

109TH CONGRESS  
1ST SESSION

# H. R. 4187

To amend the Internal Revenue Code of 1986 to limit the recognition of gain under section 355(e) of such Code to certain leveraged spin-merger transactions.

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## IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 1, 2005

Mr. CANTOR introduced the following bill; which was referred to the  
Committee on Ways and Means

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## A BILL

To amend the Internal Revenue Code of 1986 to limit the recognition of gain under section 355(e) of such Code to certain leveraged spin-merger transactions.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       **SECTION 1. AMENDMENT OF SECTION 355(e).**

4       (a) IN GENERAL.—Subsection (e) of section 355 of  
5       the Internal Revenue Code of 1986 (relating to recognition  
6       of gain on certain distributions of stock or securities in  
7       connection with acquisitions) is amended to read as fol-  
8       lows:

1       “(e) RECOGNITION OF GAIN ON CERTAIN DISTRIBUTIONS OF STOCK OR SECURITIES IN CONNECTION WITH  
2       CERTAIN LEVERAGED SPIN-MERGER TRANSACTIONS.—

4               “(1) IN GENERAL.—If there is a distribution to  
5       which this subsection applies, gain shall be recognized immediately prior to the distribution to the extent of the lesser of—

8               “(A) the excess relative leverage at the  
9       time of the distribution, and

10              “(B) the gain realized as a result of the  
11       distribution.

12              “(2) DISTRIBUTIONS TO WHICH SUBSECTION  
13       APPLIES.—This subsection shall apply to any distribution that would otherwise qualify under subsection 355(a) if—

16              “(A) there is a prearranged change in control,

18              “(B) the change in control company is highly leveraged immediately after the distribution (determined without regard to any post-distribution transactions), and

22              “(C) the change in control company has excess relative leverage.

24              “(3) DEFINITION OF PREARRANGED CHANGE IN  
25       CONTROL.—

1           “(A) IN GENERAL.—For purposes of this  
2 subsection, a prearranged change in control  
3 shall be deemed to occur if the distribution is  
4 part of a plan (or series of related transactions)  
5 pursuant to which 1 or more persons acquire  
6 directly or indirectly stock representing a 50-  
7 percent or greater interest in the distributing  
8 corporation or any controlled corporation.

9           “(B) PLAN PRESUMED TO EXIST IN CER-  
10 TAIN CASES.—If 1 or more persons acquire di-  
11 rectly or indirectly stock representing a 50-per-  
12 cent or greater interest in the distributing cor-  
13 poration or any controlled corporation during  
14 the 4-year period beginning on the date that is  
15 2 years before the date of the distribution, such  
16 acquisition shall be treated as pursuant to a  
17 plan described in subparagraph (A) unless it is  
18 established that the distribution and the acqui-  
19 sition are not pursuant to a plan or series of re-  
20 lated transactions.

21           “(C) CERTAIN PLANS DISREGARDED.—A  
22 plan or series of related transactions shall not  
23 be treated as described in subparagraph (A) if,  
24 immediately after the completion of such plan  
25 or series of transactions, the distributing cor-

poration and all controlled corporations are members of a single affiliated group (as defined in section 1504 without regard to subsection (b) thereof).

“(D) CERTAIN ACQUISITIONS NOT TAKEN INTO ACCOUNT.—Except as provided in regulations, the following acquisitions shall not be taken into account in applying subparagraph (A):

“(i) The acquisition of stock in any controlled corporation by the distributing corporation.

“(ii) The acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation.

“(iii) The acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities of such distributing or controlled corporation.

“(iv) The acquisition of stock in the distributing corporation or any controlled corporation to the extent that the percent-

age of stock owned directly or indirectly in such corporation by each person owning stock in such corporation immediately before the acquisition does not decrease.

This subparagraph shall not apply to any acquisition if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) described in subparagraph (A).

“(E) ASSET ACQUISITIONS.—Except as provided in regulations, for purposes of this subsection, if the assets of the distributing corporation or any controlled corporation are acquired by a successor corporation in a transaction described in subparagraph (A), (C) or (D) of section 368(a)(1) or any other transaction specified in regulations by the Secretary, the shareholders (immediately before the acquisition) of the corporation acquiring such assets shall be treated as acquiring stock in the corporation from which the assets were acquired.

“(F) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

“(i) CHANGE IN CONTROL COMPANY.—The term ‘change in control com-

pany’ means, with respect to any pre-  
arranged change in control, the distrib-  
uting or controlled corporation (or both)  
that undergoes such change in control.

“(ii) 50-PERCENT OR GREATER IN-  
TEREST.—The term ‘50-percent or greater  
interest’ has the meaning given such term  
by subsection (d)(4).

“(iii) DISTRIBUTIONS IN TITLE 11 OR  
SIMILAR CASE.—Paragraph (1) shall not  
apply to any distribution made in a title 11  
or similar case (as defined in section  
368(a)(3)).

“(iv) AGGREGATION AND ATTRIBU-  
TION RULES.—

“(I) AGGREGATION.—The rules  
of paragraph (7)(A) of subsection (d)  
shall apply.

“(II) ATTRIBUTION.—Section  
318(a)(2) shall apply in determining  
whether a person holds stock or secu-  
rities in any corporation. Except as  
provided in regulations, section  
318(a)(2)(C) shall be applied without  
regard to the phrase ‘50 percent or

1 more in value' for purposes of the pre-  
 2 ceding sentence.

3 “(v) SUCCESSORS AND PREDE-  
 4 CESSORS.—Any reference to a controlled  
 5 corporation or a distributing corporation  
 6 shall include a reference to any predecessor  
 7 or successor of such corporation.

8 “(4) DEFINITION OF HIGHLY LEVERAGED.—  
 9 For purposes of this subsection—

10 “(A) IN GENERAL.—A change in control  
 11 company shall be considered to be highly lever-  
 12 aged for purpose of this subsection if its ratio  
 13 of debt to equity exceeds 2 to 1.

14 “(B) RATIO OF DEBT TO EQUITY.—The  
 15 term ‘ratio of debt to equity’ means the ratio  
 16 which the total indebtedness of the company  
 17 bears to the value of the company’s equity.

18 “(C) WHEN TO MEASURE RATIO OF DEBT  
 19 TO EQUITY.—The ratio of debt to equity of the  
 20 distributing and controlled corporations shall be  
 21 measured immediately following the distribu-  
 22 tion, but prior to any transactions occurring  
 23 after the distribution involving the distributing  
 24 or controlled corporations.

25 “(D) INDEBTEDNESS.—Indebtedness—

1 “(i) shall not include indebtedness be-  
2 tween corporations that are members of an  
3 affiliated group immediately after the dis-  
4 tribution,

5 “(ii) shall not include any liabilities  
6 described in section 357(c)(3),

7 “(iii) shall be computed with reference  
8 to the adjusted issue price (as defined in  
9 section 1272(a)(4)), and

10 “(iv) shall include stock described in  
11 section 1504(a)(4).

12 “(E) VALUE OF COMPANY’S EQUITY.—The  
13 value of the company’s equity shall be based on  
14 the fair market value of all the company’s eq-  
15 uity immediately after the distribution exclud-  
16 ing the value of any equity described subpara-  
17 graph (D)(iv).

18 “(F) AFFILIATED GROUPS.—In any case  
19 in which the issuing corporation of any indebt-  
20 edness is a member of an affiliated group (with-  
21 in the meaning of section 1504(a)) which in-  
22 cludes the distributing or controlled corpora-  
23 tion, the calculation of the debt to equity ratio  
24 for purposes of this subsection shall be deter-  
25 mined, pursuant to regulations prescribed by



1 the Secretary, by treating all the members of  
2 the affiliated group in the aggregate as the  
3 issuing corporation of such indebtedness.

4 “(G) SPECIAL RULES FOR BANKS, LEND-  
5 ING OR FINANCE COMPANIES.—With respect to  
6 any corporation which is a bank (as defined in  
7 section 581) or primarily engaged in a lending  
8 or finance business, in determining the debt to  
9 equity ratio of such corporation (or of the affili-  
10 ated group of which such corporation is a mem-  
11 ber) for purposes of this subsection, the total  
12 indebtedness of such corporation shall be re-  
13 duced by an amount equal to the total indebted-  
14 ness owed to such corporation which arises out  
15 of the banking business of such corporation, or  
16 out of the lending or finance business of such  
17 corporation, as the case may be.

18 “(H) OUTSIDE LEVERAGE TEST.—If ratio  
19 of debt to equity of the change in control com-  
20 pany equals or exceeds 6 to 1 and paragraph  
21 (2)(A) is met with respect to a distribution,  
22 then—

23 “(i) the requirements of subpara-  
24 graphs (B) and (C) of paragraph (2) shall

1 be treated as met with respect to such dis-  
2 tribution and

3 “(ii) the gain realized as a result of  
4 the distribution shall be recognized not-  
5 withstanding paragraph (1).

6 “(5) DEFINITION OF EXCESS RELATIVE LEVER-  
7 AGE.—For purposes of this subsection—

8 “(A) IN GENERAL.—The term ‘excess rel-  
9 ative leverage’ means the excess, if any, of—

10 “(i) the actual indebtedness of the  
11 change in control company, over

12 “(ii) the maximum permitted indebt-  
13 edness of the change in control company.

14 “(B) MAXIMUM PERMITTED INDEBTED-  
15 NESS.—The maximum permitted indebtedness  
16 of a change in control company equals the  
17 greater of—

18 “(i) the amount of indebtedness that  
19 would result in the change in control com-  
20 pany having a debt to equity ratio of 2.0,  
21 and

22 “(ii)(I) if the change in control com-  
23 pany is the controlled company in the dis-  
24 tribution, the amount of indebtedness that  
25 would result in the controlled corporation

1           having a debt to equity ratio that equals  
2           the sum of the debt to equity ratio of the  
3           distributing corporation plus 0.25, or

4           “(II) if the change in control company  
5           is the distributing company in the distribu-  
6           tion, the amount of indebtedness that  
7           would result in the distributing corporation  
8           having a debt to equity ratio that equals  
9           the sum the debt to equity ratio of the con-  
10          trolled corporation plus 0.25.

11          To the extent the distribution involves more  
12          than one controlled corporation, the debt to eq-  
13          uity ratio of the controlled corporation for pur-  
14          poses of the preceding sentence shall be deter-  
15          mined by calculating aggregate indebtedness  
16          and equity value of all the controlled corpora-  
17          tions.

18          “(6) GAIN REALIZED AS RESULT OF DISTRIBUTION.—For purposes of this subsection, the term  
19          ‘gain realized as a result of the distribution’ means  
20          the excess (if any) of—  
21          the excess (if any) of—

22               “(A) the value of the controlled corpora-  
23               tion’s stock distributed pursuant to the dis-  
24               tribution, over

1           “(B) the distributing corporation’s tax  
2           basis in the controlled corporation’s stock dis-  
3           tributed pursuant to the distribution.

4           “(7) CROSS-REFERENCE TO SECTION 362 RE-  
5           GARDING BASIS STEP-UP IN CONNECTION WITH DIS-  
6           TRIBUTIONS TO WHICH THIS SUBSECTION AP-  
7           PLIES.—To the extent gain is recognized pursuant  
8           to this subsection, there shall be a corresponding  
9           basis step-up in the assets of the change in control  
10          company with excess relative leverage under section  
11          362(f).

12          “(8) COORDINATION WITH SUBSECTION (d).—  
13          This subsection shall not apply to any distribution to  
14          which subsection (d) applies.

15          “(9) CERTAIN CAPITAL CONTRIBUTIONS NOT  
16          TAKEN INTO ACCOUNT.—

17                 “(A) IN GENERAL.—Any equity capital re-  
18                 ceived by a change in control company at the  
19                 time of or prior to a distribution that is part of  
20                 a plan a principal purpose of which is to avoid  
21                 or reduce the gain that would otherwise be rec-  
22                 ognized pursuant to this subsection shall not be  
23                 taken into account for purposes of calculating  
24                 the debt to equity ratio and excess relative le-  
25                 verage of such change in control company.

1           “(B) CERTAIN CONTRIBUTIONS PRESUMED  
2           TO BE PART OF PLAN.—For purposes of sub-  
3           paragraph (A), any capital contribution received  
4           by the change in control company during the 12  
5           month period ending on the date of the dis-  
6           tribution shall be treated as pursuant to a plan  
7           described in subparagraph unless it is estab-  
8           lished that none of the principal purposes of the  
9           capital contribution was to avoid or reduce the  
10          gain that would otherwise have to be recognized  
11          pursuant to this subsection.

12          “(10) STATUTE OF LIMITATIONS.—If there is a  
13          distribution to which paragraph (1) applies—

14                 “(A) the statutory period for the assess-  
15                 ment of any deficiency attributable to any part  
16                 of the gain recognized under this subsection by  
17                 reason of such distribution shall not expire be-  
18                 fore the expiration of 3 years from the date the  
19                 Secretary is notified by the taxpayer (in such  
20                 manner as the Secretary may by regulations  
21                 prescribe) that such distribution occurred, and

22                 “(B) such deficiency may be assessed be-  
23                 fore the expiration of such 3-year period not-  
24                 withstanding the provisions of any other law or

1 rule of law which would otherwise prevent such  
2 assessment.

3 “(11) REGULATIONS.—The Secretary shall pre-  
4 scribe such regulations as may be necessary to carry  
5 out the purposes of this subsection, including regula-  
6 tions—

7 “(A) preventing taxpayers from circum-  
8 venting the purpose of this subsection through  
9 distributions of multiple controlled corporations,  
10 the use of unaffiliated companies, capital con-  
11 tributions prior to the distribution, or the use  
12 of strategies that attempt to distort the debt to  
13 equity ratio calculations in a manner incon-  
14 sistent with the purpose of this subsection, in-  
15 cluding, for example, transitory changes in cap-  
16 ital structure entered into for the principal pur-  
17 pose of avoiding application of the debt to eq-  
18 uity ratio calculations which have effects incon-  
19 sistent with the purposes of section 355(e),

20 “(B) providing for the application of this  
21 subsection where there is more than 1 con-  
22 trolled corporation, and

23 “(C) providing for the application of rules  
24 similar to the rules of subsection (d)(6) where

1           appropriate for the purposes of paragraph  
2           (3)(A).”.

3           (b) CONFORMING AMENDMENT.—Subsection (f) of  
4 section 362 of such Code is amended to read as follows:

5           “(f) BASIS OF ASSETS IN CONNECTION WITH DIS-  
6 TRIBUTION TO WHICH SECTION 355(e) APPLIES.—In the  
7 case of a distribution to which section 355(e) applies, the  
8 basis of the assets of the change in control company (as  
9 defined in such section) and members of its affiliated  
10 group (other than stock in any member of the acquired  
11 group) shall be increased by the amount of the gain recog-  
12 nized pursuant to section 355(e)(1) and such increase  
13 shall be allocated among such assets in a manner that re-  
14 flects the relative amounts by which the fair market values  
15 of such assets exceed their respective adjusted bases. The  
16 Secretary shall prescribe regulations providing for cor-  
17 responding adjustments in the basis of stock of members  
18 of the members of the affiliate group which includes the  
19 change in control company.”.

20           (c) EFFECTIVE DATE.—The amendments made by  
21 this section shall to—

22           (1) any distribution completed after the date of  
23 the enactment of this Act, and

24           (2) any distribution completed on or before  
25 such date to the extent any transaction completed on

1       or after such date results in a prearranged change  
2       in control (as defined in section 355(e) of the Inter-  
3       nal Revenue Code of 1986, as amended by this sec-  
4       tion).

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