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Thursday, November 18, 2004

Mr. Gregory F. Jenner  
Acting Assistant Secretary (Tax Policy)  
Department of the Treasury  
Room 3120 MT  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

The Honorable Mark W. Everson  
Commissioner  
Internal Revenue Service  
Room 3000 IR  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Dear Acting Assistant Secretary Jenner and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1071.

This report responds to the request for comments in Notice 2004-37, 2004-21 I.R.B. 947, with respect to issues concerning the promulgation of regulations to implement sections 1504(a)(5)(C) and (D) of the Internal Revenue Code of 1986. As discussed in our report, our principal recommendations in response to Notice 2004-37 are:

1. For purposes of relying on section 1504(a)(5)(C) (the "good faith exception") to establish or maintain consolidation, a consolidated group that has a reasonable basis for making a good faith determination may rely on the exception by filing its consolidated tax return in a manner consistent with satisfaction of the value test. However, a good faith determination is subject to challenge by the Internal Revenue Service (the "IRS") and if challenged, a consolidated group would have the burden of proving that it acted in good faith and reasonably determined

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the value of the subsidiary stock for the subsidiary to be a member of the group.

2. A consolidated group can rely on a good faith determination until a designated event (generally defined as in Notice 2004-37 with certain suggested additions) occurs or the group knows that another subsequent event (such as a fluctuation in stock values) has caused a subsequent value deficiency. Upon such a subsequent event, the group could rely on its original good faith determination for past but not future periods, but would be eligible for the possible application of the inadvertence exception (as defined below) for future periods. No presumptions should be adopted in favor of, or against, satisfaction of the good faith exception.
3. For purposes of continuing consolidation pursuant to section 1504(a)(5)(D) (the “inadvertence exception”), a consolidated group must establish that an inadvertent change in relative values of different classes of stock either (i) was not reasonably foreseeable, (ii) was beyond the group’s control, e.g., attributable to a natural disaster or a civil action, such as labor strike or (iii) was attributable to a mistake. No limitation should be imposed on the size of value shifts to which the inadvertence exception may apply.
4. In situations other than a mistake, a consolidated group that knows or has reason to know that the value requirement is not satisfied with respect to a subsidiary as a result of inadvertence can avoid deconsolidation of that subsidiary by satisfying the value requirement by the earlier of (i) the date a designated event occurs or (ii) the last day of the taxable year immediately following the taxable year in which the affiliated group first had knowledge of the value deficiency. The cure period for a mistake would end no later than the due date (without extension) for the tax return for the taxable year in which the mistake was made. These cure periods should be suspended in certain instances, such as the pendency of a bankruptcy proceeding, and may be extended at the reasonable discretion of the IRS for up to 36 months.
5. Failure to satisfy the value requirement by the end of the cure period for inadvertence will result in deconsolidation as of the end of such period. The occurrence of a designated event during the cure period would

trigger immediate deconsolidation, unless the value requirement is satisfied immediately after the event.

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.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'L. Steinberg', written in a cursive style.

Lewis R. Steinberg  
Chair

cc: Eric Solomon, Deputy Assistant Secretary, Regulatory Affairs  
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