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October 2, 2009

Mr. Michael Mundaca
Acting Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report on Temporary Regulations Regarding
the Hot Stock Rules Under Section 355(a)(3)(B)

Dear Sirs:

We write to comment on temporary regulations issued by the Internal Revenue Service (the "IRS") and the U.S. Department of Treasury ("Treasury") in respect of Section 355(a)(3)(B), which are commonly referred to as the "hot stock" rules.

Section 355 provides rules permitting tax-free spin-offs and split-offs by a corporation ("Distributing") of stock of a second corporation that Distributing controls ("Controlled"). The hot stock rules are one of a number of provisions intended to ensure that a spin-off is not used as a means of indirectly distributing earnings and profits to shareholders in a tax-free manner. Under Section 355(a)(3)(B), a distribution of Controlled stock will be treated as "boot" if Distributing acquired the Controlled stock in a taxable transaction within the five-year period prior to the distribution. The legislative history of the hot stock

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rules indicates that Congress intended those rules to apply to certain indirect acquisitions of Controlled by Distributing.

Section 355(b) imposes another condition to a tax-free distribution of Controlled stock, known as the “active trade or business” test. The active trade or business rules were amended in 2005 in order to eliminate the need for elaborate pre-spin off internal restructurings. As amended, Section 355(b) generally treats all members of a corporation’s separate affiliated group (“SAG”) as a single corporation, and treats certain taxable acquisitions of stock as asset acquisitions. As a result, there is a potential conflict between the hot stock rules and the active trade or business rules.

Temporary Regulation Section 1.355-2T (the “Temporary Regulations”) was issued in response to the 2005 amendments, which in part direct Treasury to prescribe regulations as are necessary or appropriate to modify the application of the hot stock rules in connection with the application of Section 355(b)(3). Under the Temporary Regulations, the scope of the hot stock rules is, in general, limited to acquisitions of Controlled stock during the pre-distribution period by Distributing (or any other member of Distributing’s separate affiliated group (“DSAG”)) if Distributing has Section 368(c) control of Controlled at the time of the spin-off but does not have Section 1504(a) control of Controlled at any time after the acquisition.

We commend the IRS and Treasury for the Temporary Regulations and their limited approach to the hot stock rules, which we believe appropriately balance the concerns that underlie Section 355(a)(3)(B) and the other protections afforded against earnings and profits bailout under Section 355, and the changes to Section 355(b) effected in 2005.

A brief summary of our comments and recommendations are as follows:

1. We concur with the IRS’s and Treasury’s conclusion that the hot stock rules should not apply to an acquisition of Controlled stock if Controlled is a member of the DSAG at any time after the acquisition, but prior to the distribution of Controlled.

2. We agree that transfers of Controlled stock within the DSAG should be disregarded for purposes of the hot stock rules.

3. We believe that the current law exception for transfers of Controlled stock among affiliated group members from application of the hot stock rules should not be eliminated, at least as it applies to transfers among domestic affiliates. For example, we believe an affiliate transfer exception is appropriate if the transferor is a domestic affiliate that held the Controlled stock throughout the pre-distribution period or if the transferor acquired the Controlled stock during the pre-distribution period in a transaction in which no gain or loss is recognized. The final regulations should also include the exception for cash for fractional shares in proposed Treasury Regulations Section 1.355-3(b)(4)(iii).

4. We believe that Section 355(a)(3)(B) should not apply to indirect acquisitions of Controlled stock except in certain limited circumstances, and that bailout concerns raised by indirect acquisitions are adequately policed by other provisions within Section 355. For these

reasons, we recommend that the IRS and Treasury confirm that the hot stock rules do not reach indirect acquisitions of Controlled stock, except in the case of an indirect acquisition entered into with a principal purpose of avoiding the hot stock rules.

5. For reasons similar to those pertaining to indirect acquisitions of Controlled stock, we recommend that the IRS and Treasury issue guidance that confirms that acquisitions by predecessors are outside the reach of the hot stock rules, except for (i) transactions entered into with a principal purpose of avoiding the hot stock rules and (ii) transactions in which the predecessor corporation was a member of Distributing's affiliated group, if the predecessor acquired the Controlled stock in a recognition transaction during the pre-distribution period.

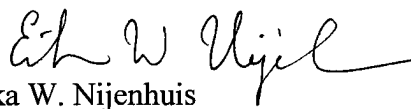
6. We believe that the Tax Court reached the correct result in *Dunn Trust v. Commissioner* and that reconciling Section 355(a)(3)(B) and Section 355(b) should not include extending the reach of the hot stock rules to apply to stock held by Controlled ("real" Controlled issues). Whether a subsidiary of Controlled is in fact the "real" Controlled due to reliance on the subsidiary's business in order to meet the requirements of Section 355(b) is more appropriately addressed within the confines of the active trade or business regime.

7. We recommend that the IRS and Treasury follow the approach adopted in Revenue Ruling 78-442 and exclude issuances of Controlled stock from the ambit of the hot stock rules.

8. We do not recommend that the IRS and Treasury adopt disguised acquisition rules applicable to the redemption by Controlled of its stock using cash or other assets provided by Distributing. A redemption that is, in substance, an acquisition of Controlled stock by Distributing should be subject to Section 355(a)(3)(B) under existing step transaction and substance over form principles.

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,


Erika W. Nijenhuis
Chair

Enclosure

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

Joshua D. Odintz
Acting Tax Legislative Counsel
Department of the Treasury

Clarissa C. Potter
Deputy Chief Counsel – Technical
Internal Revenue Service

Russell Subin
Office of Associate Chief Counsel
Internal Revenue Service

William J. Wilkins
Chief Counsel
Internal Revenue Service