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January 6, 2011

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1111 Constitution Avenue, NW
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The Honorable William J. Wilkins
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Re: Characterizing Overlap Transactions in Subchapter C

Gentlemen:

Enclosed is New York State Bar Association Report No. 1229, concerning the characterization of certain corporate transactions that may qualify as more than one type of tax-free reorganization under the Internal Revenue Code.

In recent years, the Treasury Department and Internal Revenue Service have issued significant guidance that has eliminated obstacles deemed unnecessary to protect the integrity of the subchapter C reorganization provisions. As a result of these developments, the number of permissible transactions that will qualify for nonrecognition treatment under the reorganization rules has increased. A side effect of this expansion has been an increase in the uncertainty with respect to the characterization of certain transactions in which a corporation transfers assets to one or more corporations and liquidates for

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Federal income tax purposes, where the transaction has the potential to satisfy the requirements of multiple types of reorganizations or other tax-free transactions (“Overlap Transactions”).

An example of an Overlap Transaction is a transaction in which a corporation (“Target”) contributes most of its assets to a subsidiary corporation (“Sub”) in exchange for Sub stock and Target liquidates into its parent corporation (“Parent”). Is this a downstream reorganization of Target into Sub with a distribution by Target to Parent in the reorganization, or is it an exchange of Target assets for Sub stock followed by an upstream reorganization or liquidation?

There are significant stakes involved in determining the characterization of Overlap Transactions, including whether gain or loss is recognized by the target corporation or its shareholders, the post-transaction location of tax attributes, and the computation of stock basis.

The report reviews the developments that have contributed to the occurrence of Overlap Transactions and the relevant law that provides insight into potential resolution of the issues that arise. The report considers seven approaches to characterizing Overlap Transactions: the Upstream Approach, the Directional Approach, the Directional / Minority Shareholder Approach, the Directional / Nonrecognition Approach, the Directional / Merger Approach, the Multiple Reorganizations Approach, and the Election Approach.

The Upstream Approach would characterize an Overlap Transaction as an upstream reorganization or liquidation, if the requirements are satisfied, with a downstream asset transfer. The Directional Approach would determine the characterization of Overlap Transactions in a manner consistent with the order of the taxpayer’s chosen steps, with each transfer of assets analyzed, in chronological order, to determine the first set of steps that constitutes a reorganization. The Directional / Minority Shareholder Approach would follow the Directional Approach, but would characterize a transaction as an upstream reorganization for a minority shareholder if the transaction is otherwise characterized as a downstream reorganization with respect to the target and acquiring corporations and the minority shareholder. The Directional / Nonrecognition Approach would follow the Directional Approach, but if the transaction would be characterized as a downstream reorganization under the Directional Approach and such characterization would result in gain or loss recognition by the target or parent corporation or a minority shareholder of the target corporation, the transaction would be characterized as an upstream reorganization so that the target and parent corporations and the minority shareholder would not recognize gain or loss. The Directional / Merger Approach would follow the Directional Approach, but an actual statutory merger or consolidation under state or foreign law would control the characterization of the transaction. The Multiple Reorganizations Approach would allow transactions to qualify under multiple tax-free provisions. The Election Approach would permit taxpayers to elect the characterization of an Overlap Transaction.

Hon. Michael Mundaca, Hon. Douglas H. Shulman, Hon. William J. Wilkins

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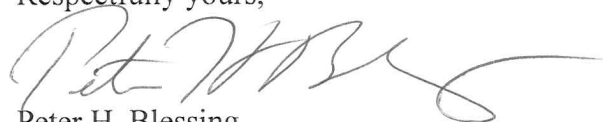
The report recommends that the Treasury and Service issue guidance setting forth a rule for characterizing Overlap Transactions. A majority of the Tax Section recommends the Directional / Minority Shareholder Approach. In general, the majority believes when a taxpayer engages in a downstream transfer of assets that is sufficient to qualify as part of a reorganization, that transfer should define the characterization of the overall transaction for purposes of the target and acquiring corporations and the majority shareholder of the target corporation, including whether gain or loss is recognized by the target corporation or the majority shareholder, the post-transaction location of tax attributes, and the computation of stock basis. For purposes of a minority shareholder of the target corporation, however, a majority of the Tax Section does not believe the exchange of target corporation stock should result in recognition. The Directional / Minority Shareholder Approach would characterize the transaction as an upstream reorganization with respect to any minority shareholder of the target corporation.

A minority of the Tax Section recommends the adoption of the Directional Approach, without the special characterization rule for a minority shareholder of the target corporation. Thus, if a transaction is characterized as a downstream reorganization under the Directional Approach, a minority shareholder of the target corporation would recognize gain or loss on the exchange of its stock. Another minority of the Tax Section recommends the Election Approach, because qualification as a reorganization is transactionally elective under the Code, there are contexts in which taxpayers cannot undertake the steps necessary to achieve the desired tax characterization (e.g., legal or regulatory restrictions), and it is not necessary to require the gain or loss recognition by the target corporation or majority shareholder that could result from the Directional / Minority Shareholder Approach because the section 1.368-2(k) regulations already allow for the tax-free division of assets in similar transactions within a related group of corporations.

In addition, the report makes several recommendations in order to allow any adopted approach to function optimally.

We appreciate your consideration of the recommendations. If you have any questions regarding this report, please feel free to contact us and we will be glad to discuss or assist in any way.

Respectfully yours,

A handwritten signature in black ink, appearing to read "Peter H. Blessing", with a long, sweeping flourish extending to the right.

Peter H. Blessing
Chair

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cc: William D. Alexander
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