NEW YORK STATE BAR ASSOCIATION
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March 6, 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
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: NYSBA Tax Section Report On Proposed Treasury Regulation Section 1.1502-13(g) Relating To Intercompany Obligations

Dear Secretary Solomon and Commissioner Stiff:

I am pleased to enclose New York State Bar Association Tax Section Report No. 1150 (the "Report"), addressing proposed regulations relating to intercompany obligations between members of a consolidated group (the "proposed -13(g) regulations").

The existing Section 1.1502-13(g) regulations generally provide that if a member of a consolidated group realizes an amount from the assignment or extinguishment of its rights or obligations under an intercompany obligation, the intercompany obligation is treated for federal income tax purposes as satisfied under a so-called "deemed satisfaction rule" and, if it remains outstanding, reissued under a so-called "deemed reissuance rule." The proposed -13(g) regulations would, among other things, (i) revise the deemed satisfaction and reissuance mechanics and (ii) add a number of exceptions to the deemed satisfaction and reissuance rule for various types of transactions.

As described in the Report, we generally support these changes, but we recommend certain changes. In short:

- We strongly support the revisions to the deemed satisfaction and reissuance rules in the context of an intragroup or outbound transfer, including (i) the use of fair market value rather than Section 1274 principles to determine deemed satisfaction and reissuance amount, (ii) the fact that a deemed reissuance is deemed to occur immediately prior to the triggering transaction (rather than immediately after), and (iii) the fact that the deemed satisfaction and reissuance is deemed to be a transaction that is separate from the triggering transaction.

- We strongly support the efforts by the Internal Revenue Service and Treasury to narrow the categories of transactions that trigger the deemed satisfaction and reissuance rules, including, in particular, the exceptions for (i) internal tax-free reorganizations and liquidations and (ii) outbound distributions of newly-created intercompany obligations in the spinoff context.

- We recommend that the material tax benefit rule (which, if it applies, triggers a deemed reissuance) be revised so that it resembles a more typical intent-based anti-abuse rule. Specifically, we believe that the material tax benefit rule should apply to a transaction only if a principal purpose of the transaction is to secure a material tax benefit that would not otherwise be enjoyed by shifting intercompany obligation items of built-in gain, loss, income or deduction between members. However, we believe that it would be appropriate to create certain pro-IRS presumptions where the facts suggest such a principal purpose, such as where:

  (i) an above-market intercompany obligation is transferred in a tax-free transaction to a member with losses limited under the separate return limitation year ("SRLY") or other rules,

  (ii) an above-market intercompany obligation is transferred to another member in exchange for stock in the member in a tax-free transaction and where, within some period (*e.g.*, two years), the gain on the intercompany obligation is triggered in a manner that increases the tax basis of other shares that are sold but where the shares received in exchange for the intercompany obligation are retained, and

  (iii) an intercompany obligation is transferred to or assumed by another member where, within some period (*e.g.*, two years), there is a direct or indirect disposition of the stock of the transferee in a transaction in which the group recognizes a loss that is not disallowed.

- We recommend that, in appropriate circumstances, a taxpayer's good faith determination of the fair market value of an intercompany obligation be presumed to be correct. Moreover, it may be appropriate in certain circumstances to treat the fair market value of an intercompany obligation as equal to its adjusted issue price. However, these special valuation conventions should not apply in the potentially abusive situations described above or if a principal purpose of the transaction is otherwise to secure a material tax benefit by shifting intercompany obligation items.

- The exception from the deemed reissuance rule for certain tax-free exchanges should be revised to (i) clarify that it may be available if gain, loss or deduction is recognized with respect to any asset other than an intercompany obligation, (ii) clarify the application of the exception for assumptions that occur in tax free exchanges and give rise to a deemed exchange of the intercompany obligation under Treasury regulation Section 1.1001-3, and (iii) clarify the application of the exception in the case of Section 332 liquidations.

- As noted above, we support the treatment of the deemed satisfaction and reissuance of an intercompany obligation as a transaction separate from the underlying transaction. We recommend that the final regulations expand upon this concept by providing that the deemed satisfaction and reissuance are (i) also treated as separate from any other transaction (even if related to the triggering transaction) and (ii) ignored in determining whether any other transaction is afforded tax-free treatment, including the determination of whether intercompany obligation is treated as a security for tax purposes.

- We recommend that the final regulations provide that, in certain limited cases where an internal distribution of an intercompany obligation precedes a transfer to a nonmember, the internal distribution not be considered a triggering transaction.

- We recommend that the final regulations be revised so that, in the case of an inbound acquisition of a debtor in a transaction that triggers cancellation of debt income, the attributes of the acquiring group (other than the debtor member and its subsidiaries) not be adjusted under Treasury regulation Section 1.1502-28.

- The proposed -13(g) regulations also include a so-called "off-market issuance rule" which would, in certain cases involving the issuance of an "off-market" intercompany obligation, deem the obligation to have been issued for cash equal to the obligation's fair market value. We recommend that the off-market issuance rule be narrowed so that it applies only in cases where a principal purpose of the issuance of the intercompany obligation or the setting of the interest rate is to secure a material tax benefit that would not otherwise be

enjoyed by shifting intercompany obligation items between members. Again, we believe that such a principal purpose should be presumed in the potentially abusive situations described above.

- Finally, we recommend that if a taxpayer, upon issuance of an intercompany obligation, makes a good faith determination that the interest rate under the intercompany obligation is a market rate, the rate should be presumed to be a market rate for the intercompany obligation so long as a principal purpose for the issuance of the intercompany obligation (or the setting of the rate) was not to secure a material tax benefit by shifting items between members. We recommend that such a principal purpose be presumed to exist in cases where (i) the intercompany obligation is issued by or to a member with losses limited under the SRLY or other rules or (ii) within some period (*e.g.*, two years) after the issuance of the intercompany obligation by or to a member, there is a direct or indirect disposition of the stock of such member in a transaction in which the group recognizes a loss that is not disallowed. Similarly, absent such a principal purpose, we recommend that the interest rate on a newly-issued intercompany obligation be deemed to be a market rate if the rate equals or is based on the parent's third-party borrowing rate (provided that the consolidated group generally uses such a rate for its intercompany obligations).

I appreciate your consideration of our recommendations and comments. Please let us know if you would like to discuss our report or the proposed -13(g) regulations further, or if we can assist you in any other way.

Respectfully submitted,

David S. Miller
Chair

cc: The Honorable Donald L. Korb
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