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February 4, 2015

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
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The Honorable John Koskinen
Commissioner
Internal Revenue Service
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Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
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Re: **Report on The Gross Receipts Test of Section 165(g)(3)(B)**

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report (the "Report") of the Tax Section of the New York State Bar Association. The Report provides comments regarding the gross receipts test in section 165(g)(3)(B) (the "Gross Receipts Test").

By way of background, Section 165(g)(3) generally permits an ordinary deduction for a loss sustained by a parent corporation ("Parent") on its investment in the stock of a subsidiary ("Subsidiary") if (i) Subsidiary's stock becomes worthless during the taxable year, (ii) Parent owns stock of Subsidiary meeting the requirements of section 1504(a)(2), and (iii) Subsidiary satisfies the Gross Receipts Test.

We do not advocate far-reaching changes to the rules governing the Gross Receipts Tests. Rather, we recommend relatively modest changes to applicable regulations and the Internal Revenue Service's procedures governing the application of the Gross Receipts Test to improve visibility and consistency and to promote administrability. Accordingly, this Report makes the following recommendations:

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A. The Internal Revenue Service (the "Service") and the U.S. Department of the Treasury (the "Treasury Department") should issue a revenue procedure to (a) confirm that the Parent can establish Subsidiary's gross receipts history using the best available evidence for as many years as evidence is available using reasonable efforts; and (b) provide factors for applying that standard. We believe that these factors should include whether a year precedes (a) the normal record retention period (say, seven years); and (b) an acquisition of the stock of Subsidiary from an unrelated person. It may be appropriate for the guidance to give this latter factor additional weight where the acquisition resulted in Parent having a cost basis in Subsidiary stock, thereby providing a cleaner break between the shareholder claiming the WSD and Subsidiary's pre-acquisition operations.

B. The Service and the Treasury Department should issue guidance as to whether certain common items create receipts for purposes of the Gross Receipts Test (e.g., proceeds from a stock issuance, receipt of loan proceeds, stock and "boot" received in tax-free or partially tax-free exchanges, etc.). Such guidance should confirm the treatment of these items which, based on our experience, generally have been applied by taxpayers and the Service in practice.

C. The Service and Treasury Department should publish guidance clarifying that receipts which would otherwise be characterized as passive will instead be considered to be active if the provision of business services or a business product developed, manufactured, distributed, or marketed by Subsidiary to the payor is a material factor in the generation of the receipts.

D. The Service and the Treasury Department should consider issuing guidance characterizing otherwise passive receipts as active in certain other circumstances. For example, such guidance could provide for receipts to be treated as active where disposition of the underlying right to receive the receipts would generate ordinary gain or loss. In addition, consideration should be given to issuing guidance definitively addressing the treatment of investment income of banking and insurance Subsidiaries as active or passive receipts.

E. The Service and the Treasury Department should issue guidance confirming that a successor succeeds to the gross receipts history of a predecessor and defining a successor as the acquiring corporation in a section 381 transaction as defined in Reg. § 1.381-1(b)(2). Further, guidance should be considered clarifying how the duplication of gross receipts is eliminated following a section 381 transaction, for example by treating the successor and the predecessor as if they had always been a single corporation and disregarding prior transactions between them.

F. The Service and the Treasury Department should issue guidance confirming that the Distributive Share Approach (as defined in the Report) is applied to allocate partnership gross receipts to the partners. Such guidance also should specify that, applying anti-duplication principles, distributions from partnerships do not create gross receipts, except potentially to the extent that the partner recognizes gain upon the distribution pursuant to section 731. Consideration should be given as to whether and to what extent, at least in certain circumstances, the disposition of a partnership interest should be treated as the disposition of an allocable share of the partnership's assets or as the disposition of a security within the meaning of section 165(g)(2) for Gross Receipts Test purposes. One construct which seems appropriate is to apply rules similar to the rules of section 731(c), varying the treatment of a disposition of a partnership interest depending on the proportion of passive or active assets held by the partnership.

G. The Service and the Treasury Department should issue Regulations providing rules specifying whether, in what circumstances, and how the "Look-Through Approach" (defined in the Report) applied by the Service in several private letter rulings ("PLRs") should be applied in the context of intercompany transactions between members of a consolidated group.

H. We believe that a limited Look-Through Approach for all intercompany distributions (whether dividends or distributions in excess of earnings and profits ("E&P")) is justifiable and administrable. However, the Service and the Treasury Department should adopt a Receipts Approach (as defined in the Report) rather than an Earnings Approach (as defined in the Report) when applying the Look-Through Approach to intercompany distributions.

I. We do not favor the adoption of a broad Look-Through Approach to all intercompany transactions, principally because of adminstrability concerns. If, contrary to our recommendation, a Look-Through Approach for all intercompany transactions is generally adopted, we believe that there should be an exception for ordinary course transactions (such as product sales between a manufacturing member and a distributor member). In addition, it would be appropriate to provide a further exception from the Look-Through Approach for consolidated groups that, as a whole, have only a small amount of passive receipts from transactions with non-members.

J. We do not favor applying a Look-Through Approach to intercompany transactions outside of the consolidated group context.

K. The Service and Treasury Department should consider adopting a subgroup approach to applying the Gross Receipts Test to a consolidated Subsidiary, treating the applicable subgroup of consolidated members of which the Subsidiary is the subgroup parent as if it were a single corporation.

We appreciate your consideration of our recommendations.

Respectfully submitted,

David H. Schnabel
Chair

Attachment

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