Volume 28 | Number 2 Article 1

1-20-2017

A "Split-Off": A Rarely Used Approach to Corporate Divisions

Neil E. Harl
Iowa State University

Agricultural Law Press
Publisher/Editor
Robert P. Achenbach, Jr.
Contributing Editor
Dr. Neil E. Harl, Esq.
* * * *

Issue Contents

Agricultural Law Digest

Volume 28, No. 2 January 20, 2017 ISSN 1051-2780

A "Split-Off": A Rarely Used Approach to Corporate Divisions

-by Neil E. Harl*

Frequently, corporate reorganizations or divisions are referred to as "spin-offs,"[1] the most common type of reorganizations; "split-offs" a rarely used form of restructuring, specifically authorized by statute[2] or "split-ups."[3]

"Spin-offs" have been popular in recent years, to the point that a letter ruling is rarely requested as guidance." Split-offs are known for their complexity and are rarely encountered in practice.

"Split-offs: the complex choice

The concept of a "split off" is lodged in I.R.C. § 1551 but it is really a limit to what can be done (or what cannot be done) with all restructurings of corporations to the unfair or improper benefit of the taxpayer. There is an almost infinite array of ways to take advantage of the Internal Revenue Code and the "split-off" rules are designed to minimize the opportunity to take advantage of those situations. Elsewhere in the Internal Revenue Code, in I.R.C. § 269, there are prohibitions against acquisitions to avoid or evade tax.[4] In addition, I.R.C. § 482 signifies that the Internal Revenue Service is given authority to allocate income and deductions for all types of organizations.

I.R.C. § 1551 contains authority to disallow the graduated corporate rates or the accumulated earnings credit to a transferee corporation that is controlled by the transferor to that corporation or its shareholders. Thus, I.R.C. § 1551 should be viewed as an additional supplemental weapon for challenging improper manipulations without limiting Sections 269 and 482 of the Internal Revenue Code.

The targets. The Internal Revenue Service can look to Section 1551 if a corporation transfers all or part of its property (other than money) to a *controlled corporation* and the transferee corporation was – (1) created for the purpose of acquiring the property or (2) was not actively engaged in business at the time of the transfer.[5] The rules of I.R.C. § 1551 apply to transfers to one of two or more corporations which the transferor and not more than four other persons control.[6]

Control. Control is defined as ownership of at least 80 percent of the voting power (or value) of each corporation Thus, for a transfer by five or fewer persons, control is defined as ownership of at least 80 percent of the value or voting power of each corporation's stock and more than 50 percent of the value or voting power of each stock, taking into account

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

Agricultural Law Digest is published by the Agricultural Law Press, 127 Young Rd., Kelso, WA 98626 (ph 360-200-5666), bimonthly except June and December. Annual subscription $90 by e-mail. http://www.agrilawpress.com Printed on recycled paper.

the ownership of each individual only to the extent their stock ownership is identical with respect to each corporation after the transfer.[7]

As might be expected, in determining whether the conditions for "control" exist, special constructive ownership of stock rules are applicable.[8] That is to say, an individual is deemed to be (1) the owner of the stock owned by the taxpayer's spouse; (2) the stock owned by minor children (3) stock owned by adult children and grandchildren if the taxpayer owns more than 50 percent of the value and voting power of the stock in the corporation; (4) stock owned by adult children and children if the taxpayer owns more than 50 percent of the value and voting power of the stock in the corporation; (5) stock owned by parents or grandparents if the taxpayer is 21 years of age or older and owns more than 50 percent of the value or voting power of the corporation's power; (6) stock held by a trust, estate, partnership or corporation in which the taxpayer owns a five percent or greater interest; and (7) stock on which the taxpayer holds an option to purchase or acquire.

If a husband and wife own and operate businesses which are separate, one of the spouses is not considered to own the other's stock if neither spouse directly owns stock in the corporation in which the other spouse owns stock; neither spouse is an employee or director in and does not take part in the management of the other's corporation, not more than 50 percent of the gross income of that corporation is from rents, royalties, dividends, interest and annuities and the other spouse's right to dispose of stock in that corporation is not substantially restricted or limited in favor of the other spouse or their minor children.[9] The charge based on facts as viewed by IRS may be avoided if the transferee corporation is in a position to establish that application of the lower graduated corporate tax rates or accumulated earnings credit is not a main purpose behind the split-up.

In conclusion

Remember, the scrutiny by IRS may be broader than Section 1551 and, where appropriate, be focused on I.R.C. § 269 or I.R.C. § 482, also. It essentially means that planned transactions that are viewed unfavorably by the Internal Revenue Service, by bearing the earmarks of transactions that lie outside the lines of propriety, may be difficult to defend.

ENDNOTES

1 See I.R.C. §§ 368, 355.

2 I.R.C. § 1551(a), (b).

3 Split-ups resemble, functionally, a complete liquidation.

4 See, e.g. I.R.C. § 269 (limiting corporate acquisitions or control of corporations).

5 I.R.C. § 1551(a).

6 I.R.C. § 1551(a); Treas. Reg. §1.1551-1(a).

7 I.R.C. § 1551(b); Treas. Reg. § 1.1551-1(e).

8 I.R.C. § 1551; Treas. Reg. § 1.1551-1(e)(2).

9 I.R.C. § 1563(e).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

HORSES. The plaintiff was a minor child who was bitten by a horse owned by the defendant at the defendant's stables. The plaintiff was at the stables with the plaintiff's mother who was teaching other children to ride horses owned by the children or the stable. The plaintiff's sister was cleaning the stall of a horse belonging to the plaintiff's mother next to the stall of the horse which bit the plaintiff. The plaintiff was bitten while walking past the horses stall but was not interacting with the horse before the accident. The plaintiff sued for negligence and the defendant argued that the New Jersey Equestrian Liabilities Act , N.J. Stat. Ann. §§ 5:15-1 to 12, provided personal immunity from the suit. The issue was whether the plaintiff was a participant in an equine activity. The plaintiff argued that that plaintiff was not involved in the care, riding or observation of equine activities but was merely there because the mother and sister were involved in such activities. The statute, N.J. Stat. Ann. § 5:15-2, defines participant to include "any person, whether an amateur or professional, engaging in an equine animal activity, whether or not a fee is paid to engage in the equine animal activity or, if a minor, the natural guardian, or trainer of that person standing in *loco parentis*, and shall include anyone accompanying the participant, or any person coming onto the property of the provider of equine animal activities or equestrian area whether or not an invitee or person pays consideration." The trial court ruled that the statute included the plaintiff as a participant in an equine activity because the plaintiff accompanied his parent and sister while they clearly engaged in equine activities. The appellate court affirmed. **Kirkpatrick v. Hidden View Farm, 2017 N.J. Super. LEXIS 4 (N.J. Super. Ct. 2017)**.

BANKRUPTCY

GENERAL

DISCHARGE. The debtor was a crop farmer who applied for a line of credit with an agricultural supplier. The debtor understated