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WAS THE SPIN-OFF OF PAYPAL FROM EBAY A TAXABLE OR A TAX-FREE REORGANIZATION?

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In 1995, Pierre Omidyar launched AuctionWeb, a web-based online auction site where buyers and sellers could trade antiques, collectables, coins, and other goods. In 1997, AuctionWeb was renamed eBay, Inc. By 2014, eBay was “a global commerce leader with 149 million active buyers” with more than 700 million live listings at any given time (eBay 2014).

In 1998, Peter Thiel and Max Levchin founded Confinity, Inc. (Confinity), which focused on mobile payments sent from personal digital assistants (Forest 2014; O’Connell 2020; eBay 2023). In 1999, Confinity launched a product that allowed individuals to make electronic payments to each other and to merchants through e-mail. In March 2000, Confinity merged with an online bank, X.com and changed its name to X.com. In October 2000, X.com decided to discontinue its online banking services and focus on its online payment product. In 2001, X.com changed its name to PayPal, Inc. (PayPal Holdings 2022).

By 2002, approximately 60 percent of PayPal’s business was processing transactions on eBay (eBay 2002). In July 2002, eBay acquired PayPal for approximately \$1.5 billion resulting in the combination of eBay’s online marketplace with PayPal’s online payments system (eBay 2023). In 2015, eBay spun off PayPal. As two independent publicly traded companies, eBay operated its marketplace business and PayPal operated eBay’s payments business (eBay 2014).

What would have been the U.S. tax and non-tax consequences of eBay’s spin-off of PayPal for eBay, PayPal, and eBay’s shareholders?

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The Company

eBay, Inc.

In 1995, Pierre Omidyar launched AuctionWeb, a site “dedicated to bringing together buyers and sellers in an honest and open marketplace” (eBay 2023). AuctionWeb pioneered person-to-person trading by developing a web-based online community where buyers and sellers could trade new and used goods in an auction format (eBay 1998). In 1995, Mark Fraser purchased the first item listed on AuctionWeb, which was a broken laser pointer (eBay 2023).

In 1995, AuctionWeb was formed as a sole proprietorship and was incorporated in California in 1996 (eBay 1998).

In 1996, \$7.2 million worth of goods was sold on AuctionWeb. In May 1997, the millionth item, a Big Bird jack-in-the-box toy from PBS’ Sesame Street, was sold on AuctionWeb. (eBay 2023, July).

In September 1997, AuctionWeb was renamed eBay and reincorporated in Delaware in 1998. In September 1998, eBay completed its initial public offering (IPO) and began trading on Nasdaq under the symbol EBAY (eBay 1998).

By 2002, PayPal was the preferred electronic payment method of eBay users (eBay 2002). In order not to lose transaction business to PayPal and build its own electronic-payment service, eBay acquired the person-to-person money transfer service, Billpoint, Inc., in 1999 (Richtel 2002).

By 2014, eBay was one of the world’s top 30 global brands and a top 10 retail global brand. eBay had an installed mobile base of 200 million apps that generated \$20 billion in mobile volume. eBay’s cross-border commerce represented 20 percent of its gross merchandise volume and 61

percent of its marketplace's revenue was international (eBay 2014, September). See Exhibit 1 for an eBay picture.

Exhibit 1. eBay's Headquarter

Source: New York Times, 2020



PayPal, Inc.

In August 1998, Peter Thiel met Max Levchin after giving a speech at Stanford University on global market opportunities (O'Connell 2020). In December 1998, they founded Confinity and began to work on digital wallets. The company focused on mobile payments sent from PDAs. In 1999, an employee developed the process of sending money transfers through email (Forest 2014). In 1999 Confinity launched a product that allowed individuals to make electronic payments to each other and to merchants through e-mail.

In 2000, Confinity merged with X.com, an online bank founded by Elon Musk, Harris Fricker, Christopher Payne, and Ed Ho in 1999, and changed its name to X.com. In October 2000, X.com decided to discontinue its internet banking services and to focus on its online payment product. In 2001, X.com changed its name to PayPal (PayPal Holdings, Inc., 2022). See Exhibit 2 for a picture of PayPal.

Exhibit 2. PayPal's San Jose Headquarters

Source: Los Angeles' Times, 2017



By 2002, approximately 60 percent of PayPal's business was eBay transactions (eBay 2002). In February 2002, PayPal completed its IPO and began trading on Nasdaq under the symbol PYPL (O'Connell 2020).

In July 2002, eBay acquired PayPal for approximately \$1.5 billion in a tax-free (tax-deferred), stock-for-stock transaction. PayPal became a wholly owned subsidiary of eBay and operated as an independent brand of eBay; Billpoint was phased out (eBay 2002). With the acquisition of PayPal, eBay, the *"web's largest marketplace,"* was united with an online payments system (eBay 2023).

Concerning the acquisition, eBay stated that payment was *"...a vital function in trading on eBay and integrating PayPal's functionality into the eBay platform..."* would allow buyers and sellers to trade with greater ease, speed, and safety (eBay 2002). eBay's president and chief executive officer (CEO) Meg Whitman stated that *"eBay and PayPal have complementary missions"* and together they could *"...improve the user experience and make online trading more compelling"* (eBay 2002). PayPal CEO Thiel stated that the *"beauty"* of the deal was that it would offer *"...our communities' new tools and flexibility to do more business"* and that the integration of the companies' services was *"...a win-win situation for millions of current and future online consumers"* (eBay 2002).

In 2014, PayPal processed four billion payments for a total payment volume of \$235 billion and generated over \$8 billion in revenues. It had 169 million active customer accounts in 203 markets. PayPal's customers were paid in more than 100 currencies, could withdraw funds from their bank accounts in 57 currencies, and held balances in their PayPal accounts in 26 currencies (PayPal 2015, July).

Pre-Spin-Off Timeline

In January 2014, eBay received a notice from one of its shareholders, Carl Icahn, proposing the spin-off of PayPal into a separate business from eBay. In response to the proposal, eBay stated that its board of directors routinely assessed eBay's strategic direction and had previously explored a spinoff or separation of PayPal. As part of its assessments, the board of directors concluded that eBay and its shareholders were best served by the current strategic direction and did not believe that separating eBay and PayPal was *"...the best way to maximize shareholder value"* (eBay 2014). Further, as part of eBay, PayPal was able to *"leverage the company's technology capabilities, commerce platforms and relationships with retailers, brands and large merchants worldwide"* (eBay 2014). Additionally, PayPal drove commerce innovation in payments at a global scale, which created value for consumers, merchants, and shareholders (eBay 2014, January).

In February 2014, Mr. Icahn (see Exhibit 3) issued a letter to eBay's shareholders stating that the separation of eBay and PayPal would allow investors to clearly see the value of sustainable double-digit growth at PayPal and eBay's strong recurring cash flows (Icahn 2014).

Exhibit 3. Carl Icahn, eBay Shareholder

Source: New York Times 2014



In March 2014, eBay CEO John Donahoe stated in response to Carl Icahn’s proposal that the separation of eBay and PayPal was a bad idea, that they were stronger together and would grow better together than apart. He also stated that PayPal was not being held back by being part of eBay, and eBay’s marketplace was not being held back by being part of PayPal (Bensinger 2014).

Also in March 2014, eBay’s board of directors issued a letter to eBay shareholders stating that shareholders and customers were *“best served by keeping PayPal and eBay together”* (eBay 2014, March). The board stated that eBay and PayPal were better together because:

- PayPal grew faster because of eBay;
- eBay accelerated PayPal’s success;
- Data sharing led to more profitable growth;
- eBay provided efficient capital for PayPal; and
- Commerce and payments were converging.

Although the board stated that keeping PayPal as part of eBay was the *“right plan for today,”* it would continue to review eBay’s strategy and legal structure with the best long-term interests of shareholders *“clearly in mind”* (eBay 2014, March).

When Mr. Icahn in April 2014 withdrew his proposal, he stated that he continued *“...to believe that eBay would benefit from the separation of PayPal at some point in the near future”* and that

he intended to continue to “press” his case through discussions with eBay (eBay 2014, September).

Spin-Off Timeline

Despite eBay’s stated resistance to splitting the company, on September 30, 2014, eBay announced that after a strategic review of eBay’s growth strategies and structure, its board of directors had approved a plan to separate eBay and PayPal into independent publicly traded companies in 2015. PayPal would operate eBay’s payment business and eBay would operate the marketplace business. The Company stated that the creation of two businesses would “...best position eBay and PayPal to capitalize on their respective growth opportunities in the rapidly changing global commerce and payments landscape...” and was the best path for creating shareholder value (eBay 2014). See Exhibit 4.

As part of its strategic review, the board concluded that the spin-off would “create sharper strategic focus and better position each business to capitalize” on growth opportunities. Further, eBay and PayPal would “...benefit more and create greater value from the strategic focus, speed, flexibility and agility...” that could come with being separate companies (eBay 2014, September).

Concerning the spin-off, eBay CEO Donahoe stated that eBay and PayPal would be “...sharper and stronger, and more focused and competitive as leading, standalone companies in their respective markets” (eBay 2014, September).

Also, as independent companies, they would enjoy “...flexibility to pursue new market and partnership opportunities” (eBay 2014, September). According to Mr. Donahoe, “The nice thing about the spin-off is that it allows eBay to keep its own profits and reinvest [them] in the business” and control its own destiny (Bertoni 2014).

Additionally, Mr. Donahoe stated that one of the objectives of the spin-off was to give PayPal the “*maximum flexibility to work with whomever [it] would like*” (Baig 2014).

About the spin-off, Mr. Icahn stated that he was “*happy*” that eBay’s board and management acted responsibly, but that they had acted “*a little later than they should have, but earlier than*” he expected (Bensinger *et al.* 2014).

Exhibit 4. eBay Spin-Off of PayPal

Source: eBay, Inc.



Reasons for Spin-Off

According to eBay, some of the reasons for the spin-off included:

- PayPal’s management would be able to exclusively focus on its payments business and eBay’s management would be solely dedicated to growing its marketplace business;
- Each company’s decision-making process would be sped up, thus allowing each one to adapt more quickly to the changing market and the customer dynamics of their markets;
- Each company would have increased flexibility to pursue new partnerships and strategic opportunities that were not previously available;
- Each company could implement a capital structure appropriate to its strategy and business needs without competing with each other for investment capital;
- Each company would have direct access to capital markets;
- Investors could separately value eBay and PayPal as distinct investments; and
- Investors would have two distinct investment opportunities (eBay 2015).

Spin-Off Transactions

As part of the spin-off process, in January 2015, eBay incorporated PayPal Holdings, Inc. On June 26, 2015, eBay and PayPal Holdings entered into a separation and distribution agreement. By the end of June 2015, eBay transferred substantially all of PayPal's assets and liabilities to PayPal Holdings. PayPal Holdings became the parent company of PayPal and directly and indirectly held all of PayPal's assets and liabilities.

On July 17, 2015, eBay distributed, on a pro rata basis, 100 percent of PayPal Holdings' outstanding common stock to eBay shareholders. Each eBay shareholder received one share of PayPal Holdings common stock for every share of their eBay common stock. Approximately 1.2 billion shares of PayPal Holdings common stock were distributed to eBay shareholders (Distribution). eBay's shareholders did not pay consideration for their PayPal Holdings shares and did not exchange their eBay shares for their PayPal Holdings shares. After the Distribution, eBay's shareholders owned stock in both eBay and PayPal Holdings (PayPal 2015, October).

On July 20, 2015, PayPal Holdings announced that it had completed its separation from eBay and was an independent public company.

On the same day, its common stock began trading on Nasdaq under its prior symbol PYPL. On the first day of trading, PayPal's stock closed up 5.4 percent for a market capitalization of \$47.13 billion, which was more than eBay's value at the time - \$34.7 billion (Tsukayama 2015).

Post Spin-Off

Devin Wenig became the CEO of eBay and Dan Schulman became the CEO of PayPal Holdings (eBay 2014, September). After the spin-off, Mr. Schulman stated that: *“As an independent company, [PayPal Holdings sees] a tremendous opportunity...to expand our role as a champion for consumers and partner to merchants, and to help shape the industry as money becomes digital at an increasingly rapid pace”* (PayPal 2015, July). He also stated that PayPal Holdings was *“unique”* and was focused on leveraging its strengths to drive long-term growth for the company and its shareholders (PayPal 2015, July). Further, he stated that PayPal Holdings had *“a singular focus on digital payments, deep commitment to customer service, a dive for innovation and technology agnostic platform that creates value for our consumers and merchants...”* (PayPal 2015, July). See Exhibit 5.

Exhibit 5. CEO Dan Schulman, PayPal

Source: eBay, Inc.



As part of the spin-off, eBay and PayPal Holdings entered into an operating agreement with PayPal Holdings continuing to process eBay’s payments (eBay 2015, July). In 2018, eBay announced that it had replaced PayPal Holdings as its primary payments processing provider with Adyen, NV, an online payment company. After July 2023, payments to eBay sellers would

be deposited directly into their bank accounts, rather than processed by PayPal Holdings and PayPal Holdings would not be option for payment by eBay buyers (eBay 2018, January).

Was the Spin-Off Successful?

PayPal Holdings, Inc. and Its Shareholders

Prior to the spin-off, PayPal Holdings' annual revenue in 2014 was \$8.025 billion, it processed 3.96 million payments, and its active user accounts were 162 million and total payment volume (TPV) was \$234 billion. When it was spun-off in 2015, PayPal Holdings' annual revenue was \$9.2 billion, a 15 percent increase over 2014. It processed 4.9 million payments, 24 percent growth over 2014. PayPal Holdings' active user accounts increased by 22 percent from 2014 to 179 million (PayPal 2016).

In 2022, PayPal Holdings revenue was \$27.5 billion, 41 percent increase from 2014. Its TPV was \$1.36 trillion, 59 percent over 2014. PayPal Holdings processed, 22.3 billion payments, 21 percent increase from 2014. Its number of active customer accounts was 435 million, 22 percent over 2014 (PayPal 2023).

If a person had invested \$1,000 on the day PayPal Holdings stock began to be publicly traded on July 20, 2015, the person's investment would have grown to \$7,460 when it closed at its all-time high of \$308.53 on July 23, 2021. However, on March 21, 2023, with PayPal Holdings' stock trading at \$73, the \$1,000 investment would have been \$1,765 (Sun 2023).

eBay, Inc.

Prior to the spin-off, eBay's annual revenue was \$17.902 billion for 2014, which decreased to \$8.592 billion for 2015, a 52 percent decrease. In 2022, eBay's annual revenue was \$9.813 billion, a 45 percent decrease from 2014 (eBay 2015, February; eBay 2016; eBay 2023)

Appendix A. U.S. Tax Concepts

Sources: U.S. Code: Title 26: Subtitle A-Income Taxes

Title 26 of the Code of Federal Regulations (26 CFR) Divisive Type D Reorganizations

26 U.S.C. § 368(a)(1)(D) provides for the tax-deferred treatment, commonly called tax-free treatment, of a transfer by one corporation (Transferor) of all or part of its assets to another corporation, with the Transferor and/or its shareholders in control of the other corporation (Controlled) immediately after the transfer. Following the transfer and pursuant to a plan, Controlled's stock or securities must be distributed in a transaction that meets the requirements of Sections 354, 355, or 356. If the requirements of both Sections of 368(a)(1)(D) and 355 are the reorganization is called a divisive Type D reorganization.

Overview Divisive Type D Reorganizations

In a divisive Type D reorganization, a corporation (Distributing) transfers part of its assets to another corporation (Controlled) and then Controlled's stock is distributed, pursuant to Section 355, in either a spin-off, split-off, or split-up transaction. In other words, for a transaction to qualify as a tax-free divisive Type D reorganization, the requirements of both Sections of 368(a)(1)(D) and 355 must be met.

To qualify as a tax-free divisive Type D reorganization, the following statutory requirements must be met:

- A corporation (Distributing) must distribute only stock of the controlled corporation (Controlled) to its shareholders;
- Distributing must distribute enough of Controlled's stock to constitute control of Controlled;
- Both Distributing and Controlled must be engaged in an active trade or business immediately after the transaction;
- The distribution must not be a device to distributed earnings and profits (E&P);
- There is not a disqualified distribution; and
- There is not a prohibited acquisition.

In addition to the above statutory requirements, the division also must be meet the requirements of one of the transactions below.

In a spin-off transaction, distributing transfers some of its assets to a newly created corporation that it controls (Controlled) in exchange for Controlled's stock, which is distributed to Distributing shareholders, who are not required to exchange their Distributing stock for Controlled's stock. After the spin-off, Distributing's shareholders own stock in both Distributing and Controlled.

In a split-off transaction, distributing transfers some of its assets to a newly created corporation that it controls (Controlled) in exchange for Controlled's stock, which is distributed to Distributing's shareholders in exchange for all of their Distributing stock. After the split-off, Distributing's shareholders only own Controlled stock.

In a split-up, distributing transfers its assets to two or more corporations it controls. The stock of both Controlled corporations is distributed to Distributing's shareholders and distributing liquidates.

The transaction must also meet the following non-statutory requirements:

- The transaction must be carried out pursuant to a plan of reorganization;
- The must be a corporate business purpose for the transaction;
- There must be continuity of shareholder interest before and after the transaction (COI); and
- There must be continuity of business enterprise (COBE).

Statutory Requirements

i. Control Requirement

First, under the control requirement, Distributing must control the corporation (Controlled) it is transferring assets to prior to the transaction, meaning that Distributing must own prior to the asset transfer at least 80 percent of the total combined voting power of all classes of Controlled's voting stock and at least 80 percent of the total number

of Controlled's shares of all other classes of stock. Second, Distributing must distribute to its shareholders at least an amount Controlled stock that constitutes control, meaning that Distributing's shareholders must own after the distribution at least 80 percent of the total combined voting power of all classes of Controlled stock entitled to vote and at least 80 percent of the total number of Controlled shares of all other classes of stock. (Internal Revenue Service Revenue Procedure 2016-40).

ii. Active Trade or Business Requirement

Under 26 U.S.C. § 355(b), both Distributing and Controlled must be engaged in an active trade or business immediately after the division. Both corporations must have conducted the active trade or business during the five-year period before the division. Also, the active trade or business cannot have been acquired in a taxable transaction during the five-year period before the division. Further, neither Distributing nor Controlled can have acquired control, directly or indirectly, over the corporation conducting the trade or business in a taxable transaction during the five-year period before the transaction. (26 U.S.C. §§ 355(a)(1)(C) and (b)).

Treas. Reg. § 1.355-3(b)(2)(ii) provides that a corporation is treated as engaged in a trade or business immediately after the division if the corporation is carrying on activities for the purpose of earning income or profit and the activities are included in every operation that forms a part or a step in the process of earning income or profit. The activities ordinarily include the collection of income and the payment of expenses.

Treas. Reg. § 1.355-3(b)(2)(iii) provides that a trade or business is actively conducted if the corporation performs active and substantial management and operational functions, which generally does not include activities performed by persons outside the corporation, such as independent contractors. The active conduct of a trade or business does not include holding stock, securities, land, or other property for investment purposes. Also, it does not include the ownership and operation of real or personal property used in a trade or business, unless the owner performs significant services to operate and manage the property.

iii. Device Requirement

26 U.S.C. § 355(a)(1)(B) provides that the division cannot be used principally as a device to distribute either Distributing's or Controlled's E&P. Some examples of factors that are considered evidence of a device include:

- A distribution that is pro rata or substantially pro rata among Distributing's shareholders;
- A sale or exchange of Distributing's and/or Controlled's stock after the division; and
- The existence of assets that are not used in a trade or business, such as cash and other liquid assets that are not related to the reasonable needs of a business. (Treas. Reg. § 1.355-2(d)(2)).

Some examples of factors that are not considered evidence of a device include:

- The corporate business purpose of the division; and
- Distributing is a publicly traded company and has no shareholder who is directly or indirectly the beneficial owner of more than five percent of any class of stock. (Treas. Reg. § 1.355-2(d)(3)).

iv. Disqualified Distribution Requirement

Although generally Distributing does not recognize gain in a qualified divisive Type D reorganization, under Section 355(d), Distributing, but not the shareholders, will recognize gain on a disqualified distribution of Controlled's stock or securities. A disqualified distribution is a Section 355 distribution where immediately after the division, a shareholder holds stock representing a 50-percent or greater interest, by vote or value, in either Distributing or Controlled that is attributable to stock or securities acquired by purchase during the five-year period ending on the distribution date. (Treas. Reg. § 1.355-6(b)).

The term purchase is defined as an acquisition of stock or securities of Distributing or Controlled for cash, marketable securities, or debt. But the term purchase does not include situations such as the acquisition of the stock or securities was from someone who died, or the acquisition was one in which the basis of the stock or securities was based on the former owner's basis in the stock and securities. (Treas. Reg. § 1.355-6(d)).

v. Prohibited Acquisition Requirement

Generally, Distributing does not recognize gain in a qualified divisive Type D reorganization. However, under Section 355©, Distributing, but not the shareholders, will recognize gain if the Section 355 distribution is part of a plan or a series of transactions pursuant to which one or more persons acquire stock equaling at least a 50-percent interest, by vote or value, in Distributing or Controlled. (Treas. Reg. § 1.355-7(a)). Distributing will recognize gain in the amount it would have recognized if it had sold Controlled stock for its fair market value (FMV) on the date of the distribution.

Whether there is a plan or series of transactions is based on all facts and circumstances. (Treas. Reg. § 1.355-7(b)(1)). Under Section 355(e)(2)(B), there is a rebuttable presumption that any acquisition two years before or after a Section 355 distribution is part of a plan, including the distribution.

Non-Statutory Requirements

i. Plan of Reorganization Requirement

The division must be carried out pursuant to a plan of reorganization that is adopted by each corporation that is a party to the transaction. (Treas. Reg. §§ 1.368-1(c) and 1.368-3(a)). If it can be established by other evidence, the plan does not have to be in a particular form or in writing. (C.T. Investment Co. v. Commissioner, 88 F2d 582 (8th Cir. 1937); James G. Murrin v. Commissioner, 24 TC 57 (1955)).

ii. Business Purpose Requirement

Other than avoiding federal income taxes, there must be at least one valid corporate business purpose for the division. Treas. Reg. § 1.355-2(b)(2) states that a “corporate business purpose is a real and substantial non-Federal tax purpose germane to the business...” of Distributing or Controlled. A shareholder’s purpose, such as for the shareholder’s personal planning, is not a corporate business purpose. However, if a shareholder’s purpose for the division may be “so nearly coextensive with the corporate business purpose,” the division may be considered to be carried for a sufficient corporate purpose. (Treas. Reg. § 1.355-2(b)(2)).

One example of a valid business purpose is a corporation dividing two businesses to protect one business from the risks of the other business (Treas. Reg. § 1.355-2(b)(5) Ex. 3). Another example of a valid business purpose is two owners of a corporation that operates two businesses decide to split the business because each of them will be able to devote their undivided attention to the business they are more interested in and proficient at. (Treas. Reg. § 1.355-2(b)(5) Ex. 2). Some other valid business purposes include a distribution made to facilitate a borrowing by Distributing or Controlled or reducing Distributing’s or Controlled’s costs. (Rev. Proc. 96-30, 1996-1 CB 696 (April 22, 1996)).

iii. Continuity of Interest Requirement

Under Treas. Reg. § 1.355-2(c)(1), Distributing’s historic shareholders before the division must maintain COI in both corporations for a period of time after the division. Each historic shareholder is not required to own an equity interest in both corporations after the division. Rather, after the division, one or more the historic shareholders must own in the aggregate (together) an amount of stock establishing continuity in both Distributing and Controlled. (Treas. Reg. § 1.355-2(c)(1)). Based Treas. Reg. § 1.355-2(c) examples, aggregate ownership by the historic shareholders of 20 percent of both corporations’ stock after the division may not be enough, but aggregate ownership of 50 percent may be enough to constitute continuity of interest in both corporations after the division.

For example, individuals A and B, who together own 100 percent of corporation X, divide X into two corporations, X and Y, with A owning 100 percent of X and B owning 100 percent of Y. Even though after the division A and B do not own stock in both corporations, the continuity of interest requirement has been met because together, as historic shareholders, they own an amount of stock to establish continuity of interest in each corporation. In other words, after the division, A owns at least 50 percent of X’s stock and B owns at 50 percent of Y’s stock, and together they own more than 50 percent of both X and Y. However, if after the division, A owns 20 percent of X and B owns 60 percent of Y, the COI requirement is not met because even though together they own 80 percent of X and Y, A does not own at least 50 percent of X to constitute COI in X. (Treas. Reg. § 1.355-2(c)(2) Exs. 1 and 4.).

There are not specific rules about how long the historic shareholders must hold their Distributing and Controlled stock after the division without violating the COI requirement. However, the Internal Revenue Service (IRS) has recognized that a disposition of stock after five years of ownership does not violate the COI. (Rev. Rul. 78-142, 1978-1 C.B. 111) The courts have recognized that a disposition after nine months did not violate COI, (Penrod v. Commissioner, 88 T.C. 415 (1987)) but a disposition of stock after seven months violated COI. (McDonald's Restaurants of Illinois v. Commissioner, 688 F.2d 520 (7th Cir. 1982)).

iv. Continuity of Business Enterprise Requirement

After a division, both Distributing and Controlled must meet the COBE requirement, meaning that each of the corporations must continue at least one of their historical businesses or use a significant portion of their historic business assets in a business. Generally, the determination of the portion of a corporation's assets considered "significant" is based on the relative importance of the assets to the operation of the business. (Treas. Reg. § 1.368-1(d)).

Tax Consequences in Qualified Divisive Type D Reorganizations

i. Tax Consequences for Distributing Corporation's Shareholders

In a divisive Type D reorganization, Distributing's shareholders do not recognize gain or loss or dividend income on receiving Controlled's stock. But they do recognize taxable income to the extent of the amount of cash and other property (boot) they receive as part of the reorganization. (26 U.S.C. § 355(a)).

However, if Distributing's shareholders receive boot and do not surrender their Distributing stock, which occurs in a spin-off, the boot is first taxed as a dividend to the extent of Distributing's E&P. Then, the amount of the boot that exceeds Distributing's E&P is taxed as a capital gain to the extent it exceeds the basis of the shareholders' Distributing stock. (26 U.S.C. § 301).

For example, as part of a spin-off, Distributing distributes to its shareholders Controlled stock pro rata with \$60 cash (boot) and the shareholders do not surrender their Distributing stock. Distributing's E&P is \$10 and Distributing shareholders' basis in their Distributing stock is \$20. Because Distributing's E&P is \$10, only \$10 of the \$60 boot is taxed as a dividend to Distributing's shareholders. After subtracting the \$10 tax as a dividend from the \$60 boot, \$50 remains of the \$60 boot (\$60 boot - \$10 taxed as a dividend = \$50). The \$50 remaining of the \$60 boot exceeds Distributing shareholders' stock basis by \$30 (\$50 remaining of the boot - \$20 Distributing shareholders' stock basis = \$30). This \$30 is taxable as a capital gain to Distributing shareholders.

Distributing shareholders' basis in their Controlled stock is based on their adjusted basis in their Distributing stock. In a spin-off, Distributing shareholders' aggregate basis in their Controlled stock equals their basis in their Distributing stock plus any amount treated as a dividend or recognized as a gain minus the amount of money and the fair market value (FMV) of other property received (boot) in the division (Distributing stock basis + dividend + recognized gain - money received - other property (boot) received = Distributing shareholders' basis in their Controlled stock).

If Distributing shareholders do not surrender their Distributing stock, as in a spin-off, they allocate their basis, calculated using the above formula, between their Distributing and Controlled stocks in proportion to their FMV. (26 U.S.C. §§ 358(a) and (b); Treas. Reg. § 1.358-2(a)).

For example, prior to a qualified divisive Type D spin-off reorganization, a Distributing shareholder's basis in his or her one share of Distributing stock was \$200 and had owned it for two years. In the spin-off, distributing shareholder received one share of Controlled stock with a \$100 FMV and no boot. Distributing shareholder's aggregate basis is \$200 (\$200 Distributing stock basis + \$0 dividend + \$0 recognized gain - \$0 cash - \$0 of other property = \$200). Because Controlled stock's FMV of \$100 is half of the basis of shareholder's Distributing stock before the division, the shareholder's \$200 basis, as calculated above, is divided in half, with \$100 allocated to each share of Distributing and Controlled stock. The Distributing shareholder's holding period in the Controlled stock equals the two-year holding period of the Distributing share.

If Distributing shareholders held their Distributing stock as a capital asset, their holding period in their Controlled stock includes their holding period in their Distributing stock. (26 U.S.C. § 1223(1)).

Distributing shareholders' basis in boot received is its FMV on the date of the distribution and the holding period for the boot begins on the date of the distribution. (26 U.S.C. §§ 358 and 1223(1)).

ii. Tax Consequences for Distributing Corporation

In a divisive Type D reorganization, Distributing will recognize no gain or loss on the transfer of its assets to Controlled and on the distribution of Controlled stock to Distributing's shareholders. (26 U.S.C. §§ 361(a), 361(c), and 357(a)).

Also, if distributing receives boot (cash or other property) from Controlled and distributes the boot to Distributing's shareholders, it will not recognize gain or loss.

Except for Distributing's E&P, its tax attributes, such as net operating losses (NOLs), do not transfer to Controlled after the division. Distributing's E&P is allocated between Distributing and Controlled generally in proportion to the value of the retained and transferred assets (Treas. Reg. § 1.312-10(a)).

iii. Tax Consequences for Controlled Corporation

In a divisive Type D reorganization, controlled will not recognize gain or loss on receiving Distributing's assets. (26 U.S.C. §§ 1032(a) and 357(a)). Controlled's basis in the assets it receives from Distributing equals Distributing's basis in those assets immediately prior to the division. (26 U.S.C. § 362(b)). Controlled's holding period in Distributing's assets includes the period Distributing held those assets. (26 U.S.C. § 1223(2)).

Tax Consequences in Non-Qualified Divisive Type D Reorganizations

If a division does not satisfy the requirements of a tax-free divisive Type D reorganization, the division is taxable to Distributing and its shareholders. Distributing shareholders receipt of Controlled's stock is taxed either as a dividend or as a gain as if a stock redemption had occurred. (26 U.S.C. §§ 301 and 302). If the division is a spin-off transaction, Distributing will be taxed as if it had sold its assets to Controlled for their FMV.

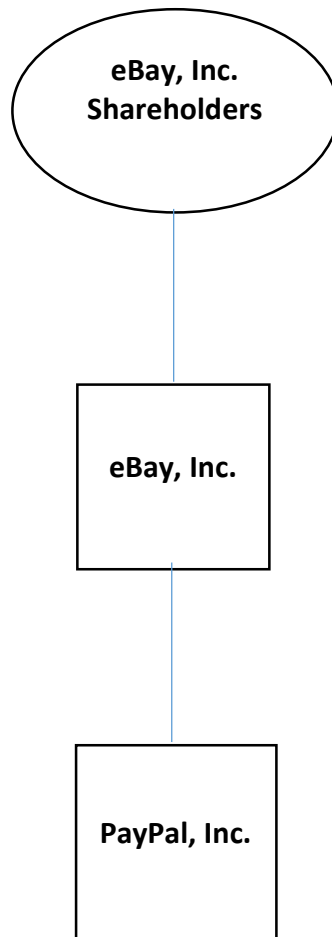
Appendix B. Spin-Off Timeline

Sources: Authors' Note

TIME	EVENT
1995	Pierre Omidyar launched AuctionWeb
1996	AuctionWeb incorporated in California
1997	AuctionWeb renamed eBay, Inc. (eBay)
1998	eBay completed its initial public offering (IPO) and began trading on Nasdaq under the symbol "EBAY" Peter Thiel and Max Levchin founded Confinity, Inc. (Confinity)
1999	A Confinity employee developed the process of sending money transfers through email. Confinity launched a free email-driven, person-to-person payment product. Elon Musk, Harris Fricker, Christopher Payne, and Ed Ho founded online bank, X.com
3/2000	Confinity merged with X.com and renamed X.com. X.com decided to discontinue its internet banking services and focus on its online payment product
2001	X.com changed its name to PayPal, Inc. (PayPal)
2002	PayPal completed its IPO and began trading on Nasdaq under the symbol "PYPL." PayPal acquired by eBay for approximately \$1.5 billion and became a wholly owned subsidiary of eBay
1/2014	eBay shareholder, Carl Icahn proposed spinning off PayPal from eBay
2/2014	In response to Carl Icahn's proposal, eBay board of directors stated that a separation of eBay and PayPal would not best serve eBay shareholders and eBay's current strategic direction
3/2014	eBay's board of directors issued a shareholder letter stating that eBay's shareholders and customers were not best served by separating eBay and PayPal
4/2014	Carl Icahn withdrew his proposal to spin-off PayPal from eBay
9/2014	After a strategic review of eBay's growth strategies and structure, eBay's board of directors approved a plan separating eBay and PayPal with PayPal operating eBay's payments business and eBay operating its marketplace business (spin-off)
6/2015	eBay incorporated PayPal Holdings, Inc. (PayPal Holdings) eBay and PayPal Holdings entered into a separation and distribution agreement. eBay transferred substantially all of PayPal's assets and liabilities to PayPal Holdings PayPal Holdings became the parent company of PayPal, holding directly and indirectly all of PayPal's assets and liabilities
7/17/2015	eBay distributed, on a pro rata basis, 100 percent of PayPal Holdings' outstanding common stock to eBay shareholders. Approximately 1.2 billion shares of PayPal Holdings common stock distributed to eBay shareholders. Each eBay shareholder received one share of PayPal Holdings common stock for every share of their eBay common stock and did not exchange their eBay stock for their PayPal Holdings stock. After the spin-off, eBay shareholders owned stock in both eBay and PayPal Holdings
7/20/2015	PayPal Holdings announced that it had completed its separation from eBay and was an independent public company. PayPal Holdings' common stock began trading on Nasdaq under the symbol "PYPL"
2018	Ebay announced it was replacing PayPal Holdings as its primary payment processor with Adyen, NV, an online payment company
2023	eBay announced that payments to eBay sellers would be deposited directly into their bank accounts, rather than processed by PayPal Holdings and PayPal Holdings would not be option for payment by eBay buyers

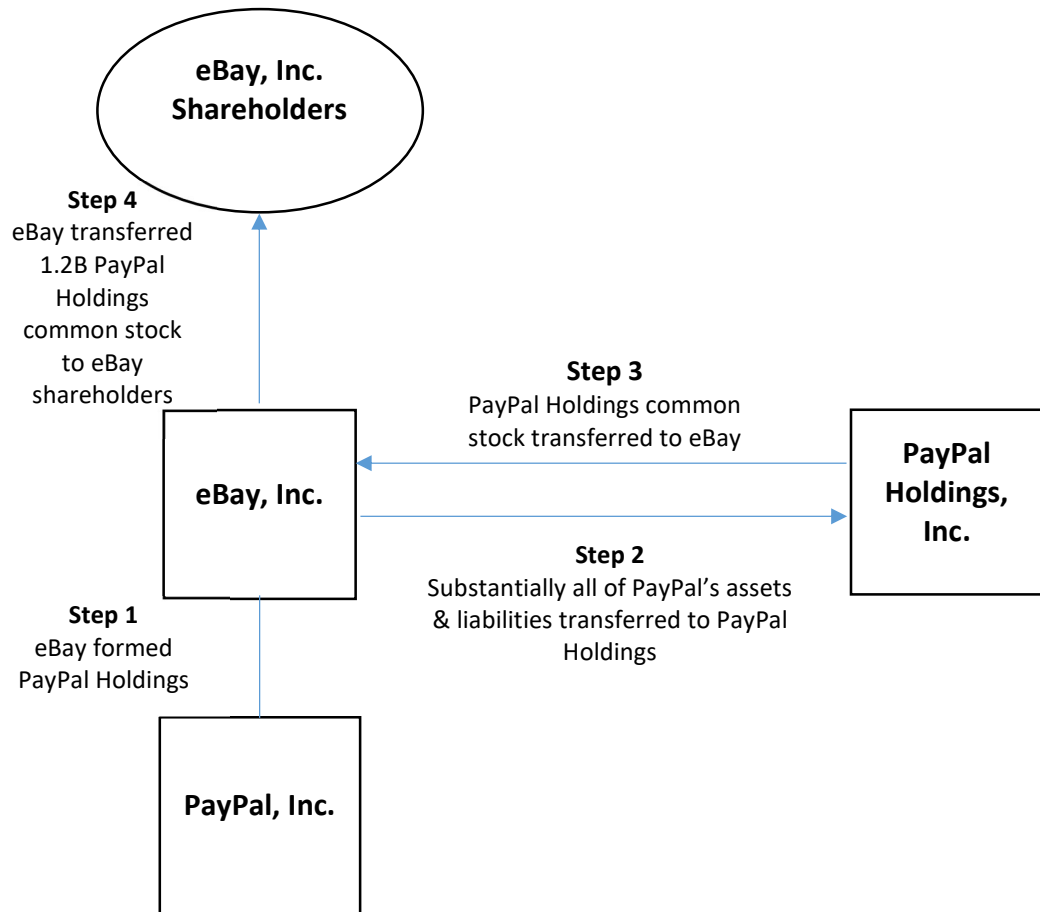
Appendix C. Pre-Spin-Off

Sources: Authors' Note



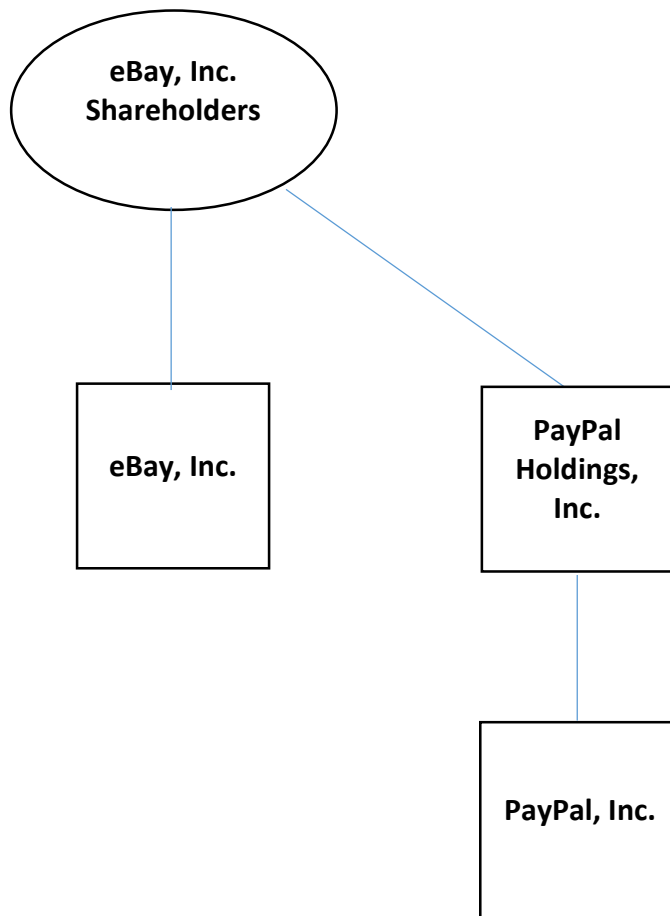
Appendix D. Spin-Off Transaction

Sources: Authors' Note



Appendix E. Post Spin-Off Transaction

Sources: Authors' Note





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