

May 15, 2000

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

Jonathan Talisman, Esq.
Acting Assistant Secretary (Tax Policy)
Treasury Department, Room 1330 MT
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Proposed Amendments to "Check-the-Box" Rules

Dear Commissioner Rossotti and Mr. Talisman:

I am pleased to enclose a report of the Tax Section¹ commenting on proposed amendments to Treas. Regs. § 301.7701-2 and -3 (the "Check-the-Box Regulations") that were published on November 29, 1999 (the "Proposed Regulations").

The Check-the-Box Regulations generally permit a foreign entity that has a single owner and is not of a type listed as a "per se corporation" to elect to be disregarded for United States federal income tax purposes. If an entity is disregarded, its assets are treated as held directly by its owner, so that a sale of stock of the entity is treated for United States federal income tax purposes as an asset sale. As discussed in the enclosed

¹ The enclosed report was prepared jointly by the Section's Committee on Foreign Activities of U.S. Taxpayers and the Section's Committee on Partnerships. The principal drafter was Emily S. McMahon.

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report, under a number of provisions of the Internal Revenue Code the consequences of an asset sale are different from those of a stock sale.

In order to prevent taxpayers from using disregarded entity elections to obtain the consequences of an asset sale under these provisions, the Proposed Regulations would override generally applicable entity-classification rules to invalidate a disregarded entity election in certain circumstances. An election would be invalidated where (i) a 10-percent interest in the entity is disposed of in one or more extraordinary transactions that occur in the period commencing one day before and ending 12 months after the effective date of the entity's change in classification to a disregarded entity, and (ii) the entity was previously classified as a corporation at any time within the 12-month period prior to the date of the extraordinary transaction.

The enclosed report does not take a position as to whether these "extraordinary transaction" rules should be adopted. Instead, the report analyzes the concerns that apparently motivated proposal of these rules, and it discusses several alternatives for addressing those concerns. While some of the Section's members who participated in preparing the report support adoption of the rules, others believe that potential abuses of the Check-the-Box Regulations would be better addressed by other means.

Reservations as to whether the Proposed Regulations should be adopted are based in part on the concern that ad hoc exceptions to the Check-the-Box Regulations, such as the extraordinary transaction rules, will undermine the simplification goals of the Regulations. Although the enclosed report does not take a position whether this concern is sufficiently great that it should prevent adoption of the extraordinary transaction rules, we believe it should be taken into account.

We also suggest that the Treasury and the Internal Revenue Service discuss publicly, in more detail, issues raised by particular uses of the Check-the-Box Regulations and the relative merits of different means of addressing potential abuses. We believe that this would help taxpayers and practitioners to comment more constructively not only on the Proposed

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Regulations, but also on possible future changes to the Check-the-Box Regulations that the government may propose to deal with other perceived abuses.

Although the report does not take a position as to whether the extraordinary transaction rules should be adopted, it concludes that the rules are overly broad as proposed. In particular, we are in agreement that the 10-percent threshold for application of the rules should be increased significantly. The report also includes some more technical comments on the extraordinary transaction rules.

In addition to the extraordinary transaction rules, the Proposed Regulations would amend rules for determining whether and when the classification of a foreign entity is "relevant" for United States federal income tax purposes. The enclosed report comments on the proposed amendments to these rules. In particular, we request clarification as to how these rules interact with provisions of the Check-the-Box Regulations that prevent an eligible entity from changing an entity classification election within 60 months.

We would be pleased to assist you in your consideration of the issues addressed in the enclosed report.

Sincerely,

Robert H. Scarborough

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Jonathan Talisman, Esq.
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cc: Treasury Department

Eric Solomon
Joseph Mikrut
Philip West
Karen Gilbreath

Internal Revenue Service

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CC:DOM:CORP:R(REG-110385-99)