NBAA

NBAA Testimony by John Hoover at Treasury Hearing on April 2, 2013
Regarding Prop. Treas. Reg. §§ 1.469-11(b)(3)(iv), 1.1411-4

I am John Hoover. I am an attorney with the firm of Dow Lohnes PLLC, and I appreciate the opportunity to provide these comments on behalf of the National Business Aviation Association.

There are three items on which I would like to comment: (1) the definition of a section 162 trade or business, (2) the entity level at which the trade or business determination is made, and (3) potential trap for the unwary in the activity regrouping election.

1. Definition of Trade or Business

The 3.8% tax applies to certain types of income including rental income, except to the extent that such income is earned in the ordinary course of a trade or business. The term ordinary course of a trade or business is not defined in the Proposed Regulations. However, based on the Preamble to the Proposed Regulations and public comments by Treasury officials involved in drafting the regulations, I understand that the ordinary course of a trade or business is determined by reference to the definition of a trade or business under section 162.

This is an important test, and it needs to be clearly set forth in the text of the regulations. Therefore, I suggest that the regulations include a specific reference to the definition of a trade or business under section 162 and the case law thereunder. Furthermore, the same issue is address in case law distinguishing section 1231 assets from capital assets. Therefore, I suggest that the regulations should include a reference to case law under those sections as well.

2. The Entity Level at Which Trade or Business Is Determined

The Proposed Regulations explain that the passive or 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. 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. However, the examples in the Proposed Regulations 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 section 162 trade or business under a separate entity approach will yield results that are inconsistent with section 162. For purposes of determining whether income is earned in a trade or business under section 162, Treasury Regulation section 1.183-1(d) provides that activities are determined by aggregating undertakings in any reasonable manner determined by the taxpayer. This aggregation applies to operations and undertakings conducted in multiple entities. In addition to aggregation, case law under section 162 has also has made the section 162 trade or business determination by

attributing section 162 trade or business status among related entities. This attribution was most recently applied in *Morton v. United States*, 98 Court of Federal Claims 596, in which the court applied a unified business enterprise concept to identify a section 162 trade or business.

Based on public comments by Treasury officials, I understand that in drafting the Proposed Regulations, Treasury has wisely sought to refrain from recreating existing law. Instead, the approach under these Proposed Regulations has been to refer to existing law as it currently exists or may evolve. There is no reason to depart from this approach in defining a section 162 trade or business. Accordingly, I suggest that the Proposed Regulations clarify that existing case law and administrative guidance should be applied in the determination of the scope of activity for purposes of determining section 162 trade or business status.

3. Late Regrouping Elections

The Proposed Regulations permit taxpayers subject to the 3.8% tax to elect to regroup their activities for passive loss purposes in 2013 or 2014. This regrouping election is intended to provide taxpayers with a fresh start so that they can make their grouping decisions with the 3.8% tax in mind.

As noted in the Preamble, the rules for making passive loss grouping elections are provided in Revenue Procedure 2010-13. That revenue procedure first applied to calendar year 2011, and it provides that taxpayers who failed to make their grouping elections in 2011 can ordinarily make the elections later with retroactive effect. This provision was intended to provide relief for taxpayers who were unaware of the requirement to file grouping elections for the first time in 2011.

These Proposed Regulations under section 1411 are complex. I anticipate that the average small business taxpayer and the average CPA will fail to thoroughly understand these regulations. 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. Therefore, this condition should not be imposed as a prerequisite for taxpayers to make the regrouping election.

Thank you again for the opportunity to provide these comments.