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stock and securities to its shareholders, provided the controlling corporation and the active corporation are engaged in an active conduct of trade or business ...

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In a Revenue Ruling, IRS has suspended two 1957 Revenue Rulings pending completion of a study on the active conduct of a trade or business (ATB) requirement under Code Sec. 355(a)(1)(C) and Code Sec. 355(b).

Code Sec. 355(a)(1) provides that, if certain requirements are met, a corporation may distribute stock and securities of a controlled corporation to its shareholders and security holders without recognition of gain or loss of income to the recipient shareholders or security holders. Among those requirements, both the distributing corporation and the controlled corporation must be engaged in the active conduct of

a trade or business immediately after the distribution. Each trade or business must

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*and operational functions. Generally, activities performed by the corporation itself do not include activities performed by persons outside the corporation, including independent contractors. A corporation may satisfy the requirements of this subdivision (iii) through the activities that it performs itself, even though some of its activities are performed by others. Separations of real property all or substantially all of which is occupied prior to the distribution by the distributing or the controlled corporation (or by any corporation controlled directly or indirectly by either of those corporations) will be carefully scrutinized with respect to the requirements of section 355(b) and this §1.355-3.*

*1.355-3(b)(2)(iv)(iv) Limitations. The active conduct of a trade or business does not include—*

*1.355-3(b)(2)(iv)(A)(A) The holding for investment purposes of stock, securities, land, or other property, or*

*1.355-3(b)(2)(iv)(B)(B) The ownership and operation (including leasing) of real or personal property used in a trade or business, unless the owner performs significant services with respect to the operation and management of the property.*

In Rev Rul 57-464, 1957-2 CB 244, IRS held that the separation of a manufacturing business from a group of real estate assets did not satisfy the active trade or business requirement under Code Sec. 355. The group of real estate assets consisted of an old factory building used for storage and four other buildings: a duplex apartment building rented to employees of the corporation, a small office building rented to a single tenant, and two houses, one of which was occupied by a sister-in-law of the president of the corporation. IRS concluded that the use of the old factory building for storage was not in itself the active operation of a business as defined in the regs. The rental activities produced only a nominal rental and negligible net income, and the properties were acquired either as an investment or as a convenience to employees of the manufacturing business.

In Rev Rul 57-492, 1957-2 CB 247, IRS held that a corporation's exploration and

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In commercial ventures, the venture did not include any income-producing activity, or any source of income.

The new guidance stated In Rev Rul 2019-9, IRS suspended Rev Rul 57-464 and Rev Rul 57-492, pending completion of a study. The IRS, as a result of a study, stated that the active trade or business requirement analysis underlying the holdings in Rev Rul 57-464 and Rev Rul 57-492 focuses, in significant part, on the lack of income generated by the activities under consideration. Consequently, these rulings could be interpreted as requiring income generation for a business to qualify as an active trade or business.

During the study, the IRS observed that a significant rise in entrepreneurial ventures whose activities consist of research and development in lengthy phases. During these phases, the ventures often collect no income or negligible income but nonetheless incur significant financial expenditures and perform day-to-day operational and managerial functions that historically have evidenced an "active" business.

For instance, a venture in the the technology field might engage in research to develop new products with the purpose of earning income in the future from sales or licenses. The venture might even forgo current income opportunities to obtain increased future income by developing products on its own. The nature and duration of the research phases is often dictated by regulatory agencies, which require complex review processes that can span multiple years and cost millions of dollars.

The immediate effect of Rev. Rul. 2019-9, would allow for a tax-free distribution of stock and securities to its shareholders, provided the controlling corporation and the active corporation are engaged in an active conduct of trade or business immediately after the distribution occurs. Rev Ruls 57-464 and 57-492, that defined an active trade or business, have been suspended. This suspension has opened the door for many taxpayers that wish to engage in an activity, albeit the activity has a business

purpose, and meets the other requirements outside of the scope of immediately

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