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

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

May 23, 2008

**Re: Notice 2008-20 (Intermediary Tax Shelters)**[1]

Dear Sirs:

In Notice 2001-16,[2] the Internal Revenue Service and the Treasury Department described an intermediary tax shelter transaction that was designed to avoid the corporate tax on a sale of the assets in a business, indicated the Service's intent to challenge the purported tax results, and identified the transaction and all "substantially similar" transactions as "listed transactions." In Notice 2008-20, the Internal Revenue Service and the Treasury Department identified four necessary components of the intermediary tax shelter described

[1] The principal drafters of this letter are Kathleen Ferrell and Michael Bretholz. Helpful comments were received from Kimberly Blanchard, Peter Blessing, Michael Farber, Edward Gonzalez, David Miller, Michael Schler, Jodi Schwartz, Linda Swartz, and Diana Wollman.

[2] 2001-1 C.B. 730.

in Notice 2001-16, and provided additional guidance for determining whether a taxpayer may be treated as a participant in the transaction.[3]

As we have expressed in the past, the Tax Section supports your efforts to promote the disclosure of potentially abusive transactions, and recognizes the challenge of achieving an adequate level of disclosure without overburdening taxpayers, their advisors and the marketplace.

In the interest of promoting the goals of Notice 2008-20, we write to suggest certain changes to ensure that a taxpayer and its advisors are able to determine, at the time a transaction is entered into, whether the taxpayer will be considered to be a participant in the listed transaction described in the Notices and to ensure that potentially abusive transactions are included.[4] We also suggest other clarifications to Notice 2008-20.

**Background**

Notice 2001-16 describes a transaction involving a seller that desires to sell stock of a corporation, a buyer that desires to purchase the corporation's assets (but not its stock), and an intermediary corporation. The seller purports to sell the stock of the corporation to the intermediary and the intermediary purports to sell the assets to the buyer. In one version of the transaction, the intermediary has losses or credits, the corporation and the intermediary file a consolidated return, and the intermediary's losses or credits offset the gain (or tax) resulting from the sale of the assets. In another version of the transaction, the intermediary is an entity that is not subject to tax and the corporation liquidates in a transaction that is not described in section 337(b)(2) or Regulations section 1.337(d)-4.[5] (The transaction described in Notice 2001-16 is sometimes referred to as an intermediary transaction tax shelter or as a "midco" transaction.) In Notice 2001-16, the IRS indicated that it may challenge the tax results of this transaction on one or more of several grounds and/or may impose penalties on the participants, and identified the transaction and substantially similar transactions as "listed transactions."

Nevertheless, after Notice 2001-16 was published, tax shelters that produced similar results continued to be marketed. For example, in one transaction that was marketed after Notice 2001-16 was published, a third party

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[3] 2008-6 I.R.B. 406.

[4] "Notices" refers to Notices 2001-16 and 2008-20, taken together.

[5] All "Section" references are to the Internal Revenue Code of 1986, as amended, and all references to the regulations are to the Treasury Regulations promulgated thereunder.

would purchase stock in a closely held corporation after the corporation had sold its assets but prior to its liquidation (*i.e.*, at a time when the company's only remaining asset was its pre-liquidation cash) in order to achieve the same result as the transaction in Notice 2001-16 (*i.e.*, avoidance of the corporate tax on the sale of the corporation's assets). Promoters argued that the transaction was not substantially similar to the transaction in Notice 2001-16 because there was no "intermediary" between the asset buyer and seller: the asset sale ostensibly occurred independently and prior to the third party's involvement, and so the third party could claim that it was not an intermediary with respect to the asset buyer or the stock seller.

On the other hand, many buyers and sellers that were not engaged in abusive transactions, and their advisors, were nevertheless concerned that their transactions might be viewed as "substantially similar" to the one described in Notice 2001-16 and reported them under Sections 6011, 6111 and 6112 and the regulations thereunder.

Notice 2008-20 seeks to require taxpayers to disclose transactions that achieve the same result as that described in Notice 2001-16 by shifting the focus away from the "intermediary" toward four objectively measurable indicia of an intermediary transaction tax shelter, while exempting certain non-abusive transactions by providing safe harbors for a narrow set of buyers and sellers.

Under Notice 2008-20, a transaction will be considered the same or substantially similar to the listed intermediary tax shelter transaction described in Notice 2001-16 if four necessary components are present in the context of a transaction that "attempts to avoid the corporate income tax from a sale of assets." In addition to the existence of an intermediary "facilitating [(but not necessarily *intermediating*)] the transaction," the following four components are necessary:

1. The target corporation directly or indirectly owns assets, the sale of which would result in taxable gain and, at the time of the stock disposition described in component 2 below, the corporation (or the consolidated group of which the corporation is a member) has insufficient "tax benefits"[6] to eliminate or offset in whole or in part such taxable gain. Notice 2008-20 refers to the tax that would result from such sale as the "Built-in Tax."

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[6] Tax benefits for this purpose exclude benefits attributable to a listed transaction or to property with a built-in loss acquired within 12 months before the stock disposition described in component 2 below, to the extent that such built-in losses exceed built-in gains in property acquired in the same transaction(s).

2. At least fifty percent of the corporation's stock (by vote or value) is disposed of by one or more sellers, other than in liquidation of the corporation, in one or more related transactions within a 12-month period.

3. Within the 12-month period before, simultaneous with, or within the 12-month period after the date on which one or more sellers dispose of at least fifty percent of the corporation's stock (by vote or value), all or most of the corporation's assets are disposed of to one or more buyers in one or more transactions in which gain is recognized with respect to the assets. The 24-month period is extended for any time when "the corporation is protected or hedged against price fluctuations." An intercompany disposition of the corporation's assets that defers gain is taken into account only when the gain is taken into account. [7]

4. All or most of the Built-in Tax that would otherwise have resulted from the disposition(s) described in component 3 is purportedly offset or avoided or not paid.

In determining whether a person is a participant in the listed transaction identified in Notices 2001-16 and 2008-20, the general rule in Treasury Regulations section 1.6011-4(c)(3)(i)(A) applies,[8] except that Notice 2008-20 provides narrow safe harbors for certain stock sellers and buyers. Specifically, (1) a stock seller will not be treated as a participant in the listed transaction if the only stock of the target corporation disposed of is traded on an established securities market and, prior to the disposition(s), the seller was not a five-percent shareholder by vote or value and (2) an asset buyer will not be treated as a participant in the listed transaction if it purchases only (i) publicly-traded securities representing a less-than-five-percent interest in that class of security or (ii) assets that are not securities and that do not include a trade or business.

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[7] It is not clear whether the 12-month periods before and after the stock disposition are tolled for periods when the corporation is hedged or protected against fluctuations in the price of its assets or some other price fluctuation.

[8] Regulations section 1.6011-4(c)(3)(i)(A) provides, in general, that a taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in the published guidance that lists the transaction. A taxpayer also has participated in a listed transaction if the taxpayer knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from tax consequences or a tax strategy described in published guidance that lists the transaction.

**Summary of Recommendations**

1. We recommend that a taxpayer be treated as a participant in an intermediary tax shelter transaction only if, at the time the taxpayer enters into a transaction, the taxpayer knows or has reason to know that the transaction is described in the Notices. This requirement will permit a taxpayer and its advisors to determine from the outset of a transaction whether the taxpayer might be treated as a participant in the listed transaction identified in the Notices.

2. We suggest an additional safe harbor for *de minimis* Built-in Taxes and suggest removal of the exclusion for sellers with *de minimis* tax benefits.

3. Finally, we request clarification of the phrase "all or most" in components 3 and 4, and guidance on the proper time for valuing assets in component 3.

**Discussion**

**1. Introduce a "knowledge" requirement for participation**

As currently drafted, Notice 2008-20 may implicate non-abusive transactions. Moreover, buyers and sellers who are not knowingly involved in a tax-avoidance plan will not be able to determine at the time they enter into the transaction whether they are about to participate in a listed transaction, and they will not be able to avoid participation through contract. For this reason, we recommend that a taxpayer be treated as a participant in an intermediary tax shelter transaction only if, at the time it enters into the transaction, the taxpayer knows or has reason to know that the transaction is described in the Notices.

Under Treasury Regulations section 1.6011-4(c)(3)(i)(A), a taxpayer is treated as a participant in a listed transaction if (1) its tax return reflects tax consequences or a tax strategy described in published guidance (here, the Notices) or (2) it knows or has reason to know that its tax benefits are derived directly or indirectly from the tax consequences or from the tax strategy described in published guidance. It appears that a stock seller's gain or loss on its stock disposition and an asset buyer's basis in its acquired assets in an intermediary tax shelter transaction would be treated as reflecting the tax consequences or strategy of the listed transaction, without regard to whether the seller or buyer knew or had reason to know that its transaction was part of such a tax strategy.

In most cases involving an intermediary tax shelter transaction, we believe that both the stock seller and the asset buyer will be aware of the existence of a tax-avoidance plan. For example, a selling shareholder may receive a price

premium that is clearly attributable to the use of an intermediary tax shelter, or the taxpayer will be aware that its counterparty has engaged in intermediary tax shelters. Such were the facts of *Enbridge Energy Co. v. United States*, where a stock seller received a substantially increased purchase price for facilitating an asset buyer's purchase through an intermediary.[9] Notice 2008-20, however, appears to apply to a taxpayer even if it does not know or have reason to know of the existence of the components described in Notice 2008-20.

Stock sellers and asset buyers may not be in a position to know at the time of the relevant closing, or for that matter ever, whether they are participating in a listed transaction. Notice 2008-20 applies to transactions in which there are sufficient dispositions of assets by a corporation within a year of (before or after) a disposition of the corporation's stock. What's more, that two-year period is tolled indefinitely when the corporation "is protected or hedged against price fluctuations." A selling shareholder, however, may not know at the time it sells its shares (or ever) whether its buyer will dispose of corporate assets during the one-year (or possibly longer) period following the sale. Conversely, an asset buyer may not know at the time of its purchase (and may never know) that the shareholders of the corporation whose assets it purchases will dispose of a sufficiently large number of their shares in the year (or longer) following its purchase to cause Notice 2008-20 to apply.

Buyers and sellers should be able to determine reasonably whether they are participating in a listed transaction at the time they enter into a transaction. Although we understand that some advisors have begun to conduct due diligence and request representations and covenants in their agreements to the effect that their counterparties will not take any action that will cause the transaction to be a listed transaction within the meaning of Notice 2008-20, this due diligence is atypical and these representations and covenants may be resisted for commercial reasons in non-abusive transactions. Moreover, contractual representations would not relieve a party of its disclosure responsibilities should its counterparty fail to comply, and may not be effectively enforceable.

In the face of this uncertainty, it has been suggested that a taxpayer should file a protective disclosure or request a ruling on the merits of its transaction. We do not believe that these approaches are in the interest of the government or taxpayers.

Instead, we recommend that a "knowledge" standard apply on a taxpayer-by-taxpayer basis in order for a taxpayer to be treated as a participant in the listed transaction described in the Notices. A stock seller or asset buyer should not be

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[9] 101 AFTR 2d 2008-1733 (Mar. 31, 2008)

treated as a participant in the listed transaction if, at the time it enters into the transaction, it does not know about a plan to engage in the listed transaction and has no reason to know that its counterparty is or will be involved in a midco transaction.[10]

In implementing this recommendation, the government might consider identifying circumstances under which a taxpayer will be presumed to have reason to know of a midco strategy. We would expect these circumstances to include where an intermediary is inserted in a purchase and sale transaction after negotiations over substantial aspects of the transaction have taken place. The government might also consider identifying circumstances under which a taxpayer will be presumed not to have such reason to know, including where the asset seller or stock purchaser is a publicly traded company.

It has been suggested that a "knowledge" standard would continue to permit underreporting by those taxpayers who might falsely deny having a reason to know that they are participating in a tax-avoidance transaction. As mentioned above, we believe that in most cases both the stock seller and the asset buyer will know or have reason to know about the midco transaction. There will inevitably be taxpayers who do not comply with any disclosure regime; Notice 2008-20 will not transform liars into honest taxpayers. However, on balance we believe that concern about fraudulent underreporting does not justify the administrative and economic burden that Notice 2008-20 imposes on compliance-minded taxpayers (and their material advisors) who neither know nor have reason to know of a midco transaction.

We further note that the intermediary transaction tax shelter identified in Notice 2001-16 specified that the parties undertook the transaction "[p]ursuant to a plan." It is not clear that Notice 2008-20 retains this concept. The answer depends on the extent to which Notice 2008-20 must be read together with Notice 2001-16. If in fact it was intended that the "plan" concept be retained, guidance should clarify that a taxpayer must either be a party to the plan, or know or have reason to know of the plan, and in both cases whether the taxpayer's respective transaction must be undertaken "pursuant" to the plan, in order to be treated as a participant.

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[10] Regardless of whether a given taxpayer knows or has reasons to know of a midco transaction, the transaction will nonetheless remain a listed transaction with respect to the intermediary and the other party (*i.e.*, the stock seller or asset purchaser, as the case may be) who have actual knowledge of the midco transaction and who are its true participants.

**2. Add a *de minimis* built-in tax safe harbor**

We recommend an additional safe harbor where the amount of Built-in Tax is *de minimis*. Under general principles, if only *de minimis* taxes are potentially avoided in a transaction, the transaction should not be considered a tax shelter.

**3. Remove the apparent *de minimis* tax benefits exemption**

The first requirement of Notice 2008-20 is that the corporation "has insufficient tax benefits to eliminate or offset such taxable gain (or the tax) *in whole or in part*" (emphasis added). Read literally, this requirement would not be satisfied if, at the time of the stock disposition(s) described in the second component, the corporation has *any* tax benefit that would offset even a small part of the taxable gain (or the tax). We believe this implication was unintended. A transaction should be treated as substantially similar to the transaction described in the Notices even if some of the potential gain would be offset by a tax benefit so long as the amount of Built-in Tax is more than *de minimis*.

**4. Define "all or most"**

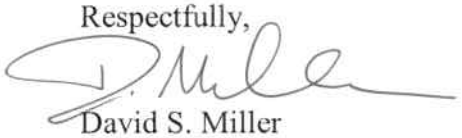
In order for an intermediary transaction tax shelter to be substantially similar to the transaction in Notice 2001-16, "all or most" of the corporation's assets must be sold within the time frame given in the third component, *and* "all or most" of the Built-in Tax purport to be offset or avoided or not paid. This is a critical feature of the Notices because a taxpayer may well try to avoid the Notices by engaging in a transaction in which the corporation disposes of just less than "all or most" of its assets, or alternatively by avoiding just less than "all or most" of the Built-in Tax. However, "all or most" is not a commonly understood term of art in the tax law. Therefore, clearer guidance on the meaning of the term would be helpful. In particular, if this test is intended to be interpreted more expansively than "all or substantially all," the Notices should be clarified to say so.

In addition, the first prong of the test in Notice 2008-20 could literally be avoided if assets having all or most of the taxable gain were sold, but those assets did not represent all or most of the assets of the corporation. The Notice would be under-inclusive if its aim is to include all transactions in which all or most of the taxable gain is avoided. On the other hand, a corporation might dispose of a portion of its assets in non-abusive circumstances, and its retention of a substantial amount of assets might be viewed as evidence that the transaction is not abusive. If, however, the Notice's intention is not to provide a safe harbor for transactions that involve only a minority disposition of assets, the Notice should be clarified to reflect its intent.

In providing clarification of the Notice, it might also be helpful to specify when the baseline value of the assets should be measured in order to determine whether "most" of the assets have been disposed of. Should valuation occur at the outset of the period described in component 3, in the middle, or at the end? In the case of assets with fluctuating or, worse even, declining values, the timing of this measurement could determine whether a transaction is described in the Notices.

We appreciate your consideration of our recommendations and comments. Please let us know if you would like to discuss this letter or if we can otherwise further assist you.

Respectfully,



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