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April 19, 2002

Pamela C. Olson
Acting Assistant Secretary (Tax Policy)
Department of the Treasury
Room 1334 MT
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Washington, DC 20020

Honorable Charles O. Rossotti
Commissioner
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Ms. Olson and Mr. Rossotti:

We write to raise questions which the Treasury and Internal Revenue Service may want to consider in revising or supplementing Rev. Rul. 92-17[1], or the related Treasury Regulations, or otherwise providing guidance on the circumstances in which a corporate partner will be regarded as engaged in an active trade or business for purposes of Section 355(b) and Regs. § 1.355-3(b) on account of the partner's ownership of an interest in a partnership.

We understand that further guidance on the issue addressed in Rev. Rul. 92-17 is contemplated. We strongly support this and do not by this letter want to delay the publication of any ruling, regulations or other guidance. The questions we raise here, if not answered by what is now under consideration, can be addressed in further rulings and/or in modifications to the regulations.

[1] 1992-1 C.B. 142.

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Rev. Rul. 92-17 concludes that a corporate general partner in a limited partnership which owns and rents commercial real estate is engaged in the active conduct of a trade or business for purposes of Section 355(b) and Regs. § 1.355-3(b) because the partner, through its officers, performs active and substantial management functions for the partnership, including the making of significant business decisions and regular participation in overall supervision, direction and control of partnership employees. The partnership had been engaged in its business for more than five years and the general partner had owned a 20% interest in the partnership for more than 5 years.

Rev. Rul. 92-17 is the only published authority that considers the circumstances in which a corporate partner will be regarded as engaged in an active trade or business for purposes of Section 355(b) and Regs. § 1.355-3(b) on account of the partner's ownership of an interest in a partnership. It was issued at a time when the use of partnerships was disproportionately to own real estate and before the proposal and subsequent adoption of the check-the-box regulations and the spread of limited liability companies.

Approach of Rev. Rul. 92-17

Most of our questions, set out below, relate to the apparent limitations imposed by Rev. Rul. 92-17 or to issues which it does not explicitly address. There is a threshold question, however, as to whether the approach of Rev. Rul. 92-17 — i.e., the decision not simply to attribute the partnership's business to any corporate partner which has a significant partnership interest — is the best choice.

There are other areas where the extent to which a partner is treated as carrying on the business of the partnership has been addressed and decided differently. These include the continuity of business enterprise regulations (Regs. § 1.368-1(d)(4)(iii)(B)(1)), which attribute the business of a partnership to a corporation which has a "significant interest" in the partnership; and the "Helen of Troy" regulations (Regs. § 1.367(a)-3(c)(5)(viii)), which impute to a foreign corporation the active trade or business carried on by a partnership in which the corporation owns a 25% or greater interest in partnership capital and profits.

If Section 355(b) is to be interpreted to attribute a partnership's business to any corporate partner with a significant interest in the partnership, the Treasury and IRS would of course have to consider whether this could be done without changing the present regulations. In particular, the regulations require that the business be "carried on by the corporation" (Regs. § 1.355-3(b)(2)(ii)) and that "generally" the corporation must "itself" perform "active and substantial management and operational functions" (Regs. § 1.355-3(b)(2)(iii)).

If a partnership business is attributed to a corporate partner with a significant interest in the partnership, there would also have to be guidance on what is a significant interest and how that is measured – a 25% interest in capital and profits satisfies Regs. § 1.367(a)-3(c)(5)(viii); a one-third percentage interest satisfies Regs. § 1.368-1(d)(4)(iii)(B), as illustrated by Example (9) of Regs. § 1.368-1(d)(5). Rev. Rul. 92-17 itself involved a general partner with a 20% "interest".

Under the continuity of business enterprise and "Helen of Troy" regulations, attribution of the partnership's business to a partner which has a significant interest in the partnership is one of two alternatives. If the partnership interest is not significant, the business will nonetheless be attributed to the partner if the partner carries on "active and substantial management functions as a partner with respect to" the partnership (see Regs.§ 1.368-1(d)(4)(iii)(B)(2) and Regs. § 1.367(a)-3(c)(5)(viii)). The Treasury and IRS might wish to compare this standard — "active and substantial management functions" — to the standard in Regs. § 1.355-3(b)(2)(ii) ("active and substantial management and operational functions") and to consider whether the standards are, or should be, the same; and also consider whether Rev. Rul. 92-17 has any relevance in interpreting the "active and substantial management functions" standard in Regs.§ 1.368-1(d)(4)(iii)(B)(2) and Regs. § 1.367(a)-3(c)(5)(viii)

Interpretation of Rev. Rul. 92-17

Turning more directly to Rev. Rul. 92-17, we have set out our questions below. We recognize that some of these involve issues that arise under Section 355(b) in cases not involving corporate partners (for example, paragraph 5 below, which involves the treatment of a business acquired with a substituted basis), but we think that these questions should also be raised in the context of Rev. Rul. 92-17.

1. Rev. Rul. 92-17 involved a corporate general partner in a limited partnership. This raises a number of questions. Is the holding of Rev. Rul. 92-17 in any way dependent on the legal form of the partnership entity or the legal form of the corporate partner's ownership interest in the entity? Specifically, must the corporate partner be exposed to a general partner's liability? Must the partnership interest have inherent management rights, such as a general partnership interest in a general or limited partnership or a managing membership interest in a limited liability company?

2. The general partner in Rev. Rul. 92-17 had owned a 20% "interest" in the partnership for more than five years. Was the size of the interest relevant and, if so, the period during which the corporation owned that much of an interest? Put differently, must it be at least 20% for five years? If size is relevant to the conclusion in Rev. Rul. 92-17, and if it is

also relevant that the corporation was a general partner, must all of the required interest be in the form of a general partnership interest?

3. Rev. Rul. 92-17 deals only with one corporate partner, and this raises the question of whether more than one corporate partner in a partnership can satisfy the requirements of that ruling. Suppose, for example, there had been two corporate partners, each of which through its officers, performed active and substantial management functions for the partnership. Could both partners have qualified as engaged in the active conduct of a trade or business? Is there a numerical limit, apart from whatever limit may follow from the answer to the questions raised in 2. above?

4. What is the relationship between the partnership's business and the historical or continuing business of the corporate partner to which that business is attributed?

Specifically, would the partnership business that is attributed to the general partner in Rev. Rul. 92-17 be the same business as that previously conducted by the partner if the business was, in whole or in part, contributed by the partner to the partnership in exchange for its partnership interest? This would be relevant, for example, in a case where the business in the partnership satisfied the five year requirement of Regs. § 1.355-3(b)(3) only if the partner's prior conduct of that business was taken into account.

If the partnership business attributed to the general partner in Rev. Rul. 92-17 had been, in whole or in part, acquired by the partnership in a purchase transaction within the five year period preceding the distribution, could that business be an "expansion" of the partner's business (and not a "new" or "different" business, within the meaning of Regs. § 1.355-3(b)(3)(ii)) if the partner directly conducted the same business or had previously contributed the same business to the partnership?

These questions are unanswered by Rev. Rul. 92-17 since the partnership in that ruling had carried on its business for more than five years and the general partner had been a partner for more than five years.

5. If a business is distributed by a partnership to a corporate partner and has a basis in the partner's hands that is determined under Section 732(b), will the business be treated, under Regs. § 1.355-3(B)(4)(i) as, in effect, "purchased" because its basis to the corporation is not a carryover basis?

6. In determining the value of a corporate partner's qualifying active trade or business for purposes of the no ruling policy in Section 4.01(31) of Rev. Proc. 2002-3, does the partner take into account its share of the gross assets of the partnership or only its share of the net assets?

7. Is there any scope to apply Rev. Rul. 92-17 if several members of a group filing consolidated federal income tax returns are partners in a partnership but only one (or in any event, less than all) would, if viewed separately, be attributed the business of the partnership under the ruling? For purposes of the rules relating to acquisitions of trades or business, members of an affiliated group have been treated, in effect, as a single corporation (see Rev. Rul. 78-442, 1978-2 C.B. 143, and Regs. § 1.355-3(b)(4)(iii) and (iv)). Specifically, can interests and activities of different members of a consolidated group be aggregated under a rule similar to the rule of Regs. § 1.1502-34?

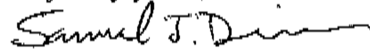
8. To what extent does Rev. Rul. 92-17 provide the only rule? Whether a trade or business is actively conducted is based on all the facts and circumstances (see Regs. § 1.355-3(b)(2)(iii)), but Rev. Rul. 92-17 has nevertheless been read by many as meaning that a corporate partner will not satisfy the active trade or business requirement on account of the ownership of a partnership interest unless the partner, through its officers, performs active and substantial management functions for the partnership, including the taking of significant business decisions and regular participation in overall supervision, direction and control of partnership employees. Is this reading warranted? Is it consistent with, for example, the holdings in Rev. Rul. 79-394, 1979-2 C.B. 141, and Rev. Rul. 80-181, 1980-2 C.B. 121, that the active trade or business requirement can be satisfied by a corporation that did not, until the distribution, have its own employees?

9. To what extent does Rev. Rul. 92-17 reflect the specific context of commercial real property held for lease? Whether and under what circumstances the ownership of real estate is an active trade or business has always been a closer call than for many other activities (see, e.g., Rev. Rul. 2001-29, 2001-26 I.R.B. 1348), including activities, such as telecommunications, which increasingly are carried on through partnerships, and in which the partnership (rather than any partner) will often employ all of the relevant employees.

There is private ruling authority on some of the questions raised above (for example, that a managing member of a limited liability company may be engaged in an active trade or business on account of its ownership of that interest). Private rulings do not, however, provide comprehensive answers or even answers that may necessarily be relied upon even in what may seem to be an identical case. The facts in most private rulings are not sufficiently transparent for the reader to know all of what was involved. We therefore do not think that the questions which we have raised should be left to development in the private ruling process.

We would be pleased to elaborate on any or all of the foregoing questions. We submit these questions now in the interest of providing you with our questions on a prompt basis.

Very truly yours,



Samuel J. Dimon
Chair

cc: Eric Solomon
Robert P. Hanson
Hon. B. John Williams, Jr.