



TAX SECTION

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

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

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

Re: Report on Notice 2010-49

Gentlemen:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1238, Report on Notice 2010-49 (the "Notice"), which requests comments regarding potential modifications to the treatment of less than 5-percent shareholders ("Small Shareholders") under section 382. We believe that the current segregation rules cause loss corporations to devote substantial time and resources tracking stock transfers involving Small Shareholders and result in ownership changes in cases where there is no identifiable abuse under section 382.

The Notice outlined two general approaches for taking into account transactions involving Small Shareholders, the Ownership Tracking Approach and the Purposive Approach, and two formulations of the Purposive Approach, the Limited Purposive Approach and the Expansive Approach.

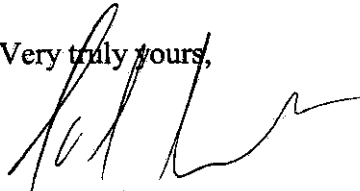
We recommend adoption of the Limited Purposive Approach in the case of a 5-percent shareholder's stock sales to Small Shareholders and a loss corporation's stock redemptions from Small Shareholders, subject to potential consideration of an anti-abuse rule in the latter case. The government has ample statutory authority to adopt the Limited Purposive Approach, and, as a policy matter, we generally do not believe it is necessary to apply the segregation rules to identifiable transactions that do not reasonably implicate the abuses that section 382 intends to prevent. Moreover, adoption of the Limited Purposive Approach would continue the government's trend of providing thoughtful, balanced relief to taxpayers in the section 382 context.

In the case of stock issuances to Small Shareholders, we recommend expansion of the small issuance and cash issuance exceptions in lieu of applying the Limited Purposive Approach. Expanding the existing exceptions to the segregation rules would provide meaningful relief to loss corporations without the complexity and related uncertainty of an anti-abuse rule, which we believe would need to accompany any adoption of the Limited Purposive Approach for stock issuances. More specifically, we recommend increasing the current 10-percent limitation for applying the small issuance exception to 25 percent, and broadening the cash issuance exception to apply to issuances in exchange for non-cash property.

Finally, the current regulations generally apply the principles of the existing segregation rules to transactions involving upper tier entities, and the Notice requests comments regarding whether to limit the look-through treatment of upper tier entities that have a relatively small direct or indirect interest in the loss corporation. It is usually extremely burdensome in the best of cases, and, in our experience, often impossible in the worst of cases, for loss corporations to obtain either current or historic ownership information from upper tier entities.

As discussed in the report, we make four recommendations regarding upper tier entities: (i) establish a minimum 30% ownership threshold before an upper tier entity is subject to the segregation rules, (ii) establish a special exemption from the segregation rules for ordinary course share issuances and redemptions by upper tier entities that provide primary liquidity to their investors by issuing or redeeming shares, (iii) modify any Limited Purposive Approach anti-abuse rule in the case of an upper tier entity otherwise subject to the segregation rules, and (iv) clarify the application of the small issuance exception in the case of an upper tier entity otherwise subject to the segregation rules.

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

Very truly yours,

Jodi J. Schwartz

cc: William D. Alexander
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