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Federal Tax Advisory

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Insights into Recent Regulatory, Judicial and Legislative Developments

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Treasury Priority Guidance Plan

The Treasury's 2011-2012 Priority Guidance Plan, released September 2, 2011, and slated to be completed before July, 2012, is not particularly ambitious and has not, to date, produced any big events, at least in the corporate area. Under the plan's consolidated return and corporate headings are several previously issued proposed and temporary regulations dealing with perennial detailed issues under Sections 358, 355 and 382 and consolidated return favorites that include "agent of the group" and the loss disallowance rule.

Several factors may contribute to the relatively slim production of guidance, including the fact that approximately one fourth of the attorney work force in IRS Chief Counsel (Corporate) (and also likely, other divisions) has been lost to retirement and otherwise in recent years and not replaced due to limitations placed on IRS budgets by Congress; also, no permanent Treasury Assistant Secretary for Tax Policy has been named due to inability of the Administration to obtain the confirmation of candidates. In addition, there may be a premonition of a relative calm during which other work should be handled before the possible storm of the 2012 congressional session, which might take up broad-scale tax reform.

Nevertheless, there are many items in the plan of potential interest to segments of taxpayers on the business plan, which items have a way of resulting in proposals—if not this year, then later. The problem for taxpayers interested in weighing in is knowing whether an item has any immediacy. Examples include the following.

Regulations under § 312 regarding the allocation of earnings and profits between a transferor and transferee corporation when assets are transferred in connection with a reorganization.

This topic may seem strange to readers who think that there is no allocation of earnings and profits among the various constituents of a corporate reorganization, as contrasted with one surviving corporation receiving all of the target's earnings and profits in an asset reorganization.

In fact there is no known example in published guidance or case law under the 1954 or 1986 codes of the allocation among the acquiring corporation and its controlled subsidiaries of the earnings and profits of a target corporation that engages in an asset reorganization. Rather, the best interpretation of the statutes and regulations is that all of the target's earnings and profits (E&P) go to one acquiring corporation, therefore not allowing allocation on the acquirer side of the reorganization. *See*, generally, Cummings, "E&P Allocations and Reorganizations?" *129 Tax Notes 345*, 2010 TNT 201-9 (Oct. 18, 2010). There may be, however, sufficient flexibility in Section 312 to allow the Treasury to provide a different rule. Why might one be wanted, in addition to flexibility?

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Earnings and profits are largely ignored in profitable domestic C corporations, but they are an important feature of controlled foreign corporations, determining the character of a distribution as dividend or not, which can have drastically different U.S. tax consequences for the domestic shareholders. Therefore, it is likely that the interest in this area stems from taxpayers trying to, or wanting to, either reduce or increase the earnings and profits of a foreign corporation through, or in connection with, corporate reorganizations, or even Section 351 exchanges.

Guidance regarding the scope and application of the rescission doctrine.

Although the Chief Counsel has not stopped issuing letter rulings on the effect of the rescission of a transaction within the same year it originally occurred (*see* LTR 201211009), the Treasury has signaled it wants to reconsider the process. However, this is one of those wheels that may not be broken and, therefore, new personnel in the Treasury may decide it does not need to be fixed.

Revenue ruling on the application of Revenue Ruling 92-53 in measuring partner insolvency under §108(d)(3).

The insolvency exemption for discharge of indebtedness income is applied at the partner level. The cited ruling concluded that "The amount by which a nonrecourse debt exceeds the fair market value of the property securing the debt is taken into account in determining whether, and to what extent, a taxpayer is insolvent within the meaning of Section 108(d)(3) of the Code, but only to the extent that the excess nonrecourse debt is discharged." Both of these rules are hard to apply and further guidance will be welcome.

Guidance under §§7701(o) and 6662(b)(6) regarding codification of the economic substance doctrine by §1409 of the Health Care and Education Reconciliation Act of 2010.

Receipt of this guidance is unlikely. It appears that the Treasury may have achieved what it wanted in the economic substance doctrine area: enough congressional force behind the concept to further scare taxpayers and enough ambiguity around the area of concern to force taxpayers to give potential application of the doctrine a wide berth, if possible. More clarity can only make taxpayers more comfortable.

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