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June 13, 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: Basis Recovery in Dividend Equivalent Redemptions

Dear Acting Deputy Assistant Secretary Solomon and Commissioner Everson:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1112, addressing the issue of basis recovery in redemption transactions that are treated as dividend equivalent redemptions under Section 301 of the Internal Revenue Code. Generally, the issue arises where a corporation redeems some of its outstanding stock and the redeemed shareholder continues to own enough stock, either actually or constructively, such that Section 302(d) treats the redemption as a Section 301 distribution. If the distribution exceeds the corporation's earnings and profits, it is applied against and reduces the adjusted basis of the shareholder's stock under Section 301(c)(2) before the redeemed shareholder must recognize gain. Thus, the issue of which basis is available for reduction can be critical.

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While this issue is not a new one, it has become a source of heightened concern as a result of a certain statements made by the Internal Revenue Service (the "Service") and the Department of Treasury ("Treasury") in recent guidance, indicating that the Service and Treasury are of the view that only the basis of the shares actually (or fictionally) redeemed may be recovered under Section 301(c)(2). Because it appears that the Service and Treasury favor this approach with respect to all transactions that result in the application of Section 301(c)(2), and because we believe that such approach is inappropriate at least as applied to "plain vanilla" dividend equivalent redemptions, the Report responds to this pronouncement and recommends that the Service and Treasury provide limited expedited guidance for such redemptions.

We believe that the fundamental principle that should inform the approach taken to this issue is to treat a dividend equivalent redemption as if an actual dividend distribution, rather than a sale or exchange of shares, had occurred. With that principle in mind, we have identified four alternative approaches to basis recovery in dividend equivalent redemptions. While we would support the adoption of any of these alternatives, we believe that the "All Shares Approach" or the "Recapitalization Approach" described in the Report are the most appropriate, as each would produce the same gain recognition as would be produced if no shares were exchanged in the redemption.

We appreciate your consideration of our recommendations and comments. We would be pleased to discuss these matters with you further or provide any other assistance that you would find helpful.

Respectfully submitted,

Kimberly S Blanchard

Kimberly S. Blanchard
Chair

Enclosure

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