



TaxNewsFlash

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Proposed regulations partially withdrawn: Guidance under section 355 concerning device and active trade or business

The U.S. Treasury Department and IRS today released a [document](#) withdrawing the “per se” device rule for section 355 distributions contained in proposed regulations (REG-134016-15) published in the Federal Register on July 15, 2016.

Specifically, the document withdrew the following portions of the 2016 proposed regulations in response to critical feedback received by the Treasury Department and IRS from stakeholders:

- “Per se” device rule in Prop. Treas. Reg. § 1.355-2(d)(5) under which if the distributing corporation’s or the controlled corporation’s “Nonbusiness Asset Percentage” (generally defined as the fair market value of Nonbusiness Assets divided by the fair market value of all assets, see Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(B)(5)) exceeded certain designated percentages (both individually and in comparison to the other corporation’s Nonbusiness Asset Percentage), the distribution would have been considered a device (and therefore taxable to both the distributing corporation and any recipient shareholders) notwithstanding the presence of any other nondevice factors (such as a corporate business purpose), with limited exceptions.
- Anti-abuse rules in Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(E) and (d)(5)(iv) under which certain transactions 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) generally would not have been given effect if undertaken with a principal purpose of affecting the aforementioned Nonbusiness Asset Percentage of any corporation as it relates to the per se device rule or device factors.
- Anti-abuse rule in Prop. Treas. Reg. § 1.355-9(d) under which certain transactions or series of transactions generally would not have been given effect if undertaken with a principal purpose of affecting the “Five-Year-Active-Business Asset Percentage” (generally the percentage of fair market value of a corporation’s assets that satisfy the active trade or business test under section 355(b) over such corporation’s total assets), which Prop. Treas. Reg. § 1.355-9(b) required to be at least 5% for both the distributing corporation and controlled corporation.

The document states that (1) the withdrawal of those proposed rules does not affect the potential application of other rules or judicial doctrines, such as the substance-over-form or step-transaction doctrines, and (2) the Treasury Department and IRS continue to study the issues addressed in the 2016 proposed regulations. In addition, the document does not withdraw all uses of the Nonbusiness Asset Percentage in the proposed regulations, and maintains other additions to the nature and use device factor, including that ownership of Nonbusiness Assets by the distributing corporation or controlled corporation is evidence of device as is a difference in Nonbusiness Asset Percentages between the distributing corporation and controlled corporation. See Prop. Treas. Reg. § 1.355-2(d)(2)(iv)(C).

The proposed regulations will be partially withdrawn as of the date the document is published in the Federal Register, which is scheduled to be October 21, 2026.

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