July 18, 2003

Gentlemen:

I am writing on behalf of the Section of Taxation of the American Bar Association concerning recent proposals considered by Congress in connection with pending tax legislation. The views expressed herein represent the position of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

In connection with the recently enacted Jobs and Growth Tax Relief Reconciliation Act of 2003 and other tax legislation that has been considered by Congress in recent months, the Section of Taxation has become concerned with whether certain of the legislative proposals are being given adequate procedural review. Some of these proposals (if enacted), would have a substantial economic impact on a large number of taxpayers yet the proposals were not the subject of a public hearing, nor was adequate time or attention given to considering the full consequences of their adoption. The Section of Taxation strongly believes that such provisions should not be included in tax legislation unless they are subjected to a more deliberative process in which affected taxpayers, stakeholder groups and government agencies are given an opportunity to testify and submit comments.

Two important examples are proposed amendments to section 269 and 362 of the Code that were not enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003, but which we understand the Congress may consider again in the near future. These proposals would have unexpected and unintended adverse consequences to numerous common business transactions.

The Senate Amendment would have amended section 269 principally by repealing the “control” requirement. The result would be to empower the Secretary to disallow tax
benefits resulting from any acquisition of stock of a corporation, and any acquisition of property by a corporation from another corporation in a transferred basis transaction, where the transaction meets the "principal purpose" test of section 269. To totally discard the historic requirement that limits this broad and powerful authority to transactions involving acquisitions of control would expand it to a new universe of transactions, adding an automatic element of uncertainty to virtually every transaction involving an acquisition of stock. A change in Section 269 in the way proposed as to asset acquisitions would subject virtually every incorporation and acquisitive reorganization to new scrutiny as well.

The proposal in respect of section 362 would reduce the aggregate adjusted basis of property contributed to a corporation in a section 351 incorporation to the aggregate fair market value of the property. This new treatment would drastically change the transferred basis regime that has applied to corporate transactions for decades, and would have a punitive effect on non-abusive transactions. Although incorporation has been historically recognized as a mere change in form of businesses with a carryover of tax attributes, the proposal would, in many instances, cause a significant substantive impact that negates the potential use of the corporate form because of the loss of basis upon incorporation. It would cause some corporations to recognize undue amounts of gain, and force many to obtain expensive and otherwise unnecessary asset appraisals. It could prove to be a costly trap for the unsophisticated or ill-advised taxpayer who incorporates for legitimate business reasons, where the transferred assets reflect significant current built-in losses due to economic conditions. A number of anti-abuse mechanisms already exist for restricting the ability of taxpayers to utilize losses. Disrupting the similar treatment of built-in-gain and built-in-loss in commonplace transactions is neither necessary nor appropriate.

We appreciate your consideration of these comments. Representatives of the Section would be pleased to discuss them in further detail with you or members of your respective staffs. Please contact William J. Wilkins, the Section’s Vice-Chair for Government Relations, at (202) 663-6204 if that would be helpful.

Very truly yours,

[Signature]

Richard A. Shaw
Chair-Elect, Section of Taxation