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January 11, 2008

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
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Report on Proposed Regulations Regarding the Active Trade or Business Requirement under Section 355(b)

Dear Assistant Secretary Solomon and Acting Commissioner Stiff:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1142 (the "Report") addressing proposed regulations issued under Section 355(b) of the Internal Revenue Code (the "Code") pertaining to the active trade or business requirement of Section 355(b) and providing guidance following the enactment of Section 355(b)(3)¹ (the "Proposed Regulations").

¹ Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. 109-222, 120 Stat. 345 (2006) ("TIPRA") as amended by the Technical Corrections Act of 2007, Pub. L. 110-72 (the "Technical Corrections Act"). Unless otherwise indicated, all "Section" references are to the Code.

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The Proposed Regulations offer a comprehensive review of the active trade or business requirement. This review was much needed because the existing Treasury Regulations are outdated and required substantial revisions to reflect the separate affiliated group (“SAG”) active trade or business rule added by TIPRA.

We commend the Treasury and IRS for having reflected in the Proposed Regulations both the policy objectives underlying TIPRA’s introduction of Section 355(b)(3) (namely reducing the many and often complex internal restructurings that corporate groups would undertake to bring elements of the relevant active trade or business into the appropriate corporate entities) and the resolution of many open issues arising out of the definition of “active trade or business.”

As discussed in the Report, we believe further clarification would be helpful in a number of areas, including the following:

- The Proposed Regulations correctly, we believe, interpret Section 355(b)(3)(A) as effectively repealing the holding company test of Section 355(b). However, “control” is still a concept used in Section 355, and Sections 355(b)(1)(A) and 355(b)(2)(D) still refer to the holding company test. Accordingly, we recommend that the final or temporary Treasury Regulations include a few additional examples illustrating the interaction between the “control” requirement for a tax-free spin-off and the Section 1504(a) affiliation requirement for a corporation to be included in the SAG would be helpful. We suggest that one example state that taxpayers with both Section 368(c) control and Section 1504(a) affiliation of a potential Controlled do not run afoul of Sections 355(b)(2)(C) and (D) should there be a subsequent disaffiliation of Controlled through a stock issuance by Controlled to the public. Other examples are described in the Report.
- The Proposed Regulations revise the commonly understood meaning of the statutory phrase “no gain or loss is recognized.” Specifically, the statute requires a corporation’s acquisition of active trade or business assets or a corporation’s acquisition of stock of a corporation engaged in an active trade or business to be an acquisition in which “no gain or loss is recognized.” In our view, the revisions in the Proposed Regulations, which are proposed in light of the TIPRA revisions and the policies of Section 355(b), constitute a marked departure from the statutory language. We do not believe that Congress, despite permitting Treasury to prescribe regulations to “carry out the purposes” of Section 355(b), authorizes the IRS and Treasury to depart so substantially from the language of the statute in this context. We do believe, however, that the IRS and Treasury may interpret reasonably the words “no gain or loss is recognized.” Specifically, we believe it is reasonable to treat certain transactions in which gain or loss is recognized as being consistent with Section 355(b) and certain transactions in which gain or loss is not recognized as being inconsistent with Section 355(b). With this background, the Report focuses on specific policy rationales underlying each of the various exceptions found in the Proposed Regulations.

- In the “hot stock” context, a general exception for stock acquired pursuant to taxable transactions that do not violate the requirements of Section 355(b) is not recommended, except for internal restructurings (transfers within the SAG or between the SAG of Distributing and the SAG of Controlled) or rules of convenience (allowing cash in lieu of fractional shares to be ignored).
- Notice 2007-60² permits a taxpayer that obtained Section 368(c) control but not Section 1504(a) affiliation of a potential Controlled in completely tax-free transactions to make a taxable purchase of the remaining Controlled shares without violating Section 355(b)(2)(C), provided, *inter alia*, the distribution is effected on or before the date the Proposed Regulations are published as final regulations in the Federal Register. We recommend clarifying that Notice 2007-60 remains valid in light of the Technical Corrections Act’s addition of Section 355(b)(3)(C) after the publication of the Notice. We recommend further that the final or temporary Treasury Regulations include a rule excepting a taxpayer’s purchase of shares of a potential Controlled where such purchase (rather than just the distribution) occurs after the date Section 368(c) control is reached and before the date the Proposed Regulations were issued. Finally, we suggest that the final or temporary Treasury Regulations expand Notice 2007-60 by providing a transitional rule permitting taxpayers that have announced (and not merely completed) a spin-off before the promulgation of the final Treasury Regulations to rely on Treasury Regulation Section 1.355-3(b)(4)(iii), thus permitting reliance on stock or asset purchases from members of the same affiliated group.

We appreciate your consideration of our comments. Please do not hesitate to contact us if you wish to discuss the Proposed Regulations or our Report, 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

² 2007-35 I.R.B. 466.

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

Russell P. Subin, Special Counsel
Office of Associate Chief Counsel (Corporate)
Internal Revenue Service