NEW YORK STATE BAR ASSOCIATION
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May 22, 2013

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Daniel I. Werfel
Acting Commissioner
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: New York State Bar Association Tax Section Report on Proposed Regulations Regarding the Tax Treatment of Noncompensatory Partnership Options

Dear Messrs. Mazur, Werfel and Wilkins:

I am pleased to submit the enclosed New York State Bar Association Tax Section report on the proposed regulations regarding the tax treatment of noncompensatory partnership options ("NCOs") issued by the Treasury Department and the Internal Revenue Service on February 5, 2013 (the "Proposed Regulations").

The Proposed Regulations were issued concurrently with final regulations (the "Final Regulations") which provide that, upon the occurrence of an event that is a "measurement event" under the Final Regulations (such as a transfer of the NCO), the NCO will be tested (under the "Characterization Test" set out in the Final Regulations) to determine if the NCO should be treated as a partnership interest rather than as an NCO for all tax purposes.

The Proposed Regulations would add: (i) three additional "measurement events," and (ii) rules addressing the tax consequences to the partnership that issued the NCO when the NCO lapses or is repurchased by the partnership. The Proposed Regulations are proposed to have the same effective date as the Final Regulation (February 5, 2013).

Our principal recommendations are as follows:

1. We generally support the addition of the new measurement events subject to two recommendations:

    a. We recommend that the Internal Revenue Service and the Treasury Department clarify that (i) the deemed events that occur pursuant to a technical termination of a partnership under Section 708(b)(1)(B) do not themselves give rise to a measurement event, and (ii) those events do not include a deemed issuance or transfer of any NCO issued by the terminated partnership or any lower-tier partnership;

    b. We recommend that some guidance be provided regarding one element of the new measurement events (what we refer to in the report as the "Principal Purpose of Reduction Test") and suggest that the Internal Revenue Service and the Treasury Department provide a list of relevant factors that should be considered in determining if the Principal Purpose of Reduction Test is met in the case of events involving transfers, issuances or modifications of partnership interests in upper-tier entities; we also suggest some factors that might be appropriate;

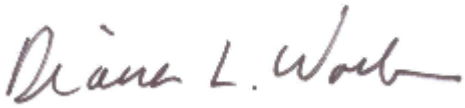
2. In response to the preamble's request for comments, we discuss in detail whether Section 751(a) should apply to the lapse, repurchase, sale, or exchange of an NCO, and conclude that it should not. We recommend that the Internal Revenue Service rely on its carefully drafted Characterization Rule to ensure that NCO holders are treated as partners (subject to Section 751) when appropriate. In the event that our recommendation is not taken, we suggest how regulations could apply Section 751(a) to transfers of NCOs;

3. In response to a request for comments in the preamble, we recommend that the Internal Revenue Service and the Treasury Department not provide rules regarding notification of partners or partnerships upon the occurrence of a measurement event, but rather that such notification procedures be left to the partners to determine; and

4. We support the proposal that the Proposed Regulations have the same effective date as the Final Regulations.

We very much appreciate your consideration of our recommendations and would be happy to discuss them with you or provide additional assistance.

Respectfully submitted,



Diana L. Wollman
Chair

Enclosure

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