Tax M&A Update

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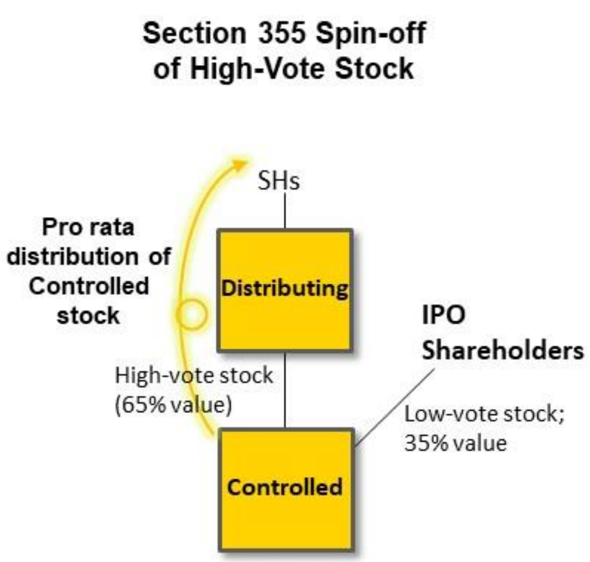
Technical Developments and Musings

Green Book "control" proposal. As part of its FY23 budget proposal, the Biden Treasury has revived a Clinton-era proposal to replace the §368(c) "control" standard in Subchapter C in the Internal Revenue Code as applied corporate stock. According to the Administration's explanation in the document known as the Green Book, the differences between the two standards provide taxpayers with the ability to "manipulate the section 368(c) control test in order to qualify or not qualify, as desired, a transaction as tax-free." In connection with transaction structuring to avoid nonrecognition treatment, Treasury expressed concern with taxpayers being able to recognize a loss. Thus, Treasury proposes swapping the §368(c) control test with the affiliation test under §1504(a)(2). Thus, "control" would be defined as the ownership of at least 80% of the total voting power and 80% of the total value of stock of a corporation; in contrast, the current and long-standing §368(c) standard doesn't explicitly consider the value of a corporation's equity, but rather whether the relevant person owns 80% of the voting power of all voting stock as well as 80% of nonvoting stock, if any. Were the proposal enacted, it would affect, among other things, the structuring and qualification of tax-free incorporations, reorganizations and divisive transactions. As illustrated here, a divisive tax-free distribution under §355 can currently be satisfied where the distributing corporation distributes "high vote" stock representing 80% of the voting power of the controlled corporation (Controlled), but with only 65% of the value of the Controlled, assuming the other applicable §355 requirements are satisfied. If the Biden Administration proposal were adopted, the illustrated spin-off would not qualify for tax-free spin-off treatment because the distributed stock would not represent at least 80% of the *value* of Controlled.



Management fees were disguised dividends. The Eighth Circuit Court of Appeals in *Aspro, Inc. v. Comm'r* affirmed the Tax Court's decision that management fees paid by a closely-held C corporation to its shareholders over a twenty year period, roughly in proportion to their shareholdings, were disguised distributions of profits that could not be deducted by the corporation. The Tax Court's decision identified six factors supporting disguised dividend treatment. (See January 2021 *Update.*) In its affirmance, the reviewing court noted that compensation paid by a corporation to its shareholders is closely scrutinized; here, among other things, the court noted there was no written agreement between the corporation and the shareholders reflecting such services nor did the taxpayer establish any methodology for quantifying the value of the services purportedly provided.

Notice-and-comment challenges to regulations and other guidance. Temporary retroactive regulations under §245A were struck down by a Colorado federal district court as not conforming with the notice-and-comment requirement of the Administrative Procedure Act, in *Liberty Global Inc. v. US*. In addition, in March, the Sixth Circuit Court of Appeals struck down, for similar reasons, a 2007 IRS notice designating certain employee-benefit plans featuring cash-value life insurance policies as listed transactions, in *Mann Construction Inc. et al. v. US*; other courts have noticed. For further info, see Tax Alert 2022-0504.