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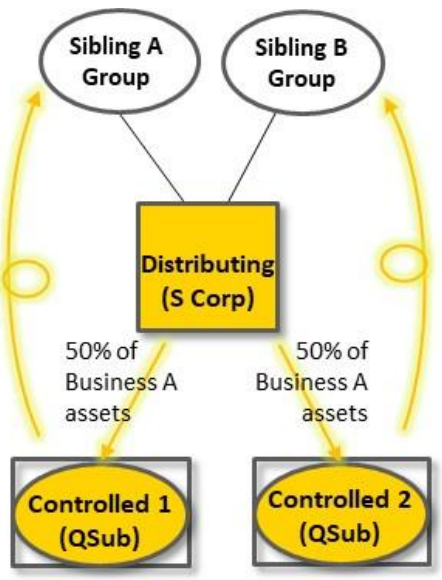
Tax M&A Update

National Tax M&A
International Tax and Transaction Services

Vol. XI, Issue 10 **June 2022**

Technical Developments and Musings

Vertical divisions of a closely-held family business. To judge from PLRs, most divisive transactions under §355 involve the separation of two or more active trades or business. Typically, one business "stays behind" in the distributing corporation while another business—held by the controlled corporation—is spun off through a distribution of controlled corporation stock to the distributing corporation's shareholders. PLR 202225006 represents something less common, namely the division of a single business that had been conducted through a standalone S corporation. In the recent PLR, however, there was "intense conflict" between two siblings who each headed different shareholder groups. So what appears to be a "vertical division" is proposed: Distributing will transfer one-half of the Business A assets to Controlled 1 and the remaining half to Controlled 2. The stock of Controlled 1 will be distributed to the Sibling A Group and the stock of Controlled 2 will be distributed to the Sibling B group. Each of the distributed companies will elect S corporation status and Distributing will terminate and dissolve under state law as soon as practically possible. Following the distribution, what had been a single business will now be two businesses conducted by two different corporations. Also worth noting: although IRS does not rule on the validity of the required business purpose for a §355 distribution, this PLR also illustrates a "going your own way" business purpose for a divisive transaction, particularly common in a closely-held setting where shareholders are also actively involved in the operation of the corporation's business or businesses.



Transition tax does not violate US Constitution (and taxable income does not require realization). The Ninth Circuit Court of Appeals affirmed the dismissal of individual shareholders' constitutional challenge to the §965 mandatory repatriation tax. The shareholders, US persons who owned 11% of a CFC, sought to invalidate the 2017 changes to §965 that created a one-time proportionate inclusion into US shareholder income of a CFC's undistributed earnings. The court concluded in *Moore v. US* that §965 neither violated the US Constitution's apportionment clause nor its due process clause. In its analysis, the court rejected the taxpayer's argument that two US Supreme Court cases, *Eisner v. Macomber* and *Glenshaw Glass,* require income to be realized before it can be taxed. The Ninth Circuit concluded that there is no constitutional requirement requiring realization while also noting that *Macomber* and *Glenshaw Glass* "do not provide a universal definition of income."

Chief counsel advice: termination fees are capital losses. IRS concluded that a "reverse" termination fee paid by the purported acquiring entity in a failed merger and a termination fee paid in connection with a failed sale of assets gave rise to capital losses to the extent related to capital assets, not deductible trade or business expenses. According to non-precedential CCA 202224010, the termination of the merger transaction and asset sale resulted in a §1001 disposition that gave rise to losses under §165 rather than business expense under §162. From regulations and statutory history IRS concluded that termination fees and facilitative costs of corporate transactions were properly treated as losses under §165 to which §1234A applies, depending on the character of the underlying assets.