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July 1, 2008

Via Messenger

Mr. Eric Solomon
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1500 Pennsylvania Ave., N.W.
Washington, DC 20220

Mr. William D. Alexander
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Re: Notice 2008-20 – Intermediary Transaction

Dear Mr. Solomon and Mr. Alexander,

The Internal Revenue Service (the "Service") recently issued Notice 2008-20, I.R.B. 2008-6 (the "Notice" or "Notice 2008-20"),[1] which identifies four components that must be satisfied for a transaction to be the same as or substantially similar to the transaction described in Notice 2001-16, 2001-1 C.B. 730 (the "Intermediary Transaction").[2] We understand that the

[1] Unless otherwise indicated or clear from context, capitalized terms used herein have the meaning ascribed to them in Notice 2008-20 and all section references are to the Internal Revenue Code of 1986, as amended (the "Code"), and to Treasury regulations issued thereunder.

[2] Notice 2001-16 designated the "Intermediary Transaction Tax Shelter" as a listed transaction. As described in Notice 2001-16, the Intermediary Transaction generally involves a

Service issued Notice 2008-20 to prevent taxpayers and their advisors from avoiding the disclosure of transactions intended to be covered by Notice 2001-16. We further understand that the Treasury Department ("Treasury") and the Service are in the process of considering modifications to Notice 2008-20. We thank Treasury and the Service for considering such modifications and include in this letter comments to assist them in doing so. For the reasons discussed below, however, we believe that Notice 2008-20 does not work, should be withdrawn, and should be replaced with a new method for identifying transactions that are the same as or substantially similar to the Intermediary Transaction.

This letter consists of five sections. Section I contains a background discussion of Notice 2008-20, disclosure obligations that apply to taxpayers and tax advisors, and professional standards that apply to tax advisors. Section II contains a general discussion of why the Notice does not work and should be withdrawn. Section III contains a brief discussion of items that Treasury and the Service should consider when adopting new standards for identifying transactions that are the same as or substantially similar to the Intermediary Transaction. Section IV contains a more detailed discussion of issues and ambiguities raised by the four components of Notice 2008-20. Section V contains our conclusions.

I. Background

A. Notice 2008-20

Notice 2008-20 clarifies the class of transactions that are the same as or substantially similar to the Intermediary Transaction (and hence a listed transaction). Notice 2008-20 sets forth four components that must be satisfied in order for a transaction to be the same as or substantially similar to the Intermediary Transaction. Under the Notice, if a transaction fails to satisfy at least one of the components, then the transaction is not the same as or substantially similar to the Intermediary Transaction.

The four components set forth in Notice 2008-20 incorporate objective criteria. Accordingly, the knowledge and motivation of the parties to the transaction do not appear to affect whether any (or all) of the four components has been satisfied.

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seller ("X") who desires to sell the stock of a target corporation ("T") to a buyer ("Y"). The buyer in the transaction desires to acquire the assets of T (rather than T stock) from X. Pursuant to a plan, X transfers the T stock to an intermediary ("M") followed by a transfer by T of its assets to Y. As a result of the transaction, Y obtains a cost basis in the T assets it receives. Notice 2001-16 identifies certain transactions as an Intermediary Transaction, including transactions involving an intermediary (i) that is a member of a consolidated group that uses consolidated tax attributes to shelter the gain otherwise resulting from the sale of T assets or (ii) that is an entity not subject to tax.

The four components of Notice 2008-20 can be summarized as follows –

- Component 1 -- A corporation ("T") directly or indirectly (*e.g.*, through a pass-through entity or a member of a consolidated group of which T is a member) owns assets the sale of which would result in taxable gain and, as of the time of the stock disposition described in Component 2 (below), T (or the consolidated group of which T is a member) has insufficient tax benefits to eliminate or offset such taxable gain (or the tax) in whole or in part. The tax that would result from such sale is referred to as T's Built-in Tax.

- Component 2 -- At least 50 percent of the T stock (by vote or value) is disposed of by T's shareholder(s) ("X"), other than in liquidation of T, in one or more related transactions within a 12-month period.

- Component 3 -- Either within 12 months before, simultaneously, or within 12 months after the date on which X has disposed of at least 50 percent of the T stock (by vote or value), all or most of T's assets are disposed of (Sold T Assets) to one or more buyers (Y) in one or more transactions in which gain is recognized with respect to the Sold T Assets.

- Component 4 -- All or most of T's Built-in Tax described in Component 1 that would otherwise result from the disposition of the Sold T Assets described in Component 3 is purportedly offset or avoided or not paid.

B. Disclosure, List Maintenance, and Professional Obligations Regarding Written Advice

Taxpayers that have participated in an Intermediary Transaction described in Notice 2001-16 and Notice 2008-20 are generally required to disclose the transaction to the Service at the time the taxpayer files the tax return for the year in which the taxpayer participates in the transaction.[3] A taxpayer has participated in a listed transaction if the taxpayer's tax return reflects tax consequences or a tax strategy described in published guidance that lists the transaction.[4]

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[3] *See* Treas. Reg. §§ 1.6011-4(a) and (e).

[4] *See* Treas. Reg. § 1.6011-4(c)(3). A taxpayer may also be treated as a participant in a listed transaction if the taxpayer "knows or has reason to know that the taxpayer's tax benefits are derived directly or indirectly from" such tax consequences or tax strategy. *Id.*

Note that, as suggested by the NYSBA in a prior comment letter to Notice 2008-20, uncertainty as to whether a transaction will be considered to be an Intermediary Transaction may

A "material advisor" to the taxpayer participating in the Intermediary Transaction must also disclose the transaction to the Service,[5] generally by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor (often the date the taxpayer enters into the transaction).[6] The material advisor must also maintain investor lists in accordance with section 6112 and the Treasury regulations issued thereunder.[7]

In addition, the tax advisor must satisfy professional standards regarding written advice set forth in Circular 230.[8] Pursuant to Circular 230, any written advice by a tax advisor to a participant concerning Federal tax issues relating to an Intermediary Transaction generally would be treated as a "covered opinion" that must satisfy the standards of Circular 230.[9] Written advice covered by Circular 230 includes electronic communications such as emails sent by the tax advisor to the taxpayer.[10]

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be avoided if "participation" in the transaction is conditioned on knowledge existing at the time the transaction is entered into by the taxpayer. *See* NYSBA Letter Regarding Notice 2008-20 -- Intermediary Tax Shelter (May 23, 2008), *available at* 2008 Tax Notes 102-67 (May 27, 2008).

[5] *See* section 6111; Treas. Reg. § 301.6111-3(a).

[6] *See* Treas. Reg. § 301.6111-3(e). A tax advisor to a taxpayer becomes a material advisor after (i) the tax advisor provides material aid, assistance, or advice, (ii) the tax advisor receives gross income directly or indirectly in excess of the statutory threshold, and (iii) the transaction is entered into by the taxpayer. *See* Treas. Reg. § 301.6111-3(b)(4).

[7] *See* section 6112; Treas. Reg. § 301.6112-1(a).

[8] *See* 31 C.F.R. § 10.35 (2008). The standards for covered opinions are onerous. The tax advisor generally must consider all "significant" Federal tax issues arising from the Intermediary Transaction and must reach a conclusion with respect to each such issue. *See* 31 C.F.R. § 10.35(c)(3) (2008). In preparing the covered opinion, the tax advisor must identify all relevant facts and cannot base any opinion on unreasonable factual assumptions or factual representations, statements or findings of the taxpayer or any other person, and must relate the applicable law to the relevant facts. *See* 31 C.F.R. § 10.35(c)(1) and (2) (2008).

[9] A "covered opinion" is defined in part as written advice by a practitioner concerning one or more Federal tax issues arising from a transaction that is the same as or substantially similar to a listed transaction. *See* 31 C.F.R. § 10.35(b)(2)(i) (2008). Certain written advice is excluded from the definition of a "covered opinion." *See* 31 C.F.R. § 10.35(b)(2)(ii) (2008). Such excluded written advice includes advice that is provided to a client if the tax advisor is reasonably expected to provide subsequent written advice to the client that satisfies the requirements of Circular 230. *See* 31 C.F.R. § 10.35(b)(2)(ii)(A) (2008).

[10] *See* 31 C.F.R. § 10.35(b)(2)(i) (2008). Thus, if a tax advisor sends a taxpayer an email concerning a Federal tax issue arising in connection with an Intermediary Transaction, that email

II. General Discussion: Notice 2008-20 Does Not Work

Treasury and the Service certainly have an interest in requiring the disclosure of abusive transactions. Unfortunately, as described below, Notice 2008-20 simply does not work. First, the Notice is based on erroneous assumptions that taxpayers will have or can obtain the information needed to determine whether a transaction satisfies the Notice's four components. Second, the Notice is substantially overbroad, potentially describing common stock and asset transactions and applying to taxpayers that are not seeking to (and in fact do not) obtain any special "tax benefit" from the transaction. Third, although taxpayers and their tax advisors arguably can respond to these problems by filing "protective disclosures" with the Service for such common stock and asset transactions (likely reducing the value to the Service of disclosures generally), the tax advisors must then refrain from issuing any written advice, including emails, to their clients in the course of the transaction unless such advice is preliminary to the advisor's issuance of an extensive "covered opinion" that the taxpayer never requested and presumably does not want to pay for. This results in significant and unnecessary tension between a taxpayer and their tax advisor in the course of a common non-abusive stock or asset sale.

A. The Erroneous Assumption of Necessary Information

Notice 2008-20 appears to assume that each party to a transaction has the information needed to determine whether the transaction satisfies the Notice's four components. This assumption is frequently incorrect.

As illustrated in the examples below, one or both parties to a stock sale or an asset sale often will lack the factual knowledge needed to determine whether the transaction is described in the Notice. Such unknown factual information could include, among other things, (i) whether the sale of all of T's assets would have resulted in net gain (Component 1), (ii) whether T sold all or most of its assets within the relevant 24-month period (Component 3), and (iii) whether T's sale of assets within such period resulted in net gain to T (Component 3).

Also as illustrated below, even if both parties know all of the relevant facts, one or both parties often will lack the knowledge needed to determine whether the stock sale allows for the use of tax attributes that would not have been used but for the stock sale (Components 1 and 4). This determination will often depend on the availability of losses incurred by T (the target corporation whose stock sale is described in Component 2) in the year in which T's stock sale occurred. Taxpayers and their advisors, however, are likely to be unable to make any determinations relating to the availability of such losses until T prepares its return for that year. As noted above, tax advisors are required to disclose a transaction described in Notice 2008-20 by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor (which often may be the date the taxpayer enters into the transaction).

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may either (i) satisfy Circular 230's requirements for covered opinions or, more likely, (ii) be preliminary to and followed by the tax advisor's issuance of a covered opinion that satisfies such requirements.

Thus, Components 1 and 4 require tax advisors to make a determination as to the availability of T's attributes before T's attributes are knowable.

Moreover, Components 1 and 4 do not appear to reflect the possibility of carrying back losses to the year of T's stock sale. This is especially problematic in determining whether Component 4 is satisfied. For example, assume that T has no loss attributes, the stock of T is sold to a member of a consolidated group in January of Year 1, and the group has no losses in Year 1. Since the group has no Year 1 losses that can be used to offset T's gain, it appears that Component 4 is not satisfied. But if the group has a loss in Year 3 that is carried back to Year 1 to offset T's gain from the asset sale, then Component 4 seems to be satisfied. Was the stock sale described in Notice 2008-20? If so, when must the seller and its tax advisors disclose the transaction to the Service?[11] How do the seller and its tax advisor obtain the information about the purchasing group's carryback of its Year 3 loss? Must all stock purchase agreements include provisions requiring purchaser's to provide such information so that sellers can determine whether Component 4 is satisfied?[12]

Ultimately, as currently drafted, the Notice is likely to force many purchasers and sellers (and their respective tax advisors) engaged in non-abusive stock and asset sales to take one of three courses of action: (i) To simply file a "protective disclosure" for the transaction despite uncertainty as to whether it is described in the Notice (effectively requiring the tax advisor to issue an extensive "covered opinion" if the advisor gives any written advice, including merely email advice regarding a narrow Federal tax issue);[13] (ii) To choose not to disclose the transaction on the ground that the Service could not have intended the Notice to apply (even though the Notice contains objective criteria and the transaction is (or might be) literally described in the Notice); or (iii) To modify the transaction (at a minimum by requiring the other party to make representations, share tax information for several years, or enter into restrictive covenants regarding assets sales or stock sales within the 12-month period before and after the relevant transaction). Taxpayers (and their tax advisors) should not have to make such a choice.

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[11] Note that the possibility of loss carrybacks is a problem for the seller as well as its tax advisor, since taxpayers must disclose the stock sale transaction to the Service at the time the taxpayer files the tax return for the year in which the transaction occurs (*i.e.*, before the expiration of the period from which losses may be carried).

[12] As noted in Section III.A., *infra*, in our view loss carrybacks should not be taken into account in determining whether a transaction is the same as or substantially similar to an Intermediary Transaction.

[13] We discuss below the linkage of (i) treating a transaction as a "listed transaction" that must be disclosed and (ii) requiring the taxpayer's tax advisor to issue a "covered opinion" if the tax advisor provides any written advice. We recognize that such linkage is not the result of Notice 2008-20 itself. We note here, however, that such linkage currently exists and, as a result, identifying a transaction as a "listed transaction" causes significant collateral costs and consequences.

B. The Overbroad Application of Notice 2008-20

Perhaps we should not be concerned with requiring such choices (along with the filing of "protective disclosures" and the unrequested issuance of "covered opinions") by taxpayers (and tax advisors) engaged in "abusive" transactions. As described below, however, the Notice can apply to garden-variety, non-abusive stock and asset sales involving a trade or business.

Consider a simple stock sale. Corporation S ("S") sells all of the stock of Target Company ("T") to Corporation B ("B"). Has S participated in a transaction substantially similar to an Intermediary Transaction, so that S must disclose the transaction? That seems to depend in part on what B does in the 12-month period after the stock sale. If B causes T to sell for a gain lots and lots of T's assets ("all or most" is the technical term in the Notice, but as discussed below the meaning of that phrase is not clear[14]) (Component 3), T has no attributes that could have been used to offset such gain (Components 1 and 4), and B has attributes that are actually used to offset T's gain (assuming B and T file a consolidated return) (Component 4), then the transaction is likely to be described in the Notice and S is likely to be a participant.[15] Note that this is the case even if S did not know (and had no reason to know) that B planned to cause T to sell assets, and even if B did not plan at the time of the stock purchase to cause T to sell assets.[16]

How does S know about T's subsequent asset sale? Must S require that B notify S if T sells such assets and B has such additional attributes? Must B covenant that it won't cause T to sell such assets for at least twelve months after the stock sale? What if B doesn't have attributes at the time of the stock sale, but incurs losses the following year that are carried back to the asset sale year? Must B notify S of that fact at the time B finally determines that the losses are being carried back (a determination presumably occurring in the year after the losses actually are incurred, or two years after the asset sale). Since much of this information is not knowable at the time S's tax advisors are required to file a disclosure for an Intermediary Transaction, must S's

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[14] *See* Section IV.C.4., *infra*.

[15] S would be treated as a participant in the Intermediary Transaction (and hence subject to the disclosure rules) if S's tax return reflects tax consequences or a tax strategy described in Notice 2008-20. *See* Treas. Reg. § 1.6011-4(c)(3)(i)(A). For example, if S reported gain or loss on the sale of the T stock, S's tax return would reflect the tax consequences of the Intermediary Transaction. Notice 2008-20 provides a narrow exception for a seller that disposes of only target stock that is traded on an established securities market if, prior to the disposition, the seller (and related persons) did not hold five percent or more (by vote or value) of any class of target stock disposed of by the seller. If the exception does not apply, S presumably is a "participant."

[16] If S must disclose the transaction, what exactly is the "transaction" that S must disclose? Presumably it is more than just S's stock sale. Presumably, S must disclose all the other transactions that cause the transaction to be the same as or substantially similar to an Intermediary Transaction, even though such other transactions are outside of S's control and S knows little (or nothing) about those other transactions.

advisors file a "protective disclosure" by the last day of the month that follows the end of the calendar quarter in which the taxpayer enters into the transaction? If so, must S's tax advisors issue a "covered opinion" with respect to the transaction if the advisors have issued any written advice (perhaps merely emails addressing narrow Federal tax issues), even though S never requested an opinion of any kind? If S does not know some or all of this information when it files a return for the year in which the transaction occurred, must S similarly file a "protective disclosure?"

Or consider a purchase of a trade or business. Corporation B ("B") purchases a trade or business from Corporation X ("X"). Has B participated in a transaction that is substantially similar to an Intermediary Transaction, so that B must disclose the transaction? That seems to depend in part on whether (i) the stock of X was purchased within the 12-month period before the asset sale (or is subsequently purchased within the 12-month period after the asset sale) (Component 2), (ii) X's theoretical sale of all of its assets would have resulting in net gain (Component 1), (iii) X sold enough assets to B and other purchasers so that X ended up selling "all or most" of its assets at a net gain within the relevant 24-month period surrounding such stock sale (Component 3), and (iv) such stock sale allowed for additional tax attributes to offset some or all of such net gain (Component 4).[17] That is an awful lot of information for B to try to obtain from X at the time of B's asset purchase and thereafter. After all, B is simply purchasing a trade or business from X, not "all or most" of X's assets. If B does not know some or all of this information, must B file a "protective disclosure" with the Service?[18] Must B's tax advisors issue a "covered opinion" with respect to the transaction if the advisors have issued any written advice (including emails addressing narrow Federal tax issues), even though B never requested an opinion of any kind.

These are not complex fact patterns engineered to show that the Notice is overbroad. These are common fact patterns illustrating that the potential application of the Notice is virtually unlimited. These common fact patterns also illustrate that the ultimate satisfaction of at least some of the Notice's components is often unknown by, and outside the control of, at least one of the "participants" to the transaction.

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[17] Once again, because of the ability to carry back tax attributes, it is possible that determining with finality whether such a stock sale allowed for the use of additional tax attributes will not be possible until the expiration of the applicable carryback period.

[18] Whether B was a "participant" in the disclosable transaction does not appear to depend on whether X recognized gain on the sale to B. *See generally* Treas. Reg. § 1.6011-4(c)(3)(i)(A). Notice 2008-20 provides a narrow exception for buyers if the only assets acquired are either (i) securities that are traded on an established securities market and represent a less-than-five-percent interest in that class of security or (ii) assets that are not securities and do not include a trade or business. If the exception does not apply, then B presumably is a "participant."

C. The Required Issuance of a "Covered Opinion"

As discussed above, a taxpayer and its tax advisor can file a "protective disclosure" when it is uncertain whether a stock sale or asset sale constitutes an Intermediary Transaction,[19] Circular 230, however, effectively forces the taxpayer's tax advisor either (i) to refrain from issuing any written Federal income tax advice (including emails) regarding such a transaction or (ii) to treat such written advice as preliminary to a covered opinion and subsequently issue to the taxpayer a covered opinion with respect to such transaction.

A tax advisor's professional obligation under Circular 230 arises even if the tax advisor is uncertain whether the transaction constitutes an Intermediary Transaction. Thus, a tax advisor can be required to issue to the client a covered opinion that the client does not want where (i) the taxpayer provides written advice regarding narrow Federal tax issues that (ii) arise in connection with a common, non-abusive transaction that (iii) might satisfy the four components of Notice 2008-20 because of (iv) transactions outside the taxpayer's control and (v) of which the taxpayer (and its tax advisor) has little if any knowledge. Not surprisingly, this state of affairs can create significant tension between the tax advisor and the client. Of course, the tax advisor could refrain from providing written advice altogether to avoid the covered opinion requirements. However, this approach seems unrealistic, would often limit the effectiveness of the tax advisor's representation during the course of traditional tax planning, and likely would also produce tension between the tax advisor and the client.

Notice 2008-20 does not create the linkage between a transaction's status as a listed transaction that must be disclosed and a tax advisor's professional standards regarding written advice concerning the transaction. In drafting Circular 230, Treasury and the Service intended tax advisors to be subject to the covered opinion requirements when written advice was given with respect to a listed transaction. However, the concerns sought to be addressed by Treasury and the Service are simply not present when tax advisors are representing taxpayers with respect

[19] We note, however, that a "protective disclosure" must contain all of the information required by the regulations for listed transaction disclosures. *See* Treas. Reg. § 1.6011-4(f)(2) (for taxpayers); Treas. Reg. § 301.6111-3(g) (for tax advisors). Form 8918 ("Material Advisor Disclosure Statement") requires a material advisor to provide information regarding (i) the parties involved in the listed transaction, (ii) the type and timing of tax benefits obtained in connection with the listed transaction, (iii) the manner in which such tax benefits were obtained, and (iv) how relevant Code provisions allow taxpayers to claim such tax benefits. Taxpayers are required to provide similar information on Form 8886 ("Reportable Transaction Disclosure Statement"). It is likely that taxpayers and tax advisors filing such protective disclosures often will not know the information required by the disclosure forms given the uncertainty surrounding whether the transaction constitutes an Intermediary Transaction. Taxpayers and tax advisors may simply indicate that they do not know the required information rather than providing speculative or hypothetical responses.

to common, non-abusive stock and asset sales, particularly when the taxpayers and their tax advisors are filing protective disclosures because they do not know whether the components of Notice 2008-20 are satisfied. In the end, we believe that the uncertain and overbroad application of Notice 2008-20 significantly increases the consequences and costs related to the Circular 230 written standards without providing sufficient (if any) benefits to the government.

D. Summary

Common stock and asset sales should not be treated as listed transactions with respect to which "protective disclosures" must be filed and "covered opinions" must be issued. This is especially true for parties (and their tax advisors) that do not (i) have the information needed to make the required factual determinations (*e.g.*, regarding other sales of stock or assets) and legal determinations (*e.g.* regarding attribute use) and (ii) benefit from transaction apart from purchasing or selling some stock or some assets (*i.e.*, do not knowingly benefit from a so-called "intermediary transaction"). Unfortunately, such transactions appear to fall well within the scope of Notice 2008-20. Accordingly, Notice 2008-20 should be withdrawn.

III. Items that Treasury and the Service Should Consider When Adopting New Standards

As noted above, although this letter urges Treasury and the Service to withdraw Notice 2008-20, the letter does not contain a proposed substitute for identifying transactions that are the same as or substantially similar to those identified in Notice 2001-16. However, this Section III summarizes items that we believe Treasury and the Service should consider when doing so.

A. Definition of "Participant"

The definition of "participant" should be revised to exclude taxpayers that are involved in a transaction but that do not know all of the underlying facts that cause the transaction to satisfy the requirements for being treated as an Intermediary Transaction (*i.e.*, "unknowing taxpayer"). In our view, such unknowing taxpayers generally will not share in the "tax benefits" of an Intermediary Transaction and, in any event, do not have enough information to determine whether the transaction is an Intermediary Transaction. Accordingly, such unknowing taxpayers should not have to disclose the transaction to the Service.[20] Correspondingly, the tax advisor to

[20] This generally should not reduce the number of transactions disclosed to the government. In our view, in most instances, at least one taxpayer will have the information needed to conclude that the transaction satisfies all the requirements for being an Intermediary Transaction. Indeed, if no taxpayer has such information, we submit that the requirements themselves should be reevaluated.

One situation in which no taxpayer may have the requisite knowledge at the time of the transaction is where a transaction ultimately is treated as an Intermediary Transaction because of the use of loss carrybacks. In our view, the use of loss carrybacks should not be taken into account in determining whether a transaction is the same as or substantially similar to an

such an unknowing taxpayer should not be required to disclose the transaction or be subject to the covered opinion requirements of Circular 230. In particular, Treasury and the Service should consider the following:

- Whether a taxpayer that sells the stock of a subsidiary ("T") should be viewed as "participating" in a listed transaction if the seller did not know at the time of the stock sale that the buyer planned to cause T to sell the requisite amount of T's assets within the 12-month period following the stock sale.

- Whether a taxpayer that buys the stock of subsidiary ("T") should be viewed as "participating" in a listed transaction if the requisite sale of T's assets occurred before the sale of T's stock to someone unrelated to both the stock seller and the stock buyer (whether or not the buyer of T's stock knows of such asset sales).[21]

- Whether a taxpayer that purchases assets of a subsidiary ("T") should be viewed as "participating" in a listed transaction if the purchaser did not know at the time of the asset purchase that T's owner planned to sell the stock of T within the 12-month period following the asset sale.[22]

Intermediary Transaction. We do not believe that taxpayers are likely to participate in transactions in order to carry back anticipated future losses to the year of the transaction or to the relevant twelve-month period before or after the transaction. Moreover, taking loss carrybacks into account results in significant uncertainty in determining whether a transaction is the same as or substantially similar to an Intermediary Transaction (*e.g.*, Component 4 of the Notice).

If loss carrybacks are taken into account in determining whether a transaction is the same as or substantially similar to an Intermediary Transaction, however, Treasury and the Service should clarify when the transaction must be disclosed. In our view, if loss carrybacks actually cause a transaction to be treated as an Intermediary Transaction, then the transaction should not be subject to disclosure until such losses are actually incurred and carried back. Treasury and the Service should clarify whether and when a transaction becomes an Intermediary Transaction in such circumstances.

[21] More broadly, it is not clear to us whether T's asset sales prior to the disposition of T's stock should be relevant at all. We are not aware of a situation where attributes of another party (*e.g.*, the buyer of T's stock) can be used to offset gain from the sale of T assets before the disposition of T's stock. *See generally* section 381(c); Treas. Reg. § 1.1502-76(b)(1). Accordingly, Treasury and the Service should consider whether T's asset sales that occur before the disposition of T's stock are relevant.

[22] As noted above, it is not clear whether T's asset sales prior to the disposition of T's stock should be relevant. *See* footnote 21, *supra*.

- Whether a taxpayer that purchases assets of a subsidiary ("T") should be viewed as "participating" in a listed transaction if the purchaser did not know at the time of the asset purchase that T planned to sell other assets and the transaction would not have been treated as a listed transaction without T's sale of such other assets.

- Whether the deadline for tax advisors to disclose Intermediary Transactions should be changed to reflect the need to take into account the existence and use of tax attributes.

B. Not a Listed Transaction

Alternatively, transactions described in Notice 2008-20 (or whatever replaces Notice 2008-20) should be classified as Reportable Transactions (such as Transactions of Interest).[23] Such transactions require disclosure by participants (and their tax advisors) but do not trigger the application of Circular 230's covered opinion requirements. In our view, Treasury and the Service should also consider the following:

- Whether a tax advisor should be permitted not to issue a covered opinion with respect to an Intermediary Transaction for which the tax advisor provided written Federal income tax advice but that is treated as an Intermediary Transaction because of actions of an unrelated party over which the tax advisor's client had no control.

- Whether a tax advisor should be permitted not to issue a covered opinion with respect to a transaction for which the tax advisor provided written Federal income tax advice but that is treated as an Intermediary Transaction because of the use of loss carrybacks (*i.e.*, because such loss carrybacks would not have been available to offset gain but for the sale of T's stock).[24]

IV. Uncertain Application of the Four Components of Notice 2008-20

Section III above identified items that we believe Treasury and the Service should consider when evaluating new methods for identifying transactions that are the same as or substantially similar to an Intermediary Transaction. If Treasury and the Service conclude that

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[23] *See* Treas. Reg. § 1.6011-4(b).

[24] If the tax advisor has not already issued a covered opinion, the tax advisor presumably would be required to issue the covered opinion after the losses are incurred and carried back to offset T's gain from asset sales within the 24-month period surrounding the stock sale. Thus, the tax advisor presumably would be required to issue the covered opinion years after the transaction (*i.e.*, the stock sale and relevant asset sales) occurred.

Notice 2008-20 should not be withdrawn but merely should be modified, such items should still be considered.

In addition, this Section IV identifies more specifically various issues that arise under the four components of Notice 2008-20 and that result either in uncertainty or inappropriate consequences. We believe that modifying Notice 2008-20 to address these specific issues will both assist taxpayers and their tax advisors to determine correctly their respective obligations and limit the potential for Notice 2008-20 to apply to non-abusive transactions.

A. Component 1

As discussed above, Component 1 of Notice 2008-20 requires that a corporation ("T") directly or indirectly (*e.g.*, through a pass-through entity or a member of a consolidated group of which T is a member) owns assets the sale of which would result in taxable gain and, as of the time of the stock disposition described in Component 2 (below), T (or the consolidated group of which T is a member) has insufficient tax benefits to eliminate or offset such taxable gain (or the tax) in whole or in part. The tax that would result from such sale is referred to as T's Built-in Tax. The language of this component raises two issues.

First, the component refers to T's ownership of "assets the sale of which would result in taxable gain." Is T's Component 1 Built-in Tax determined by looking only at T's gain assets? Are T's loss assets relevant under Notice 2008-20 only in the context of applying Components 3 and 4, and there only if T sells the loss assets within the 12-month period? Put differently, is Component 1 satisfied (and T have a Built-in Tax) if T owns some gain assets, even if in the aggregate T has a net loss in all of its assets? Presumably, the component requires that T have a net gain in all of its assets and determines T's Built-in Tax by reference to all of T's assets. We suggest that the language of Component 1 be revised to eliminate this uncertainty.

Second, the component refers to T "directly or indirectly (*e.g.*, through a pass-through entity or a member of a consolidated group of which T is a member) own[ing] assets the sale of which would result in taxable gain ...." How is the component applied where T owns stock of a subsidiary member of a consolidated group that has operating assets? Is the value and T's basis in the subsidiary's stock irrelevant? Must taxpayers take into account the greater amount of built-in gain in the subsidiary's stock or assets?[25] What if T has several tiers of subsidiaries? Should the choice of calculating Component 1's Built-in Tax by reference to the subsidiary's stock or the subsidiary's assets depend on whether T sells the stock or the subsidiary sells its

[25] Note that there are many reasons why there might be different amounts of built-in gain in the subsidiary's stock and assets, including appreciation/depreciation in the value of the subsidiary's operating assets before T purchased the subsidiary's stock, the existence of nonrecourse liabilities in the subsidiary that affect the value of the subsidiary's stock but not the subsidiary's operating assets, the existence of significant goodwill and going concern value in the subsidiary that affect the value of the subsidiary's stock but not the subsidiary's operating assets.

assets within the 12-month period following the sale of T's stock?[26] What if neither the subsidiary's stock nor the subsidiary's assets are sold? We suggest that the language of Component 1 be revised to address more thoroughly how to apply Component 1 where T owns subsidiaries.

B. Component 2

As discussed above, Component 2 of Notice 2008-20 requires that at least 50 percent of the T stock (by vote or value) be disposed of by T's shareholder(s), other than in liquidation of T, in one or more related transactions within a 12-month period. The language of this component raises two issues.

First, the scope of the exception for liquidations is unclear. Must the liquidation be described in section 332? Must there be an actual liquidation or does a deemed liquidation constitute a liquidation for these purposes? For example, what if the stock of T is acquired for cash in an intragroup cross-chain transaction and T is then liquidated into the acquiring corporation? For federal income tax purposes, the cross-chain transaction is treated as if T transferred its assets to the acquiring corporation and then liquidated into its parent corporation in a reorganization described in section 368(a)(1)(D).[27] Is the cross-chain transaction a disposition of T stock for purposes of Component 2, or is it viewed as a disposition "in liquidation of T" that does not satisfy Component 2?

Second, it is not clear why the disposition of the right to vote T stock is relevant to whether a transaction constitutes an Intermediary Transaction. Presumably, Intermediary Transactions are treated as listed transactions because Treasury and the Service believe that tax benefits resulting from noneconomic ownership of stock by the so-called intermediary are inappropriate. Disposition of voting rights, however, does not appear to result in such noneconomic ownership. Accordingly, it appears to us that the disposition of voting rights with respect to stock generally should not cause prior or subsequent asset sales from constituting, in the aggregate, an Intermediary Transaction.

C. Component 3

As described above, Component 3 requires that, within a specified time period, all or most of T's assets be disposed of (the "Sold T Assets") to one or more buyers in one or more transactions in which gain is recognized with respect to the Sold T Assets. The language of Component 3 raises several issues.

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[26] Note that although Component 1 seems to apply a look-through rule, Components 3 and 4 appear to focus on the gain recognized (and the tax incurred) by T on its actual sale of assets. *See* Section IV.C.1., *infra*.

[27] *See* Rev. Rul. 2004-83, 2004-2 C.B. 157.

1. Subsidiary Stock as a "Sold T Asset"

Although Notice 2008-20 appears to adopt (at least potentially) a look-through rule for purposes of calculating T's Component 1 Built-in Tax, Component 3 appears to focus on the assets actually disposed of by T (*i.e.*, the Sold T Assets). Thus, as currently drafted, it appears that in determining whether the Sold T Assets are disposed of in transactions in which gain is recognized with respect to the Sold T Assets, the gain or loss recognized on T's disposition of the stock of a subsidiary would be taken into account without regard to the subsidiary's built-in gain or loss on its assets.[28] Similarly, it appears that in determining whether the Sold T Assets comprise "all or most" of T's assets, the value of the stock of T's subsidiaries retained by T would be taken into account, without regard to the value of the subsidiaries' assets.

If Component 3 is applied by reference to the stock of T's direct subsidiaries (and T's other directly held assets), however, Notice 2008-20 has the potential to apply to transactions outside of its apparently intended scope. For example, assume that X transfers the T stock to an intermediary. Assume further that T subsequently transfers stock of a subsidiary to a buyer but retains other assets, and the value of the transferred stock exceeds the value of the retained assets. In this example, all or most of T's assets may be treated as transferred[29] and, if there is gain recognized on the transfer, then Component 3 may be satisfied, even though the buyer in the above example would not have obtained a cost basis in the assets held by T's subsidiary. Although the buyer would obtain the benefit of the increased basis in the subsidiary stock, Treasury and the Service should not be concerned by a step-up in the basis of the subsidiary stock.[30]

2. Identification of "Sold T Assets"

Component 3 requires that within the specified time frame "all or most of T's assets are disposed of (Sold T Assets) to one or more buyers (Y) in one or more transactions in which gain is recognized with respect to the Sold T Assets." (Emphasis added). As used in Component 3, the term "Sold T Assets" refers to the group of assets that are disposed of during the relevant time period. Because of the emphasized phrase, it appears that the Component 3 is applied by determining whether (i) all or most of T's assets are disposed of and (ii) T recognizes, in the aggregate, net gain in the disposition of the Sold T Assets (the "aggregate approach"). However, the language of Component 3 might be interpreted differently, by taking into account only the T

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[28] The value of a subsidiary's stock may differ from the value of the subsidiary's assets where the subsidiary has nonrecourse liabilities. Whether Component 3 is applied on a gross or net basis is yet an additional uncertainty.

[29] See the discussion below regarding the meaning of "all or most."

[30] *See, e.g.*, section 337(c); Treas. Reg. § 1.337(d)-2; Prop. Treas. Reg. § 1.1502-36. This is especially true where the buyer of the subsidiary stock liquidates the subsidiary in a transaction described in section 332 (and thus takes a carryover basis in the subsidiary's assets).

assets disposed of in transactions in which T recognizes gain (the "asset-by-asset approach"). Treasury and the Service should clarify whether Component 3 is applied under the aggregate approach or the asset-by-asset approach.

The two approaches can be illustrated with the following examples.

Example 1. *Facts.* T owns ten assets, each of which has a value of $10 (total value = $100). T's basis in each of asset 1-5 is $10, and T's basis in each of asset 6-10 is $8 (total basis = $90). T sells all ten assets within the relevant time period. T recognizes no gain on the sale of each asset 1-5, and recognizes $2 of gain on the sale of each asset 6-10. T's net gain is $10.

Analysis. Under the aggregate approach, Component 3 is satisfied because the Sold T Assets comprise all of T's assets and T recognizes a net gain of $10 on the disposition of the Sold T Assets. Under the asset-by-asset approach, by contrast, Component 3 presumably is not satisfied because T recognizes gain only on the disposition of assets 6-10, and assets 6-10 comprise only 50 percent of T's value and thus presumably do not comprise "all or most" of T's assets.

Example 2. *Facts.* The facts are the same as in Example 1 except that asset 1 has a value of $91 and a basis of $90, while each of asset 2-10 has a value of $1 and a basis of $5 (total value of $100 and total basis of $135). Thus, T recognizes a gain of $1 on the sale of asset 1 and a loss of $4 on the sale of each asset 2-10, for a net loss of $35.

Analysis. Under the aggregate approach, Component 3 is not satisfied because T does not recognize a net gain on the disposition of the Sold T Assets. Under the asset-by-asset approach, by contrast, Component 3 may be satisfied, because asset 1 is the only asset on which gain is recognized and asset 1 comprises 90 percent of T's value (possibly constituting all or most of T's assets).

In our view, the asset-by-asset approach makes little sense from a policy perspective and reaches the wrong result in each of these examples. We do not believe that Treasury and the Service intended to apply Component 3 under the asset-by-asset approach. Nonetheless, we are concerned that the current language is potentially ambiguous in this regard. Accordingly, we believe that Treasury and the Service clarify Component 3 so as to provide for the application of only the aggregate approach.[31]

[31] In addition, Treasury and the Service should consider how Component 3 applies where T sells both ordinary and capital assets. Assuming that the aggregate approach is the correct approach, is Component 3 satisfied where T sells all of its assets and recognizes in the aggregate $100 of ordinary gain and $110 of capital loss? What if T recognizes in the aggregate $110 of ordinary loss and $100 of capital gain?

3. Plan to Dispose of T Assets

As discussed above, as used in Component 3, the term "Sold T Assets" does not include assets disposed of after the 12-month period following the date on which X disposes of 50 percent or more of the T stock. The Notice appears to reflect a government concern where the purchaser of T's stock does not retain economic ownership over sufficient T assets for at least 12 months. Consistent with this concern, Treasury and the Service should confirm that if T assets are disposed of after the expiration of the applicable 12-month such assets are not taken into account as long as the assets are sold at their fair market value as of the date the asset sale closes, even if T or the purchaser of T's stock planned within such 12-month period to sell such assets. As long as the asset sale is at the assets' fair market values as of the time the sale closes, the purchaser of T's stock effectively will have had the economic benefits and risks of ownership for the full 12-month period following the sale of T stock. As a result, the fact that the purchaser of T's stock planned within the 12-month period to sell such assets should not cause the sale of such assets to be relevant in determining whether the transaction is the same as or substantially similar to an Intermediary Transaction.

4. Meaning of "All or Most"

Component 3 refers to T's disposition of "all or most" of T's assets. The Service does not define the phrase "all or most" in Notice 2008-20 and meaning of the phrase cannot readily be ascertained. Indeed, the phrase is subject to a surprising lack of clarity.

Looking solely at the phrase itself, "most" presumably is less than "all." In fact, the term "most" can be viewed as the "majority of."[32] Moreover, the use of the disjunctive "or" suggests that the term "all" cannot restrict the term "most." Thus, it appears that the relevant threshold may be whether T disposes of "more than 50 percent" of its assets within the relevant time period. However, it is unsettling to conclude that the Service chose to include in Component 3 the phrase "all or most" if the Service merely meant "more than 50 percent." And if the Service meant something other than "more than 50 percent," what is the applicable threshold?

The phrase "all or most" does not appear in either the Code or the regulations. The Service has used the phrase "all or most" in two different circumstances. *See* Rev. Rul. 61-191, 1961-2 C.B. 251; Publication 15, "(Circular E): Employer's Tax Guide. Neither of these

[32] *See, e.g.,* Merriam-Webster's Dictionary (11th ed. 2003) (defining the term "most" as "greatest in quantity, extent, or degree" and as the "majority of"). Note also that the title of section 119(b)(4) ("Meals Furnished To Employees On Business Premises Where Meals of Most Employees Are Otherwise Excludable") uses the phrase "most employees" and the flush language of that paragraph requires that meals of "more than half of the employees" be furnished for the convenience of the employer. *But cf.,* section 7806(b) (providing that "descriptive matter relating to the contents" of the Code not be given any legal effect).

circumstances clarifies the meaning of the phrase in Notice 2008-20 to any meaningful extent. In Rev. Rul. 61-191, 1961-2 C.B. 251, the Service concluded that a de facto dissolution occurs when, among other requirements, a corporation has disposed of *all or most* of its operating assets.[33] Publication 15, "(Circular E): Employer's Tax Guide," describes the tax responsibilities of employers. In Publication 15, the Service explains that an employer receiving *all or most* of the property used in a trade or business of another employer may include wages that the other employer paid to the acquired employees before the transfer of property for purposes of determining the annual wage base limit for social security. Notably, Treas. Reg. § 31.3121(a)(1)-1(b) requires that "substantially all" of the property be received by the employer. Needless to say, "substantially all" appears to mean more than "most" but less than "all." *See* section 3.01 of Rev. Proc. 77-37, 1977-2 C.B. 568 (for purposes of obtaining a ruling, treating the "substantially all" requirement of sections 354(b)(1)(A), 368(a)(1)(C), 368(a)(2)(B)(i), 368(a)(2)(D), and 368(a)(2)(E)(i) of the Code as satisfied if there is a transfer of at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets).

Although the Service may be hesitant to provide a bright-line test (in order to preclude taxpayers from structuring transactions that barely avoid listed transaction treatment), the Service should provide a standard that taxpayers, the Service, and the courts can apply consistently. For example, the Service may choose to adopt a more definite standard such as "substantially all" or an amount that supports constructive liquidation treatment were T to distribute the asset sale proceeds.[34]

D. Component 4

Component 4 requires that "all or most" of the Built-in Tax (determined in Component 1) that would otherwise result from the disposition of the Sold T Assets described in Component 3 be purportedly offset or avoided or not paid. The language of this component raises two issues.

First, for the reasons discussed above in Section IV.B., the phrase "all or most" is significantly, and in our view needlessly, ambiguous. The phrase should be replaced with a more certain standard.

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[33] *See also Messer v. Comm'r*, 52 T.C. 440 (1969); *Anbaco-Emig Corp. v. Comm'r*, 49 T.C. 100 (1967); *Wofac Corp. v. United States*, 269 F.Supp. 654 (D. N.J. 1967); P.L.R. 8251077 (Sept. 21, 1982); Rev. Rul. 74-462, 1974-2 C.B. 82.

[34] *See* Treas. Reg. § 1.368-2(k)(1)(i) (providing that certain distributions of assets after a tax-free reorganization will qualify for safe harbor treatment under Treas. Reg. § 1.368-2(k) if the distribution of such assets would not result in a liquidation for Federal income tax purposes); *see also* section 355(g) (providing for numerical thresholds in defining the term "disqualified investment company").

Second, and more fundamentally, the focus of Component 4 seems to be misplaced. Component 4 focuses on what percentage of T's Built-in Tax (described in Component 1) that would otherwise result from the disposition of the Sold T Assets (described in Component 3) is offset or avoided or not paid. T's Component 1 Built-in Tax already reflects the use of T's attributes. Thus, Component 4 (i) focuses on the tax resulting from the sale of the Sold T Assets that would not be offset by T's attributes, and (ii) then asks whether all or most of such tax is purportedly offset or avoided or not paid. Note that the relative amount of such tax to the value of T and to T's attributes is irrelevant. As the amount of such tax gets smaller, the possibility that "all or most" of such tax might be offset or avoided or not paid increases. The consequences of this approach can be illustrated by the following examples.

> Example 1. *Facts.* T has $100 million of net operating loss ("NOL") carryforwards. P sells T to B (the parent of a consolidated group) for $1 billion. T joins B's consolidated group. Shortly thereafter, B causes T to sell all of its assets for $1 billion. T recognizes $400 million of net gain. For purposes of applying Component 4, T offsets $100 million of that gain against T's $100 million of NOL carryforwards.[35] B then offsets $125 million of T's remaining gain against B's consolidated group losses from the year of such asset sale.[36]
>
> *Analysis.* Component 4 appears not to be satisfied. T's Built-in Tax from the disposition of the Sold T Assets is $105 million (35% of $300 million, determined by reducing T's $400 million of gain by T's $100 million of NOL carryforwards). Use of the B group's $125 million loss purportedly allows for the avoidance of $43.75 million of tax (35% of $125 million). This $43.75 million tax avoidance is less than 50 percent of $105 million (T's Built-in Tax from the disposition of the Sold T Assets). Although Component 4 appears not to be satisfied, a significant amount of tax is purportedly avoided.
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> Example 2. *Facts.* The facts are the same as in Example 1 except that T recognizes gain of only $300 million (rather than $400 million in Example 1) on the sale of all of its assets. For purposes of applying Component 4, T offsets $100 million of that gain against T's $100 million of NOL carryforwards. B then offsets $125 million of T's remaining gain against B's consolidated group losses from the year of such asset sale.
>
> *Analysis.* Component 4 is satisfied (if "all or most" is more than 50 percent). T's Built-in Tax from the disposition of the Sold T Assets is $70 million (35% of $200 million, determined by reducing T's $300 million of gain by T's $100 million of NOL carryforwards). Use of the B group's $125 million loss purportedly allows the avoidance of $43.75 million of tax (35% of $125 million). This $43.75 million tax avoidance,

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[35] This calculation is required because Component 4 refers to "T's Built-in Tax described in component one ...," and Component 1 is a hypothetical Built-in Tax determined by taking into account T's attributes.

[36] This assumes that there is no limitation on the use of attributes.

however, is more than 50 percent of $70 million (T's Built-in Tax from the disposition of the Sold T Assets). Thus, although the same amount of tax is purportedly avoided in Example 2 as in Example 1, a greater percentage of T's Built-in Tax is avoided in Example 2 (because T recognized less gain on the sale of its assets than in Example 1). Because more than 50 percent of T's Built-in Tax is purportedly avoided in Example 2, Component 4 is satisfied.

Example 3. *Facts.* The facts are the same as in Example 1 except that T has $200 million (rather than $100 million) of NOL carryforwards. (Thus, T recognizes $400 million of gain on its sale of assets.) For purposes of applying Component 4, T offsets $200 million of its gain against T's $200 million of NOL carryforwards. B then offsets $125 million of T's remaining gain against B's consolidated group losses from the year of such asset sale.

Analysis. Component 4 is satisfied (if "all or most" is more than 50 percent). T's Built-in Tax from the disposition of the Sold T Assets is $70 million (35% of $200 million, determined by reducing T's $400 million of gain by T's $200 million of NOL carryforwards). Use of the B group's $125 million loss purportedly allows the avoidance of $43.75 million of tax (35% of $125 million). This $43.75 million tax avoidance, however, is more than 50 percent of $70 million (T's Built-in Tax from the disposition of the Sold T Assets). Thus, although the same amount of tax is purportedly avoided in Example 3 as in Example 1, a greater percentage of T's Built-in Tax is avoided in Example 3 (because T had more NOL carryforwards than in Example 1). Because more than 50 percent of T's Built-in Tax is purportedly avoided in Example 3, Component 4 is satisfied.

It is not clear to us why Treasury and the Service are looking at the portion of the tax that T would have paid absent the transaction but is able to avoid as a result of the transaction rather than the amount of the tax avoided (perhaps relative to the value of T). Indeed, the use of just $1 dollar of the buyer's losses to offset T's income from the disposition of the Sold T Assets can cause Component 4 to be satisfied if T's income from such disposition exceeds T's NOL carryforwards by only $1. The rationale of this approach is not self-evident.

If Treasury and the Service retain the current approach of Component 4, they should adopt a *de minimis* rule for transactions that result in the avoidance of only a *de minimis* amount of tax (for example, because the purchaser of T's stock has a small amount of losses that can be used to offset a small portion of T's gain from T's asset sale). For example, assume that T's stock was sold for $1 million, T sold within the 12-month period following the sale of T's stock enough assets to satisfy the applicable asset-sale threshold (*i.e.*, Component 3) and recognized $300,000 of net gain, T had $250,000 of net operating loss carryforwards, and the purchaser of T's stock was able to use $50,000 of the purchaser's losses to offset T's remaining gain. In these facts, the purchaser's losses offset 100 percent of T's Built-in Tax as calculated for purposes of Component 4. But the avoided tax (approximately $17,500) is a small fraction of T's value. We

do not believe that this "tax avoidance" should be sufficient to cause the transaction to be the same as or substantially similar to an Intermediary Transaction.[37]

V. Conclusion

We recommend that Treasury and the Service consider the comments and issues raised in this letter in light of the purposes of Notice 2001-16 and Notice 2008-20. We believe that Notice 2008-20 should be withdrawn and that Treasury and the Service should adopt a new method for identifying transactions that are the same as or substantially similar to the Intermediary Transaction. Failing that, we believe that Treasury and the Service should clarify and modify Notice 2008-20 in light of the above concerns.

We would be happy to discuss any aspect of this letter with you at your convenience.

Sincerely,

Mark J. Silverman

Steven B. Teplinsky

Keith Sieverding

cc: Karen Gilbreath Sowell, Deputy Assistant Secretary (Tax Policy), Department of Treasury
Marc A. Countryman, Department of Treasury
Douglas Shulman, Commissioner, Internal Revenue Service
Donald L. Korb, Chief Counsel, Internal Revenue Service
T. Ian Russell, Office of Associate Chief Counsel (Corporate)

[37] If the current approach of Component 4 is replaced with a different approach, a *de minimis* approach may continue to be appropriate.