

December 3, 2004

Mr. Jay L. Jensen  
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Dear Mr. Jensen:

This is to comment, on behalf of the Employee Relocation Council (ERC), on the draft Coordinated Issue Paper (CIP) on relocation home purchase costs prepared by your office.

I am enclosing a copy of the draft, upon which I have entered suggested changes together with detailed comments as to the nature of and the need for the changes. I will also forward a copy of that redline to you by e-mail.

In addition, I am enclosing a number of other documents you may wish to consider should you choose to finalize the paper.

The first is a copy of the suggested ruling and analysis submitted by ERC to the Income Tax & Accounting Division (IT&A) of the Office of Chief Counsel, at the request of that office, in connection with the Priority Guidance Plan project IT&A is responsible for. That submission contains a complete and accurate description of the types of home purchase programs dealt with in the CIP, based upon standard definitions universally accepted within the relocation industry, and a more complete analysis of the arguments concerning burdens and benefits of ownership in these transactions than is presently reflected in the CIP. We believe the CIP should reflect those facts and that analysis.

The second is a copy of the standard definitions of Appraised Value, Amended Value, and Assigned Sale home purchase transactions published by ERC. These definitions were created in 1985, and have been universally accepted as standard within the relocation industry since that time. Indeed, the government's own relocation home purchase programs conform to them. The CIP currently states that there are no standard

definitions of these programs. That is not correct. We believe the CIP should reflect the industry standard definitions.

The third is a copy of the “Eleven Key Elements and Procedures of an Amended Value Option.” This document was also developed by ERC in 1985, and like the others enclosed has been universally accepted as the standard set of procedures to be followed in an Amended Value Option. Again, the discussion in the CIP does not reflect an awareness of those procedures, which are followed, with minor variations, by all companies maintaining Amended Value programs.

I am providing these documents because they reflect the prevailing practices in relocation home purchase programs, but are not reflected in the CIP discussion. The CIP discussion reflects a number of misunderstandings as to the structure, procedures, and effect of the programs in issue. It appears that this may be because the CIP is based upon information developed in a very limited number of audits of these programs that have been undertaken in recent years.

In a number of these audits, I have been consulted at some point by the taxpayer. Unfortunately, in my experience the agents conducting the audits do not fully understand the contracts, documents, relationships, and procedures involved, and often reach erroneous conclusions concerning them, some of which seem to be reflected in the CIP. This is not entirely the fault of the agents. It is also the result of poor communications and explanations on the part of some of the taxpayers under audit as to the effect of the contracts and procedures, etc., and poor articulation of how the benefits and burdens shifts that occur are the same as those that occur in ordinary real estate transactions between unrelated parties. Regardless of the source of the confusion, however, the CIP needs to be based upon a fair description of actual standard programs.

We certainly agree that substantial deviations from accepted arrangements or procedures are an appropriate subject for audit, and that taxpayers should be prepared to demonstrate that their programs fall within accepted standards. However, the CIP should reach conclusions based upon standard transactions, not unacceptable deviations that have been identified in a few audits or upon misperceptions or misunderstandings of the arrangements or procedures involved.

This problem is particularly apparent in the discussion of the Amended Value option, which is by far the most prevalent home purchase program in use today and has been repeatedly blessed by (and used by) the IRS.

The Amended Value option is nothing more than a method of determining a true market value for the home by allowing the employee to test the market before accepting the employer’s offer. It alleviates employee perceptions that the employer’s appraisals are too low, and helps the employer identify a possible buyer earlier than it might have done otherwise, which reduces its carrying costs if it is able to sell the home to that buyer.

But it is not an Assigned Sale, and does not resemble an Assigned Sale.

Unlike an Assigned Sale, there is no binding contract of sale to an outside buyer in place when the employer signs a binding contract to buy the house from the employee.

Unlike an Assigned Sale, the employer may be unable to enter into or close a contract with the potential buyer, and the employer assumes all responsibility for finding a new buyer if unable to do so.

Unlike an Assigned Sale, the employer enters into its own listing agreement with a real estate broker, and is responsible for the negotiation and execution of a contract with any prospective buyer, in its own name. That contract, unlike the contract entered into by the employee in an Assigned Sale, will include a detailed Addendum incorporating numerous additional provisions not found in standard real estate sales contracts. The Addendum has no effect upon the employer's purchase from the employee, but protects it against various potential future claims by the buyer.

Unlike an Assigned Sale, the employee has no legal liability for a real estate broker commission or closing costs.

Unlike an Assigned Sale, if the contract with the outside buyer must be renegotiated, or falls through, it is the employer who will bear the burden, or reap the benefit.

Unlike an Assigned Sale, the employer becomes immediately liable for the employee's equity based upon the outside price when it signs a contract with the employee.

Unlike an Assigned Sale, the employer has full control of the home, and full responsibility for negotiating, signing, and closing a sale with an outside buyer in its own name, and at its own risk.

In contrast, there is simply no real difference between an Amended Value sale and an Appraised Value sale (called "regular" in the CIP) except that the employer's purchase reflects a true fair market value and the employer may (but will not always) achieve a cost saving by finding a buyer earlier.

Correct treatment of a standard Amended Value sale is a critical part of the CIP. If the CIP generally finds all Amended Value programs ineffective to produce true purchases and sales, then virtually all relocation home purchase programs will fail, since the vast majority employ this option. This would include virtually all of the government's own programs, including those of the IRS itself.

Further, if the CIP does find Amended Value programs not to be true sales, then the application of section 7805(b) should be seriously considered. These are programs that have been engaged in by virtually all companies, and approved by the IRS, for more than thirty years. The IRS's own briefs in the Amdahl case would have accepted even Assigned Sales, and the National Office has repeatedly declined to challenge Amended Value transactions over the years despite repeated consideration of them. The IRS's own

relocation program employs them, as does every other government relocation program. Consequently, if the CIP is finalized with an adverse holding as to standard Amended Value sales, that holding should only be applied prospectively under section 7805(b).

Finally, the CIP also makes an assumption, both in its expression of the issues and its conclusions, that if the employer in fact makes a bona fide purchase and acquires the burdens and benefits of ownership, all costs incurred are capital and deductible only as a capital loss. This is not correct, and should be clarified.

We recognize that the IRS has, since 1982, taken the position that homes purchased in relocation transactions are capital assets. The CIP must, of course, reflect that position despite the fact that taxpayers have always disagreed with it. However, even if the IRS position is accepted, all costs are not capital. For example, maintenance costs, mortgage interest, taxes, and fees to the relocation company incurred during the period of the employer's ownership are deductible as ordinary and necessary business expenses, or as interest and taxes, regardless of whether the house is a capital asset. The CIP should be clarified on that point.

We have previously expressed our feeling that it would be better to delay producing a CIP until IT&A has completed work on the Priority Guidance Plan project and the position of the National Office is known. Having seen the draft CIP, we have no reason to believe it resolves any issues not covered by the Guidance Plan project. We again urge you to delay for the few months that would be necessary to get binding published guidance.

However, we very much appreciate the opportunity to comment on the draft. If you choose to continue with the CIP project, we think it should incorporate the changes we have suggested. It is critical that agents examining these programs be provided with accurate information as to the standard structures, procedures, and contractual agreements utilized.

I will be happy to answer any questions you may have about these comments. I can be reached at 703-893-8566.

Sincerely,

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