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September 23, 2010

The Honorable Michael Mundaca
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1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable Douglas H. Shulman
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Re: Partnership Target Allocations

Gentlemen:

The enclosed report discusses the use of "target" allocations, which have become ubiquitous in modern partnership agreements. As described in the report, this common method of allocating income and loss among partners is not motivated by tax avoidance, but rather a desire to achieve compliance with the "substantial economic effect" requirement of the regulations governing partnership allocations (the "704(b) Regulations"), without altering the pre-tax economic agreement among the partners by virtue of a drafting error. However, the 704(b) Regulations do not address explicitly under what circumstances, if any, allocations using this method will be respected.

After describing how and why target allocations are typically used and their treatment under the current 704(b) Regulations, the report makes several recommendations for guidance. Most importantly, the report recommends that guidance be issued confirming that target allocations, as described in the report, generally will be respected as being in accordance

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with the “partners’ interests in the partnership” provided the allocations achieve their targeted capital account objective. Most of the other recommendations of the report relate to the treatment of target allocations under the “economic effect equivalence” test and the safe harbor rules for allocating nonrecourse deductions and residual nonrecourse liabilities under the 704(b) Regulations.

We appreciate your consideration of our recommendations. If you have any questions regarding this report, please feel free to contact us and we will be glad to discuss or assist in any way.

Respectfully yours,



Peter H. Blessing
Chair

Enclosure

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