

REPORT #872

TAX SECTION

New York State Bar Association

Letter Objecting to the Effective Date

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New York State Bar Association

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March 22, 1996

The President
 The White House
 Washington, D.C. 20500

Dear Mr. President:

We are deeply concerned about the increasing use of immediate effective dates for legislative proposals that change fundamental tax rules in non-abusive situations. While we do not take issue with the use of early effective dates in the case of abusive transactions that produce unintended benefits under the law, the Administration's budget proposals for fiscal year 1997 reflect several situations in which the setting of early effective dates is, in our judgment, completely inappropriate.

Some of the tax proposals reflect concepts previously considered by the Congress, but many have not been so considered, and have not been embodied in any legislation passed by Congress or approved by any Committee of the Congress. Some of the latter provisions are designed to deal with abusive transactions that produce unintended benefits under existing law, but others reverse long-standing rules of law that Congress had implicitly or explicitly approved.

For example, the proposals contain a provision that would overturn the commonly-used restructuring method by which a corporation (1) spins off a subsidiary tax-free to its shareholders, following which (2) the corporation is acquired in a tax-free stock-for-stock exchange. The change generally would take effect on March 19, 1996, the date on which it was announced.

We strongly oppose the immediate effective date for this change. The tax-free status of these transactions was approved in the Morris Trust case, thirty years ago, and cannot be said to represent an

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abusive practice or loophole. The Internal Revenue Service has approved transactions structured in this manner for many years, and Internal Revenue Code § 355, applicable to these transactions, has been amended several times in the interim to curb "abuses" without Congress taking any action to curtail or prevent the use of these transactions. Notwithstanding, the Administration's proposal will prevent Morris Trust transactions from proceeding without Congressional consideration of the proposed change, and, indeed, with no assurance that Congress will approve the change when and if it comes to consider the proposal.

In our judgment, changes in settled matters of tax law ought to be made effective only once there is a meaningful likelihood of enactment -- as indicated, for example, by approval of the measure by Congress' tax-writing committees. Stated differently, we think it is highly inappropriate for the Executive Branch unilaterally to cast doubt on well-settled and non-abusive transaction formats prior to the adoption of such change in the legislative process.

Our objection to the setting of an immediate effective date for the Morris Trust change (and several of the other budget proposals) is not intended to comment favorably or unfavorably on the underlying substantive merits. Our objection is to the early effective date -- with the resulting dislocation of bona fide transactional activity -- in the absence of Congressional consideration of the change.

Respectfully Submitted,

Richard L. Reinhold
Chair