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January 28, 2009

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

Re: Report on Proposed Regulations Issued Under Sections 367, 1248 and 6038B

Dear Commissioner Shulman:

We write to comment on the proposed regulations issued under section 367, 1248 and 6038B of the Internal Revenue Code that were published in the Federal Register on August 20, 2008 and modified on September 29, 2008 (the "Proposed Regulations").

By way of background, the Proposed Regulations provide an election under which a U.S. corporation can avoid the corporate level gain recognition imposed under section 367(a)(5) on the transfer of assets to a foreign corporation in an otherwise tax-free reorganization. Four requirements must be satisfied to make the election under the Proposed Regulations.

First, the U.S. transferor must be controlled by between one and five domestic corporations (treating all members of an affiliated group as a single corporation). These corporations are referred to as the "control group".

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Second, the U.S. transferors and all controlled group members must all agree to make the election.

Third, each member of the control group must reduce its basis in the stock it receives in the transaction to preserve the control member's share of the "inside gain" of the U.S. transferor.

And, finally, the U.S. transferor must certify that if the foreign acquiring corporation at any time disposes of a significant amount of the section 367(a) property it receives with a principal purpose of avoiding the U.S. tax that would have been imposed on the sale by the U.S. transferor, the U.S. transferor will file a U.S. tax return for the year of the exchange and report (and pay any tax on) the gain that was realized but not recognized.

The Proposed Regulations also contain three ancillary (but important) provisions. First, the Proposed Regulations reverse a rule in the current regulations that requires a U.S. transferor to include in income the "section 1248 amount" attributable to the stock of a foreign corporation that is transferred in a section 361 exchange to a foreign acquiring corporation as part of a triangular reorganization. Under the Proposed Regulations, no section 1248 amount need be included in income in respect of these transactions. Second, the Proposed Regulations contain an anti-stuffing rule under which certain assets that are acquired by a U.S. transferor with a principal purpose of affecting the determination of the amount of aggregate "section 367(a) property" are disregarded for purposes of determinations under the Proposed Regulations. And, finally, the Proposed Regulations clarify the exceptions to the gain recognition requirements of section 1248(f).

We offer several recommendations. In short:

- First, we recommend that the final regulations be revised to permit a corporate transferor that elects under the Proposed Regulations to recognize a portion of its unrecognized gain in an amount equal to any net operating losses. This election will reduce the amount of inside gain that must be preserved through the basis adjustments.
- Second, we recommend that a member of a control group with unrealized outside losses not be required to forfeit the losses as a result of basis adjustments. We suggest a number of potential approaches to address this issue.
- Third, we recommend that the requirement that a U.S. transferor file amended tax returns in the event of a subsequent asset disposition by the foreign transferee to avoid taxes be limited to the five-year period of sections 367(a)(2) and 367(a)(3).
- Fourth, we request that the Treasury Department and the IRS consider extending the election under the Proposed Regulations to RICs, REITs and subchapter S corporations.
- Fifth, we recommend that the definition of a control group be expanded to accommodate indirect corporate ownership through a partnership.
- Finally, we suggest that the Treasury Department and IRS undertake a comprehensive review of the policies underlying section 367(b) and the

appropriate methods to implement those policies. Specifically, we question whether the so-called "dividend within gain" limitation of section 356(a) should apply in the context of an outbound asset reorganization. We discuss several considerations that should be taken into account as part of this review.

We also offer some additional technical comments.

We appreciate your consideration of our recommendations and comments. We would be pleased to discuss these matters with you further or provide any other assistance that you would find helpful.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. Miller", written in a cursive style.

David S. Miller

Enclosure

cc: Michael A. DiFronzo  
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