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August 5, 2010

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments Concerning Stripping Tax Credits and Notice 2010-28

Dear Commissioner Shulman:

Enclosed are comments concerning stripping tax credits and Notice 2010-29. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Stuart M. Lewis".

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
William Wilkins, Chief Counsel, Internal Revenue Service
Clifford J. Gannett, Director, Office of Tax Exempt Bonds, Internal Revenue Service
Stephen R. Larson, Associate Chief Counsel, Financial Institutions & Products, Internal Revenue Service
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**ABA SECTION OF TAXATION
COMMENTS CONCERNING STRIPPING TAX CREDITS
AND NOTICE 2010-28**

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by George G. Wolf of the Tax Exempt Financing Committee of the Section of Taxation. Substantive contributions were made by David J. Cholst, Dale S. Collinson, and Arthur M. Miller. The Comments were reviewed by Jeremy Spector, Committee Chair. The Comments were further reviewed by David Garlock, of the Section’s Committee on Government Submissions, and by Andrew J. Dubroff, Council Director for the Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: August 5, 2010

Stripping Tax Credit Bonds

Executive Summary

We want first to thank the Department of the Treasury (the “Treasury”) and the Internal Revenue Service (the “Service”) for the guidance provided in Notice 2010-28¹ (the “Notice”), concerning stripping transactions for Qualified Tax Credit Bonds (“QTCBs”), and in particular for adopting several of the suggestions in our comment letter dated October 29, 2009² (the “2009 Comment Letter”). These comments address issues raised in the Notice and make the following recommendations for further improvement:

1. Language describing the credits as “compounding quarterly” should be deleted.
2. The timing requirements for identification, especially for QTCBs issued before publication of the Notice, should be liberalized to any time before an actual stripping transaction.
3. The CUSIP requirement should be more precise and should be inapplicable to stripped credits and stripped bonds held by banks and other financial institutions which have a high rate of compliance in reporting income.
4. The proportional share rule might have significant unintended consequences and should be deleted or substantially narrowed.
5. The stripping rules of the Notice should be applied to Build America Bonds where a credit is allowed to the holder (so-called “Credit BABs”) but not to the issuer.
6. The information reporting requirements outlined in the Notice should be clarified.

¹ 2010-15 I.R.B. 541.

² See ABA Section of Taxation Comments, “Comments Concerning Stripping Tax Credits,” available at <http://www.abanet.org/tax/pubpolicy/2009/091029commentsconcerningstrippingtaxcredits.pdf>.

Comments

1. *Terminology.* Two examples in the Notice use the phrase “City X issues a qualified tax credit bond with a stated principal amount of \$12,000, a credit rate of 10% ***compounded quarterly***” (emphasis added).³

We do not believe that the use of the term “compounded” is appropriate in this context. We assume that the examples were drafted with the intent to provide that the bond has an annualized credit rate of ten percent, one-quarter of which is allowable on each credit allowance date. Because one-quarter of the annual credit is always allowable on each credit allowance date, we recommend deleting the reference to “compounded quarterly” because it is unnecessary and confusing.

2. *Timing of designation and reporting requirements.* Section 3.03(c) of the Notice sets forth the requirements for a “strippable issue” of QTCBs. Section 3.03(c)(1) requires the issuer to designate the QTCB as strippable on or before the issue date. Section 3.03(c)(2) requires the issuer to identify the QTCB as strippable on the first information return filed under section 54A(d)(3)⁴ with respect to the issue. Section 3.03(c)(1) provides that, for an issue of QTCBs issued before March 31, 2010, the designation and the identification can be made on or before May 17, 2010.

We understand the utility of the designation and identification requirements and believe it generally is appropriate to impose these requirements at the time the bonds are issued. However, we believe the Service has adequate safeguards against over-reporting of tax credits, and under-reporting of the associated income under section 54A(f), as long as the issuer makes the designation (and obtains the CUSIP numbers required by section 3.03(c)(4) of the Notice), and files the identification before any credit stripping actually occurs. Permitting this administrative flexibility would be particularly useful for bonds issued before the publication date of the Notice and could eliminate the potential for numerous section 9100 relief applications.

For example, prior to the publication of the Notice some QTCBs were issued without stripping mechanics built into the original documentation, at least in part because the issuer and its counsel were unsure whether the mechanics had to be included in the bond documentation or what form the mechanics should take. In such a situation, the issuer and its counsel may have anticipated that credit stripping transactions would take the form of prior interest coupon stripping transactions that were entirely implemented in the secondary market. Such issuers will likely require more time to consider the ramifications of the stripping designation and identification and may avoid the associated expense until requested by a holder.

³ See Notice §3.02(a)(4), Example 1, and §3.03(f), Example 1.

⁴ References to a “section” are to a section of the Internal Revenue Code of 1986 (the “Code”), unless otherwise indicated.

3. CUSIP requirements. Section 3.03(c)(4) of the Notice requires a strippable issue to obtain CUSIP numbers for the issue as a whole, for each credit allowance date, and for each right to receive cash.⁵

We also understand the need for requiring separate CUSIP numbers in administering the reporting of credits and the associated income. However, CUSIP numbers are traditionally assigned to bonds rather than to “issues,” but section 3.03(c)(4) of the Notice appears to require that a CUSIP number be obtained for each QTCB as a whole, as well as for each right to receive tax credits and each right to receive cash. Consequently, we recommend that the CUSIP requirements be clarified.

In addition, several QTCBs have been issued without CUSIP numbers, primarily to banks, where their investment tracking is affected by the presence or absence of CUSIP numbers. Because they have a generally high rate of compliance in reporting income, we recommend that the CUSIP requirement not apply to stripped credits held by banks (and other generally compliant financial institutions such as insurance companies).

4. Proportional allocation requirement. Section 3.03(d)(2) of the Notice sets forth the following requirements in order for a taxpayer holding a stripped credit to be allowed the credit:

The stripped credit coupon is either a whole credit coupon or a proportional share of a whole credit coupon. Thus, if a person holds any other division of a whole credit coupon, including any direct or indirect division or modification of a whole credit coupon effected through a partnership, trust, or other investment arrangement that, in substance, causes the person to hold a variable share of the whole credit coupon, then no tax credit is allowed with respect to that interest in the credit coupon. For example, if a person holds an interest in a partnership or a share of a trust that effects any division of a whole credit coupon held by the partnership or trust other than a proportional division, then that person (and any other person to whom the person directly or indirectly passes the credit) is not entitled to a tax credit with respect to the person’s allocable share or beneficial interest in that division of the whole credit coupon.

The scope of this proportional allocation requirement is unclear, but we believe it is intended to prevent the use of so-called tender option bond trusts (“TOBs”) to effect variable interests in credits similar to the creation of variable interests in coupon interest on regular tax exempt bonds.⁶ But the provision could inadvertently cover a wider range of business arrangements. For example, the profit-sharing percentages of many professional partnerships change from year to year, and are often established after the close of the partnership’s taxable year.⁷ Would such a variation violate this proportional requirement, or would it only be a problem if the variation in the credit allowance differs from the partners’ capital interests? Also, there is no indication of what happens to a

⁵ We assume this does not include a contingent right to receive cash in lieu of the credit if the bond loses its QTCB status.

⁶ See Rev. Proc. 2003-84, 2003-2 C.B. 1159.

⁷ See §761(c).

credit disallowed to any particular taxpayer under this provision. Does it revert to the holder of the principal strip?

We recommend that this proportional requirement be deleted. QTCBs would not be eligible for the simplified reporting permitted for TOBs because at least 95% of an electing partnership's gross income must be from tax-exempt obligations,⁸ while the deemed interest income on QTCBs is taxable.⁹ Further, we are unaware of any investment vehicles structured like TOBs that utilize regular partnership reporting.

Alternatively, we recommend that the rule be revised to permit partnerships (and comparable entities) to allocate credits in substantially the same proportions as allocations of other substantial items of income (in addition to section 54A(f) income), deduction, or credit, or to allocate credits in substantially the same proportions as the partners interests in partnership capital.

Finally, if no other simplifying amendments are adopted, we recommend that final guidance at a minimum clarify that the proportional allocation requirement is not intended to cover interest coupon stripping.

5. Extension of rules to Credit BABs. Section 5 of the Notice requests comments regarding the application of the Notice to Credit BABs.

We are not aware of any Credit BABs having been issued to date. But issuances might exist and might also arise in the future, especially if the BABs program is extended. Accordingly, we recommend that the Notice's rules for stripping the credits on QTCBs be applied to holders of stripping credits on Credit BABs. As described in our 2009 Comment Letter, the principles for stripping each kind of credit are substantially identical. Moreover, the definitions outlined in the Notice for stripping credits on QTCBs are readily applicable to Credit BABs, especially if our recommendations in these Comments are adopted.

6. Information reporting inconsistencies. Section 4 of the Notice describes certain information reporting requirements pertaining to tax credit stripping, and identifies areas where information reporting will or may be expanded. These information reporting requirements implicate systems capabilities that are better addressed by other professionals who are expert in reporting systems. However, there may be an inconsistency between statements in section 4.01 of the Notice, describing payments exempt from information reporting, and in section 4.04 of the Notice, describing the expected chain of information reporting for tax credits. Specifically, section 4.01 states:

Section 6049(b)(2)(B)(i) and section 6049(b)(4) generally exempt from information reporting interest that is paid to certain persons. Section 6049(d)(9)(B), however, generally makes this exemption inapplicable for interest on qualified tax credit bonds that is treated as paid to the following entities: (i) corporations; (ii) dealers in securities or commodities required to register under

⁸ See Rev. Proc. 2003-84. Section 4.02(1).

⁹ IRC 54A(f).

the laws of the United States, any State, the District of Columbia or any United States possession; (iii) real estate investment trusts (as defined in section 856); (iv) entities registered at all times during the taxable year under the Investment Company Act of 1940; (v) common trust funds (as defined in section 584(a); and (vi) trusts exempt from tax under section 664(c). Notwithstanding the preceding sentence, the exemption continues to apply to interest that is covered by an express regulatory exception.

Presumably the last sentence is referring to Regulation section 1.6049-4(c)(1)(ii)(O), excluding payments to nominees and custodians from information reporting.

The vast majority of registered state or local bonds are issued using the Depository Trust Corporation (“DTC”) as the nominal owner of the bonds. DTC itself, and each broker-dealer or other holder in a chain of ownership, is a nominee or custodian for the ultimate beneficial holder. Consequently, the only information reporting ordinarily required is by the last nominee or custodian to the beneficial holder. The requirement that stripped credits be held through a broker account¹⁰ appears to anticipate that the broker will provide the necessary information to beneficial holders and to the Service. Nevertheless section 4.04 of the Notice states:

Under section 6049, the IRS expects to publish a new form, Form 1097-BTC, to inform both the IRS and any recipient of a credit under section 54A of the amount of the tax credit that the credit recipient has received for each credit allowance date. ... It is anticipated that this form will be used in two distinct situations. First, it will have to be filed by, or on behalf of, the issuer. Second, a filing will also be required of each broker or intermediary that is not acting on behalf of the issuer (an independent intermediary).

As for the issuer requirement, the principles under section 6049(d)(4) are expected to apply to limit this requirement to the last responsible person or intermediary acting on behalf of the issuer.

The requirement for independent intermediaries is expected to apply whenever such an intermediary serves as an agent or nominee with respect to a credit or the intermediary receives a credit and passes it on either to another independent intermediary or to the taxpayer that will ultimately claim the credit. (Examples of independent intermediaries include a broker that is not reporting on behalf of the issuer, a partnership, a trust, an estate, and a regulated investment company or real estate investment trust that distributes tax credits with respect to its stock under section 853A or section 54A(h)).

Again, DTC will be the only holder known to the issuer (or the trustee acting for the issuer) in the vast majority of cases. We do not believe DTC is acting on behalf of the issuer. DTC is owned by its members and is acting on their behalf. Therefore, it appears that there generally will be no issuer filing requirement for Form 1097-BTC because no person serves in the role of “the last responsible person or intermediary acting

¹⁰ See Notice §3.03(d)(3).

on behalf of the issuer.” This result is appropriate. Nothing useful would result from an information return showing DTC as the recipient of a credit.

The second reporting requirement appears to contemplate that every broker in a chain will file information returns on Form 1097-BTC, even when its account holder is another custodian or nominee. This is in seeming contradiction to the foregoing suggestion that express regulatory exemptions to information reporting continue to apply. We believe that imposing reporting requirements on every broker would result in a substantial amount of duplicate reporting along the chain of intermediaries and achieve no benefit.¹¹ We believe that only the last broker in the chain should be required to provide information on the tax credits and associated interest income to beneficial holders and the Service.

We recommend that the information reporting requirements outlined in the Notice be clarified. We also believe that information reporting issues are best addressed by other professionals who are equipped to evaluate the capability of the reporting systems to comply with the requirements. We are happy to assist in any dialogue in which we could be helpful.

¹¹ To the extent that DTC is expected to be part of that chain, we understand that it does not file information returns under current income tax reporting rules; we caution that it might not be capable of doing so solely for the purpose of reporting tax credits. We recommend that the Service consult with DTC as to its reporting capabilities before imposing a new reporting requirement where it is merely a nominee owner and is clearly understood to be serving in that role.