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December 15, 2014

The Honorable Mark Mazur
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The Honorable John Koskinen
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Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: **Report on Proposed Regulations Relating to Loss Duplication in the Partnership Context**

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report on certain proposed regulations under sections 704, 734 and 743 of the Internal Revenue Code of 1986 (the "Proposed Regulations"). The Proposed Regulations primarily address amendments made to these sections by the American Jobs Creation Act of 2004, which are intended to limit the ability of taxpayers to transfer losses among partners in a partnership.

We support the framework adopted by the Proposed Regulations and our comments are primarily directed at aspects that could be clarified in the final regulations (the "Final Regulations").

Our primary recommendations are as follows:

1. We support the decision not to extend the Proposed Regulations' special basis regime for built-in loss property to reverse section 704(c) adjustments.

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2. We recommend that the Final Regulations provide additional guidance as to what portion of a partner's share of built-in losses is eliminated or transferred upon the transfer of a portion of a partnership interest.
3. In the case of a gift of a partnership interest, we recommend that the donee keep the portion of the donor's built-in loss in an item of partnership property as is needed to ensure the donee is not placed in a built-in gain position with respect to that item.
4. We recommend further coordination between the rules of sections 362 and 704(c)(1)(C). For example, consistent with the election under section 362(e)(2)(C), we recommend that Final Regulations allow an election to reduce the basis of corporate stock rather than the basis of built-in loss property when either the property or an interest in partnership holding built in loss property is contributed to a corporation.
5. In the case of a partnership's transfer of built-in loss property in which gain is recognized only in part (such as a section 351 contribution with boot), we recommend that the Final Regulations consider addressing the extent to which the partner who contributed the built-in loss property should recognize gain.
6. Where a partnership sells built-in loss property in an installment sale, we recommend that a partner be permitted to currently apply the entire amount of the special basis adjustment with respect to the contributed property where that partner would, taking into account all payments (fixed and contingent) to be received under the installment term, have an overall loss.
7. In the case of a distribution of property contributed with a built-in loss, we recommend that the Final Regulations maximize the portion of any reallocated special basis adjustment that is allocated to property of a "like" character (for example, built-in loss from a capital asset should be reallocated to capital assets and not ordinary income property). Further, we recommend that the Final Regulations clarify that, where built-in loss property is distributed to the contributing partner but the partner's outside basis has been reduced below the sum of the partnership's basis in the property and any remaining built-in loss, the partner be permitted to reallocate any remaining special basis adjustment to other partnership property, taking into account appropriate adjustments under section 734. We also recommend that the special basis adjustment to property for built-in loss not be taken into account for the purposes of section 732(f) on distributions of that property to a non-contributing partner.
8. In the case of a partnership merger or division, we recommend that, to the extent possible, property retain its pre-merger/division special basis adjustment.
9. We recommend that the Final Regulations expressly state that the substantial basis reduction threshold under section 734(d) is measured on a partner-by-partner and distribution-by-distribution basis. We also recommend that the Final Regulations provide guidance on what constitutes a single "distribution," with the goal of prohibiting techniques to bypass the \$250,000 threshold but otherwise not combining separate distributions.
10. In calculating whether the substantial built-in loss threshold of section 743(d) has been exceeded, we recommend that the Final Regulations (A) make clear that the determination is based upon

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the fair market value of partnership assets rather than a derived value based upon the sales price or other value of the partnership interest being transferred and (B) determine the value of an interest in a lower-tier partnership based on the amount for which the attributable portion of the lower-tier assets would be sold.

11. We do not recommend the adoption of any new de minimis exceptions to the mandatory basis step-down rules. However, we do recommend that the Final Regulations address the practical issue faced by partners who hold “small” interests in partnerships, by allowing such partners to rely on information provided to them by the partnership as to asset value and, in certain cases, requiring partnerships to provide such information.
12. We recommend that the Final Regulations provide additional guidance on the scope of “relatedness” for the purposes of the “substantial built-in loss anti-abuse rule” of the Proposed Regulations, which among other things, would aggregate the losses of certain “related” partnerships for purposes of calculating whether the \$250,000 loss threshold has been exceeded.
13. We generally agree with the approach of the Proposed Regulations in requiring section 734(b) and section 743(b) basis adjustments at an upper-tier partnership to “tier down” to lower-tier partnerships where each partnership has a section 754 election in effect or where the top-tier partnership has a substantial basis reduction (in the case of section 734(b) adjustments) or a substantial built-in loss (in the case of section 743(b) adjustments). However, we recommend that, where a tier-down of a section 743 adjustment would result in a net basis increase at a lower tier partnership, the tier down to such partnership be required only where the partnership has a section 754 election in effect or the upper tier partnership owns 50% or more of the capital and profits of the lower tier partnership.
14. For the purposes of the eligibility test for electing investment partnership status, in determining whether an upper-tier partnership is treated as engaged in the trade or business of a lower-tier partnership and thus ineligible, we recommend that the Final Regulations provide a rule that, if the sum of the contributions to the capital of the lower-tier partnership and the recourse liabilities allocated to the putative EIP are less than 25% of the total capital required to be contributed to the putative EIP, then the lower-tier partnership is disregarded (rather than measure against adjusted basis in the lower-tier partnership interest, as the Proposed Regulations do). We also recommend that the Final Regulations provide limited relief for inadvertent terminations of EIP status, but we do not recommend that the Final Regulations allow a partnership that has willingly revoked its EIP status to re-elect such status.
15. Where section 755(c) applies to disallow a basis step-down to stock owned by a partnership, we recommend that the basis step-down be allocated among eligible partnership property under the regular principles of Treas. Reg. § 1.755-1(c). To the extent gain is recognized under section 755(c)(2), we recommend that the gain be allocated to the partners in a similar manner to that in which basis adjustments provided for under section 734(b) are reflected in the partners’ capital accounts for purposes of section 704(b).

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16. We agree with the general position of the Proposed Regulations to require the separate tracking of each “layer” of section 704(c) allocations, as opposed to the netting of those allocations. We recommend, however, that the Final Regulations allow netting in the case of certain “small partnership,” “small asset” and “small adjustment” situations. We also recommend that the Final Regulations allow taxpayers reasonable latitude in choosing how to allocate gain and loss across layers where the “ceiling rule” applies.

We appreciate your consideration of our recommendations.

Respectfully submitted,



David H. Schnabel
Chair

Attachment

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