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June 17, 2015

The Honorable Mark Mazur
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Commissioner
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Washington, DC 20224

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

Re: **Report on the Treatment of Exculpatory
Liabilities for Purposes of Section 704 and Section 752.**

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 to the treatment of "exculpatory liabilities" of a limited liability company ("LLC") under Sections 704(b) and 752.

"Exculpatory liabilities" have been described as liabilities of a partnership that are not secured by any specific property and that are recourse to the partnership as a whole but are explicitly not recourse to any partner. Section 752 and the regulations thereunder generally provide rules for determining a partner's share of partnership liabilities; Section 704(b) and the

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corresponding regulations relating to the determination of a partner's distributive share of partnership items provide rules regarding the allocation of deductions generated by nonrecourse liabilities and of subsequent income inclusions.

To clarify the proper treatment of exculpatory liabilities held by LLCs under these rules, our principal recommendations to the Internal Revenue Service ("IRS") and the Department of the Treasury ("Treasury") are as follows:

1. *Definition of "exculpatory liability."* We recommend that the regulations promulgated under Sections 704 and 752 define the term "exculpatory liability" to include obligations that are by their terms recourse to the borrower and secured by all or part of the assets of the borrower and to include obligations that are not recourse to members of an entity by operation of the law under which the entity is organized.
2. *Characterization of an exculpatory liability.* We recommend that the Treasury and the Service confirm that exculpatory liabilities of an LLC treated as a partnership are properly characterized as nonrecourse liabilities for purposes of Sections 704(b) and 752, regardless of their characterization for purposes of Section 1001.
3. *Minimum gain generated by exculpatory liabilities.* We recommend that Treasury Regulations Sections 1.704-2(d) and 1.704-2(b)(2) be amended to clarify that for purposes of those rules, the terms "subject to" and "encumber" can properly describe the relationship between exculpatory liabilities and the assets they economically burden.
4. *Allocation of liabilities.* We recommend that the regulations promulgated under Sections 704 and 752 be amended to clarify that a partnership borrower is to treat an exculpatory liability as having a floating lien over all assets of the borrower for purposes of determining minimum gain, with an exclusion for cash and current assets as a reasonable alternative approach.
5. *Definition of partner nonrecourse debt.* We recommend that the definition of partner nonrecourse debt in Treasury Regulations Section 1.704-2(b)(4) be amended to include Section 1001 recourse liabilities for which a partner bears the economic risk of loss.

We appreciate your consideration of our recommendations.

Respectfully submitted,

David R. Sicular
Chair

Attachment

The Honorable Mark Mazur
The Honorable John Koskinen
The Honorable William J. Wilkins
June 17, 2015

Cc:

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