NEW YORK STATE BAR ASSOCIATION
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January 28, 2011

The Honorable Michael Mundaca
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
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Re: Claiming Worthlessness for a Failed Subsidiary within a Consolidated Group

Gentlemen:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1230 on Claiming Worthlessness for a Failed Subsidiary within a Consolidated Group. The report analyzes the current treatment of failed subsidiaries in consolidated groups, renews our recommendations from our 2003 report on this subject, and offers a possible intermediate alternative.

The report focuses on the timing and availability of a worthless stock deduction. Current law generally applies subchapter C rules applicable to separate entities, although adjustments are made as necessary to coordinate with the consolidated return regulations (i.e., the approach taken under current law). The 2003 report generally took a single entity approach where the consolidated group continues the insolvent subsidiary's business, thereby generally denying a worthless stock deduction upon an upstream or sideways restructuring of the subsidiary. The intermediate alternative is a hybrid approach that defers the worthless stock deduction that would otherwise result under current law until a later appropriate triggering event.

We believe that the government should provide specific rules in a consolidated return regulation to determine whether a worthless stock deduction can be recognized as a result of an upstream or sideways restructuring of an insolvent subsidiary. The interactions between the consolidated return regulations and Code-based rules for worthless stock deductions have increased and become more complex since our 2003 report. The pervasive influence of single-entity oriented rules under the consolidated return regulations with respect to worthless stock deductions for insolvent subsidiaries, as well as the complexity of the interaction between single entity and separate company rules, argue persuasively, in our view, for a single entity determination of whether an upstream or sideways restructuring can generate a worthless stock deduction.

We continue to believe that the proposals made in the 2003 report are appropriate because they represent a unified approach to the treatment of stock of an insolvent subsidiary (or subsidiary whose asset value is not in excess of the liquidation preference on its outstanding preferred stock) by generally eliminating the worthless stock deduction where the subsidiary's business remains in the group. We therefore suggest that the proposals described in the 2003 report be considered anew.

Should the government still determine not to issue a consolidated return regulation modifying the application of the tax-free reorganization provisions of section 368 to upstream and sideways restructurings of insolvent subsidiaries, we recommend that consideration be given to our intermediate alternative, which integrates single entity and separate company treatment.

We appreciate your consideration of our 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,

Peter H. Blessing
Chair

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