



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

CHIEF COUNSEL
2006 SEP 19 AM 10:42

September 8, 2006

The Honorable John Kerry
Ranking Member
Committee on Small Business
and Entrepreneurship
United States Senate
Washington, DC 20510-8350

Dear Senator Kerry:

I am writing to follow up on the letter dated May 18, 2006, from you and Senators Snowe, Isakson and Pryor regarding the proposed regulations under section 468B relating to the tax treatment of funds held by qualified intermediaries in connection with deferred exchanges of like-kind property. I am also responding on behalf of the Department of the Treasury, to which your letter was also addressed.

The letter discusses your concerns about the substance of the proposed regulations. We will take these into account as we continue to review and analyze all the comments we have received on the proposed regulations.

The letter also expresses concern about the initial regulatory flexibility analysis (IRFA) prepared with respect to the proposed regulations and points out several perceived deficiencies with the IRFA.

After receiving your letter, I reviewed the IRFA in order to make my own evaluation of whether it did in fact comply with the requirements of the Regulatory Flexibility Act. After looking into the matter, I concluded that the IRS and Department of the Treasury made a good faith effort to comply with the Regulatory Flexibility Act and that the IRFA published with the proposed regulations was technically in compliance with the law. Nonetheless, I also determined that a better job could have been done with respect to certain aspects of the IRFA. For example, regarding industry size standards, you suggest that we should have used NAICS 523991 relating to trust, fiduciary and other custody activities, rather than NAICS 531390 relating to real estate related services, such as escrow services. While we recognize that like-kind exchanges are not limited to real estate transactions, we believe both codes are under-inclusive as well as over-inclusive regarding the

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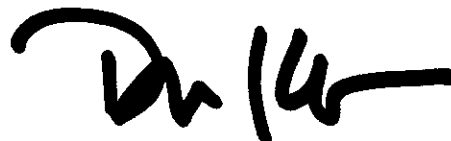
qualified intermediary industry. Hence, it may be more appropriate for the IRFA to use the higher gross receipts amount provided by NAICS 523991, or to use some kind of a composite of these industry segments.

You also criticized the IRFA for failing to adequately discuss the reasons for taking action and alternatives to the approach contained in the proposed regulation. Although the proposed regulations discuss the history of the project and contain, by implication, the reasons for the proposed regulation, this is not discussed specifically in the IRFA. In addition, although the IRFA discussed the alternative of retaining the facts and circumstances test under the 1999 proposed regulations, we agree that other alternatives could have been explicitly addressed. We will address both of these concerns in the next IRFA issued for the regulations.

Because I believe we could have done a better job with the analysis, and because the proposed regulations and the accompanying IRFA generated significant comments, I have directed my staff to commence work on a new IRFA for the proposed regulations. This will be published before the proposed regulations are finalized.

I would like to thank you for your comments on the proposed regulations and for raising these concerns with me regarding the adequacy of the IRFA with respect to these proposed regulations. I commit to you that we will take appropriate steps to address these concerns, along with the other comments we received. Also, we are undertaking a training program at the IRS concerning the requirements of the Regulatory Flexibility Act to ensure that those requirements are better adhered to in future regulatory projects.

Sincerely,

A handwritten signature in black ink, appearing to read 'DK' with a stylized flourish extending to the right.

Donald L. Korb
Chief Counsel