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March 22, 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: Temporary Regulations Under Section 7874 of the Internal Revenue Code

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1107, which comments on Temporary Treasury Regulations Section 1.7874-1T.

Those Regulations, issued on December 27, 2005, address when and in what manner affiliate-owned stock will be disregarded for purposes of determining whether a foreign corporation is a surrogate foreign corporation under Section 7874. In general, affiliate-owned stock is excluded from both the numerator and the denominator of the fraction that

determines the ownership percentage in the foreign acquiror corporation. The Temporary Treasury Regulations provide two carveouts to this general rule, under which affiliate-owned stock will be excluded from the numerator only. The first carveout generally applies if (1) before the acquisition at least 80 percent of the stock or interests in the domestic entity is owned directly or indirectly by the common parent of the expanded affiliated group that includes the foreign acquiror corporation and (2) after the acquisition less than 20 percent of the stock of the foreign acquiror corporation is owned by non-members of the expanded affiliated group by reason of their former ownership in the domestic entity. The second carveout generally applies if former shareholders or partners of the domestic entity own no more than 50 percent of the stock of any member of the expanded affiliated group. However, the carveouts do not apply to stock or partnership interests owned by an entity in which at least 50 percent of the stock or interests is owned directly or indirectly by the issuer of such stock or interests (hook stock).

We commend the Service and Treasury for promulgating Temporary Treasury Regulations that provide appropriate relief from the unintended potential overbreadth of Section 7874. However, we believe that Section 1504(a)(4) so-called "plain vanilla" preferred stock should be ignored for all purposes of those Treasury Regulations, and not merely for purposes of defining the expanded affiliated group.

We also discuss certain issues raised by the preamble to the Temporary Treasury Regulations in respect of which additional guidance may be appropriate: (1) the requirement that the expanded affiliate group's activities in the relevant foreign country not be substantial when compared to the expanded affiliate group 's total business activities; (2) whether and to what extent options on stock and other similar interests are treated as stock for the purpose of determining whether a corporation is a surrogate foreign corporation; (3) the treatment of stock sold in a public offering that is related to the acquisition; (4) possible changes to Treasury Regulations Section 1.367(a)-3(c), which governs the tax consequences at the shareholder level of certain transactions similar to those addressed by Section 7874, in light of the enactment of Section 7874; and (5) acquisitions of domestic entities by foreign pass-through entities.

We believe that additional guidance with respect to those issues is necessary. We recommend that such guidance provide for (1) a facts and circumstances test, with a specific and administrable safe harbor, for determining substantial business activities, (2) the treatment of stock rights as not stock, except as otherwise provided by common law principles or where there is an avoidance purpose, (3) (A) the definition of public offering, including that shares of the acquiring foreign corporation that are issued to shareholders of a historic foreign corporation will not be treated as issued in a public offering and (B) the treatment of certain sizeable public offerings as not ancillary, and therefore not related, to the applicable acquisition, (4) the coordination of Section 7874 and the provisions of Treasury Regulations Section 1.367-3(c) and (5) in the case of an acquisition of a domestic entity by a foreign pass-through entity where the domestic entity owns controlled foreign corporations or the group sets up foreign corporations as part of the same plan with the acquisition, the treatment of the foreign pass-through entity as a domestic partnership.

We also believe that guidance is necessary and appropriate to clarify that Section 7874 applies both to transactions structured as stock acquisitions and to transactions structured as asset acquisitions.

Respectfully submitted,

Kimberly S. Blanchard
Chair

Enclosure

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