

REPORT #899

TAX SECTION

New York State Bar Association

Letter Suggesting Possible Additions to the Treasury's 1997
Business Plan

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April 15, 1997

Jonathan Talisman
 Tax Legislative Counsel
 United States Treasury
 1500 Pennsylvania, N.W.
 Washington, D.C. 20220

Dear Jon:

The purpose of this letter is to suggest possible additions to the Treasury's 1997 business plan. We were in the process of preparing our suggestions when the plan was published and consequently have modified our comments to reflect the plan as announced.

In general, the items which we were planning to suggest for inclusion in the business plan were included. In particular, we were pleased to note that the plan includes publication of regulations relating to the significant changes in the Code enacted in 1996. Similarly, we are pleased to note that the plan includes finalization of regulations proposed in 1996 such as those dealing with continuity of interest in reorganizations, Section 467, withholding tax under Section 1441, etc. We also note that revision of the Section 367 regulations remains in the business plan; last summer the Tax Section urged such a revision and I have attached a copy of Richard Reinhold's letter to that effect. In the foreign area, we were also pleased that regulations clarifying the rules relating to PFICs are included in the plan; guidance on how one determines the existence of PFIC status is particularly needed.

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There are also a few issues which we think might be added to the business plan which we do not believe are now covered:

1. While we note that regulations under Section 7004 are included in the business plan, we would suggest that any such regulations include some clarification of the meaning of the term of "financial... business" in Section 7004(d)(2).

2. We would suggest, as an addition to the business plan, that further guidance be published, in the form of a ruling or regulation, as to the ancillary consequences of the holding in TAM 9650002 that in the acquisition of assets, by a Section 338 election or otherwise, of a corporation which has an overfunded pension plan, part of the purchase price should be allocated to the plan e.g., assuming that the plan is not terminated promptly (which was the case in the TAM), how does the acquiring entity recover its basis in the plan.

3. Finally, we would suggest that the business plan include a project to provide rules dealing generally with taxation of off-market and prepaid financial instruments.

We hope that this letter is helpful to you.

If your staff believes we can be of assistance to them in their work on any of these matters, they should feel free to contact us.

Very truly yours,

Richard O. Loengard, Jr.
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August 16, 1996

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

Hon. Margaret M. Richardson
 Commissioner
 Internal Revenue Service
 1111 Constitution Avenue, 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.

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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 1376." Many of the rules are not even in the regulations at all, but rather in the notices, the 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 "1" 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.

^{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 L Administrative News.

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 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.

^{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).

^{10/} Prop. Reg. § 1.357(a)-3(f)(1).

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 357(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 updates 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.

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 C. Reinhold
Chair, Tax Section

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

Joseph H. Guttentag,
International Tax Counsel
Department of Treasury