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Section of Taxation
NEWSQUARTERLY

Are Type III Supporting Organizations the New Private Foundations?

By Jocelyne C. Miller*

Recent legislation and an Advance Notice of Proposed Rulemaking (ANPR) issued by the Treasury Department seem to pull certain public charities effectively out of the public charity world and into the more restrictive world of private foundations. When the Pension Protection Act of 2006 (PPA) was enacted, Congress imposed new restrictions and hurdles upon public charities exempt from federal income taxes under section 501(c)(3) because they are described in section 509(a)(3)—the "supporting organizations." Supporting organizations are considered to be public charities not because of the money they receive from the public (*i.e.*, contributions, program service revenue, etc.), but rather because they maintain a particular type of relationship to an organization that is considered a public charity (or to certain other exempt organizations) because of the money that the "supported organization" receives from the public.

Arguably, the biggest change required of public charities by the PPA relates to the operations of supporting organizations classified as "Type III" by section 509(a)(3)(B)(iii). Type III organizations are operated in connection with one or more supported organizations. Unlike their Type I and Type II brethren, Type III organizations are not supervised or controlled by or in connection with the organizations they support. Rather, a lower threshold of supported organization participation in supporting organization operations has been required under the pre-PPA regulations still in effect.

The PPA directed the Treasury Secretary to issue new regulations under section 509 on payouts required by a subset of Type III organizations termed not functionally integrated (NFI). Functionally integrated (FI) Type III organizations, the other PPA created subset, are defined under the amended section 4943(f)(5) in the negative, as those not subject to the forthcoming payout requirements.

On August 2, 2007, the Service issued an ANPR under section 509 relating to Type III payout requirements and standards for differentiating NFIs from FIs. This notice shed light on current Service thinking, and that thinking is likely to appear in effective regulations. The notice indicated a significant shift towards applying many private foundation-type rules to Type III organizations.

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Stanley L. Blend*

Happy New Year! We hope that your holiday season was a happy and healthy one, and that the new year brings more of the same. If the past several months are any measure, we expect that the Section of Taxation will continue to be very busy.

Government Relations

On the legislative front, the Section submitted comments on H.R. 2834 to the House Ways & Means and Senate Finance Committees, analyzing the taxation of a carried interest. The comments were in response to the tax policy issues raised by the bill as it relates to the allocation of partnership income and the nature of compensation earned by managers of certain investment funds. Great thanks to Adam Cohen, Shelly Banoff, and Monte Jackel, the principal authors of the project, who did an outstanding job. The comments discuss the background on the current rules regarding the taxation of carried interests, and raise a number of areas that would require regulatory or other guidance should the pending legislation on character of income or gain from a carried interest be enacted. The comments also raise concerns that the legislative proposal increases the complexity of the tax system, and thereby would impose additional compliance burdens on both the Internal Revenue Service and taxpayers.

In addition, the Section filed comments on the amendments made to I.R.C. section 6694, which expands the penalties for tax return preparers and changes the standard for imposition of a penalty from “realistic possibilities of success” to “a reasonable belief that a position is more likely than not correct.” The Section expressed concern that this amendment was made without the benefit of a hearing process. The Section also raised the probability that these changes will significantly increase the cost to taxpayers for return preparation, and that it imposes a higher duty upon return preparers than upon taxpayers. Finally, the Section’s comments addressed several ambiguities in the legislation. The Section thanks Brian Skarlatos for coordinating the drafting of these comments and Michael Lang for his substantive contributions to the comments.

As you will note in the “Boxscore” section in the back of this issue, the Section continues to file a significant number of comments with the Internal Revenue Service and the Treasury Department. One submission, made with the Section of Health Law, provides comments on the redesigned Form 990, the annual filing form for tax exempt organizations. We received special thanks from the Commissioner’s Office for these comments and noted that most of our comments have been incorporated in the final Form 990.

In November, the Section conducted courtesy calls with the Assistant Secretary of the Treasury for Tax Policy, the Internal Revenue Service, and the Department of Justice Tax Division. The Section was well received, and government representatives at both Treasury and the Commissioner’s Office expressed gratitude for the substance of the comments filed by the Section, and our willingness to contribute on tax policy and tax administration issues.

Thomson Sponsorship

As 2007 drew to a close, I am also pleased to report that the Section and Thomson West and Thomson Tax and Accounting finalized an agreement to make Thomson West and Thomson Tax and Accounting a primary sponsor of the Section. We believe that this relationship will provide our members quick and easy access to the latest tax information. Our CLE materials will be made available through Thomson’s online resources and Section members will be able to access them for free from the Section’s website. In addition, our materials will be available to all Thomson subscribers and will be enhanced through online cross-referencing with the Code, Tax Court rulings, regulations, related legislation, and other sources. This is great visibility for the Section and for the valuable CLE materials that our members produce, and we appreciate Thomson’s generous support.

Section Outreach To Taxpayers

The Section produced two audio news releases which were sent to radio stations nationwide. One provided listeners information about whether they might be eligible for tax relief, if they face foreclosure on their home. The other provided information on tax relief for victims of the California wildfires. Both broadcasts were heard by millions of listeners.

Law Student Tax Challenge

The Law Student Tax Challenge (LSTC), coordinated by the Young Lawyers Forum, received more entries this year than ever before: 49 two-person teams of law school students and 23 teams of LL.M. students submitted answers to the tax problem. The growth of this contest has been phenomenal, largely due to the organization and commitment of the Young Lawyers Forum,

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* Oppenheimer, Blend, Harrison & Tate, Inc., San Antonio, TX.

Karen Gilbreath-Sowell

By Jasper L. Cummings, Jr. and Alan J.J. Swirski*

Karen Gilbreath-Sowell is Deputy Assistant Secretary of the Treasury for Tax Policy. She previously was co-head of the M&A Group at the E&Y National Tax Office. She served as chair of the ABA Tax Section Corporate Tax Committee.

Q You previously served in the Office of Tax Policy before your current appointment. Has the office changed?

A Obviously, the Administration is a different Administration and most of the players have changed, but in many ways the office is still the same. The Office of Tax Policy is a relatively small group of extremely talented people with common interests and goals. The primary goals are to set tax policy goals that make sense in the current environment and to execute upon those tax policy goals in the best way possible. We work closely with Secretary Paulson and with Congress. In addition, we work with the Internal Revenue Service to develop and execute a priority guidance plan.

Eric Solomon is truly a wonderful leader for the office. He is largely the reason that I decided to rejoin the Treasury Department. Eric and I have worked together in private practice and during my prior stint here at Treasury. Eric has made a significant contribution to the advancement of the tax system and I am very excited to be working with him again.

It is amazing how much goes on in this office, especially considering its size. Shortly after I came back to Treasury, my former partner Michael Mundaca joined us as the Deputy Assistant Secretary for International Tax. With the global nature of business, international tax plays a significant role in our tax system. The addition of Michael to the office is terrific. In September, we added eight lawyers and accountants to the staff: David Shapiro and John Harrell (International Financial Products), Jose Murillo, Itai Grinberg and Ginny Chung (International), Brandon Carlton (Accounting), Bill Evans (Benefits), and Emily Lam (Exempt Organizations and Individual). With this larger staff, we are energized and excited about executing upon the priority guidance plan, which contains over 300 items. In addition to the legal staff, there are approximately fifty economists who play a significant role in the work of the Office of Tax Policy, developing and estimating new proposals for improvements in the law. The economists generally tend to stay at Treasury longer than the lawyers and accountants, providing the office with great experience and institutional knowledge. When I was here before in a different role, my work with the economists was rather limited. Now, my interaction with the economists is almost daily, and what an education it has been!

One significant change since I was here before is that the environment that we all work in and practice in has changed dramatically as a result of changes to the regulatory system and changes in taxpayers' behaviors. For example, when I was here before the proliferation of corporate tax shelters was at its peak. We spent a lot of time trying to establish a system to address those issues properly and address the backlog of offensive transactions. Now we have a system in place to identify transactions that are offensive and we also have a system in place to guide taxpayers and their representatives as they give advice. With that backdrop, the system works a lot better, but there are still transactions that we are worried about. As you know, we continue to issue listed transaction notices. There is also a new category of transactions called "transactions of interest" that we are studying to determine whether they should become listed transactions. With this improved framework in place, we can address issues in a more measured manner and we have more time to work on normal course guidance.

Another significant development is that the regulatory environment has changed dramatically. The need for certainty is greater than it was before. FIN 48 guides the auditors, requiring a complex analysis of issues for purposes of determining reserves, and section 6694 increases the tax return preparer's standard to "more likely than not." These two developments are fraught with issues, many of which we are only beginning to understand. As a result, taxpayers and their representatives need more guidance. We are hoping to fill some of the many holes in the law, but the number of unanswered questions is limitless. We are working hard to prioritize and produce guidance to provide more certainty.

*Jasper L. Cummings, Jr., Alston & Bird LLP, Washington, DC, and Raleigh, NC, and Alan J.J. Swirski, Skadden, Arps, Slate, Meagher & Flom LLP, Washington, DC.

Q You recently told ALI-ABA that focusing on the U.S. business tax system was a priority of the Administration because other countries have reduced their business tax rates and made other changes in recent years. What does the Administration have in mind?

A Since coming to the Treasury Department, Secretary Paulson has stressed how we need to ensure that American businesses and American workers remain competitive in the 21st century global economy, and one important aspect to examine is our tax code. After the overhaul of our business tax system by the 1986 Act, many countries, including some of our major trading partners, followed our lead and have dramatically reformed their business tax codes. Yet, over the past twenty years we have stood still. As a result we now have one of the highest statutory tax rates in the world. So, we are concerned about the future of our U.S. businesses and whether they will be able to sustain their level of competitiveness.

If we don't assess whether we should change, we are fearful that we may lose our competitive edge. We are hoping to frame the debate and encourage further thinking so that business leaders, policymakers, Members of Congress, and the American people can come to a consensus on how we should deal with this important issue. To that end, we recently released a follow-up report to the discussions we started in July, when Secretary Paulson hosted a conference on *Global Competitiveness and Business Tax Reform* that brought together distinguished leaders and experts to discuss how the U.S. business tax system could be improved to make U.S. businesses more competitive. While this follow-up report did not make any specific recommendations, it instead discusses several broad approaches to reforming the U.S. business tax system.

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Q You have indicated that the Administration is studying a change to a territorial system for taxation of foreign business income with the principal stated reason being double taxation of foreign earnings. Why does the foreign tax credit system not work to prevent double taxation?

A In the work that we've been doing on looking at different areas of our business tax code and how they affect American competitiveness, an obvious issue is how we treat foreign earnings. Most of our major trading partners have some form of territorial tax system. So, as we've been looking at these issues through the lens of competitiveness, we've started to ask whether or not our current system needs changing.

There are three basic conceptual choices for taxing foreign source income: a full inclusion (or "worldwide") approach, a territorial approach, or the current U.S. approach that is a hybrid system. Under a territorial approach, a U.S. corporation would be subject only to local tax on income earned outside the United States. Thus, a U.S. corporation that owns a foreign subsidiary would not pay U.S. tax on the foreign subsidiary's income, even when the income is repatriated. There would be no foreign tax credit for the foreign taxes paid on exempt foreign income, and deductions of the U.S. company would be disallowed to the extent attributable to the exempt foreign income. There are a number of important issues that would need to be addressed in structuring a territorial system. These issues are critical to consider in deciding whether a territorial system is preferable. For example, what foreign income would be exempt? Which U.S. deductions would be treated as attributable to the exempt income and therefore nondeductible? Wouldn't there be enhanced pressure on section 482 in determining source of income and deductions? A territorial system has appeal as it would remove the perverse element of our current system that discourages repatriation of foreign earnings by requiring taxation when income earned offshore is brought back to the United States.

I suspect that companies have differing views about what the optimal U.S. system would be, depending on their situation. For example, companies that can utilize foreign tax credits from high tax countries would not benefit from a territorial system because currently those credits can be used to shield other types of income from tax. Others with substantial foreign active business income taxed at lower source country rates might benefit from a territorial system.

In your question you also suggest that our current system seems to work pretty well in preventing double taxation

because of the foreign tax credit regime. Around the margins there are things that could be done to improve our international system so that it works even better. The American Jobs Creation Act started down that path by addressing some of the features of the foreign tax credit regime that were not optimal. We are exploring other ideas to address inadequacies in our current international tax system that would better position our businesses in this global economy.

Q The Administration opposes the current Senate Finance Committee effort to "codify" the "economic substance doctrine." You have indicated that the opposition is based in part on the fact that the IRS does not need the help because it is already winning these cases. Isn't another consideration the fact that flexibility, or perhaps lack of clarity, of the doctrine generally works in the Service's favor?

A The Administration believes that the economic substance doctrine belongs in the purview of the courts. It is important that the doctrine remain flexible. Furthermore, the enactment of a strict liability penalty would have a harmful impact on the vitality of this important judicial doctrine. Depending upon what Code provision is at issue, different facts come into play. A court is in the perfect position to look at a specific provision and its purposes and identify what facts are relevant and important for assessing the issue. Regardless of what one may have thought about codification of economic substance when it was first introduced as an option, the landscape has changed quite a bit since that first introduction, including the fact that the IRS is winning in court. As we discussed in your first question, there is now an efficient system for identifying potentially abusive transactions. The overall system is working well. Further, there has been significant negative publicity for transgressing taxpayers, which also serves as a deterrent. Finally, FIN 48 has changed the landscape for reporting positions on financial statements. I believe codifying economic substance will upset the balance in the system.

Q The government has devoted tremendous effort to the continuity of interest regulations that deal with changes in value between the signing date and closing date. Does the government ever step back and ask whether continuity really matters once you drive down the required "level" to 40%?

A The basic question raised by the continuity of interest regulations is whether the target shareholders have maintained a sufficient ownership interest in the combined enterprise following an acquisition. Ten years ago when I was at Treasury, I was involved in the rather dramatic regulations package that rationalized the historic case law and administrative positions of the IRS. This significant project, led by a very talented lawyer at the IRS, Nelson Crouch, has made a terrific impact on the ability to have certainty in transactions. One aspect of that guidance was to confirm that if the target shareholders receive 40% equity in exchange for their stock, continuity is satisfied. This amount of equity remains sufficient, we believe, to distinguish between reorganizations that deserve tax deferred treatment and taxable sales. However, like any guidance, it didn't answer all the questions and the debate is shifted to new issues. Taxpayers and practitioners requested that we examine whether a practical rule could be written to provide taxpayers with certainty at the time they strike the deal, as opposed to the time the deal closes. They asked for guidance that would provide the 40% is measured at the signing date and not the closing date. That concept certainly has appeal, as stock prices can change dramatically between the signing date and closing date. The Treasury and IRS have been working on this signing date guidance for several years now, and the final regulations provide certainty for many taxpayers. It is still not quite right, however, as the permutations of facts seem limitless, rendering the regulations unusable by some taxpayers. We are considering now whether to replace the current mechanical rule with a more principles-based rule.

Q Our readers would be interested in knowing how often Office of Tax Policy officials meet with taxpayers to discuss tax issues of interest to them, and under what conditions the officials do so.

A As a general matter, we are very interested in hearing from taxpayers and practitioners. In fact, hearing from taxpayers and practitioners is essential, in many contexts, to our ability to issue appropriately targeted guidance and execute upon our tax policy goals. The Treasury attorneys and accountants generally work here for three or four years, so there are always people here with recent practical experience and insights. However, we are a small group and can't possibly keep up with everything that

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is going on in the marketplace. These meetings are important to help us determine our priorities and improve guidance that we have issued.

There are some constraints, however. First, we will not meet with taxpayers on issues that are under examination with the IRS or for which the taxpayer has a pending private letter ruling. In other words, we cannot be put in a position of interfering with the IRS' work. Outside these prohibited contexts, it is also very important that our discussions are not viewed as an "oral opinion" to support a taxpayer's position. In addition, when taxpayers or practitioners would like to meet about a proposed regulation, there are certain procedures that must be followed to ensure there is an open and public exchange of views. It is much better for the system that comments with respect to a proposed regulation are made as part of the public comment process, including the public hearing that is scheduled for each proposed regulation.

It is really important for policymakers and lawmakers, both present and future, to continuously examine our tax system to ensure we have the optimal system in place.

Q The Tax Reform Act of 1986 is generally thought to have been the most admirable piece of federal tax legislation since the 1954 Code. What elements do you think made that Act possible, and do you foresee similar forces coming together again during this Administration and is that the intent of this Administration?

A It is really important for policymakers and lawmakers, both present and future, to continuously examine our tax system to ensure we have the optimal system in place. We believe we have reached a critical point that requires serious reconsideration of our business tax system. As barriers to cross border movement of capital and products have been reduced, differences between our tax system and the systems in place in other countries become a greater factor in the success of our global companies. We need to think about what has changed in the world since 1986, and for that matter, the 1960s, when many of our international tax rules were put in place. Our work on competitiveness is a significant effort to bring attention to the issues, to try to build consensus around some of the issues, and to set the stage for change. Promoting an efficient business tax system is a high priority for Treasury, and we look forward to working with a broad range of groups to address this important issue. ■

NEWS BRIEFS

2008 NOLAN FELLOWS

The Tax Section congratulates the recipients of its 2007-2008 Nolan Fellows awards. The following six Nolan Fellows were recently honored at the Section's Midyear Meeting in Lake Las Vegas, NV.

- Megan L. Brackney, Kostelanetz & Fink, LLP, New York, NY
- William E. Hansen, McDermott Will & Emery, Washington, DC
- Sarah M. Johnson, Venable, LLP, Washington, DC
- Robb A. Longman, Joseph, Greenwald & Laake, P.A., Bethesda, MD
- Colleen M. O'Connor, Ernst & Young LLP, Herndon, VA
- Juan F. Vasquez, Jr., Chamberlain, Hrdlicka, White, Williams & Martin, Houston, TX

Named for the late Jack Nolan, a dedicated and respected Tax Section member, the distinction is awarded to young lawyers who are actively involved in the Section and have shown leadership qualities. Each one-year fellowship includes waived Section Meeting registration fees and assistance with travel to some Section Meetings. Congratulations to the new Fellows!

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The New World for Type III Supporting Organizations

The paragraphs below address the new environment for Type III organizations.

INFORMATION RETURN REQUIREMENTS

Like all supporting organizations, Type III organizations now must file annual Form 990 information returns with the Service regardless of their gross receipts. Similarly, all private foundations must file annual Form 990-PFs.

PAYOUT REQUIREMENTS

In the ANPR, the Service previewed the direction proposed regulations are expected to take on the payout requirements for Type III organizations, as well as on the distinction between FIs and NFIs. According to the notice, an FI will likely be required to meet an expenditure test resembling the qualifying distributions test under the minimum distribution requirement for private operating foundations. (Generally, 85% of the lesser of the FI's adjusted net income or its minimum investment return must be paid as qualifying distributions for the active conduct of exempt purposes, annually.) There also will be an assets test that will resemble the alternative assets test for private operating foundations (*i.e.*, requiring at least 65% of the value of the FI's assets to be devoted directly to the active conduct of exempt activities). The notice refers to "strong similarities" between FIs and private operating foundations; both are expected to actively conduct exempt activities as opposed to grant-making.

NFI organizations will likely be required to meet a payout requirement equal to the qualified distribution requirement of a private non-operating foundation (generally requiring an NFI to distribute an amount equal to at least 5% of the aggregate fair market value of all its assets "to or for the use of" its supported organizations).

Type III organizations failing to satisfy the proposed tests, when applicable, will likely be reclassified by the Service as private foundations for that taxable year and subsequent taxable years.

ABILITY TO RECEIVE DISTRIBUTIONS FROM PRIVATE FOUNDATIONS

NFIs are unlikely to receive distributions from non-operating private foundations because the distributions would not count as "qualifying distributions" under mandatory income distribution requirements. FIs are similarly unlikely to receive such distributions if a disqualified person with respect to the private foundation controls the FI. In addition to not being "qualifying distributions" under section 4942, distributions made to ineligible Type III organizations would subject any private foundation (operating or non-operating) to excise taxes under the taxable expenditure rules of section 4945 unless the private foundation exercised expenditure responsibility.

Likewise, private foundations (except for exempt operating foundations under section 4940) are unlikely to receive distributions from private foundations because such distributions are not qualifying distributions under section 4942. And, any such distributions made would subject the private foundation to the penalties of section 4945 unless expenditure responsibility was exercised.

EXCESS BENEFIT TRANSACTIONS

Any supporting organization, including a Type III organization, making grants or loans, paying compensation, or making similar payments to a substantial contributor has participated in an automatic excess benefit transaction under section 4958. Penalties imposed under section 4958 for automatic excess benefit transactions may not be avoided, even if the transaction parties can show that the transferred benefits were reasonable. The section 507 definition for substantial contributor applies for this purpose and it presently excludes any public charity that is not also considered a supporting organization under section 509(a)(3)—in other words, including any supporting organization in the automatic excess benefit trap. Note that a pending technical corrections bill would also exclude supported organizations exempt under sections 501(c)(4), 501(c)(5), or 501(c)(6) from the substantial contributor definition.

The excise taxes imposed for excess benefit transactions are 25% on the disqualified person and up to 10% on the management (with a management dollar limitation of $20,000 per transaction). If the transaction is not corrected within the taxable period, an additional 200% tax is imposed on the disqualified person.

In the private foundation world, by comparison, foundations are subject to the self-dealing rules of section 4941 for transactions comparable to those that result in the automatic section 4958 penalties described above. The self-dealing rules are based on a similar strict liability concept. However the penalties for self-dealing are actually lower than those imposed on the beneficiary under the excess benefit rules. Self-dealing excise taxes are imposed at 10% on the disqualified person, and at 5% on the management (with a dollar limitation of $20,000). If the transaction is not corrected within the taxable period, the disqualified person is subject to a 200% tax and the manager is subject to up to a 50% tax (subject to second $20,000 limitation).

The self-dealing rules have statutory exceptions for reasonable compensation (if the amounts are reasonable and necessary to carry out the private foundation's exempt purpose), and for providing disqualified persons (including substantial contributors) with goods, facilities, or services that it provides under the same terms, as an exempt activity, to the public. Presently, there is no indication that similar exceptions will be applied under the excess benefit rules.

EXCESS BUSINESS HOLDINGS

NFIs are treated like private foundations under the excess business holdings

rules. To apply these rules to an NFI, the term disqualified person generally has the same meaning as provided in section 4958. Also, a disqualified person is any organization that receives substantially all of its contributions from the same person or persons who made substantially all of the contributions to the supporting organization. Unwary NFIs may quickly find themselves subject to the second tier 200% tax on the excess holdings when they invest in entities alongside their supported organizations or other friendly organizations that are funded by the same persons.

GIFTS OR CONTRIBUTIONS FROM PERSONS RELATED TO THE SUPPORTED ORGANIZATION

Type III organizations lose this status if they accept gifts or contributions from persons (other than section 509(a)(1) or 509(a)(2) public charities) able to control the governing body of their supported organization. For example, individuals or entities with the power to appoint the supported organization's board of directors jeopardize public charity status for the supporting organization if they also make contributions to the supporting organization. If this occurs, the Type III organization would no longer qualify as "other than a private foundation" under section 509 and automatically becomes a private foundation beginning in the taxable year in which the gift or contribution was accepted.

It is really important for policymakers and lawmakers, both present and future, to continuously examine our tax system to ensure we have the optimal system in place.

Conclusion

A Treasury Department study on supporting organizations, mandated by PPA section 1226, was due in mid-August 2007. The study is late in coming and timing for its release was unknown when this article was written. The study will address the issue of charitable deductions for gifts to supporting organizations in general. At this time, the rules used to calculate available deductions are the same for public charities (including Type III organizations) and the private operating foundations that the Service finds "similar" to FIs. The deployment of non-operating foundation payout rules for NFIs by the PPA might signal a shift in the deductibility of contributions made to such organizations towards the rules applicable for non-operating foundations.

The new world of Type III supporting organizations orbits uncomfortably nearer to that of private foundations than that of public charities under the PPA and expected regulations. The price of Type III independence might be too steep for some entities, and different supporting organization structures, or, alternatively, private foundation status, may make more sense for some organizations. ■

Facade Easements Get a Facelift

By Monica D. Armstrong*

The Pension Protection Act of 2006 (PPA) includes changes to the charitable contribution rules that affect, either directly or indirectly, the facade easement deduction. One significant provision, PPA section 1213, amends the section 170(h)(4)(B) rules concerning donations of facade easements of certified historic property. As discussed below, these changes are designed to halt the longstanding abuse of facade easement deductions.

Background

In 1980, recognizing the importance of preserving America's historic structures, Congress enacted section 170(h). Generally, section 170(h) provides tax incentives for taxpayers who donate a facade easement, with respect to certain historic property, to a charitable organization. A facade easement, also called a historic preservation easement, is a legally binding agreement between a property owner and a charitable organization whereby the owner promises to protect the exterior of the building from destruction, damage, or improper alterations. In essence, the property owner is restricted from making any changes to the property's exterior that would compromise its historic character.

To be eligible for the deduction, the taxpayer must meet several requirements listed in section 170(h). First, the property to which the easement is subject must be a building that is either listed in the National Register or located in a registered historic district and certified by the Secretary of the Interior as having historical significance to the district. Second, the facade easement must be donated to a qualified charitable organization having the financial capability to enforce the easement's restrictions. Qualified charitable organizations would naturally include conservation or preservation organizations. Finally, the restrictions on the property must continue in perpetuity, thereby making all subsequent owners bound by the terms of the easement.

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Valuation Rules

The amount the taxpayer is entitled to deduct for giving up these fundamental property rights is the fair market value of the easement at the time of the donation. Treas. Reg. § 1.170A-1(c)(2) defines fair market value as "the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." In most cases, fair market value would be determined by comparing recent sales of facade easements that are similar to the donated easement. When Congress first created this tax incentive, however, there was no established market for facade easements, making it nearly impossible to apply the willing buyer/willing seller test. Treas. Reg. § 1.170A-14(h)(3) addresses that issue and provides that where there is no established market, the value of the facade easement may be determined indirectly as the difference between the fair market value of the property at its highest and best use immediately before and after the easement donation.

In using the "before and after" valuation method, the same regulations require that any local zoning, conservation, or historic preservation laws that were already in place at the time of the donation be taken into account in valuing the property. Such pre-donation restrictions could have a substantial impact on the value of the facade easement, rendering it of little or no worth. For example, no charitable deduction would be allowed to a taxpayer who donates a facade easement to a qualified charitable organization if already-existing local preservation laws prohibited him from changing the exterior of his home. On these facts, the taxpayer, as a result of the pre-existing law, had no property rights to give up, thereby rendering his facade easement worthless.

Valuation Abuses

Many appraisers did not follow these valuation directives. Instead, they routinely valued the facade easements at a flat percentage of 10%-15% of the property's value without any supporting analysis. When the permitted valuation methods were ignored, many facade easements were over-valued, resulting in taxpayers taking shockingly large deductions and receiving unwarranted tax breaks. Not surprisingly, the number of taxpayers donating facade easements increased as word spread about this tax windfall.

Congress first became aware of the widespread abuse of the facade easement deduction through a series of articles published in the *Washington Post* in 2003. In addition to reporting on the valuation problems, the articles also revealed that charitable organizations were not enforcing the easements. Some organizations even permitted donors to change the building's structure in a way that was inconsistent with the terms of the easement. A taxpayer could even donate just the front facade of a historic home and be entitled to a charitable deduction. Thus, the donor was not restricted from making major changes to other sections of the home's exterior that could potentially alter its historical qualities.

Congressional hearings to address the abuse were attended by preservation groups, appraisers, and the Service. All groups agreed that reforming the facade easement rules was necessary to prevent further misuse of the tax benefit.

Section 170(h)(4)(B)

Section 170(h)(4)(B), enacted in 2006, is designed to end abuses of the type discussed above. For example, taxpayers who contribute only a portion of the building's exterior will not receive a tax deduction. The contribution will not be considered "exclusively for conservation purposes," a prerequisite for the tax deduction. To qualify for a deduction, the facade easement restriction must preserve the whole building exterior—front, sides, rear, and height of the building. Section 170(h)(4)(B)(i).

Section 170(h)(4)(B)(i) also provides that the facade easement must sufficiently protect the historical character of the property. Consequently, no tax deduction is allowed unless the facade easement provides that the donor agrees to refrain from making changes to the exterior of the building that may adversely affect its historic character. If there is damage or destruction to the facade, the agreement must provide for repairing the exterior and returning it to its original historic appearance.

Section 170(h)(4)(B)(ii) responds to the failure of some charitable organizations to enforce the easement when the donor did something inconsistent with the character of the building. Section 170(h)(4)(B)(ii) requires the donor to execute a written agreement with the donee organization, stating under penalty of perjury, that the donee organization is one with its purpose being to preserve historic buildings, that it is financially sound enough to manage and enforce, if necessary, the easement restrictions, and that it is committed to such enforcement. Failure of the easement-holding charitable organization to enforce the conservation restriction will result in severe penalties for the organization.

Finally, section 170(h)(4)(B)(iii) requires the taxpayer to include with his or her return a copy of an appraisal of the facade easement. The facade easement must be appraised by someone who has been designated by a professional appraiser organization as qualified to appraise facade easements and regularly conduct such appraisals. The donor must also include a picture of the exterior of the building and describe the restrictions to which he or she is subject. If the charitable contribution deduction with respect to the facade easement exceeds $10,000, section 170(f)(13) requires that the donor also include a $500 filing fee, which the Service will use for enforcement purposes. ■

Proposed Regulations Regarding Property Distributions Following Assets-Over Partnership Mergers

By Joseph Vetting, Matthew Belcher, and Glenn E. Mincey*

On August 22, 2007, the Service published proposed regulations (the "Proposed Regulations") addressing property distributions following "assets-over" partnership mergers. 72 Fed. Reg. 46932 (Aug. 22, 2007), as amended in 72 Fed. Reg. 62608 (Nov. 6, 2007). The Proposed Regulations implement the principles articulated in Rev. Rul. 2004-43, 2004-1 Cum. Bull. 842. The Proposed Regulations are intended to be effective for partnership distributions of property after January 19, 2005, for property contributed in assets-over mergers after May 3, 2004.

Background

When two partnerships merge under the assets-over form, one partnership (the "transferor partnership") is treated as contributing all of its assets and liabilities to the other partnership (the "transferee partnership"), followed by a distribution of the interests in the transferee partnership in liquidation of the transferor partnership.

Under section 704(c)(1)(A), a partnership generally must allocate income, gain, loss, and deduction with respect to property contributed by a partner to the partnership with a fair market value different from the contributing partner's tax basis ("section 704(c) property") so as to take into account such variation between the adjusted tax basis of the property and its fair market value at the time of contribution. A simple example illustrates this rule. If A contributes property ("Property A") with fair market value of $100 and an adjusted basis of $0, and B contributes property ("Property B") with a fair market value and adjusted basis of $100 to the equal AB partnership, and AB sells Property A for $100, then AB must allocate the entire $100 gain to A.

The "anti-mixing bowl" rules of sections 704(c)(1)(B) and 737 generally are intended to prevent taxpayers from avoiding section 704(c) allocations by distributing section 704(c) property from partnerships instead of selling such property. Section 704(c)(1)(B) provides that if a partner contributes section 704(c) property to a partnership, and the partnership distributes that property to a partner other than the contributing partner within seven years of the contribution, the contributing partner must recognize gain or loss in an amount equal to the gain or loss that would have been allocated to the contributing partner under section 704(c) if the distributed property had been sold by the partnership for its fair market value at the time of the distribution. Thus, continuing the example from above, if instead of selling Property A, AB distributes Property A to B within seven years of A's contribution, A would recognize $100 of gain upon that distribution.

Section 737(a) provides that if a partner contributes built-in gain section 704(c) property to a partnership and receives a distribution of property (other than money) within seven years of its contribution, that partner must recognize gain in an amount equal to the lesser of (1) the excess (if any) of (A) the fair market value of property (other than money) received in the distribution over (B) the adjusted basis of the partner's interest in the partnership immediately before the distribution reduced (but not below zero) by the amount of money received in the distribution, or (2) the "net precontribution gain" of the partner (as defined in section 737(b)). Further continuing the example above, if AB distributes Property B to A within seven years of A's contribution, and A's adjusted basis in A's interest in AB is $0 at the time of the distribution, A would recognize $100 of gain.

Rev. Rul. 2004-43 addressed the application of sections 704(c)(1)(B) and 737 in an assets-over partnership merger, reaching the following conclusions (emphasis added):

- With respect to any property that had been contributed to either the transferor partnership or the transferee partnership *before* the merger, the seven year periods of the anti-mixing bowl rules do not

When two partnerships merge under the assets-over form, one partnership (the "transferor partnership") is treated as contributing all of its assets and liabilities to the other partnership (the "transferee partnership"), followed by a distribution of the interests in the transferee partnership in liquidation of the transferor partnership.

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restart with regard to the remaining section 704(c) gain or loss in such property at the time of the merger.

- Section 704(c)(1)(B) does apply, however, to *newly created* section 704(c) gain or loss in property contributed by the transferor partnership to the transferee partnership in an assets-over partnership merger.
- For purposes of section 737(b), net precontribution gain includes *newly created* section 704(c) gain or loss in property contributed by the transferor partnership to the transferee partnership in the merger.

The first conclusion was a straightforward application of Treas. Reg. §§ 1.704-4(c)(4) and 1.737-2(b). The other conclusions, however, were viewed as controversial. In fact, individual members of the Section of Taxation's Committee on Partnerships and LLCs submitted comments arguing that the principles of Rev. Rul. 2004-43 were inconsistent with the existing regulations under sections 704(c)(1)(B) and 737, and that the conclusions contained in the ruling should not be applied retroactively. 2004 TNT 135-29. The AICPA submitted comments to the same effect. 2004 TNT 174-18. In response to these comments, the Service indicated in Notice 2005-15, 2005-1 Cum. Bull. 527, which revoked Rev. Rul. 2004-43, that it would propose new regulations implementing the principles of the ruling.

The Proposed Regulations

Like the current regulations, the Proposed Regulations provide that, in an assets-over merger, sections 704(c)(1)(B) and 737 do not apply to the transfer by the transferor partnership of all of its assets and liabilities to the transferee partnership, followed by a distribution of the interests in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement.

Consistent with Rev. Rul. 2004-43, however, the Proposed Regulations provide that section 704(c)(1)(B) applies to a subsequent distribution by the transferee partnership of section 704(c) property contributed in the assets-over merger by the transferor partnership to the transferee partnership. The Proposed Regulations also provide that section 737 applies when a partner of the transferor partnership receives a post-merger distribution of property (other than money) from the transferee partnership.

The Proposed Regulations provide that the seven-year period will not restart with respect to the "original section 704(c) gain or loss" as a result of the merger. For this purpose, the amount of "original section 704(c) gain or loss" is the difference between the property's fair market value and the contributing partner's adjusted basis at the time of contribution to the transferor partnership (the "original contribution") to the extent such difference has not been eliminated by section 704(c) allocations, prior revaluations, or in connection with the merger. Accordingly, a subsequent distribution by the transferee partnership of property with original section 704(c) gain or loss is subject to sections 704(c)(1)(B) and 737 if the distribution occurs within seven years of the original contribution. With respect to new section 704(c) gain or loss (*i.e.*, gain or loss in excess of original section 704(c) gain or loss), however, the Proposed Regulations provide that the seven-year period in sections 704(c)(1)(B) and 737 begins on the date of the merger. Thus, a subsequent distribution by the transferee partnership of property with new section 704(c) gain or loss is subject to sections 704(c)(1)(B) and 737 if the distribution occurs within seven years of the merger. The Proposed Regulations note that they do not address the impact of section 704(c)(1)(C), added by the American Jobs Creation Act of 2004, relating to built-in loss embedded in contributed property. The Service notes that the regulations, when finalized, will clarify the application of section 704(c)(1)(C) to the rules in the Proposed Regulations.

The Proposed Regulations further provide that no original section 704(c) gain or loss will be recognized under section 704(c)(1)(B) or section 737 if property that was originally contributed to the transferor partnership is distributed to the original contributor. If property has new section 704(c) gain or loss, then a subsequent distribution of such property within seven years of the merger to one of the former partners of the transferor partnership is subject to section 704(c)(1)(B) only to the extent

The Proposed Regulations also provide that if less than all of a particular section 704(c) property is distributed by the transferee partnership, then a proportionate amount of original and new section 704(c) gain or loss must be recognized under section 704(c)(1)(B).

The objective of the Service and Treasury in issuing the Proposed Regulations is to provide consistency under the anti-mixing bowl rules with regard to the different layers of section 704(c) gain or loss that can exist or be created as a result of an assets-over partnership merger.

of the other former partners' shares of that gain or loss.

Under the Proposed Regulations, new section 704(c) gain or loss must be allocated among the partners of the transferor partnership in a manner consistent with the principles of Treas. Reg. § 1.704-3(a)(7) (regarding transfers of partnership interests) and newly designated § 1.704-3(a)(10) (regarding tiered partnerships; previously Treas. Reg. § 1.704-3(a)(9)). In addition, the partners of the transferor partnership are deemed to have contributed an undivided interest in the assets of the partnership. The Proposed Regulations provide that the determination of the partners' undivided interests for this purpose is to be made by the transferor partnership using any reasonable method. The Service requested comments on methods that should be considered reasonable for this purpose.

The Proposed Regulations also provide that if less than all of a particular section 704(c) property is distributed by the transferee partnership, then a proportionate amount of original and new section 704(c) gain or loss must be recognized under section 704(c)(1)(B). Similarly, if gain is required to be recognized under section 737, the Proposed Regulations provide that a proportionate amount of original and new section 704(c) gain must be recognized.

The Proposed Regulations further provide a rule regarding subsequent partnership mergers. This rule provides that, if the transferee partnership is subsequently merged (a "subsequent merger"), the new section 704(c) gain or loss that resulted from the first merger is subject to section 704(c)(1)(B) for seven years from the time of the original merger, and the new section 704(c) gain or loss that resulted from the subsequent merger will be subject to section 704(c)(1)(B) for seven years from the time of the subsequent merger.

In addition, the Proposed Regulations provide an identical ownership exception and a *de minimis* change in ownership exception to sections 704(c)(1)(B) and 737 with regard to assets-over partnership mergers. Under the identical ownership exception, section 704(c)(1)(B) will not apply to, and section 737 net precontribution gain will not include, new section 704(c) gain or loss in any property contributed in an assets-over partnership merger where the ownership of both partnerships is identical. For merging partnerships to qualify for the identical ownership exception, each partner must own identical interests in section 704(b) book capital and in each item of income, gain, loss, deductions and credit, and identical shares of distributions and liabilities in each of the transferor and transferee partnerships. According to the preamble to the Proposed Regulations, where ownership of both partnerships is identical, the merger more accurately represents a mere change in form, and should have no substantive tax consequences. The same principles apply where the change in ownership is *de minimis*. For purposes of the *de minimis* exception, a difference in ownership is *de minimis* if 97% of the interests in section 704(b) book capital, items of income, gain, loss, deductions and credit, and shares of distributions and liabilities of the transferor partnership and transferee partnership are owned by the same owners in the same proportions.

The Proposed Regulations provide rules for the transferee partnership to follow when making allocations under section 704(c)(1)(A) with respect to the property contributed by the transferor partnership. With respect to original section 704(c) gain or loss, the transferee partnership may continue to use the section 704(c) allocation method adopted by the transferor partnership or may adopt another reasonable section 704(c) method. The transferee partnership may adopt any reasonable section 704(c) method with respect to new section 704(c) gain or loss.

Conclusion

The objective of the Service and Treasury in issuing the Proposed Regulations is to provide consistency under the anti-mixing bowl rules with regard to the different layers of section 704(c) gain or loss that can exist or be created as a result of an assets-over partnership merger. It is clear, as is often the case with rulemaking, that the Service and Treasury have made certain policy decisions based upon administrative feasibility. Although questions remain, we believe that they have presented the foundation for a well-constructed and administrable framework. ■

The Selective Enforcement Defense in Civil and Criminal Tax Cases

By Steve R. Johnson*

A recognized defense in non-tax prosecutions, both federal and state, is that the Government discriminatorily and invidiously targeted the defendant. Although it fails far more often than it succeeds, the defense has been accepted in many non-tax cases. *See, e.g.*, Annotation, *What Constitutes Such Discriminatory Prosecution or Enforcement of Laws as to Provide Valid Defense in Federal Criminal Proceedings*, 45 A.L.R. Fed. 732 (1979, as currently revised). The defense is constitutional in nature, implicating the Equal Protection and Due Process guarantees.

The selective enforcement defense often has been essayed in civil and criminal tax cases as well. This article discusses the defense in three contexts: criminal tax prosecutions; civil tax audits and litigation; and settlement of civil tax cases. A related issue—whether there is a subconstitutional, judicially enforceable duty of consistency on the Service—is beyond the scope of this article. Recent discussions of this possible duty include Stephanie Hoffer, *Hobgoblins of Little Minds No More: Justice Requires an IRS Duty of Consistency*, 2006 Utah L. Rev. 317, and Christopher M. Pietruszkiewicz, *Does the Internal Revenue Service Have a Duty to Treat Similarly Situated Taxpayers Similarly?,* 74 U. Cin. L. Rev. 531 (2005).

Criminal Tax Prosecutions

A frequently cited section 7205 (false withholding information) opinion stated: "It is fundamental that selectivity in the enforcement of criminal laws is subject to constitutional constraints. Nevertheless, the conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation so long as the selection was [not] deliberately based upon an unjustifiable standard . . . . [T]here is a presumption that prosecution for violation of the criminal law is in good faith." *United States v. Amon*, 669 F.2d 1351, 1355-56 (10th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982) (citations and some punctuation marks omitted).

More particularly, "[t]o support a defense of selective or discriminatory prosecution, a defendant bears the heavy burden of establishing, at least prima facie, (1) that, while others similarly situated have not generally been proceeded against because of conduct of the type forming the basis of the charge against him, he has been singled out for prosecution, and (2) that the government's discriminatory selection of him for prosecution has been invidious or in bad faith, i.e., based upon such impermissible considerations as race, religion, or the desire to prevent his exercise of constitutional rights." *United States v. Berrios*, 501 F.2d 1207, 1211 (2d Cir. 1974).

Selective enforcement defenses appear in scores of criminal tax cases arising in a wide variety of contexts. For example, too many lawyers and accountants have a less-than-enviable record of tax compliance, and the Service episodically launches enforcement initiatives directed at these groups. Two Iowa C.P.A.s who had been convicted of willful failure to file under section 7203 challenged on appeal their prosecution under the Service's Project ACE, which gave (at the time) "special priorities" to prosecuting tax crimes of attorneys, accountants, and enrolled agents in light of their special roles and responsibilities in our tax system. The appeal failed. The circuit court concluded: "Project ACE was based upon a rational classification and was not to be administered so as to accomplish purposefully some infringement of [the C.P.A.s'] constitutional rights." *United States v. Swanson*, 509 F.2d 1205, 1210 (8th Cir. 1975).

The difficulty proponents of the defense face is illustrated by the *Amon* case cited above. The defendant was an outspoken tax protestor. Evidence was presented "tending to show that the IRS has a formal policy of prosecuting individuals who are outspoken in their criticism of federal income tax laws." 669 F.2d at 1356 n.5. Indeed, the district court specifically found, and the circuit court agreed, that "the defendant has been selected for prosecution because he is an active and outspoken protestor." 669 F.2d at 1356. For one of the circuit judges, such selection was based on the defendant's exercise of his First Amendment rights, so was impermissible. *Id.* at 1363 (McKay, J., dissenting). The other two panel judges, however, rejected the defense.

There are, however, occasional taxpayer-defendant victories. In one case, the taxpayer was convicted under section 7206(1) of making false tax returns. She was an attorney who had sued her former employer, the EEOC, for sex discrimination. The appellate court held that she was entitled to pursue discovery as to her claim that she had

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been selectively and vindictively prosecuted because of her suit against the EEOC. The taxpayer's prima facie showing included the fact that taxpayers who voluntarily amended their returns and paid their deficiencies rarely were prosecuted and testimony by a former Special Agent that the Service typically handles such cases civilly, not criminally. *Adams v. United States*, 870 F.2d 1140 (6th Cir. 1989).

Adams' victory was only temporary, however. On remand, the district court held both a nonevidentiary hearing and an evidentiary hearing involving 16 witnesses over three days. In a 28-page opinion, the district court weighed the evidence and held against the taxpayer's defense. *United States v. Adams*, 832 F. Supp. 1138 (W.D. Tenn. 1993), *aff'd per curiam*, 38 F.3d 1217 (6th Cir. 1994), *cert. denied*, 514 U.S. 1066 (1995).

Civil Tax Audits and Litigation

Taxpayers sometimes challenge Service deficiency notices on selective enforcement grounds. In analyzing such challenges, the Tax Court and other courts have imported from criminal cases the two-part standard described above.

For example, in a leading civil selective enforcement case, the taxpayer corporation argued that the Service "in [its] approach to and conduct of audits, settlement discussions, and litigation involving the issue of deductibility of reasonable compensation paid to shareholder-employees of closely held corporations has practiced invidious discrimination to the extent that [the corporation's] rights to equal protection and due process of law have been violated." *Penn-Field Inds., Inc. v. Commissioner*, 74 T.C. 720, 720 (1980). The corporation argued that, on this issue, the Service "practiced invidious discrimination against it, in particular, and against small closely held corporations in general." *Id.* at 723.

The corporation sought to conduct discovery in support of its claim of discriminatory enforcement. However, the court granted the Service's motion for a protective order under Tax Court Rule 103 because the interrogatories were unduly burdensome and irrelevant. The corporation was not entitled to discovery prior to establishing a colorable claim under the two-part standard, which the corporation had failed to do. *Id. See also United States v. Kahl*, 583 F.2d 1351, 1354-55 (5th Cir. 1978).

Among the most famous of the civil tax cases involving selective enforcement is *Hernandez v. Commissioner*, 490 U.S. 680 (1989). The Service disallowed claimed section 170 charitable contribution deductions for payments to the Church of Scientology. The Scientologists claimed that the payments were not essentially distinguishable from payments to other churches which the Service had allowed as deductions. The *Hernandez* dissent accepted this discrimination argument. *Id*. at 707-13 (O'Connor, J., dissenting). The *Hernandez* majority avoided the argument on the disingenuous ground that the record was insufficiently developed to allow comparison of the various payments. *Id.* at 700-03. The discrimination argument has continued to be troubling in post-*Hernandez* section 170 cases. *E.g., Sklar v. Commissioner,* 282 F.3d 610, 618-20 (9th Cir. 2002); *Powell v. United States*, 945 F.2d 374, 377-78 (11th Cir. 1991); *Sklar v. Commissioner*, 125 T.C. 281, 298-99 (2005).

Among the most famous of the civil tax cases involving selective enforcement is *Hernandez v. Commissioner*, 490 U.S. 680 (1989). The Service disallowed claimed section 170 charitable contribution deductions for payments to the Church of Scientology.

Civil Tax Settlements

As noted above, one aspect of the *Penn-Field* case entailed settlements. In another case, the taxpayer conceded deductions he had claimed through many tax shelters but wanted deductions for cash invested in the shelters. The taxpayer maintained that the Service had discriminatorily denied such a settlement to him while granting it to others. The court rejected the contention, holding that the taxpayer had satisfied neither of the two parts of the test. *Fresoli v. Commissioner*, T.C. Memo. 1988-384 (involving tax years preceding the effectiveness of the TEFRA unified partnership audit rules, including the consistent settlement provision in section 6224(c)(2)). *See also Estate of Campion v. Commissioner,* 110 T.C. 165 (1998), *aff'd in unpub. op. sub nom. Tucek v. Commissioner*, 198 F.3d 259 (10th Cir. 1999), *and aff'd in unpub. op. sub nom. Drake Oil Tech. Partners v. Commissioner*, 211 F.3d 1277 (10th Cir. 2000), *cert. denied*, 531 U.S. 875 (2000). For a selective enforcement settlement case outside the shelter context, see *Bunce v. United States*, 28 Fed. Cl. 500 (1993), *aff'd per curiam*, 26 F.3d 138 (Fed. Cir. 1994), *cert. denied*, 513 U.S. 1043 (1994). ■

Notice 2007-69 Grants Temporary Relief for Plans Needing to Amend Definition of Normal Retirement Age

By Barbara E. Ruiz-Gonzalez*

2007 Regulations

On May 22, 2007, the Service issued final regulations relating to distributions from a pension plan upon attainment of normal retirement age. T.D. 9325, 72 Fed. Reg. 28606 (May 22, 2007). These final regulations modified Treas. Reg. § 1.401(a)-1 by adding new paragraphs (b)(2)-(4) and amending paragraph (b)(1). Amendments were also made to Treas. Reg. § 1.411(d)-4. This article focuses on the final regulations relating to normal retirement age.

Treas. Reg. § 1.401(a)-1(b)(2)(i) requires that a qualified pension plan's normal retirement age must be "an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed." Treas. Reg. § 1.401(a)-1(b)(2)(ii) establishes a safe harbor normal retirement age of 62 for qualified pension plans, and § 1.401(a)-1(b)(2)(v) establishes a safe harbor age of 50 for qualified public safety employees. (The latter safe harbor is beyond the scope of this article.) If a pension plan's normal retirement age is between ages 55 and 62, facts and circumstances will determine whether such age is reasonably representative of the typical retirement age for the industry. Treas. Reg. § 1.401(a)-1(b)(2)(iii). If the plan's normal retirement age is under age 55, it is presumed that such age is not representative of the typical retirement age for the industry unless the plan sponsor can prove otherwise. Treas. Reg. § 1.401(a)-1(b)(2)(iv).

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Notice 2007-69

The regulations were generally made effective May 22, 2007. In response to concerns expressed by practitioners, plan sponsors and industry groups, the Service delayed the effective date for pension plans with a normal retirement age lower than age 62 provided such plans meet certain requirements. *See* Notice 2007-69, 2007-35 I.R.B. 468 (the "Notice"), released on August 10, 2007.

The Notice serves three functions:

- provide temporary relief, until the first day of the first plan year that begins after June 30, 2008, for certain pension plans under which the definition of normal retirement age may be required to be changed to comply with the regulations discussed above;
- identify potential violations of the vesting and accrued benefit requirements for defined benefit plans under section 411 that may arise when normal retirement age is defined based on a minimum period of service; and
- request comments from sponsors of governmental plans as defined in section 414(d) and other plans not subject to the requirements of section 411 on whether those plans may define normal retirement age based on years of service.

Under section 411(a)(8), normal retirement age is defined as being the earlier of age 65 (assuming the participant has reached at least his or her fifth anniversary in the plan) or normal retirement age as defined in the plan. As noted above, however, the regulations now specify that a plan's definition of normal retirement age must be consis-

The regulations provide a safe harbor of age 62 for all plans, a facts and circumstances test for plans that set a normal retirement age that falls between age 55 and age 62, and a presumption that an age below 55 is not representative of the industry unless the Service determines otherwise.

tent with an age that is reasonably representative of workers in the firm's industry. The regulations provide a safe harbor of age 62 for all plans, a facts and circumstances test for plans that set a normal retirement age that falls between age 55 and age 62, and a presumption that an age below 55 is not representative of the industry unless the Service determines otherwise.

The Notice provides two forms of relief for plans that may need to make corrections in this area. The first form of relief is for plans with a normal retirement age between 55 and 62 that cannot reasonably and in good faith determine that no amendment is necessary. They may adopt an amendment modifying normal retirement age effective no later than the first day of the first plan year beginning after June 30, 2008. The interim amendment must be adopted by the later of two dates, either the first day of the first plan year beginning after June 30, 2008, or the due date, including extensions, for filing the employer's income tax return for the taxable year that includes the first day of the first plan year beginning after June 30, 2008.

Under the second form of relief, plans with a normal retirement age lower than 55 will enjoy the same presumption as plans with a normal retirement age between 55 and 62 if they submit a request for a letter ruling on whether the plan's normal retirement age definition satisfies the new standards.

The Notice also explains how an employer can use an unusually low normal retirement age while applying for a letter ruling regarding the unusually low normal retirement age. It explains that a plan is eligible for temporary relief from the new normal retirement age regulations if it used a normal retirement age below 55 before May 22, 2007, and if no possible plan participant hired at age 18 or older could attain the plan's normal retirement age before the age of 40. The Notice concludes that "[i]f the Service determines during the ruling process that the plan's normal retirement age does not reasonably represent the typical retirement age for the industry in which the covered workforce is employed, the Service will require corrective action to be taken prospectively only from the date of issuance of the ruling letter, so that the plan's normal retirement age will not be required to be raised retroactively." The ruling request must describe the employer's industry, and it must present and analyze the data the employer used to determine the typical retirement age for its workers.

The Service requested comments with respect to the Notice. Sponsors of governmental plans and other plans not subject to the requirements of section 411 are asked to submit comments on whether normal retirement age under such plans may be based on years of service. Comments were also requested regarding pension plans with a normal retirement age conditioned on the completion of a stated number of years of service. The Service asked for comments about such plans' ability to satisfy the requirement in Treas. Reg. § 1.401(a)-1(b)(1)(i) "that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules." Comments were due by November 25, 2007. ■

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We look forward to working with you.

FROM THE CHAIR *continued from page 3*

chaired by Adam Cohen, and to Tom Greenaway; the co-chairs of the LSTC committee, Katy Morrison-Sneade and Peter Lowy; and Kelley Miller, who chaired development of the problem. The number of J.D. submissions represents a 53% increase over the prior year. The increase in LL.M. students represents a 155% increase.

Midyear Meeting

The Section's Midyear Meeting in Lake Las Vegas was a success, with excellent attendance at the substantive committee meetings. We appreciate your patience in working with two different hotels, due to space constraints. I look forward to seeing you at the May Meeting in Washington, D.C.

Nolan Fellows

Finally, as Chair, I want to personally congratulate our new Nolan Fellows: Megan Brackney, William Hansen, Sarah Johnson, Robb Longman, Colleen O'Connor, and Juan Vasquez. The Section thanks you for your involvement, and looks forward to your continued participation. ■

Tailor your ABA Tax Section membership to your practice

Join a Tax Section Committee

ABA Tax Section committees play a vital role in carrying out the Section's dynamic government relations and comprehensive CLE and publishing programs. Section Committees research new tax law, comment on regulations, prepare reports on current changes in the law within their specialties, develop CLE programs, and contribute to Section publications.

While most committees target specific substantive areas, some committees reach across practice areas. Our active and growing Young Lawyers Forum provides special networking and career development opportunities for young lawyers and law students interested in tax. Our Foreign Lawyers Forum, made up of international practitioners, provides international perspectives on topics of interest to U.S. tax lawyers. Our Diversity Committee is devoted to projects designed to increase diversity in the tax profession and in the Section.

Please visit the Section's Committee Membership website at www.abanet.org/tax/committees to find out more about the benefits of membership in any of the following committees.

- Administrative Practice
- Affiliated and Related Corporations
- Banking and Savings Institutions
- Bankruptcy and Workouts
- Business Cooperatives and Agriculture
- Capital Recovery and Leasing
- Civil and Criminal Tax Penalties
- Closely Held Businesses
- Corporate Tax
- Court Procedure and Practice
- Diversity
- Employee Benefits
- Employment Taxes
- Energy & Environmental Taxes
- Estate and Gift Taxes
- Exempt Organizations
- Fiduciary Income Tax
- Financial Transactions
- Foreign Activities of U.S. Taxpayers
- Foreign Lawyers Forum
- Formation of Tax Policy
- Government Relations
- Individual & Family Taxation
- Insurance Companies
- Investment Companies
- Low Income Taxpayers
- Membership and Marketing
- Partnerships and LLCs
- Pro Bono
- Professional Services
- Publications
- Real Estate
- S Corporations
- Sales, Exchanges, and Basis
- Sponsorships
- Standards of Tax Practice
- State and Local Taxes
- Tax Accounting
- Tax Exempt Financing
- Tax Practice Management
- Tax Shelters
- Teaching Taxation
- Technology
- Transfer Pricing
- U.S. Activities of Foreigners and Tax Treaties
- VAT & Other Consumption Taxes
- Young Lawyers Forum

Join as Many Committees as You Like

Now it's easier than ever to join as many committees as you like with our online Committee Preference form at www.abanet.org/tax/committees. Please note you will need your eight-digit ABA member ID number and password (usually your last name) to access the form. For more information, please contact the Section Office at tel. 202/662-8670.

Boxscore

Since September 2007, the Section has coordinated the following government submissions, which can be viewed and downloaded free of charge from the Section's website at www.abanet.org/tax/pubpolicy.

SUBMISSIONS AND COMMENTS ON GOVERNMENT REGULATIONS, ADMINISTRATIVE RULINGS, ABA POLICY and BLANKET AUTHORITIES*

TO	DATE	CODE SECTION	TITLE	COMMITTEE	CONTACT
Senate Committee on Finance	11/15/07	6694, 6662	Comments on Legislative Changes Impacting Standards for Imposition of Penalties	CIVIL AND CRIMINAL TAX PENALTIES	Bryan C. Skarlatos
Senate Committee on Finance, House Committee on Ways and Means	11/13/07	n/a	Comments on H.R. 2834	SECTION OF TAXATION	Adam M. Cohen
Internal Revenue Service	10/23/07	67(e)	Letter on Proposed Regulation Relating to Limitation on Estates or Trusts Deductions (REG-128224-06)	SECTION OF TAXATION, SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW	Section of Taxation, Section of Real Property, Trust and Estate Law
Internal Revenue Service	10/5/07	n/a	Comments Concerning Notice 2007-39 on the Application of Monetary Penalties in Disciplinary Procedure Under Section 822 of the American Jobs Creation Act of 2004	STANDARDS OF TAX PRACTICE	Linda Galler, Mona L. Hymel
Internal Revenue Service	10/4/07	n/a	Comments Concerning Discussion Draft of Redesigned Form 990 for Tax-Exempt Organizations	SECTION OF TAXATION, HEALTH LAW SECTION	Michael A. Clark, Robert W. Friz
Internal Revenue Service	9/28/07	42	Comments Concerning Low-Income Housing Qualified Contract Proposed Regulations	REAL ESTATE	Mitch Thompson
Internal Revenue Service	9/21/07	409A	Comments Concerning Internal Revenue Code Section 409A Relating to Compliance Deadline	EMPLOYEE BENEFITS	James R. Raborn, David Mustone
Internal Revenue Service	9/19/07	n/a	Section of Taxation's Survey Report on Independence of IRS Appeals	SECTION OF TAXATION	Section of Taxation
Internal Revenue Service	9/19/07	152(e)	Comments on Proposed Regulations Under Section 152(e) of the Internal Revenue Code	INDIVIDUAL & FAMILY TAXATION, LOW INCOME TAXPAYERS	Bryan T. Camp, William P. Nelson

*The technical comments listed in this index represent the views of the ABA Section of Taxation. They have not been approved by the ABA Board of Governors or the ABA House of Delegates and should not be construed as representing the policy of the ABA.

CLE Calendar | www.abanet.org/tax/calendar

DATE	PROGRAM	CONTACT INFORMATION
March 10-14, 2008	**ABA/IPT ADVANCED TAX SEMINARS: INCOME TAX, SALES/USE TAX, PROPERTY TAX** The Ritz-Carlton – New Orleans, LA	Tax Section **www.abanet.org/tax** | 202.662.8670
March 12, 2008	**YOUNG LAWYERS FORUM TELECONFERENCE: TAX PRACTICE OPPORTUNITIES FOR YOUNG LAWYERS**	Tax Section **www.abanet.org/tax** | 202.662.8670
April 3-4, 2008	**8TH ANNUAL TAX PLANNING STRATEGIES – U.S. AND EUROPE CONFERENCE** Madrid, Spain	Tax Section **www.abanet.org/tax** | 202.662.8670
April 10-11, 2008	**CORPORATE TAXATION** Hilton Embassy Row – Washington, DC	ALI-ABA **www.ali-aba.org** | 800-CLE-NEWS
April 17-18, 2008	**22ND ANNUAL NATIONAL INSTITUTE: EMPLOYEE BENEFITS IN MERGERS & ACQUISITIONS** New York Helmsley – New York, NY	JCEB **www.abanet.org/jceb** | 202.662.8676
May 14, 2008	**4TH ANNUAL SALT SYMPOSIUM – COMBINED REPORTING** Georgetown University Law Center Washington, DC	Georgetown CLE **www.law.georgetown.edu/cle/** | 202.662.9890
June 4-6, 2008	**22ND ANNUAL NATIONAL INSTITUTE: ERISA BASICS** The Palmer House Hilton – Chicago, IL	JCEB **www.abanet.org/jceb** | 202.662.8676
June 5-6, 2008	**CHARITABLE GIVING TECHNIQUES** Langham Hotel – Boston, MA	ALI-ABA **www.ali-aba.org** | 800-CLE-NEWS
June 11-13, 2008	**U.S. AND LATIN AMERICAN TAX PLANNING STRATEGIES CONFERENCE** Miami, FL	Tax Section **www.abanet.org/tax** | 202.662.8670
June 12-13, 2008	**HOW TO HANDLE A TAX CONTROVERSY AT THE IRS AND IN COURT** Renaissance Chicago Hotel – Chicago, IL	ALI-ABA **www.ali-aba.org** | 800-CLE-NEWS
July 9-11, 2008	**ESTATE PLANNING FOR THE FAMILY BUSINESS OWNER** Boston, MA	ALI-ABA **www.ali-aba.org** | 800-CLE-NEWS
August 7-12, 2008	**ABA ANNUAL MEETING** New York, NY	ABA Service Center **www.abanet.org** | 800.285.2221

Section Meeting Calendar | www.abanet.org/tax/calendar

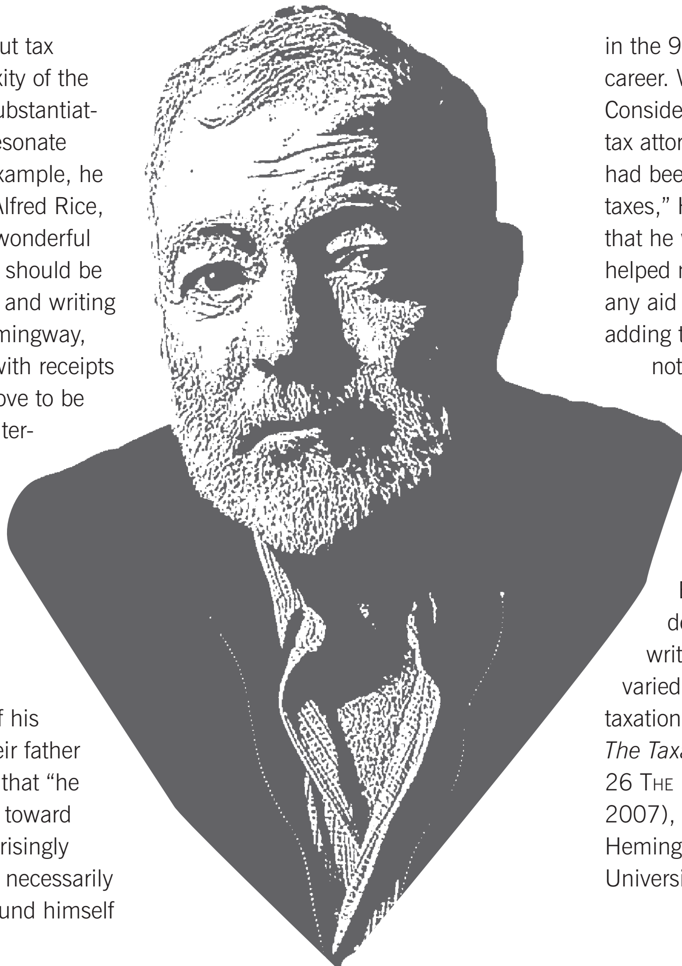
DATE	PROGRAM	LOCATION
May 8-10, 2008 September 11-13, 2008	**MAY MEETING** **JOINT FALL CLE MEETING**	Grand Hyatt | Washington, DC Hyatt Regency | San Francisco, CA
January 8-10, 2009 May 7-9, 2009 September 24-26, 2009	**MIDYEAR MEETING** **MAY MEETING** **JOINT FALL CLE MEETING**	Sheraton | New Orleans, LA Grand Hyatt | Washington, DC Hyatt Regency | Chicago, IL
January 14-16, 2010 May 6-8, 2010 September 23-25, 2010	**MIDYEAR MEETING** **MAY MEETING** **JOINT FALL CLE MEETING**	Hyatt Regency | Denver, CO Grand Hyatt | Washington, DC Sheraton | Toronto, ON

TAX BITES: AN "ERNEST" APPROACH TO FEDERAL INCOME TAXATION

by Anthony E. Rebollo*

Even today, there seems to be a never-ending fascination with just about anything concerning Ernest Hemingway and his larger-than-life exploits. His frustrations with tax season—or the "bastardly income tax epoch" as he once referred to it—are no exception. As it turns out, not even Hemingway's status as an American literary icon could free him from the rigors of having to personally devote considerable amounts of time, effort and expense to ensuring that his tax affairs were in good order. In fact, taxes played such a surprisingly prominent role in his life that he personally dealt with, or wrote about, most of the major tax concepts embodied in the Internal Revenue Code, including the state of his tax affairs and possible investigations by the Service.

Hemingway's comments about tax matters, such as the complexity of the laws or his frustration with substantiating expenses, would easily resonate with today's taxpayers. For example, he once wrote his tax attorney, Alfred Rice, that "This time I have really wonderful stuff to write but now when I should be writing I am chasing receipts and writing letters like this." And, for Hemingway, substantiating expenditures with receipts or cancelled checks could prove to be especially difficult due to the territory he covered: "You can't go along the Cuban coast writing checks and checks don't get you very far in Africa where people will not even take paper money."



But while Hemingway certainly complained about taxes—once remarking that if his children were asked what their father did in WW II, they could say that "he paid for it"—his core attitude toward having to pay taxes was surprisingly positive; not what one would necessarily expect from someone who found himself in the 90% tax bracket at the peak of his career. What's the best evidence of this? Consider Hemingway's remarks to his tax attorney (Rice): While noting that he had been "crippled, financially, by taxes," Hemingway nevertheless stated that he was "as proud of haveing [sic] helped my Government in that way as of any aid I was able to give in the field[,]" adding that "I need money, badly, but not badly enough to do one dishonorable, shady, borderline, or 'fast' thing to get it."

The Hemingway quotations in this article are found in *Ernest Hemingway: Selected Letters*, 1917-1961 (Carlos Baker ed., 1981). For an in-depth analysis of Hemingway's written remarks about broad and varied aspects of federal income taxation, see Anthony E. Rebollo, *The Taxation of Ernest Hemingway*, 26 The Hemingway Review 22 (Spring 2007), published by The Ernest Hemingway Foundation and the University of Idaho. ■

*Richardson Plowden & Robinson, P.A., Columbia, SC.

17TH ANNUAL ABA/IPT SEMINARS | MARCH 10-14, 2008 – NEW ORLEANS

The ABA Section of Taxation and the Institute for Professionals in Taxation will present the annual Sales/Use Tax, Property Tax, and Income Tax Seminars this year at the Ritz-Carlton New Orleans in New Orleans, LA. The faculty will address issues common to income, sales, use and property tax cases in all jurisdictions with an emphasis on those issues that apply generally to state and local tax appeals throughout the country.

The advance registration deadline is February 28, 2008. For a program schedule and registration information, visit the Tax Section's website at: https://meetings.abanet.org/meeting/tax/IPT08/.

4TH ANNUAL SALT SYMPOSIUM: COMBINED REPORTING | MAY 14, 2008 – WASHINGTON, DC

The Tax Section and Georgetown University Law Center are pleased to announce the 4th Annual State and Local Tax (SALT) Symposium, this year with the theme of Combined Reporting. This year's sessions will provide a comparative analysis of the states' non-uniform group reporting regimes, the principles that drive the sourcing of multijurisdictional income, the implications that stem from group reporting models that employ a single versus an aggregate taxpayer theory, and important matters for state legislatures and their taxpayers to consider when contemplating the continued use or adoption of a combined reporting regime.

The Symposium will feature nationally recognized SALT practitioners and academicians whose analysis will include a focus on tax policy issues as well as related traps and planning opportunities. To assure a broad exchange of ideas and concerns that are responsive to the interests of multijurisdictional taxpayers and the states, the program has been timed to correspond to the Law Center's 31st Annual Advanced Institute on State and Local Taxation, as well as a private meeting of the General Counsels from each of the states' Departments of Revenue that is being hosted by Georgetown. It is anticipated that many of the General Counsels will be in attendance at both the Symposium and the annual Advanced SALT Institute.

For more information or to register, please visit www.georgetowncle.org or call 202/662-9890.

UPCOMING INTERNATIONAL PROGRAMS

Over the past decade, the Section has experienced significant growth in active membership of its international tax committees, reflecting the expansion into non U.S. markets of U.S. law firms and the increased emphasis on international tax practice.

To accommodate this growing interest, the Section, in partnership with the International Bar Association, sponsors a very successful "Tax Planning Strategies—U.S. and Europe" conference, now going into its eighth year. The Section is also pleased to introduce a new conference on "U.S. and Latin American Tax Planning Strategies" this coming June in Miami.

Visit the meeting websites below for program details and registration information.

8th Annual Tax Planning Strategies - U.S. and Europe
April 3-4, 2008 | Madrid, Spain

For more information, please visit: http://meetings.abanet.org/meeting/tax/Madrid08/

U.S. - Latin American Tax Planning Strategies Conference
June 11-13, 2008 | Miami, Florida, USA

For more information, please visit: http://meetings.abanet.org/meeting/tax/Miami08

SECTION PRO BONO UPDATE

This past fall, the Section introduced a pilot program in the Washington, D.C. area, to assist the IRS Voluntary Income Tax Assistance (VITA) program in handling income tax preparation for military personnel and their families. Section volunteers became certified in VITA training, and then learned about what specific issues are relevant to military personnel. Once the training was completed, they met at Andrews Air Force Base to train those who would be working with VITA volunteers in helping prepare federal income tax returns for the military. The Section hopes to expand the project to other areas of the country, so that Tax Section volunteers can contribute their considerable skills and talents to these efforts on military bases in their communities. For more information on replicating this effort in your area, please contact the Section office at tel. 202/662-8671, e-mail tax@abanet.org.

In addition, the Section hosted a Low Income Taxpayer Clinic (LITC) workshop in Washington, D.C. in December, in lieu of holding the session at the Midyear Meeting in Lake Las Vegas. The workshop attracted over 120 LITC staff and provided a primer on the appeals process for pro bono lawyers and those working in LITCs, and featured guests from the IRS, the Tax Court and academia. The next LITC workshop is scheduled for the May Meeting in Washington, DC.

CONSUMER OUTREACH

The Section routinely reaches out to taxpayers to let them know of tax-related issues that may affect their lives and pocketbooks. In the fall, two audio news releases (ANRs) were broadcast to stations around the country, and heard by millions of listeners. For taxpayers facing foreclosure on their homes due to the "subprime lending" crisis, the Section provided information about tax relief that may be available to them. The Section also provided information to the victims of the California wildfires who may be eligible to re-file their 2006 returns or claim collateral damage in the 2007 income tax filings. For more information about these projects, and other consumer news, please see the Section's consumer web site, www.taxtips4U.org.

MISSED A MEETING?

Audiotapes, CDs, and MP3s of programs held at the Tax Section's Midyear, May, and Fall Meetings, as well as its annual Advanced Income, Sales/Use, and Property Tax Seminars cosponsored with the Institute for Professionals in Taxation, are available from Digital Conference Providers, the Section's audio provider. Orders can be placed through the DCP website at: https://www.dcporder.com/abatx/ or by calling 630/963-8311. ■

2008-2009 Nominees

In accordance with sections 6.1 and 6.3 of the Section of Taxation Bylaws, the following nominations have been submitted by the Nominating Committee for terms beginning at the conclusion of the 2008 Annual Meeting in August. Under the Section Bylaws, the current Chair-Elect, William J. Wilkins, of Washington, DC, will become Chair at the conclusion of the 2008 Annual Meeting.

CHAIR-ELECT:

Karen L. Hawkins
San Francisco, CA

VICE CHAIRS:

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Los Angeles, CA
(*Communications*)

Samuel L. Braunstein
Fairfield, CT
(*Professional Services*)

Peter J. Connors
New York, NY
(*Committee Operations*)

Armando Gomez
Washington, DC
(*Government Relations*)

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San Diego, CA
(*Publications*)

Rudolph R. Ramelli
New Orleans, LA
(*Administration*)

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Philadelphia, PA

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