

COMMENTS CONCERNING REVENUE RULING 2004-43

The following comments represent the individual views of the members of the Section of Taxation who prepared them, do not represent the position of the Section of Taxation of the American Bar Association, and do not necessarily represent the views of the firms or organizations with which such members are associated.

These comments were prepared by individual members of the Committee on Partnerships and LLCs of the ABA Section of Taxation. The principal draftspersons of these comments are Eric Sloan, Christopher McLoon, and Jennifer Alexander. Comments were received from William Caudill, R. Brent Clifton, Steven Frost, Stephen Owen, Blake Rubin, Todd Smith, Andrea Macintosh Whiteway, and James Wreggelsworth. The comments were reviewed by Richard Levine of the Section's Committee on Government Submissions and by Fred Witt, the Council Director of the Committee on Partnerships and LLCs.

Although members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization with which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

Contact: Eric Sloan
Telephone: 212.492.4159

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EXECUTIVE SUMMARY

Section 704(c) was adopted to prevent the shifting of built-in gain or loss among partners. Section 704(c)(1)(A) provides that gain or loss with respect to property contributed to a partnership by a partner will be shared among the partners so as to take into account any built-in gain or loss in the property at the time of the contribution (“precontribution gain or loss”). Generally, section 704(c)(1)(A) operates by allocating gain or loss recognized on the taxable disposition of property in a manner that takes into account the precontribution built-in gain or loss, although section 704(c)(1)(A) also can operate to specially allocate other tax items, such as depreciation deductions. Section 704(c)(1)(B) was added to the Code to ensure that a partner could not escape the reach of section 704(c) by simply causing the partnership to distribute the built-in gain or loss property to another partner. Thus, if a partnership distributes property contributed by a partner to another partner within seven years of its contribution, the contributing partner will recognize gain or loss under section 704(c)(1)(B). The amount recognized by the contributing partner is an amount equal to the gain or loss the partner would have been allocated under section 704(c)(1)(A) if the partnership had simply sold the property to the distributee partner. Section 737 was added to the Code shortly after section 704(c)(1)(B) became part of the Code to ensure that a partner could not avoid sections 704(c)(1)(A) and 704(c)(1)(B) simply by leaving the partnership before his contributed property was sold or distributed to another partner. Thus, if a partnership distributes property to a partner within seven years of such partner contributing appreciated property to the partnership, the contributing partner will recognize gain or loss under section 737. The amount recognized by the contributing partner is an amount equal to the lesser of (i) the partner’s net precontribution gain or (ii) the excess of the value of the distributed property over the adjusted basis of the partner’s partnership interest.

The Treasury regulations promulgated in 1995 under sections 704(c)(1)(B) and 737¹ provide that, following an “assets-over” partnership merger, a distribution of property by the transferee partnership to a partner of the transferee partnership that was formerly a partner of the transferor partnership is subject to sections 704(c)(1)(B) and 737 (the so-called “anti-mixing bowl rules”) “to the same extent” that a distribution by the transferor partnership would have been subject to those rules. These regulations have been the subject of considerable commentary, especially since 2000, following the issuance of proposed regulations under section 708(b)(2) regarding partnership mergers and divisions.

On April 12, 2004, in Rev. Rul. 2004-43 (the “Ruling”),² the Internal Revenue Service (the “IRS”) held that, following an “assets-over” partnership merger, a distribution of property by the transferee partnership of property transferred to the transferee partnership by the transferor partnership can result in the recognition of gain or

¹ Unless indicated otherwise, all “section” references are to the Internal Revenue Code of 1986, as amended (the “Code”), and all “Treas. Reg. §” references are to the Treasury Regulations promulgated under the Code.

² 2004-18 I.R.B. 842 (published in the Internal Revenue Bulletin on May 3, 2004).

loss to the partners of the transferor partnership under sections 704(c)(1)(B) and/or 737, as applicable. The Ruling concludes that a new seven-year period starts under section 704(c)(1)(B) and 737 for any section 704(c) gain created in an asset-over partnership merger. We believe that this holding is not supported by, and is contrary to the understanding of nearly all of the tax practitioners who have commented on, the regulations.³ Moreover, we believe that the Ruling seriously undermines the tax policy principles of predictability and equity among taxpayers. Accordingly, we respectfully request that the IRS withdraw the Ruling and issue proposed regulations on point. These actions will permit tax practitioners to participate in a rigorous examination of the technical and policy issues that are fundamental to applying sections 704(c) and 737 to partnership mergers in light of the choices made in the Ruling. We further recommend that any regulations issued be applicable only to mergers occurring after April 12, 2004, the date on which the Ruling was released. Finally, we believe that the principles of the Ruling should not apply to mergers of related partnerships because the policy rationale presumably underlying sections 704(c) and 737 is not present in such transactions.

DISCUSSION

I. The Anti-Mixing Bowl Rules Generally

Section 704(c)(1)(A) provides that income, gain, loss, or deduction with respect to section 704(c) property (*i.e.*, built-in gain or built-in loss property) contributed to a partnership by a partner must be shared among the partners so as to take into account the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Section 704(c)(1)(B) provides that any partner who contributes section 704(c) property to a partnership must recognize gain or loss on the distribution of such property to another partner within seven years of its contribution. The amount of gain or loss recognized is the amount of gain or loss that would have been allocated to such partner under section 704(c)(1)(A) if the property had been sold by the partnership to the distributee partner for its fair market value at the time of the distribution.

Section 737(a) provides that any partner who contributes section 704(c) property to a partnership may recognize gain on a subsequent distribution of property (other than money) by the partnership to that partner within seven years of the contribution. The amount of gain recognized is the lesser of (i) the amount by which the fair market value of the distributed property exceeds the distributee partner's adjusted tax basis in the partner's partnership interest, or (ii) the "net precontribution gain" of the contributing partner.⁴ A partner's "net precontribution gain" equals the net gain that would have been recognized by the distributee partner under section 704(c)(1)(B) if all property that (i) had been contributed to the partnership by the distributee partner within

³ See note 11, *infra*.

⁴ Section 737(a).

seven years of the distribution and (ii) is held by such partnership immediately before the distribution, had been distributed by such partnership to another partner.⁵

II. The Subsequent Distribution Rules

On December 26, 1995, the IRS and Treasury promulgated final regulations under section 704(c)(1)(B) and section 737 that provide guidance with respect to the application of these anti-mixing bowl rules to a contribution by a partnership of its assets and liabilities to another partnership, followed by the liquidation of the contributing partnership.⁶ (Those regulations contain specific rules governing a subsequent distribution of such contributed property (the “Subsequent Distribution Rules”).)

Treas. Reg. § 1.704-4(c)(4) states:

(4) COMPLETE TRANSFER TO ANOTHER PARTNERSHIP.

Section 704(c)(1)(B) and this section do not apply to a transfer by a partnership (transferor partnership) of all of its assets and liabilities to a second partnership (transferee partnership) in an exchange described in section 721, followed by a distribution of the interest in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement. *A subsequent distribution of section 704(c) property by the transferee partnership to a partner of the transferee partnership is subject to section 704(c)(1)(B) to the same extent that a distribution by the transferor partnership would have been subject to section 704(c)(1)(B).* See § 1.737-2(b) for a similar rule in the context of section 737. [Emphasis added.]

Similarly, Treas. Reg. § 1.737-2(b) states:

(b) Transfers to another partnership –

(1) COMPLETE TRANSFER.

Section 737 and this section do not apply to a transfer by a partnership (transferor partnership) of all of its assets and liabilities to a second partnership (transferee partnership) in an exchange described in section 721, followed by a

⁵ Section 737(b).

⁶ T.D. 8642, 60 Fed. Reg. 66,727 (Dec. 26, 1995).

distribution of the interest in the transferee partnership in liquidation of the transferor partnership as part of the same plan or arrangement. See § 1.704-4(c)(4) for a similar rule in the context of section 704(c)(1)(B).

* * *

(3) SUBSEQUENT DISTRIBUTIONS.

A subsequent distribution of property by the transferee partnership to a partner of the transferee partnership that was formerly a partner of the transferor partnership is subject to section 737 to the same extent that a distribution from that transferor partnership would have been subject to section 737. [Emphasis added.]

Under Treas. Reg. § 1.708-1(c)(3), the transaction described in the anti-mixing bowl regulations quoted above constitutes an “assets-over” partnership merger. Moreover, under Treas. Reg. § 1.708-1(c)(3)(i), every partnership merger or consolidation other than one occurring in the “assets-up” form described in Treas. Reg. § 1.708-1(c)(3)(ii), is deemed to occur in the “assets-over” form.

III. The Ruling

Rev. Rul. 2004-43 discusses the tax consequences of an assets-over merger of partnership AB and partnership CD (the “Merger”). Specifically, the Ruling discusses whether: (i) the Merger will create section 704(c) gain or loss, and (ii) for purposes of section 737(b), net precontribution gain includes any section 704(c) gain or loss created in connection with the Merger.

In the Ruling, A and B formed equal partnership AB, and C and D formed equal partnership CD. On the date of formation, A contributed Asset 1 with a basis of \$200 and a fair market value of \$300, and B contributed \$300 of cash, to AB. On the same day, C contributed Asset 2 with a basis of \$100 and a fair market value of \$200, and D contributed \$200 of cash, to CD.⁷ The partnership agreements of partnership AB and partnership CD required the revaluation of partnership property upon the admission of a new partner.

Two years later, AB and CD merge, with AB surviving the merger for federal income tax purposes. Immediately prior to the Merger, AB held Asset 1 with a fair market value of \$900 and \$300 in cash, and CD held Asset 2 with a fair market value of \$600 and \$200 in cash. After the Merger, A and B each own 30 percent, and C and D each own 20 percent, of the capital and profits in AB.

⁷

In the Ruling, Asset 1 and Asset 2 are classified as nondepreciable capital assets.

The Ruling explains that, after the Merger, AB will hold Asset 2 with a basis of \$100 and a fair market value of \$600 and that, as a result, Asset 2 has \$500 of section 704(c) gain. Of the \$500 of section 704(c) gain, \$100 results from C's contribution of Asset 2 to CD (the "CD 704(c) Pre-Merger Layer"), and \$400 results from the Merger (the "704(c) Merger Layer").⁸ Because C and D shared CD profits equally, C and D share the 704(c) Merger Layer equally. In addition, because AB's partnership agreement requires the revaluation of partnership property immediately before the admission of a new partner, AB will hold Asset 1 with a \$200 basis and a section 704(b) book value of \$900. As a result, Asset 1 has \$700 of section 704(c) gain. Of the \$700 of section 704(c) gain, \$100 results from A's contribution of Asset 1 to AB (the "AB 704(c) Pre-Merger Layer"), and \$600 results from the revaluation and is, therefore, "reverse" 704(c) gain (the "Reverse 704(c) Layer").⁹ Because A and B shared partnership AB profits equally, A and B share the Reverse 704(c) Layer equally.

Six years after the Merger, AB distributes Asset 2 to A.¹⁰ At the time of the distribution, AB holds (i) \$500 in cash, (ii) Asset 1 with a fair market value of \$900, and (iii) Asset 2 with a fair market value of \$600. The Ruling concludes that both C and D recognize \$200 of gain in connection with the distribution of Asset 2. More specifically, although section 704(c)(1)(B) does not apply to the CD 704(c) Pre-Merger Layer (because the distribution of Asset 2 to A occurs more than seven years after C's contribution of Asset 2 to partnership CD), section 704(c)(1)(B) applies to the 704(c) Merger Layer because the distribution of Asset 2 occurs within seven years of the Merger.

Neither A nor B, however, will recognize gain. The AB 704(c) Pre-Merger Layer is not included in determining A's net precontribution gain for purposes of

⁸ The Ruling provides that, if property that is section 704(c) property in the hands of the transferor partnership is contributed to the transferee partnership at a time when the property's fair market value exceeds its section 704(b) book value in the hands of the transferor partnership, the transferee partnership holds the property with two separate "layers" of section 704(c) built-in gain. The first layer is an amount equal to the excess of the section 704(b) book value of the property on the books of the transferor partnership over its adjusted basis. The second layer is the excess of the fair market value of the property in the hands of the transferee partnership over its section 704(b) book value in the hands of the transferor partnership. While we understand that employing this mechanic may be necessary to implement the principles set forth in the Ruling, we believe the concept of preserving a section 704(c) layer existing in a transferor partnership in the hands of a transferee partnership, while also creating a new layer with respect to such property, is somewhat difficult to justify in a partnership merger under the existing section 704(c) regulations. Indeed, where the IRS and Treasury have wanted to achieve such a result, they have done so explicitly. *See* Treas. Reg. § 1.704-3(a)(9) (effectively providing such a rule in the context of tiered partnerships by requiring, in pertinent part, that where a partner contributes section 704(c) property to a partnership (the "upper-tier partnership") and the upper-tier partnership contributes the section 704(c) property to a lower-tier partnership, the upper-tier partnership must allocate its distributive share of lower-tier partnership items with respect to the contributed section 704(c) property in a manner that accounts for the contributing partner's remaining built-in gain or loss).

⁹ "Reverse" section 704(c) gain or loss is gain or loss that results from the revaluation under Treas. Reg. § 1.704-1(b)(2)(iv)(f), rather than the contribution, of property. Treas. Reg. § 1.704-3(a)(6)(i).

¹⁰ The Ruling addresses two situations. Only the first is discussed in these comments.

section 737(c) because the distribution of Asset 2 to A occurs more than seven years after A's contribution of Asset 1 to partnership AB. In addition, the Reverse 704(c) Layer is not included in determining A's net precontribution gain because reverse 704(c) gain is not considered in determining net precontribution gain.

In summary, the Ruling concludes that (i) an assets-over partnership merger will create new section 704(c) gain or loss in the assets contributed by the transferor partnership, (ii) section 704(c)(1)(B) applies to the new section 704(c) gain or loss attributable to the assets contributed by the transferor partnership, and (iii) for purposes of section 737(b), net precontribution gain includes the new section 704(c) gain or loss, but not the reverse section 704(c) gain or loss, created by such a merger.

IV. Impact on Taxpayers

A significant number of articles from a broad range of leading tax practitioners have addressed the Subsequent Distribution Rule. Nearly all of these practitioners have interpreted the language in Treas. Reg. §§ 1.704-4(c)(4) and 1.737-2(b) to mean that the amount of gain recognized under section 704(c)(1)(B) as a result of a distribution by the transferee partnership should equal the amount of gain that would have been recognized under section 704(c)(1)(B) if the property had been distributed by the transferor partnership.¹¹ In other words, these practitioners have applied a literal interpretation of the phrase "to the same extent."

¹¹ See, e.g., Richard M. Lipton et al., *Real Estate Tax Planning When You Strike It Rich*, SD31 ALI-ABA 245 (1998); Eric B. Sloan et al., *New Prop. Regs. Provide Guidance on Partnership Mergers and Divisions – Part 2*, 93 J. TAX'N 261 (2000), *modified and reprinted as, Partnership Mergers and Divisions: A User's Guide*, 569 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 55 (PLI 2003); William P. Wasserman, *Interaction Between the Basis Aggregation Rule in Rev. Rul. 84-53 and Section 704(c) and Related Provisions*, 475 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 1229 (PLI 2000); James E. Wreggelsworth, *Slicing, Dicing and Combining Partnerships: A Look at the Proposed Regulations on Partnership Mergers and Divisions*, CORPORATE TAX AND BUSINESS PLANNING REVIEW, TAX MANAGEMENT MEMORANDUM Vol. 41, No. 7, Special Edition 2000-3 (March 2000); Thomas M. Stevens, *Proposed Partnership Merger and Division Regulations Provide Guidance and Some Flexibility but Require Planning*, Vol. 3, No. 5 J. PASSTHROUGH ENTITIES (October 2000); Blake D. Rubin & Andrea Macintosh Whiteway, *Creative Transactional Planning Using the Partnership Merger and Division Regulations*, 95 J. TAX'N 133 (2001); Howard E. Abrams, *Getting Out Without Selling Out: The Proposed Partnership Merger and Division Regulations*, 59th N.Y.U. INST. 11.02[1] (2001); Richard M. Lipton, *Critical Partnership Tax Issues – An Overview*, 1313 TAX STRATEGIES FOR CORPORATE ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, FINANCINGS, REORGANIZATIONS & RESTRUCTURINGS 409 (PLI 2002); Richard M. Lipton, *Critical Partnership Tax Issues – An Overview*, SJ003 ALI-ABA 481 (2003); William S. McKee, *Partnership Mergers and Divisions*, 568 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 971 (PLI 2003); James B. Sowell, *Partnership Mergers and Divisions*, 569 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 9 (PLI 2003); Barbara Spudis de Marigny, *Mergers & Divisions of Partnerships*, 528 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 769 (PLI 2003).

Some of the commentators, while endorsing such an interpretation, have acknowledged that the inclusion of a special rule for terminations under section 708(b)(1)(B) in the regulations under sections 704(c)(1)(B) and 737 casts some doubt on such an interpretation of the Subsequent Distribution Rule.

We believe that the literal interpretation represents an objective interpretation of the regulations. Given the number and near unanimity of views on the subject, it seems clear that there is substantial merit to the literal interpretation. Many practitioners have publicly adopted the literal interpretation in widely-read journals and seminar outlines, absent guidance to the contrary. As many practitioners read and understandably rely on well-reasoned articles and seminar outlines, many clients were undoubtedly advised accordingly. The Ruling will come as a surprise to the large number of taxpayers so advised. Moreover, the Ruling takes a position that is not supported by the current regulations. The Ruling asserts that a new seven-year period starts under section 704(c)(1)(B) and 737 for any section 704(c) gain created in an asset-over partnership merger. Yet there is no indication in the regulations that such result would occur. To the contrary, a literal reading of the regulations leads to the conclusion that an assets-over partnership merger does not create new section 704(c) gain subject to a new seven-year period under sections 704(c)(1)(B) and 737.

V. Policy Issues

The Ruling presents tax policy issues. Most significant among these is the treatment of a partner of the transferor partnership who contributed only cash for her transferor partnership interest. While such a person is no doubt subject to section 704(c) for shares of reverse 704(c) book-up gain, it seems counterintuitive and surprising that she could be subject to sections 704(c)(1)(B) and 737. She has not *in fact* contributed any appreciated property to either partnership (transferor or transferee). This surprising result violates tax policy favoring predictability.¹²

The Ruling also presents equity issues vis a vis partners in the transferor partnership and partners in the transferee partnership. Similarly situated taxpayers should have similar tax results. Under the Ruling, however, the partners of the transferor partnership have dramatically different tax results from the partners of the transferee partnership. We think this uneven treatment of the partners is inconsistent with equitable principles of tax policy. Further, given that well-advised parties to a transaction often can arrange their affairs to effectively choose which partnership is surviving and which is

Richard M. Lipton et al., *Real Estate Tax Planning When You Strike It Rich*, SD31 ALI-ABA 245 (1998). Other commentators, while not necessarily endorsing such an interpretation, have observed the ambiguity in the regulations and merely noted that such a reading is both more “natural” and more prevalent among tax practitioners. Eric B. Sloan et al., *New Prop. Regs. Provide Guidance on Partnership Mergers and Divisions – Part 2*, 93 J. TAX’N 261 (2000), *modified and reprinted as, Partnership Mergers and Divisions: A User’s Guide*, 569 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 55 (PLI 2003). At least one commentator interpreted the Subsequent Distribution Rule in a manner consistent with the Ruling. See James B. Sowell, *Partnership Mergers and Divisions*, 569 TAX PLANNING FOR DOMESTIC & FOREIGN PARTNERSHIPS, LLCs, JOINT VENTURES & OTHER STRATEGIC ALLIANCES 9 (PLI 2003).

¹² See *Dotson v. United States*, 87 F.3d 682, 687 (5th Cir.1996) (holding that a judicial decision could not be applied retroactively because public policy favors finality and predictability).

terminating, it seems the results of the inequity will be determined not by any principles, but rather by the parties' whims or deliberate structuring.

VI. Recommendation

For these reasons, we respectfully request that the IRS withdraw the Ruling and address the principles of Rev. Rul. 2004-43 in proposed regulations.¹³ Taking this approach will provide taxpayers notice and the opportunity to comment¹⁴ and would achieve two important objectives. First, issuing a regulation would best accomplish the IRS and Treasury's goals of ensuring that the Subsequent Distribution Rules are not applied in "structured transactions" in a manner that renders the provisions of sections 704(c)(1)(B) and 737 elective to participants in such transactions. That is, because a revenue ruling is only a statement of the IRS's litigation position and is not binding on a court,¹⁵ taxpayers may continue to rely on a more literal interpretation of Treas. Reg. §§ 1.704-4(c)(4) and 1.737-2(b) and challenge the principles of the Ruling. Second, and more importantly, issuing regulations would advance the objective of predictability. Taxpayers and advisors may be adversely affected by a "clarification" of the IRS and Treasury's views in the form of a ruling that addresses regulations that most taxpayers and advisors interpret consistently with the prevailing literal interpretation. They will not think to research beyond the regulations (such as searching for the revenue ruling) is necessary. In other words, they will not believe that there is anything to clarify. However, in issuing guidance in the form of a regulation project, the IRS will make generally known and clear its position as to the current regulations. It will place taxpayers and advisors on notice that the IRS does not adhere to the prevailing interpretation of the regulations.

As published, the Ruling applies to all transactions subject to the Subsequent Distribution Rule since January 9, 1995,¹⁶ more than nine years before the publication of the Ruling's publication.¹⁷ In view of the surprise among tax practitioners at the manner in which the Ruling applied the regulations, we recommend that the government make the principles of the Ruling applicable to mergers occurring after April

¹³ The IRS, in a 2003 revenue ruling, stated that it was contemplating issuing regulations addressing the policy concerns raised by the transaction described in the ruling and, therefore, requested comments as to whether regulations should be promulgated and, if so, what the regulations should provide. See Rev. Rul. 2003-97, 2003-34 I.R.B. 380 (concluding that interest accruing on a debt instrument issued in connection with a forward contract to purchase stock is deductible under section 163(a), and section 163(l) will not disallow such a deduction).

¹⁴ 5 U.S.C. §553 (2004) (originally enacted as Act of Sept. 6, 1966, Pub. Law No. 89-554, § 1, 80 Stat. 378).

¹⁵ *Rauenhorst v. Commissioner*, 119 T.C. 151 (2002). Some courts, however, have given deference to revenue rulings where the ruling was not unreasonable or inconsistent with the statute. See, e.g., *Salomon, Inc. v. United States*, 976 F.2d 837 (2d Cir. 1992).

¹⁶ The regulations under sections 704(c)(1)(B) and 737 are generally effective with respect to distributions of partnership property on or after January 9, 1995. Treas. Reg. §§ 1.704-4(g) and 1.737-5.

¹⁷ T.D. 8642, 1996-1 C.B. 126.

12, 2004 -- the date the IRS released Rev. Rul. 2004-43.¹⁸ This approach to the “effective date” achieves the need to protect taxpayers from the unanticipated consequences that application of the Ruling would bring where those taxpayers have already merged two or more partnerships. Moreover, applying the regulations only to mergers occurring after April 12, 2004, would be consistent with the approach Congress took when it enacted section 704(c)(1)(B) and section 737, as well as when Congress extended the five year period of such sections to seven years.¹⁹

¹⁸ Section 7805(b)(1)(C) would allow the government to make the regulations applicable as of “the date on which any notice substantially describing the expected contents of any temporary, proposed, or final regulations is issued to the public.” A minority believe that the principles of the Ruling should apply only to distributions occurring after April 12, 2004.

¹⁹ Omnibus Budget Reconciliation Act of 1989, Pub. Law No. 101-239, § 7642, 103 Stat. 2106 (1989); Energy Policy Act of 1992, Pub. Law No. 102-239, § 1937, 106 Stat. 2776 (1992); Taxpayer Relief Act of 1997, Pub. Law No. 105-34 § 1063, 111 Stat. 788 (1997).

If Treasury decides not to promulgate regulations, we believe, for the same reasons stated above, that the Ruling should apply only to mergers occurring after April 12, 2004. The IRS has the authority to conclude that the principles of the Ruling apply only to mergers occurring after April 12, 2004. Section 7805(b)(8) provides that “the Secretary may prescribe the extent, if any, to which any ruling (including any judicial decision or administrative determination other than a regulation) relating to internal revenue laws shall be applied without retroactive effect. In the past, the IRS has invoked its authority under Section 7805(b)(8). *See* Rev. Rul. 2003-97, 2003-34 I.R.B. 380 (applying only prospectively to taxpayers adversely affected by the IRS’s conclusion that interest accruing on a debt instrument issued in connection with a forward contract to purchase stock is deductible under section 163(a), and section 163(l) will not disallow such a deduction); Rev. Rul. 2002-85, 2002-2 C.B. 986 (prospectively applying, under limited facts, the IRS’s conclusion that an acquiring corporation’s transfer of the target corporation’s assets to a subsidiary controlled by the acquiring corporation as part of a plan of reorganization will not prevent a transaction that otherwise qualifies as a reorganization under § 368(a)(1)(D) from so qualifying); Rev. Rul. 2001-46, 2001-2 C.B. 321 (applying prospectively, under limited facts, the IRS’s conclusion that, if, pursuant to a plan, a newly formed wholly owned subsidiary of an acquiring corporation merges into a target corporation, and such target corporation merges into the acquiring corporation, the transaction will be treated as a single statutory merger of the target corporation into the acquiring corporation that qualifies as a reorganization under § 368(a)(1)(A)); Rev. Rul. 94-16, 1994-1 C.B. 19 (applying only prospectively the IRS’s conclusion that a corporation organized by an Indian tribe under state law is subject to federal income tax on the income earned in the conduct of its business on the tribe’s reservation); Rev. Rul. 93-72, 1993-2 C.B. 77 (applying prospectively the IRS’s conclusion that taxpayers should not interpret certain revenue rulings as allowing a current deduction of payments for future medical care extending substantially beyond the close of the taxable year where the taxpayer did not purchase the future care in connection with obtaining lifetime care); Rev. Rul. 89-97, 1989-2 C.B. 81 (prospectively applying, under limited facts, the IRS’s conclusions that a pension, profit-sharing, or stock bonus plan (the “Plan”) will not terminate, even though an amendment to terminate is adopted and benefit accruals cease, if the Plan assets are not distributed soon after the adoption of the amendment and a trust remains in existence in order to make distributions pursuant to the Plan); Rev. Rul. 84-45, 1984-1 C.B. 115 (prospectively applying, under limited facts, the IRS’s conclusion that certain defined benefit plans fail to satisfy the requirements of section 411 and may fail to satisfy the requirements of sections 401(a)(4) and (5)); Rev. Rul. 83-174, 1983-2 C.B. 108 (applying only prospectively the IRS’s revocation of Rev. Rul. 59-521 and Rev. Rul. 71-598); Rev. Rul. 80-176, 1980-2 C.B. 97 (applying only prospectively to taxpayers adversely affected by the IRS’s conclusion that the cost of a certain options should not be added to the basis of certain oil and gas properties when such properties are acquired); Rev. Rul. 80-143, 1980-1 C.B. 19 (applying only prospectively the IRS’s conclusion that unearned original issue discount received upon redemption of

VII. Related Party Transactions

We are also concerned about the application of Rev. Rul. 2004-43 to related party transactions and believe that the principles set forth in the Ruling should not apply to mergers of related partnerships.²⁰

All partnership mergers are, in some sense, merely a reorganization of the ownership of assets in modified partnership form.²¹ In those situations in which related partnerships merge, the potential for taxpayers to use the merger to effectuate a sale would seem to be substantially diminished. Therefore, we recommend that the IRS and Treasury provide that any regulations promulgated will not apply to a merger of partnerships in which the same persons own eighty percent (80%) or more of the interests in the capital and profits of the merging partnerships.²² For purposes of this exception, the ownership of capital and profits should be determined in accordance with the constructive ownership rules of sections 267(c)(1) and 267(c)(5) (to the extent it relates to section 267(c)(1)).

CONCLUSION

As we have discussed, the language of the Subsequent Distribution Rules seems clear and unambiguous to the vast majority of the persons involved in this comment letter and to many leading practitioners who previously reached a conclusion contrary to the conclusions reached in Rev. Rul. 2004-43. For these reasons, to avoid unanticipated consequences to taxpayers who acted in good faith reliance upon the more straightforward and widely-accepted interpretation of the Subsequent Distribution Rules, and to promote predictability and equity among taxpayers, we respectfully request that the IRS withdraw the Ruling and issue regulations that would apply only to partnership mergers occurring after April 12, 2004. Moreover, we believe that such regulations should not apply to mergers of related partnerships because the policy rationale presumably underlying sections 704(c) and 737 is not present in such transactions.

municipal bonds before maturity is not interest income excludable from gross income under section 103(a)(1)).

²⁰ In drafting these comments, we also considered whether the principles of the Ruling would apply to partnership conversions, as partnership conversions are potentially subject to the same statute - section 721. Rev. Rul. 84-52, 1984-1 C.B. 157. Although it seems clear that the principles of the Ruling should not apply to partnership conversions, the law dealing with partnership conversions is far from clear. Thus, we believe that it would be helpful if the IRS and Treasury provided clearer guidance regarding partnership conversions.

²¹ Cf. Treas. Reg. § 1.368-1(b) (the purpose of the reorganization provisions of section 368 is to exempt from current tax those transactions that “effect only a readjustment of continuing interest in property under modified corporate forms”).

²² If Treasury, against our recommendations, decides not to promulgate regulations, we believe, for the same reasons stated above, that the Ruling should not apply to a merger of partnerships in which the same persons own eighty percent (80%) or more of the interests in the capital and profits of the merging partnerships.