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TAX ISSUES SUMMARY

May 26, 2006

HIGHLIGHTS:

“Tax Increase Prevention and Reconciliation Act of 2005” Signed into Law, Finally

On May 17, 2006, President Bush signed into law a \$70 billion bill that extends application of the 15% tax rate on stock dividends and capital gains to 2010, extends the active financing exception under Subpart F for another two years, extends the small business expensing provision (\$100,000 annually) through the end of 2009, and extends the current alternative minimum tax (AMT) higher exemption through the end of 2006, ensuring that no additional taxpayers become subject to the AMT during the 2006 tax year. [See Legislation.](#)

IRS Outlines Changes to Procedure for Offering Guidance

In addition to a streamlined technical advice memorandum (TAM), the IRS now will issue two new categories of legal advice: a generic legal advice memorandum, and a case-specific legal advice memorandum. The new categories will replace other forms of advice, such as the technical expedited advice memorandum (TEAM). The generic legal advice memorandum will help field personnel resolve audit issues for multiple taxpayers in a particular industry, providing them with an authoritative opinion on industry issues. The case-specific legal advice memorandum will provide IRS personnel with strategic and tactical advice concerning case development. Unlike a TAM, the generic and case-specific legal advice memoranda will not be considered IRS legal determinations. Both will be disclosed publicly under I.R.C. § 6110. [See Company Issues.](#)

LEGISLATION

1. “Tax Increase Prevention and Reconciliation Act of 2005” Signed into Law, Finally

On May 17, 2006, President Bush signed into law a \$70 billion bill that extends application of the 15% tax rate on stock dividends and capital gains to 2010, extends the active financing exception under Subpart F for another two years, extends the small business expensing provision (\$100,000 annually) through the end of 2009, and extends the current alternative minimum tax (AMT) higher exemption through the end of 2006, ensuring that no additional taxpayers become subject to the AMT during the 2006 tax year. To pay for these tax benefits, as well as match the revenue loss year by year, the act also contained some new revenue raisers. For example, the act removes the income limits on conversion of traditional individual retirement accounts (IRAs) to Roth IRAs temporarily for 2010, allowing high-income taxpayers to convert their traditional IRAs to Roth IRAs and pay tax on any income amount in equal installments in 2011 and 2012. Another revenue-raiser included in the act repeals the FSC/ETI grandfathering provisions enacted under the American Jobs Creation Act of 2004 (Pub. L. No. 108-357). Because many of the usual extender provisions were left out of the reconciliation bill, Congressional leaders indicated that there could be a second “trailer” bill.

2. Progress Expected on Pension Reform

Failing to have a vote on the pension reform conference report, conferees working on the pension reform bill are optimistic that at least all the decisions will be made prior to Congress’ Memorial Day recess, leaving staff to draft the various provisions over the recess. In addition, tax conferees on pension reform have indicated that those provisions that might have been expected for a trailer bill are likely to be added to the pension reform conference report.

POLICYHOLDER ISSUE

I.R.C. § 475 — Tax Court Allows Extension of Time to Make Mark-to-Market Election Despite Late Filing

In L.S. Vines v. C.I.R., No. 12763-04 (T.C. May 11, 2006), the Tax Court held that an individual is eligible to file a late mark-to-market election and should be granted relief under section 301.9100-3 of the Procedure & Administration Regulations (otherwise referred to as “section 9100 relief”). The taxpayer, a former attorney who became a securities trader upon retirement, was not aware of and did not make a I.R.C. § 475(f) election when filing his request for a tax return extension. When he became aware of the election several months later, he filed a request for section 9100 relief that would allow him to make the election late, which the IRS denied, stating that there were no unusual or compelling circumstances that warranted relief. The court determined that the taxpayer gained no advantage by making a late election, and that the same tax result would be achieved as if the taxpayer had made a timely filing. The court in fact made its own determination and decided that the taxpayer satisfied the conditions of “reasonableness and good faith” required by the regulations, and that the interests of the Government would not be prejudiced by granting the relief. The opinion contains no discussion of whether the IRS denial of section 9100 relief was an abuse of discretion; it seemed to assume that was not the relevant standard for the decision.

COMPANY ISSUES

1. I.R.C. §§ 61, 671, and 677 — Use of Trust's Assets for Permitted Purposes Does Not Result in Gross Income

In PLR 200618025 (Jan. 20, 2006), the IRS ruled that an insurance company's transfer of funds to a trust formed to act as a premium stabilization reserve for a member health program for which the insurer issues the health insurance coverage does not result in gross income to enrolled member firms of the health insurance program. In the facts presented in the ruling, A, an I.R.C. § 501(c)(6) entity, has a small business division, B, whose members are "Enrolled Member Firms." Enrolled Member Firms purchase health care coverage through the B Health Program. Each enrolled member fund sponsors and maintains its own group health plan. C is a nonprofit corporation that provides administrative services in connection with the B Health Program. Insurer and C, in order to hold down health insurance premium rates, have agreed to create a premium stabilization reserve under the B Health Program, known as the "Underwriting Management Fund" (UMF) and to have any positive cash balance in the UMF be kept in a trust created between C and an independent corporate trustee in order to secure the UMF from the insurer's creditors. Any insurance profit in a year over a prescribed amount for the insurer is transferred into the UMF trust, and any deficit in premiums in a year would be taken from the UMF trust balance.

The IRS ruled that the B Health Program as identified with the insurer will be treated as a grantor and as the owner of the trust under I.R.C. §§ 671 and 677, and the insurer would be required to include all income, deductions and credits of the trust in computing its taxable income. The IRS also concluded that Enrolled Member Firms are not required to include amounts previously deducted as health insurance premiums in their income because of amounts transferred to the trust by the insurer, as the firms do not retain any right to direct payment of the trust assets and the trust does not permit the refund or reversion of premiums previously paid. Further, the Insured's transfer of amounts to the trust, and the use of trust assets for the purposes permitted by the trust agreement, will not result in gross income to the Enrolled Member Firms, or to A or C, under I.R.C. § 61. The IRS also concluded that, on termination of the B Health Program or the insurer's participation therein, the UMF trust will cease to be treated as a grantor trust and will be treated as a taxable trust. Finally, the ruling recognizes that the UMF trust is a welfare benefit fund, but concludes that there is no disqualified benefit as defined in and subject to excise tax under I.R.C. § 4976(b)(1)(C) because under the terms of the trust no trust assets will revert to any Enrolled Member Firm.

2. I.R.C. §§ 197, 338 and 1060 — IRS Corrects a Typographical Error in Proposed Regulations

The IRS has corrected a typographical error in proposed regulations (REG-146384-05), that provide guidance relating to I.R.C. §§ 197, 338 and 1060. The IRS said the correction was necessary because the error could prove to be misleading. The language found on page 18054, column 3, paragraph instruction Par. 5., which reads "Par. 5. Section 1.846-2 as amended by adding new paragraph (d) to read as follows:" is corrected to read "Par. 5. Section 1.846-2 is amended by adding new paragraph (d) to read as follows:". [Emphasis added].

3. I.R.C. § 807 — Prevailing State Assumed Interest Rates

In Rev. Rul. 2006-25, 2006-20 I.R.B. 882, the IRS supplemented the schedules of prevailing state assumed interest rates of Rev. Rul. 92-19, 1992-1 C.B. 227. This information is used by insurance companies to compute life insurance reserves and supplementary total and permanent disability benefits, as well as individual and group annuities and pure endowments. Then, in Announcement 2006-35, 2006-24 I.R.B. ___, the IRS announced corrections to the Schedule A listings in Rev. Rul. 2006-25, 2006-20 I.R.B. 882.

4. I.R.C. § 4251 — IRS Concedes Fight Over Telephone Excise Tax

In Notice 2006-50, 2006-25 I.R.B. ___, the IRS announced it will stop assessing and collecting the federal telephone excise tax, in light of five circuit court rulings over the past two years that have deemed the tax invalid. The notice provides guidance for companies to request credit or refund of excise taxes paid. In addition to refunding or crediting the actual amount paid by a taxpayer upon request, the IRS plans to offer a safe harbor refund amount that requires no documentation of excise taxes paid.

5. IRS Outlines Changes to Procedure for Offering Guidance

In an Office of Chief Counsel notice (CC-2006-13, May 5, 2006), the IRS announced a new initiative to revise its procedures for providing legal advice to taxpayers and its field offices. Under the new initiative, the IRS will issue three categories of legal advice: a streamlined technical advice memorandum (TAM), a generic legal advice memorandum, and a case-specific legal advice memorandum. The new categories will replace other forms of advice, such as the technical expedited advice memorandum (TEAM). The generic legal advice memorandum will help field personnel resolve audit issues for multiple taxpayers in a particular industry, providing them with an authoritative opinion on industry issues. The case-specific legal advice memorandum will provide IRS personnel with strategic and tactical advice concerning case development. Unlike a TAM, the generic and case-specific legal advice memoranda will not be considered IRS legal determinations. Both will be disclosed publicly under I.R.C. § 6110.

These changes were necessary because the IRS realized that the current TAMs have been used increasingly to obtain generic legal advice across the industry, rather than merely being a legal determination binding on the IRS with respect to one particular taxpayer. One significant change with respect to TAMs is that the mandatory conference of right in cases in which the taxpayer has not participated in the TAM from the outset will be eliminated, although the National Office will have the discretion to grant conferences. In addition, the time period for taxpayers to respond to a request for additional information will be shortened to 10 days. The plan for streamlining TAMs will be formalized in Rev. Proc. 2007-2, scheduled to be issued early in 2007.

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For comments or questions, or if you would like to receive the Tax Issues Summary via electronic mail, please contact Katherine L. Berland at (202) 434-9169 or kberland@scribnerhall.com Scribner, Hall & Thompson, LLP, website: www.scribnerhall.com