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April 26, 2005

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
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. 1086, concerning Reg. §1.367(a)-3(c), which requires US shareholders and security holders to recognize gain on an exchange of shares or securities of a US corporation for shares of a foreign corporation, notwithstanding that the exchange would otherwise qualify as a tax-free reorganization.

As discussed in the Report, we think that serious consideration should be given by the IRS and Treasury to whether Reg. §1.367(a)-3(c) continues to serve a useful purpose. The regulation was adopted to deal with corporate inversions and expatriations, but the relevant "abuse" did not involve avoidance of shareholder tax but rather avoidance of corporate-level tax. In any event, Reg. §1.367(a)-3(c) did not succeed in stopping the corporate

expatriation phenomenon, leading Congress to step in and enact Sections 7874 and 4985 of the Internal Revenue Code.

We note that many members of the Executive Committee believe that Sections 7874 and 4985 were not a sufficient response to the issues raised by inversion transactions. Because Reg. §1.367(a)-3(c) addresses the wrong concern and because it adds complexity, the Committee generally believes that it should be eliminated. The Committee is divided, however, on whether it should be eliminated before Congress takes further steps to deal with corporation inversions. We are in agreement, moreover, that Congress should take such further steps, which would presumably include tightening the earnings stripping rules and dealing with transfers of intellectual property, as discussed in our Report on Outbound Inversion Transactions dated May 24, 2002.

If the IRS and Treasury do not decide to eliminate Reg. §1.367(a)-3(c), we believe they should give serious consideration to conforming the triggers on the recognition of gain with those set out in Section 7874, relating to "expatriated entities". Under this approach there would be no gain recognition under Section 367(a) unless the shareholders of the relevant US corporation acquired 60% or more of the shares of the foreign corporation and the foreign corporation, through its expanded affiliated group, did not have "substantial business activities" in the country of its organization. This approach would have the merit of simplicity – a single set of rules to deal with corporate expatriations rather than two overlapping but different sets of rules – and it would follow the most recent Congressional directive on the subject. We recognize, however, that there may be some areas – specifically, the different trade or business tests of Section 7874 and Reg. §1.367(a)-3(c) – in which conformity may have to yield to policy concerns about facilitating inversions that might not be caught by Section 7874.

Finally, if the foregoing suggestions are not adopted, the Report makes a number of specific changes that, with the benefit of 10 years of experience, we believe should be made in Reg. §1.367(a)-3(c). Some of these will be relevant to guidance under Section 7874 as well.

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 it or to assist you in any way.

Respectfully submitted,

David P. Hariton
Chair

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