



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

June 1, 2011

The Honorable Michael F. Mundaca  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Room 3120  
Washington, DC 20220

The Honorable William J. Wilkins  
Chief Counsel  
Internal Revenue Service  
1111 Constitution Avenue, NW  
Room 3026  
Washington, DC 20224

Re: Recommendations for 2011 - 2012 Guidance Priority List (Notice 2011-39)

Dear Messrs. Mundaca and Wilkins:

The AICPA is pleased to offer our suggestions regarding the 2011 - 2012 Guidance Priority List, which were prepared by the AICPA Tax Division's committees and technical resource panels, and approved by our Tax Executive Committee.

The suggestions are listed under the AICPA working group that developed them, and we have indicated the priority order for our comments under each category of the attached document. For your convenience, contact information for each working group's chair and AICPA staff liaison is listed. Please feel free to contact these individuals directly with your specific questions or concerns.

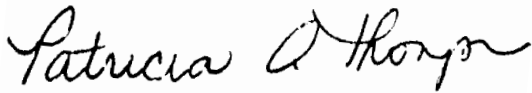
In addition, the AICPA again encourages Treasury and the IRS to continue pursuing tax simplification. Although we recognize you must balance competing interests and concerns when drafting guidance, we urge you to consider the following as part of the process:

- Use the simplest approach to accomplish a policy goal;
- Provide safe harbor alternatives;
- Offer clear and consistent definitions;
- Use horizontal drafting (a rule placed in one Code section should apply in all other Code sections) to the greatest extent possible;
- Build on existing business and industry-standard record-keeping practices;
- Provide a balance between simple general rules and more complex detailed rules; and
- Match a rule's complexity to the sophistication of the targeted taxpayers.

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Please let us know if we could be of further assistance in the business plan process by contacting me at (401) 831-0200 or [patt@pgco.com](mailto:patt@pgco.com); or Edward S. Karl, AICPA Vice President - Taxation at (202) 434-9228, or [ekarl@aicpa.org](mailto:ekarl@aicpa.org).

Sincerely,

A handwritten signature in black ink that reads "Patricia A. Thompson". The signature is written in a cursive style with a large initial "P".

Patricia A. Thompson, CPA  
Chair, Tax Executive Committee

Encl.

**AICPA Tax Division**  
**Comments on the**  
**2011 - 2012 Guidance Priority List (Notice 2011-39)**  
**June 1, 2011**

**Corporations and Shareholders Taxation Technical Resource Panel** (Nicholas P. Gruidl, Chair, (612) 629-9686, [nick.gruidl@mcgladrey.com](mailto:nick.gruidl@mcgladrey.com); or Michelle R. Koroghlanian, AICPA Technical Manager, (202) 434-9268, [mkoroghlanian@aicpa.org](mailto:mkoroghlanian@aicpa.org)).  
**NOTE:** Comments are listed in priority order.

**Consolidated Returns**

1. Provide additional guidance as to the application of Section 382(h)(6) in conjunction with Notice 2003-65, 2003-2 C.B. 747, within consolidation.
2. Provide guidance for determining when the COBE requirement is satisfied following a section 382 ownership change.
3. Provide additional guidance under Treas. Reg. § 1.1502-36.
4. Provide guidance that would permit a worthless stock deduction with respect to a class of subsidiary stock notwithstanding that there is a section 381 transaction with respect to other classes of subsidiary stock.
5. Provide guidance that would permit a reattribution of losses where a worthless stock deduction is taken on subsidiary stock and the subsidiary ceases to be a member of the group but does not have a separate return year.
6. Regarding the interaction of Treas. Reg. § 1.1502-11(c) and Treas. Reg. § 1.1502-28 (i.e., how does Treas. Reg. § 1.1502-36 apply in a year when there is a disposition at a loss in the same year as a cancellation of debt event subject to Treas. Reg. § 1.1502-28 and Reg. § 1.1502-11(c)).
7. Provide guidance with respect to group continuation and the application of Rev. Rul. 82-152. Specifically, reevaluate the existing group continuation rules under Treas. Reg. § 1.1502-75(d) to eliminate the uncertainty that exists as a result of the expanded application of Rev. Rul. 82-152.
8. Provide guidance with respect to the application of Treas. Reg. § 1.1502-76(b)(1)(ii)(B) to transactions occurring prior to or contemporaneously with the event that results in subsidiary's change in status as a member.
9. Provide regulations regarding the application of section 172(h) to a consolidated group.

10. Provide guidance regarding the treatment of intercompany transactions in determining satisfaction of the gross receipts test for purposes of section 165(g)(3)(B).

### **Corporations and Their Shareholders**

1. Guidance under section 382:
  - Provide guidance on identifying 5% shareholders of public companies.
  - Provide guidance under sections 382 and 384, including regulations regarding built-in items under section 382(h)(6).
2. Guidance with respect to section 108:
  - Provide guidance concerning how an election under section 108(i) affects the determination of recognized built-in gain or loss under section 382(h)(6).
  - Provide guidance as to the application of section 108(e)(6) if the subsidiary is insolvent before the contribution of the debt.
  - Provide guidance under section 108 for determining if a publicly traded company is insolvent when the stock is trading above \$0.
3. Finalize regulations regarding transactions involving the transfer or receipt of no net equity value.
4. Provide guidance on the application of the solely voting stock requirement, meaningless gesture and deemed issuances under section 368(a)(1)(C) in the event of an upstream reorganization where no actual shares are issued and the transferee corporation has multiple both voting and non-voting classes of stock.
5. Finalize regulations under section 368(a)(1)(F).
6. Provide guidance on what constitutes an effective abandonment of stock.
7. Provide guidance as to what represents a “characterization” for purposes of section 385(c)(1) regarding a characterization of an interest as stock or indebtedness.

**Employee Benefits Taxation Technical Resource Panel** (Karen Field, Chair, (202) 533-4234, [kfield@kpmg.com](mailto:kfield@kpmg.com); or Melissa M. Labant, AICPA Technical Manager, (202) 434-9234, [mlabant@aicpa.org](mailto:mlabant@aicpa.org)). **NOTE:** The comments are listed in priority order.

### **Retirement Benefits**

1. Guidance updating the Employee Plans Compliance Resolution System (EPCRS), in particular to expand corrections advice for 403(b) plans, has been in the pipeline for some time.
  - We strongly agree with giving this item priority – many 403(b) sponsors have discovered operational and similar errors for the first time per the 2009 plan year audits now required by Employee Benefits Security Administration (EBSA). This has left them with a strong need to make corrections but with less guidance specific to this type of plan than is available for 401(k) plans.
2. Guidance on international tax issues relating to qualified retirement plans.
  - We are seeing these issues come up with increasing frequency as plan sponsors “go global” and move employees into and out of the United States. Guidance in this area would be timely and helpful (it is intended to address issues raised previously by the Advisory Committee on Tax Exempt and Government Entities).
3. Guidance on church plan and government plan status (intended to develop a common position on these types of plans with Department of Labor and Pension Benefit Guarantee Corporation (PBGC)).
  - Guidance in this area would be welcome if it led to resumption of issuing rulings, particularly on church plan status. Many sponsors have had ruling requests pending for a long time since rulings were suspended in this area several years ago.
4. Guidance on employee stock option plans (ESOP) rules under sections 409 and 4975
  - The use of ESOPs has undergone a revival in the last several years, and the additional guidance promises for several years would assist sponsors in complying with the requirements of the Code.
5. Guidance on issues relating to lifetime income from retirement plans.
  - The possibility of encouraging participants to take life annuity contracts through defined contribution plans has been gaining some interest, and guidance will be necessary to address some technical issues this idea presents.

6. Provide model language for prototype documents to provide for the deferral of unused vacation and leave time.
  - The current administration supported the use of unused vacation and leave time to be deferred into their 401(k) plan. Currently, only those plans using “individually designed” documents can utilize the feature. This leaves the majority of Americans - mostly those working for small and intermediate sized employers, the lifeblood of the US economy - without access to this option. The IRS should publish model amendment language that can be adopted by employers to add this feature to their plans. This would act to more fully implement the administrations intent for this feature.
7. Guidance on the new form 8955-SSA with respect to 403(b) plans.
  - Currently it is unclear as to whether 403(b) plans which have never filed a form 5500, and therefore a schedule SSA that is attached to this filing, should complete the new 8955-SSA to capture all previous participants that have terminated with vested benefits.
8. Final regulations on suspension/reduction of 401(k) safe harbor contributions.
  - These issues received a lot of attention over the last several years as the economy was weakening, but with the economic rebound most sponsors who were contemplating this type of action have already done so or elected not to take such actions now. Guidance in this area is probably not a top priority for plan sponsors any more.

### **Executive Compensation, Health Care and Other Benefits, and Employment Taxes**

1. Consolidated Omnibus Budget Reconciliation Act (COBRA) related guidance, including:
  - Guidance on the applicability of section 162(l) to COBRA premiums.
  - Guidance under section 4980B regarding calculation of the application premium for COBRA continuation coverage.
2. Guidance on the application of section 409A(b) as amended by the Pension Protection Act of 2006, especially guidance on employees transferred from one country to another.
3. Guidance is needed to simplify the determination of when an employer-provided cell phone or similar device is considered a working condition or de minimis fringe benefit under Section 132. A safe harbor approach is recommended for simplification purposes and in light of the fact that cell phones often allow for unlimited phone calls making any personal use de minimis. When the safe harbor is not met treating the device as a non-taxable fringe benefit, guidance should be

- provided to enable taxpayers to determine the taxable amount of the benefit in a simple manner.
4. Final regulations on income inclusion under section 409A. Proposed regulations were published on December 8, 2008.
  5. Guidance on reporting of aggregate cost of employer sponsored health coverage under section 6051(a)(14) as added by the Patient Protection and Affordable Care Act (“ACA”).
  6. We suggest guidance on the treatment of partnership employees working for a single member limited liability company (SMLLC) owned by an upper tier partnership after the SMLLC employment tax reporting rules changed effective in 2009. Is an owner of the upper tier entity treated as a partner or an employee if he or she provides service to the lower tier SMLLC?
  7. Guidance under sections 280G and 4999(a) on change in ownership.
  8. Guidance under section 457(f) on ineligible plans.
  9. Regulations under section 512 explaining how to compute unrelated business taxable income of voluntary employees’ beneficiary associations described in section 501(c)(9). Temporary regulations were issued on January 29, 1986.
  10. Guidance under section 45R as added by the ACA.
  11. Regulations implementing new section 3121(z), as added by section 302 of the Heroes Earnings Assistance and Relief Tax Act of 2008, on foreign employers.
  12. Regulations under section 4980G on interaction of section 4980G and section 125 with respect to comparable employer contributions to employees’ health savings accounts.
  13. Regulations under section 83 to incorporate the holding in Rev. Rul. 2005-48.
  14. Guidance providing model language on section 83(b) elections.
  15. Final regulations on cafeteria plans under section 125. Proposed regulations were published on August 6, 2007.
  16. Regulations under section 162(m) on the transition relief under Treas. Reg. § 1.162-27(f)(1).
  17. Guidance under section 457A as added by section 801 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008.

18. Guidance on the employee retention credit under section 1400R, as added by the Gulf Opportunity Zone Act of 2005.
19. Regulations under section 3504 designating certain parties who file employment tax returns under their employer identification numbers for their clients' workers persons required to perform acts of employers.
20. Guidance updating Rev. Rul. 95-7 on tips.
21. Regulations and related guidance under sections 3127, 3121(b)(3)(A) and 3306(c)(5) making certain FICA exemptions available for disregarded entities.

**Exempt Organizations Technical Resource Panel** (Debra Cook, Chair, (405) 552-3827, [dcook@kpmg.com](mailto:dcook@kpmg.com); or Melissa M. Labant, AICPA Technical Manager, (202) 434-9234, [mlabant@aicpa.org](mailto:mlabant@aicpa.org).) **NOTE:** Comments are in priority order.

1. Change the extension process for Form 990, *Return of Organization Exempt from Income Tax*, from two separate three-month extensions to one single six-month extension. A single 6-month extension for the Forms 990, 990-EZ, and 990-PF would be beneficial for several reasons.

IRC section 6033 describes the annual return and information required of exempt organizations. Exempt organizations who want a 6-month extension to file Forms 990, 990-EZ, or 990-PF must file two separate 3-month extensions. However, taxpayers who file other types of annual returns, such as the Forms 990-T, 1040, and 1120, only need to submit a single 6-month extension. Some may argue that the Forms 990, 990-EZ, and 990-PF are information returns or reporting forms, not tax forms such as the Form 990-T, 1040, and 1120. Nevertheless, all of these forms have in common an annual filing requirement that involves the gathering of extensive data, both financial and informational. It is logical for all of these forms to have a single 6-month extension.

A single 6-month extension would also simplify the filing requirements for exempt organizations. These organizations are very likely to request both 3-month extensions in order to completely and accurately file their annual returns, so it makes sense to simplify the filing requirement and only require a single 6-month extension. Especially with the emphasis on transparency in the new and improved Form 990, many organizations are taking extra time and care to properly disclose all relevant activities. A single 6-month extension will not only reduce the burden on exempt organizations, but also on the Internal Revenue Service, benefitting both parties.

2. Please clarify who constitutes a "patient" for purposes of the definition of "patient care". For example would the following services be considered "patient care", especially when the individual receiving the services is not an inpatient of a hospital at the time the services are rendered: services provided via a

- telemedicine network; reading of images, laboratory services and pathology services where the technician or physician interpreting the tests does not actually see or “touch” the patient. Such guidance under section 501(r) would reduce uncertainty and support the move toward accountable care organization (ACO) and cost effective health care methods. In addition, absent guidance, costly information technology changes are being made by hospitals which will likely have to be made again when guidance is finally issued.
3. Issue guidance on whether Revenue Ruling 75-435 or General Counsel Memos 37001 (Feb. 10, 1977) or 38327 (Mar. 31, 1980) is the controlling authority on whether contributions from foreign governments to public charities exempt under section 509(a)(1) are subject to the 2 percent limitation on excess contributions.
  4. Similar to the revised public support test on Form 990, *Return of Organization Exempt from Income Tax*, add a section for supporting organizations to substantiate their type to erase uncertainty by the reader of the 990 as well as for the organization to document for its records.
  5. Withdraw Temp. Reg. § 1.170A-9T. Issue final regulations defining section 170(b)(1)(A) organizations with one change to the “Definition of support; meaning of general public” under Temp. Reg. § 1.170A-9T(f)(6)(i). Similar to governmental units and organizations described in section 170(b)(1)(A)(vi), provide an exception from the 2 percent limitation for organizations described in section 170(b)(1)(A)(i)-(iv). There is no reason to limit the support that churches, schools, hospitals, supporting organizations and similar entities provide to other charitable organizations.
  6. Issue a Revenue Procedure allowing all members under a group ruling (including the central organization and the subordinate organizations) to file a single consolidated return rather than the current process which requires a separate return for the central organizations and a consolidated return for all consenting subordinates. We strongly believe a single consolidated return more accurately reflects the operations of the group.
  7. Issue guidance limiting the reporting in Sch. R, Parts III and IV of brother-sister related party affiliates of central or subordinate members of a group exemption similar to the exclusion from reporting of tax-exempt members of the group. For example, there may be hundreds of organizations taxable as partnerships or corporations that are affiliated with a particular church whose exempt members are covered by a group ruling and not reportable in Sch. R, Part II. But many of those taxable entities may meet the technical definition of related parties merely because of the centralized structure at some high level in the church and as such are currently reportable on multiple Forms 990 for the various members covered by the group ruling. However, there may be no board overlap and no intercompany transactions with those entities beyond their direct owners and their brother-sister affiliates controlled by their direct owners. Issue guidance limiting the reporting to only those related parties directly controlled by the filing

organization or with whom the filing organization has engaged in transactions exceeding a fixed dollar amount.

**Individual Income Taxation Technical Resource Panel** (Annette Nellen, Chair, (408) 924-3508, [anellen@email.sjsu.edu](mailto:anellen@email.sjsu.edu) ; or Melissa M. Labant, AICPA Technical Manager, (202) 434-9234, [mlabant@aicpa.org](mailto:mlabant@aicpa.org)). **NOTE:** Comments are listed in priority order.

1. Formal guidance is needed on the filing procedures for Registered Domestic Partners (RDPs) and same-sex couples in states that grant these individuals community property rights.

In 2010, PLR 201021048, CCA 201021049 and CCA 201021050 were issued. These rulings note that due to a state law change, California RDPs should treat income that is community property income for state purposes, as such when they file their federal return.

Publication 17 for 2010 returns (page 5): states: “A registered domestic partner in California, Nevada, or Washington must report half the combined community income earned by the individual and his or her domestic partner.” A similar statement is included in the 2010 Form 1040 instructions (page 19).

This informal guidance raises several issues that need to be addressed in a more detailed and formal manner. These issues include the following:

- Not all affected taxpayers were aware of or understood the new guidance. Per CCA 201021050, “for tax years beginning after December 31, 2006, a California registered domestic partner must report one-half of the community income, whether received in the form of compensation for personal services or income from property, on his or her federal income tax return.” This CCA goes on to state that for “tax years beginning before June 1, 2010, registered domestic partners may, but are not required to, amend their returns to report income in accordance with this CCA.”

This statement about amending returns seems to imply that the requirement to report community income as such on the federal income tax return is not effective until 2011 tax returns. However, the “June 1, 2010” date appears to be incorrect because in May 2010 when the CCA was issued, 2010 returns could not be amended because they were not yet filed.

Thus, some who were aware of the guidance or read summaries of it may have believed that the new way of reporting community income did not apply until 2011.

Guidance is needed in the form of revenue rulings and/or regulations that are published in the Internal Revenue Bulletin and constitute higher level authority than counsel rulings. This formal guidance should also be

highlighted on the IRS websites for the general public and practitioners, as well as in press releases so that more people are aware of the new rules. It should also clearly state what the treatment is in all community property states and for both RDPs and same-sex couples. This guidance should also explain what affected taxpayers should do who did not properly report community income in 2010 (and prior years).

- A new reporting form is needed to allow for efficient compliance and administration of returns of RDPs and same-sex couples with community income. We also recommend an extra box on Form 1040 to easily identify RDP and same-sex couples and to provide a taxpayer's partner's social security number.

When RDPs or same-sex couples report their share of community income, these amounts do not match amounts reported on Forms W-2 and 1099 received. Thus, these couples are at risk of receiving notices from the IRS of incorrectly reported income. A new reporting form is needed that allows RDPs and same-sex couples with community property income to indicate the full amount of such income from Forms W-2 and 1099 and other sources for both partners/spouses. The form should indicate the split of the community income and the 1040 lines on which to report it. This additional form should make compliance and administration easier for taxpayers and the IRS.

- A procedure for filing amended returns for eligible RDPs and same-sex partners is needed. As noted in the 2010 informal guidance, amended returns can be filed for 2007, 2008 and 2009. Without a procedure in place for handling these returns, taxpayers are at risk of having penalties and interest assessed. For example, where one partner had high income in 2008 and the other partner had much lower income, amended returns would be recommended. On the amended returns, one partner will have a refund which the other's amended return will show tax due. Given the clarification of prior year state property law offered by the 2010 guidance, penalties should not be applied. Guidance in this area for returns processing personnel, tax practitioners and taxpayers would be helpful.

2. Official guidance is needed on the treatment of Medicare Part B and section 162(l) for self-employed individuals. A change in the treatment of this item was noted in the 2010 Form 1040 instructions. In addition, Publication 535, *Business Expenses*, states on page 18: "Medicare premiums you voluntarily pay to obtain insurance that is similar to qualifying private insurance can also be used to figure the deduction. If you previously filed a return without using Medicare premiums to figure the deduction, you can file an amended return to refigure the deduction." This new interpretation should be issued in an official pronouncement, such as a revenue ruling, rather than in form instructions and publications which are not considered binding guidance or "authority" for Section 6662 purposes. In addition, "voluntarily pay" should be explained in the official guidance.

3. Update and finalize the longstanding temporary regulations under section 163(h) to provide greater clarity to taxpayers and practitioners.

The Tax Reform Act of 1986 made changes to section 163 regarding personal and home mortgage interest. Further changes were made to the home mortgage interest rules by the Revenue Act of 1987. Temporary regulations were issued on these provisions soon after the legislative changes. Several of the regulations were issued prior to the effective date of the change made to section 7805 by the Technical and Miscellaneous Revenue Act of 1988 providing that temporary regulations expire within three years of issuance (effective for regulations issued after November 20, 1988). Thus, temporary regulations issued after enactment of the Tax Reform Act of 1986 and before November 21, 1988, which have not been finalized, remain in their temporary form.

In addition, not all of the regulations are complete or current, such as Treas. Reg. § 1.163-10T on home mortgage interest. Among unsettled issues are the following:

- Section 163(h)(4)(A) does not provide certainty on how to define a qualified residence or a second residence in the context of divorce.
  - Must the taxpayer be both responsible for the mortgage and own the underlying property before the interest is deductible? (Or, may the taxpayer satisfy only one of these two requirements?) For example, husband may transfer ownership of the residence to the wife but remain responsible for the mortgage. Is the interest deductible?
  - Further, guidance is needed regarding whether the \$1,000,000 “aggregate” acquisition indebtedness referred to in section 163(h)(3)(B) refers to and applies per taxpayer or per residence. This is particularly important with regard to unmarried taxpayers who jointly own a residence in light of the interpretation presented in CCA 200911007, issued on March 13, 2009.
4. Guidance is needed relating to the coordination of a tuition payment and the receipt of a distribution from a 529 Plan. Specifically, what is the permitted period of time prior to and after the payment of a qualified expense to make a qualified distribution? For example, if a taxpayer makes a tuition payment in September 2010, but receives the 529 distribution in January 2011, assuming no other tuition payments are made, is the 2011 distribution taxable? Section 529(c)(3) does not address the question. The same question arises if the distribution precedes the payment of qualified education expenses. Guidance is needed on what constitutes a taxable event with regard to the timing of distributions and subsequent payments.

In January 2008, the IRS issued an advance notice of proposed rulemaking (Announcement 2008-17; 2008-9 IRB 512, March 3, 2008) (ANPRM) to curb the possible abuse of section 529 qualified tuition program accounts by creating a

general anti-abuse rule and other obstacles to prevent individuals and entities from using the accounts to avoid transfer and other types of taxes. Although a number of organizations commented, there has been no action to date.

5. Guidance is needed on the statutory terms that were introduced by Title XII of the Pension Protection Act of 2006 pertaining to appraisals and individuals performing these appraisals. Proposed regulations (REG-140029-07--Charitable Contributions: Cash and Noncash: Substantiation) were published in August 2008 but have not been issued to date. The AICPA submitted [comments on November 5, 2008](#), requesting further clarification of the terms “generally accepted appraisal standards” and “qualified appraiser.”

**International Taxation Technical Resource Panel** (Joseph M. Calianno, Chair, (202) 521-1505, [joe.calianno@us.gt.com](mailto:joe.calianno@us.gt.com); or Michelle R. Koroghlanian, AICPA Technical Manager, (202) 434-9268, [mkoroghlanian@aicpa.org](mailto:mkoroghlanian@aicpa.org)). **NOTE:** Under each numbered category, the first three bulleted items are the most important.

1. Guidance is needed in the following areas related to Subpart F/Deferral:
  - Provide regulations under section 954(h) on the subpart F exception for active financial services income, especially with regard to the application of the substantial activity requirement of section 954(h)(3)(C) and the “substantially all the activities” requirement of section 954(h)(3)(A)(ii).
  - Provide regulations under section 954(c) relating to the active rent or royalty exception.
  - Finalize the proposed regulations under section 959 regarding exclusions from income of previously taxed earnings.
  - Provide guidance under section 961(c) regarding basis adjustments to the stock of a controlled foreign corporation (CFC) held through partnerships.
  - Finalize the proposed section 898 regulations on conforming year-ends of certain foreign corporations to the year-ends of their U.S. shareholders.
  - Provide guidance to explain the application of section 304(b)(6).
  - Provide guidance on the amendment made to section 304(b)(5) by The Education Jobs and Medicaid Assistance Act (P.L. 111-226, August 20, 2010), including guidance on what is considered “subject to tax” for purposes of section 304(b)(5)(B).
  - Provide more complete and definitive guidance under the passive foreign investment company (PFIC) regulations. In particular, (1) update the PFIC regulations to take into account the enactment of section 1297(e), which

eliminates the overlap of the PFIC and Subpart F regimes under certain circumstances (including the application of section 1297(e) to a PFIC owned by a U.S. partnership that has U.S. partners) (see e.g., PLR 200943004), (2) provide guidance under section 1297(c) regarding the 25 percent ownership look-through rule and its interaction with the section 1297(b)(2)(C) related party income rules, and (3) provide guidance on the application of section 1297(b)(1)'s definition of passive income and in particular on the interaction of section 954(h) and (i) with section 1297(b)(2).

- Issue revised Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, (or successor form) and instructions under section 1297(f) for annual reporting by PFICs that impact returns for years beginning after March 18, 2010 (including fiscal years ending March 31, 2011 due June 15, 2011).
- Issue regulations pursuant to Notice 2007-13 regarding the substantial assistance rules for foreign base company services income.
- Provide guidance with respect to the Treas. Reg. § 1.954-2(b)(4) substantial assets test relevant to qualification under the same country exception for interest and dividends, as applied to (i) stock in non-CFC foreign corporations; and (ii) banks and insurance companies.
- Provide guidance under section 267(a)(3)(B), including guidance regarding the timing of deduction for interest, rental and royalty payments to CFCs that qualify for exclusion under section 954(c)(6) or the same country exception and guidance regarding exceptions for appropriate transactions pursuant to section 267(a)(3)(B)(ii). Also, provide guidance relating to when an item payable to a CFC, and subject to section 267(a)(3)(B), that is included in the gross income of a United States person by reason of section 956 or the payment of an actual dividend (i.e., other than by reason of section 951(a)(1)(A)), will be considered an amount attributable to such item that is includible in the gross income of such United States person.
- With respect to section 952(c)(2) subpart F income recapture, provide guidance regarding the application of “rules similar to rules applicable under section 904(f)(5),” and in particular the latter section’s incorporation of the disposition rules of section 904(f)(3).

2. Guidance is needed in the following areas related to inbound transactions:

- Continue providing guidance, beyond that in Notices 2010-60 and 2011-34, on the new withholding provisions (sections 1471 - 1474) that were enacted as part of the Hiring Incentives to Restore Employment Act (the “HIRE Act”).

- Revise, as appropriate, and finalize the proposed section 163(j) “earnings stripping” regulations, taking into account taxpayer comments and developments since the original issuance of the proposed regulations.
  - Provide guidance on the application of Temp. Reg. § 1.897-6T and section 1445 to non-recognition transactions involving transfers of USRPIs to partnerships, and dispositions of interests in partnerships that directly and indirectly hold USRPIs.
  - Following the retroactive withdrawal of Treas. Reg. § 1.1441-1(b)(7)(iii) by T.D. 9323, guidance on liability of a withholding agent for interest with respect to withholding under section 1445 or section 1446, if the withholding agent does not withhold with respect to a foreign person that has no U.S. tax liability, or that has satisfied its U.S. tax liability.
3. Guidance is needed in the following areas related to outbound transactions:
- Finalize existing proposed regulations under sections 367(a), 367(a)(5), 367(b), 1248(a), 1248(e), 1248(f) and 6038B. [Note: [See AICPA comments to IRS submitted on May 20, 2009.](#)]
  - Provide guidance on the application of Treas. Reg. § 1.367(a)-8(c)(3)(B) when there is an indirect stock transfer under Treas. Reg. § 1.367(a)-3(d).
  - Finalize existing temporary regulations under section 7874 relating to inversion transactions. As part of that guidance, reinstate a “safe harbor” relating to when a taxpayer should be treated as satisfying the substantial business activities test.
  - Issue updated regulations under section 367(d), reflecting changes to the statute since their original issuance. We also suggest interim guidance be issued on the changes to section 367(d) under Section 406(a) of the American Jobs Creation Act of 2004, including the retroactive application of that provision.
  - Issue guidance under section 332(d) regarding its interaction with section 337.
  - Finalize the proposed section 987 regulations relating to foreign currency translation gains and losses with respect to branch transactions (taking into account public comments with respect to the proposed regulations). [Note: [See AICPA comments to IRS submitted on March 29, 2007.](#)]
  - Issue guidance relating to the carryover of tax attributes in section 355 transactions. Finalize the proposed regulations under section 367(b) addressing these issues (i.e., Treas. Reg. § 1.367(b)-8).

- Issue guidance that internal restructurings within a U.S. multinational group following a section 338(g) election of a foreign target corporation made by one of the members of the U.S. multinational group is not a transaction described in Notice 2004-20.
  - Issue additional guidance under the relevancy rules Treas. Reg. § 301.7701-3(d), including the impact of certain acquisitions of entities that are not relevant and the consequences of certain elections relating to such entities.
4. Guidance is needed regarding foreign tax credits, in particular:
- Provide additional guidance on section 909, including what arrangements will be treated as giving rise to foreign tax credit splitting events in post-2010 tax years and, if there is a foreign tax credit splitting event, how related income will be determined.
  - Provide guidance under section 901(m), including providing exemptions for certain covered asset acquisitions where basis difference is de minimis and where a taxpayer receives a basis step-up for local tax purposes that is comparable to the U.S. tax step-up. Guidance also is requested on the interactions of sections 901(m) and 909 relating to arrangements or transactions in which both provisions may apply.
  - Provide guidance on section 960(c), including guidance on the application of the provision when there is either a deficit or previously taxed earnings and profits in an upper-tier foreign corporation in the chain of ownership. Additionally, guidance also is requested on the application of this provision when a taxpayer has section 956 investments that pre-date and post-date the effective date of section 960(c).
  - Provide guidance on the application of section 904(d)(6), including the interaction of such provision in the context of treaties that already contain their own separate limitation regime for the treaty credit.
  - Guidance is needed under section 905(c) regarding taxes paid after a liquidation, stock sale or section 338 election.
  - Finalize overall foreign loss (OFL) and overall domestic loss (ODL) rules contained in Temp. Reg. §§ 1.904(f)-1T, -2T and -8T, and Temp. Reg. §§ 1.904(g)-1T, -2T and -3T.
  - Finalize guidance under Temp. Reg. §§ 1.905-3T, -4T and -5T.
  - Expand the exceptions to section 901(l)(1)(B) contained in Notices 2010-65 and 2005-90 to include property (tangible and intangible) licensed or leased in so-called back-to-back arrangements undertaken in the ordinary course of a taxpayer's business, such as the use of entities that act as regional collection

and administration agents, or are used to reduce foreign withholding taxes, as the application of section 901(l)(1)(B) to such property is not necessary to carry out the purposes of this subsection. Also provide guidance on the definitions of “related payments” and “positions in substantially similar or related property” for purposes of section 901(l)(1)(B). Provide an exception from the 15-day holding period of section 901(l)(1)(A) for sales of inventory property (e.g., copyrighted articles) that may be subject to withholding tax.

- Consider finalizing a portion of the proposed regulations (issued on August 3, 2006) providing guidance under section 901 on the allocation of foreign taxes.
- Issue guidance under new section 904(f)(3)(D), relating to the application of the overall foreign loss rules to certain dispositions of CFC stock, and, in particular, section 368(a)(1)(B) reorganizations, as well as relating to the provision’s interaction with section 355.
- Issue guidance relating to the application of the overall foreign loss rules to certain dispositions involving partnerships.
- More complete guidance regarding the application of Treas. Reg. § 1.865-1(a)(2) and Treas. Reg. § 1.865-2(a)(3) under which losses are allocated to reduce foreign source income if gain on the sale of the property (including stock) would have been taxable by a foreign country and the highest marginal rate of tax imposed on such gains in the foreign country is at least 10 percent.

5. Guidance is needed in the following additional areas:

- Provide guidance regarding the new foreign asset reporting under section 6038D, which impacts Forms 1040 for calendar year 2011, generally due April 15, 2012. Issue final Form 8938, Statement of Foreign Financial Assets (or successor form), and issue draft instructions.
- Provide additional guidance relating to Form TD F 90-22.1 for the reporting of foreign bank and financial accounts. [Note: See [AICPA comments to Treasury, IRS and FinCEN submitted on November 19, 2010](#), [AICPA comments to FinCEN \(with copies to Treasury and IRS\) submitted on April 30, 2010](#), as well as [AICPA comments to Treasury, IRS and FinCEN submitted on November 16, 2009](#).]
- Clarify and relax the double reporting rules under the section 1461 regulations and the treaty-based reporting requirements under section 6114.
- Provide guidance regarding the treatment of domestic hybrid disregarded entities owned by foreign persons for treaty purposes, including the determination of profits attributable to a permanent establishment and application of the branch profits tax.

- Provide guidance regarding the application of reduced or zero-rate tax provisions in treaties with respect to dividends received through hybrid disregarded entities. The Service has issued private letter rulings relating to this issue. See e.g., PLRs 200626009 and 200522006.

**IRS Practice and Procedures Committee** (Danny R. Snow, Chair, (901) 685-5575, [dsnow@tdplc.com](mailto:dsnow@tdplc.com); or Benson S. Goldstein, AICPA Senior Technical Manager, (202) 434-9279, [bgoldstein@aicpa.org](mailto:bgoldstein@aicpa.org)). **NOTE:** Comments are listed in priority order.

1. The IRS has implemented its Return Preparer Initiative which generally requires tax return preparers to obtain a preparer tax identification number and meet certain other requirements. The AICPA recommends that the Service continue to work with stakeholders to issue additional guidance for the program, including further frequently asked questions (FAQs).
2. The Service is phasing in the Modernized e-file (MeF) program to handle the electronic filing of Forms 1040 returns. We recommend that the IRS issue guidance and expand the capability of the MeF program to accept amended returns, claims for refund, and various supporting schedules.
3. Section 6662A imposes an accuracy-related penalty on any reportable transaction understatement attributable to a listed transaction or a reportable avoidance transaction for taxable years ending after October 22, 2004. We recommend that Treasury issue regulations under section 6662A which addresses (among other matters): (a) the definition of a “reportable transaction understatement;” (b) coordination of the reportable transaction understatement penalty with the substantial understatement penalty, particularly when multiple years and both penalties are involved; (c) coordination of the reportable transaction understatement penalty with the accuracy-related penalty on underpayments; and (d) application of the penalty (if any) to net operating loss (“NOL”) carryback and carryover years.
4. Under section 6662A, if a partnership fails to properly disclose a reportable transaction and the transaction creates a reportable transaction understatement, the partners of the partnership can find themselves liable for a section 6662A penalty with no avenue to challenge the penalty because they did not make the required disclosure under Treas. Reg. § 1.6011-4, even though the partners might never have been aware of the transaction creating the understatement. Accordingly, we recommend that guidance be issued under section 6662A to address the application of the penalty to partnerships and partners.
5. While the IRS generally relies on correspondence, field, and office audits of taxpayer’s returns, correspondence audits are the primary mode of examination for the Service. According to the National Taxpayer Advocate 2009 Annual Report to Congress, 72 percent of all examinations in fiscal year 2008 were correspondence audits, a significant increase from the 54 percent level in fiscal

year 2000. The Advocate's report suggests that this increasing reliance on correspondence audits has a lot to do with the fact IRS employees spent an average of only 1.6 hours in "direct time" on each correspondence examination in FY 2008, as compared to 8.5 hours on each office examination, and 46.4 hours on each field examination.

In general, a correspondence examination involves an individual or small business taxpayer receiving a letter from the IRS requesting the taxpayer to address a few limited issues about the tax return; often focusing on credit or deduction issues. Unfortunately, many taxpayers (when receiving the letter) either: (a) assume they made a mistake on their return and quickly send in a check to cover the IRS's computation of the underpayment of taxes; or (b) ignore the response deadline set out in the Service's letter, which is often 30 days. If the IRS's letter is ignored, the Service's computers automatically send out the notice of deficiency to the taxpayer.

According to Treasury Inspector General for Tax Administration (TIGTA) Report (February 18, 2011, Reference number 2011-30-016), the IRS has made significant improvements in its handling of correspondence cases. Nevertheless, TIGTA found that the IRS continued to make errors based on a statistical sampling of 62 cases, including circumstances where IRS employees did not always take into account taxpayer correspondence before closure of the case.

With the IRS's increasing reliance on correspondence audits as the primary procedure for examining taxpayers' returns, the AICPA recommends that Treasury and IRS issue additional guidance (in the form of more plain-language publications) for individual and small business taxpayers. We also recommend that a webpage be set up at [irs.gov](http://irs.gov) dedicated to correspondence audits. Implementation of these suggestions should contribute to an increase in tax compliance and respect for the tax administration process by taxpayers.

6. Generally, a disregarded entity is not treated as separate from its owner. See Treas. Reg. § 301.7701-2(c)(1). However, under an exception in Treas. Reg. § 301.7702-2(c)(2)(iv), among other things, a disregarded entity is treated as a separate entity with respect to employment taxes under Chapter 24 and, as such, the disregarded entity is responsible for its own employment tax obligations. In the preamble to the final regulations under Treas. Reg. § 301.7701-2(c)(2)(iv) published at 72 FR 45892 (Aug 16, 2007), the IRS clarified that this exception was intended to apply to employment taxes with respect to wages, and not with respect to non-wage payments that are subject to backup withholding under section 3406. See 72 FR 45892. Despite this written expression of clear intent on the part of Treasury and the IRS, the text of the regulation did not carve-out section 3406 from application of Treas. Reg. § 301.7701-2(c)(2)(iv). Without such a carve-out, a disregarded entity, and not its owner, is responsible for taxes under Chapter 24, inclusive of backup withholding under section 3406. We urge Treasury and the IRS to rectify this drafting oversight by amending the regulations under Treas. Reg. § 301.7701-2(c)(2)(iv) to exclude section 3406. In

addition, it is important for the regulations to clarify that a disregarded entity is not required to issue its own Forms 1099.

7. Given the mandate for tax return preparers to e-file most Forms 1040 and 1041, many more tax return preparers will be required to obtain an EFIN to participate in the e-file system as an electronic return originator (ERO). However, unlike the PTIN rules, a taxpayer with any outstanding account balance (even if the taxpayer disputes the account balance) cannot obtain an EFIN even if that taxpayer is diligent in engaging with the IRS to work through the issues, is a taxpayer that is a reputable tax advisor, and has a history of compliance with the tax laws, and the individual(s) from the taxpayer who will be named as responsible parties on the EFIN application have a PTIN. The inability to obtain an EFIN under these circumstances is unfair, particularly since the statute requires that the practitioner participate in the e-file system. Although the IRS has procedures that allow the preparer to prepare and a taxpayer to file a paper return in these circumstances, the limit on a preparer's ability to obtain an EFIN undermines the e-file mandate. We recommend that the IRS consider coordinating the rules for obtaining an EFIN with the rules for obtaining a PTIN. Such coordination would not only allow PTIN-registered preparers the ability to e-file, but will reduce burden and duplication of effort on the part of the preparer and the IRS. With the current preparer e-file mandate in effect, the AICPA recommends the issuance of immediate guidance to address this matter.

**Partnership Taxation Technical Resource Panel** (Sarah I. Staudenraus, Chair, (202) 533-4574, [sarahstaudenraus@kpmg.com](mailto:sarahstaudenraus@kpmg.com); or Marc A. Hyman, AICPA Technical Manager, (202) 434-9231, [mhyman@aicpa.org](mailto:mhyman@aicpa.org)). **NOTE:** Comments are listed in priority order.

1. Guidance is requested that would grant relief from the sections 6698 and 6722 failure to file penalties to partnerships that inadvertently file a late short period return and associated Schedules K-1 due to a technical termination under section 708(b)(1)(B). Relief should be granted such that penalties would not be imposed as long as the short period return is filed by the date the original partnership return would have been due had the partnership not technically terminated. It is common for partnerships to be unaware of events that would cause a technical termination until after the due date of the tax return for the short year.
2. Guidance is needed on the treatment of limited liability company members (and limited partners in light of recent judicial rulings) under section 1402(a)(13). Regardless of the political nature of this issue, some taxpayers aggressively avoid classifying LLC income as earnings from self-employment, while others may be overly conservative in this regard. Without guidance, widespread inconsistency will continue to flourish and practitioners trying to do the "right" thing have difficulty retaining clients who prefer an overly aggressive position. The Service should withdraw and re-propose or finalize existing regulations addressing this important issue.

3. Expanded guidance is needed under the principles of Revenue Rulings 99-5 and 99-6.

#### **Revenue Ruling 99-5**

- The amount of the LLC's liabilities that is included in the seller's amount realized on the deemed asset sale that occurs under Rev. Rul. 99-5, Situation 1.
- The treatment of the LLC's liabilities to its single owner upon the formation of the partnership in Rev. Rul. 99-5, Situations 1 and 2.
- The treatment of transfers that are not described in Rev. Rul. 99-5 Situations 1 and 2, but which result in the conversion of the single-member LLC to a partnership.

#### **Revenue Ruling 99-6**

- The amount of the LLC's liabilities that are considered assumed by the buyer (a) as part of the purchase of the selling partner's interest in the LLC and (b) as part of the buying partner's liquidating distribution from the LLC.
  - The amount of the LLC's assets that are considered acquired by the buyer (a) from the selling partner, and (b) as part of the buying partner's liquidating distribution from the LLC.
  - The deemed extinguishment of any liabilities of the LLC to the acquiring partner that results from the merger of the debtor-creditor relationship which occurs upon the termination of the partnership.
  - Application of the section 704(c)(1)(B) and section 737 "mixing bowl" rules to the acquiring partner with respect to the deemed liquidating distributions that occur as part of the Rev. Rul. 99-6 construct.
  - Application of the section 751(b) "disproportionate distribution" provisions to the acquiring partner with respect to the deemed liquidating distributions that occur as part of the Rev. Rul. 99-6 construct.
  - The treatment of transfers that are not described in Rev. Rul. 99-6, Situations 1 and 2, but which result in the conversion of the partnership to a disregarded LLC.
  - Application of Rev. Rul. 99-6 to interest over partnership merger transactions.
4. Guidance is requested on the treatment of targeted allocations under section 704(b), including under what circumstances the targeted allocations would qualify under the economic effect equivalence test under the regulations.

5. Guidance is requested under sections 165 and 166 on the attributions of a partnership's trade or business to a partner in determining whether a bad debt is a business or non-business expense or loss. Is the deduction a business expense under section 62(a)(1) or as miscellaneous itemized deduction under section 67(b)(2)?
6. Guidance is needed to clarify whether the section 752 regulations defining nonrecourse and recourse debt are applicable in determining the classification of partnership indebtedness for purposes of section 1001. The current economic downturn has resulted in an increase in the number of federal tax partnerships that are entering into arrangements with their creditors to work out their indebtedness. Depending on whether the partnership liability is "nonrecourse" or "recourse" for section 1001 purposes, a foreclosure by a creditor on partnership property results in the partnership recognizing (a) the amount realized on the sale or disposition of property subject to nonrecourse debt, or (b) the amount realized plus cancellation of indebtedness (COD) income on the sale or disposition of property subject to recourse debt. Neither section 1001, the regulations thereunder, nor IRS rulings address the characterization of partnership debt as "recourse" or "nonrecourse" for this purpose. This uncertainty is exacerbated by the prevalence of (a) limited liability companies taxed as partnerships (a situation that was not in existence when the section 1001 regulations were written) which have debts that are recourse to the entity's assets under state law, but for which no member has liability and (b) partnerships that hold multiple properties subject to recourse debts in separate disregarded entities.
7. Update and finalize the longstanding temporary regulations under section 469 to provide greater clarity to taxpayers and practitioners.

The Tax Reform Act of 1986 created section 469, "Passive Activity Losses and Credits Limited." Temporary regulations were issued on these provisions soon after the legislative changes were made. Several of the regulations were issued prior to the effective date of the change made to section 7805 by the Technical and Miscellaneous Revenue Act of 1988 providing that temporary regulations expire within three years of issuance (effective for regulations issued after November 20, 1988). Thus, temporary regulations issued after enactment of the Tax Reform Act of 1986 and before November 21, 1988 that have not been finalized, remain in their temporary form. While parts of the section 469 regulations have been finalized (generally because portions were modified after November 20, 1988), many parts remain in temporary form. The current state of these regulations is problematic for a few reasons including the fact that it is difficult to find, read and apply the regulations because portions of a single regulation (e.g., Treas. Reg. §§ 1.469-2(f) and 1.469-2T(f) on re-characterizations), are part final and part temporary.

8. Guidance is requested as to what constitutes a reasonable estimate for an accrual-basis taxpayer with respect to its interests in a partnership under Treas. Reg. § 1.451-1(a). For example, does a draft K-1 provided by the partnership constitute

- a reasonable estimate such that an accrual-basis taxpayer can file a final return using those numbers and make any adjustments once the final K-1 is received in the following year?
9. Guidance is requested on the treatment of unamortized organizational costs under section 709 and start-up costs under section 195 upon a technical termination. Are such costs written off because the tax entity terminates or are they treated as a property contribution to the new partnership under section 721 so that amortization continues?
  10. Guidance on the methodology of applying section 743 for partnerships using the special aggregation rule for securities partnerships under Treas. Reg. § 1.704-3(e). Guidance would be expected to include a similar aggregation rule for allocating the section 743 adjustment under section 755 and a methodology for determining when the section 743 adjustment is taken into account.
  11. Guidance under Treas. Reg. § 1.704-3(e)(4) to permit the aggregation of assets for certain partnerships that do not qualify for section 704(c) aggregation under the provisions of Treas. Reg. § 1.704-3(e)(3) or under Rev. Proc. 2007-59. Such guidance would expand the requirements to allow a greater number of taxpayers the ability to aggregate in appropriate situations.
  12. Guidance is needed to address the revaluation of partnership assets where the assets were either contributed to the partnership or previously revalued by the partnership. This guidance should include (1) how the multiple layers under section 704(c) are maintained; (2) the impact on minimum gain calculations under section 704(b); (3) the impact on nonrecourse debt allocations under section 752; and (4) the treatment of debt obligations including Treas. Reg. § 1.752-7 in a revaluation.
  13. Guidance is requested on the treatment of partnership level section 481 adjustments. Several unresolved issues include guidance on (1) allocation of the 481 adjustment where there has been a change in ownership, (2) the impact of the 481 adjustment on a section 754 basis adjustment, (3) the treatment of a 481 adjustment on a section 708(b)(1)(B) termination, and (4) the treatment for purposes of 751.
  14. Guidance is requested granting optional relief from the “single basis in a partnership” rule of Rev. Rul. 84-53 for owners of interests in publicly traded partnerships, similar to the special exception in the holding period rules of Treas. Reg. § 1.1223-3(c)(i) for publicly traded partnerships.
  15. Guidance is requested granting relief to publicly traded partnerships to use simplifying assumptions for purposes of calculating section 743 adjustments and section 751(a) amounts upon sale. Such relief would allow the partnership to use the same price for all trades in a particular month to calculate the section 743 adjustments of transferees as opposed to actual purchase price as required in the

regulations. Such relief is necessary for ease of administration and due to the lack of precise trading data. Similar simplifying conventions would be used for calculating the gain on the hypothetical sale of “hot assets” under section 751(a) to transferors.

16. General guidance on what constitutes a merger or a division under section 708(b)(2) is needed. In the preamble to the regulations issued in 2001, the IRS declined to provide a precise definition. Nevertheless, it would be helpful if the IRS provided some examples showing mergers vs. non-mergers. Further, such guidance should address what constitutes a continuation under section 708(b)(1)(A) when one or more historic partner(s) continue in the new partnership.
17. Clarification is needed under section 42 regarding what items (other than impact fees) are included in the eligible low income housing credit basis, such as tap fees, offsite costs, construction loan fees and bond costs.

**S Corporation Taxation Technical Resource Panel** (Kevin J. Walsh, Chair, (907) 456-2222, [kwalsh@wks CPA.com](mailto:kwalsh@wks CPA.com); or Marc A. Hyman, AICPA Technical Manager, (202) 434-9231, [mhyman@aicpa.org](mailto:mhyman@aicpa.org)). **NOTE:** Comments are listed in priority order.

1. Guidance is requested with respect to the S corporation stock basis ordering rule for losses and deductions that have been carried forward. Section 1366(d) states that losses and deductions that are disallowed for any taxable year due to a lack of basis shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder. We ask that guidance follow this statutory construction.
2. Guidance is needed regarding the temporary shortening of the recognition period under section 1374(d)(7)(B). Specifically, we request that guidance be issued excluding recognized built-in gain that is deferred in 2009, 2010 or 2011 (and beyond, should the provision be further extended) as a result of an income limitation or installment sale and later recognized during the recognition period under section 1374(d)(2)(B) or under the installment sales rules not be subject to tax. In addition, we request clarification as to (1) what happens if a section 444 election is made during the recognition period resulting in a change in the tax year; (2) whether the “7<sup>th</sup> taxable year” for years beginning in 2009 or 2010 (per American Recovery and Reinvestment Act of 2009) or “5<sup>th</sup> taxable year” for years beginning in 2011 (per Small Business Jobs Act of 2010), as appropriate, or the “stub-period” months as defined in the regulations determines the temporary end of the recognition period; and (3) whether the temporary rule applies to regulated investment companies and real estate investments trusts.
3. Guidance is needed regarding the inability to utilize certain suspended passive activity losses upon redemption. Section 469(g) generally allows for the utilization of all suspended passive activity losses that have been carried forward

when a taxpayer disposes in a taxable transaction of his entire interest in a passive activity. This rule does not apply, however, when the sale of S corporation stock is to a related party described in sections 267(b) and 707(b)(1). When the related party exception applies, the loss is deferred until the party acquiring such stock interest in the passive activity disposes of it to a party that is unrelated to the initial selling taxpayer. In the case of a redemption of S corporation stock, the second disposition can never be achieved because the stock redeemed no longer exists for federal income tax purposes. It is not possible to trace the redeemed stock to a subsequent disposition.

The legislative history to the provision does not appear to contemplate this situation. Although the statute treats redemptions of corporations differently than redemptions of partnership interests with regard to the ability to recognize realized losses on redemption (see section 707(b)(1) allowing for losses on redemption of partnership interests; and see section 267(b) and Revenue Ruling 57-387 for disallowance of loss on redemption of corporate stock), we believe it appropriate that all suspended losses be allowable upon a complete redemption of interests in a pass through entity. Suspended passive losses do not result from a sale or exchange of property between related parties, but rather from true economic losses. The sale transaction solely governs the timing of taking the loss into account. If such losses were not allowed upon a complete redemption in a pass through entity, true economic losses would never be recognized as the provisions of section 469(g) could never be satisfied.

4. We recommend that the guidance from PLRs 200308035 and 201017019 be incorporated into a revenue ruling. Specifically, guidance is requested concerning whether a second class of stock is created by an S corporation's pro rata distributions made to pay: (1) taxes in year one; (2) redemptions in year two; (3) additional taxes in year three for an amendment of its year one tax return; and (4) subsequent distributions to pay additional year one taxes.

PLR 201017019 provides that there is only one class of stock when an S corporation pays distributions to its shareholders based on the apportionment of taxable income for a given period. The distribution plan discussed in the ruling also provides that if a subsequent audit increases taxable income for a prior period, the corporation may make distributions to shareholders in proportion to their relative shares of taxable income during the prior period. The payment policy described in this ruling appears to relate to distributions on specific dates or events, and there is at least an implication that there may be more than one distribution, subject to different formulae, within a single corporate taxable year.

Additionally, guidance is needed to confirm that an S corporation can simultaneously make both pro rata distributions according to current stock ownership and other distributions that meet the varying interest rule of Treas. Reg. § 1.1361-1(1)(2)(iv) without creating a second class of stock.

5. Guidance is needed to reconcile apparent conflicts between Subchapter C and Subchapter S rules. The rules for each subchapter sometimes conflict or leave gaps in understanding of the proper treatment of entities moving between C and S. The following examples provide specific situations where additional guidance is requested.

- Guidance is needed regarding the allocation of items on the day an S corporation acquires a C corporation and makes a QSub election for such acquired C corporation.

Because of what appears to be a conflict between various timing rules regarding the recognition of income and the effects of a QSub election, uncertainty exists on how to allocate income on the date of a QSub election. For example, under Treas. Reg. § 1.1361-4(b)(3), if an S corporation does not own 100 percent of the stock of the subsidiary on the day before the QSub election is effective, the liquidation described in Treas. Reg. § 1.1361-4(a)(2) occurs immediately after the time at which the S corporation first owns 100 percent of the stock. When an S corporation acquires a subsidiary from a consolidated group, the timing of the QSub election may not reconcile with the consolidated return regulations. Treasury Reg. § 1.1502-76(b)(1)(ii) states that the departing member is included in the consolidated group through the end of the day on which it leaves. A departing member, for example, might account for inventory under the LIFO method. It is not clear in this case who recognizes the LIFO recapture. The consolidated regulations have a “next day” rule that generally allocates items that occur on the day of deconsolidation to the next day if they are more properly attributable to activities occurring after the subsidiary has left the group. In the case of a QSub election, there is no “next day” of the departing member to which items may be allocated. Accordingly, the recapture of the LIFO reserve would appear to be recognized on the selling consolidated group’s return. However, if the S corporation is deemed to acquire the stock of the member after taking into account the consolidated return rule which says the subsidiary remains a member through the day of deconsolidation, then the liquidation might happen on a separate one second return immediately after the target is deemed to leave the consolidated group under Treas. Reg. § 1.1502-76(b)(1)(ii).

- Guidance and clarification are requested on who is a shareholder of stock both on the date of a stock sale and the date of a stock issuance.

Section 1362(e)(1) states that in the case of an S termination year, the taxable year of the corporation should be treated as consisting of an S short year and a C short year. The S short year is the year that runs from the first day of the corporation’s year to the day before the terminating event. Section 1362(e)(1)(A). The C short year is the year that starts on the termination date and runs through the end of the corporation’s year. Section 1362(e)(1)(B).

Section 1362(d)(2)(B) states that an S election terminates whenever the corporation ceases to be a small business corporation. Treasury Reg. § 1.1362-2(b)(2) clarifies that the election terminates on the date of the event that caused the termination, e.g., the acquisition of stock by an ineligible shareholder.

Section 1377 states that except when an election to terminate the tax year is made, S corporation items are allocated on a per share per day method by assigning an equal amount of the income, loss, deduction or credit to each day and dividing that amount by the shares *outstanding on such day*.

### Stock Sale

Treasury Reg. §1.1377-1(a)(2)(ii) contains special rules for determining the shareholder. A shareholder who disposes of his stock is treated as the shareholder for the date of disposition. This rule is different than Treas. Reg. §1.1377-1(a)(2)(i) which states that “solely for purposes of determining a shareholder’s pro-rata share of an item for a taxable year under section 1377(a)...” In other words, the disposition rule seems to apply for all sub S purposes.

Thus there appears to be conflict between the section 1377 rule and the rule under section 1362(d). If a shareholder sells stock to an ineligible shareholder on March 15th, under section 1377, the S election continues through March 15th, while under section 1362(d), the S election seems to terminate on March 15th and S status is only maintained through March 14th. The IRS should clarify which rule takes precedence.

### Stock Issuance

Neither the statute nor the regulations are clear on when newly issued stock is taken into account for purposes of allocating income or treating a shareholder as a shareholder. Is a person to whom shares are issued a shareholder on the date of issuance? Under section 1377, it appears so as the pro-rata amount is determined based on the shares outstanding on each day. Might the shares be considered issued as of the close of business? Would an issuance on December 31 (or the last day of a tax year) cause the recipient to be a shareholder on that last day or if issued to an ineligible shareholder terminate S status on December 31 causing a 1 day C corporation return? Treasury Reg. § 1.1368-1(g)(2)(i) suggests the issued shares are not counted until the next day. In determining the allocation of income for “qualifying dispositions” (one of which is an issuance of shares equal to or greater than 25 percent of the previously outstanding shares), the regulation breaks the year into two years, one ending on the date of the issuance and the other starting the day after. This appears consistent with the section 1377 rule that states a shareholder disposing of stock is considered the shareholder through the close of the day.

- Guidance should be issued that (1) addresses the interplay between the consolidated return and the QSub regulations regarding the timing of the deemed liquidation when a member of a consolidated group is acquired by an S corporation and a QSub election is made for the former member and (2) specifies on which return the LIFO recapture amount is recognized.

Similarly in the context of an acquisition of a stand-alone C corporation, it is unclear which laws/regulations are applicable. Treasury Reg. § 1.1361-4(b)(3) states that the deemed liquidation as a result of a QSub election is effective immediately after the acquisition if the S corporation did not own stock of the corporation on the day preceding the effective date of the election. Treasury Reg. § 1.1361-4(b)(3)(ii) contains a special rule with respect to acquired S corporations for which QSub elections are made. That rule states the deemed liquidation occurs at the beginning of the day the termination of S status is effective. Accordingly, the acquired S corporation is deemed to liquidate into the acquiring S corporation at the beginning of the day of the acquisition and all the activities for such day are presumably reported on the “parent” S corporation return.

With respect to an acquisition of a C corporation, the result is unclear. Section 381 prescribes rules regarding the carryover of attributes in certain acquisitions. Section 381(a)(1) generally applies to section 332 liquidations. Many QSub elections are treated as section 332 liquidations. Section 381(b)(1) and (2) provide that generally, the taxable year of the liquidating company shall end on the date that the liquidating distribution of assets is completed. Treasury Reg. § 1.381(b)-1(a)(1) provides that the taxable year of the transferor corporation ends with the close of the date of distribution or transfer.

We request guidance clarifying that all activities of the acquired C corporation for the date of acquisition by an S corporation are reported on the final C corporation return when a QSub election is made for the acquired C corporation effective on the date of acquisition.

6. Guidance is requested regarding the ability to elect S corporation status when in the formation of the electing corporation, an ineligible shareholder is a transitory owner on the date of formation.

For instance, under Rev. Rul. 2004-59 and Treas. Reg. § 301.7701-3(g)(1), a conversion via a state law seamless conversion statute or a “check the box” election is treated as an “assets-over” transaction. The partnership is deemed to transfer all its assets and liabilities to a new corporation in exchange for the new corporation stock and then distribute the stock interests out to its partners in liquidation of the partnership.

Technically, the partnership is momentarily a shareholder on the corporation’s first day of its first taxable year. Treasury Reg. § 1.1362-6(a)(2)(ii)(B) prohibits

an S election from being effective if the corporation has an ineligible shareholder at any time during its taxable year occurring before the date the election is made. See Example 3 of Treas. Reg. § 1.1362-6(a)(2)(iii).

This momentary ownership issue also arises when an S corporation distributes a QSub to its shareholders in a transaction qualifying as reorganization under sections 368(a)(1)(D) and 355. The distribution of the QSub is treated as if the S corporation, immediately prior to the distribution, formed a new C corporation by transferring all of the QSub's assets and liabilities to the new corporation in exchange for stock. See section 1361(b)(3)(C)(i). A similar issue is also present when an S corporation distributes the stock of a newly formed C corporation (immediately after the formation) either in connection with a tax free D/355 transaction or as a section 301 distribution.

We believe the proper answer is that momentary ownership should be disregarded in these situations. Treasury Reg. § 1.1361-5(c)(3) indicates the momentary ownership may be disregarded at least in the case of the distribution of a QSub; however, the issue is not addressed directly in that regulation and the other situations mentioned above would not be covered by the regulation.

The Internal Revenue Service regularly issues private rulings holding that momentary ownership is disregarded for purposes of determining S corporation eligibility. We recommend that the IRS issue public guidance in the form of a revenue ruling that may be relied upon by all taxpayers. This would relieve the IRS of allocating resources to drafting private letter rulings on a routine matter.

7. Clarification is needed regarding the ordering rule for adjustments to AAA when ordinary and redemption distributions are made in the same year and an ordinary distribution occurs after the redemption distribution. Under Treas. Reg. § 1.1368-2(d)(1)(ii), AAA is adjusted first for ordinary distributions and then for redemptions. The regulations provide an example where the redemption occurs later in the year than the ordinary distribution, but does not provide an example where the redemption occurs prior to the ordinary distribution. Since the redemption distribution is based on the AAA amount as of the date of the redemption, the rule is not clear in the case of a post-redemption ordinary distribution. The regulation simply says to adjust first for ordinary distributions but does not make a distinction for those ordinary distributions that are before or after redemption. One could interpret the rule either way. Reducing the AAA balance for all ordinary distributions regardless of the timing relative to the redemption provides the best answer in most circumstances. Since a complete redemption is a sale or exchange transaction, the presence of AAA is irrelevant for purposes of determining the shareholder's gain or loss on the redemption. Allocating more AAA to redemptions by ignoring post redemption distributions doesn't benefit the redeemed shareholder while it leaves less AAA for the post redemption distribution to be recovered tax free by the recipient shareholders. We specifically request an example where ordinary distributions are made subsequent to a redemption and how AAA is impacted in that situation.

8. Guidance is needed as to whether the extraterritorial income exclusion (ETI) increases AAA and stock basis.
9. Guidance is needed as to when, for alternative minimum tax purposes, S corporations will have attributes which will be different for regular tax and alternative minimum tax purposes. For example, does an S corporation have an Accumulated Adjustments Account for alternative minimum tax purposes which would differ by the adjustments of sections 56, 57 and 58 from the Accumulated Adjustments Account for regular tax purposes? Assuming there are Accumulated Adjustment Accounts kept for each type of tax, if distributions in excess of the regular tax and AMT Accumulated Adjustments Accounts are made by an S corporation with accumulated earnings and profits, how much is taxable to the recipient shareholder for regular tax purposes and how much for AMT purposes? As more and more taxpayers become subject to the AMT, it is increasingly important for taxpayers to have guidance on how the regular tax and AMT interface with respect to common transactions.
10. Guidance is requested under section 6699 regarding the penalty for failure to file an S corporation return. Specifically, guidance is requested that allows an exception from the penalty for certain S corporations in a manner similar to the exception provided by Revenue Procedure 84-35, 1984-1 CB 509, for partnerships with 10 or fewer partners. [Note: [See AICPA Proposed Revenue Procedure to Exempt Certain S Corporations from Failure to Timely File Penalty under Section 6699 dated December 2, 2008.](#)]
11. Guidance is needed as to whether a state tax refund attributable to the S-portion of an ESBT is allocated to the S-portion.
12. Clarification is needed about who should sign the final return of a corporation that is the target of a section 338(h)(10) acquisition by an S corporation. We believe this guidance can be easily provided in the instructions to the relevant forms.
13. Treasury Reg. § section 1.1361-5 should be updated to reflect the addition of clause (ii) (relating to termination of a QSub by reason of the sale of QSub stock) to section 1361(b)(3)(C) made by section 8234 of P.L. 110-28. This can be accomplished in any of three ways: (1) delete the obsolete portion of existing regulation; (2) add a sentence to indicate that the old rules apply only for years before the effective date of the changes; or (3) revise and expand the regulations to indicate that the old rules apply to years before the effective date of the changes and also set forth new rules that apply for years after the effective date of the changes.

**Tax Methods and Periods Technical Resource Panel** (David Auclair, Chair, at (202) 521-1515, [david.auclair@us.gt.com](mailto:david.auclair@us.gt.com); or Michelle R. Koroghlanian, AICPA Technical Manager, (202) 434-9268, [mkoroghlanian@aicpa.org](mailto:mkoroghlanian@aicpa.org)). **NOTE:** Comments are listed in priority order.

1. Final regulations under section 263(a) regarding the deduction and capitalization of expenditures for tangible assets. [Note: [See AICPA comments to IRS submitted on February 22, 2011.](#)]
2. Guidance regarding the relevant factors for determining who is the tax owner of property for section 199 purposes, including clarification that the standard for benefits and burdens under section 199 should be consistent with the standard for benefits and burdens under section 263A in contract manufacturing situations.
3. Proposed regulations under sections 263(a) and 167 providing guidance on the treatment of capitalized transaction costs, including safe harbor amortization periods, for certain capitalized costs.
4. Update the advance consent procedures for accounting method changes in Rev. Proc. 97-27.
5. Modify certain procedures for obtaining automatic and advance consent to change a method of accounting. [Note: [See AICPA comments to IRS submitted on February 15, 2008.](#)]
6. Guidance addressing a taxpayer's eligibility for Rev. Proc. 2004-34, as modified by Rev. Proc. 2011-18, in situations where receipts from gift card sales are never included in financial statement income.
7. Guidance regarding the time when a business is considered to start for purposes of section 195.
8. Proposed regulations under section 263A for resellers (i) updating rules to reflect changes in retail business practices (including those resulting from technological advances and current trends) that have affected the application and administrability of the existing regulations under section 263A to retailers that transact both on-site sales and sales that are not on-site sales from the same sales facility, and (ii) modifying the definitions of on-site sales, a retail customer, a retail sales facility, a dual-function storage facility, and other terms in Treas. Reg. § 1.263A-3(c)(5)(ii) to reflect current business practices of retailers that transact both on-site sales and sales that are not on-site sales from the same sales facility.
9. Proposed regulations under section 263A: (i) clarifying definition of costs included in and excluded from the simplified service cost production and labor cost formulas, (ii) clarifying sufficient documentation for classification of activities and departments (e.g., sufficiency of interviews with employees), and

- (iii) updating examples to reflect more common situations such as an IT department.
- 10. Final regulations under section 381(c)(4) and (5) regarding changes in method of accounting.
- 11. Guidance under section 174 regarding changes in method of accounting from an impermissible method.
- 12. Additional guidance under section 6655 regarding estimated tax payments.
- 13. Additional guidance under section 118 specifically relating to the treatment of refundable and transferable credits and incentives as non-shareholder contributions to capital.

**Tax Practice Responsibilities Committee** (Gregory M. Fowler, Chair, (202) 414-1603, [greg.fowler@us.pwc.com](mailto:greg.fowler@us.pwc.com); or Jina Etienne, AICPA Director, (202) 434-9227, [jetienne@aicpa.org](mailto:jtienne@aicpa.org)). **NOTE:** Comments are listed in order of priority. See item 3 on page 30, items 4 and 6 on page 31, item 3 on page 32, and item 23 on page 35, all with regard to Circular 230.

1. Guidance is needed to provide certain core principles for defining “tax shelter” under section 6662(d), including that the term “tax shelter” is intended to apply to an entity, plan or arrangement involving an abusive application of the federal income tax laws, but that the determination of whether a “tax shelter” exists depends upon all pertinent facts and circumstances. The definition is important for purposes of the taxpayer accuracy-related penalties under section 6662 and 6662A, the tax return preparer penalty under section 6694, the section 7525 federal tax practitioner privilege, and the Circular 230 written tax advice rules.
2. Little general information is available regarding the investigations of practitioners and the processing of cases by the Office of Professional Responsibility (OPR). Guidance or information is therefore needed regarding OPR procedures, such as a comprehensive “plain English” publication or other statement of a practitioner’s rights in the case of a referral to OPR. This might be done in a publication similar to the current IRS Publication 1, *Your Rights as a Taxpayer*.
3. Guidance is needed under Circular 230’s covered opinion standards (Section 10.35), including –
  - Consideration of a principle-based approach within the standards to better support Circular 230’s essential role and to alleviate the unintended consequences that have occurred.

- Consideration of substantial changes to Circular 230 written tax advice standards to remove current impediments on delivery of tax advice to clients and on the role of tax advice in the administration of the tax system.
  - Additional written guidance on the appropriate application of the aspirational standards of Section 10.33 and the binding standards of Section 10.35 to clarify the appropriate level of due diligence in situations where either set of rules could apply. [Note: [See AICPA comments on Circular 230's covered opinion standards, submitted on March 6, 2006.](#)]
4. Amendments are needed to Circular 230, proposed Section 10.34. [Note: [See AICPA Comments on Proposed Regulations, REG-138637-07 Regarding Standards with Respect to Tax Returns submitted on December 11, 2007](#), and [Comments on Proposed Regulations, REG-138637-07 Relating to Regulations Governing Practice Before the Internal Revenue Service submitted October 7, 2010](#)].
  5. Guidance is needed regarding a wide variety of issues arising under the Codification of Economic Substance Doctrine and Penalties (sec. 1409 of the Health Care and Education Reconciliation Act of 2010). These include, but are not limited to, the application of taxpayer penalties, adequacy of disclosure by taxpayers, definitions regarding certain statutory terms and related IRS administrative practices. Guidance is needed on an expedited basis because the statute is already effective for transactions currently being planned or undertaken, which could be subject to challenge as lacking economic substance, beyond those provided in Notice 2010-62 (2010-40 I.R.B. 411) . [Note: [See AICPA comments to IRS and Treasury submitted on January 18, 2011.](#)].
  6. Additional guidance is needed regarding the imposition of monetary penalties under Circular 230 as amended by Section 822 of the American Jobs Creation Act of 2004. [Note: [See AICPA comments on Notice 2007-39 regarding this issue, submitted on August 22, 2007.](#)]
  7. Guidance, with the opportunity for prior comment, is needed regarding criteria the IRS will use in determining: (1) whether to assert a section 6694 preparer penalty; and (2) whether to refer a matter to OPR, in particular in the case of alleged violations under the section 6694 preparer penalty provisions.
  8. Guidance is needed regarding the penalties under section 6708.

**Trust, Estate and Gift Tax Technical Resource Panel** (Gordon Spoor, Chair, (727) 343-7166, [fgs@spoorcpa.com](mailto:fgs@spoorcpa.com); or Eileen Sherr, AICPA Senior Technical Manager, (202) 434-9256, [esherr@aicpa.org](mailto:esherr@aicpa.org)) **NOTE:** High priority items are listed first. See item 3 on page 30, items 4 and 6 on page 31, item 3 on page 32, and item 23 on page 35, all with regard to Circular 230.

### **High Priority Items**

1. The very highest priority is immediate guidance on issues arising for estates of decedents who died in 2010 and who wish to elect out of the estate tax regime and apply the modified carryover basis regime to the decedent's assets. A form (Form 8939) to elect out of the estate tax and to compute and report the basis of each asset under the modified carryover basis rules is urgently needed. The assets in these estates are being sold and income tax may currently be due depending on the basis of the assets. So determining the basis in those assets is of utmost importance. [Note: [See AICPA comments to Treasury and IRS, submitted December 3, 2010](#), and also [see AICPA comments to Congress, submitted January 13, 2010](#).]
2. Guidance is needed on the disclosure rules on listed transactions as applied to estates and trusts under sections 6011, 6111 and 6112 for tax shelters, transactions of interest, and reportable transactions. IRS Notice 2006-16, Sec. 3.02 (issued February 27, 2006) and T.D. 9350 (issued September 17, 2007) were useful in eliminating duplicate disclosures by taxpayers; however, additional guidance is still needed on the application of these provisions in the estate, gift, and GST tax area.
3. Guidance is needed regarding Circular 230 and how the requirements relate to estate planning, gift tax planning, etc., for example, whether the statutory exclusion applies to combination strategies like installment sales to defective grantor trusts.
4. Guidance is needed on issues relating to foreign trusts and the HIRE Act. [Note: [See AICPA comments to Treasury and IRS on this issue submitted on March 28, 2011](#).]
5. Guidance is needed on issues relating to foreign trusts and the Foreign Bank Account Report (FBAR). [Note: See AICPA [comments](#) on this issue submitted to FINCEN, Treasury, and IRS on [November 19, 2010](#) and [November 16, 2009](#).]
6. A change in the due date of Form 3520A is requested from March 15 to April 15, to coincide with the due date for calendar year filers of related returns. If a change in the due date is not possible, then an extension or penalty relief is requested for taxpayers who file by April 15. In addition, IRS should consider adding a box to Form 7004 to permit an extension of time to file Form 3520 in cases where the beneficiary's income tax return (Form 1040 and Form 1040NR) is not going to be extended. [Note: [See AICPA comments to IRS on this submitted on June 12,](#)

[2008, March 3, 2008, January 31, 2007, and June 17, 2003](#). See also proposed legislation, [S. 845](#), introduced 4/14/11 by Senators Enzi and Snowe, that would make this change in the Form 3520A due date.]

7. Regulations under section 6034 should add an administrative exception to the Form 1041-A filing requirement for complex trusts that claim charitable deductions under section 642(c) solely for contributions flowed through to them from partnerships and S corporations. The amendment to these regulations could be done as part of a project to update the section 6034 regulations to reflect the changes made to that section by the Pension Protection Act of 2006. In order to implement this administrative exception as soon as possible, a Notice should be issued stating that regulations will be revised to allow this administrative exception to the Form 1041-A filing requirement for these trusts and that these trusts no longer have to file Form 1041-A. [Note: [See AICPA letter submitted to IRS on September 14, 2010](#)]
8. A simplified procedure is needed to obtain an extension of time to elect out of the automatic allocation of the GST exemption to indirect skips and at the end of the estate tax inclusion period, similar to Rev. Proc. 2004-46. Several PLRs have been issued allowing extensions of time to elect out of the automatic rules, but a simplified method for obtaining such extensions without the need for a private letter ruling would benefit taxpayers and the IRS. [Note: [See AICPA comments to IRS, submitted June 26, 2007](#).]
9. Guidance is needed under section 2632(c), regarding the deemed allocation of GST exemption to certain lifetime transfers to GST trusts. In particular, clarification is requested with regard to the exceptions to the definition of a GST trust contained in section 2632(c)(3)(B)(i)-(vi) as well as the exception in the flush language of this section dealing with gift tax annual exclusions. Six types of GST trusts are defined, but there are many gray areas that we would request additional guidance. Finally, until regulations are issued under section 2632(c)(3)(B)(i)(III), as required by such section, we believe this provision has no effect.
10. Guidance is needed on the ability to split gifts under section 2513 in Crummey or similar situations, where the donee spouse has an interest in the trust and others have the ability to withdraw the contributed assets but all the transfers made to the trust during the year may be withdrawn by trust beneficiaries.  
  
Such guidance is particularly needed in the case of late filing of gift tax returns. Because of the late filing, there is no opportunity to elect out of deemed allocation (i.e., each spouse's GST exemption would be allocated to his or her portion of the transfer) (Treas. Reg. § 26.2632-1(b)(4)(iii), Ex. 5). [Note: [See AICPA comments to IRS, submitted June 26, 2007](#).]
11. The current tax reporting on Form 1040NR for foreign non-grantor trusts (and foreign grantor trusts with a US owner) is extremely difficult because the IRS

form is not designed for fiduciary tax return reporting. IRS instructions direct the preparer to “change the form” for Subchapter J provisions, but attempts to do so result in inconsistent or inadequate changes and lead to return processing errors and confusion. The creation of a new Form 1041NR, which could include information currently reported on Forms 3520 and 3520-A, would eliminate confusion and mistakes in processing returns and would enhance tax compliance filing requirements. [Note: [See AICPA comments to IRS on this submitted on September 22, 2008, March 3, 2008, and January 31, 2007.](#)]

12. Guidance is needed on whether a foreign trust with a U.S. grantor is required to file Form 1041 or Form 1040NR and whether a foreign trust with a foreign grantor and some U.S. income is required to file Form 1041 or Form 1040NR.
13. A final revenue ruling is needed on the consequences under various estate, gift, and generation-skipping transfer tax provisions of using a family-owned company as the trustee of a trust. [Note: [See AICPA pre-release comments on this item submitted on March 29, 2006](#), and [AICPA comments on the proposed revenue ruling, submitted on November 12, 2008.](#)]
14. Guidance is needed for marital trusts under section 2056(b)(7) similar to Rev. Rul. 2006-26, regarding plans other than IRAs and defined contribution plans (i.e., defined benefit plans and deferred compensation plans).
15. Guidance is needed on the reporting of and recognition of gain under the expatriation mark-to-market rules in section 877A, including guidance on the interplay of sections 877A and 684, relating to a transfer to a foreign estate or trust.

### **Other Priority Items**

16. Guidance is needed on the allocation of indirect deductions for charitable remainder trusts. Charitable remainder trusts routinely incur administration expenses, such as trustee’s fees and tax return preparation fees, which are not directly attributable to a particular type of income. It is unclear how these expenses are to be allocated to the income of a charitable remainder trust. The trustee should be able to allocate indirect expenses to items of income in any manner under the third rule of reg. section 1.664-1(d)(2). This treatment is consistent with the manner in which indirect expenses of regular trusts are permitted to be allocated. [Note: [See AICPA comments to IRS, submitted June 26, 2007.](#)]
17. Guidance is needed under Treas. Reg. § 301.6501(c)-1(f)(2)(iii) in the form of a Rev. Proc. with a model disclosure for “a brief description of the terms of the trust” as that would eliminate the need for taxpayers and practitioners to attach copies of every trust to every single return. AICPA is willing to provide a draft of this model.

18. Guidance is needed regarding the appropriate means and timing of GST allocations to pour over trusts from GRAT terminations. Guidance is also needed under section 2632(c)(5)(A)(i) and examples, addressing the application of the GST exemption automatic allocation rules for indirect skips in a situation in which a trust subject to an estate tax inclusion period (ETIP) terminates upon the expiration of the ETIP, at which time the trust assets are distributed to other trusts that may be GST trusts. [Note: [See AICPA comments to IRS, submitted June 26, 2007.](#)]
19. Guidance is needed on how the GST applies to grandfathered domestic trusts that become foreign trusts. This issue may be analogous to a GST-grandfathered trust that migrates from one state to another; thus, similar rules and safe harbors should be considered.
20. Clarification is needed in the instructions to Form 709 with regard to Column C in Part 3 of Schedule A as to the election made under section 2632(c) (electing “in and out” of a deemed allocation.) The instructions state that checking the box in Column C applies only for transfers reported on the return. Confusion can result as the instructions provide that, if a prior election has been made with respect to future transfers, the box in Column C should not be checked and no explanatory statement should be filed with the applicable Form 709. One suggestion would be to have an additional column to check if an election was made in a prior year that affects the GST exemption for a transfer made in the current year.
21. Guidance is needed under section 642(c) on whether income in respect of a decedent (IRD) that is reported and used in calculating the estate’s charitable deduction on the estate tax return should be treated as “gross income” and allowed as a charitable deduction on the estate’s fiduciary income tax return when the IRD is paid to a charitable organization pursuant to the governing instrument.
22. Guidance is needed regarding obtaining of bonds for all section 6166 cases in light of the Tax Court’s decision in *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007). We note that Notice 2007-90, issued November 13, 2007, stated that IRS will determine on a case-by-case basis whether security will be required when a qualifying estate elects under section 6166 to pay all or a part of the estate tax in installments. We believe this is helpful, but general guidance on this issue is still needed.
23. Guidance is needed regarding Circular 230 and avoiding section 6694 penalties for preparers of foreign trust information and tax returns. For example, guidance is needed on the standards of “due diligence” in preparing a “complete” Form 3520 or Form 3520-A when the information is found to be lacking or only available in a foreign country.
24. It would be helpful to harmonize what is necessary to satisfy the adequate disclosure requirements of sections 301.6501(c)-1(e) and -1(f). At a minimum,

section 301.6501(c)-1(e) should contain a safe harbor for appraisal reports as exists in section 301.6501(c)-1(f).

25. A new form or procedure is needed for consistent treatment for all trust and estate federal tax payments, including estimated tax payments, backup withholding, and regular withholding for section 643(g) purposes. A trust or, for its final tax year, a decedent's estate, may elect under Sec. 643(g) to have any part of its estimated tax payments (but not income tax withheld) treated as made by a beneficiary. To make the election, the fiduciary must file Form 1041-T by the 65<sup>th</sup> day after the close of the tax year. Credit for backup withholding (for example, as reflected on a Form 1099-INT or Form 1099-DIV) can be distributed (and allocated to each beneficiary) on Form 1041 Schedule K-1 when Form 1041 is filed. Withholding from other sources (Form W-2 for example) also cannot be distributed on Schedule K-1.

The difficulty for taxpayers is that in the final year of the trust/estate, there may be estimated tax payments or withholding that can only be refunded. If it is truly the final year, often there is no bank account for the entity. To treat similarly situated taxpayers the same for purposes of allocating tax payments to beneficiaries, procedures should be developed so that estimated tax payments and other withholding are treated in the same manner as backup withholding. This proposal should simplify processing for IRS as well as taxpayers. One alternative would be to allow this treatment on a final return only.

26. Guidance is needed regarding reporting the receipt of a "covered gift or bequest" and the payment of tax thereon required under section 2801(a). While the IRS has stated in Notice 2009-85, 2009-45 IRB 598, that satisfaction of the reporting and tax obligations for covered gifts or bequests will be deferred pending the issuance of guidance, the longer the delay, the longer the undue burden on those who are required to comply with section 2801(a). This guidance should also include the determination of the reduction of this liability by the credit for the payment of foreign gift or estate taxes on a covered gift or bequest under section 2801(d).
27. Guidance is needed regarding the making of an election by a foreign trust to be treated as a domestic trust under section 2801(e)(4)(B)(iii).
28. Guidance is needed as to what qualifies as a "reasonable period of time" for a U.S. grantor or beneficiary of a foreign trust to pay the trust the "fair market value" (FMV) for the "personal use" of trust property under section 643(i)(2). This guidance should also include the determination of the proper FMV measurement and whether "de minimis" amounts can be so small as to make accounting for them unreasonable or administratively impractical. "Safe harbor" guidelines to administer this new law also would be appreciated. For example, a grantor or beneficiary might personally maintain landscaping requirements (at no compensation) for a rental property owned by a foreign trust, but have little or no

personal use of the property during the year. [Note: [See AICPA comments to IRS, submitted March 28, 2011.](#)]

29. Regulations are needed to enhance guidance in Notice 2009-85 regarding the reporting of tax withholding and payment of these taxes by trustees to the IRS. Such guidance is needed as to the appropriate forms and reporting on applicable tax returns. Guidance on possible “expedited” procedures for successful receipt of a private letter ruling for an expatriate to determine the value of his or her interest in the trust would be appreciated. This guidance should also define “adequate security” for a “tax-deferred agreement” for the covered expatriate’s return under section 877A(b).
30. Regulations are needed under section 6677 regarding the failure to file information with respect to certain foreign trusts. The HIRE Act amended section 6677, but guidance is not adequate in Notice 97-34, the only IRS guidance on making a determination on penalties under section 6677. New recently designed letters, as described in IRS memorandum SBSE-20-0709-016, provide determination letters based upon a review of a taxpayer’s compliance with section 6677, but taxpayers need regulations to provide them with guidance before the applicable letter is issued.