December 2, 2011

The Honorable Max S. Baucus
Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

The Honorable Dave Camp
Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Orrin G. Hatch
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510-6200

The Honorable Sander Levin
Ranking Member
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

Re: Options for Tax Reform Relating to Partnerships

Dear Chairmen and Ranking Members:

Enclosed please find a description of options for tax reform relating to partnerships. These options for tax reform are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

These options are submitted as part of a series of tax reform options prepared by the American Bar Association Section of Taxation, the objectives of which are to improve the tax laws and to make them simpler to understand and administer.

The Section would be pleased to discuss the options with you or your staffs if that would be helpful.

Sincerely yours,

William M. Paul
Chair, Section of Taxation

Charles H. Egerton
Last Retiring Chair, Section of Taxation

Enclosure

cc: Mr. Russell Sullivan, Majority Staff Director, Senate Finance Committee
Mr. Christopher Campbell, Minority Staff Director, Senate Finance Committee
Mr. Jon Traub, Majority Staff Director, House Ways and Means Committee
Ms. Janice A. Mays, Minority Chief Counsel, House Ways and Means Committee
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
Honorable Emily S. McMahon, Acting Assistant Secretary (Tax Policy), Department of the Treasury
Honorable William J. Wilkins, Chief Counsel, Internal Revenue Service
Honorable Douglas H. Shulman, Commissioner, Internal Revenue Service
AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

OPTIONS FOR TAX REFORM IN THE
PARTNERSHIP TAX PROVISIONS OF THE
INTERNAL REVENUE CODE

These options for tax reform (“Options”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

These Options are submitted as part of a series of tax reform options from the American Bar Association Section of Taxation, the objectives of which are to improve the tax laws and to make them simpler to understand and to administer.

These Options were prepared by individual members of the following four Committees of the American Bar Association Section of Taxation: Partnerships and LLCs, Real Estate, Corporate Tax and State and Local Taxes. Principal responsibility for preparing these Options was exercised by Richard Lipton, Noel Brock and Jeanne Sullivan of the Partnerships and LLCs Committee (the “Committee”). These Options were reviewed by Bahar Schippel, Chair of the Committee. They were further reviewed by Eric Sloan, Council Director for the Committee, and by Mary McNulty, on behalf of the Committee on Government Submissions.

Although many of the members of the Section of Taxation who participated in preparing these Options have clients who may be affected by the federal tax principles addressed in these Options or who have advised clients on the application of such principles, no such member (or the firm or organization to 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 Options.

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Date: December 2, 2011
EXECUTIVE SUMMARY

1. **Partners as Employees.** The position of the Internal Revenue Service (the “Service”) is that a partner who performs services for his/her partnership cannot be classified as an employee, even if the partner would be an employee under general tax law principles and regardless of the size of the individual’s interest in the partnership. Employee status provides more certainty in the application of the tax rules, more security to the government in the collection of tax revenue and less administrative cost to the employer and employee. Therefore, we recommend consideration of the following option: (1) that partners who would otherwise qualify as employees under general tax principles and who own 10% or less of the profits and capital of a partnership (“de minimis partners”) may be classified by their employer partnership as employees, and (2) that the partnership may make a one-time non-revocable election to treat as wages the guaranteed payments for services provided to the partnership by all of its de minimis partners.

2. **Income from Self-Employment of Limited Partners.** Section 1402(a)(13) provides that, other than with respect to a guaranteed payment for services, the distributive share of a limited partner is excluded from self-employment income. The statutory language of section 1402(a)(13) is outdated since it does not address the tax treatment of new legal entities such as limited liability companies. In addition, partners who provide both services and capital to a partnership have no definitive guidance to determine which portion of their income is subject to SECA. Therefore, we recommend consideration of the following option: that section 1402(a)(13) be amended to focus on whether income is attributable to services provided or capital contributed to a partnership (rather than state law labels) and to provide that income that is attributable to capital is not subject to SECA. Treasury should be given the regulatory authority to provide clear rules and safe harbors under this section.

3. **Hot Assets Under Section 751(b).** Section 751 was adopted in the 1954 Code to prevent the conversion of ordinary income into capital gain and the shifting of ordinary income among partners on sales of interests and distributions by the partnership. Section 751(b) (which applies to distributions) is complex and the regulations are outdated. Accordingly, a viable option for both simplification and achievement of consistency would be to amend section 751(b) to clarify that it operates in a manner consistent with section 751(a) (which applies to sales of interests) and takes into account only the unrealized gain/loss in assets deemed exchanged as a result of a disproportionate distribution. Moreover, Treasury and the Service should be given explicit authority to address the consequences of a change in the partners’ shares of ordinary income in a manner other than the bilateral exchange described in the current regulations.
4. **Section 465 At-Risk Rules.** Section 465 limits certain taxpayers’ losses from an activity to the amount the taxpayer has “at risk” in the activity. There are similar rules under section 752 that also look to taxpayer’s economic risk of loss. The rules are inconsistent and may provide different results for partners for the same trade or business or investment activity conducted through a partnership. Accordingly, a viable option for both simplification and achievement of consistency would be to amend section 465 to provide that a partner is “at risk” for debt if the debt is treated as recourse under section 752.

5. **Section 708(b)(1)(B) Technical Termination.** A partnership terminates for federal income tax purposes whenever there is a sale or exchange of 50% or more of the interests in profits and capital of a partnership within a 12-month period. Because of changes made by the Tax Reform Act of 1986, section 708(b)(1)(B) is no longer necessary and operates often as a trap for the unwary. Accordingly, a viable option for tax reform is to repeal section 708(b)(1)(B).

6. **Section 197(f)(9) Anti-Churning Rules.** Section 197 allows amortization of certain intangibles (such as goodwill and going concern value) that had not been amortizable under prior law. Section 197(f)(9) was enacted to prevent taxpayers from engaging in transactions with related parties soon after the enactment of section 197 solely to generate amortizable basis. Because it has been 18 years since the enactment of section 197, the anti-churning rules of section 197(f)(9) are no longer necessary and consideration should be given to the repeal of this complex provision.

7. **Expand section 108(e)(6) to Cover Partnerships.** When a corporation acquires its indebtedness from a shareholder as a contribution to capital, the corporation is deemed to have satisfied the indebtedness with an amount of money equal to the shareholder’s adjusted basis in the indebtedness. By its terms, section 108(e)(6) applies only to corporations. Because the same policies that support the application of section 108(e)(6) to corporations apply to the contribution of partnership debt to partnerships, consideration should be given to the expansion of section 108(e)(6) to cover partnerships.
Partnership Legislation Simplification

I. Partners as Employees

a. Present Law

The position of the Internal Revenue Service (the “Service”) is that a partner who performs services for his/her partnership cannot be classified as an employee, even if the partner would be an employee under general tax law principles and regardless of the size of the individual’s interest in the partnership.¹ Rather, a partner is treated as a self-employed individual and, as such, is subject to tax on income from self-employment under section 1402(a)² (the Self Employment Contributions Act, or “SECA”) on the partner’s share of the partnership’s income from any trade or business carried on by the partnership (except to the extent excluded under section 1402(a)). This includes payments that would otherwise constitute wages under general tax law principles, which, in the case of a partner, are treated as section 707(c) guaranteed payments.

The treatment of employees and self-employed individuals differs in a number of significant respects. Employers are required to withhold income³ and Social Security taxes⁴ (imposed by the Federal Insurance Contributions Act (FICA)) for the employee, must pay a tax equal to the employee’s portion of the FICA tax,⁵ and are responsible for a federal unemployment tax (FUTA) on all wages paid to employees in a quarter.⁶ In contrast, the self-employed individual is responsible for his or her own Social Security taxes in the form of the SECA tax. The SECA tax rate is equal to the FICA tax rate and is subject to the same wage base limitation as the limitation applicable under FICA. The self-employed individual pays both the “employee” and the “employer” portions of the SECA tax and is allowed to deduct one-half of these SECA payments.

¹ See, e.g., Estate of S.U. Tilton, 8 B.T.A. 914 (1927); Commissioner v. Doak, 234 F.2d 704 (4th Cir. 1956); but see Armstrong v. Phinney, 394 F.2d 661 (5th Cir. 1968); Rev. Rul. 69-184, 1969-1 C.B. 256; Reg. § 1.707-1(c); GCM 34001; GCM 34173.

² References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise indicated.

³ I.R.C. § 3401.

⁴ I.R.C. § 3102(a).

⁵ I.R.C. § 3111. In this connection, the FICA tax is composed of (i) Old Age Survivors’ and Disability Insurance (OASDI) and (ii) Health Insurance (HI). The OASDI portion is limited to the wage base; the HI portion is not.

⁶ I.R.C. §§ 3301, 3302.
taxes. No income taxes are withheld for the self-employed individual. Instead, partners are subject to estimated tax with respect to their share of partnership income. This difference contributes significantly to the tax gap and results in a greater loss of tax revenue from self-employed individuals than from employees.

Although there are other differences in the tax treatment of employees and self-employed individuals, such differences do not appear to cause a clear advantage with respect to either classification. Employer-provided fringe benefits are generally deductible by the employer and excluded from the income of the employee, while these tax advantages are not generally available to self-employed individuals. On the other hand, expenses incurred by an employee are deductible as miscellaneous itemized deductions, subject to the two-percent-of-adjusted-gross-income floor, while expenses incurred by a self-employed individual are not subject to this limitation. Classification of payments for services as wages also has an impact in other areas of income taxation, such as the deduction for domestic production activities (section 199), the work opportunity credit (section 51), and empowerment zone employment credits (section 1396).

b. Reasons for Change

Partnerships often award small “profits interests” to employees to reward, retain, and/or incentivize them. Under current law, this “award” converts the employee into a partner and the employee’s wages into guaranteed payments for services. Because of the increased tax cost and administrative burdens of compliance with SECA resulting from partner status, the partnership will often increase the recipient’s pay by a “gross-up” amount. More commonly, however, neither the partnership nor the employee is aware of the change in the employee’s status; both continue to treat the profits interest holder as an employee; and the partnership does not “gross up” the employee’s pay. To later bring the business into compliance with the tax rules involves significant complexity and cost and causes dissatisfaction between the parties.

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7 I.R.C. §§ 164(f), 1402(a)(12).
8 I.R.C. § 6654; see also Reg. § 1.707-1(c).
9 See “Present Law and Background Relating to Worker Classification for Federal Tax Purposes,” prepared by the Staff of the Joint Committee on Taxation, JCX-26-07, at page 10.
10 Examples of these types of fringe benefits include properly structured health benefits, life insurance, educational assistance, and dependent care assistance. In addition, qualified cafeteria plans allow an employee to contribute funds from the employee’s salary to the plan to purchase benefits and exclude the contributed amount from income.
11 For a comprehensive discussion of the differences see “Description of the Social Security Tax Base,” prepared by the staff of the Joint Committee on Taxation, JCX-36-11.
Further, the treatment of partner/employee wages as a guaranteed payment creates substantial administrative burdens at the state level. In the early years of a partnership, many partner/employees may not be allocated any share of partnership income beyond their guaranteed payment for services as a result of preferential distributions to the investor partners. However, because states generally follow the federal tax classification, they still require the partner/employee to file tax returns in each state in which the partnership operates even though the partner/employee receives no allocable share of income other than a guaranteed payment. Because employee status provides more certainty in the application of the tax rules, it provides more security to the government in the collection of tax revenue and less administrative cost to the employer and employee. Therefore, the tax rules should be modified to permit certain partners to be treated as employees for all federal tax purposes.

c. **Option for Consideration**

We recommend consideration of the following option: Partners who would otherwise qualify as employees under general tax principles and who own 10% or less of the profits and capital of a partnership ("de minimis partners") may be classified by their employer partnership as employees. The partnership may make a one-time non-revocable election to treat as wages the guaranteed payments for services provided to the partnership by all of its de minimis partners.
II. Income from Self-Employment of Limited Partners

a. Present Law
Section 1402(a)(13) provides that, other than with respect to a guaranteed payment for services, the distributive share of a limited partner is excluded from self-employment income. When this provision was adopted in 1977, state laws generally did not permit limited partners to participate in the management of the partnership’s activities without losing their limited liability protection. In many states, that proscription no longer applies. In addition, new forms of state law entities have developed, such as limited liability companies and limited liability partnerships, and section 1402(a)(13) has not been amended to clarify whether members of such limited liability entities are “limited partners” for purposes of SECA. Since Treasury’s attempt to define “limited partner” for purposes of SECA in 1998, no new guidance has been promulgated.12

b. Reason for Change
The statutory language of section 1402(a)(13) is outdated.13 Partners who provide both services and capital to a partnership have no definitive guidance to determine which portion of their income is subject to SECA. The lack of such guidance leads to uncertainty and complexity in planning and compliance and to the non-uniform application of the tax laws by similarly situated taxpayers.

c. Option for Consideration
We recommend consideration of the following option: Amend Section 1402(a)(13) to focus on whether income is attributable to services provided or capital contributed to a partnership (rather than state law labels) and to provide that income that is attributable to capital is not subject to SECA. Treasury would be given the regulatory authority to provide clear rules and safe harbors under this section.

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12 Prop. Treas. Reg. § 1.1402(a)-2 (62 Fed. Reg. 1702) (Jan. 13, 1997). Section 935 of the Taxpayer Relief Act of 1997 provided that this regulation could not be made temporary or final before July 1, 1998. While that date has long-passed, Treasury still has not finalized this regulation.

13 See, e.g., Options to Improve Tax Compliance and Reform Tax Expenditures, prepared by the Staff of the Joint Committee on Taxation, January 27, 2005 (JCA-02-05).
III. Hot Assets Under Section 751(b)

a. Present Law

Section 751 was adopted in the 1954 Code to prevent the conversion of ordinary income into capital gain and the shifting of ordinary income among partners. Section 751(a) provides that when a partner sells an interest in the partnership, the amount realized is treated as ordinary to the extent of the partner’s share of the partnership’s ordinary income assets (“hot assets”) allocable to the portion sold. Section 751(b) provides that a distribution to a partner that effects an exchange of the partner’s share of hot assets for other assets, or vice versa, is treated as a taxable exchange of the relinquished assets for the acquired assets.

The examples in the regulations under section 751(b) interpret the statute as requiring a complex calculation involving the partners’ pre- and post-distribution shares of the partnership’s assets. This approach is inconsistent with the section 751(a) approach of looking only to the built-in gain in such hot assets. Moreover, this approach does not focus on the potential shift in appreciation or depreciation in assets deemed exchanged. Instead, it requires a comparison of the pre- and post-distribution gross values (including basis). As a result, tax can be triggered when there is no change in the partners’ shares of ordinary income and yet not triggered when there is a change in the partners’ shares of ordinary income. Many tax practitioners believe that this result is not consistent with the statute.

In Notice 2006-14, 2006-1 C.B. 498, the Service proposed a simplified approach to section 751(b) in determining both the partners’ shares of ordinary income and the tax consequences of a change in those shares. Tax practitioners generally agree that the Service has the authority to confirm that the measurement of ordinary income is the same for all purposes of section 751. Some tax practitioners are concerned that the Service and Treasury may not have the authority to modify the portion of the regulations addressing the consequences of a change in the partners’ shares of ordinary income (i.e., the “bilateral exchange”).

b. Reason for Change

Section 751(b) is complex and the regulations are outdated. Consequently, lack of taxpayer compliance is a significant issue.

c. Option for Consideration

We recommend consideration of the following option: Amend Section 751(b) to clarify that it operates in a manner consistent with section 751(a) and takes into account only the unrealized
gain/loss in assets deemed exchanged as a result of a disproportionate distribution. Provide Treasury and the Service with explicit authority to address the consequences of a change in the partners’ shares of ordinary income in a manner other than the bilateral exchange described in the current regulations.
IV. Section 465 At-Risk Rules

a. Present Law
Section 465 limits certain taxpayers’ losses from an activity to the amount the taxpayer has “at risk” in the activity. The “at risk” amount generally includes borrowed amounts only to the extent the taxpayer has personal liability for the repayment of the loan or has made a pledge of property (not used in the activity) to secure the debt. Final and proposed regulations under section 465 provide rules for determining whether a taxpayer is treated as personally liable for debt. Generally, if a taxpayer who is required to satisfy a debt will be reimbursed or otherwise protected against loss, that person is not “personally liable” for the debt for purposes of section 465. These rules are imprecise, and, as a result, courts have crafted different approaches to interpreting section 465 under which the payor of last resort is the person treated as “at risk” for debt.

Section 752 provides analogous rules for purposes of subchapter K. The regulations under section 752 define a recourse liability and provide a concrete test for determining which partner, if any, has the economic risk of loss for a liability. 14

b. Reasons for Change
The rules for determining at-risk and economic risk of loss under sections 465 and 752, respectively, are not clearly consistent with each other and may provide different results. For example, under Proposed Regulation section 1.465-6(d), a guarantee of a debt with respect to which a person is the primary obligor does not increase the guarantor’s at-risk amount until the guarantor makes payment on the guarantee. In contrast, if a partner guarantees certain partnership debt, the guaranteeing partner has the economic risk of loss for the guaranteed portion of the debt under Regulation section 1.752-2(b)(3). However, Proposed Regulation section 1.465-24(a)(2)(i) provides a rule more consistent with the section 752 approach. Since the objective of the rules is similar -- to give credit to a taxpayer for debt that it may be required to satisfy with personal assets -- subtle differences in the application of these rules create complexity when applying sections 752 and 465 in similar factual situations.

14 Reg. § 1.752-2.
c. **Option for Consideration**

We recommend consideration of the following option: Amend Section 465 to provide that a partner is “at risk” for debt if the debt is treated as recourse to the partner under the rules of section 752.
V. Section 708(b)(1)(B) Technical Terminations

a. Present Law

A partnership terminates for U.S. federal income tax purposes whenever, among other things, there is a sale or exchange of 50% or more of the total interest in partnership capital and profits within a 12-month period.\(^\text{15}\) Such a termination is known as a “technical termination” because the partnership continues to exist for state law purposes – the termination occurs solely for U.S. federal income tax purposes. Section 708(b)(1)(B) was enacted as part of the Internal Revenue Code of 1954 to prevent trafficking in partnerships with advantageous fiscal tax years, as a method for avoiding the strictures of section 706(b) respecting adoption of fiscal years by partnerships.\(^\text{16}\) Under then-existing law, section 708(b)(1)(B) prevented the use of grandfathered fiscal years by persons acquiring partnership interests if the acquisition caused a 50% or more change in the ownership of a partnership.

b. Reasons for Change

The Tax Reform Act of 1986 substantially modified the permitted taxable year of a partnership and caused section 708(b)(1)(B) to no longer serve a useful purpose. Specifically, the Tax Reform Act of 1986 modified section 706 to require that a partnership not have a taxable year other than (i) the taxable year of one or more partners having an aggregate interest in partnership profits and capital of more than 50% or, (ii) if there is no such taxable year, the taxable year of all principal partners (partners with interests in capital and profits of 5% or more) partners, or, (iii) if there is no such taxable year, the calendar year.\(^\text{17}\) Pursuant to section 706(b)(1)(B)(i), upon a 50% or more ownership change, the taxable year of the partnership would generally change to the taxable year of the acquirers of 50% or more of the interests. As a result, a technical termination is no longer necessary in order to cause a change in the taxable year of a partnership. Thus, section 708(b)(1)(B) serves no useful purpose after the 1986 amendment to section 706.

Moreover, over the years, section 708(b)(1)(B) has been incorporated into numerous provisions outside of subchapter K that can cause adverse results – even to partners who did not sell their interests and even though the transferees of partnership interests may be totally and wholly

\(^{15}\) I.R.C. § 708(b)(1)(B).


\(^{17}\) I.R.C. § 706(b).
controlled by the transferors. Although regulations promulgated in 1997 eliminated many of the ramifications of a section 708(b)(1)(B) technical termination, section 708(b)(1)(B) remains a trap for the unwary, with two of the most significant ramifications being a restart of section 168 depreciation lives and the potential acceleration of section 481 adjustments. A section 708(b)(1)(B) technical termination causes a restart of depreciation under the section 168(i)(7) anti-churning rules as though each asset of the partnership was acquired for a new cost equal to its then adjusted tax basis (not considering the impact of an election under section 754, if any). This provision applies even as to partners who did not sell their interests and regardless of whether the transferees of the partnership interests are totally and wholly controlled by the transferors (e.g., a distribution of a second-tier partnership interest by a first-tier partnership interest to its partners – section 761(e) – or a contribution of a partnership interest to a wholly-owned corporation under section 351 in exchange for stock). In addition, a section 708(b)(1)(B) technical termination could also accelerate a section 481 adjustment. It is not clear that Congress fully appreciated that the term “sale or exchange” under section 708(b)(1)(B) could include tax free transfers among affiliates. Further, it is not clear that Congress intended that partners who do not transfer their interests and are innocent bystanders would be penalized by section 708(b)(1)(B) technical terminations.

c. **Option for Consideration**
We recommend consideration of the following option: Repeal Section 708(b)(1)(B) and make all necessary technical and conforming changes to the Code, including the elimination of cross-references to section 708(b)(1)(B).
VI. Repeal Section 197(f)(9) Anti-Churning Rules

a. Present Law

Section 197(f)(9) contains anti-churning rules that except from the definition of amortizable section 197 intangible any otherwise amortizable section 197 intangible for which depreciation and amortization deductions would not have been allowed under prior law. Specifically, goodwill and going concern value are not amortizable if (1) the intangible was held or used at any time on or after July 25, 1991, and on or before August 10, 1993 (the “transition period”), by the taxpayer or a related person; (2) the taxpayer acquired the intangible from a person who held it during the transition period, and the user of the intangible does not change as part of the transaction; or (3) the taxpayer grants the right to use the intangible to a person (or a person related to that person) who held or used the intangible at any time during the transition period, but only if the transaction in which the taxpayer grants the right and the transaction in which the taxpayer acquired the intangible are part of a series of related transactions.

The section 197(f)(9) anti-churning rules were generally enacted to prevent taxpayers from engaging in transactions with related parties soon after the enactment of section 197 solely to generate amortizable basis, where the same parties continue to hold or use the intangible after the transactions (so-called “churning” transactions). Congress explained the purpose of section 197(f)(9), which was enacted with the Omnibus Reconciliation Act of 1993, to be to “prevent taxpayers from converting existing goodwill, going concern value, or any other section 197 intangible for which a depreciation or amortization deduction would not have been allowable under [prior] law into amortizable property.” Treasury described the purpose of section 197(f)(9) as being “to prevent the amortization of section 197(f)(9) intangibles unless they are transferred after the applicable effective date in a transaction giving rise to a significant change in ownership or use.”

b. Reasons for Change

Because it has been 18 years since the enactment of section 197, the purpose for the anti-churning rules no longer exists. Most of the section 197(f)(9) intangibles in existence today came into existence after 1993. Most often, only a minor portion of the total fair market value attributable to section 197(f)(9) intangibles existed before 1993. As we move further away in

\[\text{\textsuperscript{18}}\text{H.R. Rep. No. 103-213, at pp. 672-696 (1993).}\]

\[\text{\textsuperscript{19}}\text{Reg. § 1.197-2(h)(1)(ii).}\]
time from 1993, the fair market value of the pre-1993 section 197(f)(9) intangibles becomes a smaller percentage of the total fair market value of such property. Thus, section 197(f)(9) has outlived its stated purpose and now simply adds complexity to the tax law, particularly when applied to partnership transactions.

c. **Option for Consideration**

We recommend consideration of the following option: Repeal Section 197(f)(9) and make all necessary technical and conforming changes to the Code, including the elimination of cross-references to section 197(f)(9).
VII. Expand Section 108(e)(6) to Cover Partnerships

  a. Present Law

When a corporation acquires its indebtedness from a shareholder as a contribution to capital, the corporation is deemed to have satisfied the indebtedness with an amount of money equal to the shareholder’s adjusted basis in the indebtedness.\(^\text{20}\) By its terms, section 108(e)(6) applies only to corporations because it refers only to a “debtor corporation.” Section 108(e)(6) was enacted with the Bankruptcy Tax Act of 1980 (the “1980 BTA”) to overturn the result reached in the case of *Putoma Corp. v. Commissioner*,\(^\text{21}\) in which a cash basis shareholder-employee forgave a debt owed to him by the corporation for which he was employed.\(^\text{22}\) The court held that the corporation did not have COD income even though it had previously deducted the accrued liability.

  b. Reason for Change

Although the House version of the 1980 BTA seemed to apply the rules contained in current section 108(e)(6) to partnerships, the Senate version omitted a reference to partnerships.\(^\text{23}\) At least one commentator has suggested that the Senate Finance Committee had not addressed partner contributions of debt to partnerships and that the Joint Committee on Taxation had not given thought to the question.\(^\text{24}\) More recently, in 2004, Congress amended section 108(e)(8) to expand its coverage to include partnerships. Congress also could have made a corresponding change to section 108(e)(6) but failed to do so. Since that time, other commentators have questioned whether the principles of section 108(e)(6) apply to partnership transactions.\(^\text{25}\) The same policies supporting the application of section 108(e)(6) to corporations support the application of section 108(e)(6) to partnerships.

\(^{20}\) I.R.C. § 108(e)(6).

\(^{21}\) 66 T.C. 652 (1976), *aff’d*, 601 F.2d 734 (5th Cir. 1979).

\(^{22}\) S. Rep. No. 96-1035, at pp. 8, 19 n.22 (1980).

\(^{23}\) TAX ANALYSTS, PARTNER CONTRIBUTIONS OR INDEBTEDNESS: CONGRESSIONAL INTENT OF TECHNICAL OVERSIGHT, 28 TAX NOTES (TA) 1319 (Sept. 16, 1985).

\(^{24}\) Id.

c. **Option for Consideration**

We recommend consideration of the following option: Expand Section 108(e)(6) to cover partnerships in a manner similar to the 2004 expansion of section 108(e)(8) to cover partnerships.