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Rev. Rul. 2017-09: Tax treatment of “north-south” transactions

The IRS today released an advance version of Rev. Rul. 2017-09 providing guidance regarding the federal tax treatment of certain transactions referred to as “north-south” transactions. The ruling removes “north-south transactions” from the list of issues under study, meaning that the IRS is open to ruling on the integration of steps in such a transaction.

Read [Rev. Rul. 2017-09](#) [PDF 41 KB]

Background

Rev. Rul. 2017-09 addresses two factual situations. In Situation 1:

- P owns all the stock of D, which owns all the stock of C. The fair market value of the C stock is \$100X.
- P has been engaged in Business A for more than five years, and C has been engaged in Business B for more than 5 years. Business A and Business B each constitutes the active conduct of a trade or business within the meaning of Code section 355(b).
- D is not engaged in the active conduct of a trade or business, directly or through any member of its separate affiliated group (within the meaning of section 355(b)(3)) other than C.
- On Date 1, P transfers the property and activities constituting Business A, having a fair market value of \$25X, to D in exchange for additional shares of D stock.

- On Date 2, pursuant to a dividend declaration, D transfers all the C stock to P for a valid corporate business purpose. D retains the Business A property and continues the active conduct of Business A after the distribution.
- The purpose of P's transfer of the property and activities of Business A to D is to allow D to satisfy the active trade or business requirement of section 355(b)(1)(A).

The second factual situation (Situation 2) considers the follow:

- P owns all the stock of D, which owns all the stock of C.
- D has been engaged in Business A for more than five years. C has been engaged in Business B for more than five years.
- Business A and Business B each constitutes the active conduct of a trade or business within the meaning of section 355(b).
- On Date 1, C transfers \$15X of money and property having a fair market value of \$10X to D, pursuant to a dividend declaration, and D retains the money and property.
- On Date 2, D transfers to C property having a basis of \$20X and a fair market value of \$100X, and D distributes all the C stock to P in a transaction qualifying as a reorganization under sections 368(a)(1)(D) and 355.
- C and D planned and executed the Date 1 transfer in pursuance of the plan of reorganization.

Holdings in Rev. Rul. 2017-09

The IRS ruled in Situation 1 that the transfer by P to its subsidiary, D, of property (including a transfer of property constituting an active trade or business for the purpose of meeting the requirements of section 355(b)(1)(A)), immediately followed by the distribution by D to P of the stock of its controlled subsidiary, C, is treated as an exchange to which section 351 applies, followed by a distribution of C stock to which section 355 applies.

In Situation 2, the IRS concluded that section 361—and not section 301—applies to the transfer of money or other property by C to D, made in pursuance of the plan of reorganization under sections 368(a)(1)(D) and 355.

KPMG observation

The revenue ruling applies the standard that the tax treatment of a transaction generally follows a taxpayer's chosen form unless:

- There is compelling alternative policy.
- The effect of all or part of the steps of the transaction is to avoid a particular result intended by otherwise-applicable Code provisions.

- The effect of all or part of the steps of the transaction is inconsistent with the underlying intent of the applicable Code provisions.

In Situation 1, form is respected because each step provides for continued ownership in modified corporate form, the steps do not resemble a sale, and none of the interests is liquidated or otherwise redeemed. The nonrecognition treatment that follows form is not inconsistent with the intent of sections 351 and 355.

In Situation 2, the distribution of cash and property is integrated with the reorganization to be consistent with the intent that section 361 apply broadly to transfers in pursuance of the plan of reorganization.

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