that have been modified, altered, or repaired so that the performance of the requirements of this AD is affected, the owner/operator must request approval for an alternative method of compliance in accordance with paragraph (e) of this AD. The request should include an assessment of the effect of the modification, alteration, or repair on the unsafe condition addressed by this AD; and, if you have not eliminated the unsafe condition, specific actions you propose to address it.

(f) *Where can I get information about any already-approved alternative methods of compliance?* Contact Karl Schletzbaum, Aerospace Engineer, FAA, Small Airplane Directorate, 901 Locust, Room 301, Kansas City, Missouri 64106; telephone: (816) 329–4146; facsimile: (816) 329–4090.

(g) *What if I need to fly the airplane to another location to comply with this AD?* The FAA can issue a special flight permit under sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate your airplane to a location where you can accomplish the requirements of this AD.

(h) *How do I get copies of the documents referenced in this AD?* You may get copies of the documents referenced in this AD from SOCATA Groupe AEROSPATIALE, Customer Support, Aerodrome Tarbes-Ossun-Lourdes, BP 930—F65009 Tarbes Cedex, France; or the Product Support Manager, SOCATA—Groupe AEROSPATIALE, North Perry Airport, 7501 Pembroke Road, Pembroke Pines, Florida 33023. You may look at these documents at FAA, Central Region, Office of the Regional Counsel, 901 Locust, Room 506, Kansas City, Missouri 64106.

Note 2: The subject of this AD is addressed in French AD 2000–375(A), dated September 20, 2000.

Issued in Kansas City, Missouri, on December 22, 2000.

Marvin R. Nuss,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 00–33405 Filed 12–29–00; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–107566–00]

RIN 1545–AY42

Guidance under section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities In Connection with an Acquisition

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These proposed regulations affect corporations and are necessary to provide them with guidance needed to comply with these changes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by April 24, 2001. Outlines of topics to be discussed at the public hearing scheduled for May 15, 2001, at 10 a.m. must be received by April 24, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–107566–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–107566–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brendan P. O'Hara, (202) 622–7530; concerning submissions of comments, delivering comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A. State of the Law Before Section 355(e)

Section 355 generally provides that, if a corporation distributes to its shareholders stock of a corporation that it controls immediately before the distribution and certain other conditions are met, neither the distributing corporation (hereinafter referred to as Distributing) nor its shareholders recognize gain or loss. A number of the conditions for tax free treatment (for example, the continuity of interest requirement of § 1.355–2(c), the ''no device'' requirement of section 355(a)(1)(B), the 5-year active business requirement of section 355(b), and the limitation on disqualified stock under section 355(d)) operate to limit the circumstances in which Distributing or the controlled corporation (hereinafter referred to as Controlled) can undergo changes of control in conjunction with a distribution that qualifies for corporate

and shareholder-level nonrecognition under section 355. Nevertheless, prior to the enactment of section 355(e), it was possible for such changes to occur, for example, in the context of tax free reorganizations, while qualifying for tax free treatment under section 355. See, *e.g., Commissioner* v. *Mary Archer W. Morris Trust*, 367 F.2d 794 (4th Cir. 1966).

B. Enactment of Section 355(e)

Section 355(e), which was enacted in 1997, provides that the stock of a controlled corporation generally will not be qualified property under section 355(c)(2) or section 361(c)(2) if the stock is distributed as ''part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.'' Thus, if section 355(e) applies to a distribution, Distributing is taxed on the amount by which the distributed stock's fair market value exceeds its basis. Distributee shareholders receive Controlled stock tax free, but do not increase their bases to reflect the corporate level gain recognized by Distributing on the distribution.

Section 355(e)(2)(B) provides that, unless the taxpayer establishes otherwise, a plan (or series of related transactions) (hereinafter referred to as a plan) exists if ''1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation during the 4-year period beginning on the date which is 2 years before the date of the distribution.''

The committee reports state that section 355 was intended to permit the tax free division of existing business arrangements among existing shareholders. The reports state that ''[i]n cases in which it is intended that new shareholders will acquire ownership of a business in connection with a spin off, the transaction more closely resembles a corporate level disposition of the portion of the business that is acquired'' and provide that gain is recognized ''if, pursuant to a plan or arrangement in existence on the date of distribution, either the controlled or distributing corporation is acquired * * *'' H.R. Rep. No. 105–148, at 462 (1997); see also S. Rep. No. 105–33, at 139–40 (1997) (slight variation in language). The Conference Report adds, ''[a]s under the House bill and Senate amendment, a public offering of sufficient size can result in an acquisition that causes gain recognition under the provision.'' H.R. Conf. Rep. No. 105–220, at 533 (1997).

C. Previous Proposal of Regulations

On August 24, 1999, the IRS and the Department of the Treasury published proposed regulations under section 355(e) (REG–116733–98) in the **Federal Register** (64 FR 46155) (hereinafter referred to as the 1999 proposed regulations). The 1999 proposed regulations provided the exclusive means by which a taxpayer could establish that a distribution and an acquisition were not part of a plan, and required that the taxpayer must establish the absence of a plan with clear and convincing evidence.

A public hearing regarding the 1999 proposed regulations was held on March 2, 2000. In addition, written comments were received. Commentators asserted that the approach of the 1999 proposed regulations, providing exclusive rebuttals for establishing that transactions are not part of a plan, was inappropriate because it unfairly limited the evidence taxpayers could produce that may be relevant to whether transactions are part of a plan. In addition, commentators argued that section 355(e) does not require the IRS and the Department of the Treasury to adopt a clear and convincing evidence standard for establishing whether transactions are part of a plan. Further, commentators were concerned that the exclusive rebuttals contained in the 1999 proposed regulations may not be available in cases in which there was an intent to facilitate any acquisition, regardless of its type or size, even if the acquisition being tested was not the intended acquisition. Finally, one of the rebuttals in the 1999 proposed regulations was only available if the taxpayer proves, among other things, that ''[a]t the time of the distribution, neither the distributing corporation, the controlled corporation, nor their controlling shareholders reasonably would have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in the distributing corporation or the controlled corporation within 2 years after the distribution * * * who would not have acquired such interests if the distribution had not occurred.'' 1999 Prop. Reg. § 1.355–7(a)(2)(iii)(B). Many commentators indicated that determining whether it was reasonably anticipated that an event was more likely than not to occur was impractical and that the consequent uncertainty inhibited normal business transactions.

Explanation of Provisions

After consideration of the comments received, the IRS and the Department of the Treasury have decided to withdraw the 1999 proposed regulations and issue new proposed regulations (hereinafter referred to as the 2000 proposed regulations) to provide guidance concerning the interpretation of the phrase ''plan (or series of related transactions).'' The 2000 proposed regulations also address the determination of Distributing's gain when multiple controlled corporations are distributed and the distributions are part of a plan pursuant to which a 50-percent or greater interest in one or more, but not all, of the distributed controlled corporations is acquired.

The IRS and the Department of the Treasury plan to issue regulations addressing other issues arising under section 355(e), including the definition of an acquisition, the application of the aggregation and attribution rules, the treatment of successors and predecessors, and the administration of the statute of limitations provision of section 355(e)(4)(E). Comments concerning the 2000 proposed regulations, the additional issues described above, and other issues that should be addressed in regulations are welcome.

A. Plan or Series of Related Transactions

The 2000 proposed regulations provide that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. They include nonexclusive lists of facts and circumstances to be considered in making the determination. Because the determination of whether a plan exists is dependent on the facts and circumstances, the 2000 proposed regulations provide a general statement of the policy underlying whether a distribution and an acquisition are part of a plan for purposes of section 355(e).

In the case of an acquisition after a distribution, the 2000 proposed regulations provide that, in general, the distribution and acquisition are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the distribution, that the acquisition or a similar acquisition occur in connection with the distribution. The reference to ''a similar acquisition'' ensures that changes in the terms of the acquisition intended at the time of the distribution (including, in certain circumstances, a substitution of acquirer) do not prevent the distribution

and the acquisition that actually occurs from being considered part of a plan.

In the case of an acquisition before a distribution, the 2000 proposed regulations provide that, in general, the distribution and acquisition are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the acquisition, that a distribution occur in connection with the acquisition.

As indicated above, the facts and circumstances surrounding the distribution and the acquisition must be examined to determine whether the transactions were intended to occur in connection with each other. In addition, the 2000 proposed regulations contain six safe harbor provisions that, when applicable, provide that the acquisition and distribution are not part of a plan.

Under the 2000 proposed regulations, Distributing must test each acquisition of Distributing or Controlled stock to determine whether it is part of a plan that includes a distribution. The 2000 proposed regulations aggregate all acquisitions of stock of a corporation that are pursuant to a plan including a particular distribution to determine whether the 50 percent threshold of section 355(e)(2)(A)(ii) is met.

1. Facts and Circumstances

For those situations to which the safe harbor provisions do not apply, the 2000 proposed regulations provide two nonexclusive lists of facts and circumstances (hereinafter referred to as factors) to consider in assessing whether an acquisition and a distribution are part of a plan. One list of factors tends to demonstrate that a distribution and an acquisition are part of a plan and the other list tends to demonstrate that a distribution and an acquisition are not part of a plan. The weight of the factors depends on the particular case. The existence of a plan should not be determined merely by comparing the number of factors tending to show that the acquisition and distribution are, or are not, part of a plan.

Plan Factors

Many of the factors tending to show that a distribution and an acquisition are part of a plan (the plan factors) focus on whether Distributing, Controlled or their respective controlling shareholders participated in discussions with outside parties regarding the second transaction of the pair being tested before the first transaction occurred (factors (i), (ii), (iii), (iv), (v), and (vi)). Such discussions provide evidence that Distributing, Controlled or any of their respective controlling shareholders had an intent that the transactions occur in connection with each other.

Other plan factors (factors (vii), (viii), and (ix)) inquire into other indications of the intent of Distributing, Controlled and their respective controlling shareholders. Factor (vii) considers whether the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled. The operating rule in proposed § 1.355–7(e)(1)(i) states that evidence of a business purpose to facilitate an acquisition of Distributing or Controlled exists if there was a reasonable certainty that within 6 months after the distribution an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding an acquisition. The operating rule in proposed § 1.355–7(e)(1)(ii) applies to acquisitions before a distribution, asking whether the acquisition occurred after the date of the public announcement of the planned distribution, or whether, at the time of the acquisition, it was reasonably certain that within 6 months after the acquisition the distribution would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding the distribution. The operating rule in proposed § 1.355–7(e)(2) provides that the fact that internal discussions occurred may be indicative of the business purpose that motivated the distribution. The operating rule contained in proposed § 1.355–7(e)(3) provides that, if Distributing distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing is treated as having a business purpose to facilitate the acquisition of the corporation that was acquired.

The rule regarding reasonable certainty is necessary to implement section 355(e) because where a taxpayer was reasonably certain that an acquisition would occur, that acquisition was likely to be taken into account in determining whether to effect a distribution. While the IRS and the Department of the Treasury believe that reasonable certainty (even where no discussions with potential acquirers have occurred) is relevant in determining whether a plan exists, it should be noted that this concept is significantly modified from the 1999 proposed regulations. This operating rule will apply only in cases where there was a strong probability that, within 6 months after the distribution, an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur.

Factor (viii) considers whether an acquisition and a distribution occured within 6 months of each other, or whether there was an agreement, understanding, arrangement, or substantial negotiations regarding the second transaction (or, if an acquisition is the second transaction, a similar acquisition) within 6 months after the first transaction.

Finally, factor (ix) examines whether the debt allocation between Distributing and Controlled made an acquisition of Distributing or Controlled likely in order to service the debt.

Nonplan Factors

The 2000 proposed regulations also provide a nonexclusive list of factors tending to show that a distribution and an acquisition are not part of a plan (the nonplan factors). Just as discussions with outside parties about the second transaction prior to the first transaction tend to show that Distributing, Controlled or their respective controlling shareholders had an intent that the second transaction occur in connection with the first transaction, the absence of such discussions tends to show that the transactions did not occur in connection with each other. Thus, there are nonplan factors that are analogous to the plan factors related to discussions (factors (i), (ii), and (iv)).

The existence of a corporate business purpose, other than a business purpose to facilitate the acquisition or a similar acquisition, that motivated Distributing, in whole or substantial part, to make the stock distribution tends to show that a distribution and an acquisition are not part of a plan (factor (vi)). The presence of a business purpose to facilitate the acquisition or a similar acquisition is relevant in determining the extent to which the distribution was motivated in whole or substantial part by another corporate business purpose within the meaning of § 1.355–2. Analyzing whether there is another substantial corporate business purpose for the distribution in light of an acquisition-related purpose is similar to analyzing whether there is a corporate business purpose for a distribution in light of the potential avoidance of federal taxes. See § 1.355–2(b)(1) and (5), *Example 8.* Thus, another business purpose must be real and substantial even in light of the acquisition business purpose. In making this determination, the operating rules in proposed § 1.355–7(e) apply.

Factors (iii) and (v) consider whether there was an identifiable, unexpected change in market or business conditions after the first of the two transactions being tested that resulted in the second, unexpected transaction. Factor (vii) considers whether the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a previously proposed similar acquisition.

2. Safe Harbors

The 2000 proposed regulations include six safe harbor provisions. A distribution and an acquisition are not part of a plan if they are described in one of the safe harbors. The first two safe harbors address acquisitions more than 6 months after a distribution. Safe Harbor I applies to an acquisition more than 6 months after a distribution if there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution and the distribution was motivated in whole or substantial part by a corporate business purpose other than a business purpose to facilitate an acquisition. The nonacquisition corporate business purpose for the distribution is considered in light of any business purpose to facilitate an acquisition, and the operating rules in proposed § 1.355–7(e) apply.

Safe Harbor II, like Safe Harbor I, applies only to acquisitions more than 6 months after a distribution for which there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution. However, where Safe Harbor I applies to cases where the distribution was motivated in whole or substantial part by a nonacquisition business purpose, Safe Harbor II applies to situations where the distribution was motivated in whole or substantial part by a business purpose to facilitate an acquisition. Under Safe Harbor II, an acquisition will not be treated as part of a plan with a distribution if the distribution was motivated in whole or substantial part by a corporate business purpose to facilitate an acquisition or acquisitions of no more than 33 percent of the stock of Distributing or Controlled, and no more than 20 percent of the stock of the corporation whose stock was acquired in the acquisition or acquisitions that motivated the distribution was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations before a date that is 6 months after the distribution. Safe Harbor II is intended to alleviate the concerns commentators expressed about the unavailability of the rebuttals in the 1999 proposed regulations if the distribution was motivated by an intent to facilitate an acquisition regardless of its type or size.

Safe Harbors III and IV address acquisitions and distributions more than 2 years apart. Under Safe Harbor III, acquisitions more than 2 years after a distribution are not pursuant to a plan if there is no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter. Under Safe Harbor IV, acquisitions more than 2 years before a distribution are not part of a plan if there is no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within 6 months thereafter.

Safe Harbor V provides that an acquisition of Distributing or Controlled stock that is listed on an established market (as defined in the 2000 proposed regulations) is not part of a plan if the stock is transferred between shareholders of Distributing or Controlled who are not 5-percent shareholders. In general, a person will be considered a 5-percent shareholder if, immediately before or after each transfer, the person owns, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), 5 percent or more of any class of stock of the corporation whose stock is transferred.

Safe Harbor VI provides that an acquisition of stock by an employee or director in connection with the performance of services, including an acquisition resulting from the exercise of certain compensatory stock options, is not part of a plan.

3. Agreement, Understanding, Arrangement, or Substantial Negotiations

There are many references in the 2000 proposed regulations to the existence of an agreement, understanding, arrangement, or substantial negotiations. The 2000 proposed regulations do not define those concepts precisely. A binding contract clearly is included as an agreement but, depending on all relevant facts and circumstances, parties can have an agreement, understanding, or arrangement even though they have not reached agreement on all terms. Under certain circumstances, such as in public offerings or auctions of Distributing's or Controlled's stock, an agreement, understanding, arrangement, or substantial negotiations can exist regarding an acquisition even if the acquirer has not been specifically identified.

4. Options

The 2000 proposed regulations enumerate interests treated as options. If stock of Distributing or Controlled is acquired pursuant to an option, the option is treated as an agreement to acquire stock on the date of writing unless Distributing establishes that, on the later of the date of the stock distribution or the writing of the option, the option was not more likely than not to be exercised. The 2000 proposed regulations also address the treatment of an agreement, understanding, or arrangement to write an option and substantial negotiations regarding the writing of an option. The 2000 proposed regulations exempt certain options from treatment as options unless they are written, transferred, or listed with a principal purpose of avoiding the application of section 355(e) or the 2000 proposed regulations. The enumerated exceptions cover certain commercially customary options that are unlikely to be used to avoid section 355(e) or the 2000 proposed regulations.

B. Any Controlled Corporation

Section 355(e)(2)(A)(ii) provides that section 355(e)(1), which causes Distributing to recognize its gain in Controlled stock as if Distributing had sold the stock for its fair market value, applies to any distribution to which section 355 (or so much of section 356 as relates to section 355) applies and ''which is part of a plan * * * pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation *or any controlled corporation*'' (emphasis added). A question has arisen concerning the measure of gain to Distributing if, pursuant to a plan, the stock of more than 1 controlled corporation is distributed and stock representing a 50-percent or greater interest is acquired in some, but not all, of the distributed controlled corporations. The 2000 proposed regulations clarify that under those circumstances, Distributing only recognizes gain on the stock of the distributed controlled corporations that were subject to 50-percent or greater acquisitions. If Distributing is the acquired corporation, it must recognize gain on all of the distributed controlled corporations.

Proposed Effective Date

The regulations in this section are proposed to apply to distributions occurring after the regulations in this

section are published as final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) and comments sent via the Internet that are submitted timely to the IRS. The Department of the Treasury and the IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 15, 2001, beginning at 10 a.m. in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by April 24, 2001. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Brendan P. O'Hara, Office of the Associate Chief Counsel (Corporate). However, other personnel from the Department of the Treasury and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.355–7 also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355–0 is amended by revising the section heading and adding introductory text and an entry for § 1.355–7 to read in part as follows:

§ 1.355–0 Outline of sections.

In order to facilitate the use of §§ 1.355–1 through 1.355–7, this section lists the major paragraphs in those sections as follows:

* * * * *

§ 1.355–7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) In general.
(b) Plan.
(c) Multiple acquisitions.
(d) Facts and circumstances.
(e) Operating rules.
(1) Reasonable certainty evidence of business purpose to facilitate an acquisition.
(2) Internal discussion evidence of business purpose.
(3) Hostile takeover defense.
(4) Effect of distribution on trading in stock.
(5) Consequences of section 355(e) disregarded for certain purposes.
(6) Substantial diminution of risk.
(f) Safe harbors.
(1) Safe Harbor I.
(2) Safe Harbor II.
(3) Safe Harbor III.
(4) Safe Harbor IV.
(5) Safe Harbor V.
(i) In general.
(ii) Special rules.
(6) Safe Harbor VI.
(g) Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests.
(1) Treatment of options.
(i) General rule.
(ii) Agreement, understanding, arrangement, or substantial negotiations to write an option.
(2) Instruments treated as options.
(3) Instruments generally not treated as options.
(i) Escrow, pledge, or other security agreements.
(ii) Compensatory options.
(iii) Options exercisable only upon death, disability, mental incompetency, or separation from service.
(iv) Rights of first refusal.
(v) Other enumerated instruments.
(h) Multiple controlled corporations.
(i) [Reserved]
(j) Valuation.
(k) Definitions.
(1) Agreement, understanding, arrangement, or substantial negotiations.
(2) Controlled corporation.
(3) Controlling shareholder.
(4) Established market.
(5) Five-percent shareholder.
(l) [Reserved]
(m) Examples.
(n) Effective date.

Par. 3. Section 1.355–7 is added to read as follows:

§ 1.355–7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) *In general.* Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution—

(1) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) That is part of a plan (or series of related transactions) (hereinafter, plan) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or any controlled corporation (Controlled).

(b) *Plan.* (1) Whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. In general, in the case of an acquisition after a distribution, the distribution and the acquisition are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the distribution, that the acquisition or a similar acquisition occur in connection with the distribution. In general, in the case of an acquisition before a distribution, the acquisition and the distribution are considered part of a plan if Distributing,

Controlled, or any of their respective controlling shareholders intended, on the date of the acquisition, that a distribution occur in connection with the acquisition.

(2) For purposes of paragraph (b)(1) of this section, the actual acquisition and the intended acquisition may be similar even though the identity of the person acquiring stock of Distributing or Controlled (acquirer), the timing of the acquisition or the terms of the actual acquisition are different from the intended acquisition. For example, in the case of a public offering or auction, the actual acquisition and the intended acquisition may be similar even though there are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the public offering or auction.

(c) *Multiple acquisitions.* All acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution pursuant to paragraph (b) of this section will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section.

(d) *Facts and circumstances.* (1) The facts and circumstances to be considered in demonstrating whether a distribution and an acquisition are part of a plan include, but are not limited to, the facts and circumstances specified in paragraphs (d)(2) and (d)(3) of this section. The weight to be given each of the facts and circumstances depends on the particular case. Therefore, whether a distribution and an acquisition are part of a plan does not depend on the relative number of facts and circumstances present under paragraph (d)(2) as compared to paragraph (d)(3) of this section.

(2) Among the facts and circumstances tending to show that a distribution and an acquisition are part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed the acquisition or a similar acquisition by the acquirer before the distribution. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions. The existence of an agreement, understanding, arrangement or substantial negotiations at the time of the distribution is given substantial weight.

(ii) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed an acquisition before the distribution and a similar acquisition by a different person occurred after the distribution. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions and the similarity of the acquisition actually occurring to the acquisition discussed before the distribution.

(iii) In the case of an acquisition involving a public offering or auction after a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions.

(iv) In the case of an acquisition before a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions.

(v) In the case of an acquisition before a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition and a similar acquisition by a different person occurred before the distribution. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions and the similarity of the acquisition actually occurring to the potential acquisition that was discussed.

(vi) In the case of an acquisition involving a public offering or auction before a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed a distribution with an investment banker or other outside adviser before the acquisition. The weight to be accorded the discussions depends on the nature, extent and timing of the discussions.

(vii) In the case of an acquisition either before or after a distribution, the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(viii) In the case of an acquisition either before or after a distribution, the acquisition and the distribution occurred within 6 months of each other or there was an agreement, understanding, arrangement, or substantial negotiations regarding the second transaction within 6 months after the first transaction. Also, in the case of an acquisition occurring after a distribution, there was an agreement, understanding, arrangement, or substantial negotiations regarding a similar acquisition at the time of the distribution or within 6 months thereafter.

(ix) In the case of an acquisition either before or after a distribution, the debt allocation between Distributing and Controlled made an acquisition of Distributing or Controlled likely in order to service the debt.

(3) Among the facts and circumstances tending to show that a distribution and an acquisition are not part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, neither Distributing nor Controlled and the acquirer or any potential acquirer (nor any of their respective controlling shareholders) discussed the acquisition or a similar acquisition before the distribution.

(ii) In the case of an acquisition involving a public offering or auction after a distribution, neither Distributing nor Controlled (nor any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution.

(iii) In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.

(iv) In the case of an acquisition (other than involving a public offering or auction) before a distribution, neither Distributing nor Controlled and the acquirer (nor any of their respective controlling shareholders) discussed a distribution before the acquisition. This paragraph (d)(3)(iv) does not apply if the acquisition occurred after the date of the public announcement of the planned distribution.

(v) In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.

(vi) In the case of an acquisition either before or after a distribution, the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled. The presence of a business

purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(vii) In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition (including a previously proposed similar acquisition that did not occur).

(e) *Operating rules.* The operating rules contained in this paragraph (e) apply for all purposes of this section.

(1) *Reasonable certainty evidence of business purpose to facilitate an acquisition.* (i) In the case of an acquisition after a distribution, if, at the time of the distribution, it was reasonably certain that before a date that is 6 months after the distribution an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding an acquisition of Distributing or Controlled, the reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) In the case of an acquisition before a distribution, if the acquisition occurred after the date of the public announcement of the planned distribution, or if, at the time of the acquisition, it was reasonably certain that before a date that is 6 months after the acquisition the distribution would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding the distribution, the public announcement or reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Internal discussions evidence of business purpose.* The fact that internal discussions regarding an acquisition occurred may be indicative of the business purpose that motivated the distribution.

(3) *Hostile takeover defense.* If Distributing distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing will be treated as having a business purpose to facilitate the acquisition of the corporation that was likely to be acquired.

(4) *Effect of distribution on trading in stock.* The fact that the distribution made all or a part of the stock of Controlled available for trading or made Distributing or Controlled's stock trade more actively is not taken into account in determining whether the distribution and an acquisition of Distributing or Controlled stock were part of a plan.

(5) *Consequences of section 355(e) disregarded for certain purposes.* For purposes of determining the intentions of the relevant parties under this section, the consequences of the application of section 355(e), and the existence of any contractual indemnity by Controlled for tax resulting from the application of section 355(e) caused by an acquisition of Controlled, are disregarded.

(6) *Substantial diminution of risk.* The running of any time period prescribed in this section shall be suspended for any period during which risk of loss is substantially diminished under the principles of section 355(d)(6)(B).

(f) *Safe harbors*—(1) *Safe Harbor I.* (i) A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(A) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(B) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) For purposes of paragraph (f)(1)(i)(B) of this section, the presence of a business purpose to facilitate an acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Safe Harbor II.* A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(i) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(ii) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355–2(b)) to facilitate an acquisition or acquisitions of no more than 33 percent of the stock of Distributing or Controlled, and no more than 20 percent of the stock of the corporation (whose stock was acquired in the acquisition or acquisitions that motivated the distribution) was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations before a date that is 6 months after the distribution.

(3) *Safe Harbor III.* If an acquisition occurs more than 2 years after a distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(4) *Safe Harbor IV.* If an acquisition occurs more than 2 years before a distribution, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(5) *Safe Harbor V*—(i) *In general.* An acquisition of Distributing or Controlled stock that is listed on an established market is not part of a plan if the acquisition is pursuant to a transfer between shareholders of Distributing or Controlled, neither of whom is a 5-percent shareholder. For purposes of the preceding sentence, the term 5-percent shareholder is defined in paragraph (k)(5) of this section, except that the corporation can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its 5-percent shareholders.

(ii) *Special rules*—(A) This paragraph (f)(5) does not apply to public offerings or redemptions.

(B) This paragraph (f)(5) does not apply to a transfer of stock by or to a person who, pursuant to a formal or informal understanding with other persons (the coordinating group), has joined in coordinated transfers of stock if, at any time during the period the understanding exists, the coordinating group owns, in the aggregate, 5 percent or more of the stock of the corporation whose stock is transferred (determined by vote or value) immediately before or after each transfer or at the time of the distribution. A principal element in determining if such an understanding exists is whether the investment decision of each person is based on the investment decision of 1 or more other existing or prospective shareholders.

(C) This paragraph (f)(5) does not apply to a transfer of stock by or to a person if the corporation the stock of which is being transferred knows, or has reason to know, that the person (or a coordinating group, treating it as a single person) intends to become a 5-percent shareholder at any time during the 4-year period beginning 2 years before the distribution.

(6) *Safe Harbor VI.* If stock of Distributing or Controlled is acquired by an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) in a transaction to which section 83 applies, the acquisition is not an acquisition that is part of a plan as described in paragraph (b)(1) of this section.

(g) *Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests*—(1) *Treatment of options*—(i) *General rule.* For purposes of this section, if stock of Distributing or Controlled is acquired pursuant to an option, the option will be treated as an agreement to acquire the stock on the date the option is written unless Distributing establishes that on the later of the date of the stock distribution or the writing of the option, the option was not more likely than not to be exercised. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances, taking control premiums and minority and blockage discounts into account in determining the fair market value of stock underlying an option.

(ii) *Agreement, understanding, arrangement, or substantial negotiations to write an option.* If there is an agreement, understanding, or arrangement to write an option, the option will be treated as written on the date of the agreement, understanding, or arrangement. If an agreement, understanding, or arrangement to write an option is reached, or an option is written, more than 6 months but not more than 2 years after the distribution, and there were substantial negotiations regarding the writing of the option or the acquisition of the stock underlying the option before the end of the 6-month period beginning on the date of the distribution, the option will be treated as written within 6 months after the distribution.

(2) *Instruments treated as options.* For purposes of this paragraph (g), except to the extent provided in paragraph (g)(3) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interests are treated as options.

(3) *Instruments generally not treated as options.* For purposes of this paragraph (g), the following are not treated as options unless (in the case of paragraphs (g)(3)(i), (iii), and (iv) of this section) written, transferred (directly or indirectly), or listed with a principal purpose of avoiding the application of section 355(e) or this section.

(i) *Escrow, pledge, or other security agreements.* An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(ii) *Compensatory options.* An option to acquire stock in Distributing or Controlled with customary terms and conditions provided to an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) and that immediately after the distribution and within 6 months thereafter—

(A) Is nontransferable within the meaning of § 1.83–3(d); and

(B) Does not have a readily ascertainable fair market value as defined in § 1.83–7(b).

(iii) *Options exercisable only upon death, disability, mental incompetency, or separation from service.* Any option entered into between shareholders of a corporation (or a shareholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the shareholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the shareholder's separation from service.

(iv) *Rights of first refusal.* A bona fide right of first refusal regarding the corporation's stock with customary terms, entered into between shareholders of a corporation (or between the corporation and a shareholder).

(v) *Other enumerated instruments.* Any other instrument the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(h) *Multiple controlled corporations.* Only the stock or securities of a controlled corporation in which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan involving the distribution of that corporation will be treated as not qualified property under section 355(e)(1) if—

(1) The stock or securities of more than 1 controlled corporation are distributed in distributions to which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in Distributing pursuant to a plan involving any of those distributions.

(i) [Reserved]

(j) *Valuation.* Except as provided in paragraph (g)(1)(i) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(k) *Definitions*—(1) *Agreement, understanding, arrangement, or substantial negotiations.* Whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. The parties do not necessarily have to have entered into a binding contract or have reached agreement on all terms to have an agreement, understanding, or arrangement. However, an agreement, understanding, or arrangement clearly exists if enforceable rights to acquire stock exist. In public offerings or auctions by Distributing or Controlled of Distributing or Controlled's stock, an agreement, understanding, arrangement, or substantial negotiations can exist even if the acquirer has not been specifically identified. The existence of such an agreement, understanding, arrangement, or substantial negotiations will be based on discussions with an

investment banker or other outside adviser.

(2) *Controlled corporation.* For purposes of this section, a controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 (or so much of section 356 as relates to section 355) applies.

(3) *Controlling shareholder.* (i) A controlling shareholder of a corporation the stock of which is not listed on an established market is any person who, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), possesses voting power in Distributing or Controlled representing a meaningful voice in the governance of the corporation.

(ii) A controlling shareholder of a corporation the stock of which is listed on an established market is a 5-percent shareholder who actively participates in the management or operation of the corporation.

(iii) For purposes of this section, a person is a controlling shareholder if that person meets the definition of controlling shareholder in this paragraph (k)(3) immediately before or immediately after the acquisition being tested.

(iv) If a distribution precedes an acquisition, Controlled's controlling shareholders immediately after the distribution are considered Controlled's controlling shareholders at the time of the distribution.

(4) *Established Market.* An established market is—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Act of 1934 (15 U.S.C. 78o-3); or

(iii) Any additional market that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(5) *Five-percent shareholder.* A person will be considered a 5-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)) 5 percent or more of any class of stock of the corporation whose stock is transferred. A person is a 5-percent shareholder if the person meets the requirements of the preceding sentence immediately before or after each transfer. All options are treated as exercised for the purpose of determining whether the shareholder is a 5-percent shareholder.

(l) [Reserved]

(m) *Examples.* The following examples illustrate paragraphs (a) through (k) of this section. Throughout these examples, assume that Distributing (D) owns all of the stock of Controlled (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies and to which section 355(d) does not apply. Unless otherwise stated, assume the corporations do not have controlling shareholders. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. Unwanted assets. (i) D is in business 1. C is in business 2. D is relatively small in its industry. D wants to combine with X, a larger corporation also engaged in business 1. X and D begin negotiating for X to acquire D, but X does not want to acquire C. To facilitate the acquisition of D by X, D agrees to distribute all the stock of C pro rata before the acquisition. D and X enter into a binding contract for D to merge into X subject to several conditions. D distributes C and D merges into X one month later. As a result of the merger, D's former shareholders own less than 50 percent of the stock of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into X are part of a plan. To determine whether the distribution of C and the merger of D into X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into X are part of a plan: X and D discussed the acquisition before the distribution (paragraph (d)(2)(i) of this section), D was motivated by a business purpose to facilitate the merger (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Because the merger was not only discussed, but was agreed to, before the distribution, the fact described in paragraph (d)(2)(i) of this section is given substantial weight.

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the merger of D into X are part of a plan under paragraph (b)(1) of this section.

Example 2. Substituted acquirer. (i) The facts are the same as in *Example 1,* except that after D distributes C, X is unable to fulfill one of the conditions of the merger agreement and the merger of D into X does not occur. Y, one of X's competitors, perceives this as an opportunity and begins discussing with D a merger into Y. Five months after D distributes C, D merges into Y. As a result of the merger, the D shareholders own less than 50 percent of the outstanding Y stock.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into Y are part of a plan. To determine whether the distribution of C and the merger of D into Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into Y are part of a plan: X, a potential acquirer, and D discussed an acquisition before the distribution and a similar acquisition by Y occurred (paragraph (d)(2)(ii) of this section), D was motivated by a business purpose to facilitate an acquisition similar to the merger with Y (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(v) As in *Example 1,* none of the facts and circumstances listed in paragraph (d)(3) of this section exist in this case. Although a substituted acquirer acquired D, the merger of D into Y was similar to the negotiated merger of D into X.

(vi) The distribution of C and the merger of D into Y are part of a plan under paragraph (b)(1) of this section.

Example 3. Public offering.

(i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public. They decide a public offering of 50 percent of D's stock with D as a stand alone corporation would be in D's best interest. To facilitate a stock offering by D of 50 percent of its stock, D distributes all the stock of C pro rata to D's shareholders. D issues new shares amounting to 50 percent of its stock to the public in a public offering 7 months after the distribution.

(ii) No Safe Harbor applies to this acquisition. Safe Harbor V, relating to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(iii) The issue is whether the distribution of C and the public offering by D are part of a plan. To determine whether the distribution of C and the public offering by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the public offering by D are part of a plan: D discussed the public offering with its investment banker before the distribution (paragraph (d)(2)(iii) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and there were substantial negotiations regarding the public offering within 6 months after the distribution (paragraph (d)(2)(viii) of this section).

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the public offering by D are part of a plan under paragraph (b)(1) of this section.

Example 4. Public offering followed by unexpected opportunity—(i) *Facts.* D's managers, directors, and investment banker discuss the possibility of offering C stock to the public. D decides to distribute C pro rata to D's shareholders solely to facilitate a 20 percent stock offering by C. To take advantage of favorable market conditions, C issues new shares amounting to 20 percent of its stock in a public offering 1 month before D distributes its remaining 80 percent of the C stock. The public offering documents disclose the intended distribution of C, which is expected to occur shortly after the public offering. At the time of the distribution, it is not reasonably certain that an acquisition will occur, an agreement, understanding, or arrangement concerning an acquisition will exist, or substantial negotiations concerning an acquisition will occur within 6 months. Two months after the distribution, C is approached unexpectedly regarding an opportunity to acquire X. Five months after the distribution, C acquires X in exchange for 40 percent of the C stock.

(ii) *Public offering.* (A) No Safe Harbor applies to the public offering. Safe Harbor V, related to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(B) The issue is whether the 20 percent public offering by C and the distribution by D of the remaining C stock are part of a plan. To determine whether the distribution and the public offering are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the public offering are part of a plan: D discussed the distribution with its investment banker before the public offering (paragraph (d)(2)(vi) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and the public offering and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(D) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(E) The public offering of C and the distribution of C are part of a plan under paragraph (b)(1) of this section.

(iii) *X acquisition.* (A) No Safe Harbor applies to the X acquisition.

(B) The issue is whether the distribution of C and the acquisition by C of X are part of a plan. To determine whether the distribution of C and the acquisition by C of X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and acquisition by C of X are part of a plan: The distribution and the acquisition occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). The fact described in paragraph (d)(2)(vii) of this section does not exist in this case because D's business purpose was to facilitate the public offering and C's acquisition of X is not similar to that acquisition.

(D) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition by C of X are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition of X or a similar acquisition with potential acquirers before the distribution (paragraph (d)(3)(i) of this section), D had a substantial business purpose for the distribution other than a business purpose to facilitate the acquisition of X or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition of X (paragraph (d)(3)(vii) of this section). The distribution was announced and accomplished to facilitate the 20 percent public offering by C. D and C were unaware of the opportunity to acquire X at the time of the distribution.

(E) Weighing the facts and circumstances, the acquisition by C of X and the distribution of C by D are not part of a plan under paragraph (b)(1) of this section.

(F) If C's acquisition of X had occurred more than 6 months after the distribution and had not been the subject of an agreement, understanding, arrangement, or substantial negotiations before the date that is 6 months after the distribution, Safe Harbor II would have applied to C's acquisition of X.

Example 5. Hot market. (i) D is a widely held corporation the stock of which is listed on an established market. D announces a distribution of C and distributes C pro rata to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e) caused by the acts of C. The distribution is motivated by a desire to improve D's access to financing at preferred customer interest rates, which will be more readily available if D separates from C. At the time of the distribution, although D has not been approached by any potential acquirer of C, it is reasonably certain that within 6 months after the distribution either an acquisition of C will occur or there will be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C. Corporation Y acquires C in a merger described in section 368(a)(2)(E) within 6 months after the distribution. The C shareholders receive less than 50 percent of the stock of Y in the exchange.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the acquisition of C by Y are part of a plan. To determine whether the distribution of C and the acquisition of C by Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). In addition, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that at the time of the distribution it was reasonably certain that an acquisition of C would occur or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution (paragraphs (d)(2)(vii) and (e)(1)(i) of this section).

(v) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition or a similar acquisition with Y or any other potential acquirers before the distribution (paragraph (d)(3)(i) of this section). Furthermore, D may be able to demonstrate that the distribution was motivated in whole or substantial part by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section). D's stated purpose for the distribution (facilitating D's access to favorable financing) must be evaluated in light of the evidence of a business purpose to facilitate an acquisition. D also may be able to demonstrate that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section).

(vi) Under paragraph (e)(5) of this section, the existence of the indemnity is irrelevant in analyzing whether the distribution and acquisition of C are part of a plan.

(vii) In determining whether the distribution of C and the acquisition of C by Y are part of a plan, one should consider the importance of D's stated business purpose for the distribution in light of the reasonable certainty that C would be acquired or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution. If D's stated business purpose for the distribution is substantial even though the reasonable certainty that C would be acquired is evidence of a business purpose to facilitate an acquisition, and if D would have distributed C regardless of Y's acquisition of C, Y's acquisition of C and D's distribution of C are not part of a plan.

Example 6. Unexpected opportunity. (i) D, the stock of which is listed on an established market, announces that it will distribute all the stock of C pro rata to D's shareholders. At the time of the announcement, the distribution is motivated wholly by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate an acquisition. After the announcement but before the distribution, widely held X becomes available as an acquisition target. There were no discussions between D and X before the announcement. D negotiates with and acquires X before the distribution. After the acquisition, X's former shareholders own 55 percent of D's stock. D distributes the stock

of C pro rata within 6 months after the acquisition of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the acquisition of X by D and the distribution of C are part of a plan. To determine whether the distribution of C and the acquisition of X by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the acquisition of X by D and the distribution of C are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Also, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that the acquisition occurred after the public announcement of the planned distribution (paragraphs (d)(2)(vii) and (e)(1)(ii) of this section).

(v) Under paragraph (d)(3) of this section, D would assert that the following tends to show that the distribution of C and the acquisition of X by D are not part of a plan: The distribution was motivated by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section). That D decided to distribute C and announced that decision before it became aware of the opportunity to acquire X suggests that the distribution would have occurred at approximately the same time and in similar form regardless of D's acquisition of X. X's lack of participation in the decision also helps establish that fact.

(vi) In determining whether the distribution of C and acquisition of X by D are part of a plan, one should consider the importance of D's business purpose for the distribution in light of D's opportunity to acquire X. If D can establish that the distribution continued to be motivated by the stated business purpose, and if D would have distributed C regardless of D's acquisition of X, then D's acquisition of X and D's distribution of C are not part of a plan.

Example 7. Multiple acquisitions—(i) *Facts.* (A) D, the stock of which is listed on an established market, engages in business 1. C engages in business 2. D has a business strategy of growth through acquisitions and is interested in continually expanding business 1. D's ownership of C has been an impediment to acquisitions by D. D believes the distribution of C will make its acquisition program more economical overall, regardless of D's success with any particular acquisition target. D has no specific goals regarding how much D stock will be used for acquisitions.

(B) D and its investment banker identify X and Y as potential acquisition targets before D publicly announces the planned distribution. After D publicly announces the distribution, the sole purpose of which is to facilitate acquisitions by D, but before the distribution date, D negotiates with X, but has no contact with Y. D distributes all of the C stock. One month after the distribution, D consummates the negotiated acquisition of X. A, X's sole shareholder, receives 30 percent of D's stock. Seven months after the distribution, D begins negotiating with Y. One year after the distribution, D acquires Y. Y's shareholders receive 19 percent of D's stock. After the distribution, D and its investment banker identify Z as another desirable target. Eighteen months after the distribution, D acquires Z. Z's shareholders receive 17 percent of D's stock. If aggregated, the acquisitions of X, Y and Z would result in a change in the stock ownership of D of more than 50 percent.

(ii) *X acquisition.* (A) No Safe Harbor applies to the X acquisition.

(B) The issue is whether the distribution of C and the acquisition of X by D are part of a plan. To determine whether the distribution of C and the acquisition of X by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the acquisition of X by D are part of a plan: D and X discussed the acquisition before the distribution (paragraph (d)(2)(i) of this section), D had a business purpose to facilitate the X acquisition or a similar acquisition (paragraph (d)(2)(vii) of this section), and the distribution and the X acquisition occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(D) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(E) The distribution of C and the acquisition of X are part of a plan under paragraph (b)(1) of this section.

(iii) *Y acquisition.* (A) No Safe Harbor applies to the Y acquisition. Safe Harbor I does not apply because the distribution was not motivated in whole or substantial part by a corporate business purpose (within the meaning of § 1.355–2(b)) other than a business purpose to facilitate an acquisition. Safe Harbor II does not apply because D's business purpose to facilitate acquisitions was not limited to 33 percent or less of the D stock. Also, more than 20 percent of D's stock was acquired in an acquisition that motivated the distribution before the date that was 6 months after the distribution (D's acquisition of X using 30 percent of D's stock 1 month after the distribution).

(B) The issue is whether the distribution of C and the acquisition of Y by D are part of a plan. To determine whether the distribution of C and the acquisition of Y by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the acquisition of Y by D are part of a plan: D and a potential acquirer (X) discussed an acquisition before the distribution and a similar acquisition with a different acquirer (Y) occurred (paragraph (d)(2)(ii) of this section) and D had a business purpose to facilitate the Y acquisition or a similar acquisition (paragraph (d)(2)(vii) of this section).

(D) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(E) The distribution of C and the acquisition of Y are part of a plan under paragraph (b)(1) of this section.

(iv) *Z acquisition.* The analysis is identical to the Y acquisition. The distribution of C and the acquisition of Z are part of a plan under paragraph (b)(1) of this section.

(v) Under paragraph (c) of this section, all acquisitions of stock of D pursuant to a plan involving a distribution will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section. Because the acquisitions by D of X, Y, and Z are each part of a plan involving D's distribution of C, those three acquisitions are aggregated.

(n) *Effective date.* This section applies to distributions occurring after these regulations are published as final regulations in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–116733–98]

RIN 1545–AW79

Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws the notice of proposed rulemaking relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition that was published in the **Federal Register** on August 24, 1999. The withdrawal is in response to written comments received and oral comments presented at a public hearing.

FOR FURTHER INFORMATION CONTACT: Brendan O'Hara, (202) 622–7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 24, 1999, the IRS issued proposed regulations (REG–116733–98) in the **Federal Register** (64 FR 46155)