New York State Bar Association

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January 20, 2006

Mr. Eric Solomon
Acting Deputy Assistant Secretary (Tax Policy)
Department of the Treasury
Room 3112 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

Re: Proposed Regulations Regarding Formations, Reorganizations and <u>Liquidations Involving Insolvent Corporations</u>

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. 1102 (the "Report") on proposed Treasury Regulations issued under sections 332, 351, and 368 of the Internal Revenue Code (the "Proposed Regulations"), which provide rules regarding formations, reorganizations, and liquidations involving insolvent corporations. We commend the Internal Revenue Service (the "Service") and the Department of the Treasury ("Treasury") for focusing on the issues underlying the Proposed Regulations and for undertaking this project with a view to providing greater clarity in an area where the law is particularly unclear.

We generally support the conclusion in the Proposed Regulations that an upstream restructuring of an insolvent subsidiary cannot qualify as tax-free under section 332 or section 368. The Report offers some observations and considerations regarding interactions with the consolidated return regulations that are created by the Proposed Regulations, as well as issues that arise when a subsidiary corporation transfers its assets to the parent corporation with respect to one class of stock while the other class receives nothing.

We also support the proposed modifications to the continuity of interest ("COI") provisions and offer recommendations to improve specific aspects of the COI provisions, including: (1) priority claims which receive special treatment under the Bankruptcy Code should also receive special treatment for COI purposes; (2) the final regulations should contain an example demonstrating the disproportionate receipt of acquiring corporation stock and other property among the senior class of creditors; (3) the Service and Treasury should clarify the circumstances in which the receipt of stock by a creditor or shareholder will be disregarded for COI purposes; (4) amounts received on partially secured creditor claims without a formal allocation between the bifurcated portions of the claim should be allocated based on the regulations under section 108(e); and (5) pre-transaction payments should affect COI only if made in connection with the transaction.

We believe that the COI requirement, as modified by the Proposed Regulations, addresses the policy concerns expressed in the Proposed Regulations in respect of reorganizations. In light of such policy considerations and the existing authorities, we recommend that the Service and Treasury eliminate the net value requirement for reorganizations from the Proposed Regulations and clarify that no exchange requirement will be imposed on sideways reorganizations outside of the bankruptcy context.

We also recommend that the net value requirement in the Proposed Regulations be modified to require only that the transferee must issue stock that has value in exchange for the property transferred in a putative section 351 transfer. Value for this purpose would be defined as the value that a third party willing buyer would pay for the stock, instead of the corporation's net asset value (as in the Proposed Regulations).

Finally, we agree that if a net value requirement or modified COI provisions are adopted, liabilities should be broadly defined for purposes of determining net value and a definition of liability similar to the definition of "obligation" in Treasury Regulation section 1.752-1(a)(4)(ii) should be adopted. We recommend generally that all liabilities should be valued using a fair market value approach because it offers the best economic determination of whether net value has been surrendered and received. In recognition that such an approach creates numerous and difficult valuations, we further recommend that the Service and Treasury consider including certain safe harbors for valuation purposes.

We appreciate your consideration of our recommendations and comments. 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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