

Part III - Administrative, Procedural, and Miscellaneous

Elections under § 355(b)(3)(C)

Notice 2006-81

This notice provides guidance for making an election under § 355(b)(3)(C) of the Internal Revenue Code.

BACKGROUND

Section 355(b)(3) was enacted on May 17, 2006, as part of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 348. Section 355(b)(1) generally provides, in part, that § 355(a) only applies to transactions in which both the distributing corporation and the controlled corporation are engaged in the active conduct of a trade or business immediately after the distribution. Section 355(b)(2) generally provides, in part, that, for purposes of § 355(b)(1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if such corporation is engaged in the active conduct of a trade or business, or if substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) that is so engaged (the latter phrase hereinafter referred to as the “Holding Company Test”).

New § 355(b)(3)(A) generally provides that, for distributions made after May 17, 2006, and on or before December 31, 2010, a corporation shall be treated as meeting the requirements of § 355(b)(2)(A) if and only if such corporation is engaged in the active conduct of a trade or business. New § 355(b)(3)(B) generally provides that, for purposes of § 355(b)(3)(A), all members of such corporation's separate affiliated group shall be treated as one corporation. Section 355(b)(3)(B) also provides that a corporation's separate affiliated group is the affiliated group that would be determined under § 1504(a) if such corporation were the common parent and § 1504(b) did not apply. Thus, in light of the restrictive language in § 355(b)(3), the Holding Company Test does not apply to any distribution for which § 355(b)(3) applies.

New § 355(b)(3)(C) contains transition rules providing that § 355(b)(3)(A) shall not apply to any distribution made pursuant to a transaction that was: (i) made pursuant to an agreement that was binding on May 17, 2006, and at all times thereafter; (ii) described in a ruling request submitted to the Internal Revenue Service on or before May 17, 2006; or, (iii) described on or before May 17, 2006, in a public announcement or in a filing with the Securities and Exchange Commission. Therefore, corporations whose distributions are described in the preceding sentence and otherwise meet the requirements of § 355 shall be governed under § 355(b)(2)(A) (including the Holding Company Test), notwithstanding the enactment of § 355(b)(3). However, § 355(b)(3)(C) also provides that these corporations may elect not to have the transition rule apply. If one of these corporations elects not to have the transition rule apply,

§ 355(b)(3)(A) and (B) will apply. Any such election, once made, shall be irrevocable.

The Service has determined that corporations whose transactions are described in the transition rule and who desire tax-free treatment under § 355 will not be required to make an affirmative election under § 355(b)(3)(C), provided that their transaction is described in § 355(b) as in effect either before or after the enactment of § 355(b)(3). Such corporations will be deemed to have satisfied the requirements of § 355(b)(2)(A) or (b)(3), as applicable. However, corporations must make the election described in § 355(b)(3)(C) if the purpose of the election is to disqualify the distribution under § 355(a). Corporations whose transactions are described in the transition rule but do not desire tax-free treatment under § 355 and require § 355(b)(2)(A) to apply to ensure taxable treatment are not required to file the election, but must report the distribution as taxable.

The Service will treat elections as effective under § 355(b)(3)(C) if they are made in the form and manner as set forth in this notice. The Service will also treat elections as effective under § 355(b)(3)(C) if they are made in a different form and manner, provided that the form and manner of the election apprise the Service that an election has been made with respect to a particular transaction and by particular parties.

PROCEDURES

If a distributing corporation makes a distribution of stock or securities of a controlled corporation in a transaction described in § 355(b)(3)(C)(i), (ii), or (iii), it

intends that the distribution not qualify under § 355(a), and it is making the election described in § 355(b)(3)(C) to ensure that result, the distributing corporation may make a valid election by including a statement as described below on or with its tax return filed by the due date (including extensions) for filing its original return for the taxable year in which the distribution occurs.

The statement should be titled “ELECTION PURSUANT TO NOTICE 2006-81 BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY)], A DISTRIBUTING CORPORATION.” The statement should provide the names and taxpayer identification numbers, if any, of the distributing and controlled corporations and should include a representation that the distributing corporation is eligible to make the election described in this notice and that the distributing corporation elects to have § 355(b)(3) apply to its distribution.

EFFECTIVE DATE

This notice is effective for all elections under § 355(b)(3)(C).

DRAFTING INFORMATION

The principal author of this notice is Sameera Y. Hasan of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice contact Sameera Y. Hasan at (202) 622-7770 (not a toll-free call).