November 29, 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. 1072, Proposed Regulations Regarding Continuity of Interest and Pre-Closing Stock Value Fluctuation.

This report offers recommendations with respect to proposed regulations published in the Federal Register on August 10, 2004 regarding the continuity of proprietary interest requirement applicable to tax-free reorganizations under Section 368 of the Internal Revenue Code. In our prior report, *Continuity of Interest and Pre-Closing Stock Value Fluctuation*, dated January 23, 2004, we recommended that the Internal Revenue Service respond to taxpayer concerns that an acquisition that is intended to qualify as a reorganization may fail to satisfy the continuity of proprietary interest requirement as a result of a decline in the value of the stock of the acquiring corporation between the date that the parties agree to the terms of the transaction (the signing date) and the date that the transaction closes (the closing date). The proposed regulations provide that continuity will be determined based on the value of the acquiring corporation's stock as of the end of the last business day before the signing date, provided that the acquisition agreement is a binding contract that provides for fixed consideration consisting only of stock and cash.

The regulations represent a significant improvement in the administrability of the continuity of interest doctrine from the point of view of taxpayers and the Internal Revenue Service. We believe that the proposed regulations are consistent with the underlying premise of the reorganization provisions—to separate sale transactions from transactions that "effect only a readjustment of continuing interest in property under modified corporate forms." We believe, however, that certain additions and clarifications would improve the proposed regulations so that they apply appropriately and equitably to common commercial transactions.

In particular, our report offers recommendations regarding the proposed regulations' definition of "fixed consideration". Specifically, the report recommends that:

- the regulations confirm that "fixed consideration" refers to the aggregate pool of consideration (not the per share consideration);
- increases and decreases in the amount of stock and cash consideration that occur between the signing and closing dates should not prevent the consideration from being considered "fixed," provided that such increases and decreases are *de minimis* or do not change the proportion of stock and cash consideration, or, alternatively, result in a *greater* proportion of stock consideration than the proportion measured at signing; and
- acquisition agreements that utilize a traditional "collar" to determine the amount of consideration should be tested using signing date values, provided that the collar adheres to requirements described in the report.

In addition, the report recommends that:

- the 40 percent stock consideration threshold presented by Examples 10 and 11 of the proposed regulations should apply to both fixed and non-fixed consideration transactions;
- the meaning of "the end of the last business day" be clarified;

- the rules applicable to modified tender offers be clarified;
- signing date values should be used to measure continuity in the case of transactions involving boot other than cash; and
- the scope of the proposed regulations' escrow rule should be clarified.

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,

Lewis R. Steinberg
Chair

cc: Eric Solomon, Deputy Assistant Secretary, Regulatory Affairs
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