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December 22, 2009

Mr. Michael Mundaca
Acting Assistant Secretary
(Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

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

Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: <u>Report on Final Guidance under Section 382(*l*)(3)(C)</u>

Dear Sirs:

We are pleased to submit a report on Section 382(*l*)(3)(C), which addresses the effect of certain value fluctuations on the determination of whether a loss corporation has an ownership change under Section 382(g). This Report is intended to inform the difficult technical and policy choices that the government must make in formulating final guidance with respect to Section 382(*l*)(3)(C).

Section 382(g)(1) generally provides that an ownership change occurs if, on a testing date, a "5-percent shareholder" of a corporation has increased its ownership in the stock of a corporation by more than 50 percentage points during the preceding three-year period. Section 382(*l*)(3)(C) modifies Section 382(g) by providing, "Except as provided in regulations, any change in proportionate ownership which is attributable solely to fluctuations in the relative fair market values of different classes of stock shall not be taken into account." Temporary regulations issued in

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1987 "reserved" with respect to the treatment of changes in proportionate ownership attributable to fluctuations in value. Because of the lack of guidance, questions surrounding fluctuations of value under Section 382(*l*)(3)(C) thus far have been resolved on a case-by-case basis through the Internal Revenue Service's private letter ruling program.

The threshold issue under Section 382(*l*)(3)(C) is whether the provision should be limited only to prohibiting fluctuations in the relative values of two or more classes of stock from causing a testing date, or whether it should more broadly factor out such value fluctuations in the owner shift analysis. We support an approach to Section 382(*l*)(3)(C) that does not limit its application to the mere avoidance of a testing date when relative values change and would allow taxpayers to factor out value fluctuations in at least certain circumstances.

The next issue is whether the government should craft a broad rule generally factoring out value fluctuations or prescribe a rule that more narrowly targets specified circumstances. A majority of the Tax Section's Executive Committee supports some formulation of a broad approach that generally factors out value fluctuations in determining owner shifts. We envision that such an approach would be similar to the methodology that the IRS has used in a number of private letter rulings (the "PLR Methodology"). However, we did not reach an unequivocal consensus on this point, as a significant minority of the Tax Section's Executive Committee supports a narrower approach.

The majority's viewpoint is fundamentally grounded in the belief that value fluctuations are not indicative of loss trafficking and thus generally should not cause the imposition of a limitation on the use of corporate tax attributes. As a matter of general principles, the majority would distinguish between (i) situations in which a shareholder's proportionate interest increases solely from value fluctuation – that is, where the shareholder has not acquired additional shares, and (ii) those in which the shareholder's proportionate interest increases by virtue of a combination of value fluctuation and acquisition. The majority would factor out the impact of value fluctuation in the former case, but not in the latter case.

The report recommends that additional guidance be issued in order to improve administrability of the PLR Methodology and prevent abusive results, some of which are illustrated in the examples this Report. In particular, the report recommends that if the PLR Methodology is adopted as the framework for final guidance, regulations should (i) address the impact of fluctuations in value prior to the testing period, (ii) provide one or more conventions for a shareholder that redeems or disposes of stock, where the shareholder has acquired multiple blocks of that stock at different times, (iii) clarify the interaction of the PLR Methodology with the small issuance and cash issuance exceptions, and (iv) address the effect of recapitalizations and other exchanges of stock.

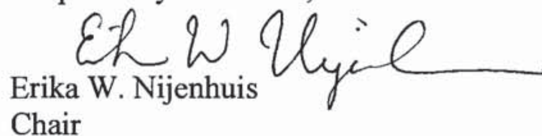
The minority's viewpoint is based on the belief that Section 382's owner shift analysis was only intended to be a rough-cut method of identifying circumstances that have the potential for loss trafficking or inconsistency with the income averaging function of the carryover regime. In the minority's view, a broad approach to factoring out fluctuations in value would necessarily involve substantial complexity, could create unintended opportunities for abuse, or both. Accordingly, in this view, fluctuations in relative value among multiple classes

of stock should be factored out in certain limited circumstances: where shifts resulting from actual share movements are de minimis, and potentially where relatively small shifts occur shortly before or during a bankruptcy proceeding. The approach of adopting a few limited exceptions may alleviate a considerable amount of complexity, but may be criticized as providing relief in too narrow a range of cases, lacking a persuasive conceptual framework, and raising line-drawing issues.

In the end, there is no one perfect solution for whether, the extent to which, and how fluctuations in relative value should be disregarded in calculating owner shifts under Section 382. It is clear that trade-offs will be required to be made (e.g., between complexity and precision). But there can be no doubt that it is important for the Service and the Treasury to bring clarity to this uncertain area of practice.

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

Donald W. Bakke
Attorney Advisor
Department of the Treasury

Mark S. Jennings
Branch Chief
Office of the Associate Chief Counsel
(Corporate)
Internal Revenue Service

Lee A. Kelley
Deputy Associate Chief Counsel (Corporate)
Internal Revenue Service

Emily S. McMahon
Deputy Assistant Secretary for Tax Policy
Department of the Treasury

Marie C. Milnes-Vasquez
Senior Technical Reviewer
Office of the Associate Chief Counsel
(Corporate)
Internal Revenue Service

Joshua Odintz
Acting Tax Legislative Counsel
Department of the Treasury

Keith E. Stanley
Attorney
Office of the Associate Chief Counsel
(Corporate)
Internal Revenue Service

Jeffrey Van Hove
Deputy Tax Legislative Counsel –
Tax Regulation
Department of the Treasury