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May 30, 2014

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

The Honorable John Koskinen
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: **Report on the Proposed Regulations on the
Allocation of Partnership Liabilities and Disguised Sales**

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report of the Tax Section of the New York State Bar Association. The report provides comments on regulations proposed on January 30, 2014 (the "Proposed Regulations"), concerning the allocation of partnership liabilities under section 752 and disguised sales under section 707.

Section 752 and the regulations thereunder generally provide rules for determining a partner's share of partnership liabilities. The existing regulations under section 752 were issued 1991 in response to a Congressional directive in 1984 to override the result in *Raphan v. United States*, 3 Cl. Ct. 457 (1983), *aff'd in part and rev'd in part*, 759 F.2d 879 (Fed. Cir. 1985), holding that a general partner's guarantee of a nonrecourse liability of a limited partnership did not prevent the limited partners from sharing in the liability for purposes of section 752.

Section 707(a)(2)(B) generally provides that, under regulations, if: (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to that partner (or another partner), and (iii) the

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transfers described above, when viewed together, are properly characterized as a sale or exchange of property, then the transfers will be treated as either occurring between a partnership and one who is not a partner, or between two or more partners acting other than in their capacity as members of the partnership. The existing section 707 regulations incorporate many of the liability allocation rules under the existing section 752 regulations.

The Proposed Regulations were issued in response to perceived ambiguities and flaws in the existing regulations under sections 752 and 707, particularly as they relate to the treatment of guarantees and other “payment obligations.” The Proposed Regulations would result in a significant change in the treatment many partnership liabilities. Although we support the overall objective of the Proposed Regulations to give effect only to *bona fide*, commercial payment obligations, we have concerns about some of the specific proposals contained in the Proposed Regulations and therefore recommend a number of changes.

In addition, we recommend that the Internal Revenue Service (the “IRS”) and the Department of the Treasury (“Treasury”) consider whether the final regulations should approach the allocation of liabilities for purposes of section 707 somewhat differently from the manner in which liabilities are allocated under section 752. The provisions of the Proposed Regulations addressing section 707 are in many respects severable from those addressing section 752.

Our principal recommendations relating to the Proposed Regulations are as follows:

1. We recommend that:
 - a. The IRS and Treasury should consider treating all liabilities as nonrecourse solely for purposes of the disguised sale rules. Under this approach, a partner’s allocable share of a partnership liability (including a liability assumed or taken subject to by the partnership in connection with the contribution of property by the partner to the partnership) would equal the portion of the liability that would be allocated to the partner if the entire liability were allocable among the partners under the provisions of Treas. Reg. § 1.752-3(a)(3) (but excluding for this purpose the Significant Item Method and the Alternative Method (both as defined in the attached report); *provided, however*, that the partner’s allocable share of any such liability should not include any portion of the liability with respect to which another partner bears the economic risk of loss).
 - b. The provisions of the Proposed Regulations relating to recourse liabilities under section 752 that should be finalized should be limited to:
 - i. The provisions limiting bottom-dollar guarantees in Prop. Treas. Reg. § 1.752-2(b)(3)(ii)(F) and (G), as modified by recommendation 3 in the report. If, however, it is determined that doing so would result in significant changes to the manner in which partnership deductions are allocated under section 704(b) (applying traditional section 704(b) principles), we recommend that the IRS and Treasury consider seeking additional public comments before finalizing those provisions.
 - ii. The provisions expanding the application of the net value rule of Treas. Reg. § 1.752-2(k), as modified by recommendation 4 in the report. If, however, the approach described in paragraph 1(a) is adopted, the IRS and Treasury should consider whether the benefits of expanding the net value rule are outweighed by the administrative difficulties the expansion is likely to create for both taxpayers and the IRS and whether it would be

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preferable simply to expand the anti-abuse rule currently found in Treas. Reg. § 1.752-2(j).

2. If the approach described in paragraph 1 above is not adopted, we would recommend that:
 - a. Solely for disguised sale purposes (and not for purposes of allocating liabilities among partners under section 752), the final regulations should:
 - i. Prevent all bottom-dollar guarantees by adopting the requirements in Prop. Treas. Reg. § 1.752-2(b)(3)(ii)(F) and (G).
 - ii. Impose minimum net worth requirements on all partners and related persons, including individuals and decedents' estates.
 - iii. Prohibit the use of the Significant Item Method and the Alternative Method.
 - b. Regarding payment obligations in general, the final regulations should provide that only payment obligations that contain terms that are reasonably consistent with customary commercial practices for similar arrangements among unrelated third parties will be given effect under the section 752 regulations. For this purpose, the final regulations should contain a nonexclusive list of facts and circumstances that would be relevant in determining whether this requirement was satisfied and should provide that no single factor is determinative.

We also have a number of recommendations regarding other aspects of the Proposed Regulations under section 752, including those relating to the payment obligations requirements, "bottom-dollar" guarantees, net value rules, the allocation of recourse liabilities, and transition rules. In addition, we have a number of recommendations regarding the Proposed Regulations under section 707.

We appreciate your consideration of our recommendations.

Respectfully submitted,



David H. Schnabel
Chair

Enclosures

cc: Deane M. Burke
Office of Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Mr. Mazur
Mr. Koskinen
Mr. Wilkins
May 30, 2014

Erik Corwin
Deputy Chief Counsel (Technical)
Internal Revenue Service

Craig Gerson
Attorney-Advisor (Tax Policy)
Department of the Treasury

Emily S. McMahon
Deputy Assistant Secretary (Tax Policy)
Department of the Treasury

Clifford Warren
Special Counsel to the Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Curt Wilson
Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Lisa Zarlenga
Tax Legislative Counsel (Regulatory Affairs)
Department of the Treasury