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Internal Revenue Service
Room 5203
P.O. Box 7604
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Washington, D.C. 20044

RE Comments on Prop. Treas. Reg. §§ 1.469-11(b)(3)(iv), 1.1411-4
77 Fed. Reg. 72,612 *et seq.* (Dec. 5, 2012)
And Request to Appear at Hearing

We appreciate the opportunity to provide these comments on behalf of the National Business Aviation Association ("NBAA"). NBAA represents over 9,000 owners and operators of business aircraft.

In view of the importance and complexity of these proposed regulations, we request that a hearing be scheduled. If a hearing is scheduled, we request the opportunity to speak at the hearing.

1. Ordinary Course of Business Exception

a. Definition of Trade or Business

I.R.C. § 1411(c)(1)(A) imposes an excise tax at the rate of 3.8% on certain types of income including rental income, except if such income is earned in the ordinary course of a trade or business. The Preamble to the Proposed Regulations explains in Section 5.A(vi)(b), at 77 Fed. Reg. 72,619, and again in Section 6.A, at 72,623, that the term ordinary course of trade or business is not defined in the Proposed Regulations. The Preamble in Section 6.A explains that ordinary course of trade or business is defined by reference to the I.R.C. § 162(a) definition of a trade or business based on the "large body of case law and administrative guidance interpreting section 162's meaning of trade or business."

Setting this important test out merely in the Preamble falls short of the level of guidance needed. The reference to case law and administrative guidance interpreting § 162(a) as the applicable guidance should be included in the text of the regulations under Prop. Treas. Reg. § 1.1411-4(b). In addition, case law discussing the distinction between § 1231 assets and capital assets should be referenced as also relevant to this determination.

b. Scope of Activity and Entity Level at Which Trade or Business Is Determined

Prop. Treas. Reg. § 1.1411-4(b)(2) explains that the passive/nonpassive status of items of income is determined at the individual level (consistent with the passive activity rules) and that the trade or business of being a trader in financial instruments is determined at the entity level. While these provisions do not prescribe the level at which the trade or business determination is to be made for purposes of the trade or business exception, the examples under Prop. Treas. Reg. §§ 1.1411-4(b)(3), -5(b)(2) appear to assume that the trade or business determination is made for this purpose at the level of each separate entity.

Determining whether income is earned in a § 162 trade or business under a strictly separate entity approach will yield unexpected results that are inconsistent with § 162. For purposes of determining whether income is earned under § 162, Treas. Reg. § 1.183-1(d) provides that activities are determined and their § 162 trade or business status is evaluated by aggregating undertakings in any reasonable manner determined by the taxpayer. In addition, case law has made the § 162 trade or business determination by attributing § 162 trade or business status among related entities in appropriate circumstances. *See Morton v. United States*, 98 Fed. Cl. 596 (2011) (applying unified business enterprise concept to determine § 162 trade or business).

In keeping with the overall approach under these proposed regulations of referencing existing law rather than redefining existing law for purposes of § 1411, the final regulations should explain that in determining § 162 trade or business status, existing case law and administrative guidance should be applied in all aspects of the § 162 trade or business determination, including the scope of activity and the entity level at which the determination is made.

2. Regrouping Election

Prop. Treas. Reg. § 1.469-11(b)(3)(iv) permits taxpayers subject to the 3.8% tax to elect to regroup their activities for passive loss purposes in 2013 or 2014. As explained in the Preamble, at 72,624, this provision is intended to provide taxpayers with a "fresh start" so that they can make their grouping decisions with the 3.8% tax in mind. The Preamble further explains that taxpayers are expected to follow the existing passive activity rules regarding disclosure of their grouping elections under Rev. Proc. 2010-13.

Rev. Proc. 2010-13 contains provisions to mitigate the otherwise harsh results for a taxpayer who is unaware of the need to file formal grouping elections. These provisions allow taxpayers to file their grouping elections in a subsequent year, with retroactive effect as long as their prior reporting was consistent with their grouping election.

The proposed regulations under § 1411 are complex and the average small business taxpayer will not read them or understand them. Likewise, many of them will work with professional CPAs who either do not understand these grouping rules or do not recognize that they may apply to a particular taxpayer's situation. Accordingly, it is entirely foreseeable that

many small business taxpayers will not learn of the regrouping election until after their 2014 returns have been filed.

In the interests of fair administration of the tax laws, taxpayers who fail to make regrouping elections in 2013 or 2014 should be entitled to make their regrouping election later with retroactive effect, as long as they amend their returns beginning in 2014 to reflect the regrouping. It would not be reasonable to expect taxpayers making a late election to have reported their income based on the new grouping election. Accordingly, this condition should not be imposed as a prerequisite for taxpayers to make the regrouping election.

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We appreciate your attention to these concerns. If further explanation is needed, please do not hesitate to contact us. I can be reached at sobrien@nbaa.org or (202) 783-9451.

Sincerely,

Scott O'Brien
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