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TAXATION
A Section of the American Bar Association

Section of Taxation

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May 8, 2012

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments Concerning Notice 2010-50

Dear Commissioner Shulman:

Enclosed are comments concerning notice 2010-50. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

William M. Paul

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. McMahon, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service

ABA SECTION OF TAXATION
COMMENTS CONCERNING NOTICE 2010-50

These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Jonathan Forrest, Mark Hoffenberg, Kevin M. Jacobs, Lisa Joire, and Todd Reinstein of the Corporate Tax Committee of the Section of Taxation. Helpful written comments were submitted by Elliot Freier and Michael Schler. Various members of the Corporate Tax Committee provided insightful oral comments. The Comments were reviewed by Joseph Pari, Chair of the Corporate Tax Committee. The Comments were further reviewed by Sonya S. Jindal of the Section's Young Lawyers Forum, John Barrie of the Section's Committee on Government Submissions, and Eric Solomon, Council Director of the Corporate Tax Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contact: Lisa Joire
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Date: May 8, 2012

EXECUTIVE SUMMARY

On June 11, 2010, the Internal Revenue Service (the "Service") issued Notice 2010-50[1] (the "Notice") which provided guidance and requested comments pertaining to whether taxpayers should be able to back out fluctuations in value in determining whether there was an ownership change under section 382,[2] and if so, under what method(s) taxpayers should be able to do so. These Comments propose a methodology for the Department of the Treasury (the "Treasury") and the Service to consider in drafting Regulations under section 382(l)(3)(C).

We recommend that backing out the effect of fluctuations in relative value of different classes of stock is appropriate and should be mandatory. We are proposing a single methodology to accomplish this purpose in order to eliminate uncertainty in this area and to enhance the administrability of a very complicated concept in an already complicated area of the tax law. Our proposed methodology is designed to ensure that the results do not differ regardless of whether shareholders participate in over-the-top transactions (for example, an actual purchase by an existing or new shareholder from an existing shareholder) or transact with the loss corporation (for example, a redemption or issuance), which we treat for purposes of this analysis as a deemed sale or purchase. To accomplish this objective, the following is a summary of our recommendations, including the impact of certain transactions on the determination of whether a section 382 ownership change has occurred:

1. The determination of whether a shareholder is a "5-percent shareholder" within the meaning of section 382(k)(7) (a "5-percent shareholder") should be based on the shareholder's hold constant ownership percentage ("HCP percentage").

2. Shareholders' historical HCP percentage should be reset to fair market value ("FMV") at the beginning of each testing period and, therefore, fluctuations need only and should only be backed out from the beginning of the testing period.

3. For purposes of determining a shareholder's HCP percentage:

   a. Acquisitions should increase the acquiring shareholder's HCP percentage by the FMV percentage ("FMV percentage") of the ownership interest purchased.

   b. Dispositions should reduce the selling shareholder's HCP percentage proportionately based on the relative FMV percentages

[1] Notice 2010-50, 2010-27 I.R.B. 12 (June 11, 2010).

[2] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated, and references to "Regulations" are to the Treasury Regulations under the Code.

of such shareholder’s interest before and after the disposition. Stated differently, if after a disposition, a shareholder’s FMV percentage drops by 25%, its HCP percentage should also be reduced by 25%.

c. Issuances should be treated as an acquisition of stock by the purchaser from the corporation’s existing shareholders. Therefore, the purchaser’s HCP percentage is generally increased by the FMV percentage of its increased ownership in the corporation, and the HCP percentage of a diluted shareholder is treated as reduced in the same proportion as the reduction in its FMV percentage. Additionally, eligibility for and computation of the cash and small issuance exemption should be determined based on FMV percentages rather than HCP percentages, but the allocation of the exempted stock should be determined based on HCP percentages.

d. Redemptions should be treated as an acquisition of stock by the non-redeemed shareholders from the redeemed shareholder. Therefore, the non-redeemed shareholders’ HCP percentage is generally increased by the FMV percentage of the interests deemed acquired and the redeemed shareholders’ HCP percentage is reduced proportionately based on the percentage reduction in such shareholder’s FMV percentage.

e. The impact of a conversion of a company’s equity pursuant to its terms or upon a recapitalization of a company’s equity on the company’s shareholders’ HCP percentage is dependent on whether the value of the stock received post-transaction is equal to the pre-transaction value of the stock (that is, a “value-for-value conversion”) or if the values are not equal (that is, a “non-value-for-value conversion”). A value-for-value conversion should not impact any shareholders’ HCP percentages. A non-value-for-value conversion should be broken into two separate transactions: a deemed value-for-value conversion followed by a transaction that reflects the economics of the non-value-for-value conversion (for example, a deemed issuance or a deemed redemption).

4. Our proposed methodology would be mandatorily applicable for all testing dates beginning six months after the effective date of final Regulations.

5. Our proposed methodology would be treated as a reasonable method under the Notice, thereby permitting application thereof prior to its regulatory adoption.

DISCUSSION

I. Background

Section 382 was designed to discourage acquisitions of loss corporation ("LossCo") stock that would result in the acquirer benefitting from the use of the pre-acquisition tax attributes of the LossCo. Absent section 382, acquirers could use LossCo's tax attributes by first acquiring the stock of LossCo and then either contributing income-producing assets to LossCo or diverting income-producing opportunities to LossCo. Section 382 limits the ability of acquirers to utilize tax attributes generated while LossCo was owned by other shareholders, making acquisitions of a LossCo more neutral for tax purposes.

Section 382 and its Regulations contain complex mechanical rules designed to track the acquisition of LossCo stock by new shareholders who were not owners of LossCo at the time that the tax attributes were generated. Instead of requiring knowledge about every shareholder, section 382 generally limits its shareholder information requirements to those shareholders owning five percent or more of LossCo stock. All shareholders not meeting this five percent threshold are aggregated into one or more public groups under section 382(g)(4)(A).

A Section 382 ownership change is deemed to occur if,

> immediately after any owner shift involving a 5-percent shareholder or any equity structure shift—
>
> (A) the percentage of the stock of the loss corporation owned by 1 or more 5-percent shareholders has increased by more than 50 percentage points, over
>
> (B) the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.[3]

Because the determination of percentage ownership of 5-percent shareholders and public groups depends on the value of all classes of stock outstanding under Regulation section 1.382-2(a)(3)(i), that percentage ownership is affected by shifts in value among multiple classes of stock for those corporations that have multiple classes of stock outstanding, even where such shifts in value are involuntary and do not constitute loss trafficking. Section 382(l)(3)(C) provides that "except as otherwise provided in the Regulations, any change in proportionate ownership which is attributable solely to fluctuations in the relative fair market values of different classes of stock shall not be taken into account." A number of private letter rulings were issued prior to the issuance of the Notice that interpreted how section 382(l)(3)(C) can be applied to factor out any

[3] I.R.C. § 382(g).

change in proportionate ownership which is attributable solely to fluctuations in the relative FMVs of different classes of stock.[4]

II. Notice 2010-50

On June 11, 2010, the Service issued the Notice, which provided some guidance and requested comments pertaining to whether taxpayers should be able to back out fluctuations in value in determining whether there was an ownership change under section 382, and if so, under what method(s) taxpayers should be able to do so. To that end, the Service, within the Notice, has identified the "Full Value Methodology," and two hold-constant methodologies that it currently views as acceptable.

We believe that taxpayers should only be allowed to use one methodology and that the methodology should require taxpayers to back out fluctuations in value.[5] Use of such a single method would prevent ownership changes not arising from loss trafficking, would provide administrative ease, simplification, and certainty for taxpayers and the Service, and would prevent "elections against the fisc". At its core, our recommended methodology is designed to ensure that the results do not differ regardless of whether shareholders participate in over-the-top transactions (for example, a purchase by an existing or new shareholder from an existing shareholder) or transact with the LossCo (for example, a redemption or issuance).

Before discussing our recommendation, we thought it would be helpful if we discussed the three methods that are discussed in the Notice.

A. Full Value Methodology

Under the Full Value Methodology, the percentage of stock that a shareholder owns on each testing date is based on the FMV of the stock owned by such shareholder on that date divided by the total FMV of all of the outstanding stock of the LossCo on that date. In essence, under the Full Value Methodology, all shares are marked to market on each testing date.

The Full Value Methodology takes fluctuations in value fully into account, rather than ignoring them. This methodology could yield unexpected results, such as having a

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[4] *See* PLR 200411012 (Dec. 5, 2003); PLR 200511008 (Dec. 6, 2004); PLR 200520011 (Feb. 18, 2005); PLR 200622011 (Feb. 2, 2006); PLR 200901001 (Sept. 30, 2008); PLR 200901003 (Sept. 12, 2008); PLR 200934002 (May 19, 2009); PLR 200952004 (Sep. 23, 2009); PLR 201001017 (Oct. 1, 2010); PLR 201005019 (Oct. 27, 2009); PLR 201010009 (Dec. 4, 2009); PLR 201015023 (Dec. 30, 2009); PLR 201017002-4 (Jan. 11, 2010).

[5] This principle may result in non-intuitive results (*i.e.*, the sum of the HCP percentages for all of a LossCo's shareholders could be more or less than 100%). We believe that such a result is both an inevitable and an appropriate consequence of backing out fluctuations in value, because some shareholders will be treated as having a different percentage of shares than they actually own (as a result of backing out the effect of fluctuations), while others (particularly those who bought their shares more recently and thus have not been effected by fluctuations in relative value) will be carried at their actual FMV percentages.

shareholder's percentage ownership of LossCo increase even if it sells some of its shares, because the relative FMV of its remaining shares increased in value compared to other shares of LossCo. This methodology can also create owner shifts attributable to shareholders who do not participate in any transaction, even while the number of outstanding shares remains constant.

B. Hold Constant Principle (HCP) Alternative 1 Methodology: Look Back from Testing Date

Under the Notice's HCP Alternative 1 Methodology, the percentage of stock that a shareholder owns is based on the assumption that all of LossCo's stock, regardless of class, performed in the same manner as the class of stock that is being evaluated. In essence, under the HCP Alternative 1 Methodology, the actual realities of the performance of each class of stock are ignored and the ownership of LossCo is determined on a shareholder-by-shareholder basis.

In our view, utilizing the HCP Alternative 1 Methodology does not reflect the economic realities of a transaction, because it fictionally treats each class as having performed in the same manner as the class being analyzed prior to the time that the effect of an issuance or redemption is analyzed. Because the proportion of shares of LossCo that are effectively purchased or sold upon an issuance or redemption depends on the actual percentage of LossCo that is issued or redeemed, ignoring prior fluctuations in assessing the effect of an issuance or redemption gives rise to a different result than the result obtained if an actual over-the-top purchase or sale to or from each shareholder of a specified percentage of LossCo's stock had occurred.

C. HCP Alternative 2 Methodology: Ongoing Adjustments from Acquisition Date – Current Values Approach and Relative Historical Values Approach

Under the Notice's HCP Alternative 2 Methodology, the percentage ownership associated with a block of stock that a shareholder acquires is adjusted only when that shareholder disposes of shares or when there is an issuance or redemption that results in a dilutive or accretive effect on that percentage ownership. The HCP Alternative 2 Methodology makes adjustments based on current values or historical values. The "Current Values Approach" bases the dilutive and accretive adjustments for issuances and redemptions and the reduction in percentage ownership from dispositions on the difference between the current values of the shareholder's percentage ownership before and after the transaction. The "Relative Historical Values Approach," which is derived from the last paragraph of Section 3(c) of the Notice, bases the dilutive and accretive adjustments for issuances and redemptions on the percentage of stock issued or redeemed and the reduction in percentage ownership from dispositions on a proportionate decrease in that shareholder's historical percentage ownership. In essence, under both of the approaches to the HCP Alternative 2 Methodology, each share of stock is proportionately increased or decreased based on an actual transaction, regardless of the fluctuations of value associated with each class.

In our view, utilizing either approach to the HCP Alternative 2 Methodology gives rise to distortive results in a variety of situations, depending on whether the Current Values Approach or the Relative Historical Values Approach is used. In an issuance, using the Current Values Approach, the historical percentage ownership is adjusted by the difference between the current values of the shareholder's percentage ownership before and after the issuance, which can lead to shareholders with a negative HCP percentage if the decline in percentage ownership caused by the dilutive effect of the issuance is greater than that shareholder's prior HCP percentage. In a redemption, using the Relative Historical Values Approach, the accretive adjustment for the HCP percentage of the non-redeemed shareholders is based on their prior HCP percentage, rather than on the value of the additional ownership acquired, which gives rise to a different result than the result obtained if an actual over-the-top purchase had occurred.

III. Our Proposal

The following summary discusses our recommendations for a single methodology of applying section 382(l)(3)(C) to owner shift calculations under section 382.

There are two initial determinations that must be made prior to assessing the cumulative owner shifts or equity structure shifts on each testing date: (1) the identification of the 5-percent shareholders and (2) the determination of the historic lowest percentage ownership of each 5-percent shareholder.

A. Identification of the 5-percent shareholders

Section 382(k)(7) defines a 5-percent shareholder as "any person holding 5 percent or more of the stock of the corporation at any time during the testing period."

The question arises as to what impact, if any, fluctuations in value should have in determining whether a person is a 5-percent shareholder. In other words, should a person be treated as a 5-percent shareholder if its ownership exceeds five percent purely as a result of fluctuations, or not be treated as a 5-percent shareholder if its ownership is less than five percent solely because the value of its stock has declined relative to other shares. It is our view that a person's HCP percentage should be utilized in determining whether or not it is a 5-percent shareholder. While we recognize that the five percent threshold was intended at least in part to facilitate ease in identifying shareholders of public companies, in which case actual FMV percentage ownership would be the relevant test, we believe that consistency with the overall objectives of backing out fluctuations of value is a more significant objective and that such objective dictates that the HCP percentage be used to identify 5-percent shareholders.

For example, if a person owns two percent of LossCo at the beginning of the testing date and during the testing period, the person's equity increases in proportionate value to six percent and there have not been any transactions involving LossCo's equity, we believe that the appropriate result is that the person is not a 5-percent shareholder, even though its ownership interest actually represents six percent of LossCo's total equity value.

B. Determination of the Historic Shareholders' Historical HCP Percentages

The Notice solicits recommendations on whether fluctuations in relative value should be backed out solely from the beginning of the testing period, or since a date before the beginning of the testing period as, for example, the date on which the stock was initially acquired by the shareholder. It is our view that shareholders' historical HCP percentage should be reset at the beginning of each testing period and, therefore, fluctuations need only and should only be backed out from the beginning of the testing period.

Conceptually, although marking percentage ownership to market at the beginning of a testing period may change computations during the testing period by adjusting the baseline value of certain shares, we believe that such a result is not offensive, because it still allows for a full back out of any fluctuations in value that occur during the testing period. Furthermore, we believe that such treatment on balance promotes greater administrative convenience because information does not have to be gathered from earlier periods that may not be relevant for other section 382 purposes, such as acquisitions that occurred prior to the corporation becoming a LossCo or prior to the enactment of section 382. We recognize that this approach will require additional computations on each testing date to determine the historic shareholders' HCP percentage at the beginning of each testing period compared to the alternative approach in which historic shareholders' HCP percentage rolls forward from testing date to testing date. However, we believe that the burden of making such additional computations is less than the burden imposed by the alternative, in which taxpayers are required to chronologically reconstruct ownership percentages and chronologically distant fluctuations, which possibly involve predecessor classes of shares.

C. Transactions involving LossCo Equity

As discussed above, a guiding principle in our proposal focuses on what the result would have been had an over-the-top transaction occurred. The following discussion and examples demonstrate how a transaction would be viewed from an over-the-top perspective.[6] To illustrate a number of scenarios in applying the methodology in our proposal, we have created the following series of examples.[7]

[6] For simplicity, all of the calculations within our examples are based on rounding to two decimal places.

[7] Although Proposed Regulations were recently issued providing exceptions to the segregation rules under section 382, our examples are based on the segregation rules contained in the current Regulations. *See* Prop. Reg. § 1.382-3(i), -3(j), 76 Fed. Reg. 72362 (Nov. 23, 2011). While the revisions to the current segregation rules may impact some of the examples contained within our proposal, we have considered the impact of the proposed revisions and do not believe our proposal needs to be changed to reflect the finalization, or lack thereof, of these Proposed Regulations. In other words, the new segregation rules merely affect the location of the ownership in the loss corporation and not when the percentage ownership in the loss corporation is adjusted to reflect fluctuations in the relative values of different classes

1. Acquisitions

a) Acquisitions by New Shareholders

Similar to the Full Value Methodology, HCP Alternative Methodology 1 and HCP Alternative Methodology 2, under our proposal, if a new shareholder purchases shares in a corporation, that shareholder's ownership percentage would be equal to the FMV of the ownership percentage that it purchased on the date of such purchase.

Example 1: Acquisition by New Shareholders

<u>Facts</u>: On the first day of the testing period ("Date 1"), LossCo has five shareholders: A, an individual who owns 500 common shares whose aggregate value is $500; B, a corporation that is equally owned by C and D, that owns 470 voting preferred shares, whose aggregate value is $470; and three shareholders ("Public Group") who collectively own 30 common shares whose aggregate value is $30. As of Date 1, for section 382 purposes, A owns 50% of LossCo, B owns 47% of LossCo, and the Public Group owns 3% of LossCo.

	Date 1		
	Value	FMV %	HCP %
A	$500	50.00%	50.00%
B	$470	47.00%	
Public Group	$30	3.00%	3.00%
Indirect owners of LossCo:[8]			
C	$235	23.50%	23.50%
D	$235	23.50%	23.50%

Before the second testing date occurs, but within the same testing period ("Date 2"), the aggregate value of A's common shares and the Public Group's common shares declined to $100 and $6, respectively, while the aggregate value of B's preferred shares remained constant. In other words, A's stock now represents 17.36% of LossCo's value,

of corporate stock. We recommend that the use of percentage ownership in the revised segregation rules be consistent with our recommendations in similar areas. For example, we recommend that the pro-rata allocation of shares among public groups be made using HCP ownership percentages as we propose for the cash and small issuance exceptions and that the identification of exceptions to the segregation rules for first and higher tier entities based on level of percentage ownership be based upon HCP ownership percentages as we propose for the identification of 5-percent shareholders.

[8] Note that because B is a first tier entity, it is its owners, C and D, whose shifts in ownership are ultimately relevant. Because C and D are 5-percent shareholders of LossCo, we separately reflect their HCP percentages, rather than adding their ownership to the Public Group, and we do not reflect in these illustrations an HCP percentage for B.

B’s stock now represents 81.60% of LossCo’s value, and the Public Group’s stock now represents 1.04% of LossCo’s value.

	Date 1			Date 2		
	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:						
C	$235	23.50%	23.50%	$235	40.80%	23.50%
D	$235	23.50%	23.50%	$235	40.80%	23.50%

The next day (“Date 3”), A sells half of its interest in LossCo (250 shares) to Z in exchange for $50.

Analysis: Neither C nor D, directly or indirectly, nor the Public Group is involved in the transaction and so their respective HCP percentage will remain the same at 23.50%, 23.50% and 3.00%, respectively, (even though they represent 40.80%, 40.80% and 1.04% of LossCo’s value, respectively). Z, who purchased the 250 shares from A will have an HCP percentage of 8.68%, representing the aggregate value of the shares acquired relative to all other shares of LossCo stock outstanding on the acquisition date. We should note that under our proposal, it does not matter if Z is an individual, or a new public group; the results would be the same. If Z is a first tier entity, then its owners would calculate their respective HCP percentages to determine whether they are 5-percent shareholders of LossCo based on their proportionate ownership interest in Z.

For a discussion of the impact of this transaction on A’s HCP percentage, see Example 4 below.

b) Acquisitions by Existing Shareholders

Similar to the example above, under our proposed methodology, if an existing shareholder purchases additional shares in a corporation from another shareholder, the buying shareholder should increase its ownership percentage by the FMV of the ownership percentage that it purchased.

Example 2: Acquisition by Existing Shareholders

Facts: The facts are the same as Example 1, except on Date 3, A sells all of its interest in LossCo to B instead of Z.

Analysis: B acquired all of A’s interest at a time when those shares represented a value of 17.36%. Although B’s shares represent 98.96% of the value of LossCo, C and D’s section 382 ownership percentage would only be increased in aggregate by 17.36%

to 64.36%. Under our proposal, the acquiring shareholder would take its pre-acquisition HCP percentage and add to it the FMV percentage of the interest it purchases.

For a discussion of the impact of this transaction on A’s HCP percentage, see Example 3 below.

2. Dispositions

Under our proposal, a selling shareholder’s ownership percentage is proportionately reduced to reflect the percentage of the selling shareholder’s equity that it is selling. This approach of proportionately reducing a shareholder’s historic section 382 ownership based on a proportionate disposition is a governing principle of our proposed methodology.

a) Complete Dispositions

With regards to complete dispositions by direct shareholders, we believe that the selling shareholder’s interest should be reduced to zero percent to reflect the fact that the selling shareholder no longer owns any interests in LossCo.

Example 3: Complete Disposition by Direct Shareholder

<u>Facts:</u> The facts are the same as Example 2.

<u>Analysis:</u> A has sold 100% of its interests in LossCo. Therefore, its HCP percentage is reduced by 50% (50% [Previous HCP percentage] * 100% [Percentage Disposed]) down to zero percent (50% - 50%). Therefore, after the disposition, LossCo’s ownership will be as follows:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%			
B	$470	47%		$470	81.60%		$570	98.96%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$285	49.48%	32.18%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$285	49.48%	32.18%

b) Partial Dispositions

With regards to dispositions, as discussed above, under our proposal, if a shareholder sells its entire interest, then the selling shareholder’s HCP percentage should be reduced to zero percent. Following that approach, if a selling shareholder sells only a portion of its interest, this should result in a proportionate reduction of the selling shareholder’s HCP percentage.

Example 4: Partial Disposition by Direct Shareholder

Facts: Same as Example 1.

Analysis: A has sold 50% of its interests in LossCo. Therefore, its ownership percentage is reduced by 25% (50% [Previous HCP percentage] * 50% [Percentage Disposed]) down to 25% (50% - 25%). Therefore, after the disposition, LossCo's ownership will be as follows:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$50	8.68%	25.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Z							$50	8.68%	8.68%
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	40.80%	23.50%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	40.80%	23.50%

c) Consequences of Disposing Shareholder Holding Multiple Blocks of Stock

As discussed previously, under our proposal, a selling shareholder's ownership percentage is proportionally reduced to reflect the percentage of the selling shareholder's equity that it is selling, irrespective of whether the selling shareholder has one or more blocks of stock. In other words, a selling shareholder is deemed to sell a pro-rata portion of each of its ownership equity blocks. In making this determination, we had considered several options including, last-in first-out (LIFO), first-in first-out (FIFO), pro-rata, and actual knowledge. However, for administrative convenience, we believe the pro-rata approach should be adopted as the ability to track this information can be overly burdensome on taxpayers and the Service, and we can identify no principled reason to stack the disposed shares in a manner that would either maximize or minimize the disposition of shares that have previously undergone the greatest historic fluctuations in relative value.

Example 5: Disposition of Multiple Blocks of Stock

Facts: Same as Example 1 and 4. However, on a day after Date 3, but still part of the same testing period ("Date 4"), the collective value of the common stock falls by 25% to $79.50. The next day ("Date 5"), A sells its remaining shares to Z (so that Z now owns all 500 of A's common shares). Immediately after the transaction, the ownership would be as follows:

	Date 3			Date 4			Date 5		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$50	8.68%	25.00%	$37.50	6.82%	25.00%			
B	$470	81.60%		$470.00	85.53%		$470.00	85.53%	
Z	$50	8.68%	8.68%	$37.50	6.82%	8.68%	$75.00	13.69%	15.50%
Public Group	$6	1.04%	3.00%	$4.50	0.82%	3.00%	$4.50	0.82%	3.00%
Indirect owners of LossCo:									
C	$235	40.80%	23.50%	$235	42.77%	23.50%	$235	42.77%	23.50%
D	$235	40.80%	23.50%	$235	42.77%	23.50%	$235	42.77%	23.50%

Z's HCP percentage is equal to 15.50% because it is Z's original HCP percentage (8.68%) plus the FMV of the shares it just acquired (6.82%).

The next day ("Date 6"), the value of LossCo had not changed and Z decided to sell half of all of its investment in LossCo to Y, an individual, for $37.50.

Analysis: Y acquired its ownership interest for $37.50, which represents 6.82% of the total FMV of the Company. Therefore, Y's HCP percentage would be equal to 6.82%. Z is treated as disposing of half of its ownership interests. Because the sale is treated as a sale pro-rata amongst its ownership interests, Z's HCP percentage would be reduced by 7.75% (15.50% [Previous HCP %] * 50% [Percentage Disposed]) down to 7.75% (15.50% - 7.75%). Therefore, after the disposition, LossCo's ownership will be as follows:

	Date 4			Date 5			Date 6		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$37.50	6.82%	25.00%						
B	$470.00	85.53%		$470.00	85.53%		$470.00	85.53%	
Y							$37.50	6.82%	6.82%
Z	$37.50	6.82%	8.68%	$75.00	13.69%	15.50%	$37.50	6.82%	7.75%
Public Group	$4.50	0.82%	3.00%	$4.50	0.82%	3.00%	$4.50	0.82%	3.00%
Indirect owners of LossCo:									
C	$235	42.77%	23.50%	$235	42.77%	23.50%	$235	42.77%	23.50%
D	$235	42.77%	23.50%	$235	42.77%	23.50%	$235	42.77%	23.50%

3. Issuances

Our proposed methodology assumes that, when a LossCo issues new shares, the existing shareholders sell a portion of their interests to the shareholder who purchased the newly issued shares in an over-the-top acquisition, and then all of the shareholders infuse value into the corporation on a pro-rata basis.[9] For issuances that qualify for the cash issuance exception to the segregation rules,[10] we propose that the exempt shares for the cash issuance exception be calculated based on the actual FMV percentage of the stock held by the corporation's public groups immediately before the issuance because that percentage is not shareholder specific and more accurately reflects the likelihood of participation by the corporation's existing public groups. We propose, however, that the pro-rata allocation of shares among public groups under the cash and small issuance exceptions be made based on HCP percentages so that the allocation of shares is not affected by fluctuations in relative value that might distort the relative ownership of the public groups.

a) Issuances to New Shareholders

Under our proposed methodology, when a LossCo issues new shares to a new shareholder, the new shareholder's interest is effectively reducing the existing shareholders' ownership. Therefore, applying an over-the-top approach, it is as if the new shareholder purchased its shares from the existing shareholders.

Example 6: Issuance of New Shares to a New Shareholder (Individual or First Tier Entity)

Facts: The facts are the same as Example 1, except on Date 3, LossCo issues to Z, an individual or a first tier entity, 500 new common shares, whose aggregate value is \$100 or 14.79% of LossCo's post-issuance equity value of \$676.

Analysis: Due to the issuance, Z owns 14.79% of LossCo's value, and so for section 382 purposes, Z's ownership is 14.79% (that is, the FMV percentage of the new stock on its acquisition date). From A's, C's, D's and the Public Group's perspective, it is as if each of them sold 14.79% of their respective ownership in LossCo, thereby reducing their respective HCP percentages by 14.79% (that is, they each own 85.21% of what they previously owned, because Z purchased 14.79% of their shares from each of them). Therefore, A's HCP percentage is reduced to 42.61% (50% - (50% x 14.79%)), each of C's and D's HCP percentage is reduced to 20.03% (23.5% - (23.5% x 14.79%)), and the Public Group's HCP percentage is reduced to 2.56% (3% - (3% x 14.79%)).

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[9] Note that this is true even if the newly issued shares are of a different class than the shares held by the shareholder who is diluted. In such a case, the over-the-top model could be viewed as involving a sale by the old shareholder to the new shareholder, followed by a recapitalization of the purchased shares into the class of shares actually acquired in the issuance.

[10] Reg. § 1.382-3(j)(3).

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	14.79%	42.61%
B	$470	47.00%		$470	81.60%		$470	69.53%	
Z							$100	14.79%	14.79%
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	0.89%	2.56%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.76%	20.03%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.76%	20.03%

The illustration above assumes that Z is an individual. If Z is a first tier entity, then its owners would reflect the 14.79% increase.

Example 7: Issuance of New Shares to a New Shareholder (Public Group)

Facts: The facts are the same as Example 6, except Z is a public group.

Analysis: Due to the issuance, the new public group ("Public Group – New") has acquired 14.79% of LossCo's value. The tax consequences of this acquisition are dependent on whether the issuance is determined to be "solely for cash" under the cash issuance exception in Regulation section 1.382-3(j)(3). If the acquisition is not solely for cash, then the results of the acquisition would be the same as Example 6, with Z representing Public Group – New. However, if the acquisition is solely for cash, then, pursuant to Regulation section 1.382-3(j)(3), the Public Group is treated as receiving a percentage of the newly issued stock equal to 50% of the FMV percentage of the Public Group's equity immediately before the issuance. We should note that in applying the cash issuance exception, we are utilizing the Public Group's FMV percentage ownership of LossCo rather than its HCP percentage, because we believe the FMV percentage more accurately reflects the likelihood of participation by the existing public shareholders.

Therefore, in this example, the Public Group is treated as acquiring 0.52% (50% * 1.04% [the FMV percentage of the existing Public Group's equity immediately before the issuance]) of the newly issued common shares, whose aggregate value is $0.52 (0.52% [the percentage of the issued shares deemed to be acquired by the existing Public Group] * $100 [the aggregate value of all of the issued shares]) or 0.08% ($^{\$0.52}/_{\$676}$) of LossCo's total value post-issuance. The remaining 99.48% of the newly issued common shares, whose aggregate value is $99.48 (99.48% [the percentage of the issued shares deemed to be acquired by the Public Group – New] * $100 [the aggregate value of all of the issued shares]), are treated as being acquired by the Public Group – New.

Focusing solely on the Public Group – New, it has acquired 14.72% of LossCo's value ($^{\$99.48}/_{\$676}$) from A, C, D, and the Public Group. For the impact on A, C, D and the Public Group, see the further discussion at Example 9.

b) Issuances to Existing Shareholders

Under our proposal, when a LossCo issues new shares to an existing shareholder, it is as if the buying shareholder purchases its shares from all of the existing shareholders, including itself. However, for HCP purposes, a shareholder's HCP percentage should not be adjusted for self-dealing transactions (that is, the shares that it is treated as buying from itself).

Example 8: Issuance of New Shares to an Existing Shareholder (Individual or First Tier)

<u>Facts:</u> The facts are the same as Example 1, except on Date 3, A purchases 500 new common shares, whose aggregate value is $100 or 14.79% of LossCo's post-issuance equity value of $676, from LossCo.

<u>Analysis:</u> Under our proposal, A is treated as acquiring its 14.79% of LossCo from LossCo's existing shareholders, including itself. In other words, as part of this transaction, A is both selling shares and acquiring shares. In order to determine the impact of the issuance, it is necessary to determine what percentage each seller is selling to A. As of Date 2, A owned 17.36%, C and D indirectly owned 81.60% in the aggregate, and the Public Group owned 1.04% of LossCo's FMV; which economically represents the percentage that each seller is selling of the total shares acquired by A. Therefore, A is treated as selling 17.36% of the new shares to itself. This means that under our proposal, A would increase its HCP percentage by 12.22% (14.79% [the FMV of all of the shares purchased] – 2.57% [the percentage of A's acquisition that is treated as being sold by A (14.79% * 17.36%)); resulting in a net HCP percentage of 62.22% (50.00% + 12.22%).

C, D and the Public Group are treated as selling 14.79% of their shares to A. Therefore each of C's and D's HCP percentage is reduced to 20.03% (23.5% - (23.5% x 14.79%)) and the Public Group's HCP percentage is reduced to 2.56% (3% - (3% x 14.79%)).

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$200	29.59%	62.22%
B	$470	47.00%		$470	81.60%		$470	69.53%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	0.89%	2.56%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.76%	20.03%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.76%	20.03%

Example 9: Deemed Issuance of New Shares to an Existing Shareholder (Public Group)

Facts: The facts are the same as Example 7 and the stock was issued solely for cash.

Analysis: As discussed above, the Public Group is deemed to acquire 0.08% of LossCo's post-issuance value from A, C, D and itself. For A, C and D, their HCP percentages are reduced to reflect the 14.8% of value acquired by the Public Group and the Public Group – New, in the aggregate.

With regards to the Public Group, it is both an acquirer of shares as a result of its own participation in the issuance and as a seller of shares as a result of the participation of the Public Group – New. Under our proposal, when an issuance or redemption involving multiple shareholders has such an effect on a participating 5-percent shareholder, its HCP percentage is adjusted only to the extent that the 5-percent shareholder has a net increase or decrease in actual FMV proportionate ownership. In this example, the FMV of the Public Group's ownership in LossCo post-issuance is $6.52 ($6.00 [pre-issuance value] + $0.52 [value of equity it is deemed to purchase as described in Example 7 above]) and its FMV percentage ownership is 0.96% ($^{\$6.52}/_{(\$100+\$470+\$6.52+\$99.48)}$). This reflects a 7.69% reduction in the Public Group's FMV percentage ownership ($^{(1.04\% - 0.96\%)}/_{1.04\%}$). Therefore, its HCP percentage is reduced from 3.00% to 2.77% (3% - (3% x 7.69%)).

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	14.79%	42.61%
B	$470	47.00%		$470	81.60%		$470	69.53%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6.52	0.96%	2.77%
Public Group - New							$99.48	14.72%	14.72%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.77%	20.03%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	34.77%	20.03%

4. Redemptions

Under our proposed methodology, when a LossCo redeems shares from a shareholder, the redemption of interest is effectively increasing the remaining shareholders' ownership. Therefore, applying an over-the-top approach, it is as if all of the existing shareholders are purchasing the redeemed shares from the redeemed shareholder in an over-the-top disposition, and then the corporation makes a pro-rata distribution of value to all of its remaining shareholders.

a) Complete Redemptions

As suggested above, when a LossCo completely redeems a shareholder, it is as if the remaining shareholders effectively purchase all of the redeemed shareholder's equity because their respective ownership of LossCo increases with the elimination of the redeemed shares. Therefore, the result is a combination of the analysis previously provided under Acquisition by Existing Shareholder (Example 2) and Complete Disposition by Direct Shareholder (Example 3).

Example 10: Complete Redemption

Facts: The facts are the same as Example 1, except on Date 3, LossCo redeems all of A's shares for $100.

Analysis: Applying an over-the-top approach, the redemption of A's shares can be viewed as a purchase of all of A's shares by C, D and the Public Group. With regard to A, its HCP percentage would be reduced by 50% (50% [Previous HCP percentage] * 100% [Percentage Disposed]) down to 0% (50% - 50%).

With respect to C, D and the Public Group, it is as if they purchased their pro-rata portion of A's shares: C and D each purchased 49.37% ($^{40.8\%}/_{(81.60\% + 1.04\%)}$) of A's shares and the Public Group purchased the remaining 1.26% ($^{1.04\%}/_{(81.60\% + 1.04\%)}$). Therefore, each of C's and D's HCP percentage would increase by 8.57% (49.37% [the percentage of the redeemed shares purchased they are each treated as purchasing] * 17.36% [the FMV of the shares "purchased"]) and the Public Group's HCP percentage would increase by 0.22% (1.26% [the percentage of the redeemed shares the Public Group is treated as purchasing] * 17.36% [the FMV of the shares "purchased"]). We should note that because the redemption is deemed to be an over-the-top transaction, the Public Group acquiring the shares is the same Public Group, rather than a segregated Public Group. Therefore, the following table summarizes the respective ownership on the various dates:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%			
B	$470	47%		$470	81.60%		$569	98.78%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$7	1.22%	3.22%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$285	49.39%	32.07%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$285	49.39%	32.07%

We should note that under our proposal, it does not matter what type of shareholder is redeemed, the analysis would be the same.

b) Partial Redemptions

Under our proposal, when a LossCo partially redeems a shareholder, it is as if the partially redeemed shareholder is disposing of a portion of its equity in an over-the-top transaction. Therefore, the result is a combination of the analysis previously provided under Acquisition by Existing Shareholder (Example 2) and Partial Disposition by Direct Shareholder (Example 4).

Additionally, similar to the analysis provided above related to dispositions by shareholders holding multiple classes of stock on page 12, we believe that if the partially redeemed shareholder has more than one block of equity, the redemption should be pro-rata amongst all of the blocks of the redeemed stock.

Example 11: Partial Redemption

<u>Facts:</u> The facts are the same as Example 1, except on Date 3, LossCo redeems half of A's shares for $50.

<u>Analysis:</u> Applying an over-the-top approach, the redemption of A's shares can be viewed as a purchase of half of A's shares by all of LossCo's shareholders.

Each LossCo shareholder is treated as purchasing its pro-rata share of A's redeemed shares. This is computed by determining their percentage of the LossCo's FMV percentage ownership immediately after the redemption. Therefore, A is treated as purchasing 9.51%, C and D are each treated as purchasing 44.68%, and the Public Group is treated as purchasing 1.14% of the LossCo shares that are actually redeemed. A's actual proportionate ownership, based on FMV percentages, is decreased from 17.36% to 9.51%, meaning that A is treated as disposing of 45.22% of its shares ($^{(17.36\% - 9.51\%)}/_{17.36\%}$). It should be noted, that even though A actually disposed of half of its shares, it effectively sold some of those shares to itself. Therefore, A's HCP percentage must be reduced by 45.22% of 50%, its HCP percentage before the redemption, leaving A with an HCP percentage of 27.39%. C, D and the Public Group are each purchasing their interest from another shareholder. Therefore, each of C's and D's HCP percentage would increase by 3.88% (44.68% [the percentage of the redeemed shares deemed to be purchased by the shareholder] * 8.68% [the FMV of the redeemed shares]) and the Public Group's percentage would increase by 0.098% (1.14% [the percentage of the redeemed shares deemed to be purchased by the Public Group] * 8.68% [the FMV of the redeemed shares]). Similar to the complete redemption context, because the partial redemption is deemed to be an over-the-top transaction, the public group acquiring the shares is the same public group, rather than a segregated public group. Therefore, the following table summarizes the respective ownership on the various dates:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%	$50	9.51%	27.39%
B	$470	47%		$470	81.60%		$470	89.35%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.14%	3.098%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	44.68%	27.38%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	44.68%	27.38%

5. Conversions and Recapitalizations

When a shareholder has its equity converted (either pursuant to the terms of the instrument or pursuant to a recapitalization that was not provided for in the terms of the original stock) into other classes of equity (for example, the conversion of preferred stock into common stock or the conversion of Class A common into Class B common stock), the impact on LossCo's shareholders' HCP percentage, is dependent on whether the value of the stock the shareholders whose equity is being converted (the "converted shareholders") is equal to the value of the equity which is being converted (that is, a "value-for-value conversion") or if the values are not equal (that is, a "non-value-for-value conversion").

a) Value-for-value conversion

In a value-for-value conversion, the converted shareholders are receiving equity whose value is equal to the value of the equity that is being converted. Therefore, this transaction would not impact any of the shareholders' FMV ownership percentage of LossCo, and, under our proposal, this transaction would be ignored for purposes of determining the shareholders' respective HCP percentage.

Example 12: Value-for-value conversions

<u>Facts:</u> The facts are the same as Example 1, except on Date 3, LossCo converts all of A's equity in LossCo to another class of LossCo equity which is worth $100.

<u>Analysis:</u> Prior to the transaction, A owned equity in LossCo whose value is equal to $100. As part of the conversion, A is converting its equity in LossCo for equity worth $100, which means the transaction qualifies as a value-for-value conversion. Therefore, the FMV ownership percentage and the HCP percentage will remain constant.

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47%		$470	81.60%		$470	81.60%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	40.80%	23.50%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	40.80%	23.50%

b) Non-value-for-value conversion

In a non-value-for-value conversion, the converted shareholders are receiving equity whose value is not equal to the value of the equity that is being converted. Therefore, the conversion needs to be broken into two separate transactions. The first transaction is a deemed conversion of the converted shareholders' equity into equity whose value is the same as the equity being converted (that is, this step puts the converted shareholders in the same position they would have been had the conversion been a value-for-value conversion). The second transaction is dependent on whether the converted shareholder is receiving equity whose value is greater than or less than the value of the equity being converted. If the received equity is worth more, then the second transaction is a deemed issuance by LossCo (that is, the converted shareholder is treated as buying the excess value from the existing LossCo shareholders). If the received equity is worth less, then the second transaction is a deemed redemption by LossCo (that is, the converted shareholder is treated as selling the shortfall in value to the existing LossCo shareholders). In all cases, however, the portion of the exchange that is value-for-value does not impact the shareholders' FMV percentage ownership or HCP percentage in LossCo.

Example 13: Non-value-for-value conversions (conversion of all equity)

Facts: The facts are the same as Example 12, except on Date 3, LossCo converts all of A's equity in LossCo to another class of LossCo equity which is worth $125, presumably because A is providing something else of value to LossCo.

Analysis: Prior to the transaction, A owned equity in LossCo whose value is equal to $100. As part of the conversion, A is converting its equity in LossCo for equity worth $125, which means the transaction is a non-value-for-value conversion. Because A is receiving equity whose value is greater than its old equity, it is as if A purchased the additional equity from C, D, and the Public Group.

The amount of the deemed purchase is equal to the difference between A's FMV percentage ownership before the transaction and after the transaction. In other words, the difference between 17.36% and 20.80% ($^{\$125}/_{(\$125+\$470+\$6)}$), or 3.44% of LossCo's total value. Therefore, it is treated as if A purchased 3.44% from C, D, and the Public Group, which results in each of C's and D's HCP percentage being reduced by 3.44% of its pre-conversion HCP percentage or 0.81% (23.5% * 3.44%) and the Public Group's HCP percentage being reduced by 3.44% of its pre-conversion HCP percentage or 0.10% (3.00% * 3.44%). A increases its HCP percentage by 3.44%, because it purchased an additional 3.44% of LossCo.

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%	$125	20.80%	53.44%
B	$470	47%		$470	81.60%		$470	78.20%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.00%	2.90%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	39.10%	22.69%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	39.10%	22.69%

Example 14: Non-value-for-value conversions (conversion of partial equity)

Facts: The facts are the same as Example 13, except on Date 3, LossCo converts half of A's equity in LossCo to another class of LossCo equity which is worth $25, presumably because A is receiving something else of value from LossCo.

Analysis: Prior to the transaction, A owned equity in LossCo whose value was equal to $100. As part of the conversion, A converts half of its equity in LossCo that is worth $50 into equity worth $25, which means the transaction is a non-value-for-value conversion. Because A is receiving equity whose value is less that its old equity, it is as if A sold a portion of its equity to C, D and the Public Group.

The amount of the deemed sale is equal to the difference between A's FMV percentage ownership before the transaction and after the transaction. In other words, the difference between 17.36% and 13.61% ($^{\$75}/_{(\$75+\$470+\$6)}$), or 3.75% of LossCo's total value is the amount of the deemed sale. Therefore, it is treated as if A sold 21.60% of its interest ($^{3.75\%}/_{17.36\%}$) to C, D and the Public Group, which results in A's HCP percentage being reduced by 21.60% of its pre-conversion HCP percentage or 10.80% (50.00% * 21.60%) down to 39.20% (50.00% - 10.80%).

C, D and the Public Group, on the other hand, are deemed to purchase their pro-rata portion of A's sold shares: each of C and D purchased 49.37% ($^{40.8\%}/_{(81.60\% + 1.04\%)}$) of A's shares and the Public Group purchased the remaining 1.26% ($^{1.04\%}/_{(81.60\% + 1.04\%)}$). Therefore, each of C and D purchased an additional 1.85% (49.37% * 3.75%) of LossCo's value and the Public Group purchased an additional 0.05% (1.26% * 3.75%) of LossCo's value, which in turn increases their respective HCP percentage by the amount purchased.

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%	$75	13.61%	39.20%
B	$470	47%		$470	81.60%		$470	85.30%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.09%	3.05%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	42.65%	25.35%
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$235	42.65%	25.35%

D. Transactions involving Equity of First or Higher Tier Entities

As discussed above, our proposal focuses on what the result would have been had an over-the-top transaction occurred. According to Temporary Regulation section 1.382-2T(j)(3), transactions that involve the equity of the first or higher tier entities are considered in determining whether there is a section 382 ownership change. The following discussion and examples demonstrate how a transaction involving the equity of a first or higher tier entity would be viewed from an over-the-top perspective, which is essentially similar to the previous thirteen examples.

1. Acquisitions by Shareholders of a First or Higher Tier Entity

a) Acquisition by New Shareholders of the First Tier Entity

Similar to the treatment of direct shareholders that acquire new shares in the LossCo stock, under our proposal, if a new shareholder purchases shares in an entity that owns five percent or more of the LossCo stock, that shareholder's indirect ownership percentage in the LossCo would be equal to the FMV of the indirect ownership percentage that it purchased.

Example 15: Acquisition by New Shareholders

<u>Facts:</u> The facts are the same as Example 1, except on Date 3, C sells 20% of its interest in B to Z in exchange for $47.

<u>Analysis:</u> Similar to the analysis in Example 1, neither the direct section 382 shareholders of LossCo (A and the Public Group) nor D are involved in the transaction and so their respective HCP percentage will remain the same at 50.00%, 3.00% and 23.50%, respectively, (even though they represent 17.36%, 1.04% and 40.80%, of LossCo's value, respectively). The acquisition by Z from C needs to be examined to determine the amount of indirect HCP percentage for each holder of B. Z is acquiring 20% of C's ownership or 10% of B's total ownership. Therefore, Z's HCP indirect ownership percentage would 8.16% (10% [Z's acquired ownership of B] * 81.60% [the FMV percentage of B's ownership interest in LossCo]). We should note that under our

proposal, it does not matter if Z is an individual, a first tier entity in B, or a new public group; the results would be the same.

For a discussion of the impact on C, see Example 18 below.

b) Acquisition by Existing Shareholders of the First Tier Entity

The previous example illustrated how a new shareholder of a first tier entity will have a single block of stock whose indirect ownership percentage in the LossCo is based on the percentage of the first tier entity that the new shareholder acquires and the FMV of the first tier entity's shares in the LossCo on the date the shareholder acquired its first tier entity shares. Similarly, under our proposal, a new block of shares acquired by an existing first tier entity shareholder will have a HCP percentage in the LossCo based on the percentage of the first tier entity that the existing shareholder acquires and the FMV of the first tier entity's shares in the LossCo on the date that the shareholder acquired the additional shares, even though the first tier entity shares that had been previously acquired by that shareholder will continue to have the same HCP percentage in the LossCo that they had before the new acquisition.

Example 16: Acquisition by Existing Shareholders

<u>Facts:</u> The facts are the same as Example 15, except on Date 3, C sells all of its interest in B to D instead of Z.

<u>Analysis:</u> D acquired all of C's interest at a time when those shares represented a value of 40.80% in LossCo. Under our methodology, D's HCP percentage would be increased by 40.80% to 64.30%. Under our proposal, the acquiring shareholder would have two blocks of stock, one with a pre-acquisition HCP percentage (23.50%) and another with a FMV percentage (40.80%). D's total indirect HCP percentage in LossCo would be the sum of these two percentages.

For a discussion of the impact on C, see Example 17 below.

2. Dispositions by Shareholders of a First or Higher Tier Entity

Similar to our analysis for direct shareholders on page 11, dispositions can be either a complete disposition or a partial disposition.

a) Complete Dispositions

Example 17: Complete Disposition by Direct Shareholder

<u>Facts:</u> The facts are the same as Example 16.

<u>Analysis:</u> C has sold 100% of its interests in B to D. Therefore, its HCP percentage is reduced by 23.50% (23.50% [Previous HCP percentage] * 100%

[Percentage Disposed]) down to 0% (23.50% - 23.50%). After the disposition, LossCo's ownership will be as follows:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50%	50%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47%		$470	81.60%		$470	81.60%	
Public Group	$30	3%	3%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.5%	23.5%	$235	40.80%	23.50%			
D	$235	23.5%	23.5%	$235	40.80%	23.50%	$285	81.60%	64.30%

b) Partial Dispositions

Example 18: Partial Disposition

Facts: Same as Example 15.

Analysis: Similar to our analysis in Example 4, C has sold 20% of its indirect equity interest in LossCo. Therefore, its ownership percentage is reduced by 4.70% (23.50% [Previous HCP percentage] * 20% [Percentage Disposed]) down to 18.80%. After the disposition, LossCo's ownership will be as follows:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$188	32.63%	18.80%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	40.80%	23.50%
Z							$47	8.16%	8.16%

c) Consequences of Disposing Shareholder Holding Multiple Blocks of Stock

Similar to our previous analysis for direct shareholders on page 12, if a shareholder of a first tier or higher tier entity has one or more blocks of stocks, then the selling shareholder is deemed to sell a pro-rata portion of each of its indirect ownership equity blocks.

3. Issuances by First or Higher Tier Entities

Our proposed methodology assumes that indirect shareholders are treated similarly to direct shareholders for issuances. If a first or higher tier entity issues its own stock, the existing shareholders of that entity would be treated as selling a portion of their interest to the shareholder who purchased the newly issued shares in an over-the-top acquisition.

Under Regulation section 1.382-3(j)(11), the principles of the small issuance and cash issuance exceptions also apply to equity issuances by an upper tier entity that owns at least five percent of the LossCo's stock. As with direct shareholders, for issuances of stock at first and higher tier entities that qualify for the cash issuance exception to the segregation rules, we propose that the exempt shares for the cash issuance exception be calculated based on the actual FMV percentage of the stock held by the first or higher tier entities' public groups, as applicable, immediately before the issuance because that percentage is not shareholder specific and more accurately reflects the likelihood of participation by the first or higher tier entities' existing public groups, as applicable. In addition, also consistent with the treatment of issuances to direct shareholders, the pro-rata allocation of shares among public groups under the cash and small issuance exceptions would be made at the first or higher tier entity level based on HCP percentage so that the allocation of shares is not affected by fluctuations in relative value that might distort the relative ownership of the public groups.

a) Issuances to New Shareholders

Under our proposal, when a LossCo issues new shares to a new shareholder, the new shareholder's interest is effectively reducing the existing shareholders' ownership. Therefore, applying an over-the-top approach, it is as if the new shareholder purchased its shares from the existing shareholders.

Example 19: Issuance of New Shares to a New Shareholder (Other Than a Public Group)

<u>Facts:</u> The facts are the same as Example 1, except on Date 3, B issues to Z, an individual or a first tier entity of B, equity that represents one third of its ownership for $235.

<u>Analysis:</u> Due to the issuance, Z owns 33.33% of B and indirectly 27.20% of LossCo's value, and so for section 382 purposes, Z's ownership in B is 27.20% (that is, the indirect FMV percentage of the new stock in LossCo on its acquisition date). From C's and D's perspective, it is as if Z purchased 33.33% of their respective shares in B, thereby reducing their respective HCP percentages in LossCo by 33.33%. Therefore, C's and D's HCP percentage is reduced to 15.67% (23.50% - (23.50% x 33.33%)).

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	27.20%	15.67%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	27.20%	15.67%
Z							$235	27.20%	27.20%

We should note that under our proposal, it does not matter if Z is an individual or a first tier entity of B; the results would be the same.

Example 20: Issuance of New Shares to a New Shareholder (Public Group)

Facts: The facts are the same as Example 19, except D is an existing public group of B and the $235 of B equity is sold to the public. We will refer to B's new public group as Z.

Analysis: As discussed previously, the tax consequences of this acquisition are dependent on whether: (1) there is an existing public group and (2) the issuance is "solely for cash" under Regulation section 1.382-3(j)(3). If the acquisition is not solely for cash, then the results of the acquisition would be the same as Example 19. However, if the acquisition is solely for cash, then pursuant to Regulation section 1.382-3(j)(3), D, the existing public group, is treated as receiving a percentage of the newly issued stock equal to 50% of the FMV percentage of D's equity immediately before the issuance. As noted previously, in applying the cash issuance exception, we are utilizing D's FMV percentage ownership of LossCo rather than its HCP percentage, because we believe the FMV percentage more accurately reflects the likelihood of participation by the members of D.

Therefore, in this example, D is treated as acquiring 25% (50% * ($^{\$235}/_{(\$235+\$235)}$) [the FMV percentage of D's equity of B immediately before the issuance]) of the newly issued B equity, whose aggregate value is $58.75 (25% [the percentage of the issued shares deemed to be acquired by D] * $235 [the aggregate value of all of the issued shares]) or 8.33% ($^{\$58.75}/_{\$705}$) of B's total value post-issuance. The remaining 75% of the newly issued equity, whose aggregate value is $176.25 (75% [the percentage of the issued shares deemed to be acquired by Z] * $235 [the aggregate value of all of the issued shares]), are treated as being acquired by Z.

Focusing solely on Z, it has acquired 25% of B's value ($^{\$176.25}/_{\$705}$) from C and D. Because Z holds its interest in a first tier entity, Z's HCP percentage would be 20.4% (25% [percentage of ownership of B] * 81.60% [B's FMV percentage of LossCo]).

For a discussion of the impact on D, see the further discussion at Example 22.

b) Issuances to Existing Shareholders

Similar to the analysis applicable to direct shareholders of LossCo, under our proposal, when a first tier or higher tier entity issues new shares to an existing shareholder, it is as if the buying shareholder purchases its shares from all of the existing shareholders, including itself. However, for HCP purposes, a shareholder's HCP percentage should not be adjusted for self-dealing transactions (that is, the shares that it is treated as buying from itself).

Example 21: Issuance of New Shares to an Existing Shareholder (Individual or First Tier)

Facts: The facts are the same as Example 1, except on Date 3, B issues additional equity to C for $235.

Analysis: Under our proposal, C is treated as acquiring its 33.33% of B from B's existing shareholders, including itself. In other words, as part of this transaction, C is both selling shares and acquiring shares. In order to determine the impact of the issuance, it is necessary to determine what percentage each "seller" is selling to C. As of Date 2, C owned 50.00% and D owned 50.00% of B's FMV; which also represent the percentage that each seller is selling of the total shares. Therefore, C is treated as acquiring 50.00% of its new shares from itself. This means that under our proposal, C would increase its HCP percentage by 13.60% (81.60% [the FMV of B's total interest in LossCo] * 16.67% [(33.33% [the percentage of B's ownership purchased by C] – 16.67% [the percentage of C's acquisition that is treated as being purchased from itself (33.33% * 50.00%)]); resulting in a net HCP percentage of 37.10% (23.50% + 13.60%).

D is treated as selling 33.33% of its shares to C, which causes its HCP percentage to be reduced to 15.67% (23.50% - (23.50% x 33.33%)).

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$470	54.40%	37.10%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	27.20%	15.67%

Example 22: Deemed Issuance of New Shares to an Existing Shareholder (Public Group)

Facts: The facts are the same as Example 20 and the stock was issued solely for cash.

Analysis: As a result of the issuance, D's actual FMV proportionate ownership in B is 41.67% ($^{(235 \text{ [pre-transaction FMV of D's equity] } + 58.75 \text{ [value of equity deemed to be acquired by D]})}/_{(470 \text{ [B's total pre-transaction FMV pre-transaction] } + 235 \text{ [additional contribution]})}$) and its interest in LossCo is decreased from 40.8% to 34% (81.60% [FMV of B's interest in LossCo] * 41.67% [D's FMV percentage ownership in B]), a 16.67% decrease ($^{(40.8\% - 34\%)}/_{40.8\%}$). (This is because the amount effectively acquired by Z from D exceeds the amount that D acquires from C.) Our proposed methodology thus treats D as disposing of 16.67% of its shares, causing its HCP percentage to go from 23.5% to 19.58%.

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$235	27.20%	15.67%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$293.75	34.00%	19.58%
Z							$176.25	20.40%	20.40%

4. Redemptions by First or Higher Tier Entities

Similar to our analysis above, under our proposal, when a first tier or higher tier entity redeems shares from a shareholder, the redemption of the interest is effectively increasing the remaining shareholders' ownership. Therefore, applying an over-the-top approach, it is as if the shareholders are purchasing the redeemed shares from the redeemed shareholder, which would result in an adjustment of the first tier or high tier shareholders' HCP percentage in LossCo.

a) Complete Redemptions

As suggested above, when a first or higher tier entity completely redeems a shareholder, it is as if its remaining shareholders effectively purchase all of the redeemed indirect shareholder's equity because their respective ownership of the first or higher tier entity, and consequently the LossCo, increases with the elimination of the redeemed first or higher tier entity shares. Therefore, the result is a combination of the analysis previously provided under Acquisition by Existing Shareholder (Example 15) and Complete Disposition by Direct Shareholder (Example 16).

Example 23: Complete Redemption at First Tier Entity Level

Facts: The facts are the same as Example 1, except on Date 3, B redeems all of C's shares for $235.

Analysis: Applying an over-the-top approach, the redemption of C's shares can be viewed as a purchase of all of C's shares by D. With regards to C, its HCP percentage would be reduced by 23.5% (23.5% [Previous HCP percentage] * 100% [Percentage Disposed]) down to zero percent (23.5% - 23.5%).

With respect to D, it is as if it purchased all of C's shares. Therefore, D's HCP percentage would increase by 40.8%, the FMV percentage of the shares "purchased". Therefore, D would have an HCP percentage of 64.3% (23.5% [Previous HCP percentage] + 40.8% [FMV percentage "Purchased"]).

The following table summarizes the respective ownership on the various dates:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%			
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$470	81.60%	64.30%

As with the redemptions of direct shareholders of the LossCo, we should note that, under our proposal, it does not matter what type of shareholder is redeemed, the analysis would be the same.

b) Partial Redemptions

Example 24: Partial Redemption

Facts: The facts are the same as Example 1, except on Date 3, B redeems half of C's shares for $142.50.

Analysis: Applying an over-the-top approach, the redemption of C's shares can be viewed as a purchase of half of C's shares by all of B's shareholders.

Each B shareholder is treated as purchasing its pro-rata share of C's redeemed shares. This is computed by determining their percentage of B's FMV percentage ownership immediately after the redemption. Therefore, C is treated as purchasing one third and D is treated as purchasing two-thirds of the B shares that are actually redeemed. C's actual proportionate ownership in LossCo, based on FMV percentages, is decreased by one third from 40.8% to 27.2%, meaning that C is treated as disposing of 33.33% of its shares in B (and LossCo) ($^{(40.8\% - 27.2\%)}/_{40.8\%}$) or 16.67% of B's total shares (50% [C's pre-transaction ownership in B] * 33.33% [percentage of B shares sold]). It should be noted, that even though C actually disposed of half of its shares, it effectively sold some of those shares to itself. Therefore, C's HCP percentage in LossCo must be reduced by 33.33% of 23.50%, its HCP percentage in B before the redemption, leaving C with an HCP percentage of 15.67%. D is purchasing the 16.67% of B's shares that C is deemed to have sold to another shareholder. Therefore, D's HCP percentage would increase by the FMV associated with B's LossCo's shares purchased by D or 13.60% (16.67% [the percentage of B that D is deemed to purchase] * 81.60% (the FMV percentage of B's total interest in LossCo) from 23.50% to 37.10% (23.50% + 13.60%).

The following table summarizes the respective ownership on the various dates:

	Date 1			Date 2			Date 3		
	Value	FMV %	HCP %	Value	FMV %	HCP %	Value	FMV %	HCP %
A	$500	50.00%	50.00%	$100	17.36%	50.00%	$100	17.36%	50.00%
B	$470	47.00%		$470	81.60%		$470	81.60%	
Public Group	$30	3.00%	3.00%	$6	1.04%	3.00%	$6	1.04%	3.00%
Indirect owners of LossCo:									
C	$235	23.50%	23.50%	$235	40.80%	23.50%	$156.67	27.20%	15.67%
D	$235	23.50%	23.50%	$235	40.80%	23.50%	$313.33	54.40%	37.10%

5. Conversions of first or higher tier entity stock

a) Value-for-value

Similar to the discussion above, in a value-for-value conversion involving a first or higher tier entity, the converted shareholders of first or higher tier entities are receiving equity in that entity whose value is equal to the value of the equity being converted. Therefore, this transaction does not impact any of the shareholders' FMV ownership percentage of the first or higher tier entity or such shareholders' indirect FMV ownership percentage of the LossCo, and under our proposal, this transaction is ignored for purposes of determining the shareholders' respective HCP percentage in the LossCo.

b) Non-value-for-value

Similar to the discussion above, in a non-value-for-value conversion involving a first or higher tier entity, the converted shareholders are receiving equity whose value is not equal to the value of the equity that is being converted. Therefore, as discussed above in the direct shareholder context, under our proposal, the non-value-for-value conversion is bifurcated into two separate transactions. The first transaction is a deemed conversion of the converted shareholders first or higher tier equity into equity of the same entity with a value that is equal to the value of the equity being converted (that is, this step puts the converted shareholders in the same position they would have been had the conversion been a value-for-value conversion). The second transaction is dependent on whether the converted shareholder is receiving equity whose value is greater than or less than the value of the equity being converted. If the shareholders received equity that is worth more, then the second transaction is a deemed issuance by the first or higher tier entity (that is, the converted shareholder is treated as buying the excess value from the existing first or higher tier shareholders). If the received equity is worth less, then the second transaction is a deemed redemption by the first or higher tier entity (that is, the converted indirect shareholder is treated as selling the shortfall in value to the existing first or higher tier shareholders). In all cases, however, the portion of the exchange that is value-for-value does not impact the shareholders' FMV percentage ownership or HCP percentage in the LossCo.

E. Removal of fluctuations in value and sections 382(l)(5) and (l)(6)

Given that we believe that owner shifts attributable to fluctuations in the relative value of stock should be backed out in all circumstances, we do not suggest that such backouts should occur only in connection with a bankruptcy, and we similarly do not believe that any special rules or adjustments to our methodology are necessary in the context of sections 382(l)(5) and (6). Upon emergence from bankruptcy, whether there has been an ownership change would be determined under our proposed methodology backing out the effect of fluctuations in the relative value of different classes of stock. If there has been an ownership change under our proposed methodology, the question of whether the section 382(l)(5) requirement that at least 50% of the post-emergence stock be attributable to certain pre-change equity and debt interests would simply be based on the actual FMV of the post-emergence equity.

F. Effective Date

If this proposal is adopted, we recommend that, as of six months after the effective date of final Regulations, the rules be mandatorily applicable for all testing dates.

We acknowledge that in some unusual circumstances, the implementation of our methodology in this manner may be said to have a retroactive effect, as reflected in the following example. However, the only way to avoid such a result is to have the rules be mandatorily applicable for all testing periods beginning on the day after the effective date of final Regulations. On balance, we believe that such a delay, which may be as long as up to three years, is unwarranted. We believe that six months after finalization of the regulations (as well as notice while the regulations are in proposed form) is sufficient time to permit taxpayers to take these rules into account with respect to contemplated transactions.

Example 25: Effective Date

<u>Facts:</u> At the beginning of the testing period, B owns all of the 40 common shares and 60 preferred shares (all shares being worth $1 each at the time).

	Date 1		
	Value	FMV %	HCP %
B	$100	100.00%	100.00%

Then, on Date 2, A buys the 40 common shares for $40, at a time when the preferred shares are still worth $60.

	Date 2		
	Value	FMV %	HCP %
A	$40	40.00%	40.00%
B	$60	60.00%	60.00%

Before the next testing date occurs, but within the same testing period, the aggregate value of A's common shares depreciates to $10, and the aggregate value of B's preferred shares appreciate to $90.

	Date 3		
	Value	FMV %	HCP %
A	$10	10.00%	40.00%
B	$90	90.00%	60.00%

On Date 4 (still within the same testing period), B sells $12 worth of its shares to C.

	Date 4		
	Value	FMV %	HCP %
A	$10	10.00%	40.00%
B	$78	78.00%	52.00%
C	$12	12.00%	12.00%

If the taxpayer in this situation uses the proposed methodology, this series of transactions would result in an ownership change because A would have a 40 percentage point increase and C would have a 12 percentage point increase, resulting in a cumulative owner shift of 52 percentage points.

Instead, if the taxpayer uses the current Regulations or the Full Value Methodology of the Notice, this series of transactions would not result in an ownership change on Date 4 because A would only have a 10 percentage point increase, B would have an 18 percentage point increase from 60% to 78%, and C would continue to have a 12 percentage point increase, for a cumulative shift of 40 percentage points.

Assuming the taxpayer is not already applying our proposed methodology and the Treasury implements the proposal and the effective date as proposed, six months after the Regulations are finalized, C sells 1% to D, triggering an ownership change.

	Date 5		
	Value	FMV %	HCP %
A	$10	10.00%	40.00%
B	$78	78.00%	52.00%
C	$11	11.00%	11.00%
D	$1	1.00%	1.00%

Although D’s 1 percentage point increase simply offsets 1 percentage point of C’s earlier 12 percentage point increase, A is treated as having a 40 percentage point increase under the new HCP Regulations, rather than just a 10 percentage point increase under the current Regulations or the Full Value Methodology of the Notice.

G. Application to Prior Periods

Finally, we also recommend that the government state in any implementing guidance that our proposed methodology would be a reasonable method under the Notice, thereby permitting application to prior testing dates.