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January 21, 2005

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

Dear Commissioner Everson:

I am pleased to submit the New York State Bar Association Tax Section's Report No. 1077 with respect to the Section 1045 gain rollover rules for qualified small business stock ("QSBS"). This report addresses the Proposed Regulations issued by the Treasury Department and the Internal Revenue Service on July 15, 2004, as corrected on August 10, 2004, relating to the application of Section 1045 to partnerships and their partners.

The Proposed Regulations provide clarification on the mechanical operation and scope of the Section 1045 gain rollover rules in the partnership context. We commend the Treasury Department and the Internal Revenue Service for proposing rules that are clear and mechanical, drawing on the underlying principles of the statute to provide greater certainty for taxpayers. Given the importance of venture capital funds and other partnership vehicles in facilitating investments in QSBS, guidance in this area is extremely important.

Our report identifies several areas where we believe the Proposed Regulations could provide for greater flexibility, although we acknowledge that greater flexibility must be balanced against the desire for simplicity. For example, the Proposed Regulations could provide greater flexibility in the rules related to the acquisition of replacement QSBS by allowing for the indirect acquisition of replacement QSBS in a tiered partnership arrangement or through a separate chain of partnerships. In addition, greater flexibility could be provided by permitting a partner to opt out of a partnership's Section 1045 election.

While we support the concept of a "non-recognition limitation" in the Proposed Regulations, consideration should be given to the application of this

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rule to complex partnership structures that are quite common in practice. While we do not endorse any particular approach, we urge that consideration be given to the appropriate way to address this issue in a manner that is fair and avoids undue complexity.

Finally, our report identifies certain aspects of the Proposed Regulations that are compelled by the statute but that we believe may be unnecessarily restrictive. For these areas, we recommend giving consideration to a statutory revision project. These areas include the prohibition against treating the sale of a partnership interest as the sale of QSBS and the rule preventing QSBS that is contributed by a partner to a partnership from retaining its QSBS character.

As always, we would be pleased to provide assistance in any way we can.

Respectfully submitted,



Lewis R. Steinberg  
Chair

cc: Eric Solomon, Acting Deputy Assistant Secretary (Tax Policy),  
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