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May 18, 2012

The Honorable Emily S. McMahon
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The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
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The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report on the Proposed Continuity of Interest Regulations

Dear Ms. McMahon, Mr. Wilkins, and Mr. Shulman:

I am pleased to submit Report No. 1266. The report comments on the proposed regulations issued on December 19, 2011 regarding the common law "continuity of interest" ("COI") requirement governing reorganizations under Section 368 of the Code. The report also comments on the final "signing date" COI regulations, which were issued simultaneously with the proposed regulations.

By way of background, the purpose of the COI requirement is to prevent mergers and other corporate acquisitions that resemble sales from qualifying for nonrecognition of gain or loss as a reorganization. A corporate acquisition satisfies the COI requirement if the former shareholders of the target corporation preserve a substantial part of the value of their former proprietary interest in the target corporation. In general, if at least 40 percent of the aggregate consideration payable to the target shareholders consists of stock of the acquiring corporation, the acquisition will satisfy the COI requirement.

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Ms. McMahon
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In general, COI is determined based on the value of the stock of the acquiring corporation on the closing date. Under the “signing date” regulations, however, it is determined based on the pre-signing date value of the stock, but only if the contract provides for “fixed consideration”.

The purpose of the proposed regulations is to extend the benefit of the signing date regulations to certain acquisitions that do not provide for fixed consideration but nevertheless expose the target shareholders to the economic fortunes of owning the stock of the acquiring corporation. In general, the proposed regulations seek to achieve this purpose under two different rules: the floor price rule and the ceiling price rule. The floor price rule and the ceiling price rule apply when the amount of consideration payable to the target shareholders is adjusted up or down as the value of the acquiror’s stock decreases or increases between signing and closing. If the closing date value of the stock is below the floor price or above the ceiling price, taxpayers must determine whether the COI requirement is satisfied based on such floor price or ceiling price, respectively.

The proposed regulations will eliminate much of the uncertainty regarding the treatment of many acquisitions that do not provide for fixed consideration as reorganizations under the Code. Although we support the proposed extension of the signing date rule to these transactions, we recommend that final regulations limit the floor price rule and the ceiling price rule to typical “market” collars where the pre-signing date value of the acquiror’s stock approximates the midpoint between the floor price and the ceiling price. This will ensure that these rules only apply to price protection mechanisms that do not deprive the target shareholders of meaningful economic exposure to fluctuations in the price of the acquiror’s stock between signing and closing.

The report also includes a number of other comments and recommendations.

Respectfully submitted,



Andrew W. Needham
Chair

Enclosure

Ms. McMahon
Mr. Wilkins
Mr. Shulman
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