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March 18, 2005

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
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Room 3104 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 Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1082, which addresses how various provisions of new Section 965 of the Internal Revenue Code should be applied when there has been a merger, acquisition or disposition (including a spin-off) (an "Extraordinary Transaction") at any time during the period that is relevant to the Section 965 computations. We understand that the Treasury Department and the Internal Revenue Service intend to issue guidance on this subject shortly, and we appreciate the opportunity to provide our views. As you know, the need for guidance on this matter is critical, and we have prepared this Report on an expedited schedule in hopes that it may be useful to you. We commend you for undertaking to issue guidance on this subject so quickly.

Generally, Section 965 permits a U.S. corporation to claim an 85% dividends received deduction for certain dividends received from its foreign subsidiaries during a one-year election period. The amount of

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dividends eligible for the deduction is determined by three historical factors.¹ The computation of these factors covers a period of time that could be eight years or longer.² Any Extraordinary Transaction that took place during this period could impact the computation of the three historical factors in ways that are unclear in the absence of guidance. Guidance is therefore needed to determine how these computations should be made in light of Extraordinary Transactions.

We have approached the problem by positing four “template transactions” and proposing a set of rules for both the acquirer and the transferor in each template transaction. Our proposed rules may provide for different treatments depending upon when the transaction occurred relative to the cut-off dates used in Section 965 for the computation of the historical factors. The four template transactions are: (1) the acquisition of the parent of a U.S. consolidated group, where the group owns controlled foreign corporations; (2) the acquisition (and disposition) of a U.S. corporation that is a member of a consolidated group where the acquired corporation owns a controlled foreign corporation; (3) the acquisition (and disposition) of a controlled foreign corporation; and (4) a spin-off (or other disposition) by a U.S. consolidated group of a U.S. corporation that owns a controlled foreign corporation, where the distributed corporation becomes the parent of a new consolidated group.

The rules we propose are founded on a number of goals and guiding principles which we lay out in detail in our Report. Briefly, these include the following: (1) the taxpayers involved in an Extraordinary Transaction, taken together, should neither lose nor gain anything as a result of the Extraordinary Transaction; (2) any adjustment and allocation rules should be consistent with the statutory scheme and fair to the taxpayers involved; (3) the rules should be simple and straightforward enough to be understood by taxpayers, and to be applied consistently and with a high degree of certainty by taxpayers and the government; and (4) the rules should not expose the government to the risk of being whipsawed – *i.e.*, attributes that benefit taxpayers should not be duplicated, and attributes that could be detrimental to taxpayers should not be inappropriately eliminated.

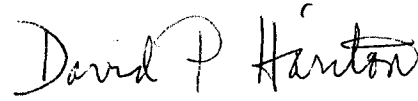
¹ Very generally, the three historical factors include the following: (1) the dividends received during the election year must exceed the annual average dividends received from foreign subsidiaries over a multi-year “base period”, which generally includes the five most recent taxable years ending on or before June 30, 2003; (2) the dividends eligible for the Section 965 deduction may not exceed the greater of (A) the amount of earnings shown as permanently reinvested outside the United States on the U.S. corporation’s last audited financial statement certified on or before June 30, 2003, and (B) \$500 million; and (3) the amount of dividends received during the election year which may be taken into account under Section 965 is reduced by any increase, since October 3, 2004, in the debt of the taxpayer’s foreign subsidiaries owed to related persons.

² More specifically, the computation of these factors covers a span of time that begins with the first day of the fifth taxable year ending on or before June 30, 2003, and ends with the last day of the taxpayer’s 2004 or 2005 tax year.

The rules for the treatment of the acquirer and the transferor are intended to work together. We believe that the rules for each of the various template transactions are as consistent as possible and achieve the purposes of the legislation to the greatest extent possible. In our Report, we discuss the alternatives we considered, our evaluation of those alternatives, and how we settled on the rules we are proposing.

We appreciate your consideration of our proposals and the issues we have addressed in the Report. As always, we would be pleased to discuss these matters with you further or provide any other assistance that you would find helpful.

Respectfully submitted,



David P. Hariton
Chair

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