



May 19, 2016

The Honorable John A. Koskinen
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Internal Revenue Service
1111 Constitution Avenue, NW
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Re: Proposal to Reduce the User Fees Charged for S Corporation Private Letter Ruling Requests Under Sections 1362(b)(5) and 1362(f)

Dear Messrs. Koskinen, Wilkins, West, and Wilson:

The American Institute of CPAs (AICPA) is a long-time advocate for the reduction of compliance burdens placed on taxpayers. To further our mission, we propose that the Internal Revenue Service (IRS or “Service”) consider a reduction in user fees charged for S corporation private letter ruling requests under Internal Revenue Code (IRC or “Code”) sections 1362(b)(5)¹ and 1362(f) to more accurately reflect the time spent on these rulings. Currently, taxpayers obtaining rulings under these sections are unfairly bearing the costs associated with other more complex ruling requests.

Our comments below set forth a background of the issue as well as an analysis of our proposal to review these specific user fee amounts for S corporations. The recommendations included in this letter were developed by the AICPA S Corporation Taxation Technical Resource Panel (TRP) and approved by the AICPA Tax Executive Committee.

SUMMARY OF RECOMMENDATION

The AICPA proposes that the Service establish a separate user fee category for private letter rulings under sections 1362(b)(5) and 1362(f) because these rulings should require significantly less time

¹ All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder, unless otherwise specified.

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by IRS personnel than most other ruling requests for which a current user fee of \$28,300² is generally charged. We believe that a reduced user fee for ruling letters in these categories will remove a significant disincentive for affected taxpayers to remedy the effects of a late election or inadvertent ineffective election or termination of S corporation or qualified subsidiary (QSub) status. The reduced fee would also mitigate a potential source of conflict between affected taxpayers and their tax return preparers who are precluded from signing their tax returns without an assurance that remedial action will be taken to address the underlying issue. A reduced user fee will also bring the cost of such rulings in line with similar ruling requests seeking other types of late election relief under the “9100” standards.

BACKGROUND

Section 10511 of the Omnibus Budget Reconciliation Act of 1987³ required the IRS to establish a program requiring the payment of user fees for requests to the IRS for letter rulings, opinion letters, determination letters, and other similar requests. Under the program, the fees charged may vary according to categories (or subcategories) established by the Service and are determined after taking into account the average time for (and difficulty of) complying with requests in each category (and subcategory). The average fee for a request for a letter ruling under the jurisdiction of the Chief Counsel was a required minimum of \$200.⁴

Section 1362(b)(5) gives the Service authority to treat a late filed S corporation election as timely upon determining that there was reasonable cause for failure to timely file such an election. Under section 1362(f), the Service may grant a waiver of an inadvertent ineffective S corporation election or waive the inadvertent termination of an S corporation election. Also under section 1362(f), the Service may grant a waiver of an inadvertent ineffective QSub election or waive the inadvertent termination of a QSub election.

The Service issued guidance under which certain taxpayers may treat a late filed S corporation election or QSub election as timely or obtain a waiver of an inadvertently ineffective or terminated S corporation election or QSub election, without obtaining a letter ruling.⁵ However, this guidance only applies in limited situations; thus, taxpayers must frequently request a letter ruling in order to:

- Treat a late filed S corporation election as timely beyond the time limits established by Rev. Proc. 2013-30;

² Rev. Proc. 2016-1, 2016-1 I.R.B. 1.

³ Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (1987). This “off Code” provision was subsequently codified as section 7528 by Pub. L. No. 108-89, 117 Stat. 1131 (2003).

⁴ *Id.*

⁵ *See, e.g.*, Rev. Proc. 2013-30, 2013-36 I.R.B. 173. This guidance consolidated, and expanded upon, prior guidance providing expedited relief for a variety of late elections under subchapter S. *See, e.g.*, Rev. Proc. 2003-43, 2003-1 C.B. 998; Rev. Proc. 2004-48, 2004-2 C.B. 172; and Rev. Proc. 2007-62, 2007-2 C.B. 786.

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- Treat an inadvertent ineffective S corporation election or QSub election as valid; or
- Obtain a waiver of the inadvertent termination of an S corporation election or QSub election.

The current user fee charged for a request for a letter ruling under section 1362(b)(5) or section 1362(f) is generally \$28,300. However, if a taxpayer has gross income of less than \$1 million and more than \$250,000 (as determined for its last completed taxable year and subject to other applicable conditions and modifications), the user fee is reduced to \$6,500. If a taxpayer has gross income of less than \$250,000, the user fee is reduced to \$2,200.⁶

We roughly estimate that the Service has issued over 3,000 private letter rulings granting taxpayers permission to treat late filed S corporation elections as timely filed⁷ and over 2,000 private letter rulings granting waivers of inadvertent terminations or treating inadvertent ineffective S corporation elections (or QSub elections) as effective.⁸ We recognize that the Service has made significant efforts to reduce the number of letter ruling requests that are required to be filed under sections 1362(b)(5) and 1362(f) by authorizing the service centers to grant relief in certain categories through a more expeditious (and less expensive) process. Nevertheless, there remain important categories of late election and inadvertent termination relief for which there is no alternative to a request for a letter ruling.

ANALYSIS

Since user fees for private letter rulings are “to be determined after taking into account the average time for (and difficulty of) complying with requests,” we believe that the Service should determine the average amount of time spent on ruling requests under sections 1362(b)(5) and 1362(f) and adjust the user fees for such requests accordingly. We recognize that it is not feasible for the Service to analyze the average time spent on every type of ruling request it receives to determine the appropriate user fee to charge. However, given the significant number of ruling requests issued by the Service under sections 1362(b)(5) and 1362(f), a review of the appropriateness of the user fee charged for these types of rulings is warranted.

⁶ Rev. Proc. 2016-1, 2016-1 I.R.B. 1, Appendix A. It is apparent that by basing the reduced user fees on the gross income of the taxpayer, the Service seeks to reduce the burden of these fees on small businesses. Although gross income is certainly one objective measure of the size of the taxpayer, this sole criterion does not necessarily identify a class of taxpayers with the limited profitability or assets to justify a reduced fee. Moreover, in our experience, a gross income threshold of \$1 million nevertheless subjects many small business taxpayers to the highest user fee level and discourages such taxpayers from seeking a letter ruling even where it is the exclusive means of obtaining the required relief.

⁷ Information based on a search of the terms “1362(b)(5)” in “IRS Private Letter Rulings and Technical Advice Memoranda” on Lexis Nexis.

⁸ Information based on a search of the terms “1362(f)” in “IRS Private Letter Rulings and Technical Advice Memoranda” on Lexis Nexis.

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Specifically, we believe a review of the user fees charged under sections 1362(b)(5) and 1362(f) is warranted for the following reasons:

1. Requests for rulings under sections 1362(b)(5) and 1362(f) are generally required to obtain or maintain intended tax status.

If a taxpayer fails to timely file an S corporation election or its S corporation election (or a QSub election) is inadvertently ineffective or terminated, the taxpayer may require a private letter ruling from the IRS in order to obtain S corporation status when intended or to maintain its S corporation status (or QSub status).

We recognize that the Service has alleviated the letter ruling and related user fee requirements for many situations involving late S corporation elections and inadvertently invalid or terminated S corporation elections and QSub elections through the issuance of guidance under which relief is available.⁹ However, many taxpayers do not meet the requirements of Rev. Proc. 2013-30, and for those taxpayers, there is no self-help mechanism available. These taxpayers are required to request a private letter ruling and pay the corresponding user fee. In cases where an affected taxpayer declines to pursue the required relief due to cost or other considerations, its historic tax return preparer may be obligated to refuse to prepare and sign tax returns, because a taxpayer's assertion of S corporation or QSub status, as the case may be, does not even have a reasonable basis under the circumstances.

In matters arising under other provisions of the Code, many taxpayers request letter rulings that are optional and are not required by law. For example, a taxpayer who plans to engage in a reorganization may choose to request a letter ruling to resolve one or more significant issues under the Code sections that address the income tax consequences of such a reorganization.¹⁰ Unlike a ruling under section 1362(f) or section 1362(b)(5), a taxpayer who requests a letter ruling to determine the tax consequences of a proposed transaction may proceed with its transaction without requesting a letter ruling. In contrast, a taxpayer who does not correct an inadvertently ineffective or terminated S corporation election or a QSub election, or a late filed S corporation election, cannot proceed as if the election is in effect, unless it receives relief from the IRS.

⁹ Rev. Proc. 2013-30, *supra*, fn. 4.

¹⁰ In general, the Service no longer issues comprehensive letter rulings on the consequences of a reorganization, a section 351 exchange, a complete liquidation, or a section 355 distribution. Rev. Proc. 2016-3, 2016-1 I.R.B. 126, section 3.01(50). Instead, letter rulings are limited to issues of law the resolution of which is not essentially free from doubt and that is germane to determining the tax consequences of the transaction.

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2. The Service’s explanation for an increase in user fees supports the performance of a review.

In 2015, Tax Analysts published an article in which it described how the Service determines user fees for letter rulings:

[A]t least every other year, the Office of Chief Counsel reviews how much time its attorneys are spending to comply with letter ruling requests and makes a determination under section 7528 regarding whether the fees charged are appropriate. Among other things, it looks at the average time spent on rulings and various overhead costs. . . . “Where reduced user fees are allowed, the IRS has not attempted to recoup the foregone [sic] revenue by passing the unrecovered costs on to other requesters,” the IRS said. . . . The IRS said it has increased the fees in recent years because “more complex rulings come to represent a larger proportion of the rulings that get worked and there is a corresponding increase in the average number of hours spent on each ruling” . . . [and] because of a slight increase in average salaries “mainly due to changes in the composition of the workforce caused by hiring restrictions.”¹¹

The first reason that the Service gives for an increase in user fees supports our view that the user fees for ruling requests under sections 1362(b)(5) and 1362(f) are too high, relative to the average number of hours spent on these types of rulings. The law relating to sections 1362(b)(5) and 1362(f) has remained relatively unchanged for a number of years and we have no reason to believe that the ruling requests issued under these Code sections have changed in complexity to any significant extent. Rather, the issuance of guidance reducing the number of requests under these sections (and other sections where the ruling process is straightforward) has had the effect of increasing user fees because the Service is, on a proportionate basis, dealing with more complex rulings. Consistent with the user fee mandate, we believe that the user fees for rulings under section 1362(b)(5) and 1362(f) require a reduction to more accurately reflect the time spent on these rulings. Currently, taxpayers obtaining rulings under these sections are inappropriately subsidizing the costs associated with other more complex ruling requests.

The second reason given by the Service for the increase in user fees is the increase in average salaries. However, publicly-available data indicate that the Federal GS wage scale has been increased only to reflect the cost of living in many years while being frozen in other years. Clearly, the “slight” increase in average salaries since the user fees were first imposed is not commensurate with the user fee increase over the same period.

¹¹ *Letter Ruling Fees Have More Than Doubled in 4 Years*, 2015 TNT 56-1 (March 24, 2015).

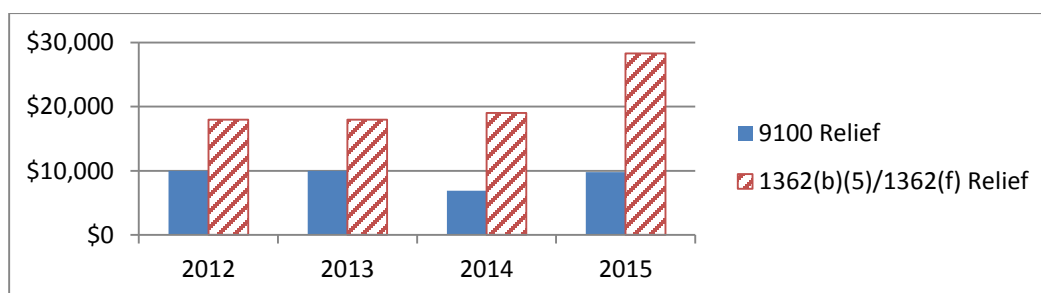
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Inasmuch as the user fee for a category of letter rulings is required to reflect the product of time and overhead costs (including salaries), we are unaware of any justification for the significant increase in the user fees for rulings filed under sections 1362(b)(5) and 1362(f).

3. The user fee amounts for requests under Treas. Reg. § 301.9100-3 are significantly lower than rulings under Code sections 1362(b)(5) and 1362(f).

The Service has established a separate user fee for ruling requests under Treas. Reg. § 301.9100-3, relating to late elections. Based on our experience, ruling requests under Treas. Reg. § 301.9100-3 are often of similar complexity to those under sections 1362(b)(5) and 1362(f).

Until 2011, the user fee for requests for relief under sections 1362(f) and 1362(b)(5) was the same as the fee for a request for relief under Treas. Reg. § 301.9100-3. However, beginning in 2012, the user fee for requests for relief under sections 1362(f) and 1362(b)(5) drastically increased above the user fee for Treas. Reg. § 301.9100-3 relief. The following chart compares these user fees for the years 2012 to 2015.¹²



We believe that the user fee for rulings under sections 1362(b)(5) and 1362(f) should not exceed the user fee for rulings under Treas. Reg. § 301.9100-3 (and arguably should be less because of their straightforward nature). In this regard, it is worth noting that where the termination of an S corporation election results from the failure of a trust beneficiary to file a qualified subchapter S trust (QSST) election or of a trust to file an electing small business trust (ESBT) election, a taxpayer should theoretically be able to remedy such a termination either by obtaining an extension of time to file a QSST or ESBT election under Treas. Reg. § 301.9100-3 (with a user fee of \$9,800) or by obtaining a waiver under section 1362(f) (with a user fee of \$28,300).¹³ A taxpayer may also obtain relief for a late QSub election under Treas. Reg. § 301.9100-3.

¹² Between 1997 and 2011, the user fees for requests under Treas. Reg. § 301.9100-3, section 1362(b)(5), and section 1362(f) were the same.

¹³ Based on one experience, it appears that the Service requires taxpayers to seek relief under section 1362(f) and pay the higher user fee, although no explanation was provided for this requirement.

4. Reduced user fees apply to other categories of private letter ruling requests.

A reduced user fee applies to other categories of private ruling requests, including:

- Ruling requests made on Form 1128, *Application to Adopt, Change, or Retain a Tax Year*;
- Ruling requests made on Part II of Form 2553, *Election by a Small Business Corporation*, to use a fiscal year based on a business purpose; and
- Accounting method change requests made on Form 3115, *Application for Change in Method of Accounting*.

Presumably, the reduced fees for these types of requests were set after a determination was made that a lower fee is appropriate based on the amount of time spent by the Service in handling such requests. We believe these other examples of reduced user fees establish a precedent that supports a review of the appropriateness of the user fees charged for private letter rulings under sections 1362(b)(5) and 1362(f).

5. The current user fee creates an undue financial hardship for many taxpayers.

The user fee imposed for private letter ruling requests under sections 1362(b)(5) and 1362(f) may result in a financial hardship for many taxpayers, discouraging them from seeking such rulings. Creating a financial difficulty for taxpayers who need relief under section 1362(b)(5) or section 1362(f) seems fundamentally inconsistent with Congressional intent in authorizing the Service to grant such relief.

Section 1362(f) was enacted as a part of the Subchapter S Revision Act of 1982. The Senate Report to the Subchapter S Revision Act, in discussing section 1362(f) of the Code, states, in part:

The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. In granting a waiver, it is hoped that taxpayers and the government will work out agreements that protect the revenues *without undue hardship* to taxpayers...

S. Rep. No. 97-640 (97th Cong., 2d Sess. 12 (1982), 1982-2 C.B. 718, 723-24 (emphasis added).

One can argue that onerous user fees currently imposed for rulings under sections 1362(b)(5) and 1362(f) represent an undue hardship to taxpayers, and in some cases may even preclude taxpayers from obtaining this much needed relief.

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6. A reduced user fee can be justified notwithstanding the recently announced “full cost” policy.

Recently the Service announced that it completed its 2015 biennial review of its user fees in order to determine whether such fees recover the full cost of providing the relevant services. In addition to announcing specific increases in the user fees for pre-filing agreements,¹⁴ the Service also announced that in the near future it expects to revise a number of existing user fees and implement new user fees for some additional services.¹⁵ The expected updated schedule of user fees will offer services at less than full cost only when there is a compelling tax administration reason to do so, for example, in the case of certain services provided to low-income taxpayers. We believe that our proposal is fully consistent with the stated goal of providing private letter rulings under sections 1362(b)(5) and 1362(f) at the full cost of these services. For all of the reasons set forth above, we believe that a separate category or categories for such rulings could be established with a user fee significantly below the current \$28,300 fee for private letter rulings while still reflecting the full cost of issuing these rulings.

CONCLUSION

In those cases where a request for a private letter ruling is the only available means of obtaining relief under sections 1362(b)(5) and 1362(f), the current user fee raises important policy concerns. For the reasons indicated above, the required user fee discourages affected taxpayers from seeking appropriate relief and creates a conflict between taxpayers and their tax advisors who prepare and sign their tax returns. Such letter rulings should require less IRS personnel processing time than most other ruling requests for which a \$28,300 user fee is charged. Thus, taxpayers obtaining rulings under these sections are unfairly bearing the costs associated with other more complex ruling requests. In order to provide financial relief and reduce the unfair burdens placed on taxpayers, the AICPA respectfully proposes that the IRS establish a separate user fee category for S corporation private letter ruling requests under sections 1362(b)(5) and 1362(f).

* * * * *

The AICPA is the world’s largest member association representing the accounting profession, with more than 412,000 members in 144 countries, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

¹⁴ Rev. Proc. 2016-30, 2016-21 I.R.B. __ (to be published in May 23, 2016 Internal Revenue Bulletin).

¹⁵ This document may be accessed at www.irs.gov/uac/Newsroom/IRS-User-Fee-Program.

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We appreciate your consideration of these recommendations and we welcome the opportunity to discuss these items further. If you have any questions, please feel free to contact me at (801) 523-1051, or tlewis@sisna.com; or you may contact Kevin Anderson, Chair, AICPA S Corporation Taxation Technical Resource Panel, at (202) 644-5413, or kdanderson@bdo.com; or Amy Wang, Senior Technical Manager – AICPA Tax Policy & Advocacy, at (202) 434-9264, or awang@aicpa.org.

Sincerely,

A handwritten signature in black ink that reads "Troy K. Lewis". The signature is written in a cursive style with a large, sweeping initial "T".

Troy K. Lewis, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: The Honorable Mark Mazur, Assistant Secretary, Office of Tax Policy, Department of the Treasury
Ms. Donna M. Young, Deputy Associate Chief Counsel, Passthroughs and Special Industries, Internal Revenue Service