

Spin off. If a stock offering business purpose motivates a distribution of controlled corporation stock by a distribution corporation, the inability of the controlled corporation to complete the offering as a result of an unexpected deterioration in market conditions will not prevent the distribution from having satisfied the corporate business purpose requirement of section 1.355-2(b)(1) of the regulations.

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ISSUE

Is the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations satisfied if the distribution of the stock of a controlled corporation is, at the time of the distribution, motivated, in whole or substantial part, by a corporate business purpose, but that purpose cannot be achieved

as the result of an unexpected change in circumstances following the distribution?

FACTS

D is a publicly traded corporation that conducts Business A and Business B directly and Business C through its wholly owned subsidiary C. Business C needs to raise a substantial amount of capital in the near future to invest in plant and equipment and to make acquisitions. D has been advised by its investment banker that the best way to raise this capital is through an initial public offering of C stock after C has been separated from D. The investment banker believes, based on its analysis of comparable situations, and taking into account the current market climate, that such an offering would be more efficient than a stock offering by C or D without first separating from the other because it would raise the needed capital with significantly less dilution of the existing shareholders' interests in the combined enterprises.

In reliance on the investment banker's opinion, D distributes the stock of C to its shareholders, and C prepares to offer its stock to the public as soon as practicable but with a target date approximately six months after the distribution. Following the distribution and before the offering can be undertaken, market conditions unexpectedly deteriorate to such an extent that, in the judgment of C and its advisors, the offering should be postponed. One year after the distribution, conditions have not improved sufficiently to permit the offering to go forward and C funds its capital needs through the sale of debentures.

Apart from the issue of whether the business purpose requirement of § 1.355-2(b) is satisfied, the distribution meets all of the requirements of § 355 of the Internal Revenue Code.

LAW

Section 355 provides that if certain requirements are met, a corporation may distribute stock and securities in a controlled corporation to its shareholders and security holders without causing the distributing corporation or the distributees to recognize gain or loss.

To qualify as a distribution described in § 355, a distribution must, in addition to sat-

isfying the statutory requirements of § 355, satisfy certain requirements in the regulations, including the business purpose requirement. Section 1.355-2(b)(1) provides that a distribution must be motivated, in whole or substantial part, by one or more corporate business purposes. A corporate business purpose is a real and substantial non-federal tax purpose germane to the business of the distributing corporation, the controlled corporation, or the affiliated group to which the distributing corporation belongs. Section 1.355-2(b)(2). The principal reason for the business purpose requirement is to provide nonrecognition treatment only to distributions that are incident to readjustments of corporate structures required by business exigencies and that effect only readjustments of continuing interests in property under modified corporate forms. Section 1.355-2(b)(1).

ANALYSIS

To satisfy the business purpose requirement of § 1.355-2(b)(1), a distribution of controlled corporation stock must be motivated, in whole or substantial part, by a corporate business purpose. A corporate business purpose is a real and substantial non-federal tax purpose germane to the business of the distributing corporation, the controlled corporation, or the affiliated group to which the distributing corporation belongs. The regulations do not require that the corporation in fact succeed in meeting its corporate business purpose, as long as, at the time of the distribution, such a purpose exists and motivates, in whole or substantial part, the distribution. An unexpected change in market or business conditions following a distribution that prevents achievement of the business purpose will not prevent satisfaction of the business purpose requirement. Hence, notwithstanding the fact that, as a result of the unexpected deterioration in market conditions, C does not complete the stock offering that motivated its separation from D, the business purpose requirement of § 1.355-2(b)(1) is satisfied.

HOLDING

The business purpose requirement of § 1.355-2(b) is satisfied if the distribution of the stock of a controlled corporation is, at the time of the distribution, motivated, in whole or substantial part, by

a corporate business purpose, but that purpose cannot be achieved as the result of an unexpected change in circumstances following the distribution.

DRAFTING INFORMATION

The principal author of this revenue ruling is Wayne T. Murray of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Murray at (202) 622-7700 (not a toll-free call).