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June 18, 2008

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

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

Re: Report on Distributions in Connection with Acquisitions

Dear Secretary Solomon and Commissioner Shulman:

We write to recommend changes to the federal income tax treatment of distributions in connection with acquisitions.

By way of background, a number of authorities make clear that distributions in connection with an acquisition of target stock are governed by a source rule. Thus, if the target is the source of the distribution, the distribution is governed by Sections 301 or 302 and is not taken into account in determining whether the transaction qualifies as a tax-free reorganization. On the other hand, if the acquiror is the source of the distribution, the distribution is treated as Section 356 boot and is taken into account in determining whether the transaction qualifies as a reorganization.

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For distributions in connection with potential asset reorganizations, the existing authorities do not provide a coherent or consistent set of rules. Some authorities imply that the same source rule applies to distributions in connection with asset reorganizations, but other authorities determine the federal income tax treatment based on the timing of the distribution instead of its source.

In the attached report, we consider two models. First, we consider extending the stock acquisition source rule to asset acquisitions. Alternatively, we consider a rule that would apply a source rule to determine whether a stock or asset acquisition qualifies as a reorganization, but would apply Section 356 to all distributions in connection with reorganizations. Ultimately, we recommend a modified version of the source rule.

Under the approach we recommend, for acquisitions of target stock, distributions would continue to be governed by the source rule for purposes of determining whether the transaction qualifies as a reorganization and for purposes of determining the tax consequences of the distribution.

For asset acquisitions, distributions made prior to the acquisition (even a moment before the acquisition) would be governed by the source rule. However, distributions made pursuant to the asset acquisition would be governed by Section 356, regardless of the source of funds. Finally, the treatment of distributions made after an asset acquisition would depend on the facts. Thus, a distribution made after an asset acquisition could be treated as a Section 301 dividend from the acquiror, as an adjustment to the merger consideration governed by Section 356, or as a pre-acquisition distribution governed by the source rule.

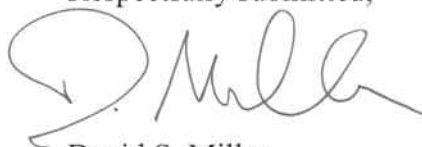
Even if our modified version of the source rule is not adopted, we believe that dividends should be subject to the source rule for both stock and asset reorganizations.

We also seek guidance on two additional questions. First, we would appreciate confirmation that a shareholder's holding period for purposes of the Section 1(h)(11) reduced rate on qualified dividend income is not tolled when a target enters into an acquisition agreement. We do not believe that Congress intended acquisition agreements to toll the holding period because the legislative history indicates that the holding period requirement was enacted to prevent shareholders from accomplishing a tax arbitrage without economic exposure to the underlying stock for the required period.

Finally, in the context of reorganizations that have a "substantially all" requirement, we would welcome guidance on the extent to which the company holding target assets after the acquisition can borrow the funds that finance the cash consideration. In particular, we would appreciate guidance regarding how to analyze the "substantially all" requirement when the corporation holding target assets also holds other non-target assets that could support the borrowing.

We appreciate your consideration of our suggestions. 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,

A handwritten signature in black ink, appearing to read "D. Miller". The signature is fluid and cursive, with a large initial "D" and a long, sweeping underline.

David S. Miller,  
Chair

Enclosure

cc: The Honorable Donald F. Korb  
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