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January 23, 2004

The Honorable Pamela F. Olson  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
Room 3120 MT  
1500 Pennsylvania Avenue, N.W.  
Washington, DC 20220

The Honorable Mark W. Everson  
Commissioner  
Internal Revenue Service  
Room 3000 IR  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Dear Secretary Olson and Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1049 on the Taxation of Partnership Interests Received for Services and Compensatory Partnership Options. The Tax Section previously submitted a report on the taxation of Partnership Options and Convertible Securities in response to Notice 2000-29.<sup>1</sup>

This report is in response to a request for additional comment contained in the preamble to the Proposed Regulations regarding Non-

<sup>1</sup> New York State Bar Association Tax Section Report No. 1005, dated January 29, 2002.

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Compensatory Partnership Options. We are submitting this report as a companion report to a separate report<sup>2</sup> on those Proposed Regulations.

We commend the Treasury and the Internal Revenue Service for their attention to the complicated issues posed by compensatory partnership interests. There are presently very difficult questions, most related to the interaction between Section 83 and Subchapter K principles, for which there is little guidance.

Our report makes a number of recommendations. The principal ones are these:

- Treasury regulations should be issued providing that the amount of income realized by a service provider upon the receipt of a compensatory interest in a partnership generally should be equal to the liquidation value of the partnership interest at the time it is issued.
- Treasury regulations should be issued providing, in the case of the issuance of an unvested profits interest, that no taxable income is realized either upon the receipt or the vesting of such interest, without the need to make any affirmative Section 83(b)-type election.
- Treasury regulations should clarify the tax consequences to the partnership and its historic partners of the issuance of a compensatory capital interest. Our report discusses some of the considerations to be taken into account in those regulations.

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<sup>2</sup> New York State Bar Association Tax Section Report No. 1048, dated January 23, 2004.

- As recommended in our 2002 report, the new Treasury Regulations, as they relate to compensatory options to acquire partnership interests, should provide for a tax result that generally corresponds to the treatment of nonqualified compensatory options to acquire stock. That is, the grant of the option would not be a taxable event for the partnership or the service provider. The exercise of the option would be treated for tax purposes as the issuance, at the time of exercise, of a partnership interest in exchange for services, with the tax consequences being determined under principles to be enumerated in such regulations.

As always, we will be pleased to provide additional commentary as requested. If you have any questions regarding the report, please do not hesitate to contact us.

Respectfully submitted,

A handwritten signature in black ink that reads "Andrew N. Berg". The signature is written in a cursive style with a large initial 'A' and 'B'.

Andrew N. Berg  
Chair

cc: Eric Solomon, Deputy Assistant Secretary, Regulatory Affairs,  
Department of Treasury

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