May 16, 2012

The Honorable Emily S. McMahon  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Room 3120  
Washington, DC 20220

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

Re: Recommendations for 2012-2013 Guidance Priority List

Dear Ms. McMahon and Mr. Wilkins:

The American Bar Association Section of Taxation welcomes the opportunity to provide recommendations for inclusion in the 2012-2013 Treasury-IRS Guidance Priority List. These recommendations 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.

The enclosed list contains recommendations made by the members of various committees within the Section of Taxation. I hope you find the suggestions helpful as you formulate the new Priority Guidance List. The recommendations include items submitted by the following committees:

- Bankruptcy and Workouts  
- Capital Recovery and Leasing  
- Exempt Organizations  
- Partnerships and LLCs  
- Real Estate  
- Tax Exempt Financing  
- Teaching Taxation  
- U.S. Activities of Foreigners and Tax Treaties

We would be happy to discuss the recommendations with you or your staff, if that would be helpful.

Sincerely,

[Signature]

William M. Paul  
Chair, Section of Taxation

Enclosure
As requested in Notice 2012-25, the Section of Taxation of the American Bar Association has identified the following tax issues that we recommend be addressed through Regulations, rulings or other published guidance in 2012-2013. In each case, the name and contact information for a representative of the committee making the suggestion are provided.

**Bankruptcy and Workouts**
Ken Weil, Bankruptcy and Workouts Committee, 206-292-0060 weilkc@weilkc.com

1. Finalize regulations under section 108 regarding the treatment of disregarded entities.
2. Guidance as to when contingent liabilities are treated as liabilities for purposes of sections 108(d)(3) (insolvency) and 1017(b)(2) (limitation on basis reduction).
3. Guidance regarding the application of paragraphs (5) and (6) of sections 382(l)(5) to a consolidated group.
4. Guidance regarding the potential application of section 382(l)(6) to acquisitions of subsidiaries of bankrupt entities.
5. Guidance regarding the application of section 597 (and the regulations thereunder), taking into account changes in how failed bank transactions have been structured in recent years.

**CAPITAL RECOVERY AND LEASING**
Katherine M. Breaks, Capital Recovery and Leasing Committee, (202)533-4578, kbreaks@kpmg.com

1. Proposed Regulations under section 263(a) regarding the treatment of capitalized transaction costs in contexts such as stock acquisitions and tax-free reorganizations.

**EXEMPT ORGANIZATIONS**
Suzanne R. McDowell, Exempt Organizations Committee, (202)429-6209, smcdowell@steptoe.com

1. Guidance regarding the measurement and extent of political campaign activity by section 501(c) exempt organizations other than those exempt under subsection 501(c)(3), specifically including guidance concerning the application of reserved Regulation section 1.527-6(b)(3), “Expenditures allowed by Federal Election Campaign Act,” in light of the

---

3 354 F.3d 786 (8th Cir. 2004).
Citizens United v. Federal Election Commission, decision, which broadens the scope of activity that must be constitutionally permitted under FECA.

2. Guidance to clarify that borrowing in order to make charitable grants or to support charitable programs does not normally constitute acquisition indebtedness within the meaning of section 514(c), including examples clarifying the application of the "but for" and "reasonably foreseeable" tests under section 514(c)(1)(C) to situations in which a charity borrows to fund charitable programs or grants.

3. Update the definition of “control” in Regulation section 1.512(b)-1(I)(4) to conform to the changes made by the Tax Reform Act of 1997.6

4. Guidance regarding how to obtain a revised determination letter without the need for filing a new exemption application on Form 1023 or 1024, where there is a mere change in the form or state of incorporation (Rev. Rul. 67-390, 1967-2 C.B. 179, Case 4).

5. Guidance regarding when a member of a tax-exempt organization’s board of directors can be considered independent for purposes of the rebuttable presumption of Regulation section 53.4958-6 notwithstanding a financial relationship between the organization and the director or the director’s employer, under a de minimis standard or otherwise.

6. In addition to updating the regulations on group returns, which was included on the 2011-2012 Guidance Plan, update Rev. Proc. 80-27, 1980-1 C.B. 677, with respect to the process for applying for group exemptions.

7. Guidance regarding the application of section 501(m) and commercial-type insurance. Following the Supreme Court’s decision in Rush Prudential HMO, Inc. v. Moran,7 the Service’s withdrawal of its HMO audit guidelines in this area, and the expiration of the 18-month directive suspending the application of section 501(m) to HMOs, there is no guidance concerning the Service’s interpretation of section 501(m).

8. Guidance on the deductibility under section 170 of gifts made to a disregarded entity, the sole owner of which is an organization described in section 501(c)(3).

9. Guidance confirming that support from a non-U.S. governmental entity counts as public support in the same manner as support from a federal, state, or local governmental entity counts for purposes of the public support calculation under section 509(a).

10. Guidance under Sections 1441 and 861 through 863 for withholding on grants and other payments made by 501(c) organizations outside the U.S., including:

- Clarifying when a grant constitutes a gift upon which no withholding is required.

- Clarifying the consequences when grants involve travel to or from the United States.

---

5 558 U.S. 50 (2010).
PARTNERSHIPS & LLCs
Bahar Schippel, Partnerships and LLCs Committee, (602)382-6357, bschippel@swlaw.com

1. Clarification regarding the application of the codified economic substance doctrine in section 7701(o) to common partnership transactions.

2. Guidance regarding the application of Rev. Rul. 99-6,\(^8\) Situation 1, to (i) nonrecognition transactions and (ii) situations in which the terminating partnership has liabilities, section 751 property, or section 704(c) property.

3. Guidance clarifying and expanding the application of the current aggregation rules under section 704(c) for securities partnerships.

4. Guidance allowing securities partnerships that use an aggregation method for qualified financial assets under Regulation section 1.704-3(e) to treat basis adjustments under sections 734(b) and 743(b) as separate assets and to recover them under a reasonable method, rather than allocating the basis adjustments to particular partnership assets.

5. Guidance confirming that subpart F inclusions and qualified electing fund inclusions are qualifying income for purposes of section 7704 regardless of whether cash equal to such inclusions are distributed.

6. Items from 2011-2012 Guidance Plan that continue to be open such as regulations under the 2004 AJCA changes to sections 734, 743, and 755 and regulations on partnership options.

7. Guidance under section 751(b). Consideration should be given to splitting the guidance project into two parts, the first that updates the regulations to reflect the hypothetical sale approach to measuring shares of hot assets, and the second that adopts an exchange model that minimizes the recognition of capital gain in hot asset exchanges to the maximum extent possible.

8. Clarification of certain section 704(c) issues set forth in Notice 2009-70.

9. Guidance modifying or clarifying the application of Rev. Rul. 84-53, 1984-1 C.B. 159, and Regulation section 1.704-3(a)(7) to transfers of partial interests (i) in nonrecognition transactions and (ii) when the transferred interest and the retained interest are not identical.

10. Revoke or modify Regulation section 1.267(b)-1(b) to take into account the enactment of section 267(b)(10) in 1982, and the amendment of section 707(b)(1) in 1986.

11. Guidance suspending the enforcement of the anti-churning rules of section 197(f)(9) in the interests of sound tax administration.


\(^8\) 1999-1 C.B. 432.
\(^9\) 122 T.C. No. 17 (2004).
REAL ESTATE
Eliot L. Kaplan, Real Estate Committee, (602)528-4036, ekaplan@ssd.com

1. Revisions to Regulation section 1.514(c)-2. The Tax Section submitted comments on this topic on January 19, 2010.10

2. Guidance under section 108(c), with particular focus on definition of “secured by real property.”

3. Guidance regarding the determination of a partner’s insolvency and the application of Revenue Ruling 92-5311 in the context of discharged nonrecourse debt of a partnership.

4. Guidance regarding the treatment of cancellation of indebtedness income as “unrelated business taxable income” under section 512.

5. Guidance regarding treatment of an interest in a money market fund as a “cash item” under section 856(c)(4)(A) The Tax Section submitted comments on this topic on April 22, 2009.12

6. Revisions to Regulation section 1.856-5(c) addressing distressed debt acquisitions and modifications.

8. Guidance regarding preferential dividends under section 562(c) (extension of Private Letter Ruling 20110900313).

9. Guidance to address unresolved issues relating to stock dividends by REITs.

10. Final Regulations under section 460 relating to the home construction contracts exemption. The Tax Section submitted comments on this topic on April 27, 2009.14

11. Comprehensive guidance regarding transactions involving distressed debt.

12. Regulations providing that the five percent publicly traded FIRPTA stock test in section 897(c)(3) is applied to stock owned by partnerships at the partner level (rather than the partnership level).


13. Regulation Section 1.110-1(b)(3) adds a “purpose requirement” for the safe harbor that requires language be included in the lease that is quite specific and, for lessees unfamiliar with the regulations under Section 110, may well not be included in a lease. This issue is already addressed by the requirement under Regulation Section 1.110-1(b)(5) that the lessor claim depreciation deductions for the cost of the leasehold improvements which is intended to avoid the lessor and lessee reporting inconsistently. We recommend that Regulation Section 1.110-1(b)(3) be amended to expressly provide that, for purposes of “qualified lessee construction allowances” the lease agreement for the retail space does not require the express statement mandated by Regulation Section 1.110-1(b)(3).

14. Guidance under Regulation Section 1.267(b)-1(b)(1). We recommend the revocation of this regulation as it became obsolete when the related party rules under Section 707(b) were enacted.

15. Consider withdrawing Notice 2007-55 addressing the treatment of certain distributions under Section 897(h)(1).

16. Guidance regarding the treatment of a deemed loan arising in connection with prepaid rent under Section 467 (as well as deemed interest thereon) for purposes of Section 856.

17. Guidance indicating that publicly traded debt is treated as debt from a “qualified person” for purposes of Section 49(a)(1)(D) and Section 465, and consideration whether the term “qualified person” should include third party funds and single purpose loan vehicles.

**TAX EXEMPT FINANCING**

John Swendseid, Tax Exempt Financing Committee, (775)323-1980, jswendse@sah.com

1. Final Regulations on the allocation and accounting provisions of section 141.

2. Final Regulations on the public approval provisions of section 147.

3. Guidance on and expansion of the safe harbors for determining private use of management contracts for bond financed facilities through updates to Revenue Procedure 97-13.\(^{15}\)

4. Guidance on record retention requirements for tax exempt bonds and tax credit bonds, including safe harbor guidance regarding any records required to support the periodic returns required to be filed in the case of direct pay Build America Bonds, and other direct pay tax credit bonds.

5. Guidance with respect to arbitrage rules related to qualified hedge and yield reduction payments.

6. Guidance on the definition of “issue price” for tax-exempt bonds, Build America Bonds, and other direct pay tax credit bonds.

7. Guidance with respect to the financing of short-term and long-term working capital deficits.

\(^{15}\) 1997-1 C.B. 632.
8. Guidance on bond financing of grants. The Tax Section submitted comments on this topic on January 5, 2011.\textsuperscript{16}

**TEACHING TAX**  
Adam Chodorow, Teaching Tax Committee, (480) 727-8574, adam.chodorow@asu.edu

On May 5, 2010, the IRS published CCA 201021050, concluding that the federal tax treatment of community property, as set forth in *Poe v. Seaborn*,\textsuperscript{17} should apply to Registered Domestic Partners (RDPs) in California, effective beginning January 1, 2007. Specifically, the CCA stated that all community income, including compensation for personal services, should be split 50/50 between the two partners. These income splitting rules apply to RDPs in California, Washington, and Nevada, as well as to same-sex spouses in California (and presumably also in Washington once Washington’s marriage law takes effect).

Tax return preparers and legal advisors have now completed a tax season of reporting income based on the 2010 CCA and are well into the 2011 season. The experiences of these practitioners make it clear that further guidance on the effect of extending *Seaborn* to same-sex partners and spouses is needed.

The IRS has responded to some practitioner questions by issuing a document titled “Questions and Answers for Registered Domestic Partners in Community Property States and Same-Sex Spouses in California” – available on the IRS web page (hereinafter Q & A). This document provides useful guidance for taxpayers who are wrestling with the application of the community property rules, but, in our opinion, it is not sufficient to answer all of the questions. We believe additional guidance is required as follows:

1. Clarification regarding the substantive rules that apply to same-sex spouses or RDPs who are now required to report under the *Poe v. Seaborn* rules regarding community income and deductions, including the following:

   - Guidance about whether or not all deductions should be split 50/50 when they are paid with community funds even in cases where it is not clear that one of the partners would be entitled to the deduction that he or she paid.

   **Comment:** For example, one recurring question is how to treat mortgage interest and property taxes paid out of community funds, when the property is the separate property of one of the partners. Applying existing tax rules, one could justify splitting the deduction 50/50 in a number of different ways. For example, whenever community funds are used to pay for part of the purchase price of separate property the community either becomes a pro rata owner of the property or is entitled to a reimbursement for funds expended (state laws differ on this point). In either case, presumably the community holds a sufficient equitable interest in the property to justify allocating the payments made with community funds 50/50 to the partners who made the payments. Alternatively, early case law analyzing how *Seaborn* should be applied to allocate similar payments between spouses could serve as a guide. The Court of Appeals for the Ninth Circuit reasoned that the only fair result was to split all deductions paid out of

---

\textsuperscript{17} 282 U.S. 101 (1930).
community income 50/50 so that the deductions would match the 50/50 allocation of the income itself.\(^\text{18}\)

- Clarification about how the adoption credit should be treated if the expenses are paid with community funds.  
  **Comment:** See Q & A item 16 which does clarify that the credit may be split between RDPs and that it may not exceed the $13,170 limitation, but fails to address the issues that arise when the adoption expenses are paid with community funds. If the adoption is a joint adoption by both partners and the expenses are paid from community funds, then presumably the credit is split between the partners because each partner is deemed to have paid half the expenses. It is less clear what the result should be if only one partner adopts and the adoption expenses are paid out of community funds. If the *Newcombe* principle applies, then presumably each partner would be entitled to 50% of the credit amount.

- Confusion has arisen about the effect of the IRS position that self-employment income must be reported by filing a schedule C for each partner, even when one partner is not engaged in self-employment activities.  
  **Comment:** When a partner of a self-employed person reports Schedule C income, tax return software responds as though that person is actually self-employed and thus treats the income as earned income for other purposes. For example, taxpayers may be prompted to contribute to an IRA or SEP and are confused about their ability to do so. General principles need to be developed to clarify when community income of a non-employee or non-self-employed person will be treated as earned income for other purposes.

  **Additional comment:** Non-working partners who are receiving social security payments are worried that by reporting Schedule C income, their social security payments will be reduced. Social security benefits are reduced by a taxpayer’s wages and self-employment income.\(^\text{19}\) Self-employment income is defined, for social security purposes, in 42 U.S.C. §411, using exactly the same language as the tax provision defining self-employment income.\(^\text{20}\) As a matter of both theory and policy, allocation of Partner A’s self-employment income to Partner B should not reduce B’s social security payments because B is not working. But by requiring B to file a Schedule C and treat the income as his self-employment income under section 1402, it does seem as though B has self-employment income under the parallel social security provisions. If this is in fact the result for B (and most practitioners believe that the self-employment earnings should not be split to cause this result), that result needs to be publicly communicated so that taxpayers can plan around the potential loss of social security income.

\(^{18}\) See *Commissioner v. Newcombe*, 203 F.2d 128 (9th Cir. 1953) (allowing husband and wife to split 50/50 the alimony payment made in 1943 by husband to his ex-wife, using community funds; because current wife was viewed as making 50% of the payment, husband could not be treated as making the payment and was only entitled to a deduction for his 50%).

\(^{19}\) See 42 U.S.C. §403.

\(^{20}\) 26 U.S.C. §1402
Confusion has also arisen as to how opposite sex RDPs should be treated under the federal tax law. A clear statement of the applicable legal principles would be helpful to clarify this matter.

Comment: Registered Domestic Partnerships were created by certain states as an alternative to marriage. There are some important differences between registration and marriage. The legalization of the two different relationships is accomplished through different procedures, as is the dissolution of the relationships. However, substantive rules as to rights and responsibilities are the same. An informal letter from the Office of Chief Counsel responding to a request from a tax return preparer in the state of Illinois concludes that an Illinois civil union is to be treated as a marriage under federal tax law. That advice is now posted on the Illinois Department of Revenue web page. Most registered domestic partners of the opposite sex do not consider themselves to be in a marriage. If the federal tax law presumes that they are, then that is an important fact that needs to be communicated clearly in published authority. This same problem arises for partners in a civil union in states that recognize opposite sex civil unions. Both Illinois and Hawaii recognize opposite sex civil unions.

2. Additional guidance about the mechanics of how same-sex spouses and Registered Domestic Partners subject to community property laws ought to report their income, including the following. [Please note that most of these concerns would require making adjustments to computer programs or to forms. If such adjustments are not feasible, more prominent warning to taxpayers about these procedural problems would be helpful to those affected.]

- If partners/spouses use line 21 to reflect the required community property adjustment, is there any way to avoid audits of taxpayers who report line 21 amounts?
  Comment: Amounts reported on line 21 appear to be triggering a high number of automatic CP2000 letters and, in some cases, real audits. For example, taxpayers who split their wages on line 21 in their 2010 returns have received CP2000 letters assessing self-employment taxes and penalties even though neither partner had any self-employment income.

- Is there any way to make it possible for RDPs/same sex spouses in community property states to e-file?
  Comment: The primary barrier at the moment appears to be the fact that withholding must be split and that the IRS computers do not recognize this split even though it is authorized by CCA 201021050. Fixing this might require making some changes in Form 1040. One possibility would be to require each taxpayer to report the actual amount of tax withheld on that taxpayer’s W-2, but include an adjustment line for a community property adjustment.

- Creation of an IRS-approved community property spreadsheet for e-filing purposes would also be helpful.

21 See http://www.revenue.state.il.us/Individuals/Same-Sex-Civil-Unions.htm.
When taxpayers receive letters telling them they cannot split income because they are not married, it would be helpful to have some expedited process for reviewing and correcting these letters.

Comment: Many taxpayers received such letters when returns splitting community income were first submitted. Many of these were amended returns for earlier years. Practitioners have worked with IRS personnel, especially with the Office of the National Taxpayer Advocate, and the incidence of such letters has decreased. However, a number of taxpayers who have recently filed for 2011 are again receiving such letters. Preparers are spending an inordinate amount of time trying to get this problem fixed. It appears to be impossible to correct the problem by telephone, and, it takes weeks to correct the problem in written correspondence. As a result, taxpayers who were expecting early refunds are having to wait much longer for those refunds.

U.S. ACTIVITIES OF FOREIGNERS AND TAX TREATIES
Alan I. Appel, U.S. Activities of Foreigners and Tax Treaties Committee, (212) 541-2292, aiappel@bryancave.com

1. Guidance under sections 1471 through 1474 (“Chapter 4”) with respect to:
   - Certification requirements for foreign financial institutions (“FFIs”);
   - Coordination of withholding under sections 1441 through 1464 (“Chapter 3”) and Chapter 4;
   - Procedures to eliminate double withholding and minimize over- and under-withholding, especially with respect to pass-thru payments; and
   - Allocation of gross proceeds among beneficial owners by FFIs that are partners.

2. Guidance updating the “per se list” of Regulation section 301.7701-2(b) to address new entities such as the Colombian SAS and to consolidate all guidance into a single Regulation or Ruling.

3. Guidance for deferred compensation to individual expatriates under section 877A to:
   - Address double taxation of covered expatriates (nonresident aliens (“NRAs”)) receiving eligible deferred compensation for foreign services (i.e. U.S. tax on eligible deferred compensation deemed imposed under section 871, but no double tax relief for NRAs); and
   - Provide a procedure for a foreign payer to elect, under section 877A(d)(3)(A)(ii), to be treated as a U.S. person for purposes of the withholding obligation under section 877A(d)(1).

4. Guidance under section 7874 on the “substantial presence” test, ideally including one or more safe harbors.

5. Guidance regarding the estate and gift tax treatment of a non-resident alien’s interest in assets held through a partnership.
6. Guidance regarding claims of treaty benefits by a hybrid treaty entity (with, for example, a non-treaty owner) for non-fixed, determinable, annual or periodic income, such as:

- effectively connected income not attributable to a permanent establishment;
- reduced rate of, or exemption from, branch profits tax; and
- application of limitation of benefits provisions for the hybrid entity.