The Tax Law Center NYU LAW

June 2, 2022

Submitted via the Federal eRulemaking Portal

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
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Washington, DC 20224

William Paul
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Internal Revenue Service
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Re: Recommendations for the 2022-2023 Priority Guidance Plan

Dear Assistant Secretary Batchelder, Commissioner Rettig, and Principal Deputy Chief Counsel Paul,

Thank you for the opportunity to comment on the 2022-2023 Priority Guidance Plan. The Tax Law Center at NYU Law is a public interest initiative that seeks to improve the integrity of the tax system. Our staff includes tax law experts with experience in tax administration, private practice, and the tax legislative process. Our comment identifies particular projects that we believe are consistent with the Department of the Treasury and the IRS engaging in rulemaking in the public interest.

We would be pleased to discuss these recommendations with you or your staff.

Sincerely,

Chye-Ching Huang
Executive Director, Tax Law Center at NYU Law

Enclosure

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The Tax Law Center NYU LAW

Recommendations for the 2022-2023 Priority Guidance Plan

In response to Notice 2022-21,[1] the Tax Law Center at NYU Law recommends that the Department of the Treasury ("Treasury") and Internal Revenue Service ("IRS") include the following guidance projects in the 2022-2023 Priority Guidance Plan ("PGP").[2] In general, our recommendations prioritize projects that would promote sound tax administration, encourage stronger tax compliance, and improve confidence in the fairness and integrity of the tax system.[3] These priorities are consistent with our comment on the 2021-2022 PGP as well as the mandate in Executive Order 13985 that federal agencies strive for "consistent and systematic fair, just, and impartial treatment of all individuals."[4] In addition, this comment highlights certain proposals that are relatively less likely to be raised by other commenters.[5]

We recognize that, while additional resources are being considered by lawmakers, Treasury and the IRS are currently facing staffing and other resource constraints on their ability to develop guidance. Thus, while we recommend a number of new projects for inclusion in the PGP, our comment includes additional suggestions for projects under development, and we further recommend that Treasury and the IRS also prioritize completing guidance projects that are already in advanced stages of development.

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[1] 2022-20 I.R.B. 1057.

[2] Unless otherwise noted, all references to the "Code" are to the Internal Revenue Code of 1986, as amended, all references to "section" are to sections of the Code, and all references to "Treas. Reg. §" are to Treasury regulations issued thereunder.

[3] This comment only includes a limited number of recommendations affecting low-income taxpayers because of pending legislation that could affect child tax credits, earned income tax credits, and other important matters related to poverty reduction, including administrative capacity to achieve access and outreach improvements. Such projects are important and should be pursued with high priority.

[4] *See* Tax Law Center at NYU Law, Notice 2021-28, 2021-2022 Priority Guidance Plan (PGP) Recommendations 2 ("Tax Law Center at NYU Law 2021-2022 PGP Comment"), ("Heavily weighing […] tax administration considerations when developing the PGP is consistent with Executive Order 13985"). We recommended in that comment that Treasury and the IRS explicitly mention this Executive Order when calling for PGP comments, as they have done in the past with other relevant Executive Orders. While Notice 2022-21 did not adopt this suggestion, we recommend that Treasury and the IRS reconsider it for the next request for comments on the PGP.

[5] *See* Tax Law Center at NYU Law 2021-2022 PGP Comment, at footnotes 7 through 11.

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Corporations and their Shareholders

Prevent basis shifting by related parties through corporations

Priority: High

Regulations under section 302 provide that, when a redemption distribution described in section 302(d) is treated as a dividend, "proper adjustments" are made to the basis of the remaining stock with respect to the stock redeemed.[6] An example illustrates the case of a husband and wife who each own half of the shares of stock in a corporation.[7] When the husband is completely redeemed, the basis that would otherwise remain in his redeemed shares shifts to the wife's shares.[8]

Based on this regulation and example, corporate groups commonly use redemption distributions that are treated as dividends to shift basis from the redeemed shareholder to the surviving shareholder(s). This technique is facilitated by section 304, which makes it relatively easy for a corporate group to create a deemed redemption distribution. The enactment of P.L. 115-97 (known as the Tax Cuts and Jobs Act or "TCJA") changed, but did not eliminate, the incentives motivating this planning.[9]

[6] Treas. Reg. § 1.302-2(c).

[7] Treas. Reg. § 1.302-2(c), *Example 2*.

[8] *Id.*

[9] For example, the application of sections 951A and 965 has resulted in significantly more previously taxed earnings and profits ("PTEP"), and thus increased the need for basis in the stock of certain controlled foreign corporations ("CFCs") to avoid gain recognition under section 961(b)(2) upon distribution of such amounts.

On multiple occasions, Treasury and the IRS have proposed to address this issue with proposed regulations that were subsequently withdrawn.[10] Treasury and the IRS should again publish proposed regulations to prevent corporate basis shifting. The proposal, which could provide that the redeemed shareholder recognizes a capital loss that is suspended until the occurrence of certain future events, would complement the Administration's proposal to address basis shifting in the partnership context.[11] Treasury and the IRS should consider issuing this guidance as a standalone proposal instead of waiting to develop a more comprehensive set of rules that address a wider array of basis issues.[12]

Revise the federal income tax treatment of certain corporate "buybacks"

Priority: Medium

A pro rata distribution by a publicly traded corporation typically yields ordinary income for shareholders, but an economically equivalent redemption (a "public buyback") typically yields capital gains (or losses).[13] Paragraphs (b)(1) through (5) of section 302 provide the five pathways to this capital gain (or loss) treatment.[14] While paragraphs (b)(2) through (5) contain relatively mechanical tests, the statutory language of section 302(b)(1), which provides that a redemption is treated as a sale or exchange if it is "not essentially equivalent to a dividend," is more open to interpretation. In Rev. Rul. 76-385, Treasury and the IRS relied on *US v. Davis*[15] to find that a public buyback that reduced a shareholder's interest from .0001118% to .0001081% was *not* essentially equivalent to a dividend.[16] Today, in significant part due to this ruling, virtually every

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[10] *See* Announcement 2006-30, 2006-1 C.B. 879 (withdrawing Redemptions Taxable as Dividends, REG-150313-01, 67 Fed. Reg. 64,331 (October 18, 2002)); The Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities; Withdrawal, 84 Fed. Reg. 11,686 (March 28, 2019) (withdrawing The Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities, REG-143686-07, 74 Fed. Reg. 3,509 (January 21, 2009)) ("2019 Withdrawal").

[11] *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals* (March 2022) 11-12 ("FY2023 Green Book").

[12] Treasury and the IRS should also consider proposing a standalone regulation confirming their view that a shareholder recovers its stock basis in a section 301 distribution using a share-by-share approach, consistent with *Johnson v. US*, 435 F.2d 1257 (4th Cir. 1971). *See* 2019 Withdrawal, 84 Fed. Reg. at 11,687. Due to the lack of regulatory guidance, taxpayers currently take positions inconsistent with *Johnson*.

[13] *See* Daniel J. Hemel & Gregg D. Polsky, *Taxing Buybacks*, 38 Yale J. on Reg. 246, 253 (2021) ("Two transactions—one denominated a buyback, the other characterized as a cash dividend—can achieve economically identical results both for the corporation and for its shareholders.")

[14] While almost all public buybacks result in capital gains (or losses), it is unclear how many are governed by section 302(b)(1) (i.e., as opposed to paragraphs (b)(2) through (5) of section 302).

[15] 397 U.S. 301 (1970). In *Davis*, the Court ruled that a redemption by a closely held corporation with a sole shareholder is not essentially equivalent to a dividend if it results in "a meaningful reduction of the shareholder's proportionate interest in the corporation." *Id.* at 313.

[16] 1976-2 C.B. 92.

public buyback is treated as resulting in capital gains (or losses), even if it only causes an infinitesimal reduction in a shareholder's interest.[17]

The overly broad interpretation of *Davis* in Rev. Rul. 76-385 effectively nullifies section 302(b)(1) for public buybacks and contributes to the divergent tax treatment of transactions with similar underlying economics.[18] Treasury and the IRS have clear authority to revoke this revenue ruling and publish regulatory guidance more appropriately interpreting section 302(b)(1).[19] Accordingly, in order to improve the federal income tax treatment of public buybacks, Treasury and the IRS should (i) revoke Rev. Rul. 76-385, (ii) revoke or clarify Rev. Rul. 81-289,[20] and (iii) propose regulatory guidance treating public buybacks that are not described in paragraphs (b)(2) through (5) of section 302 as dividend-equivalent.[21] This guidance could distinguish public buybacks from *Davis*, which addressed a redemption by a closely-held corporation.[22] Alternatively, this guidance could re-interpret the *Davis* concept of a "meaningful reduction" for purposes of public buybacks.[23]

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[17] In rare circumstances, a public buyback may be treated as dividend-equivalent. *See* Rev. Rul. 81-289, 1981-2 C.B. 82 (percentage interest of a shareholder who participated in a public buyback was not changed because of simultaneous participation by other shareholders).

[18] *See* Philip F. Postlewaite & Susan Rogers Finneran, *Section 302(b)(1): The Expanding Minnow*, Va. L. Rev. 561, 591 (1978) ("The generosity of [Rev. Rul. 76-385] is startling in light of the historical perspective of the continual efforts of Congress, the courts, and the Service to narrow the escape from dividend treatment under section 302(b)(1) […]."). *See also* Federal Income Taxation of Corporations and Shareholders, Thomson Reuters/Tax & Accounting, 7th Ed. 2000 & Supp 2020-3 ("While defensible in the abstract, it is not hard to imagine [the principle of Rev. Rul. 76-385] being stressed to the point of rupture.").

[19] Regulations under section 302(b)(1) are sparse and have not been substantively updated since 1955. *See* Treas. Reg. § 1.302-2(b). In addition, there is no meaningful judicial authority interpreting a "meaningful reduction" in the context of public buybacks. In *Brown v. US*, 345 F. Supp. 241 (S.D. Ohio 1972), *aff'd without opinion*, 477 F.2d 599 (6th Cir.), *cert. denied*, 414 U.S. 1011 (1973), the court applied *Davis* to evaluate the redemption by a corporation of preferred stock held by a family that controlled 99.3% of the vote of the corporation. While the facts are unclear, it appears that some of the stock of the corporation may have been held by the public.

[20] *See supra* footnote 17. Rev. Rul. 81-289 incorrectly asserts that the Tax Court "applied the meaningful reduction standard in a situation involving a publicly held corporation." *Id.* The ruling cites to *Sawelson v. Comm'r*, which involved a redemption by a closely-held corporation. *See infra* footnote 22.

[21] If this recommendation is pursued, Treasury and the IRS should consider whether additional changes are required to ensure that a public buyback does not result in a deemed dividend to the non-participating shareholders under section 305(c). *See* Treas. Reg. §§ 1.305-3 and -7; *but see* Treas. Reg. § 1.305-3(e), *Example 13* (providing that the non-participating shareholders in a series of public buybacks are not treated as receiving a deemed distribution under section 305 because there was no "plan to increase the proportionate interest of some shareholders and distribute property to other shareholders").

[22] *See supra* footnote 15. Courts have generally held that *Davis* is not limited to closely-held corporations with a single shareholder. *See Coates Trust v. Comm'r*, 480 F.2d 468 (1973) (applying the *Davis* standard to a closely-held corporation with multiple shareholders); *Sawelson v. Comm'r,* 61 T.C. 109 (1973) (same).

[23] The recommended guidance addressing section 302(b)(1) would interact with, but could complement, proposed legislation that would levy a 1% excise tax on public buybacks. *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 4501(e)(6).

Update outstanding guidance addressing the active trade or business requirement of section 355(a)(1)(C) and (b)

Priority: Medium

Historically, the IRS generally allowed a trade or business of de minimis size to satisfy the active trade or business requirement of section 355(a)(1)(C) and (b) (the "ATB Requirement"), regardless of the amount of other assets involved in the transaction, as a practical accommodation of mechanical difficulties imposed under prior law.[24] In 2006 and 2007, however, Congress addressed this issue with the enactment of section 355(b)(3), which provides much greater flexibility in satisfying the ATB Requirement. Proposed regulations published in 2016 would replace the prior de minimis standard with a requirement that the fair market value ("FMV") of a trade or business represent at least 5% of the FMV of a corporation's total assets.[25]

In the guidance announced in the 2021-2022 PGP,[26] Treasury and the IRS should raise this threshold to 33 1/3%[27] to better reflect legislative intent that a nontaxable divisive transaction "involve only the separation of assets attributable to the carrying on of an active business."[28] In light of this policy objective and the mechanical relief provided by section 355(b)(3), there is little justification for a standard as low as 5%.[29] However, the threshold should not be raised above 33 1/3% without legislative action in order to avoid conflict with section 355(g).[30] Consideration should also be given to concurrently finalizing the 5% standard of the proposed

[24] *See* Guidance Under Section 355 Concerning Device and Active Trade or Business, REG-134016-15, 81 Fed. Reg. 46,004, 46,007 (July 15, 2016). Under prior law, a corporation could generally satisfy the ATB Requirement only if it was directly engaged in an active trade or business or if substantially all of its assets consisted of stock or securities of corporations that were engaged in an active trade or business.

[25] This 5% standard was apparently based on the private letter ruling ("PLR") policy in place from 1996 to 2003 under which the IRS would not rule on a transaction unless (i) the FMV of the trade or business relied on to satisfy the ATB Requirement was at least 5% of the FMV of the gross assets of the relevant corporation, or (ii) the taxpayer could otherwise demonstrate that the trade or business was not de minimis. *See* Rev. Proc. 96-43, 1996-2 C.B. 330; Rev. Proc. 2003-48, 2003-2 C.B. 86.

[26] *See* Corporations and Their Shareholders, item 4.

[27] *See* Joint Committee on Taxation, JCX-19-05R, Summary of Joint Committee Staff Options to Improve Tax Compliance and Reform Tax Expenditures 17 (April 12, 2005) (proposing a 50% standard); Michael L. Schler, *Simplifying and Rationalizing the Spinoff Rules*, 56 SMU L. Rev. 239, 264-265 (2003) (same); Herbert N. Beller, *Section 355 Revisited: Time for a Major Overhaul*, 72 The Tax Lawyer 131, 176 (Fall 2018) (same).

[28] *See* S. Rep. No. 83-1622, at 50 (1954).

[29] The position that a qualifying active trade or business may be small, or even de minimis, is generally based on an incomplete reading of Rev. Rul. 73-44, which states that there is "no requirement in section 355(b) that a specific percentage of the corporation's assets be devoted to the active conduct of a trade or business." 1973-1 C.B. 182. In the ruling, the relevant corporation's active trade or business represented more than a "substantial portion" of its total assets but less than half.

[30] Section 355(g) generally provides that section 355 does not apply to a non-pro rata distribution if, immediately after the distribution, 66 2/3% of the FMV of the assets of either the distributing or controlled corporation consists of investment assets. Thus, if the minimum percentage threshold for the ATB Requirement is raised above 33 1/3%, it could effectively nullify section 355(g).

regulations, which are not effective until finalized,[31] because taxpayers continue to rely on de minimis trades or businesses to satisfy the ATB Requirement.[32]

In connection with this change, Treasury and the IRS should consolidate the outstanding regulatory and subregulatory guidance addressing the ATB Requirement[33] in one updated notice of proposed rulemaking in order to simplify compliance and administration. Among other modifications, the new proposed regulations should also (i) streamline the rules addressing section 355(b)(2)(C) and (D), with greater reliance on the regulatory authority of section 355(b)(3)(D), and (ii) limit the expansion rules in Prop. Treas. Reg. § 1.355-3(b)(3)(ii) (e.g., by providing that an acquisition is not treated as an expansion if the value of the acquired business exceeds that of the existing business or if the acquisition is part of a plan to distribute the stock of the acquired corporation (or the acquired business) in a section 355 distribution).

Address the use of divisive transactions to avoid the repeal of the *General Utilities* doctrine

Priority: Medium

In Notice 2015-59, Treasury and the IRS announced a study of issues under sections 337(d) and 355 relating to divisive transactions with certain characteristics including the ownership of substantial amounts of investments assets and the disproportionate allocations of investment assets between the distributing and controlled corporation.[34] The notice emphasized that these transactions raised concerns under various section 355 requirements as well as the Code provisions intended to implement repeal of the so-called *General Utilities* doctrine ("GU Repeal"). However, proposed regulations published in 2016 focused solely on the device prohibition of section 355(a)(1)(B) (the "Device Prohibition"), the ATB Requirement, and the business purpose requirement of Treas. Reg. § 1.355-2(b)(1). For reasons that were not explained, the proposed regulations did not directly address GU Repeal.

While the 2016 proposed regulations (along with Rev. Proc. 2015-43[35]) discouraged at least some of the transactions that prompted Notice 2015-59,[36] the rules addressing the Device Prohibition have created significant doctrinal and technical confusion.[37] Treasury and the IRS

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[31] *See* Prop. Treas. Reg. § 1.355-9(e)(1).

[32] The finalized 5% standard would be replaced by the 33 1/3% standard when the latter is eventually finalized.

[33] *See* Guidance Regarding the Active Trade or Business Requirement Under Section 355(b), REG-123365-03, 72 Fed. Reg. 26,012 (May 8, 2007); *supra* footnote 24; Notice 2007-60, 2007-2 C.B. 466; Rev. Rul. 2019-09, 2019-14 I.R.B. 925.

[34] 2015-40 I.R.B. 459.

[35] 2015-40 I.R.B. 467.

[36] *See, e.g.,* Amy S. Elliott, *Yahoo Drops Plans to Spin off Alibaba, Aims for Reverse Spinoff*, Tax Notes Federal (December 14, 2015).

[37] *See, e.g.,* Lauren Azebu, Robert Rizzi, and Lisa Zarlenga, *A New Role for the Device Test?*, Tax Notes Today Federal (March 22, 2016); New York State Bar Association, *Report No. 1342 – Report on Notice 2015-59 and Revenue Procedure 2015-43 Relating to Substantial Investment Assets, De Minimis Active Trades or Businesses and*

should propose regulations under section 337(d) that more narrowly target the use of divisive transactions to avoid GU Repeal.[38] If that guidance is published, Treasury and the IRS can significantly simplify the section 355 regulatory regime by withdrawing the rules addressing the Device Prohibition in the 2016 proposed regulations. Concurrently, Treasury and the IRS could also revise the final regulations under Treas. Reg. § 1.355-2(d) to more precisely focus on the stated policy concerns of the Device Prohibition – that is, preventing the use of section 355 distributions to avoid the dividend provisions of the Code (or to facilitate basis recovery). Such revisions could include providing that when the distributing corporation is widely-held and publicly-traded, the distribution is ordinarily considered not to violate the Device Prohibition.

Address the application of section 382 to foreign corporations

Priority: Medium

Section 382 limits the use of a "loss corporation's" net operating losses ("NOLs") and certain other tax attributes when the corporation undergoes an ownership change. When section 382 applies, the loss corporation can generally only use those attributes in an annual amount equal to its value multiplied by the long-term tax-exempt rate. Before the enactment of the TJCA, the relevance of section 382 to foreign corporations without income effectively connected with a US trade or business ("ECI") was limited.[39] Nevertheless, there were narrow circumstances when the application of section 382 could potentially affect a foreign corporation without ECI.[40] These situations raised a number of questions, including whether the foreign loss corporation should be treated as having a value of zero, as the statute suggests.[41]

The TCJA elevated the importance of this issue.[42] Today, if a foreign corporation with built-in losses or disallowed business interest expense under section 163(j) undergoes an ownership change, the application of section 382 will likely affect the corporation's subpart F income and tested income. As a result, there is greater pressure on a number of section 382 mechanics,

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C-to-RIC Spin-Offs Part V (April 12, 2016) ("NYSBA Report No. 1342"); New York State Bar Association, *Report No. 1356 – Report on Proposed Regulations under Section 355 Concerning the Device Prohibition and the Active Trade or Business Requirement* Part IV.B (October 14, 2016).

[38] *See* NYSBA Report No. 1342 (making the same recommendation).

[39] A foreign corporation cannot have an NOL carryover unless it has ECI. Treas. Reg. § 1.367(b)-3(e); Rev. Rul. 72-421, 1972 C.B. 166. In addition, while a foreign corporation generally computes its taxable income as if it were a domestic corporation for subpart F purposes, NOL deductions are disallowed for this computation. Treas. Reg. § 1.952-2(c)(5)(ii).

[40] *See*, *e.g.*, CCA 200238025 (June 14, 2002); 1999 FSA Lexis 401 (February 22, 1999); 1997 FSA Lexis 17 (January 22, 1997).

[41] *See* section 382(e)(3). In addition, because section 382 arguably does not apply for purposes of computing earnings and profits ("E&P"), these situations also raised the question of whether a foreign corporation's recognized built-in-losses could be used to limit or eliminate its subpart F income. *See* David S. Miller, *How U.S. Tax Law Encourages Investment Through Tax Havens*, Tax Notes Federal (April 11, 2011); s*ee also infra* footnote 42, Part III.

[42] *See generally* Amanda P. Varma and Eric Solomon, *Loss Limitations as Applied to CFCs*, Tax Notes Federal (August 30, 2021).

including the determination of the foreign corporation's value.[43] Treating the value as zero under a direct application of section 382(e)(3) would produce a harsh result by effectively eliminating the foreign corporation's use of its attributes after an ownership change. Perhaps for this reason, many taxpayers are currently taking positions contrary to section 382(e)(3) under the prescription of Treas. Reg. § 1.952-2 that, for purposes of computing its subpart F income and tested income, a foreign corporation compute its taxable income as if it were a domestic corporation (and thus, presumably, without reference to section 382(e)(3)).[44]

Allowing multiple approaches to proliferate in the absence of clear guidance creates risks for both taxpayers and sound tax administration. Accordingly, after publishing the guidance under section 382 announced in the 2021-2022 PGP,[45] Treasury and the IRS should resolve the uncertainty in this area by exercising the regulatory authority in section 382(e)(3) to provide rules for determining the value of a foreign corporation without ECI in a manner consistent with the broader policy objectives of section 382.

Provide that inbound and outbound transactions cannot qualify as section 368(a)(1)(F) reorganizations

Priority: Low

Subchapter C has long permitted cross-border transactions to qualify as a "mere change" described in section 368(a)(1)(F) (an "'F' reorganization").[46] However, the significant differences in the federal income tax treatment of domestic and foreign corporations appear inconsistent with the principle that an "F" reorganization involve "only the simplest and least significant of corporate changes" and that the "surviving corporation is the same corporation as the predecessor in every respect, except for minor or technical differences."[47]

This inconsistency was highlighted by a recent case involving an outbound "F" reorganization.[48] The taxpayer argued that the foreign resulting corporation should be allowed to pay itself a deemed section 367(d) royalty under the theory that the resulting corporation is the same as the

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[43] This pressure is expected to increase as corporations incur greater disallowed business interest expense due to (i) accounting for depreciation, amortization, and depletion for taxable years beginning before January 1, 2022, under section 163(j)(8)(A)(v), and (ii) rising interest rates.

[44] *See* New York State Bar Association, *Report No. 1457 – Report on the Application of Section 382 to Foreign Corporations* Part IV.B.8, 39 (January 18, 2022).

[45] *See* Corporations and Their Shareholders, item 5.

[46] *See*, *e.g.,* Rev. Rul. 87-27, 1987-1 C.B. 134 (outbound "F" reorganization); Rev. Rul. 88-25, 1988-1 C.B. 116 (inbound "F" reorganization).

[47] *See Berghash v. Comm'r*, 43 T.C. 743, 752 (1965) (citation and footnotes omitted), *aff'd*, 361 F.2d 257 (2d Cir. 1966). *See also* Reorganizations Under Section 368(a)(1)(F); Section 367(a) and Certain Reorganizations Under Section 368(a)(1)(F), T.D. 9739, 80 Fed. Reg. 56,904, 56,907 (September 21, 2015) ("[T]he Final Regulations are based on the premise that it is appropriate to treat the Resulting Corporation in an F reorganization as the functional equivalent of the Transferor Corporation and to give its corporate enterprise roughly the same freedom of action as would be accorded a corporation that remains within its original corporate shell.").

[48] *See TBL Licensing LLC v. Comm'r*, 158 T.C. No. 1 (2022).

transferor corporation.[49] The court rejected this argument, finding that the foreign resulting corporation was "essentially different" from the domestic transferor. While this analysis avoided a nonsensical interpretation of section 367(d), the fact that the resulting corporation was "essentially different" is precisely the reason the transaction should not qualify as a "mere change." Cross-border "F" reorganizations have become more popular recently as special purpose acquisition companies expatriate or domesticate prior to combining with a target. The various motivations for undertaking these transactions (including the avoidance of the passive foreign investment company ("PFIC") regime) strains the notion that the transferor corporation and resulting corporation are the same "in every respect, except for minor or technical differences."[50]

Treasury and the IRS should resolve this doctrinal confusion by revising the regulations under section 368(a)(1)(F) to provide that neither an inbound nor an outbound transaction can qualify as an "F" reorganization.[51] If this recommendation is pursued, various conforming changes beyond section 368 will be required.[52]

Employee Benefits

Finalize proposed regulations addressing the "family glitch" under section 36B

Priority: High

Section 36B provides a premium tax credit ("PTC") for taxpayers who meet certain eligibility requirements. A PTC is not available for any month for which the individual is eligible for minimum essential coverage (MEC).[53] In the case of employer coverage, an individual is generally only considered eligible for MEC if the offer of coverage is "affordable" (referring to plans with premiums higher than 9.61% of household income in 2022) and of "minimum value."[54]

In 2011, Treasury and the IRS published proposed regulations under section 36B providing that affordability for related individuals is based on the amount of an employee's "required contribution for self-only coverage," rather than costs for family coverage.[55] This so-called

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[49] *See id.* at 22.

[50] *See Berghash,* 43 T.C. at 752.

[51] *See also* 2021-2022 PGP, General Tax Issues, item 34.

[52] *See, e.g.*, Treas. Reg. § 1.367(a)-1(e)-(f) (containing certain operating rules for outbound "F" reorganizations); Treas. Reg. § 1.367(b)-2(f)(4) (containing certain operating rules applicable to inbound "F" reorganizations); Treas. Reg. § 1.367(b)-2(h) (treating a section 953(d) domestication election as an inbound "F" reorganization); Treas. Reg. § 1.7874-2(j) (treating a deemed domestication by reason of section 7874(b) as an inbound "F" reorganization); Rev. Rul. 89-103, 1989-2 C.B. 65 (treating a deemed domestication by reason of section 269B as an inbound "F" reorganization).

[53] *See* section 36B(a), (b)(1), and (c)(2)(B).

[54] *See* section 36B(c)(2)(C)(i), (ii), and (iv) and Rev. Proc. 2021-36, 2021-35 I.R.B. 357, section 2.02(2).

[55] *See* Health Insurance Premium Tax Credit, REG-131491-10, 76 Fed. Reg. 50,931, 50,935 (August 17, 2011).

"family glitch," which was finalized in 2013,[56] means that "a PTC is not allowed for children and other family members who have been offered employer coverage if the cost of the employee's self-only coverage is affordable, regardless of the employee's cost to cover those family members."[57] The Kaiser Family Foundation estimated last year that over 5 million people are in households affected by the "family glitch."[58]

Our comment on the 2021-2022 PGP recommended that Treasury and the IRS address the "family glitch."[59] In April 2022, Treasury and the IRS published a proposed rule[60] that would determine eligibility for PTCs based on the affordability of family coverage, rather than employee-only coverage, for filers with family members in need of health insurance.[61] Treasury and the IRS should finalize this rule to eliminate the "family glitch" in time for Marketplace Open Enrollment for 2023.

Revise methods for valuation of personal use of company aircraft under section 61

Priority: Low

When an employee (or an employee's family member) flies on a company aircraft for personal purposes, the employee is required to include in income an amount equal to the value of the flight.[62] The regulations provide two valuation methods for this purpose. Under the general valuation rules, the value of the flight is equal to the value that an individual would have paid to charter the same or a similar flight.[63] Alternatively, in many cases, the flight may be valued using the "Standard Industry Fare Level" ("SIFL") method.[64] Under this method, the value of the flight is determined by multiplying the applicable SIFL cents-per-mile rate by an "aircraft multiple" (which is based on the weight of the aircraft) and then adding an applicable terminal charge.[65]

The SIFL method can be thought of as providing an administrative safe harbor that provides certainty to both taxpayers and the IRS regarding the amount of income resulting from the personal use of company aircraft. However, use of the aircraft multiples in the regulations

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[56] *See* Treas. Reg. § 1.36B-2(c)(3)(v)(A)(*2*) in Health Insurance Premium Tax Credit, T.D. 9611, 78 Fed. Reg. 7,264 (February 1, 2013).

[57] *See* Affordability of Employer Coverage for Family Members of Employees, REG-114339-21, 87 Fed. Reg. 20,354, 20,356 (April 7, 2022).

[58] Cynthia Cox, Krutika Amin, Gary Claxton, and Daniel McDermott, *The ACA Family Glitch and Affordability of Employer Coverage*, Kaiser Family Foundation (April 7, 2021).

[59] *See* Tax Law Center at NYU Law 2021-2022 PGP Comment, at 10.

[60] *See* Prop. Treas. Reg. § 1.36B-2(c)(3)(v)(A)(*2*) in *supra* footnote 57.

[61] Such guidance appears to have been described in 2021-2022 PGP, General Tax Issues, item 33.

[62] *See* section 61.

[63] *See* Treas. Reg. § 1.61-21(b)(6)(i)-(ii).

[64] *See* Treas. Reg. § 1.61-21(g).

[65] *See* Treas. Reg. § 1.61-21(g)(5) and (7).

typically results in income inclusions that are substantially lower than the FMV of the flight.[66] Thus, this regulatory safe harbor creates a non-statutory tax break for executives who take personal flights on company aircraft.

The SIFL method should be retained to continue providing certainty while reducing taxpayer and administrative burden and potential disputes over valuation. However, Treasury and the IRS should modify the SIFL method to more accurately reflect income related to personal use of company aircraft by increasing the "aircraft multiples" listed in Treas. Reg. § 1.61-21(g)(7).

Gifts and Estates and Trusts

Require recognition for transactions between a grantor and certain grantor trusts

Priority: High

As a general rule, trusts are separate taxpayers for purposes of the federal income tax.[67] However, section 671 provides that if a trust is a "grantor trust," then the trust's income will be included in the grantor's income tax return. Neither the statutory provisions nor the regulations thereunder necessitate that the grantor and their grantor trust be treated as the same or a single taxpayer for all federal income tax purposes. Nevertheless, Rev. Rul. 85-13[68] (which declined to follow *Rothstein v. US*[69]) provides that a grantor and their grantor trust will not be treated as separate taxpayers for federal income tax purposes and as a result, transactions between a grantor and their grantor trust will not be recognized for federal income tax purposes. This ruling enables taxpayers to take advantage of the grantor trust rules[70] and engage in highly leveraged wealth transfer transactions, death-bed basis shifting transactions, and even perpetuities planning[71] with no federal income tax consequences. These transactions serve to minimize transfer tax obligations and maximize valuation discounts and tax-free basis step up on death.

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[66] *See* Rick Farley, *Tax news and developments affecting company aircraft*, PwC Aircraft Club (April 2021) ("The charter rate method typically results in a much higher income inclusion to an employee for a personal flight on an employer-provided aircraft than the SIFL method."); Ruth M. Wimer, *Use of the Company Jet Just Became a Little Cheaper: DOT Releases Revised SIFL Rates for Use of Employer-Owned Aircraft*, Benefits Blast (August 27, 2019) ("Although two methods for imputing income are available, the SIFL rates generally are considerably lower than the charter rates.").

[67] *See* section 641(b).

[68] 1985-1 C.B. 1984.

[69] 735 F.2d 704 (2d Cir. 1984).

[70] *See* sections 671-679.

[71] Trust assets held in trusts subject to a perpetuities period are subject to some transfer tax following the trust's termination. Tax planners avoid this outcome by utilizing the grantor trust rules to transfer assets out of an expiring trust and into a dynasty trust. For example, an expiring trust can be granted a section 678 power over a dynasty trust, and the trust assets can be sold to the dynasty trust at a substantial discount. Because the expiring trust is the grantor of the dynasty trust, the transaction is not recognized for federal income tax purposes. Further, this transaction is not reported on any returns and can be repeated as necessary to substantially shrink the value of a trust subject to a nearing perpetuities date.

Treasury and the IRS should revoke Rev. Rul. 85-13 and propose new regulations in Treas. Reg. § 1.671-1, -2, or -3 to generally align the treatment of transactions between grantors and certain grantor trusts with *Rothstein*.[72] The grantor trust rules were intended to confer special treatment on trust arrangements where a taxpayer retains a high degree of control over the trust property.[73] Accordingly, the new proposed regulations could further refine the grantor trust rules and provide special treatment for certain trust arrangements where there is a particularly high degree of control over the trust property. For example, the new proposed regulations could provide a special rule for grantor trusts that Treasury and the IRS consider appropriate to remain wholly disregarded for all federal income tax purposes, such as investment trusts, "rabbi trusts,"[74] liquidating trusts, environmental remediation trusts, and fully revocable trusts (collectively, "wholly disregarded trusts"). This special rule could consider any person treated as the grantor of any portion of a wholly disregarded trust as directly owning the trust assets attributable to that portion of the wholly disregarded trust for all federal income tax purposes.[75]

For grantor trusts other than wholly disregarded trusts (if carved out), the revocation of Rev. Rul. 85-13 would cause common estate planning techniques (like sales to grantor trusts, deathbed basis planning, and perpetuities planning with expiring trusts) to be recognized for federal income tax purposes. The existing grantor trust rules would still apply to shift the federal income tax burden with respect to trust assets to the grantor. Finally, this proposal would have the added benefit of limiting the efficiency of grantor retained annuity trusts ("GRATs"), which are typically established as grantor trusts.[76]

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[72] *See* Daniel J. Hemel, *How Treasury and the IRS Have Allowed High-Net-Worth Taxpayers to Exploit Stepped-Up Basis on Intergenerational Wealth Transfers, and How They Can Stop It: Answers to Question for the Record* (January 17, 2022) ("Ideally, after rescission of Revenue Ruling 85-13, Treasury and the IRS would promulgate regulations via notice-and-comment rulemaking that adopt Judge Friendly's position in *Rothstein*."); *see generally* Jonathan Curry, *How Industry Pushback Sank the Grantor Trust Changes – For Now*, Tax Notes Federal (January 31, 2022).

[73] For a comprehensive discussion of the history of the grantor trust rules and a detailed legislative proposal, *see* Mark L. Ascher, *The Grantor Trust Rules Should be Repealed*, 96 Iowa L. Rev. 885 (2011).

[74] This arrangement, where an employer funds a grantor trust with assets intended to satisfy its deferred compensation obligations to its employees, is so identified because it was first publicly used to secure benefits for a rabbi. *See* PLR 8113107 (December 31, 1980) and Rev. Proc. 92-64, 1992-2 C.B. 422 (providing model trust provisions for a "rabbi trust").

[75] This suggestion is a narrow version of Prop. Treas. Reg. § 1.671-2(f). The special rule for wholly disregarded trusts would present limited wealth transfer planning opportunities because of the applicable restrictions and tax attributes of wholly disregarded trusts. The assets of wholly disregarded trusts or the interests therein are generally subject to the creditors of the settlors or interest holders and estate tax on the interest holder's death. These features of wholly disregarded trusts are distinct from those of intentionally defective grantor trusts and indicative of a greater degree of dominion over the trust property, consistent with the intended purposes of the grantor trust rules.

[76] *See* "Limit efficiency of GRATs for transfer tax avoidance," *infra* at pg. 14.

Limit efficiency of GRATs for transfer tax avoidance

Priority: High

Section 2702(a) provides a method for valuing a grantor's retained interest in a split-interest trust. The regulations thereunder provide the method for determining the gift tax value of the remainder interest passing to the remainder beneficiaries.[77] The value of the remainder interest is calculated by subtracting the value of the taxpayer's retained interest as determined under section 2702(a) from the total value of the assets transferred to the trust.[78] Section 2702(a) provides that unless the retained interest is a "qualified interest," the value of the retained interest is zero. In effect, the entire value of the split-interest trust is subject to gift tax if the retained interest does not meet the requirements for a "qualified interest."

Treasury and the IRS should propose regulations clarifying that a "qualified interest" has a minimum required annuity term. The current definition of a "qualified interest" as one that pays an annuity "at least annually" does not specify what the minimum or maximum annuity term for a qualified interest may be. Clarifying under the authority provided in section 7805(a) that a "qualified interest" has a minimum and maximum term will eliminate the inappropriate planning opportunities created by very short-term or very long-term GRATs.

Treasury and the IRS could also adopt a rule prohibiting the trustee of a GRAT from converting a substantial portion or all of the GRAT assets into debt obligations through a sale of such assets to trusts created by the annuitant or other related parties. Taxpayers are prevented from allocating their exemption from the generation-skipping transfer ("GST") tax to assets in a GRAT until the earlier of the grantor's death or the end of the annuity term.[79] However, taxpayers circumvent this restriction by having the GRAT sell assets to an existing GST exempt trust in exchange for a note amortized over the GRAT's annuity term. This sale transaction is not reported to the IRS and allows appreciation transferred through the GRAT structure to benefit from the existing trust's GST exempt status. Adopting a rule that prohibits the trustee of a GRAT from converting a substantial portion or all of the GRAT assets into debt obligations through such a sale would complement other additional regulatory requirements that govern qualified interests.[80]

Additionally, Treasury and the IRS should clarify the prohibition on "additional contributions"[81] as it applies to trusts with "qualified interests." Typically, taxpayers insulate their GRATs from market volatility by swapping appreciated assets out of the GRAT in exchange for promissory notes of equal value. Under the regulations, it is not clear what an additional contribution to a

[77] *See* Treas. Reg. § 25.2702-1(b). Arguably, this method could be adjusted through the regulations to measure the gift to the remainder beneficiaries, if any, at the time the annuity or unitrust term ends and property is actually transferred to the remainder beneficiaries.

[78] *Id.*

[79] *See* section 2642(f)(1) and (3).

[80] *See* Treas. Reg. § 25.2702-3(d)(2) and (6) (providing that a qualified interest cannot be satisfied either directly or indirectly through the issuance of a note or other debt instrument, nor can the payment of a qualified interest be subject to any contingencies).

[81] *See* Treas. Reg. § 25.2702-3(b)(5).

trust is and whether replacing appreciated assets in a GRAT with new assets is considered an additional contribution to the trust. By contrast, the regulations explicitly prohibit the grantor from swapping or selling trust property in a qualified personal residence trust ("QPRT").[82] Like GRATs, QPRTs are split-interest trusts and a creation of the regulations under section 2702. Consistent with the model provided for QPRTs under the authority of section 2702, Treasury and the IRS should consider expanding the prohibition on additional contributions to include asset sales and substitutions.

Finally, in the case of a remainder interest that is not a "qualified remainder interest," Treasury and the IRS should clarify that section 2702 does not apply to determine the value of the remainder interest for purposes of determining the value of such an interest on any transfer following its creation.[83] While this result follows from a strict reading of the rules in section 2702, a rule or example can be added to make this explicit.

Republish proposed regulations under section 2704 with technical clarifications

Priority: High

Transfer tax regulations provide that the applicable standard for determining the value of transferred property is FMV.[84] In determining an asset's FMV, appraisers often adjust the value based on factors that include form of ownership, restrictions on transferability, and prevailing market conditions. The application of valuation discounts to closely-held operating businesses has motivated taxpayers to create and fund non-operating limited liability companies or partnerships (sometimes referred to as "family limited partnerships" or "FLPs") solely to reduce the value of property for transfer tax purposes.

In 2016, Treasury and the IRS published proposed regulations that identified restrictions that would be disregarded for purposes of valuing an entity.[85] The proposed regulations were subsequently withdrawn in 2017.[86]

Though valuation presents complex compliance issues for the IRS, Treasury and the IRS should still consider republishing the proposed regulations with some clarifications to deter the most abusive uses of FLPs for tax planning purposes. Technical revisions that clarify the impact of the proposed regulations could include:

- Clarifying the effect of a "disregarded restriction" on entity valuation by (i) indicating that the proposed regulations do not imply particular substantive rights (such as a right to

[82] *See* Treas. Reg. § 25.2702-5(c)(9).

[83] If section 2702 does not apply, any transfer of a remainder interest must be valued as an ordinary remainder interest under Treas. Reg. § 25.2512-5(d)(2) (without subtracting out the grantor's retained interest).

[84] *See* Treas. Reg. §§ 20.2031-1(b), 25.2512-1, and 26.2642-2(a)(1) and (b)(1).

[85] *See* Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, REG-163113-02, 81 Fed. Reg. 51,413 (August 4, 2016).

[86] *See* Executive Order 13789—Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, 82 Fed. Reg. 48,013, 48,014 (October 16, 2017) ("EO 13789 Report"); Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, 82 Fed. Reg. 48,779 (October 20, 2017).

have an interest redeemed), and (ii) addressing the relevance of default state laws that do not directly restrict a particular owner's ability to redeem or liquidate their interest, but that otherwise restrict the termination or liquidation of the entity itself; and

- Clarifying the meaning of "member of the family" for purposes section 2704(b) by providing that the cross-reference in Prop. Treas. Reg. §§ 25.2704-2(c) and -3(c) to Treas. Reg. § 25.2701-2(b)(5) is for the definition of "control" rather than for the definition of "controlled entity." These clarifications would respond to comments on the 2016 proposed regulations noting these as areas of significant uncertainty.[87]

Treasury and the IRS could also reconsider the treatment of lapses in voting or liquidation rights under Treas. Reg. § 25.2704-1(c)(1) and Prop. Treas. Reg. § 25.2704-4(b)(1) by removing the pre-existing exception to section 2704(a) altogether, or by clarifying the proper valuation date for the deemed gift under Prop. Treas. Reg. § 25.2704-4(b)(1) and providing an illustration of how double taxation at death is avoided if the proposed valuation rules apply.

Finally, Treasury and the IRS could clarify the meaning of "same type of entity" in Prop. Treas. Reg. § 25.2704-2(b)(4)(ii). An applicable restriction does not include a restriction imposed or required to be imposed by federal or state law.[88] However, Prop. Treas. Reg. § 25.2704-2(b)(4)(ii) provides that "a restriction is not imposed or required to be imposed by federal or state law if that law also provides . . . a different statute for the creation and governance of that same type of entity that does not mandate the restriction." As drafted, this language potentially poses administrability and enforcement concerns. It is not clear how an entity for which restrictions on liquidations are mandated can be the "same type of entity" as one for which they are not. Treasury and the IRS could, at a minimum, clarify that determining the "type of entity" entails consideration of the nomenclature used for the entity, as well as similarity of mandatory governing law provisions, particularly those that do not relate to restrictions on liquidations and redemptions.

Adopt required valuation assumptions

Priority: Medium

Because the FMV standard that applies for transfer tax purposes is based on parties dealing at arm's length, it can be difficult to apply to transfers among related parties. This difficulty creates many opportunities for inappropriate valuations and a significant burden for Treasury and the IRS. As an alternative or in addition to proposing additional regulations under section 2704

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[87] *See generally*, Howard M. Zaritsky, Jonathan G. Blattmachr, and Mitchell Gans, *Treasury Proposes New Regulations to Restrict Valuation Discount Planning*, 155 Trusts & Estates 15, 21 (2016); *see also* Kevin Matz, *Proposed Regulation Under IRC Section 2704*, NYS Society of CPAs (2016) (noting, "[s]ome commentators have speculated that the implication of the Proposed Regulations is to actually read 'deemed put rights' into the governing documents and local law for valuation purposes, as if the interest holder were granted the affirmative right to withdraw its interest in exchange for a pro rata share of the entity's 'minimum value' upon six months' notice. It does not appear, however, that the Proposed Regulations indicate such an interpretation . . . .").

[88] *See* section 2704(b)(3)(B).

(concerning the definition of "value" for certain intra-family transfers),[89] Treasury and the IRS could revise the regulations providing the definition of "value" for transfer tax purposes to incorporate certain valuation "assumptions" or valuation "rules" that must be considered when determining the FMV of FLP interests transferred between family members.

New rebuttable valuation assumptions, as they relate to intrafamily transfers of FLP interests, could include the following:

- An assumption that, when determining the FMV of FLP interests for gift tax purposes, any discretionary liquidation, conversion, dividend, or put rights retained by the donor or the donor's spouse will not be exercised by them in a manner adverse to the donee's interest if the donee is a member of the donor's family unless the transfer is made pursuant to a divorce or other type of judicial settlement;
- An assumption for purposes of the "willing buyer, willing seller" construct of FMV that the willing buyer and the willing seller will be limited to individuals designated as permissible transferees in the governing documents, where the governing document limits transferability of interests in the FLP to family members; or
- An assumption that the "non-tax benefits" of forming an FLP confer real economic benefits to the owners and should be accounted for in valuation. This assumption would accept a taxpayer's assertion that putting passive assets in a FLP has substantial non-tax benefits such as keeping legacy investments in the family, permitting centralized and efficient investing, facilitating transfers of interests in real estate, and protecting assets from claimants and spendthrifts and intra-family disagreements. As a result, in effect, a valuation premium would be required on interests in FLPs before any discount for lack of marketability or control could be imposed. To the extent that the valuation premium would apply, it would only offset valuation discounts. The nature of this premium and the factors on which it is based would need to be reflected in determining the genuine size of valuation discounts.

Clarify reporting requirement for US persons receiving assets from foreign trusts under section 6048(c)

Priority: Medium

Under section 6048(c), a US person is subject to a reporting requirement if such person receives (directly or indirectly) "any distribution from a foreign trust." There are no regulations clarifying whether a "distribution from a foreign trust" includes the conversion of foreign trust structures into domestic trust structures by replacing a foreign trustee with a US trustee. Some practitioners and taxpayers deal with this uncertainty by filing protective Forms 3520 when they convert offshore trust structures into US trust structures.[90] There is otherwise no reporting requirement in

[89] *See* "Republish proposed regulations under section 2704 with technical clarifications," *supra* at pg. 15.

[90] *See* Caroline Rule, *IRS Form 3520, Penalties, and Whether to Make a Protective Filing*, The CPA Journal (December 2017).

the Code for foreign trust structures that are moved into trust-friendly states like Wyoming, Nevada, South Dakota, or Delaware.

The 2021-2022 PGP announced the intention to issue guidance under section 6048 concerning foreign trusts.[91] As part of this project, Treasury and the IRS should propose regulations under section 6048(c) clarifying that a US trustee is treated as receiving a distribution from a foreign person upon the receipt of trust assets from a foreign trustee. This interpretation would be consistent with Treasury and the IRS's otherwise broad application of section 6048.[92] This rule would eliminate uncertainty around filing requirements and enhance transparency around foreign assets being brought into the US. The reporting that this rule would compel would build upon Strategic Objective 2.1 of the President's Strategy on Countering Corruption,[93] which calls for enhanced beneficial ownership transparency through rulemaking under the Corporate Transparency Act.

Address basis of grantor trust assets at death under section 1014

Priority: Low

The termination of grantor trust status during a grantor's lifetime is treated as a transfer by the grantor of trust assets to the trust, in exchange for any consideration provided by the trust to the grantor (i.e., a recognition event).[94] As a result, when grantor trust status is terminated, the trust becomes a separate taxpayer and taxable income to the grantor could potentially be generated if certain liabilities of (or deemed to be of) the trust exceed the basis of the trust's assets. There is no guidance concerning the income tax treatment of the termination of grantor trust status at the grantor's death.

Treasury and the IRS should propose regulations stating that assets in a grantor trust do not receive a tax-free basis step up when the grantor dies. Alternatively, if Rev. Rul. 85-13 is not revoked,[95] these proposed regulations could apply the same rules for termination of grantor status during the grantor's lifetime to the termination of grantor status on account of the grantor's death. In effect, this would treat the termination of grantor trust status at the grantor's death as a recognition event if certain liabilities of (or deemed to be of) the trust exceed the basis in the trust assets. Consistent with Treas. Reg. § 1.684-2(e)(2), *Example 2*,[96] regulations could provide

[91] *See* International, G. Other, item 4.

[92] *See* Notice 97-34, 1997-1 C.B. 422, sections II and VI (defining "beneficiary" for purposes of section 6048 as any person that could possibly benefit from a trust whether or not such person is named in the trust instrument or can receive a distribution from the trust (including any trustee that receives excessive fees) and applying a Form 3520 filing requirement to domestic trusts that receive "contributions" from foreign persons).

[93] *See* The White House, United States Strategy on Countering Corruption 20 (December 2021) ("White House Anti-Corruption Strategy").

[94] *See* Treas. Reg. § 1.1001-2(c), *Example 5*; Rev. Rul. 77-402, 1977-2 C.B. 222; GCM 37228 (August 23, 1977); *Madorin* v. *Comm'r*, 84 T.C. 667 (1985).

[95] *See* "Require recognition for transactions between a grantor and certain grantor trusts," *supra* at pg. 12.

[96] The example concludes that the termination of grantor trust status at the death of the US grantor of a foreign trust is treated as if the grantor had transferred the assets to the trust at the moment before death.

that the grantor is treated as having transferred assets to the trust the moment before their death. Alternatively, the regulation could provide that a transfer occurs on the moment after the grantor's death.[97]

Clarify the bona fide sale exception of sections 2035 through 2038

Priority: Low

Many taxpayers minimize estate tax by selling assets at a valuation discount to their grantor trusts in exchange for an installment note. Section 2036(a)(1) includes in a decedent's gross estate any property transferred by the decedent in which the decedent retained the possession or enjoyment of, or the right to income from, the transferred property. The only exception to section 2036(a)(1) is for property transferred in a "bona fide sale for an adequate and full consideration."

Case law suggests a sale to a grantor trust should be respected as having resulted in a transfer rather than a retained interest under section 2036(a)(1) only if the trust has assets, other than those sold to the trust in the sale transaction, available to satisfy the resulting promissory note.[98] Further, Treas. Reg. § 20.2043-1 defines a "bona fide sale" for purposes of sections 2035 through 2038 and section 2041 as a transfer "made in good faith." Courts have interpreted the "good faith" requirement to necessitate heightened scrutiny in the review of intra-family transfers.[99]

There is an informal standard that a sale to a grantor trust will be viewed as a bona fide sale made in good faith if, outside of the sale transaction, the trust owns assets with a value equal to at least 10% of the value of the assets sold (the "10% rule").[100] Because this standard is not reflected in formal guidance, taxpayers can structure their sales by selling assets to an empty trust or have themselves, family members, or trust beneficiaries guarantee a portion of the note used in the sale. The use of guarantees allows a transferor to avoid making a taxable gift while superficially following the 10% rule.

As an extension of the good faith requirement, Treas. Reg. § 20.2043-1 should be revised to apply, at a minimum, the 10% rule for intra-family sale transactions. By requiring that a purchasing trust has sufficient assets to issue a promissory note to the grantor, this revision would minimize situations where the purchasing trust's assets decline significantly in value and, mimicking the flexibility of a GRAT, the grantor and the grantor trust simply unwind the transaction with no income tax or gift tax consequences because the trust has no other assets

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[97] *But see Crane v. Comm'r*, 331 U.S. 1 (1947) (indicating that death is not a recognition event).

[98] *See Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274 (1958).

[99] *See Estate of Raab v. Comm'r*, T.C. Memo 1985-52; *US v. Allen*, 293 F.2d 916 (10th Cir. 1961).

[100] *See* Bloomberg BNA Portfolio 838-2nd: Dynasty Trusts, V. Funding Issues, E. Installment Sale to Grantor Trust (indicating that the 10% rule has only been indicated by the IRS informally).

from which to pay.[101] Finally, Treasury and the IRS should also limit the use of specific parties as guarantors for purposes of determining whether a sale was bona fide.[102]

Limit availability of discounts on gift loans at death

Priority: Low

Under section 7872, if a promissory note bears interest at a rate at least equal to the applicable federal rate ("AFR"), the lender will not be considered to make a gift as result of the loan that gave rise to the promissory note. The AFR is generally well below the prevailing market interest rate for arm's length loans. Under estate tax regulations, the value of a note includable in a decedent's estate is the unpaid principal plus accrued interest, unless the evidence shows that the note is worth less (e.g., due to a low interest rate or inability to collect).[103] When a decedent dies holding a promissory note bearing interest at the AFR, the executor of the decedent's estate may take a valuation discount on the value of the note because the note bears a below market interest rate. As a result, while the note bears sufficient interest during the taxpayer's life to not cause gift tax implications, under estate tax valuation rules, the note can be discounted for bearing interest at a rate well below market norms.

A long-outstanding proposed regulation under section 7872 addresses the valuation of a term loan made with donative intent by providing that it equals the lesser of (i) the unpaid principal and accrued interest; or (ii) the sum of the present value of all payments due under the note using the AFR in effect on the decedent's death.[104] Although this proposed regulation project has not appeared in recent PGPs, Treasury and the IRS should republish the proposed rule and consider broadening its application to demand and term loans regardless of donative intent. These revised rules could resemble the FY2023 Green Book proposal to limit the discount rate on notes for estate tax valuation purposes to the greater of the note's actual interest rate and the AFR in effect on the date of the decedent's death.[105] Such regulations could be promulgated under the authority of sections 2031, 7872, and 7805(a) as necessary for appropriately determining the FMV mandated for estate tax purposes consistent with the standards for valuation reflected under section 7872.

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[101] In this situation, the grantor typically takes back the assets as a nominal payment on the note and forgives the remaining balance on the note. Where the grantor trust has no other assets, it is unclear whether the grantor has made any gift to the trust beneficiaries by terminating the note.

[102] For example, guarantees of payments on a note by the grantor of the trust, the grantor's spouse, or an entity involved in the sale transaction could be disregarded in determining whether the trust had sufficient economic substance for a sale to be respected.

[103] *See* Treas. Reg. § 20.2031-4.

[104] *See* Prop. Treas. Reg. § 20.7872-1 in Below-Market Loans, LR-165-84, 50 Fed. Reg. 33,553 (August 20, 1985).

[105] See FY2023 Green Book, at 43.

International

Address foreign corporation ownership by partnerships and partners

Priority: High

Section 958 sets forth stock ownership rules for purposes of implementing the subpart F regime. However, the regulations under section 958 provide insufficient guidance for determining ownership in fact patterns involving partnerships, and particularly limited partnerships and those in which there is variation in interests in profits, loss, and capital. In the absence of guidance, taxpayers may take positions that are inconsistent with the purpose of the section 958 rules in an effort to exclude foreign corporations from the subpart F regime or minimize the amounts included with respect to CFCs. Such positions could be facilitated by the fact that section 958(b) incorporates the principles of section 318, with ambiguous results for section 958. This is because section 318 attributes stock ownership by a partnership to its partners proportionately, but without specifying whether such attribution is based on legal control or economic interests, or both, and if on economic interests, how such economic interests are measured. Although these are longstanding issues, the extension of the aggregate treatment of partnerships from foreign partnerships to domestic partnerships[106] has increased their importance.

There is substantial commentary about the need for detailed guidance under section 958 addressing partnerships.[107] If Treasury and the IRS anticipate a significant delay in the issuance of such guidance, consideration should be given to interim, more limited guidance that would address potential inappropriate taxpayer planning. Such guidance could address the treatment of general partners' voting rights and the possibility of inconsistent positions being taken over time, along with any more substantive issues on which Treasury and the IRS have a developed view or could use additional input.[108]

Publish proposed regulations under section 245A

Priority: Medium

Section 245A provides a dividend received deduction ("DRD") for the foreign-source portion of dividends received by a domestic corporation from certain foreign corporations. The foreign-source portion appears to be based on all of the foreign corporation's E&P,[109] but there is no additional guidance. Thus, it is currently unclear how the determination of the foreign-source portion accounts for (i) the application of section 316(a), (ii) the possibility of undistributed

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[106] *See* Treas. Reg. § 1.958-1(d)(1).

[107] *See* Greg W. Featherman, *Tax Issues Raised by the Use of Cross-Border Partnerships,* Tax Notes Today International (January 31, 2022), Part IV.A; Jonathan S. Brenner & Josiah P. Child, *I'm Looking Through You, You're Not the Same: Partnership-Held CFCs,* Tax Notes Today Federal (October 22, 2019), Part B; New York State Bar Association, *Report No. 1423 – Report on June 2019 GILTI and Subpart F Regulations* Part III.A.6, 49 (September 18, 2019).

[108] Such guidance would be described in, and could accompany guidance already planned under, 2021-2022 PGP, International, A. Deemed Inclusions from Foreign Entities, etc., item 2.

[109] *See* section 245A(c).

foreign earnings in excess of undistributed earnings, or (iii) the interaction with a DRD under section 245. If section 316(a) applies (e.g., rather than a proportionate or tracing approach) to determine the E&P from which a distribution was made for purposes of section 245A, non-"foreign-source" E&P earned in early years could affect the determination of the foreign-source portion in subsequent years, preventing a shareholder from ultimately claiming the full amount of section 245A DRDs to which it appears to be entitled.[110] By contrast, losses in non-"foreign-source" E&P could result in undistributed foreign earnings exceeding undistributed earnings, potentially allowing section 245A DRDs to exceed the amount of dividends. Similarly, in certain circumstances, the combination of DRDs under sections 245A and 245 could exceed the amount of dividends paid by a foreign corporation. In the guidance announced in the 2021-2022 PGP,[111] Treasury and the IRS should publish proposed regulations under section 245A addressing some or all of the aforementioned issues, including rules for accounting for the E&P treated as distributed for purposes of section 245A and limitations on the amount of the DRD.

Clarify interaction of section 959 with general E&P and dividend rules

Priority: Medium

The interaction between the rules governing PTEP of a CFC in section 959 and the general rules governing corporate distributions in subchapter C raises a number of coordination issues. For example, section 959(c) provides that in order to determine whether a distribution is made out of PTEP, section 316(a)(2) (relating to current year E&P), and then section 316(a)(1) (relating to accumulated E&P), is applied to three categories of a foreign corporation's earnings – two related to PTEP, and one related to non-PTEP E&P.[112] This rule could be interpreted in multiple ways, and it is not clear whether section 959(c) requires that each category be further divided between current and accumulated subcategories.[113] In addition, Notice 2019-1 suggests a limited role for section 316 in determining PTEP distributions.[114]

[110] If, for example, a wholly-owned CFC accumulates 100x of ECI E&P in year 1 and 100x of "foreign-source" E&P in year 2, one would expect its United States shareholder ("US shareholder") to be eligible for up to 100x of section 245A DRDs over time. If, however, the foreign corporation distributes 100x in each of year 2 and year 3, and the US shareholder takes into account section 316(a) in computing its section 245A DRD, it would only be eligible for a 50x DRD in year 2 and no DRD in year 3.

[111] *See* International, C. Outbound Transactions, item 1.

[112] Section 316(a) defines a dividend as a distribution of property made by a corporation to its shareholders first out of current E&P (described in section 316(a)(2)) and then accumulated E&P (described in section 316(a)(1)).

[113] Section 316(a)(2), and then section 316(a)(1), could be applied to each category, in turn, before moving on to the next category. Alternatively, section 316(a)(2) could be applied to all three categories before then applying section 316(a)(1) to all three categories.

[114] *See* 2019-2 I.R.B. 275, section 3.02 (stating that the reference to section 316 merely indicates that a distribution of PTEP requires E&P otherwise sufficient to support a dividend).

Separately, Notice 2019-1 provides that a CFC's current year deficit in E&P does not affect the amount of its PTEP.[115] This rule is consistent with Rev. Rul. 86-131,[116] which coordinates the general rules for reducing E&P on a distribution of property[117] with the three section 959(c) categories. However, the notice does not reference Rev. Rul. 86-131.

Treasury and the IRS should publish the proposed regulations announced in Notice 2019-1 expeditiously[118] and more explicitly address the interaction of section 959 with subchapter C. Specifically, Treasury and the IRS should clearly address the coordination of section 959(c) and section 316 with a discussion of which interpretations are rejected, how the interpretation that is adopted aligns with the introductory language in section 959(c), and how that interpretation relates to the "PTEP-first" approach reflected in the notice.

In addition, the proposed regulations should confirm the point illustrated by Rev. Rul. 86-131 that distributions of loss property do not reduce PTEP in excess of the FMV of the property, and thus must reduce non-PTEP E&P to the extent of the loss. Finally, the proposed regulations should clarify that (i) the interaction of section 959(a) and (b) with section 316 means PTEP can be distributed before earnings that generate the PTEP have been earned, and (ii) reductions to E&P under section 312(a)(3) are made to accumulated, rather than current, E&P, and accordingly do not affect current year PTEP. When Treasury and the IRS publish these proposed regulations, they should also announce the intent to withdraw Rev. Rul. 86-131 upon finalization.

Republish proposed regulations under section 1291

Priority: Medium

A US person owning shares of a PFIC is generally subject to the "excess distribution" rules of section 1291 when it receives certain distributions from or disposes of the stock of the PFIC. These rules are intended to capture the deferral benefit of investing through PFICs and thereby deter their use. In 1992, the IRS published proposed regulations under section 1291, which address a number of topics.[119] Taxpayers and their representatives have consistently requested final guidance on the topics addressed by these proposed regulations, including the treatment of options under section 1298(a)(4) and nonrecognition transactions under section 1291(f).

Under the proposed regulations, excess distributions allocated to prior PFIC years are explicitly excluded from gross income in the year of an "excess distribution" (i.e., the current year).[120]

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[115] *See id.,* at section 3.03.

[116] 1986-2 C.B. 135.

[117] *See* section 312(a)(3) and Treas. Reg. § 1.312-1(b).

[118] This guidance is described in 2021-2022 PGP, International, A. Deemed Inclusions from Foreign Entities, etc., item 4.

[119] *See* Treatment of Shareholders of Certain Passive Foreign Investment Companies, INTL-941-86, INTL-656-87, INTL-704-87, 57 Fed. Reg. 11,024 (April 1, 1992).

[120] *See* Prop. Treas. Reg. § 1.1291-2(a) and (e)(2)(iii).

However, this treatment is not required by the statute.[121] Although section 1291(a)(1)(B) might be read to suggest that it describes the "only" amounts included in gross income for the current year, it could be read more narrowly to simply limit the amounts included as ordinary income for such year. This interpretation is consistent with the fact that paragraphs (a)(1)(C) and (c) of section 1291 provide for a special computation of the tax on amounts allocated to the prior PFIC years. Furthermore, treating such amounts as gross income for the year of an "excess distribution" pursuant to the default rule of section 61 would make it more likely that the statute of limitations for the year would be extended under section 6501(e)(1)(A), improving the government's ability to enforce the application of section 1291.

Treasury and the IRS should republish proposed regulations under section 1291, and expediently finalize them, with modifications to Prop. Treas. Reg. § 1.1291-2 to make clear that prior PFIC year amounts that are subject to the "excess distribution" rules are nevertheless included in gross income under section 61 in the current year for purposes of the statute of limitations.

Overhaul the "check-the-box" regulations

Priority: Medium

The so-called "check-the-box" regulations issued in 1996 (the "CTB Regulations")[122] expanded taxpayers' ability to elect the tax status of an entity (a "CTB Election").[123] Since then, the relevance of the CTB Regulations to international tax planning has evolved as legislative developments have modified the broader system. Although planning opportunities have decreased since the CTB Regulations were issued, the CTB Regulations continue to facilitate tax-motivated planning today. Most prominently, taxpayers may use a CTB Election before a disposition to elect into or out of subpart F income[124] or otherwise alter the consequences of the disposition.[125] The optionality facilitated by CTB Elections also allows taxpayers to claim stock losses that can offset income at the general US corporate rate while ensuring that any gains are subject to the reduced GILTI rate. In addition, taxpayers may use a CTB Election to minimize a

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[121] *Contra Toso v. Comm'r,* 151 T.C. 27 (2018) (rejecting the government's argument in this regard).

[122] Treas. Reg. §§ 301.7701-1 through -3.

[123] While this regime enhanced certainty regarding the previously unsettled area of entity classification, it also created many opportunities for tax planning and avoidance (many of which were identified soon after the issuance of the CTB Regulations). *See* Joint Committee on Taxation, JCS-6-97, *Review of Selected Entity Classification and Partnership Tax Issues* (April 8, 1997). Within a decade, scholars identified the CTB Regulations as playing a critical role in profit shifting out of the US. *See* Rosanne Altshuler & Harry Gruber, *The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational* Companies, 7 Fla. Tax. Rev. 152 (2005); Lawrence Lokken, *Whatever Happened to Subpart F – U.S. CFC Legislation after the Check-the-Box Regulations*, 7 Fla. Tax. Rev. 185 (2005).

[124] *See* sections 954(c)(1)(B) and 964(e); *cf.* Notice 2003-46, 2003-28 I.R.B. 53.

[125] *See, e.g.,* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals* 16 (May 2021) ("FY2022 Green Book") (providing background for the rule contained in Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138124(f)).

US shareholder's global intangible low-taxed income ("GILTI") inclusion or increase the amount of foreign tax credits that may be claimed as a result of a GILTI inclusion.[126]

In the domestic context, taxpayers may combine a CTB Election with a state law conversion statute to "strip" assets out of a lower-tier corporation while avoiding GU Repeal.[127] This planning complies mechanically with (but arguably departs conceptually from) the rule that an entity generally cannot elect to change its classification more than once in a 60-month period.[128]

Given the centrality of entity classification to the taxation of business activities, it is axiomatic that the CTB Regulations affect many other rules and regimes beyond those identified here, creating planning opportunities, complexity, and administrative burden. Treasury and the IRS should revise the CTB Regulations to provide that (i) a foreign entity is not eligible to make a CTB Election,[129] and (ii) state law conversions and similar techniques[130] are treated as CTB Elections for purposes of the 60-month rule.[131]

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[126] *See generally* Moshe Spinowitz and Robert Stevenson, *To Check or Not to Check? The TCJA's Impact on Entity Classification Decisions*, International Tax Journal (March-April 2019). While this GILTI planning generally allows US shareholders to achieve results that align more closely with "aggregate" treatment of its CFCs, it is inconsistent with the mechanics of section 951A. Thus, these issues should be addressed, if at all, under the GILTI regime and not by giving sophisticated taxpayers the optionality for "self-help" under the CTB Regulations.

[127] For example, a corporation with a single corporate shareholder may (i) convert to a limited liability company under a state law conversion statute (treated as a disregarded entity under the default classification rules), (ii) distribute assets to the shareholder in a transaction that is disregarded for federal income tax purposes, and then (iii) elect to be treated as a corporation. *See* Internal Revenue Service, *IRS statement regarding private letter rulings on certain corporate transactions* (October 13, 2017), item 4 (stating that "substantial scrutiny" will be applied to such transactions in the PLR program).

[128] *See* Treas. Reg. § 301.7701-3(c)(1)(iv).

[129] *See also* S. 991, Corporate Tax Dodging Prevention Act, section 5 (proposing repeal of the CTB Regulations for many foreign entities); H.R. 1786, Stop Tax Haven Abuse Act, section 101 (similar); Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* 30 (May 2009) (similar); *How U.S. International Tax Policy Impacts American Workers, Jobs, and Investments*, Hearing Before the Senate Committee on Finance, 117th Cong. (2021) (Testimony of Chye-Ching Huang). As suggested by legislative proposals that have generally prescribed rules for the classification of foreign entities, consideration would need to be given to a suitable replacement for the CTB Regulations in order to avoid reverting to the state of uncertainty that existed before them. *See supra* footnote 123. However, defaulting to corporate treatment, as some of the legislative proposals would do, could potentially facilitate planning through the creation of reverse hybrid entities. Accordingly, consideration should be given to conforming the US tax treatment of foreign entities with their local country treatment. Such treatment would be consistent with other recent international tax rules that seek to conform US and foreign tax treatment to reduce disparities and planning opportunities. *See, e.g.,* Treas. Reg. § 1.861-20. Where such treatment is of no consequence in the entity's local country, such as because it is formed in a jurisdiction that does not impose tax, consideration could be given to a default US treatment.

[130] For example, a corporation may also merge into a disregarded entity with the disregarded entity surviving.

[131] *See also* 2021-2022 PGP, General Tax Issues, item 34.

Republish proposed regulations under section 898

Priority: Low

Section 898 sets forth rules for determining the required taxable year for certain foreign corporations based on the taxable years of their owners. The general statutory rule is that testing for purposes of identifying the required taxable year occurs on the first day of the foreign corporation's taxable year determined without regard to section 898.[132] However, under proposed regulations published in 1993 and never finalized,[133] additional testing days would include days on which a substantial change in US ownership of a foreign corporation occurs.[134] The IRS has recently issued PLRs that imply (but do not state) that taxpayers can rely on the proposed rules concerning testing days,[135] notwithstanding the prospective applicability of those proposed rules[136] and their lack of reliance language, creating uncertainty and the potential for disparate treatment among taxpayers. Treasury and the IRS should republish proposed regulations under section 898 (with updates as necessary to reflect any legislative changes[137]), and permit taxpayers to rely on them.

Synchronize treatment of subpart F inclusion basis

Priority: Low

Under section 961(a) and (b), adjustments are required to be made to the basis of a US shareholder of stock in a CFC or property by reason of which the US shareholder is treated under section 958(a)(2) as owning stock of a CFC. Under section 961(c), if a US shareholder is treated under section 958(a)(2) as owning stock of a CFC ("CFC 2") owned by another CFC ("CFC1"), under regulations, similar adjustments are required to the basis of the CFC2 stock and the basis of any other CFC stock by reason of which the US shareholder is treated under section 958(a)(2) as owning CFC2 stock. However, the basis adjustments under section 961(c) apply only for purposes of determining inclusions under section 951.

Provided that section 961(c) basis adjustments are not expanded to apply for all purposes,[138] as do section 961(a) and (b) basis adjustments, is it important to ensure that movements of CFC

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[132] *See* section 898(c)(3)(B)(i).

[133] *See* Taxable Year of Certain Foreign Corporations Beginning after July 10, 1989, INTL-0848-89, 58 Fed. Reg. 290 (January 5, 1993).

[134] *See* Prop. Treas. Reg. § 1.898-3(a)(5)(iii).

[135] *See, e.g.,* PLR 202012009 (November 13, 2019).

[136] *See supra* footnote 133, at 291.

[137] *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138122.

[138] *See* Amendment in the Nature of a Substitute to the Committee Print Offered by Mr. Neal of Massachusetts, September 12, 2021, section 138129(d). (This change was consistent with a proposed change included among proposed technical corrections to the TCJA. *See* Tax Technical and Clerical Corrections Act Discussion Draft, January 2, 2019, section 4(hh)(6).) *See also* Senate Finance Committee Draft, section 128129(c)(5) (providing

stock do not prevent basis adjustments that would have been allowed had a CFC always been a first-tier CFC or allow basis adjustments that would not have been allowed had a CFC always been a lower-tier CFC.[139]

One way to address the issue without requiring extensive rules addressing all the circumstances in which CFC stock might be transferred would be to deviate from the approach of the current and previously proposed regulations, which require basis adjustments to be made in connection with the event that triggers the basis adjustment. Nothing in section 961 specifies when basis adjustments are to be made, so regulations could instead require a notional accounting of basis adjustments separate and apart from CFC stock. Basis in a notional account with respect to specific CFC stock would only attach to that CFC's stock at the time that the basis is relevant (e.g., upon a distribution with respect to the stock or disposition of the stock), based on the holding of the CFC at such time. Such a system would allow an evaluation of the basis adjustments that should be taken into account based on the organizational structure when the basis is relevant and thus prevent inappropriate allowance or disallowance of basis.

Revisit measurement of assets under section 1297

Priority: Low

Section 1297(a)(2) provides that a foreign corporation is a PFIC if the average percentage of its assets that produce passive income or are held for the production of passive income is at least 50%. This determination is made using the value of the assets for (i) publicly traded corporations, and (ii) corporations that are not CFCs that do not make an election to use adjusted basis.[140] For CFCs or any other non-publicly traded corporations that elect the application of section 1297(e)(2), the assets are measured using adjusted basis.[141]

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authority for Treasury to prescribe the purposes for which section 961(c) basis adjustments apply). All of the versions of the Build Back Better Act would clarify the scope of the section 961(c) cross-reference to section 961(b). *See, e.g.,* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138129(c)(5). However, notably, their retention of the introductory language of section 961(c) would arguably prevent them from expanding the scope of section 961(c) basis adjustments to both interests in partnerships directly held by a US shareholder and stock in CFCs held by a US shareholder only through partnerships. The unmodified section 961(c) introductory language could also arguably prevent section 961(c) adjustments from applying to other partnership interests, but presumably, in light of the clear expansion of the scope of section 961(c) beyond CFC stock, the reference in such language to CFC stock "owned by another" CFC would be interpreted expansively in regulations to include ownership within the meaning of section 958(a)(2).

[139] Suppose, for example, that an individual owns CFC2 directly at the time that CFC2 accumulates 100x of PTEP. If the resulting basis in the CFC2 stock continues to be respected as basis for all purposes after the individual contributes CFC2 to CFC1, there could be no subpart F or E&P consequences upon a subsequent sale of the CFC2 stock by CFC1 to a third party. As a result, the duplication of section 961(a) basis through the contribution would permit the individual and the CFC2 buyer to collectively recover 200x of basis from a single 100x inclusion by the individual (and its consequent section 961(a) basis adjustment).

[140] Section 1297(e)(1).

[141] Section 1297(e)(2).

The proposed regulations published in 2019[142] would have provided that if a foreign corporation is not publicly traded for the entire year, assets are measured by value for the entire year if the corporation was publicly traded during the majority of the year or if section 1297(e)(2) did not apply to the corporation during the majority of the year.[143] Otherwise, assets would be measured by adjusted basis for the entire year.[144] By contrast, the final regulations promulgated in 2021[145] provide that if the corporation was a CFC during the year, assets are measured by adjusted basis only for the periods during which it was a CFC, potentially allowing measurement by value for other periods.[146] The final regulations further provide that not only must lower-tier subsidiaries generally use their upper-tier parent's method for measuring assets for the determination of the upper-tier parent's PFIC status, but that such method applies even for the determination of the lower-tier subsidiaries' PFIC status.[147]

Given that, as noted in the preamble to the 2019 proposed regulations, using a combination of methods for measuring assets of a corporation within a year (as would be allowed under the final regulations) could be distortionary,[148] consideration should be given to returning to the "one method per year rule" contained in the 2019 proposed regulations. Furthermore, consideration should be given to reversing the rules binding lower-tier subsidiaries to their upper-tier parent's asset measurement method for the lower-tier subsidiaries' PFIC determination, as requiring a method would seem inconsistent with the optionality provided by section 1297(e). The final regulations seem to go beyond the modifications requested by comments on the 2019 proposed regulations.[149] Thus, Treasury and the IRS should propose modifications to the final regulations, either in connection with the open guidance project concerning the asset test[150] or on a standalone basis.[151]

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142 Guidance on Passive Foreign Investment Companies, REG-105474-18, 84 Fed. Reg. 33,120 (July 11, 2019).

143 *See* Prop. Treas. Reg. § 1.12971-1(d)(1)(v)(A).

144 *Id.*

145 Guidance on Passive Foreign Investment Companies, T.D. 9936, 86 Fed. Reg. 4,516 (January 15, 2021).

146 *See* Treas. Reg. § 1.1297-1(d)(1)(v)(B) and (C).

147 *See* Treas. Reg. § 1.1297-1(d)(1)(v)(C)(*2*)(*i*), (*ii*), and (*iii*) (second sentence).

148 *See supra* footnote 142, at 33,125 (noting that electivity between multiple methods "could facilitate the avoidance of the PFIC rules, and that the rule in the proposed regulation imposes the least administrative burden").

149 The only comment on the rules described in the preamble to the final regulations seems to have requested rules providing for asset measurement on the basis of value throughout a year to the extent possible (not a mix of value and adjusted basis measurement) and rules for measuring a subsidiary's assets solely for purposes of the parent corporation's PFIC determination (not for all purposes). *See supra* footnote 145, at 4,523.

150 *See* Prop. Treas. Reg. § 1.1297-1(d) in Guidance on Passive Foreign Investment Companies and the Treatment of Qualified Improvement Property Under the Alternative Depreciation System for Purposes of Sections 250(b) and 951A(d), REG-111950-20, 86 Fed. Reg. 4,582 (January 15, 2021). Final rules are contemplated in the 2021-2022 PGP. *See* International, A. Deemed Inclusions from Foreign Entities, etc., item 5.

151 The Tax Law Center at NYU Law believes that it would also be appropriate to reconsider other recent regulatory decisions addressing international tax, such as the issuance of regulations providing for a "high-tax" exception from tested income and the treatment of CFC stock as an "exempt asset" on the basis of section 250. *See* Treas. Reg. §§ 1.951A-2(c)(1)(iii) and (7) and 1.861-8(d)(2)(ii)(C), respectively. However, unlike the section 1297 regulations

Partnerships

Consider addressing the treatment of carried interest

Priority: High

Managers of private investment funds (including hedge funds, venture capital funds, and private equity funds) are often compensated through a combination of "management fees" taxed at ordinary income rates and "carried interest" taxed at low capital gains rates.[152] Many argue that carried interests should be taxed as ordinary income, similar to most other service income.[153] Over the years, there have been many attempts to address the advantageous treatment of compensation derived from carried interests.[154] The FY2023 Green Book proposes to apply ordinary income treatment to income received with respect to an "investment services partnership interest."[155]

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discussed herein, these issues have already been addressed extensively in public commentary. *See* Stephen E. Shay, *A GILTI High-Tax Exclusion Election Would Erode the U.S. Tax Base*, Tax Notes Today Federal (December 4, 2019); Mindy Herzfeld, *Reconciliation Proposals: The Big Deal About Expense Allocation*, Tax Notes Today International (August 16, 2021) ("Writing the rule in that manner generally means that less interest expense is allocated to the GILTI basket, leading to a larger FTC limitation in the GILTI category. In the absence of [Treas. Reg. § 1.861-8(d)(2)(ii)(C)], allocating expenses under the pre-TCJA rules would have meant an even lower FTC GILTI limitation…"). In addition, Treasury and the IRS appear to have at least considered whether these regulations implement sound policy. *See* Foreign Tax Credit Guidance Related to the Tax Cuts and Jobs Act, Overall Foreign Loss Recapture, and Foreign Tax Redeterminations, T.D. 9882, 84 Fed. Reg. 69,022, 69,024 (December 17, 2019) ("One comment argued that the full allocation of expenses to the section 951A [sic] is needed to prevent base erosion. The comment recommended that the rules in proposed § 1.861–8(d)(2)(ii)(C) that treat income offset by the section 250 deduction as exempt income and the assets that give rise to that income as exempt assets are inappropriate and should be withdrawn"); FY2022 Green Book, at 7-8. If Treasury and the IRS were to reconsider these regulations, the Tax Law Center at NYU Law would be happy to provide feedback on such guidance. *Cf.* "Finalize proposed regulations addressing the 'family glitch'," *supra* at pg. 10.

[152] *See* section 702.

[153] *See, e.g.,* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 49 (2008); Jonathan H. Choi, *Democrats should finally close the carried interest loophole for the wealthy*, Wash. Post (September 14, 2021) (citing his survey of all American tax law professors, in which 86.7% of respondents supported taxing carried interest as ordinary income). *But see, e.g.,* Steven B. Klinsky, *The Carried Interest Loophole? What Loophole?*, N.Y. Times (July 15, 2016) and *Private Equity and the Treatment of Carried Interest: An Overview*, American Investment Council (May 4, 2007) (arguing that capital gains treatment for carried interest is appropriate).

[154] For recent legislative examples, see, *e.g.*, S. 1639, the Ending the Carried Interest Loophole Act, and H.R. 1068, the Carried Interest Fairness Act of 2021. As part of the TCJA, Congress enacted section 1061 to extend the holding period required to receive long-term capital gains treatment with respect to partnership profits interests from one year to three years. *See* P.L. 115-97, section 13309. While it would not eliminate the incentives to seek capital treatment for carried interests, the surcharge on high income individuals contained in the Build Back Better Act would increase the rate on capital income, including carried interest income, by up to 8%. *See* Rules Committee Print 117-18, Text of H.R. 5376, Build Back Better Act, November 3, 2021, section 138203. In addition, the FY2023 Green Book would reduce the rate preference for capital income for high-income taxpayers. *See* 30-33. If the proposal were to become law, the benefit of capital gains treatment for carried interest would be reduced.

[155] *See* FY2023 Green Book, at 50-51.

In the absence of legislative action, Treasury and the IRS should consider guidance to improve the tax treatment of carried interest. There is a broad menu of options Treasury and the IRS could consider. Revocation of Rev. Proc. 93-27[156] and Rev. Proc. 2001-43[157] is one way to start the reversal of the status quo.[158] An additional option is to illustrate by example that the anti-abuse rule under Treas. Reg. § 1.701-2 applies to preclude capital gains treatment for carried interests.[159] If this option is pursued, consideration should be given to distinguishing between the treatment of carried interests and the treatment of other interests in a partnership, such as those of passive investors.[160] While each of the administrative options for addressing the treatment of carried interest has technical strengths and weaknesses, Treasury and the IRS should evaluate these options both on their own terms and in comparison to the deficiencies of current law.

Republish or finalize proposed regulations and publish related subregulatory guidance addressing fee waivers under section 707

Priority: High

Section 707(a)(2) provides Treasury broad authority to recharacterize certain transactions involving disguised fee for service arrangements based on "Congress's concern that partnerships and service providers were inappropriately treating payments as allocations and distributions to a

[156] 1993-2 C.B. 343.

[157] 2001-2 C.B. 191.

[158] This could be accompanied by guidance treating a carried interest as compensation, causing an income inclusion of the FMV of the carried interest at issuance. If this option is pursued, a strong valuation regime should be considered.

[159] *See Carried Interest, Part II*, Hearing Before the Senate Committee on Finance, 110th Cong. (2007) (Testimony of Charles I. Kingson at footnote 4) ("If the partnership anti-abuse rule has any bite, use of partnership to claim capital gain from performing services should be high on the list [of abusive arrangements]."); Andrea Monroe, *What's In A Name: Can the Partnership Anti-Abuse Rule Really Stop Partnership Tax Abuse?*, 60 Case W. Rsrv. L. Rev. 401, 465 (2010) ("Remarkably, the most promising candidate to sustain subchapter K is perhaps its least successful, most controversial provision… a revised [partnership anti-abuse rule] could more effectively challenge partnership tax shelters and provide subchapter K with much needed structural support."). However, some argue that the anti-abuse rule exceeds Treasury's delegated authority. *See, e.g.,* Linda D. Jellum, *Dodging the Taxman: Why the Treasury's Anti-Abuse Regulation is Unconstitutional*, 70 U. Mia. L. Rev. 152 (2015); Richard M. Lipton, *The Partnership Anti-Abuse Regs. Revisited: Is There Calm After the Storm?*, 83 J. Tax'n 68 (1995).

[160] Without such a distinction, this proposal could be viewed as analogous to proposals to clarify the definition of capital asset under section 1221 to exclude property held by private equity funds. *See* Steven M. Rosenthal, *Taxing Private Equity Funds as Corporate 'Developers,'* Tax Notes Today Federal (January 22, 2013). Significantly, the "developer" approach would be both broader than approaches focused solely on carried interest, as it would impact the tax treatment of all investors in such funds (not just those with profits interests related to services), and likely narrower, in that it might be most appropriately tailored to private equity funds and not other types of funds. The "developer" approach would also be analogous to, but an expansion on, the holding in *Dagres v. Comm'r* that carried interests are compensation related to a trade or business rather than capital assets. 136 T.C. 263, 289 (2011). *Cf.* Laura Saunders, *'Carried Interest' in the Cross Hairs*, Wall St. J. (August 6, 2011) ("Prof. Graetz says Treasury officials could use the decision to do administratively what Congress hasn't done legislatively—tax carried interest as ordinary income").

partner even when the service provider acted in a capacity other than as a partner."[161] Pursuant to this authority, Treasury and the IRS published proposed regulations in 2015[162] to address "fee waivers," a common planning technique used by private equity firms that purport to convert their partners' annual management fees (which would otherwise be taxed as ordinary income) into additional allocations of long-term capital gain without meaningfully altering the economics of the deal between the managers and their investors.[163] The proposed regulations would provide a framework and operating rules for determining whether a fee waiver arrangement should be treated as a disguised payment for services. The proposed regulations also announced modifications to Rev. Proc. 93-27 to clarify that the administrative safe harbor provided by the revenue procedure does not apply to fee waiver arrangements. Treasury and the IRS should republish the proposed regulations, or finalize them (if it is determined that no significant changes are warranted)[164] and publish the new revenue procedure, in order to curb the ongoing improper use of fee waiver arrangements.[165] Such proposal or finalization would publicly confirm the IRS's understanding of current law.[166]

Republish debt allocation proposed regulations

Priority: Medium

Under the partnership disguised sale rules, transfers to and by a partnership that are more properly characterized as transactions between the partnership and a non-partner or between two

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[161] *See* Disguised Payments for Services, REG-115452-14, 80 Fed. Reg. 43,652, 43,653 (July 23, 2015) (internal citations omitted).

[162] *See id*.

[163] *See* Saba Ashraf & Alyson K. Pirio, *Management Fee Waivers: The Current State of Play*, 27 J. Tax'n & Reg. Fin. Institutions 5, 18 (2013) ("The reality is that most partners engaging in fee waivers want to do so on terms that do not meaningfully alter their right to receive the underlying funds, or subject it to greater risk."); Karen C. Burke, *Back to the Future: Revisiting the ALI's Carried Interest Proposals*, Tax Notes Today Federal (October 12, 2009) (noting that fee waiver arrangements "may be intended solely to transmute the manager's current ordinary-income compensation into deferred capital gain."). *See also* Jesse Drucker and Danny Hakim, *Private Inequity: How a Powerful Industry Conquered the Tax System,* N.Y. Times (June 21, 2021).

[164] *See* Monte A. Jackel, *Top Suggestions for Partnership Guidance*, Tax Notes Today Federal (September 9, 2019) ("The 2015 proposed fee waiver regulations should be either re-proposed or finalized"); *see also* Lee Sheppard, *News Analysis: Current Developments for Investment Funds*, Tax Notes Today International (June 5, 2017) (discussing hedge funds' reliance on example 2 of Treas. Reg. § 1.707-1(c), which led to modifications of that example in the proposed regulations).

[165] New proposed regulations could potentially also address carry waivers. While the preamble to the proposed section 1061 regulations warned that "[t]axpayers should be aware that these and similar arrangements may not be respected and may be challenged under section 707(a)(2)(A), §§ 1.701-2 and 1.704-1(b)(2)(iii), and/or the substance over form or economic substance doctrines," the final regulations were silent on carry waiver arrangements. *See* Guidance under Section 1061, REG-107213-18, 85 Fed. Reg. 49,754, 49,758 (August 14, 2020).

[166] *See* Eric Yauch, *Fee Waiver Regs on Back Burner, but IRS Enforcement Continues*, Tax Notes Today Federal (May 7, 2018) (quoting statement of an OCC official that the IRS does not need the 2015 proposed regulations to challenge the most aggressive fee waiver arrangements, and is, in fact, doing so). *See also* Gregg D. Polsky, *A Compendium of Private Equity Tax Games*, Tax Notes Today Federal (February 3, 2015), Strategy 2.

or more partners are treated as such.[167] Like any transaction involving a partnership, the tax consequences of a disguised sale depend in part on a partner's basis in its partnership interest,[168] which depends in part on the partner's share of the partnership's liabilities.[169] Under regulations in effect before 2016, as well as current regulations, the rules for allocating partnership debt for purposes of the disguised sale rules differ depending on whether a liability is recourse or nonrecourse.[170] Because such rules provide for the allocation of recourse liabilities to partners based on their economic risk of loss,[171] taxpayers can engage in transactions with a partnership without triggering gain under the disguised sale rules by assuming the risk of loss with respect to partnership liabilities (for example, by guaranteeing them). For example, a partner may contribute appreciated assets to the partnership, which then borrows cash to distribute to the partner. Despite the contributing partner effectively selling their interest in the contributed asset, as long as the amount borrowed by the partnership is treated as recourse and allocated to the partner, the consequent increase in the partner's basis in the partnership interest means there is no taxable gain upon the distribution to the partner.

In 2016, Treasury and the IRS published temporary and proposed regulations under section 707 to prevent deferral of gains by a partner contributing liabilities to a partnership through transactions like the one described above.[172] However, these regulations were subsequently removed and replaced.[173] Proposals under section 752 could potentially obviate the need for debt allocation rules specific to the disguised sale rules.[174] However, in the absence of such broader change and consistent with prior announcements that disguised sale regulations are under development,[175] Treasury and the IRS should republish the proposed regulations under section 707, which would, for disguised sale purposes, treat all liabilities as nonrecourse liabilities that must be allocated among all partners in accordance with their respective interests in partnership profits.[176]

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[167] *See* section 707(a)(2).

[168] *See, e.g.,* section 731(a).

[169] *See* section 752(a) and (b).

[170] *See* Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, T.D. 9788, 81 Fed. Reg. 69,282, 69,283 (October 5, 2016) ("2016 Temporary Regulations"); Removal of Temporary Regulations on a Partner's Share of a Partnership Liability for Disguised Sale Purposes, T.D. 9876, 84 Fed. Reg. 54,027 (October 9, 2019) ("2019 Removal").

[171] *See* Treas. Reg. §§ 1.707-5(a)(2)(i) and 1.752-2(a).

[172] 2016 Temporary Regulations; Liabilities Recognized as Recourse Partnership Liabilities Under Section 752, REG-122855-15, 81 Fed. Reg. 69,301 (October 5, 2016) ("2016 Proposed Regulations").

[173] *See* EO 13789 Report, 82 Fed. Reg. at 48,016; 2019 Removal.

[174] *See, e.g.,* proposed section 752(e) in section 12 of draft legislation released by Senator Ron Wyden (September 10, 2021).

[175] *See* Allyson Versprille, *IRS Has Draft of Revamped Disguised Sale Rules, IRS Official Says*, Bloomberg Daily Tax Report (January 29, 2021). It is unclear whether such regulations are those described in the 2021-2022 PGP, Partnerships, item 8.

[176] *See* Prop. Treas. Reg. § 1.707-5(a)(2)(i) in 2016 Proposed Regulations.

Tax Administration

Clarify treatment of digital assets as specified foreign financial assets under section 6038D

Priority: High

Under section 6038D(a) and Treas. Reg. § 1.6038D-2(a)(1), a "specified person" that has any interest in a "specified foreign financial asset" during the taxable year must disclose certain information about each specified foreign financial asset on Form 8938 if the aggregate value of all such assets exceeds the relevant threshold amount.

Some practitioners believe certain digital assets could qualify as "specified foreign financial assets"[177] and have requested guidance in the past.[178] Though Treasury and the IRS asked for comments on the proper treatment of virtual currency under section 6038D in 2014, it has yet to release any guidance on applying section 6038D to digital assets.[179] Treasury and the IRS should issue guidance under the grant of regulatory authority in section 6038D(h) that describes the circumstances in which a digital asset would qualify as a "specified foreign financial asset." The FY2023 Green Book recognizes that "[t]he global nature of the digital asset market offers opportunities for U.S. taxpayers to conceal assets and taxable income by using offshore digital asset exchanges and wallet providers."[180] The FY2023 Green Book then proposes adding certain digital assets to the section 6038D reporting regime. This proposal is sound. However, Treasury and the IRS have clear authority today under sections 7805 and 6038D(h) to provide clarifying guidance on the treatment of digital assets without additional legislation. Issuing such guidance would combat tax evasion and offer clarity to taxpayers.

Extend section 6045 broker reporting to certain art and antiquities transactions

Priority: High

Section 6045 provides that the Secretary of the Treasury can require a "broker" to submit an information return that identifies the name and address of each customer and provides details regarding gross proceeds and other information prescribed by the Secretary.[181] A "broker" includes a dealer, barter exchange, "any person who (for consideration) regularly acts as a middleman with respect to property or services," and "any person who (for consideration) is

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[177] *See* New York State Bar Association, *Report No. 1433 – Report on the Taxation of Cryptocurrency* 33-34 (January 26, 2020) ("NYSBA Report No. 1433"); Mindy Herzfeld, *Beyond Digital: Is Cryptocurrency the Next Tax Frontier?*, Tax Notes Today International (June 15, 2020).

[178] *See* NYSBA Report No. 1433, at 30-34; American Institute of Certified Public Accountants, *Comments on Revenue Ruling 2019-24, the New Question on Schedule 1 (Form 1040), and the Internal Revenue Service's Frequently Asked Questions on Virtual Currency Transactions* 21 (February 28, 2020).

[179] *See* Reporting of Specified Foreign Financial Assets, T.D. 9706, 79 Fed. Reg. 73,817, 73,821 (December 12, 2014).

[180] FY2023 Green Book, at 100.

[181] Section 6045(a).

responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."[182] This provision affords broad discretion to Treasury and the IRS to define the scope of broker reporting.

Regulations under section 6045 have not extended broker reporting requirements to art and antiquities brokers. Treasury has concluded that "[i]n schemes to defraud the IRS by means of fraudulent expenses or deductions, the art is typically purposefully overvalued to improperly maximize the deduction. In this context, additional reporting from due diligence programs may be beneficial . . . ."[183] Treasury and the IRS should exercise the regulatory authority under section 6045(a) to require broker reporting on art and antiquities transactions above an appropriate threshold to focus reporting where the greatest risk of non-compliance lies and minimize filer and administrative burden.[184] Art and antiquities broker reporting would improve voluntary tax compliance and likely raise revenue in a progressive manner that is consistent with the President's stated anti-corruption goals.[185]

The regulations would need to define "art" and "antiquities" in a manner suitable for this information reporting. Treasury and the IRS could draw on definitions of "art" and "artist" in existing tax statutes and guidance and other areas of law to craft a definition of "art" for the art and antiquities broker reporting regulations.[186] Treasury and the IRS should consider using an illustrative list, similar to the structure of the "art" definition in Rev. Proc. 96-15, with a goal of

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[182] Section 6045(c)(1), as in effect for returns required to be filed, and statements required to be furnished, after December 31, 2023. *See* P.L. 117-58, section 80603(c).

[183] Department of the Treasury, *Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art* 28 (February 2022); *see also* Jason Felch, *Beverly Hills antiquities dealer sentenced to jail for smuggling scheme*, Art News (December 16, 2015) (two individuals were "sentenced to probation for their role in a related tax evasion scheme in which looted antiquities were donated to local museums in exchange for inflated tax write-offs."). Individuals may also use transactions in high-value art and antiquities to evade sanctions and launder money. *See* Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *The Art Industry and U.S. Policies that Undermine Sanctions* (July 27, 2020) ("[C]ertain Russian oligarchs appear to have used transactions involving high-value art to evade sanctions imposed on them by the United States . . . ."); Anti-Money Laundering Regulations for Dealers in Antiquities, 86 Fed. Reg. 53,021, 53,022-23 (September 24, 2021) ("Certain characteristics of the trade in antiquities may be exploited by money launderers and terrorist financiers to evade detection by law enforcement."); Tom Mashberg, *The Art of Money Laundering*, 56 Finance & Development 30 (September 2019).

[184] Thresholds could be applied on an asset-by-asset basis, a transaction-by-transaction basis, or on an annual basis. A transaction-by-transaction basis is likely easiest to administer but allows for more gaming than an annual threshold (which would require more tracking). Treasury and the IRS can look to other reporting thresholds to determine an appropriate level. *See, e.g.,* sections 6041(a), 6050I(a), and 6050W(e).

[185] *See* White House Anti-Corruption Strategy, at 24.

[186] *See* Rev. Proc. 96-15, 1996-1 C.B. 627, section 4.01 (defining "art"); section 263A(h)(3) (defining "artist" and "photographer"); United States International Trade Commission, *Harmonized Tariff Schedule of the United States Revision 4* 97-3-97-4 (2022) (specifying what articles qualify as "works of art, collectors' pieces and antiques").

ensuring that all transactions that implicate similar tax evasion and money laundering risks are subject to similar reporting.[187]

In determining the scope of art market participants who are covered brokers, Treasury and the IRS should develop rules that minimize duplicative reporting while ensuring that as many covered transactions as possible are subject to reporting.[188]

Publicize closing agreements entered into by Associate Chief Counsel offices

Priority: Medium

The IRS regularly enters into closing agreements under section 7121 with taxpayers to dispose of issues related to their tax liability. Many closing agreements are entered into by the exam and appeals functions of the IRS. However, subject matter experts within Associate Chief Counsel ("ACC") offices periodically enter into closing agreements[189] that "interpret[] and appl[y] tax laws to a specific set of facts," in lieu of issuing PLRs that would be subject to disclosure rules under section 6110.[190] Use of closing agreements in lieu of PLRs to address the application of the law to particular sets of taxpayer facts prevents disclosure that could apprise other taxpayers or other stakeholders of potential IRS views of the law, including those that may contradict guidance or other public statements.[191] Although the dearth of information created by use of closing agreements instead of PLRs could potentially be addressed by announcements of IRS willingness to consider taxpayers' facts, the effectiveness of that possibility is hampered by inconsistency in the use or form of such announcements, as well as the lack of specificity provided by a full document setting forth the relevant law and the IRS's analysis thereof.

ACC offices should consider treating closing agreements that analyze the application of the law to taxpayer facts as constituting rulings subject to disclosure under section 6110.[192] If such a change is not undertaken, the Office of Chief Counsel ("OCC") should consider compiling and regularly releasing high-level information about closing agreements entered into by ACC offices. Such information should at least be sufficient to apprise the public of substantive topics on which the IRS is creating what would otherwise be private law and would ideally contain a high-level

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[187] Treasury and the IRS should also consider requiring broker reporting on other collectibles because collectibles present similar tax evasion and money laundering concerns as art and antiquities. If this recommendation is pursued, an administrable definition of "collectible" would need to be developed. *Cf.* section 408(m).

[188] Appropriate exceptions may be warranted, such as for certain charity auctions.

[189] *See* Internal Revenue Manual 32.3.4.1 and 32.3.4.2.

[190] *See* Treas. Reg. §§ 301.6110-1(a) and 2(a) and (d).

[191] *Cf.* Libin Zhang, *Double Taxation Trouble with Transition Tax*, Tax Notes Today Federal (December 2, 2019) ("If Treasury and the IRS have reconsidered their view … , it would be helpful for any relief to be provided in broadly available guidance, instead of case-by-case determinations that may result in disparate and unequal treatment of similarly situated taxpayers.").

[192] Such treatment would also permit disclosure of redacted versions of requests that led to such agreements. *See* section 6110(a) and (b)(2). By contrast, closing agreements and underlying documents generally may not be disclosed, although data that cannot be identified with a particular taxpayer may be released. *See* section 6103(b)(2)(D).

description of the legal position taken in the closing agreement and its relationship to existing guidance.

Revise guidance addressing extensions of time to make elections

Priority: Medium

Treas. Reg. §§ 301.9100-1 through -3 describe how a taxpayer can obtain an extension of time to make an election if it has missed certain deadlines ("9100 relief"). However, these regulations (and the PLRs granting extensions) do not clearly distinguish between the different types of 9100 relief. If the taxpayer intended to make the election and has filed consistently therewith, but simply failed to make the actual election, only 9100 relief should be necessary; no other adjustments are appropriate or required. On the other hand, if the taxpayer did not know about the availability or advisability of an election at the time it was due, the taxpayer likely has not filed consistently with the election having been made. Thus, 9100 relief should require that the taxpayer simultaneously but separately also obtain any other relief necessary, such as permission to change its accounting methods and adjust its attributes.[193] The failure to distinguish between the different types of 9100 relief has created significant administrative burden and facilitated inappropriate planning by well-advised taxpayers.

In addition, sophisticated taxpayers have used Rev. Proc. 2009-41[194] to inappropriately extend the period of time for making a CTB Election. The revenue procedure, which permits a missed CTB Election to be made up to three years and 75 days late if certain conditions are satisfied, departs from the general regulatory standards that prohibit a taxpayer from using hindsight in making the election.[195] Based on this difference, taxpayers have taken the position that Rev. Proc. 2009-41 supplants the applicable regulatory requirements. As the revenue procedure provides for 9100 relief without OCC review,[196] taxpayers have considerable latitude to liberally interpret the reasonable cause standard as well as other requirements.[197] Separately, although the IRS has informally announced that the hindsight prohibition is violated if 9100 relief is motivated by a change in law occurring after the due date for making the election,[198] it is not clear if that standard has been consistently applied.

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[193] *See, e.g.,* PLR 202037010 (July 17, 2020), supplementing PLR 201924005 (March 19, 2019).

[194] 2009-39 I.R.B. 439.

[195] Treas. Reg. § 301.9100-3(b), which conditions 9100 relief on the taxpayer acting "reasonably and in good faith," provides that a taxpayer that uses hindsight in requesting relief is deemed not to have acted reasonably and in good faith. *See* Treas. Reg. § 301.9100-3(b)(3). However, Rev. Proc. 2009-41 only requires "reasonable cause" for making the election. *See supra* footnote 194, at section 2.08. *Compare* Rev. Proc. 2003-33, 2003-1 C.B. 803.

[196] *See supra* footnote 194, at section 4.03.

[197] *See id.*, at section 4.01(2)(a)-(b) (requiring that either no return has been filed with respect to the entity or returns have been filed consistent with the election).

[198] *See* Nathan J. Richman, *TCJA Doesn't Justify Missed Election Relief*, Tax Practice Expert (July 1, 2019).

In the guidance announced in the 2021-2022 PGP,[199] Treasury and the IRS should (i) revise Treas. Reg. §§ 301.9100-1 through -3 (and the OCC should revise its PLR standards) to distinguish between the different types of 9100 relief and their ancillary requirements, (ii) revoke Rev. Proc. 2009-41 or revise it to ensure consistency with the general requirements of Treas. Reg. § 301.9100-3, and (iii) clarify the hindsight prohibition and its application in connection with changes in law.

Continue to improve FAQ practice and revise regulations to reflect FAQ policy

Priority: Low

The IRS issues frequently asked questions ("FAQs") to expeditiously address potential tax issues and concerns from taxpayers and to clarify the application of certain rules. In 2021, the IRS announced a new process for significant FAQs, under which such FAQs and later updates thereto will be announced in news releases, as well as dated and archived in separate fact sheets on IRS.gov.[200] The IRS also indicated that a taxpayer who reasonably relies on FAQs (whether subject to the significant FAQ process or not) in good faith will have a reasonable cause defense against any accuracy-related penalty, even if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case.

While this is an improvement on prior practice, the limited and relatively undefined scope of the new significant FAQ process continues to create potential burdens and confusion for taxpayers.[201] Furthermore, because the new significant FAQ process only applies to future FAQs, taxpayers are still subject to uncertainty concerning reliance with respect to older FAQs that have not been archived and may be subject to change without notice. There also remains potential for confusion about whether taxpayers acting in good faith will have a reasonable cause defense against accuracy-related penalties, because regulations indicate that reasonable cause may not exist where a taxpayer's knowledge conflicts with provided information.[202]

Accordingly, all future and still relevant pre-existing FAQs should be released and archived in a consistent manner, with changes over time in the pre-existing FAQs documented to the extent possible.[203] While developing a system for FAQs, consideration could also be given to developing a more taxpayer-friendly system for searching other guidance, including Internal

[199] *See* General Tax Issues, item 25.

[200] *See* Internal Revenue Service, IR-2021-202.

[201] *See* Marie Sapirie, *How to Improve the Archiving of FAQs*, Tax Notes Today Federal (February 22, 2022).

[202] *See* Treas. Reg. § 1.6664-4(b).

[203] *See also* Joshua D. Blank & Leigh Osofsky, *The Inequity of Informal Guidance*, 75 Vand. L. Rev. 1093, 1147 (2022) (similarly suggesting that "[i]n the interest of fairness and government transparency, the IRS should provide taxpayers with notice of changes that it makes to its informal guidance") and at 1153-1154 (noting that the focus on "significant" FAQs "will likely do little to help unrepresented taxpayers, who rely on a broad swath of informal guidance...because they lack the ability to access formal law"). Blank and Osofsky also suggest providing effective dates for FAQs and providing warnings when the law is unsettled or in conflict with an FAQ and explanations as to how and why an FAQ is changed. *See id.* at 1146-1147.

Revenue Bulletin guidance, on the IRS website.[204] Furthermore, the regulations should be updated to incorporate the concept of reasonable cause reliance on FAQs. While resource constraints are likely an important factor in determining how quickly some of these practical changes can be adopted, there may be substantial downstream savings in other parts of IRS operations if filers and advisors are able to more quickly identify and reasonably rely upon relevant FAQs or other guidance.

[204] *See also id.,* at 1147 (suggesting that "the IRS should... create a searchable database that taxpayers can use to research previous IRS statements."). *Cf. supra* footnote 201.