

REPORT #806

TAX SECTION

New York State Bar Association

REPORT ON NOTICE 94-46 RELATING TO CERTAIN
OUTBOUND STOCK TRANSFERS

October 18, 1994

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TAX SECTION

New York State Bar Association

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October 18, 1994

Hon. Leslie B. Samuels
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Hon. Margaret M. Richardson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Notice 94-46 under Section 367(a)

Dear Secretary Samuels and Commissioner Richardson:

Enclosed are copies of a Report by the New York State Bar Association Tax Section concerning Notice 94-46, 1994-18 I.R.B. 7. The Notice provides rules for the tax treatment of U.S. persons who transfer the stock of a U.S. corporation (D) to a foreign corporation (F) in exchange for F stock.

The Report discusses several methods of tax avoidance at which the Notice is directed, and agrees with and generally supports the objectives and general approach of the Notice. The Report suggests, however, that two modifications be made to the rules provided in the Notice:

First, the Notice should not apply if F is engaged in an active business and the U.S. transferors own less than 2/3 (rather than 50%) of the stock of F after the transfer.

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Second, certain stock ownership attribution rules in the Notice should not apply if both D and F are publicly traded.

The Report strongly urges that prompt action be taken on the issues raised by the Notice so that nonabusive transactions may proceed.

I hope this Report is helpful in the development of the Section 367(a) regulations. Please let me know if the Tax Section can be of further help in this area.

Sincerely,

Michael L. Schler
Chair, Tax Section

NEW YORK STATE BAR ASSOCIATION
TAX SECTION
REPORT ON NOTICE 94-46 RELATING TO CERTAIN
OUTBOUND STOCK TRANSFERS^{1/}

October 18, 1994

This report comments on Notice 94-46, 1994-18 I.R.B. 7, which sets forth certain rules that are to be incorporated into regulations to be issued under section 367(a) of the Internal Revenue Code.

In Notice 94-46, the Internal Revenue Service and the Department of the Treasury announced that certain transfers of stock or securities of a domestic (i.e., U.S.) corporation to a foreign corporation by a U.S. person in a transaction that would otherwise qualify for tax-free treatment will be taxable under section 367(a).^{2/} Such treatment will apply where the U.S. transferors own in the aggregate 50 percent or more of the total voting power or value of the stock of the transferee corporation immediately after the exchange. Under Notice 94-46 (as under Notice 87-85 and the proposed section 367(a) regulations), for purposes of determining ownership of the transferee foreign corporation, absent proof to the contrary, it is presumed that U.S. transferors own 50 percent or more of the total voting power

^{1/} The principal authors of this report are Diana M. Lopo and Philip R. West. Helpful comments were received from Peter C. Canellos, Michael Hirschfeld, Charles I. Kingson, Richard O. Loengard, Jr., Mark L. Lubin, Pinchas Mendelson, Charles M. Morgan, III, Yaron Z. Reich, Richard L. Reinhold and Michael L. Schler.

^{2/} The notice does not apply to transfers of stock of foreign corporations.

or total value of the stock of the transferee foreign corporation immediately after the exchange.

Notice 94-46 did not modify certain rules set forth in Notice 87-85, 1987-2 C.B. 395, and in the proposed section 367(a) regulations in cases where all U.S. persons transferring stock or securities of the domestic corporation own less than 50 percent of the total voting power and value of the stock of the transferee foreign corporation immediately after the transfer. In those cases (1) a U.S. transferor owning less than 5 percent of the voting power and value of the stock of the transferee foreign corporation immediately after the transfer is not taxed on the transfer and (2) a U.S. transferor owning 5 percent or more (by vote or value) of the transferee foreign corporation after the transfer can avoid recognizing gain on the transfer by entering into a five-year gain recognition agreement.

However, under Notice 87-85 and the proposed regulations, if U.S. transferors own 50 percent or more of the total voting power or value of the stock of the transferee foreign corporation, the transfer (1) is not taxable to a U.S. transferor owning less than 5 percent of the vote and value of the transferee corporation after the transfer, and (2) is taxable to a U.S. transferor owning 5 percent or more (by vote or value) of the transferee foreign corporation after the transfer unless such U.S. transferor enters into a ten-year gain recognition agreement. However, if one U.S. transferor owns more than 50 percent (by vote or value) of the transferee foreign corporation, such U.S. transferor (as well as any other U.S. transferor owning at least 5 percent of the transferee) recognizes gain on the transfer and cannot defer the gain by entering into a gain recognition agreement.

Notice 94-46 modifies the rules in the preceding paragraph and, in general, makes all transfers by U.S. persons of stock and securities of a domestic corporation to a foreign corporation taxable if all U.S. transferors own 50 percent or more in vote or value of the transferee foreign corporation. Notice 94-46 continues the rebuttable presumption, contained under prior rules, that the U.S. transferors own 50 percent or more of the total voting power or total value of the stock of the transferee foreign corporation immediately after the exchange. The Notice is effective for transfers occurring on or after April 18, 1994.

Notice 94-46 states that the Internal Revenue Service and Treasury Department are concerned that certain widely held U.S. companies with foreign subsidiaries which are controlled foreign corporations ("CFCs") recently have undertaken tax-motivated restructurings. The Internal Revenue Service and the Treasury Department are concerned generally about transactions in which stock of a U.S. parent corporation is transferred to a foreign corporation that is not a CFC, with the result that the former shareholders of the domestic corporation own stock of the foreign corporation.

These transactions may take at least four specific forms:

1. The transfer of the stock of a domestic corporation in exchange for the stock of the foreign corporation, followed by the sale or other transfer of the domestic corporation's stock in a transaction that is not taxable because the foreign corporation is not a U.S. taxpayer, a CFC or a PFIC.
2. The transfer of the stock of a domestic corporation in exchange for stock of the foreign corporation, followed by the transfer of the assets of foreign subsidiaries of the domestic corporation to newly organized foreign subsidiaries of the foreign corporation in

exchange for notes or stock of the newly organized foreign subsidiaries (the "Helen of Troy" transaction).

3. The transfer described in (2) above followed, not by a sale of assets, but by a "migration" of any new business (which would, in the typical course, have been directed to the foreign subsidiaries of the domestic corporation) to newly organized foreign subsidiaries of the foreign corporation.
4. The so-called "McDermott" transaction - a transfer of the stock of a publicly held domestic corporation to a foreign subsidiary of the domestic corporation in exchange for stock of the foreign subsidiary, followed by a transfer or "migration" of businesses owned by other foreign subsidiaries of the domestic corporation as described above.

The tax avoidance to be addressed in the first transaction is a tax-free outbound property transfer followed by a sale of that property not subject to U.S. tax because the seller is foreign, not a CFC and not a PFIC. Prior to Notice 94-46, such a transfer and sale could be achieved as long as the transferors were less-than-5 percent shareholders. Thus, as few as 21 unrelated transferors could act in concert to achieve such a tax-free disposition. It is now thought that such a transfer and sale should not be allowed where there is such a small number of transferors. In fact, it is believed, such a transfer and sale should not be allowed where the clear intention is to avoid section 367(a), no matter how great the number of transferors.^{3/}

In the second transaction, the tax avoidance to be addressed would appear to be the loss of U.S. tax on the built-in gain in the assets of the foreign subsidiaries and, subsequently,

^{3/} This transaction presents an opportunity for tax avoidance regardless of whether the domestic corporation owns stock in any CFCs. Arguably, therefore, it is not one of the transactions at which the Notice is aimed. The Notice specifically refers to U.S. corporations owning CFCs. The tax avoidance presented thereby is, however, the garden variety tax avoidance historically targeted by section 367(a).

the loss of U.S. tax on the future earnings from the assets so disposed of by the foreign subsidiaries.^{4/} Notice 94-46 responds by taxing the built-in gain of the domestic corporation's stock disposed of by the U.S. transferors.^{5/}

In the third transaction, the tax avoidance would appear to be the exploitation, without consideration, by non-CFCs of business opportunities created by CFCs. Although this would appear to be tax avoidance that is within the ambit of section 482 to address, policing foreign-to-foreign transactions under section 482 may be difficult.^{6/} Therefore, Notice 94-46 responds by taxing the built-in gain of the domestic corporation's stock disposed of by the U.S. transferors.

In the fourth transaction, the tax avoidance could be similar to the types of tax avoidance described in the two preceding paragraphs, with section 1248(i) addressing the potential avoidance of tax on a portion of the built-in gain of

^{4/} The built-in gain on the assets is not subject to tax because that gain is not Subpart F income. See Temp. Treas. Reg. § 1.954-2T(e)(3). Moreover, the Subpart F rules might not require shareholder taxation of the income of the historic foreign subsidiaries solely due to their receipt of consideration that yields interest or dividends from related persons. See Code S 954(c)(3)(A)(i). The historic foreign subsidiaries also should not become PFICs because a related party rule similar to that of Subpart F would be available. See Code § 1296(b)(2)(C). A variation of this transaction would involve monetizing the stock of the foreign subsidiaries to realize the built-in gain of those subsidiaries. This transaction would also not be subject to tax.

^{5/} We agree with the implication of the Notice that U.S. taxation of future earnings of the foreign corporations is not necessary if the toll charge applies.

^{6/} Moreover, in certain cases, the Internal Revenue Service may be restricted in penalizing transfer pricing abuses occurring in foreign-to-foreign transactions. See Code § 6662(e)(3)(B)(iii).

the transferee foreign corporation's stock.^{7/} Notice 94-46 responds by taxing the built-in gain of the domestic corporation's stock disposed of by the U.S. transferor.

In addition, the Notice appears to be aimed at a more generalized type of tax avoidance: Corporations that are "U.S. businesses" in an "economic" and "political" sense should not be allowed to become foreign-owned without an exit tax or toll charge.

We agree that this policy is appropriately furthered by, and the four transactions described above present opportunities for tax avoidance that are appropriate targets for, I.R.S. and Treasury action under section 367(a).^{8/} Although, in certain cases, we would prefer action that was more closely tailored to the specific policies to be furthered and types of tax avoidance targeted, we recognize the difficulties that such an approach would entail. Therefore, we agree with and generally support the objective and general approach of Notice 94-46 as stated above^{9/}

^{7/} It has been noted that, outside the section 1248 context, this transaction presents the potential for tax avoidance that section 1248(i) does not address. See Canellos, Acquisition of Issuer Securities by a Controlled Entity: Peter Pan Seafoods, May Department Stores and McDermott, 45 Tax Lawyer 1, 10-14 (1991). See also Staff of Jt. Comm. on Taxation, 98th Cong., 2d Sess. General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 448 (Comm. Print 1984). These additional types of tax avoidance may be addressed now that the Service has issued Notice 94-93.

^{8/} It is possible that section 269 may apply to some of the transactions described above.

^{9/} We considered the position that, at least in the case of very large transactions, which are not likely to be tax motivated, the abuses could be addressed by broadening the types of subsequent acts that would trigger gain under a gain recognition agreement. On balance, however, we believe that this approach would not be sufficient.

We would like, however, to respond to the request for comments in the Notice by stressing the importance of appropriate exceptions. In our view, certain fact patterns that would result in taxation under the Notice should be eligible for deferral of gain or gain recognition agreements, as in Notice 87-85 and the proposed regulations. We strongly urge the Department of the Treasury and the Internal Revenue Service to finalize promptly the section 367(a) regulations with the modifications to Notice 94-46 suggested below or, failing such prompt finalization, to issue a notice setting forth such modifications. Notice 94-46 has adversely affected transactions that should not be considered abusive. These transactions are jeopardized both by the broad reach of the Notice and by the lack of guidance as to how the principles announced in the Notice are to be applied.¹⁰/

1. The Ownership Limit. We believe that Notice 94-46 should not apply to the exchange by a U.S. person of stock of a domestic corporation for stock of a foreign corporation if, after the exchange, less than two-thirds of the voting power and value of the stock of the foreign corporation is owned by U.S. transferors, provided that the transferee foreign corporation is engaged in the active conduct of a trade or business prior to the exchange.¹¹/ For these purposes, a foreign corporation should generally be considered to be engaged in an active

¹⁰/ In this regard, we understand that the Internal Revenue Service has been hesitant to issue rulings for transactions involving the transfer of stock and securities of a domestic corporation to a foreign corporation until the regulations under section 367(a) are finalized. In part for this reason, we urge prompt finalization of the regulations or prompt issuance of other guidance and a greater willingness, under appropriate circumstances, to provide rulings even before the regulations are finalized.

¹¹/ It might also be reasonable to require that the domestic corporation be engaged in the active conduct of a trade or business.

trade or business if^{12/} it has (1) been in existence for at least three taxable years prior to the exchange and (2) derived an average of 80 percent of its gross income for such three-year period, and 50 percent of its gross income for the taxable year immediately prior to the exchange, from one or more active trades or businesses, conducted directly or through subsidiaries.^{13/} For these purposes, a subsidiary should include any corporation of which the foreign corporation owns at least 50 percent of the voting power and value of the outstanding stock.

We believe that the higher two-thirds threshold is appropriate because it provides the flexibility required for a non-tax-motivated cross-border merger or combination in which the domestic corporation is larger than the foreign corporation.^{14/} The presence of one- third unrelated foreign owners of the transferee corporation shows significant non-tax motivation. We believe that there will frequently be non-tax motivated transactions in which the U.S. entity is larger than the foreign entity, but the foreign entity acquires the U.S. entity. Moreover, even if the policy were to allow only entities of approximately equal size to combine, fluctuation in the values of the stock exchanged and received can result in a taxable transaction even where the parties attempt to come within the 50 percent rule. We believe that a limit higher

^{12/} This test is modeled on the active business test of section 861(c).

^{13/} To allow for an amalgamation of a U.S. and a foreign business in a new corporate shell, these tests should be applicable, in the case of such an amalgamation, to the foreign business contributed to the new entity, and not to the new entity itself.

^{14/} The gain recognition agreement required by Notice 87-85 would continue to be required of shareholders owning 5 percent or more of the transferee foreign corporation.

than two-thirds is not appropriate, however, because transactions in which domestic corporations are transferred to foreign corporations less than half their size are relatively unusual and would more likely be tax-motivated.

With respect to the transaction in which the U.S. transferors receive more than 50 percent but less than two-thirds of the transferee, the active trade or business requirement should guard against situations where tax avoidance is a primary motive for the combination. Where an active trade or business exists, it may be presumed that the combination transaction is being undertaken for legitimate business reasons and should be permitted to occur tax-free. If the foreign corporation does not satisfy the active trade or business test, the exchange would be taxable if 50 percent or more of the total voting power or value of the stock of the transferee foreign corporation immediately after the exchange was owned by U.S. transferors^{15/}

2. The Ownership Presumption. We believe that one of the most difficult issues raised by Notice 94-46, as well as by Notice 87-85 and the proposed regulations, is the presumption that the U.S. transferors are considered to own 50 percent or more of the total voting power or value of the transferee foreign corporation, and the resulting obligation placed on the domestic corporation and the foreign transferee corporation to identify their shareholders in order to determine whether the

^{15/} In appropriate cases, the rule could apply to stock on a class-by-class basis. For example, if the stock held by foreigners was voting preferred, and U.S. transferors held all of the common equity (but less than two thirds of the aggregate vote and value), a different result might be appropriate.

ownership limitations have been exceeded.^{16/} Such a presumption may, depending on the facts, involve either or both of two "embedded" presumptions, namely that (1) all the shareholders of the transferred U.S. corporation are U.S. persons, and (2) such shareholders also independently own stock of the transferee foreign corporation to the extent necessary to bring their aggregate ownership in the transferee corporation (counting both stock received in the exchange and any preexisting ownership) above 50 percent. We believe the first presumption is reasonable. However, if both corporations are publicly traded immediately before the exchange, we do not believe the second presumption is reasonable as to shareholders owning less than 5 percent of the U.S. corporation.

As a result, we believe the overall presumption is fair if either the domestic corporation or the transferee foreign corporation is not publicly traded immediately prior to the exchange. If the U.S. corporation is not publicly traded, the nationality of the shareholders of that corporation, as well as their ownership (if any) of stock of the foreign corporation, should be easy to determine, making it possible to rebut the presumption in appropriate cases. If the U.S. corporation is publicly traded but the foreign corporation is not, it should be possible to rebut the embedded presumption of cross-ownership, and it is reasonable to require the parties to rebut the embedded presumption that the old shareholders of the U.S. corporation (who are new shareholders of the foreign

^{16/} Our comments regarding the presumption apply to the situations addressed in Notice 94-46, and also to the application of the presumption in the situations not covered by the Notice, i.e., to determine whether a five year or ten-year gain recognition agreement is required.

corporation) are U.S. persons.

On the other hand, based on our views regarding the embedded presumptions discussed above, we believe the presumption in the Notice should be modified if both corporations are publicly traded.^{17/} In that case, on the exchange of stock and securities of a publicly traded domestic corporation for stock and securities of a publicly traded foreign corporation, the presumption of U.S. ownership should apply only to (i) stock issued in the exchange to shareholders of the domestic corporation and (ii) stock of the foreign corporation (other than that acquired in the exchange) held by persons who are 5 percent or greater shareholders of the domestic corporation^{18/} and who are required to disclose that fact under the Securities and Exchange Act of 1934, as discussed below.^{19/} Less-than-5 percent shareholders of the domestic corporation should be conclusively presumed not to own any stock in the transferee foreign corporation other than stock received in the transaction.^{20/} Moreover, for practical reasons, attribution rules should not apply in determining who is a 5 percent shareholder. For purposes of identifying 5 percent shareholders, however, a transaction (such as a sale or

^{17/} Our recommendations in this section are predicated on a threshold level of public trading in the stock of the corporations involved. See, e.g., U.S.-Netherlands Treaty Article 26(1)(c)(i), 26(8). The recommendations should apply only to the extent of such public trading.

^{18/} See, e.g., Code § 897(c)(3).

^{19/} Moreover, we do not believe that the parties should be required to determine whether a 5 percent shareholder of the transferee foreign corporation before the exchange also owns less than 5 percent of the U.S. corporation prior to the transfer.

^{20/} It appears that regulation section 1.382-2T(k)(1) contains a similar conclusive presumption. Section 1.382-2T(k)(2) does not appear to undercut this presumption because it imposes an actual knowledge standard that applies to transactions by 5 percent shareholders, and not in determining who is a 5 percent shareholder.

distribution of the stock of the domestic corporation) undertaken by a 5 percent shareholder to reduce its ownership below 5 percent should be disregarded if such transaction were entered into in anticipation of the exchange with the intention of avoiding the rules set forth above.

In the case of a publicly traded corporation, it is not practical nor should it be necessary to require the corporation to determine the identity of all of its shareholders and whether those shareholders own stock of another corporation.^{21/} Of course, 5 percent shareholders of a domestic corporation can be identified due to the requirements of the United States securities laws that persons acquiring 5 percent or more of the stock of a domestic corporation disclose this to the Securities and Exchange Commission (the "SEC"). Therefore, even if the domestic corporation is publicly traded, it is reasonable to require it to determine whether 5 percent or greater shareholders own stock of the transferee foreign corporation immediately prior to the exchange. Obtaining this information should not impose an undue burden on the domestic corporation.

^{21/} It has been suggested that cross-ownership of the domestic target and transferee foreign corporations can be determined by means of a signed statement the form of which would be distributed with the transmittal letter sent to the domestic corporation's shareholders and a completed copy of which would be returned by the shareholders. There are three fundamental problems with this approach. First, most transactions would not be consummated if such shareholder statements in fact indicated that all U.S. shareholders would be taxable; it is impracticable to negotiate a transaction and ask shareholders to tender their shares with such significant condition (outside the control of the parties) to consummation of the transaction. Second, there is a high likelihood that many shareholders will not return the form, unless such return is a condition to receipt of the new stock. Even then, however, it is possible that not all shareholders will respond or will respond inaccurately, potentially putting the tax fate of the transaction in the hands of many small shareholders. Third, our experience with shareholder certifications is unsatisfactory where, as in the case of the Notice, certification would have to be made with regard to section 958 attribution. We believe that even sophisticated shareholders are not able to certify, with sufficient accuracy, that they do or do not own a specified amount of stock taking into account section 958.

This solution is similar to that provided by the section 382 regulations.^{22/} For these purposes, a domestic corporation should be entitled to rely on Schedules 13D and 13G filed with the SEC to determine its 5 percent shareholders.^{23/}

3. Transferee Ownership by Transferred Corporation.

Notice 94-46 also states that, for purposes of determining whether U.S. shareholders of the domestic corporation own the requisite percentage of the transferee foreign corporation, stock of the transferee foreign corporation owned by the domestic corporation will be disregarded. The effect of this rule will be to reduce the total number of shares of the foreign transferee deemed outstanding by the number of such "internally" owned shares, thereby making it more likely that U.S. transferors will own more than 50 percent of the foreign transferee. The objective of the tests under Notice 87-85 and the proposed section 367 regulations is to determine what percentage of the "equity" ownership of the domestic corporation is owned by U.S. transferors. "Internally" owned stock does not, in reality, diminish the percentage ownership that the U.S. transferors own. Accordingly, we agree with the rule set forth in the Notice.

4. The CFC Exception. We considered whether an exception to the rules set forth in Notice 94-46 should be provided for transfers of stock and securities of a domestic corporation to a foreign corporation which is a CFC after the exchange. This exception would be based on the theory that, as long as a foreign corporation remained a CFC, there would be little or no avoidance of the U.S. foreign tax rules since gain

^{22/} Treas. Reg. § 1.382-2T(k).

^{23/} Cf. Treas. Reg. § 1.382-2T(k)(1).

on disposition of the U.S. target would be treated as Subpart F income to 10 percent "United States shareholders" and 5 percent shareholders would continue to be subject to gain recognition agreements.

The exception would have the effect of exempting transferring shareholders to which Notice 94-46 otherwise would apply from automatic gain recognition, and instead applying to them the rules of Notice 87-85 and the proposed regulations. Thus, the exception would apply only where U.S. transferors owned more than 50% of the stock of the transferee foreign corporation and that corporation was a CFC.

In this situation, less-than-five-percent shareholders of the transferee foreign corporation would not be "United States shareholders" of such corporation, as that term is defined in section 951(b). As such, they would not include in income under Subpart F any gain recognized by the transferee foreign corporation on a subsequent disposition of the domestic corporation's stock. Therefore, if a CFC exception were included, the tax avoidance identified above could continue as to their share of the income on the sale. On the other hand, as long as a sale would result in taxable gain to other shareholders under Subpart F (which would be the case as long as the foreign corporation continued to be a CFC) or under a gain recognition agreement, such a sale may be less likely to occur.

Five-percent-or-greater shareholders that were not ten percent "United States shareholders" would similarly avoid tax on a sale of the domestic corporation stock after the expiration of the gain recognition agreement. However, as described above, such a sale might be less likely as long as the "United States

"shareholders" of the CFC would be taxed on their share of Subpart F income arising on the sale.

Finally, five-percent-or-greater shareholders that were ten percent "United States shareholders" could avoid recognizing taxable gain on the sale of the U.S. corporation if the sale occurred after the expiration of the gain recognition agreement and if the transferee foreign corporation had ceased to be a CFC, for example by the issuance of new equity by the CFC to foreign shareholders. At this point, no U.S. owners of the foreign corporation would be taxable on gain arising on the sale of the stock of the U.S. corporation, and there would no longer be any incentive not to sell.

Even if there was never a plan for the stock of the U.S. corporation to be sold, if the transferee foreign corporation was decontrolled after the transfer to it of the stock of the U.S. corporation, the resulting structure would be similar to that employed in the Helen of Troy and McDermott transactions described above. This would facilitate the other types of tax avoidance at which Notice 94-46 was aimed.

Therefore, we recommend against a CFC exception unless safeguards (such as a toll charge) are added to protect against the CFC ceasing to be treated as such.

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October 21, 1994

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Re: 1995 Priorities

Dear Secretary Samuels and Commissioner Richardson:

On behalf of the New York State Bar Association Tax Section, I am writing to provide you with our list of the areas of the tax law in which we believe guidance is most urgently needed, and that we therefore believe should receive the highest priority for 1995. We have not included in our list the finalization of a number of outstanding proposed regulations that we understand Treasury and the Service already intend to finalize in the near future.

Our priorities are the following, in no particular order:

1. Contingent debt. Proposed and ultimately final regulations should be issued concerning the proper tax treatment of contingent debt. Existing proposed regulation S 1.1275-4 is generally considered unsatisfactory. The lack of certainty of tax treatment hinders development and marketing of nonabusive debt instruments and gives taxpayers opportunities to take positions most

FORMER CHAIRMEN OF SECTION:

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Samuel Brodsky	Richard H. Appert	David Sachs
Thomas C. Plowden-Wardlaw	Ralph O. Winger	J. Roger Mentz
Edwin M. Jones	Hewitt A. Conway	Willard B. Taylor
Hon. Hugh R. Jones	Martin D. Ginsburg	Richard J. Hiegel
Peter Miller	Peter L. Faber	Dale S. Collinson

Richard G. Cohen	Donald Schapiro
Herbert L. Camp	William L. Burke
Arthur A. Feder	James M. Peaslee
John A. Corry	Peter C. Canello

favorable to themselves. We submitted a report making suggestions for regulations in this area in November 1993.

2. Assumption of contingent liabilities.

One of the most important and most intractable areas of the tax law has been the tax consequences to the purchaser and seller of the purchaser's assumption of contingent liabilities in a taxable asset acquisition. Such transactions are extremely common, often involve large sums of money, and could be significantly adversely affected (for no good policy reason) by various interpretations of the law. We believe taxpayers are entitled to know the tax consequences of these transactions before they are entered into rather than risk having these issues be raised on audit with an uncertain outcome. In November 1990 the Tax Section submitted a report on this subject, and in April 1994 we submitted a letter reiterating the need for prompt guidance in this area (and requesting guidance on the assumption of contingent liabilities in section 351 transactions).

3. PFICs. The PFIC rules in sections

1291-1297 are designed to tax U.S. shareholders of foreign corporations that have largely passive income or assets. There are a number of important areas under these provisions in need of guidance. We believe the most important of these is the scope of the section 1296(b) exemptions from the PFIC rules for foreign banks and securities dealers. To a significant extent these exemptions are not merely a matter of statutory interpretation, but rather are available only to the extent provided in regulations. The guidance that has been provided in this area (Notice 88-22, 1988-1 C.B. 489; Notice 89-81, 1989-2 C.B. 399) is generally agreed not to be adequate. Guidance in this area has recently become even more important because of the adoption in 1993 of section 956A (dealing with U.S. shareholders of foreign corporations holding "excess passive assets"), since exemption from section 956A for foreign banks and securities dealers is generally determined by reference to exemption from the PFIC rules.

4. LLCs. Almost every state has now

adopted legislation authorizing limited liability companies (and in some cases limited liability partnerships). Taxpayers can and will utilize these entities only if they have assurance that the entities will be treated as partnerships for Federal income tax purposes. As a result, taxpayer

utilization of these entities will be impeded until the Service issues a revenue procedure providing advance ruling guidelines for partnership classification of these entities (similar to Rev. Proc. 89-12, 1989-1 C.B. 798, providing advance ruling guidelines for limited partnerships). We understand that such a revenue procedure is under active consideration and urge that it be issued as promptly as possible.

We hope that these suggestions are helpful. We would of course be happy to work with the Treasury and the Service in any way that would be helpful to them in the development of guidance in these areas.

Sincerely,

Michael L. Schler
Chair, Tax Section