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# New York State Bar Association

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December 19, 2007

The Honorable Eric Solomon
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Linda E. Stiff
Acting Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Report on Proposed Consolidated Return Stock Loss Regulations

Dear Assistant Secretary Solomon and Acting Commissioner Stiff:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1138 (the "Report"). The Report comments on the proposed regulations providing rules for the treatment of stock of a consolidated subsidiary disposed of at a loss (the "Proposed Stock Loss Regulations").[1]

The Tax Section supports finalizing the Proposed Stock Loss Regulations with certain modifications (summarized below), principally aimed at making them easier to apply in practice. The principle that should

[1] Unified Rule for Loss on Subsidiary Stock," Notice of Proposed Rulemaking, REG-157711-02, 72 Fed. Reg. 2964 (January 23, 2007).

be given the greatest weight in shaping the regulatory response to noneconomic stock loss and loss duplication is the need to reach a systemic balance that is administrable. We believe that the policy judgments underlying the Proposed Stock Loss Regulations are fundamentally sound and thus the overall framework of the regulations is an improvement on current law and makes conceptual sense. However, we have serious concerns about the administrability of certain aspects of the regulations and recommend that significant changes be made in these areas.

- We recommend that the government consider permitting taxpayers, as an alternative to applying Prop. Treas. Reg. § 1.1502-36(b) (the "Basis Redetermination Rule") on a non-deconsolidating transfer of some but not all of the shares of a subsidiary, to elect to defer basis recovery in excess of value on transferred loss shares – for example, to the extent that such basis is attributable to the allocation of prior positive investment adjustments to the transferred loss shares, or of prior negative adjustments to non-transferred shares. We generally would oppose broader basis leveling approaches either on a member-by-member basis or a group-wide basis, especially to the extent that such approaches would permit shifting basis attributable to capital investment under I.R.C. Section 358 or Section 1012.

- We support the netting of positive and negative basis adjustments across taxable years as provided in the net positive adjustment factor of the Prop. Treas. Reg. § 1.1502-36(c) (the "Basis Reduction Rule") and the rejection of various exceptions to the presumptions used therein that would reintroduce tracing (e.g., an exception for "after-acquired" assets or a sunset on the net positive adjustment factor). We do, however, support an exclusion from the factor of cancellation of debt income or bond redemption premium resulting from the satisfaction of intercompany debt in limited circumstances. We also support using the disconformity amount as a cap on basis reduction, and the government's decision to address its under-inclusivity as a loss duplication problem. We recommend that the government permit taxpayers to elect to determine the net inside attribute amount with respect to tiered subsidiary structures solely by reference to inside attributes, treating the subsidiary's subgroup as a single entity and disregarding intercompany debt and equity within the subgroup.

- Prop. Treas. Reg. § 1.1502-36(d) (the "Attribute Reduction Rule") fails to achieve its goal of eliminating loss duplication in certain cases, is very complex, and likely will be unworkable as a practical matter with respect to complicated corporate structures. We believe that the goal of eliminating loss duplication would be better achieved in a more administrable fashion by focusing on duplication of stock loss in the "inside" attributes of lower-tier subsidiaries (i.e., asset basis, net operating losses, etc.), rather than in determining whether there is greater duplication in the inside attributes of such subsidiaries or in the basis of their stock. Under this approach, the attribute reduction amount would be determined by reference to the net inside attribute amount for the subsidiary's sub-group, determined as described in the immediately preceding bullet, with conforming adjustments to the stock basis of lower tier subsidiaries. We also recommend considering a simpler methodology for allocating the attribute reduction amount: a reverse I.R.C. Section 1060 methodology.

- We suggest that the final regulations permit taxpayers to make protective elections for reducing stock basis in lieu of inside attributes and for reattributing attributes.

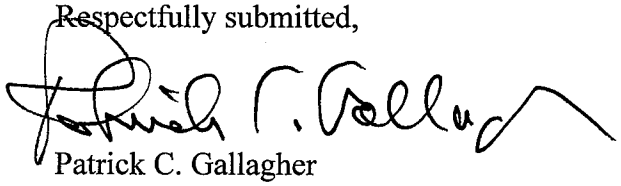
- We would eliminate Prop. Treas. Reg. § 1.1502-13(e)(4), which provides rules governing the application of I.R.C. Section 362(e)(2) in the consolidated return context, because it relies on tracing and creates a new system of tracing mechanics. We would instead either rely on an anti-abuse rule or treat the Section 362 amount as a deferred loss subject to the intercompany transaction regulations.

- We recommend deferring application of the Basis Redetermination, Basis Reduction, and Attribute Reduction Rules upon an intercompany transfer of loss stock.

- The Proposed Stock Loss Regulations can have a significant impact on buyers and sellers of loss stock, but are proposed to become effective immediately upon publication of final regulations in the Federal Register. We recommend that the final regulations contain a grandfather rule so that existing law continues to apply to any transfer of loss stock made pursuant to a contract binding on the date the final regulations are published.

We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully submitted,



Patrick C. Gallagher
Chair

cc:

Donald L. Korb
Chief Counsel
Internal Revenue Service

Karen Gilbreath Sowell
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

Michael J. Desmond
Tax Legislative Counsel
Department of the Treasury

Marc A. Countryman, Attorney Advisor
Office of Tax Legislative Counsel
Department of the Treasury

William D. Alexander
Associate Chief Counsel (Corporate)
Internal Revenue Service

Mark A. Schneider
Deputy Associate Chief Counsel (Corporate)
Internal Revenue Service

Theresa A. Abell, Special Counsel
Office of Associate Chief Counsel (Corporate)
Internal Revenue Service