support structure. This condition could result in failure of a main transmission frame and subsequent loss of control of the helicopter.

(c) Comments Due Date

We must receive comments by September 13, 2016.

(d) Compliance

You are responsible for performing each action required by this AD within the specified compliance time unless it has already been accomplished prior to that time.

(e) Required Actions

(1) For helicopters with a frame assembly with a P/N shown in Table 1 to paragraph (e)(1) or Table 2 to paragraph (e)(1) of this AD, before further flight, remove from service any part that has reached or exceeded its new life limit. Fwd STA 328 frame assemblies that are altered and changed to P/N 92070–20124–064, 92070–20124–067, 92070–20127–045, 92070–20124–065, 92070–20124–047, or 92070–20127–046 must be removed from service upon accumulating 12,000 hours TIS from the alteration or 28,500 hours TIS total (regardless of P/N), whichever occurs first.

TABLE 1 TO PARAGRAPH (e)(1)

	Life limit hours TIS
Fwd STA 328 frame assembly P/N:	
92070–20124–064	12,000
92070–20124–067	12,000
92070–20127–045	12,000
92070–20124–065	12,000
92070–20124–047	12,000
92070–20127–046	12,000
92070–20124–063	12,000
92070–20124–066	12,000
92070–20127–041	12,000
Aft STA 362 frame assembly P/N:	
92070–20124–041	10,400
92070–20124–044	10,400
92070–20127–042	10,400
92070–20124–042	10,400
92070–20124–045	10,400
92070–20127–049	10,400
92070–20124–043	10,400
92070–20124–046	10,400
92070–20127–050	10,400
92070–20141–050	17,000
92070–20141–051	17,000
92070–20141–052	17,000

TABLE 2 TO PARAGRAPH (e)(1)

	Life limit hours TIS
Fwd STA 328 frame assembly P/N:	
92070–20097–058	28,500
92080–20047–047	28,500
92070–20097–060	28,500
92080–20047–048	28,500

(2) For helicopters with a frame assembly with a P/N shown in Table 1 to paragraph (e)(1), Table 2 to paragraph (e)(1), or Table 3 to paragraph (e)(2) of this AD: Within 24 clock-hours, and thereafter before the first flight of each day or at intervals not to exceed 24 clock-hours, whichever occurs later, using a 10X or higher power magnifying glass, inspect the skin, straps, and fasteners of the top deck for a crack and loose fasteners in two locations from the STA 328 frame to the STA 305 frame between the right butt line (BL) 16.5 beam and the left BL 16.5 beam, and from the STA 362 frame to the STA 379 frame between the right BL 16.5 beam and the left BL 16.5 beam. If there is a loose fastener or a crack:

(i) Repair or replace any cracked part and any loose fastener before further flight.

(ii) Inspect the STA 328 frame and STA 362 frame between the left and right BL16.5 beams and inspect the area on the left and right BL 16.5 beams six inches on either side of the mounting pads for a crack and loose fasteners. If there is a loose fastener or a crack, repair or replace any cracked part and any loose fastener before further flight.

(iii) Inspect the STA 328 and STA 362 outboard frames, left and right sides, from the BL 16.5 beam to water line 252.25 for a crack and loose fasteners. If there is a loose fastener or a crack, repair or replace any cracked part and any loose fastener before further flight.

TABLE 3 TO PARAGRAPH (e)(2)

Fwd STA 328 frame assembly P/N	Aft STA 362 frame assembly P/N
92209–02106–042	92070–20097–062
92209–02106–043	92080–20047–051
92070–20097–041	92209–02109–043
92080–20047–041	92209–02109–044
	92070–20097–042
	92080–20047–042
	92070–20097–064
	92080–20047–052

(3) For each frame assembly listed in Table 1 to paragraph (e)(1) or Table 4 to paragraph (e)(3) of this AD with 1,801 or more hours TIS, and for each frame assembly listed in Table 2 to paragraph (e)(1) or Table 3 to paragraph (e)(2) of this AD with 1,301 or more hours TIS, within 150 hours TIS and thereafter at intervals not to exceed 150 hours TIS, perform the inspections in paragraphs (e)(2)(ii) and (e)(2)(iii) of this AD.

TABLE 4 TO PARAGRAPH (e)(3)

Fwd STA 328 frame assembly P/N	Aft STA 362 frame assembly P/N
92209–02107–042	92070–02108–042
92209–02107–103	92080–02108–103

(f) Alternative Methods of Compliance (AMOC)

(1) The Manager, Boston Aircraft Certification Office, FAA, may approve AMOCs for this AD. Send your proposal to: Kristopher Greer, Aviation Safety Engineer, Engine & Propeller Directorate, 1200 District Avenue, Burlington, Massachusetts 01803; telephone (781) 238–7799; email *Kristopher.Greer@faa.gov.*

(2) For operations conducted under a 14 CFR part 119 operating certificate or under 14 CFR part 91, subpart K, we suggest that you notify your principal inspector, or lacking a principal inspector, the manager of the local flight standards district office or certificate holding district office before operating any aircraft complying with this AD through an AMOC.

(g) Additional Information

Sikorsky S–92 Alert Service Bulletin (ASB) 92–53–008, Basic Issue, dated June 13, 2012; ASB 92–53–009, Basic Issue, dated December 6, 2012; ASB 92–53–012, Basic Issue, dated February 10, 2014, and Sikorsky Special Service Instructions No. 92–074–E, Revision E, dated April 9, 2014, which are not incorporated by reference, contain additional information about the subject of this AD. For service information identified in this AD, contact Sikorsky Aircraft Corporation, Customer Service Engineering, 124 Quarry Road, Trumbull, CT 06611; telephone 1–800–Winged–S or 203–416–4299; email *sikorskywcs@sikorsky.com.*

You may review a copy of information at the FAA, Office of the Regional Counsel, Southwest Region, 10101 Hillwood Pkwy., Room 6N–321, Fort Worth, Texas 76177.

(h) Subject

Joint Aircraft Service Component (JASC) Code: 5311 Fuselage Main, Frame.

Issued in Fort Worth, Texas, on July 7, 2016.

Scott A. Horn,

Acting Manager, Rotorcraft Directorate, Aircraft Certification Service.

[FR Doc. 2016–16749 Filed 7–14–16; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–134016–15]

RIN 1545–BN47

Guidance Under Section 355 Concerning Device and Active Trade or Business

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 355 of the Internal Revenue Code (Code). The proposed regulations would clarify the application of the device prohibition and the active business requirement of section 355. The proposed regulations would affect corporations that distribute the stock of controlled corporations, their shareholders, and their security holders.

DATES: Written or electronic comments and requests for a public hearing must be received by October 13, 2016.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–134016–15), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–134016–15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224. Submissions may also be sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–134016–15).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stephanie D. Floyd or Russell P. Subin at (202) 317–6848; concerning submissions of comments and/or requests for a public hearing, Regina Johnson at (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A. Introduction

This document contains proposed regulations that would amend 26 CFR part 1 under section 355 of the Code. The proposed regulations would provide additional guidance regarding the device prohibition of section 355(a)(1)(B) and provide a minimum threshold for the assets of one or more active trades or businesses, within the meaning of section 355(a)(1)(C) and (b), of the distributing corporation and each controlled corporation (in each case, within the meaning of section 355(a)(1)(A)).

This Background section of the preamble (1) summarizes the requirements of section 355, (2) discusses the development of current law and IRS practice under section 355 and the regulations thereunder, and (3) explains the reasons for the proposed regulations.

B. Section 355 Requirements

Generally, if a corporation distributes property with respect to its stock to a shareholder, section 301(b) provides that the amount of the distribution is equal to the amount of money and the fair market value of other property received. Under section 301(c), this amount is treated as (1) the receipt by the shareholder of a dividend to the extent of the corporation's earnings and profits, (2) the recovery of the shareholder's basis in the stock, and/or (3) gain from the sale or exchange of property. The corporation recognizes gain under section 311(b) to the extent the fair market value of the property distributed exceeds the corporation's adjusted basis in the property. However, section 355 provides that, under certain circumstances, a corporation (Distributing) may distribute stock and securities in a corporation it controls within the meaning of section 368(c) (Controlled) to its shareholders and security holders without causing either Distributing or its shareholders or security holders to recognize income, gain, or loss on the distribution.

Section 355 has numerous requirements for a distribution to be tax-free to Distributing and its shareholders. Some of these requirements are intended to prevent a distribution from being used inappropriately to avoid shareholder-level tax on dividend income. As examples, section 355(a)(1)(B) provides that the transaction must not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (a device), and section 355(a)(1)(C) and (b) require Distributing and Controlled each to be engaged, immediately after the distribution, in the active conduct of a trade or business (an active business). To qualify for this purpose, an active business must have been actively conducted throughout the five-year period ending on the date of the distribution and must not have been acquired, directly or indirectly, within this period in a transaction in which gain or loss was recognized. Section 355(b)(2)(B), (C), and (D).

Distributions of the stock of Controlled generally take three different forms: (1) A pro rata distribution to Distributing's shareholders of the stock of Controlled (a spin-off), (2) a distribution of the stock of Controlled in redemption of Distributing stock (a split-off), or (3) a liquidating distribution in which Distributing distributes the stock of more than one Controlled, either pro rata or non-pro rata (in either case, a split-up).

C. Development of Current Law and IRS Practice

1. Early Legislation

The earliest predecessor of section 355 was section 202(b) of the Revenue Act of 1918, ch. 18 (40 Stat. 1057, 1060), which permitted a tax-free exchange by a shareholder of stock in a corporation for stock in another corporation in connection with a reorganization. This section did not allow tax-free spin-offs. In section 203(c) of the Revenue Act of 1924, ch. 234 (43 Stat. 253, 256), Congress amended this provision to allow tax-free spin-offs pursuant to plans of reorganization.

Taxpayers tried to use this provision to avoid the dividend provisions of the Code by having Distributing contribute surplus cash or liquid assets to a newly formed Controlled and distribute the Controlled stock to its shareholders. *See, e.g.,Gregory* v. *Helvering,* 293 U.S. 465 (1935). Congress reacted to this abuse by eliminating the spin-off provision in the Revenue Act of 1934, ch. 277 (48 Stat. 680). The legislative history states that the provision had provided a method for corporations ''to pay what would otherwise be taxable dividends, without any taxes upon their shareholders'' and that ''this means of avoidance should be ended.'' H.R. Rep. No. 73–704, at 14 (1934).

In section 317(a) of the Revenue Act of 1951, ch. 521 (65 Stat. 452, 493), Congress re-authorized spin-offs pursuant to plans of reorganization:

> . . . unless it appears that (A) any corporation which is a party to such reorganization was not intended to continue the active conduct of a trade or business after such reorganization, or (B) the corporation whose stock is distributed was used principally as a device for the distribution of earnings and profits to the shareholders of any corporation a party to the reorganization.

During debate on this legislation, Senator Hubert Humphrey expressed concerns about spin-offs and argued that these restrictions were necessary. *See, e.g.,* 97 Cong. Rec. 11812 (1951) (''Unless strictly safeguarded, [a spin-off provision] can result in a loophole that will enable a corporation to distribute earnings and profits to stockholders without payment of the usual income taxes.''); *Id.* (''Clauses (A) and (B) of section 317 provide very important safeguards against the tax avoidance which would be possible if section 317 were adopted without clauses (A) and (B).''). *See also* 96 Cong. Rec. 13686 (1950) (''It was the viewpoint of the committee that [a spin-off] must be strictly a bona fide transaction, not colorable, not for the purpose of evading the tax.'').

Until 1954, a spin-off, split-off, or split-up was eligible for tax-free treatment only if Distributing transferred property to Controlled as part of a reorganization. In 1954, Congress adopted section 355 as part of the 1954 Code. As a significant innovation, section 355 allowed spin-offs, split-offs, and split-ups to be tax-free without a reorganization, and this innovation remains in effect.

2. Case Law

Courts applying section 355 (or a predecessor provision) have generally placed greater emphasis on the substance of the transaction than on compliance with the technical requirements of the statute. Thus, some courts have determined that a transaction does not qualify under section 355 (or a predecessor provision), notwithstanding strict statutory compliance, on the basis that the substance of the transaction was inconsistent with congressional intent. For example, in *Gregory,* the Supreme Court held that compliance with the letter of the spin-off statute was insufficient if the transaction was otherwise indistinguishable from a dividend. The Supreme Court observed that the transaction in *Gregory* was ''an operation having no business or corporate purpose–a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character.'' *Gregory,* 293 U.S. at 469.

Other courts have found that a transaction does qualify under section 355 despite its failure to comply with all of the statutory requirements. For example, in *Commissioner* v. *Gordon,* 382 F.2d 499 (2d Cir.1967), *rev'd on other grounds,* 391 U.S. 83 (1968), the court addressed section 355(b)(2)(C). Pursuant to that section, a corporation is treated as engaged in the active conduct of a trade or business only if the trade or business was not acquired in a transaction in which gain or loss was recognized in whole or in part within the five-year period ending on the date of the distribution. The court concluded that, despite the fact that gain was recognized when Distributing transferred a trade or business to Controlled, section 355(b)(2)(C) was not violated because new assets were not brought within the combined corporate shells of Distributing and Controlled. The court stated:

> We think that the draftsmen of Section 355 intended these subsections to apply only to the bringing of new assets within the combined corporate shells of the distributing and the controlled corporations. Therefore, it is irrelevant in this case whether gain was recognized on the intercorporate transfer.

Id. at 507.

3. Device Regulations

a. 1955 Regulations

Regulations under section 355 of the 1954 Code were issued in 1955 (the 1955 regulations). TD 6152 (20 FR 8875). These regulations included § 1.355–2(b)(3), which provided the following:

> In determining whether a transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or both, consideration will be given to all of the facts and circumstances of the transaction. In particular, consideration will be given to the nature, kind and amount of the assets of both corporations (and corporations controlled by them) immediately after the transaction. The fact that at the time of the transaction substantially all of the assets of each of the corporations involved are and have been used in the active conduct of trades or businesses which meet the requirements of section 355(b) will be considered evidence that the transaction was not used principally as such a device.

b. 1989 Regulations

Additional regulations under section 355 were issued in 1989 (the 1989 regulations). TD 8238 (54 FR 283). These regulations provide substantially more guidance than the 1955 regulations to determine whether a distribution was a device. Section 1.355–2(d)(1) provides that ''a tax-free distribution of the stock of a controlled corporation presents a potential for tax avoidance by facilitating the avoidance of the dividend provisions of the Code through the subsequent sale or exchange of stock of one corporation and the retention of the stock of another corporation. A device can include a transaction that effects a recovery of basis.''

This provision clarifies that, although the device prohibition primarily targets the conversion of dividend income to capital gain, a device can still exist if there would be a recovery of stock basis in lieu of receipt of dividend income and even if the shareholder's federal income tax rates on dividend income and capital gain are the same.

The 1989 regulations also expand on the statement in the 1955 regulations that the device analysis takes into account all of the facts and circumstances by specifying three factors that are evidence of device and three factors that are evidence of nondevice. One of the device factors, described in § 1.355–2(d)(2)(iv)(B), expands the statement in the 1955 regulations that consideration will be given to the nature, kind, and amount of the assets of Distributing and Controlled immediately after the transaction (the nature and use of assets device factor). First, this provision provides that ''[t]he existence of assets that are not used in a trade or business that satisfies the requirements of section 355(b) is evidence of device. For this purpose, assets that are not used in a trade or business that satisfies the requirements of section 355(b) include, but are not limited to, cash and other liquid assets that are not related to the reasonable needs of a business satisfying such section.'' This provision continues to provide that ''[t]he strength of the evidence of device depends on all the facts and circumstances, including, but not limited to, the ratio for each corporation of the value of assets not used in a trade or business that satisfies the requirements of section 355(b) to the value of its business that satisfies such requirements.'' Finally, the provision provides that ''[a] difference in the ratio described in the preceding sentence for the distributing and controlled corporation is ordinarily not evidence of device if the distribution is not pro rata among the shareholders of the distributing corporation and such difference is attributable to a need to equalize the value of the stock distributed and the value of the stock or securities exchanged by the distributees.''

Although this provision describes the factor, it provides little guidance relating to the quality or quantity of the relevant assets and no guidance on how the factor relates to other device factors or nondevice factors.

The nondevice factors in § 1.355–2(d)(3) are the presence of a corporate business purpose, the fact that the stock of Distributing is publicly traded and widely held, and the fact that the distribution is made to certain domestic corporate shareholders.

Section 1.355–2(d)(5) specifies certain distributions that ordinarily are not considered a device, notwithstanding the presence of device factors, because they ordinarily do not present the potential for federal income tax avoidance in converting dividend income to capital gain or using stock basis to reduce shareholder-level tax. These transactions include a distribution that, in the absence of section 355, with respect to each distributee, would be a redemption to which sale-or-exchange treatment applies.

4. Active Business Requirement Regulations

Section 1.355–3 provides rules for determining whether Distributing and Controlled satisfy the active business requirement. Proposed regulations issued in 2007 would amend § 1.355–3. REG–123365–03 (72 FR 26012). The Treasury Department and the IRS continue to study the active business requirement issues considered in those proposed regulations.

5. Administration of the Active Business Requirement

The fact that Distributing's or Controlled's qualifying active business is small in relation to all the assets of Distributing or Controlled is generally recognized as a device factor. A separate issue is whether a relatively small active business satisfies the active business requirement. In Rev. Rul. 73–44 (1973–1 CB 182), Controlled's active business represented a ''substantial portion'' but less than half of the value of its total assets. The revenue ruling states:

> There is no requirement in section 355(b) that a specific percentage of the corporation's assets be devoted to the active conduct of a trade or business. In the instant case, therefore, it is not controlling for purposes of the active business requirement that the active business assets of the controlled corporation, Y, represent less than half of the value of the controlled corporation immediately after the distribution.

The IRS has taken the position, in letter rulings and internal memoranda, that an active business can satisfy the active business requirement regardless of its absolute or relative size. However, no published guidance issued by the Treasury Department or the IRS takes this position.

In 1996, the Treasury Department and the IRS issued Rev. Proc. 96–43 (1996–2 CB 330), which provided that (1) the IRS ordinarily would not issue a letter ruling or determination letter on whether a distribution was described in section 355(a)(1) if the gross assets of the active business would have a fair market value that was less than five percent of the total fair market value of the gross assets of the corporation directly conducting the active business, but (2) a ruling might be issued ''if it can be established that, based upon all relevant facts and circumstances, the trades or businesses are not de minimis compared with the other assets or activities of the corporation and its subsidiaries.'' This no-rule provision was eliminated in Rev. Proc. 2003–48 (2003–2 CB 86). Since that time, until the publication of Rev. Proc. 2015–43 (2015–40 IRB 467) and Notice 2015–59 (2015–40 IRB 459), discussed in Part D.1 of this Background section of the preamble, the IRS maintained its position that the relative size of an active business is a device factor rather than a section 355(b) requirement. The IRS issued numerous letter rulings on section 355 distributions involving active businesses that were de minimis in value compared to the other assets of Distributing or Controlled.

The IRS interpreted section 355(b) in this manner in part as a result of the mechanical difficulties of satisfying the active business requirement. These mechanical difficulties are discussed further in Part D.3.c of this Background section of the preamble.

As an example, until section 355(b) was amended by section 202 of the Tax Increase Prevention and Reconciliation Act of 2005, Public Law 109–222 (120 Stat. 345, 348); Division A, section 410 of the Tax Relief and Health Care Act of 2006, Public Law 109–432 (120 Stat. 2922, 2963); and section 4(b) of the Tax Technical Corrections Act of 2007, Public Law 110–172 (121 Stat. 2473, 2476) (the Separate Affiliated Group, or SAG, Amendments), if, immediately after the distribution, a corporation did not directly engage in an active business, it could satisfy the active business requirement only if substantially all of its assets consisted of stock and securities of corporations it controlled that were engaged in an active business (the holding company rule). *See* section 355(b) prior to the SAG Amendments. Because of the limited application of the holding company rule, corporations often had to undergo burdensome restructurings prior to section 355 distributions merely to satisfy the active business requirement. *See, e.g.,* H.R. Rep. No. 109–304, at 54 (2005).

As another example, until 1992, no guidance provided that Distributing or Controlled could rely on activities conducted by a partnership to satisfy the active business requirement, even if Distributing or Controlled held a substantial interest in the partnership and participated in its management. This situation changed after the Treasury Department and the IRS published revenue rulings permitting this reliance. *See* Rev. Rul. 92–17 (1992–1 CB 142) *amplified by* Rev. Rul. 2002–49 (2002–2 CB 288) *and modified by* Rev. Rul. 2007–42 (2007–2 CB 44).

6. Administration of the Device Prohibition

The device prohibition continues to be important even though the federal income tax rates for dividend income and capital gain may be identical for many taxpayers. In Rev. Proc. 2003–48, the Treasury Department and the IRS announced that the IRS would no longer rule on whether a transaction is a device or has a business purpose. As a result, since the publication of Rev. Proc. 2003–48, the IRS has made only limited inquiries as to device and business purpose issues raised in requests for private letter rulings under section 355.

D. Reasons for Proposed Regulations

1. Rev. Proc. 2015–43 and Notice 2015–59

As explained in Part C of this Background section of the preamble, section 355 and its predecessors have had a long and contentious history. Despite the safeguards in the Code and regulations, and the courts' interpretations in accordance with congressionally-articulated statutory purposes, taxpayers have attempted to use section 355 distributions in ways that the Treasury Department and the IRS have determined to be inconsistent with the purpose of section 355.

On September 14, 2015, the Treasury Department and the IRS issued Rev. Proc. 2015–43 and Notice 2015–59 in response to concerns relating to distributions involving relatively small active businesses, substantial amounts of investment assets, and regulated investment companies (RICs) or real estate investment trusts (REITs). The notice states that the Treasury Department and the IRS are studying issues under sections 337(d) and 355 relating to these transactions and that these transactions may present evidence of device, lack an adequate business purpose or a qualifying active business, or circumvent the purposes of Code provisions intended to implement repeal of the *General Utilities* doctrine, a doctrine under which a corporation generally could distribute appreciated property to its shareholders without recognizing gain (*General Utilities* repeal). The notice invited comments with respect to these issues and one commenter (the commenter) submitted a comment letter.

The proposed regulations in this notice of proposed rulemaking would address the device prohibition (including the business purpose requirement as it pertains to device) and the active business requirement. Congress has addressed certain other issues discussed in Notice 2015–59. *See* section 311 of the Protecting Americans from Tax Hikes Act of 2015, Public Law 114–113 (129 Stat. 3040, 3090), in which Congress added section 355(h), which generally denies section 355 treatment if either Distributing or Controlled is a REIT unless both are REITs immediately after the distribution, and section 856(c)(8), which generally provides that Distributing or Controlled will not be eligible to make a REIT election within the ten-year period after a section 355 distribution. Separate temporary and proposed regulations address transactions that avoid the application of sections 355(h) and 856(c)(8). *See* REG–126452–15 (Certain Transfers of Property to RICs and REITs) (81 FR 36816), cross-referencing TD 9770 (81 FR 36793). The Treasury Department and the IRS continue to study issues relating to *General Utilities* repeal presented by other transactions involving the separation of nonbusiness assets from business assets, and are considering issuing guidance under section 337(d) to address these issues. *See* Part D.4 of this Background section of the preamble.

2. Comments Regarding Device

The commenter believes that new rules are not needed for transactions that raise the purely shareholder-level concerns that are the subject of the device prohibition. According to the commenter, those transactions likely do not qualify under section 355 under current law and are infrequent. Although largely agreeing with this statement, the Treasury Department and the IRS have determined that certain clarifying changes should be made to the device rules. As discussed in Part C.3.b of this Background section of the preamble, the current regulations relating to device are not specific as to the quality or quantity of assets relevant in the nature and use of assets device factor or the appropriate weighing of the device and nondevice factors. The Treasury Department and the IRS have determined that, in some situations, insufficient weight has been given to the nature and use of assets device factor and that device factors have not been balanced correctly against nondevice factors.

For example, if, after a distribution, Distributing or Controlled holds mostly liquid nonbusiness assets, the shareholders of that corporation can sell their stock at a price that reflects the value of the nonbusiness assets, and such a sale is economically similar to a distribution of the liquid nonbusiness assets to the shareholders that would have been treated as a dividend to the extent of earnings and profits of the corporation. *See, e.g., Gregory.* If Distributing's ratio of nonbusiness assets to total assets differs substantially from Controlled's ratio, the distribution could facilitate a separation of the nonbusiness assets from the business assets by means of the sale of the stock in the corporation with a large percentage of nonbusiness assets. No corporate-level gain, and possibly little or no shareholder-level gain, would be recognized.

Taxpayers have taken the position that nondevice factors in the regulations can outweigh the substantial evidence of device presented in such distributions. For example, certain taxpayers have viewed even a weak business purpose, combined with the fact that the stock of Distributing is publicly traded, as offsetting evidence of device presented by distributions effecting a separation of nonbusiness assets from business assets, even if pressure from public shareholders was a significant motivation for the distribution. The Treasury Department and the IRS do not agree that these types of nondevice factors should outweigh the substantial evidence of device presented by a distribution that separates nonbusiness assets from business assets.

Accordingly, the Treasury Department and the IRS have determined that the regulations should provide clearer, more objective guidance regarding the nature and use of assets device factor and the appropriate weighing of device factors and nondevice factors. The Treasury Department and the IRS also have determined that if a high enough proportion of assets of Distributing or Controlled consists of nonbusiness assets, and if the assets of the other corporation include a much lower proportion of nonbusiness assets, the evidence of device is so strong that nondevice factors generally should not be allowed to overcome the evidence of device.

The commenter also noted that the importance of device, traditionally understood as reflecting shareholder-level policies, has diminished in the context of a unified rate regime for long-term capital gains and qualified dividend income for some taxpayers. However, because of continuing differences in the federal income tax treatment of capital gains and dividends, including the potential for basis recovery (*see* § 1.355–2(d)(1)) and the availability of capital gains to absorb capital losses, the device prohibition continues to be important.

3. Comments Regarding Active Business

a. Section 355(b) Requires Minimum Size Active Business

The commenter stated that section 355 is meant to apply to genuine separations of businesses, and that section 355(b) should not function as a formality. Nevertheless, the commenter does not believe that the active business requirement needs to be strengthened through the adoption of a requirement of a minimum amount of active business assets.

After studying this issue, the Treasury Department and the IRS have determined that Distributing or Controlled should not satisfy the active business requirement by holding a relatively de minimis active business. As described in the remainder of this Part D.3, the Treasury Department and the IRS have determined that interpreting section 355(b) as having meaning and substance and therefore requiring an active business that is economically significant is consistent with congressional intent, case law, and the reorganization provisions. In addition, given the developments in the tax law described in Part D.3.c of this Background section of the preamble, the Treasury Department and the IRS have determined that allowing a de minimis active business to satisfy the active business requirement is not necessary to reduce the burden of compliance with the active business requirement. Furthermore, requiring a minimum relative size for an active business is not inconsistent with the facts of Rev. Rul. 73–44 or with its conclusion. *See* Part D.3.d of this Background section of the preamble.

b. Consistent With Congressional Intent, Case Law, and the Reorganization Provisions

Allowing section 355(b) to be satisfied with an active business that is economically insignificant in relation to other assets of Distributing or Controlled is not consistent with the congressional purpose for adopting the active business requirement. It is generally understood that Congress intended section 355 to be used to separate businesses, not to separate inactive assets from a business. *See* S. Rep. No. 83–1622, at 50–51 (section 355 ''contemplates that a tax-free separation shall involve only the separation of assets attributable to the carrying on of an active business'' and does not permit ''the tax free separation of an existing corporation into active and inactive entities''); *see also Coady* v. *Commissioner,* 33 T.C. 771, 777 (1960), *aff'd,* 289 F.2d 490 (6th Cir. 1961) (stating that a function of section 355(b) is ''to prevent the tax-free separation of *active* and *inactive* assets into *active* and *inactive* corporate entities'') (emphasis in original); § 1.355–1(b) (''[s]ection 355 provides for the separation . . . of one or more existing businesses''). Additionally, when the active business of Distributing or Controlled is economically insignificant in relation to its other assets, it is unlikely that any non-federal tax purpose for separating that business from other businesses is a significant purpose for the distribution. *See* § 1.355–2(b)(1) (''Section 355 applies to a transaction only if it is carried out for one or more corporate business purposes. . . . The potential for the avoidance of Federal taxes by the distributing or controlled corporations . . . is relevant in determining the extent to which an existing corporate business purpose motivated the distribution.'').

Further, as the Supreme Court held in *Gregory,* transactions are to be taxed in accordance with their substance. The reorganization regulations adopt the same principle. For example, § 1.368–1(b) provides that ''[b]oth the terms of the specifications [of the reorganization provisions] and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule.'' Additionally, § 1.368–1(c) provides that ''[a] scheme, which involves an abrupt departure from normal reorganization procedure in connection with a transaction on which the imposition of tax is imminent, such as a mere device that puts on the form of a corporate reorganization as a disguise for concealing its real character, and the object and accomplishment of which is the consummation of a preconceived plan having no business or corporate purpose, is not a plan of reorganization.''

Accordingly, when a corporation that owns only nonbusiness assets and a relatively de minimis active business is separated from a corporation with another active business, the substance of the transaction is not a separation of businesses as contemplated by section 355.

c. Developments in the Tax Law Reduce the Burden of Complying With Section 355

In the past, the active business requirement was more difficult to satisfy than it is today, in part because of the limited application of the holding company rule, discussed in Part C.5 of this Background section of the preamble. However, several developments in the tax law have occurred that make the active business requirement easier to satisfy and negate the historical need to reduce the administrative burden of complying with section 355(b).

In the SAG Amendments, Congress amended section 355(b) to adopt the separate affiliated group rules of section 355(b)(3). Section 355(b)(3)(A) provides that, for purposes of determining whether a corporation meets the requirements of section 355(b)(2)(A), all members of the corporation's separate affiliated group (SAG) are treated as one corporation. Section 355(b)(3)(B) provides that a corporation's SAG is the affiliated group which would be determined under section 1504(a) if the corporation were the common parent and section 1504(b) did not apply.

Additionally, as discussed in Part C.5 of this Background section of the preamble, section 355(b) now can be satisfied through the ownership of certain interests in a partnership that is engaged in an active business. *See* Rev. Rul. 2007–42 and Rev. Rul. 92–17. Similarly, § 301.7701–3 now allows an eligible entity to elect to be disregarded as an entity separate from its owner and permits a corporation to satisfy the active business requirement through a tax-free acquisition without having to assume liabilities relating to an active business. Finally, the expansion rules of § 1.355–3(b)(3)(ii) have been developed so that it is easier to acquire the assets of an active business in a taxable transaction while complying with section 355(b). *See, e.g.,* Rev. Rul. 2003–18 (2003–1 CB 467) and Rev. Rul. 2003–38 (2003–1 CB 811) (both describing facts and circumstances to be considered in determining whether one trade or business is in the same line of business as another).

d. Rev. Rul. 73–44

Rev. Rul. 73–44 is sometimes cited in support of the proposition that a de minimis active business satisfies the section 355(b) requirement. However, Rev. Rul. 73–44 states only that there is no requirement in section 355(b) that a specific percentage of a corporation's assets be devoted to the active conduct of a trade or business, not that any size active business can satisfy section 355(b). In fact, the size of the active business in that ruling represented a substantial portion of Controlled's assets, although less than half of Controlled's value. Accordingly, Rev. Rul. 73–44 does not validate a section 355 distribution involving a de minimis active business, and the proposed regulations in this notice of proposed rulemaking addressing the minimum relative size of active businesses would not change the conclusion set forth in that revenue ruling. Nevertheless, the Treasury Department and the IRS intend to modify Rev. Rul. 73–44 with regard to the statement in the revenue ruling that there is no requirement that a specific percentage of a corporation's assets be devoted to the active conduct of a trade or business.

4. General Utilities Repeal

The Treasury Department and the IRS have observed, as noted in Notice 2015–59, that taxpayers may attempt to use section 355 distributions in ways that are inconsistent with the purpose of *General Utilities* repeal. Specifically, the Treasury Department and the IRS are concerned that certain taxpayers may be interpreting the current regulations under sections 337(d) and 355 in a manner allowing tax-free distributions motivated in whole or substantial part by a purpose of avoiding corporate-level taxation of built-in gain in investment or nonbusiness assets. *See* § 1.355–1(b) (''Section 355 provides for the separation . . . of one or more existing businesses formerly operated, directly or indirectly, by a single corporation . . . .''). The Treasury Department and the IRS continue to study whether permitting tax-free separations of large amounts of nonbusiness assets from business assets, especially when the gain in the nonbusiness assets is expected to be eliminated, is consistent with *General Utilities* repeal in all circumstances. Comments are welcome on potential additional guidance under section 337(d) addressing such transactions.

Explanation of Provisions

A. Modification of Device Regulations

The proposed regulations would modify § 1.355–2(d), which addresses transactions that are or are not a device. The proposed regulations would modify the nature and use of assets device factor in § 1.355–2(d)(2)(iv), modify the corporate business purpose nondevice factor in § 1.355–2(d)(3)(ii), and add a per se device test.

1. Nature and Use of Assets

The Treasury Department and the IRS have determined that device potential generally exists either if Distributing or Controlled owns a large percentage of assets not used in business operations compared to total assets or if Distributing's and Controlled's percentages of these assets differs substantially. A proposed change to the nature and use of assets device factor in § 1.355–2(d)(2)(iv) would focus on assets used in a Business (Business Assets) (each as defined in proposed § 1.355–2(d)(2)(iv)(B)) rather than assets used in an active business meeting the requirements of section 355(b) (a Five-Year-Active Business, as defined in proposed § 1.355–9(a)(2)). In general, Business would have the same meaning as a Five-Year-Active Business, but without regard to whether the business has been operated or owned for at least five years prior to the date of the distribution or whether the collection of income requirement in § 1.355–3(b)(2)(ii) is satisfied. Business Assets would be gross assets used in a Business, including reasonable amounts of cash and cash equivalents held for working capital and assets required to be held to provide for exigencies related to a Business or for regulatory purposes with respect to a Business. The Treasury Department and the IRS have determined that the presence of

Business Assets generally does not raise any more device concerns than the presence of assets used in a Five-Year-Active Business (Five-Year-Active-Business Assets). Thus, the proposed regulations would modify § 1.355–2(d)(2)(iv)(B) to take into account Business Assets, not just Five-Year-Active-Business Assets.

Rev. Proc. 2015–43 (now incorporated into Rev. Proc. 2016–3 (2016–1 IRB 126)) and Notice 2015–59 focus on investment assets (using a modified section 355(g) definition) of a corporation as assets that may raise device concerns. However, after further study, the Treasury Department and the IRS have determined that investment assets as defined therein may include certain assets that do not raise device concerns, such as cash needed by a corporation for working capital, and may not include other assets that do raise device concerns, such as real estate not related to the taxpayer's Business. The Treasury Department and the IRS have determined that focusing on Nonbusiness Assets, as defined in the proposed regulations, is a better method of evaluating device or nondevice as compared to using investment assets as described in Rev. Proc. 2016–3 and Notice 2015–59. Thus, the proposed regulations would focus on Nonbusiness Assets rather than investment assets.

The proposed regulations would provide thresholds for determining whether the ownership of Nonbusiness Assets (gross assets that are not Business Assets) and/or differences in the Nonbusiness Asset Percentages (the percentage of a corporation's Total Assets (its Business Assets and Nonbusiness Assets) that are Nonbusiness Assets) for Distributing and Controlled are evidence of device. If neither Distributing nor Controlled has Nonbusiness Assets that comprise 20 percent or more of its Total Assets, the ownership of Nonbusiness Assets ordinarily would not be evidence of device. Additionally, a difference in the Nonbusiness Asset Percentages for Distributing and Controlled ordinarily would not be evidence of device if such difference is less than 10 percentage points or, in the case of a non-pro rata distribution, if the difference is attributable to a need to equalize the value of the Controlled stock and securities distributed and the consideration exchanged therefor by the distributees. Accordingly, the Treasury Department and the IRS propose to treat such circumstances as ordinarily not constituting evidence of device.

2. Corporate Business Purpose

The Treasury Department and the IRS also propose to revise the nondevice factor in § 1.355–2(d)(3)(ii), which relates to corporate business purpose for a transaction as evidence of nondevice. Under the proposed revision, a corporate business purpose that relates to a separation of Nonbusiness Assets from one or more Businesses or from Business Assets would not be evidence of nondevice, unless the business purpose involves an exigency that requires an investment or other use of the Nonbusiness Assets in a Business. The Treasury Department and the IRS have determined that, absent such an exigency, such separations are not consistent with the intent of Congress to prevent section 355 from applying to a distribution that is used principally as a device.

3. Per se Device Test

The Treasury Department and the IRS also propose to add a per se device test to the device determination in proposed § 1.355–2(d)(5). Under proposed § 1.355–2(d)(5), if designated percentages of Distributing's and/or Controlled's Total Assets are Nonbusiness Assets, the transaction would be considered a device, notwithstanding the presence of any other nondevice factors, for example, a corporate business purpose or stock being publicly traded and widely held. By their nature, these transactions present such clear evidence of device that the Treasury Department and the IRS have determined that the nondevice factors can never overcome the device potential. The only exceptions to this per se device rule would apply if the distribution is also described in § 1.355–2(d)(3)(iv) (distributions in which the corporate distributee would be entitled to a dividends received deduction under section 243(a) or 245(b)) or in redesignated § 1.355–2(d)(6) (§ 1.355–2(d)(5) of the current regulations, relating to transactions ordinarily not considered as a device).

The per se device test would have two prongs, both of which must be met for the distribution to be treated as a per se device.

The first prong would be if Distributing or Controlled has a Nonbusiness Asset Percentage of 66⅔ percent or more. If 66⅔ percent or more of the Total Assets of either corporation consist of Nonbusiness Assets, a strong device potential exists.

The second prong of the test would compare the Nonbusiness Asset Percentage of Distributing with that of Controlled. The comparison would be similar to the comparison, in § 1.355–2(d)(2)(iv)(B) of the current regulations, between Distributing's ratio of assets not used in a Five-Year-Active Business to assets used in a Five-Year-Active Business and Controlled's ratio of such assets. However, the Treasury Department and the IRS recognize that valuation of assets may be difficult and that determining whether certain assets are Business Assets also may be difficult. Accordingly, rather than requiring Distributing and Controlled to make exact determinations of their Nonbusiness Asset Percentages, which would then be compared to the other corporation's Nonbusiness Asset Percentage, the second prong of the per se device test would provide for three bands in making this comparison. These bands generally would provide for the comparison of the Nonbusiness Asset Percentages of Distributing and Controlled but require less precision in asset valuation.

In the first band, if one corporation's Nonbusiness Asset Percentage is 66⅔ percent or more, but less than 80 percent, the distribution would fall within the band if the other corporation's Nonbusiness Asset Percentage is less than 30 percent. In the second band, if one corporation's Nonbusiness Asset Percentage is 80 percent or more, but less than 90 percent, the distribution would fall within the band if the other corporation's Nonbusiness Asset Percentage is less than 40 percent. In the third band, if one corporation's Nonbusiness Asset Percentage is 90 percent or more, the distribution would fall within the band if the other corporation's Nonbusiness Asset Percentage is less than 50 percent. All of these bands represent cases in which the Nonbusiness Asset Percentages of Distributing and Controlled are significantly different.

If both prongs of the per se device test are met, that is, if the Nonbusiness Asset Percentage for either Distributing or Controlled is 66⅔ percent or more and the Nonbusiness Asset Percentages of Distributing and Controlled fall within one of the three bands, the distribution would be a per se device. Otherwise, the general facts-and-circumstances test of § 1.355–2(d), as modified by these proposed regulations, would apply to determine if the transaction was a device.

4. Certain Operating Rules

In making the determination of which assets of a corporation are Business Assets and which are Nonbusiness Assets, if Distributing or Controlled owns a partnership interest or stock in another corporation, the proposed regulations would provide four operating rules.

First, all members of a SAG with respect to which Controlled is the common parent (CSAG) and all members of a SAG with respect to which Distributing is the common parent excluding Controlled and its SAG (DSAG) would be treated as a single corporation. Thus, any stock owned by one member of a SAG in another member of the same SAG and any intercompany obligations between the same SAG members would be disregarded.

Second, a partnership interest would generally be considered a Nonbusiness Asset. However, if, by reason of a corporation's ownership interest or its ownership interest and participation in management of the partnership, the corporation is considered to be engaged in the Business conducted by such partnership (based on the criteria that would be used to determine whether such corporation is considered to be engaged in the Five-Year-Active Business of such partnership under Rev. Ruls. 92–17, 2002–49, and 2007–42), the fair market value of the partnership interest would be allocated between Business Assets and Nonbusiness Assets in the same proportion as the proportion of the fair market values of the Business Assets and the Nonbusiness Assets of the partnership.

Third, a rule similar to the partnership interest rule would apply for corporate stock owned by Distributing or Controlled. That is, stock in a corporation, other than a member of the DSAG or the CSAG, would generally be a Nonbusiness Asset. However, there would be an exception for stock in a Member of a 50-Percent-Owned Group. For this purpose, a 50-Percent-Owned Group would have the same meaning as SAG, except substituting ''50-percent'' for ''80-percent,'' and a Member of a 50-Percent-Owned Group would be a corporation that would be a member of a DSAG or CSAG, with such substitution. If a Member of a 50-Percent-Owned Group with respect to Distributing or Controlled owns stock in another Member of such 50-Percent-Owned Group (other than a member of the DSAG or the CSAG, respectively), the fair market value of such stock would be allocated between Business Assets and Nonbusiness Assets in the same proportion as the proportion of the fair market values of the Business Assets and the Nonbusiness Assets of the issuing corporation.

Fourth, the proposed regulations would provide for adjustments to prevent distortion if Distributing or Controlled owes money to or is owed money by a partnership or Member of a 50-Percent-Owned Group.

The partnership rules and the 50-Percent-Owned Group rules are designed to recognize that ownership of a partnership interest or stock in a Member of a 50-Percent-Owned Group may reflect an investment in Business Assets, Nonbusiness Assets, or both, while minimizing the significance of changes in the form of ownership of Business Assets and Nonbusiness Assets.

5. Multiple Controlleds

If a transaction involves distributions by Distributing of the stock of more than one Controlled, proposed §§ 1.355–2(d)(2)(iv) and 1.355–2(d)(5) would apply to all such Controlleds. To the extent any rule would require a comparison between characteristics of Distributing and Controlled, there would have to be a comparison between Distributing and each Controlled and between each Controlled and each other Controlled. If any comparison under proposed § 1.355–2(d)(2)(iv) or § 1.355–2(d)(5) would result in a determination that a distribution is a device, then all distributions involved in the transaction would be considered a device.

B. Minimum Size for Active Business

Section 355(b) does not literally provide a minimum absolute or relative size requirement for an active business to qualify under section 355(b). Nevertheless, as discussed in Part D.3 of the Background section of the preamble, the Treasury Department and the IRS have determined that Congress intended that section 355(b) would require that distributions have substance and that a distribution involving only a relatively de minimis active business should not qualify under section 355 because such a distribution is not a separation of businesses as contemplated by section 355.

To ensure that congressional intent is satisfied and to reduce uncertainty, the Treasury Department and the IRS propose to add new § 1.355–9. This section would provide that, for the requirements of section 355(a)(1)(C) and (b) to be satisfied with respect to a distribution, the Five-Year-Active-Business Asset Percentage (the percentage determined by dividing the fair market value of a corporation's Five-Year-Active-Business Assets by the fair market value of its Total Assets) of each of Controlled (or the CSAG) and Distributing (or the DSAG excluding Controlled and other CSAG members) must be at least five percent. Similar to the proposed definition of Business Assets, Five-Year-Active-Business Assets would include reasonable amounts of cash and cash equivalents held for working capital and assets required to be held to provide for exigencies related to a Five-Year-Active Business or for regulatory purposes with respect to a Five-Year-Active Business.

In making the determination of the percentage of a corporation's assets that are Five-Year-Active-Business Assets, if a corporation is considered to be engaged in a Five-Year-Active Business of a partnership, the fair market value of the partnership interest would be allocated between Five-Year-Active-Business Assets and Non-Five-Year-Active-Business Assets (assets other than Five-Year-Active-Business Assets) in the same proportion as the proportion of the fair market values of Five-Year-Active-Business Assets and Non-Five-Year-Active-Business Assets of the partnership.

Except in the case of a member of its SAG, neither Distributing nor Controlled would be considered to be engaged in the Five-Year-Active Business of a corporation in which it owns stock. Accordingly, such stock in a corporation would be considered a Non-Five-Year-Active-Business Asset. Although the proposed regulations relating to the device prohibition would provide an allocation rule for assets held by a Member of a 50-Percent-Owned Group, discussed in Part A.4 of this Explanation of Provisions section of the preamble, the Treasury Department and the IRS believe the SAG Amendments, discussed in Parts C.5 and D.3.c of the Background section of the preamble, limit the ability to take into account assets held by subsidiaries for purposes of the active business requirement. Accordingly, proposed § 1.355–9 would not provide a similar allocation rule for stock owned by Distributing or Controlled.

The commenter stated that the regulations should not provide a minimum size requirement for an active business in any distribution and that such a requirement could be especially problematic in intra-group distributions in preparation for a distribution outside of a group. Internal distributions often are necessary to align the proper assets within Distributing and Controlled prior to a distribution of the stock of Controlled outside the group. If a minimum size requirement is imposed on each of these internal distributions, taxpayers may have to undertake movements of active businesses within groups to meet the minimum size requirement for each internal distribution.

In enacting the SAG Amendments, Congress did not provide an exception to the requirements of section 355(b) for internal distributions that are preparatory to external distributions, although Congress permitted Distributing and Controlled to rely on active businesses held by members of their respective SAGs, even if such assets were distributed or sold within the SAG in a taxable transaction. Under the commenter's rationale, the regulations should not only permit an internal distribution with a de minimis active business, but could also permit tax-free treatment for taxable distributions or sales of assets within the SAG if such assets need to be moved in preparation of the external distribution. The Treasury Department and the IRS have determined that each distribution must meet all the requirements of section 355, including the requirement that Distributing and each Controlled conduct an active business immediately after the distribution. Accordingly, the proposed regulations would provide a five-percent minimum Five-Year-Active-Business Asset Percentage requirement for all distributions.

C. Timing of Asset Identification, Characterization, and Valuation

For purposes of determining whether a transaction would be considered a device and whether one or more Five-Year-Active Businesses would meet the five-percent minimum Five-Year-Active-Business Asset Percentage requirement of proposed § 1.355–9, the assets held by Distributing and by Controlled must be identified, and their character and fair market value must be determined. The assets under consideration would be the assets held by Distributing and by Controlled immediately after the distribution. Thus, for example, the stock of Controlled that is distributed would not be an asset of Distributing for this purpose. The character of the assets held by Distributing and by Controlled, as Business Assets or Nonbusiness Assets or as Five-Year-Active-Business Assets or Non-Five-Year-Active-Business Assets, also would be the character as determined immediately after the distribution.

The proposed regulations would provide, however, that the fair market value of assets would be determined, at the election of the parties on a consistent basis, either (a) immediately before the distribution, (b) on any date within the 60-day period before the distribution, (c) on the date of an agreement with respect to the distribution that was binding on Distributing on such date and at all times thereafter, or (d) on the date of a public announcement or filing with the Securities and Exchange Commission with respect to the distribution. The parties would be required to make consistent determinations between themselves, and use the same date, for purposes of applying the device rules of proposed § 1.355–2(d) and the five-percent minimum Five-Year-Active-Business Asset Percentage requirement of proposed § 1.355–9. If the parties do not meet these consistency requirements, the valuation would be determined as of immediately before the distribution unless the Commissioner determines that the use of such date is inconsistent with the purposes of section 355 and the regulations thereunder.

D. Anti-Abuse Rules

The proposed regulations would also provide anti-abuse rules. Under the anti-abuse rules, a transaction or series of transactions (such as a change in the form of ownership of an asset; an issuance, assumption or repayment of indebtedness; or an issuance or redemption of stock) would not be given effect if undertaken with a principal purpose of affecting the Nonbusiness Asset Percentage of any corporation in order to avoid a determination that a distribution was a device or affecting the Five-Year-Active-Business Asset Percentage of any corporation in order to avoid a determination that a distribution does not meet the requirements of § 1.355–9. The transactions covered by the anti-abuse rules generally would not include an acquisition or disposition of assets, other than an acquisition from or disposition to a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to Distributing or Controlled, or a transfer of assets between Distributing and Controlled. However, such transactions would not be given effect if they are transitory, for example, if Distributing contributes cash to Controlled and retains some of the stock of Controlled or Controlled debt instruments, and there is a plan or intention for Controlled to return the cash to Distributing in redemption of the stock or repayment of the debt.

Statement of Availability of IRS Documents

IRS revenue procedures, revenue rulings, notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS Web site at *http://www.irs.gov.*

Effect on Other Documents

Section 3 of Notice 2015–59 is obsolete as of July 15, 2016. The IRS will modify Rev. Rul. 73–44, as of the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**, as necessary to conform to § 1.355–9 of these proposed regulations. The IRS solicits comments as to whether other publications should be modified, clarified, or obsoleted.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect larger corporations operating more than one business and with a substantial number of shareholders. Thus, these regulations are not expected to affect a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations, including—

1. Whether there should be any exceptions to the application of proposed § 1.355–9.

2. Whether additional exceptions should be incorporated into the per se device rule in proposed § 1.355–2(d)(5).

3. The scope of the safe harbors relating to presence of Nonbusiness Assets as evidence of device under

proposed § 1.355–2(d)(2)(iv)(C)(*1*) and (*2*) and whether additional safe harbors should be added to proposed § 1.355–2(d).

4. Whether the definition of Business Assets in proposed § 1.355–2(d)(2)(iv)(B)(*2*) should be revised, for example, to include additional categories of assets or to include cash or cash equivalents expected to be used for other categories of expenditures.

5. Whether the operating rules applicable to proposed § 1.355–2(d)(2)(iv)(D)(*6*) through (*8*) concerning the allocation of the value of a partnership interest between Business Assets and Nonbusiness Assets to its partners, the allocation of the value of the stock of a Member of a 50-Percent-Owned Group between Business Assets and Nonbusiness Assets to its shareholders, and certain borrowings should be modified, including whether the partnership rule should allocate an allocable share of the partnership's gross assets to its partners, whether different allocation rules should be used for partnership interests with different characteristics(for example, limited liability vs. non-limited liability), and whether the rules relating to borrowing between a partnership and a partner or between a Member of a 50-Percent-Owned Group and a shareholder should be made more specific.

6. Whether the anti-abuse rules in the proposed regulations pertaining to device and the five-percent minimum Five-Year-Active-Business Assets requirement should be revised, for example, to include or exclude additional transactions or to include a reference to acquisitions of assets by Distributing or Controlled on behalf of shareholders.

7. Whether the absence of any device factor, for example, a small difference in Nonbusiness Asset Percentages for Distributing and Controlled, should be considered a nondevice factor.

All comments will be available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Stephanie D. Floyd and Russell P. Subin of the Office of Associate Chief Counsel (Corporate). Other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 6 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.355–0 is amended by:

■ 1. Removing from the introductory text ''1.355–7'' and adding ''1.355–9'' in its place.

■ 2. Revising the entry for § 1.355–2(d)(2)(iv)(B).

■ 3. Adding entries for § 1.355–2(d)(2)(iv)(B)(*1*), (*2*), (*3*), (*4*), (*5*), (*6*), and (*7*).

■ 4. Redesignating the entry for § 1.355–2(d)(2)(iv)(C) as the entry for § 1.355–2(d)(2)(iv)(F).

■ 5. Adding a new entry for § 1.355–2(d)(2)(iv)(C).

■ 6. Adding entries for § 1.355–2(d)(2)(iv)(C)(*1*), (*2*), and (*3*).

■ 7. Adding an entry for § 1.355–2(d)(2)(iv)(D).

■ 8. Adding entries for § 1.355–2(d)(2)(iv)(D)(*1*), (*2*), (*3*), and (*4*).

■ 9. Adding entries for § 1.355–2(d)(2)(iv)(D)(*4*)(*i*) and (*ii*).

■ 10. Adding entries for § 1.355–2(d)(2)(iv)(D)(*5*) and (*6*).

■ 11. Adding entries for § 1.355–2(d)(2)(iv)(D)(*6*)(*i*) and (*ii*).

■ 12. Adding an entry for § 1.355–2(d)(2)(iv)(D)(*7*).

■ 13. Adding entries for § 1.355–2(d)(2)(iv)(D)(*7*)(*i*) and (*ii*).

■ 14. Adding an entry for § 1.355–2(d)(2)(iv)(D)(*8*).

■ 15. Adding an entry for § 1.355–2(d)(2)(iv)(E).

■ 16. Redesignating the entry for § 1.355–2(d)(5) as the entry for § 1.355–2(d)(6).

■ 17. Adding a new entry for § 1.355–2(d)(5).

■ 18. Adding entries for § 1.355–2(d)(5)(i), (ii), (iii), and (iv).

■ 19. Adding entries for § 1.355–2(i)(1), (i)(1)(i) and (ii), and (i)(2).

■ 20. Adding an entry for § 1.355–8.

■ 21. Adding entries for § 1.355–9.

The revisions and additions read as follows:

§ 1.355–0 Outline of sections.

* * * * *

§ 1.355–2 Limitations.

* * * * *

(d) * * *

(2) * * *

(iv) * * *

(B) Definitions.

(*1*) Business.

(*2*) Business Assets.

(*3*) Nonbusiness Assets.

(*4*) Total Assets.

(*5*) Nonbusiness Asset Percentage.

(*6*) Separate Affiliated Group, SAG, CSAG, and DSAG.

(*7*) 50-Percent-Owned Group, Member of a 50-Percent-Owned Group.

(C) Presence of Nonbusiness Assets as evidence of device.

(*1*) Ownership of Nonbusiness Assets.

(*2*) Difference between Nonbusiness Asset Percentages.

(*3*) Cross-reference.

(D) Operating rules.

(*1*) Multiple controlled corporations.

(*2*) Treatment of SAG as a single corporation.

(*3*) Time to identify assets and determine character of assets.

(*4*) Time to determine fair market value of assets.

(*i*) In general.

(*ii*) Consistency.

(*5*) Fair market value.

(*6*) Interest in partnership.

(*i*) In general.

(*ii*) Exception for certain interests in partnerships.

(*7*) Stock in corporation.

(*i*) In general.

(*ii*) Exception for stock in Member of a 50-Percent-Owned Group.

(*8*) Obligation between distributing corporation or controlled corporation and certain partnerships or Members of 50-Percent-Owned Groups.

(E) Anti-abuse rule.

* * * * *

(5) Distributions involving separation of Business Assets from Nonbusiness Assets.

(i) In general.

(ii) Definitions and operating rules.

(iii) Certain distributions involving separation of Nonbusiness Assets from Business Assets.

(iv) Anti-abuse rule.

* * * * *

(i) * * *

(1) Paragraph (d) of this section.

(i) In general.

(ii) Transition rule.

(2) Paragraph (g) of this section.

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§ 1.355–8 Reserved.

§ 1.355–9 Minimum percentage of Five-Year-Active-Business Assets.

(a) Definitions.

(1) Distributing, Controlled.

(2) Five-Year-Active Business.

(3) Five-Year-Active-Business Assets.

(4) Non-Five-Year-Active-Business Assets.

(5) Total Assets.

(6) Five-Year-Active-Business Asset Percentage.

(7) Separate Affiliated Group, CSAG, and DSAG.

(b) Five percent minimum Five-Year-Active-Business Asset Percentage.

(c) Operating rules.

(1) Treatment of SAG and fair market value.
(2) Time to identify assets, determine character of assets, and determine fair market value of assets.
(3) Interest in partnership.
(i) In general.
(ii) Exception for certain interests in partnerships.
(d) Anti-abuse rule.
(e) Effective/applicability date.
(1) In general.
(2) Transition rule.

■ **Par. 3.** Section 1.355–2 is amended by:
■ 1. Adding the language ''federal'' before the language ''tax avoidance'' in the second sentence of paragraph (d)(1).
■ 2. Removing the last sentence of paragraph (d)(1) and adding two sentences at the end of the paragraph.
■ 3. Revising paragraphs (d)(2)(iv)(A) and (B).
■ 4. Redesignating paragraph (d)(2)(iv)(C) as (d)(2)(iv)(F).
■ 5. Adding new paragraphs (d)(2)(iv)(C), (D), and (E).
■ 6. Revising paragraph (d)(3)(ii).
■ 7. Removing from paragraph (d)(3)(ii)(A) the language ''the business'' and adding the language ''one or more Businesses (as defined in paragraph (d)(2)(iv)(B)(*1*) of this section) of the distributing corporation, the controlled corporation, or both'' in its place.
■ 8. Revising paragraph (d)(4).
■ 9. Redesignating paragraph (d)(5) as (d)(6).
■ 10. Adding a new paragraph (d)(5).
■ 11. Revising newly designated paragraph (d)(6)(i).
■ 12. Removing from newly designated paragraph (d)(6)(v) the language ''subparagraph (5)'' and adding the language ''paragraph (d)(6)'' in its place.
■ 13. Removing from the last sentence of newly designated paragraph (d)(6)(v) *Example 1* the language ''(d)(5)(i)'' and adding the language ''(d)(6)(i)'' in its place.
■ 14. Removing from the sixth sentence of newly designated paragraph (d)(6)(v) *Example 2* the language ''(d)(5)(i)'' and adding the language ''(d)(6)(i)'' in its place.
■ 15. Removing from the last sentence of newly designated paragraph (d)(6)(v) *Example 2* the language ''made from all the facts'' and adding the language ''made from either the presence of a separation of Business Assets from Nonbusiness Assets as described in paragraph (d)(5) of this section or from all the facts'' in its place.
■ 16. Adding to paragraph (h) the language ''and § 1.355–9 (relating to Minimum Percentage of Five-Year-Active-Business Assets)'' immediately before the language ''are satisfied''.
■ 17. Revising paragraph (i).

The revisions and additions read as follows:

§ 1.355–2 Limitations.

* * * * *

(d) * * *

(1) * * * However, if a transaction is specified in paragraph (d)(5)(iii) of this section, then it is considered to have been used principally as a device unless it is also specified in paragraph (d)(3)(iv) of this section or paragraph (d)(6) of this section. If a transaction is specified in paragraph (d)(6) of this section, then it is ordinarily considered not to have been used principally as a device.

(2) * * *

(iv) * * * (A) *In general.* The determination of whether a transaction was used principally as a device will take into account the nature, kind, amount, and use of the assets of the distributing corporation and the controlled corporation.

(B) *Definitions.* The following definitions apply for purposes of this paragraph (d)(2)(iv):

(*1*) *Business. Business* means the active conduct of a trade or business, within the meaning of section 355(b) and § 1.355–3, without regard to—

(*i*) The requirements of section 355(b)(2)(B), (C), and (D), and § 1.355–3(b)(3) and (4) (relating to active conduct throughout the five-year period preceding a distribution and acquisitions during such period);

(*ii*) The collection of income requirement in § 1.355–3(b)(2)(ii); and

(*iii*) The requirement of § 1.355–9 (relating to Minimum Percentage of Five-Year-Active-Business Assets (as defined in § 1.355–9(a)(3))).

(*2*) *Business Assets. Business Assets* of a corporation means its gross assets used in one or more Businesses. Such assets include cash and cash equivalents held as a reasonable amount of working capital for one or more Businesses. Such assets also include assets required (by binding commitment or legal requirement) to be held to provide for exigencies related to a Business or for regulatory purposes with respect to a Business. For this purpose, such assets include assets the holder is required (by binding commitment or legal requirement) to hold to secure or otherwise provide for a financial obligation reasonably expected to arise from a Business and assets held to implement a binding commitment to expend funds to expand or improve a Business.

(*3*) *Nonbusiness Assets. Nonbusiness Assets* of a corporation means its gross assets other than its Business Assets.

(*4*) *Total Assets. Total Assets* of a corporation means its Business Assets and its Nonbusiness Assets.

(*5*) *Nonbusiness Asset Percentage.* The *Nonbusiness Asset Percentage* of a corporation is the percentage determined by dividing the fair market value of its Nonbusiness Assets by the fair market value of its Total Assets.

(*6*) *Separate Affiliated Group, SAG, CSAG, and DSAG. Separate Affiliated Group* (or *SAG*) means a separate affiliated group as defined in section 355(b)(3)(B), *CSAG* means a SAG with respect to which a controlled corporation is the common parent, and *DSAG* means a SAG with respect to which a distributing corporation is the common parent, excluding the controlled corporation and any other members of the CSAG.

(*7*) *50-Percent-Owned Group, Member of a 50-Percent-Owned Group. 50-Percent-Owned Group* has the same meaning as SAG, except that ''50-percent'' is substituted for ''80-percent'' each place it appears in section 1504(a)(2), for purposes of section 355(b)(3)(B). A *Member of a 50-Percent-Owned Group* is a corporation that would be a member of a DSAG or a CSAG, with the substitution provided in this paragraph (d)(2)(iv)(B)(*7*).

(C) *Presence of Nonbusiness Assets as evidence of device*—(*1*) *Ownership of Nonbusiness Assets.* Ownership of Nonbusiness Assets by the distributing corporation or the controlled corporation is evidence of device. The strength of the evidence will be based on all the facts and circumstances, including the Nonbusiness Asset Percentage for each corporation. The larger the Nonbusiness Asset Percentage of either corporation, the stronger is the evidence of device. Ownership of Nonbusiness Assets ordinarily is not evidence of device if the Nonbusiness Asset Percentage of each of the distributing corporation and the controlled corporation is less than 20 percent.

(*2*) *Difference between Nonbusiness Asset Percentages.* A difference between the Nonbusiness Asset Percentage of the distributing corporation and the Nonbusiness Asset Percentage of the controlled corporation is evidence of device, and the larger the difference, the stronger is the evidence of device. Such a difference ordinarily is not itself evidence of device (but may be considered in determining the presence or the strength of other device factors) if—

(*i*) The difference is less than 10 percentage points; or

(*ii*) The distribution is not pro rata among the shareholders of the distributing corporation, and the difference is attributable to a need to equalize the value of the controlled stock and securities (if any) distributed and the value of the distributing stock and securities (if any) exchanged therefor by the distributees.

(*3*) *Cross-reference. See* paragraph (d)(5) of this section for a rule under which a distribution is considered to have been used principally as a device when the distributing corporation or the controlled corporation has a large Nonbusiness Asset Percentage and there is a large difference between Nonbusiness Asset Percentages of the two corporations.

(D) *Operating rules.* The following operating rules apply for purposes of this paragraph (d)(2)(iv):

(*1*) *Multiple controlled corporations.* If a transaction involves distributions by a distributing corporation of the stock of more than one controlled corporation, this paragraph (d)(2)(iv) applies to all such controlled corporations. If any provision in this paragraph (d)(2)(iv) requires a comparison between characteristics of the distributing corporation and the controlled corporation, the provision also requires such a comparison between the distributing corporation and each of the controlled corporations and between each controlled corporation and each other controlled corporation. If any distribution involved in the transaction is determined to have been used principally as a device by reason of this paragraph (d)(2)(iv), all distributions involved in the transaction are considered to have been used principally as a device.

(*2*) *Treatment of SAG as a single corporation.* The members of a DSAG are treated as a single corporation, the members of a CSAG are treated as a single corporation, references to the distributing corporation include all members of the DSAG, and references to the controlled corporation include all members of the CSAG.

(*3*) *Time to identify assets and determine character of assets.* The assets of the distributing corporation and the controlled corporation that are relevant in connection with this paragraph (d)(2)(iv), and the character of these assets as Business Assets or Nonbusiness Assets, must be determined by the distributing corporation and the controlled corporation immediately after the distribution. Accordingly, for purposes of this paragraph (d)(2)(iv), the assets of the distributing corporation do not include any asset, including stock of the controlled corporation, that is distributed in the transaction.

(*4*) *Time to determine fair market value of assets*—(*i*) *In general.* The distributing corporation and the controlled corporation each must determine the fair market value of its assets at the time of the distribution as of one of the following dates: Immediately before the distribution; on any date within the 60-day period before the distribution; on the date of an agreement with respect to the distribution that was binding on the distributing corporation on such date and at all times thereafter; or on the date of a public announcement or filing with the Securities and Exchange Commission with respect to the distribution.

(*ii*) *Consistency.* The distributing corporation and the controlled corporation must make the determinations described in paragraph (d)(2)(iv)(D)(*4*)(*i*) of this section in a manner consistent with each other and as of the same date for purposes of this paragraph (d)(2)(iv), paragraph (d)(5) of this section, and § 1.355–9. If these consistency requirements are not met, the fair market value of assets will be determined immediately before the distribution for purposes of all such provisions, unless the Commissioner determines that the use of such date is inconsistent with the purposes of section 355 and the regulations thereunder.

(*5*) *Fair market value.* The fair market value of an asset is determined under general federal tax principles but reduced (but not below the adjusted basis of the asset) by the amount of any liability that is described in section 357(c)(3) (relating to exclusion of certain liabilities, including liabilities the payment of which would give rise to a deduction, from the amount of liabilities assumed in certain exchanges) and relates to the asset (or to a Business with which the asset is associated). Any other liability is disregarded for purposes of determining the fair market value of an asset.

(*6*) *Interest in partnership*—(*i*) *In general.* Except as provided in paragraph (d)(2)(iv)(D)(6)(*ii*) of this section, an interest in a partnership is a Nonbusiness Asset.

(*ii*) *Exception for certain interests in partnerships.* A distributing corporation or controlled corporation may be considered to be engaged in one or more Businesses conducted by a partnership. This determination will be made using the same criteria that would be used to determine for purposes of section 355(b) and § 1.355–3 whether the corporation is considered to be engaged in the active conduct of a trade or business conducted by the partnership (relating to the corporation's ownership interest or to its ownership interest and participation in management of the partnership). If a distributing corporation or controlled corporation is considered to be engaged in one or more Businesses conducted by a partnership, the fair market value of the corporation's interest in the partnership will be allocated between Business Assets and Nonbusiness Assets in the same proportion as the proportion of the fair market values of the Business Assets and Nonbusiness Assets of the partnership.

(*7*) *Stock in corporation*—(*i*) *In general.* Except as provided in paragraph (d)(2)(iv)(D)(7)(*ii*) of this section, stock in a corporation other than a member of the DSAG or the CSAG is a Nonbusiness Asset.

(*ii*) *Exception for stock in Member of a 50-Percent-Owned Group.* If a Member of a 50-Percent-Owned Group with respect to the distributing corporation or the controlled corporation owns stock in another Member of the 50-Percent-Owned Group (other than a member of the DSAG or the CSAG, respectively), the fair market value of such stock will be allocated between Business Assets and Nonbusiness Assets in the same proportion as the proportion of the fair market values of the Business Assets and Nonbusiness Assets of the issuing corporation. This computation will be made with respect to lower-tier Members of the 50-Percent-Owned Group before the computations with respect to higher-tier members.

(*8*) *Obligation between distributing corporation or controlled corporation and certain partnerships or Members of 50-Percent-Owned Groups.* If an obligation of the distributing corporation or the controlled corporation is held by a partnership described in paragraph (d)(2)(iv)(D)(*6*)(*ii*) of this section or by a Member of its 50-Percent-Owned Group, or if an obligation of a partnership described in paragraph (d)(2)(iv)(D)(*6*)(*ii*) of this section or of a Member of its 50-Percent-Owned Group, with respect to the distributing corporation or the controlled corporation, is held by the distributing corporation or the controlled corporation, proper adjustments will be made to prevent double inclusion of assets or inappropriate allocation between Business Assets and Nonbusiness Assets of the distributing corporation or the controlled corporation on account of such obligation. *See Examples 6* and *7* of paragraph (d)(4) of this section.

(E) *Anti-abuse rule.* A transaction or series of transactions undertaken with a principal purpose of affecting the Nonbusiness Asset Percentage of any corporation will not be given effect for purposes of applying this paragraph (d)(2)(iv). For this purpose, a transaction or series of transactions includes a change in the form of ownership of an asset; an issuance, assumption, or repayment of indebtedness or other obligations; or an issuance or redemption of stock. However, this paragraph (d)(2)(iv)(E) generally does not apply to a non-transitory acquisition or disposition of assets, other than an acquisition from or disposition to a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to the distributing corporation or the controlled corporation, or to a non-transitory transfer of assets between the distributing corporation and the controlled corporation.

* * * * *

(3) * * *

(ii) *Corporate business purpose.* A corporate business purpose for the transaction is evidence of nondevice. The stronger the evidence of device (such as the presence of the device factors specified in paragraph (d)(2) of this section), the stronger the corporate business purpose must be to prevent the determination that the transaction is being used principally as a device. Evidence of device presented by ownership of Nonbusiness Assets (as defined in paragraph (d)(2)(iv)(B)(*3*) of this section) can be outweighed by the existence of a corporate business purpose for the ownership. Evidence of device presented by a difference between the Nonbusiness Asset Percentages (as defined in paragraph (d)(2)(iv)(B)(*5*) of this section) of the distributing corporation and the controlled corporation can be outweighed by the existence of a corporate business purpose for the difference. A corporate business purpose that relates to a separation of Nonbusiness Assets from one or more Businesses or Business Assets (as defined in paragraph (d)(2)(iv)(B) of this section) is not evidence of nondevice unless the business purpose involves an exigency that requires an investment or other use of the Nonbusiness Assets in one or more Businesses of the distributing corporation, the controlled corporation, or both. The assessment of the strength of a corporate business purpose will be based on all of the facts and circumstances, including, but not limited to, the following factors:

* * * * *

(4) *Examples.* The provisions of paragraphs (d)(1) through (3) of this section may be illustrated by the following examples. For purposes of these examples, A and B are individuals; P is a partnership; D and C are the distributing corporation and the controlled corporation, respectively; D and C each has no assets other than those described; there is no other evidence of device or nondevice other than as described; D has accumulated earnings and profits; and D distributes the stock of C in a distribution which, but for the issue of whether the transaction has been used principally as a device, satisfies the requirements of section 355(a).

Example 1. Sale after distribution (device). A owns all of the stock of D, which is engaged in the warehousing business. D owns all of the stock of C, which is engaged in the transportation business. All of D's and C's assets are Business Assets. D employs B, who is extremely knowledgeable of the warehousing business in general and the operations of D in particular. B has informed A that he will seriously consider leaving D if he is not given the opportunity to purchase a significant amount of stock of D. Because of his knowledge and experience, the loss of B would seriously damage the business of D. B cannot afford to purchase any significant amount of stock of D as long as D owns C. Accordingly, D distributes the stock of C to A and A subsequently sells a portion of his D stock to B. However, instead of A selling a portion of the D stock, D could have issued additional shares to B after the distribution. In light of the fact that D could have issued additional shares to B, the sale of D stock by A is substantial evidence of device. The transaction is considered to have been used principally as a device. See paragraph (d)(1), (2)(i), (ii), and (iii)(A), (B), and (D), and (3)(i) and (ii) of this section.

Example 2. Disproportionate division of Nonbusiness Assets (device)—(i) *Facts.* D owns and operates a fast food restaurant in State M and owns all of the stock of C, which owns and operates a fast food restaurant in State N. The value of the Business Assets of D's and C's fast food restaurants are $100 and $105, respectively. D also has $195 cash which D holds as a Nonbusiness Asset. D and C operate their businesses under franchises granted by competing businesses F and G, respectively. G has recently changed its franchise policy and will no longer grant or renew franchises to subsidiaries or other members of the same affiliated group of corporations operating businesses under franchises granted by its competitors. Thus, C will lose its franchise if it remains a subsidiary of D. The franchise is about to expire. The lease for the State M location will expire in 24 months, and D will be forced to relocate at that time. While D has not made any plans, it is weighing its option to purchase a building for the relocation. D contributes $45 to C, which C will retain, and distributes the stock of C pro rata among D's shareholders.

(ii) *Analysis.* After the distribution, D's Nonbusiness Asset Percentage is 60 percent ($150/$250), and C's Nonbusiness Asset Percentage is 30 percent ($45/$150). D's and C's ownership of Nonbusiness Assets of at least 20 percent of their respective Total Assets is evidence of device with respect to each. The difference between D's Nonbusiness Asset Percentage and C's Nonbusiness Asset Percentage is 30 percentage points, which is also evidence of device. The corporate business purpose for the distribution does not relate to a separation of Nonbusiness Assets from one or more Businesses or Business Assets and is evidence of nondevice. However, D has no corporate business purpose for the difference of Nonbusiness Asset Percentages. While D is considering purchasing a building for use in the State M location, this purchase is not required by any exigency. The fact that the distribution is pro rata is also evidence of device. Based on all the facts and circumstances, the transaction is considered to have been used principally as a device. See paragraph (d)(1), (2)(i), (ii), (iv)(A) and (C), and (3)(i) and (ii)(A), (B), and (C) of this section.

Example 3. Proportionate division of Nonbusiness Assets (nondevice). The facts are the same as in *Example 2,* except that D contributes $95 of the cash to C instead of $45. After the distribution, D's Nonbusiness Asset Percentage is 50 percent ($100/$200) and C's Nonbusiness Asset Percentage is 47.5 percent ($95/$200), each of which is evidence of device. The difference between D's Nonbusiness Asset Percentage and C's Nonbusiness Asset Percentage (2.5 percentage points) is less than 10 percentage points and thus is not evidence of device. The corporate business purpose for the distribution is evidence of nondevice. Based on all the facts and circumstances, the transaction is considered not to have been used principally as a device. See paragraph (d)(1), (2)(i), (ii), (iv)(A) and (C), and (3)(i) and (ii)(A), (B), and (C) of this section.

Example 4. Disproportionate division of Nonbusiness Assets (nondevice). The facts are the same as in *Example 2,* except that the lease for the State M location will expire in 6 months instead of 24 months, and D will use $80 of the $150 cash it retains to purchase a nearby building for the relocation. After the distribution, D's Nonbusiness Asset Percentage is 60 percent, and C's Nonbusiness Asset Percentage is 30 percent. D's and C's ownership of Nonbusiness Assets of at least 20 percent of their respective Total Assets is evidence of device with respect to each. The difference between D's Nonbusiness Asset Percentage and C's Nonbusiness Asset Percentage is 30 percentage points, which is also evidence of device. However, D has a corporate business purpose for a significant part of the difference of Nonbusiness Asset Percentages because D's use of $80 is required by business exigencies. The fact that the distribution is pro rata is also evidence of device. The corporate business purpose for the distribution is evidence of nondevice. Based on all the facts and circumstances, the transaction is not considered to have been used principally as a device. See paragraph (d)(1), (2)(i), (ii), (iv)(A) and (C), and (3)(i) and (ii)(A), (B), and (C) of this section.

Example 5. Nonbusiness Asset Percentage (50-Percent-Owned Group)—(i) *Facts.* C's assets consist of 50% of the stock of S1 and other assets consisting of $10,000 of Business Assets and $5,000 of Nonbusiness Assets. S1's assets consist of 40% of the stock of S2, 60% of the stock of S3 and other assets consisting of $1,000 of Business Assets and $500 of Nonbusiness Assets. S1 has $500 of liabilities, owed to unrelated persons. S2's assets consist of $500 Business Assets and $100 Nonbusiness Assets. S2 has $200 of liabilities. S3's assets consist of $3,000 Business Assets and $1,500 Nonbusiness Assets. S3 has $3,500 of liabilities, owed to unrelated persons.

(ii) *Determination of S1's Business Assets and Nonbusiness Assets.* Because C owns at least 50% of the stock of S1, S1 is a member of C's 50-Percent-Owned Group. See paragraph (d)(2)(iv)(B)(*7*) of this section. In determining the amount of C's Business Assets and Nonbusiness Assets, whether S1's stock in S2 and S3 are Nonbusiness Assets or partially Nonbusiness Assets and partially Business Assets must first be determined. See paragraph (d)(2)(iv)(D)(*7*)(*ii*) of this section (computations are made with respect to lower-tier Members of a 50-Percent-Owned Group before the computations with respect to higher-tier members). The fair market value of S1's stock in S2 is $160 (40% of $400 ($500 + $100 − $200)). Because S1 owns less than 50% of the stock of S2, S2 is not a member of C's 50-Percent-Owned Group, and thus the S2 stock is a $160 Nonbusiness Asset in the hands of S1. See paragraph (d)(2)(iv)(B)(*7*) and (D)(*7*)(*i*) of this section. The fair market value of S1's stock in S3 is $600 (60% of $1,000 ($3,000 + $1,500 − $3,500)). Because C owns at least 50% of the stock of S1 and S1 owns at least 50% of the stock of S3, S3 is a member of C's 50-Percent-Owned Group. See paragraph (d)(2)(iv)(B)(*7*) of this section. Thus, the fair market value of the S3 stock is allocated between Business Assets and Nonbusiness Assets in the same proportion as S3's proportion of Business Assets and Nonbusiness Assets. See paragraph (d)(2)(iv)(D)(*7*)(*ii*) of this section. Because S3 has Business Assets of $3,000 and Nonbusiness Assets of $1,500, this proportion is 66⅔% Business Assets ($3,000/$4,500) and 33⅓% Nonbusiness Assets ($1,500/$4,500). The $600 fair market value of S1's stock in S3 is allocated $400 to Business Assets ($600 × 66⅔%) and $200 to Nonbusiness Assets ($600 × 33⅓%). Thus, S1's assets consist of $1,400 of Business Assets ($1,000 held directly + $400 allocated from S3) and $860 of Nonbusiness Assets ($500 held directly + $160 fair market value of its S2 stock + $200 allocated from S3).

(iii) *Determination of C's Business Assets and Nonbusiness Assets.* The fair market value of C's stock in S1 is $880 (50% of $1,760 ($160 + $600 + $1,000 + $500 − $500)). Because C owns at least 50% of the stock of S1, S1 is a member of C's 50-Percent-Owned Group. See paragraph (d)(2)(iv)(B)(*7*) of this section. Thus, the fair market value of the S1 stock is allocated between Business Assets and Nonbusiness Assets in the same proportion as the proportion of S1's Business Assets and Nonbusiness Assets. See paragraph (d)(2)(iv)(D)(*7*)(*ii*) of this section. Because S1 has Business Assets of $1,400 and Nonbusiness Assets of $860, this proportion is 61.95% Business Assets ($1,400/$2,260) and 38.05% Nonbusiness Assets ($860/$2,260). The $880 fair market value of C's S1 stock is allocated $545 to Business Assets ($880 × 61.95%) and $335 to Nonbusiness Assets ($880 × 38.05%). Thus, C's assets consist of $10,545 of Business Assets ($10,000 + $545) and $5,335 of Nonbusiness Assets ($5,000 + $335), for Total Assets of $15,880. C's Nonbusiness Asset Percentage is 33.6% ($5,335/$15,880).

Example 6. Partnership interest held by Distributing. (i) *Facts.* D has directly-held Business Assets of $1,000, directly held Nonbusiness Assets of $2,000, and a 40% partnership interest in P. P has $450 of Business Assets and $1,350 of cash, which P holds as a Nonbusiness Asset, and owes a liability of $800.

(ii) *Analysis.* Pursuant to paragraph (d)(2)(iv)(D)(*6*)(*ii*) of this section, D is allocated $100 of Business Assets from P ($400 (value of D's 40% interest in P) × 25% ($450/$1,800)) and $300 of Nonbusiness Assets from P ($400 (value of D's 40% interest in P) × 75% ($1,350/$1,800)), which are added to D's directly held Business Assets and Nonbusiness Assets, respectively. D's Nonbusiness Asset Percentage is 67.6% ($2,300 Nonbusiness Assets/$3,400 Total Assets).

Example 7. Borrowing by Distributing from partnership. (i) *Facts.* The facts are the same as in Example 6, except that D borrows $500 from P and invests the proceeds in a Nonbusiness Asset. P's directly-held Nonbusiness Assets increase by $500. The D obligation is a Nonbusiness Asset in P's hands.

(ii) *Analysis.* D's directly-held Nonbusiness Assets increase by $500, to $2,500. There is no corresponding decrease in the amount of Business Assets or Nonbusiness Assets allocated to D from P, because a Nonbusiness Asset of P ($500 cash) has been replaced by another $500 Nonbusiness Asset, the obligation from D. Effectively, because D has a 40% interest in P, D has borrowed $200 (40% of $500) from itself. Accordingly, D's Nonbusiness Assets must be decreased by $200. D's Business Assets will continue to be $1,100 ($1,000 directly held plus $100 allocated from P), and D's Nonbusiness Assets will be $2,600 ($2,500 directly held, plus $300 allocated from P less the $200 decrease to prevent double inclusion of the obligation and the obligation proceeds).

* * * * *

(5) *Distributions involving separation of Business Assets from Nonbusiness Assets*—(i) *In general.* A distribution specified in paragraph (d)(5)(iii) of this section is considered to have been used principally as a device, notwithstanding the presence of nondevice factors described in paragraph (d)(3) of this section or other facts and circumstances. However, this paragraph (d)(5)(i) does not apply to a distribution that is described in paragraph (d)(3)(iv) of this section (distributions to domestic corporations entitled to certain dividends received deductions absent application of section 355(a)) or paragraph (d)(6) of this section (transactions ordinarily not considered to be a device).

(ii) *Definitions and operating rules.* The definitions in paragraph (d)(2)(iv)(B) of this section and the operating rules in paragraph (d)(2)(iv)(D) of this section apply for purposes of this paragraph (d)(5). For purposes of paragraph (d)(2)(iv)(D)(*1*), (*2*), and (*3*), references to paragraph (d)(2)(iv) of this section are treated as references to this paragraph (d)(5).

(iii) *Certain distributions involving separation of Nonbusiness Assets from Business Assets.* A distribution is specified in this paragraph (d)(5)(iii) if both—

(A) The Nonbusiness Asset Percentage of the distributing corporation or the controlled corporation is 66⅔ percent or more, and

(B) If the Nonbusiness Asset Percentage of the distributing corporation or the controlled corporation is—

(*1*) 66⅔ percent or more but less than 80 percent, and the Nonbusiness Asset Percentage of the other corporation (the controlled corporation or the distributing corporation, as the case may be) is less than 30 percent;

(*2*) 80 percent or more but less than 90 percent, and the Nonbusiness Asset Percentage of the other corporation (the controlled corporation or the distributing corporation, as the case may be) is less than 40 percent; or

(*3*) 90 percent or more, and the Nonbusiness Asset Percentage of the other corporation (the controlled corporation or the distributing corporation, as the case may be) is less than 50 percent.

(iv) *Anti-abuse rule.* The anti-abuse rule in paragraph (d)(2)(iv)(E) of this section applies for purposes of this paragraph (d)(5), with references to paragraph (d)(2)(iv) of this section treated as references to this paragraph (d)(5) and references to paragraph (d)(2)(iv)(E) of this section treated as references to this paragraph (d)(5)(iv).

(6) *Transactions ordinarily not considered as a device*—(i) *In general.* This paragraph (d)(6) specifies three distributions that ordinarily do not present the potential for federal tax avoidance described in paragraph (d)(1) of this section. Accordingly, such distributions are ordinarily considered not to have been used principally as a device, notwithstanding the presence of any of the device factors described in paragraph (d)(2) of this section or a separation of Business Assets from Nonbusiness Assets as described in paragraph (d)(5) of this section. A

transaction described in paragraph (d)(6)(iii) or (iv) of this section is not protected by this paragraph (d)(6) from a determination that it was used principally as a device if it involves the distribution of the stock of more than one controlled corporation and facilitates the avoidance of the dividend provisions of the Code through the subsequent sale or exchange of stock of one corporation and the retention of the stock of another corporation. * * *

* * * * *

(i) *Effective/applicability date*—(1) *Paragraph (d) of this section*—(i) *In general.* Except as provided in paragraph (i)(1)(ii) of this section, paragraph (d) of this section applies to transactions occurring on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(ii) *Transition rule.* Paragraph (d) of this section does not apply to a distribution that is—

(A) Made pursuant to an agreement, resolution, or other corporate action that is binding on or before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register** and at all times thereafter;

(B) Described in a ruling request submitted to the Internal Revenue Service on or before July 15, 2016; or

(C) Described in a public announcement or filing with the Securities and Exchange Commission on or before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Paragraph (g) of this section.* Paragraph (g) of this section applies to distributions occurring after October 20, 2011. For rules regarding distributions occurring on or before October 20, 2011, *see* § 1.355–2T(i), as contained in 26 CFR part 1, revised as of April 1, 2011.

■ **Par. 5.** Reserved § 1.355–8 is added to read as follows:

§ 1.355–8 [Reserved]

■ **Par. 6.** Section 1.355–9 is added to read as follows:

§ 1.355–9 Minimum percentage of Five-Year-Active-Business Assets.

(a) *Definitions.* The following definitions apply for purposes of this section:

(1) *Distributing, Controlled. Distributing* means the distributing corporation within the meaning of § 1.355–1(b). *Controlled* means the controlled corporation within the meaning of § 1.355–1(b).

(2) *Five-Year-Active Business. Five-Year-Active Business* means the active conduct of a trade or business that satisfies the requirements and limitations of section 355(b)(2) and § 1.355–3(b).

(3) *Five-Year-Active-Business Assets. Five-Year-Active-Business Assets* of a corporation means its gross assets used in one or more Five-Year-Active Businesses. Such assets include cash and cash equivalents held as a reasonable amount of working capital for one or more Five-Year-Active Businesses. Such assets also include assets required (by binding commitment or legal requirement) to be held to provide for exigencies related to a Five-Year-Active Business or for regulatory purposes with respect to a Five-Year-Active Business. For this purpose, such assets include assets the holder is required (by binding commitment or legal requirement) to hold to secure or otherwise provide for a financial obligation reasonably expected to arise from a Five-Year-Active Business and assets held to implement a binding commitment to expend funds to expand or improve a Five-Year-Active Business.

(4) *Non-Five-Year-Active-Business Assets. Non-Five-Year-Active-Business Assets* of a corporation means its gross assets other than its Five-Year-Active-Business Assets.

(5) *Total Assets. Total Assets* of a corporation means its Five-Year-Active-Business Assets and its Non-Five-Year-Active-Business Assets.

(6) *Five-Year-Active-Business Asset Percentage.* The *Five-Year-Active-Business Asset Percentage* of a corporation is the percentage determined by dividing the fair market value of its Five-Year-Active-Business Assets by the fair market value of its Total Assets.

(7) *Separate Affiliated Group, SAG, CSAG, and DSAG. Separate Affiliated Group* (or *SAG*), *CSAG,* and *DSAG* have the same meanings as in § 1.355–2(d)(2)(iv)(B)(*6*).

(b) *Five percent minimum Five-Year-Active-Business Asset Percentage.* For the requirements of section 355(a)(1)(C) and section 355(b) to be satisfied with respect to a distribution, the Five-Year-Active-Business Asset Percentage of each of Distributing and Controlled must be at least five percent.

(c) *Operating rules.* The following operating rules apply for purposes of this section:

(1) *Treatment of SAG and fair market value.* The operating rules in § 1.355–2(d)(2)(iv)(D)(*2*) (treatment of SAG as a single corporation) and (*5*) (fair market value) apply.

(2) *Time to identify assets, determine character of assets, and determine fair market value of assets.* The provisions of § 1.355–2(d)(2)(iv)(D)(*3*) (time to identify assets and determine character of assets) apply, except that references to paragraph (d)(2)(iv) are treated as references to this section and ‘‘Business Assets or Nonbusiness Assets’’ is replaced with ‘‘Five-Year-Active-Business Assets or Non-Five-Year-Active-Business Assets,’’ and the provisions of § 1.355–2(d)(2)(iv)(D)(*4*) (time to determine fair market value of assets) apply.

(3) *Interest in partnership*—(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, an interest in a partnership is a Non-Five-Year-Active-Business Asset.

(ii) *Exception for certain interests in partnerships.* If Distributing or Controlled is considered to be engaged in one or more Five-Year-Active-Businesses conducted by a partnership, the fair market value of the corporation's interest in the partnership will be allocated between Five-Year-Active-Business Assets and Non-Five-Year-Active-Business Assets in the same proportion as the proportion of the fair market values of the Five-Year-Active-Business Assets and Non-Five-Year-Active-Business Assets of the partnership.

(d) *Anti-abuse rule.* A transaction or series of transactions undertaken with a principal purpose of affecting the Five-Year-Active-Business Asset Percentage of any corporation will not be given effect for purposes of applying this § 1.355–9. For this purpose, a transaction or series of transactions includes a change in the form of ownership of an asset; an issuance, assumption, or repayment of indebtedness or other obligations; or an issuance or redemption of stock. However, this paragraph (d) generally does not apply to a non-transitory acquisition or disposition of assets, other than an acquisition from or disposition to a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to Distributing or Controlled, or to a non-transitory transfer of assets between Distributing and Controlled.

(e) *Effective/applicability date*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies to transactions occurring on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

(2) *Transition rule*—This section does not apply to a distribution that is—

(i) Made pursuant to an agreement, resolution, or other corporate action that is binding on or before the date the

Treasury decision adopting these regulations as final regulations is published in the **Federal Register** and at all times thereafter;

(ii) Described in a ruling request submitted to the Internal Revenue Service on or before July 15, 2016; or

(iii) Described in a public announcement or filing with the Securities and Exchange Commission on or before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2016–16512 Filed 7–14–16; 8:45 am]

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DEPARTMENT OF JUSTICE

28 CFR Part 32

[Docket No.: OJP (BJA) 1716]

RIN 1121–AA85

Public Safety Officers' Benefits Program

AGENCY: Office of Justice Programs, Justice.

ACTION: Notice of proposed rulemaking.

SUMMARY: This rule proposes to make the following changes to current regulations implementing the Public Safety Officers' Benefits (PSOB) Act: Adopting the World Trade Center (WTC) Health Program's List of WTC-Related Health Conditions (List), the WTC Health Program's standards for certifying that an injury is covered for treatment under the Program, and related regulatory provisions, establishing payment offset provisions between the PSOB Program and the September 11th Victim Compensation Fund, and revising the provisions that define when the statutory presumption of line-of-duty death resulting from certain heart attacks, strokes, and vascular ruptures is rebutted. The proposed changes based on the WTC Health Program's List and related provisions would provide a means for claimants to establish that certain public safety officers with chronic, often latent, health conditions sustained a line-of-duty injury under the PSOB Act. The proposed payment offset provisions are intended to implement statutory amendments to the PSOB Act requiring such offset and to facilitate claims processing. Similarly, the proposed rule implementing the statutory presumption associated with certain heart attacks, strokes, and vascular ruptures is intended to amend the current regulation to conform to recent amendments to the PSOB Act and to improve the processing of such claims.

DATES: Written comments must be postmarked and electronic comments must be submitted on or before September 13, 2016. Comments received by mail will be considered timely if they are postmarked on or before that date. The electronic Federal Docket Management System (FDMS) will accept comments until Midnight Eastern Time at the end of that day.

ADDRESSES: Please address all comments regarding this rule by U.S. mail, to: Hope Janke, Bureau of Justice Assistance, Office of Justice Programs, 810 7th Street NW., Washington, DC 20531; or by telefacsimile to (202) 354–4135. To ensure proper handling, please reference OJP Docket No. 1716 on your correspondence. Comments may also be sent electronically through *http://regulations.gov* using the electronic comment form provided on that site. An electronic copy of this document is also available at the *http://regulations.gov* Web site. OJP will accept attachments to electronic comments in Microsoft Word, WordPerfect, or Adobe PDF formats only.

FOR FURTHER INFORMATION CONTACT: Hope Janke, BJA, OJP, at (202) 514–6278, or toll-free at 1 (888) 744–6513.

SUPPLEMENTARY INFORMATION:

I. Posting of Public Comments

Please note that all comments received are considered part of the public record and made available for public inspection online at *http://www.regulations.gov.* Information made available for public inspection includes personal identifying information (such as your name, address, etc.) voluntarily submitted by the commenter.

The Office of Justice Programs (OJP) does not require commenters to submit personal identifying information (such as your name, address, medical information, etc.) as part of your comment. However, if you wish to submit such information, but do not wish it to be posted online, you must include the phrase ''PERSONAL IDENTIFYING INFORMATION'' in the first paragraph of your comment. You must also locate all the personal identifying information that you do not want posted online in the first paragraph of your comment and identify what information you want the agency to redact. Personal identifying information identified and located as set forth above will be placed in the agency's public docket file, but not posted online.

If you wish to submit confidential business information as part of your comment but do not wish it to be posted online, you must include the phrase ''CONFIDENTIAL BUSINESS INFORMATION'' in the first paragraph of your comment. You must also prominently identify confidential business information to be redacted within the comment. If a comment has so much confidential business information that it cannot be effectively redacted, the agency may choose not to post that comment (or to only partially post that comment) on *http://www.regulations.gov.* Confidential business information identified and located as set forth above will not be placed in the public docket file, nor will it be posted online.

If you wish to inspect the agency's public docket file in person by appointment, please see the **FOR FURTHER INFORMATION CONTACT** paragraph.

II. Background

A. General

The Public Safety Officers' Benefits (PSOB) Program, 42 U.S.C. 3796 *et seq.* (established pursuant to the Public Safety Officers' Benefits Act of 1976), is administered by the Bureau of Justice Assistance (BJA) of the Office of Justice Programs (OJP), U.S. Department of Justice. Generally speaking, the PSOB Program provides a one-time financial payment to the statutorily-eligible survivors of public safety officers who die as the direct and proximate result of personal injuries sustained in the line of duty, as well as educational assistance for their spouses and eligible children.

Alternatively, the PSOB Program also provides a one-time financial payment directly to public safety officers determined to be permanently and totally disabled as the direct and proximate result of personal injury sustained in the line of duty, as well as educational assistance for their spouses and eligible children.

B. Establishing a Line-of-Duty Injury Under the PSOB Act and Implementing Regulations

42 U.S.C. 3796(a) authorizes the payment, to statutory survivors, of a benefit of $250,000, currently adjusted for inflation at $339,881, when the administering agency determines, under its regulations ''that a public safety officer has died as the direct and proximate result of a personal injury sustained in the line of duty.'' Similarly, 42 U.S.C. 3796(b) authorizes the agency