

REPORT #883

TAX SECTION

New York State Bar Association

Letter on Simplification of Section 367 Regulations

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August 16, 1996

Hon. Donald C. Lubick
Acting Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

Hon. Margaret M. Richardson
Commissioner
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Re: Simplification of Section 367 Regulations

Dear Secretary Lubick and Commissioner Richardson:

We are writing to strongly urge that the Treasury and IRS devote significant resources towards adopting a comprehensive set of final regulations under Section 367. The existing guidance under Section 367 is probably the most confusing of all the guidance that currently exists under the Code. The effort we are suggesting would be well in keeping with the announced efforts of Treasury and the IRS to make tax regulations more "user friendly".

The existing guidance under Section 367 is a very confusing (some would say incomprehensible) patchwork of final regulations, temporary regulations and notices. Many of the temporary regulations have been "temporary" since 1977, and, remarkably, are printed in the Code of Federal Regulations under the heading "Temporary Income Tax Regulations Under the Tax Reform Act of 1976." Many of the rules are not even in the regulations at all, but rather in the notices, the

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Key one of which has been outstanding since 1987.^{1/} Some temporary and final regulations each fill in the gaps in the other and can only be understood if read together.^{2/} Some final regulations merely provide definitions for use in temporary regulations.^{3/}

Moreover, of the temporary regulations, some start with "1",^{4/} and others start with "7".^{5/} As a result, the tax services do not organize the regulations in a logical sequence. Moreover, the Code of Federal Regulations publishes the "7" regulations several volumes away from the rest of the Section 367 regulations, with no cross reference, and one well known compilation of tax regulations omits the "7" regulations altogether.^{6/} It goes without saying that a practitioner could easily overlook completely the existence of some of these regulations. Likewise, notices can easily be overlooked by those not thoroughly familiar with the Section 367 rules.

In addition, there are presently outstanding numerous proposed Section 367 regulations that are to be adopted as final regulations, and even proposed amendments to revise temporary regulations.^{7/} Some of the proposed amendments have retroactive effective dates, and others have effective dates 30 days after final regulations are promulgated.^{8/} Still others have elective retroactive effective dates.^{9/} At least one of the latter contains the unfortunately typical but true statement that in the absence of the retroactivity election, the

^{1/} See Notice 87-85, which in December 1995 earned a cross-reference in Temp. Reg. § 1.367(a)-3T(d).

^{2/} See, e.g., Reg. § 1.367(b)-7 and Temp. Reg. § 7.367(b)-7.

^{3/} See Reg. § 1.367(b)-2.

^{4/} See, e.g., Temp. Reg. § 1.367(a)-1T through -3T.

^{5/} See Temp. Reg. § 7.367(b)-1 through -13, and § 7.367(c)-1 through -2.

^{6/} See the 5-volume hard-bound set of Federal Tax Regulations published annually by West Publishing Co. as part of the U.S. Code Congressional & Administrative News.

^{7/} See, e.g., proposed amendments to Temp. Reg. § 1.367(a)-1T.

^{8/} See Prop. Reg. § 1.357(b)-6 (a), 8/26/91, as an example of both.

^{9/} See, e.g., Prop. Reg. § 1.367(a)-3(f)(1).

transaction in question is governed by temporary regulations as modified by a notice.^{10/}

Because of this state of affairs, in our experience even very knowledgeable tax practitioners, unless they have extensive experience and familiarity with the Section 367 rules, have an extraordinarily difficult time determining the answers to even simple Section 367 questions. The regulations are also a trap for the unwary, because a tax practitioner may find an apparently clear answer to a question without realizing the need to do further research to determine whether the answer has been superseded by a notice or other authority.

This state of affairs is most unfortunate. We are not aware of any other Code section under which the regulations are currently in such a confused state. Until recently, a similarly unorganized set of regulations was the information reporting and backup withholding rules in Temp. Reg. § 35a.9999-1 through -5. However, the Treasury and IRS recently proposed to replace most of those regulations with new, well organized, comprehensive regulations.

Moreover, on August 11 the Treasury and IRS took a helpful step in the direction we are proposing by reissuing all the regulations under Section 367(e)(1) as a unified set of temporary regulations, rather than issuing new temporary regulations, (or, worse, a notice) overriding just some aspects of the existing regulations. The Section 367 (e) (1) regulations have not in the past been the source of the confusion discussed above. However, this August 11 approach avoided the creation of additional complexity that would have arisen through the issuance of a notice or narrow temporary regulations.

We believe an effort to organize and unify all the Section 367 regulations would be most worthwhile, and we strongly urge that it be undertaken. We acknowledge that this effort would cause resources to be diverted from other projects. However, we believe this effort deserves priority status. In addition to the help that a unified set of regulations would provide to taxpayers, the result would no doubt greatly aid Treasury and IRS personnel in future updatings of the regulations.

If this effort is undertaken, we urge that the resulting regulations be published as a unified set of temporary and proposed regulations. This would provide taxpayers with the opportunity to comment on whether the unified regulations comport with their understanding of the present existing and proposed rules, and on whether the rules as so unified make sense.

^{10/} Prop. Reg. § 1.367(a)-3(f)(1).

We would be pleased to assist the Treasury and the IRS in this effort. Please let me know if we can be of help.

Sincerely,

Richard Lf Reiphold
Chair, Tax Section

cc: Stuart L. Brown,
Chief Counsel
Internal Revenue Service

Joseph H. Guttentag,
International Tax Counsel
Department of Treasury