RESOLVED that the American Bar Association recommends to the Congress that it:

(I) simplify section 702(a) of the Internal Revenue Code of 1986, by substituting a requirement that each partner shall take into account separately his distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately; and

(ii) that it repeal section 702(c), which provides that, in any case where it is necessary to determine the gross income of a partner, a partner shall include his distributive share of the gross income of the partnership.

REPORT

Section 702(a) provides that a partner must take into account in determining his or her own income tax liability his or her distributive share of the partner's-

(1) gains and losses from sales or exchanges of capital assets held for not more that 1 year;

(2) gains and losses from sales or exchanges of capital assets held for more than 1 year

(3) gains and losses from sales or exchanges of property described in section 1231...

(4) charitable contributions

(5) dividends with respect to which there is a deduction under part VIII of subchapter B;

(6) [foreign] taxes...

(7) other items of income, gain, loss deduction, or credit, to the extent provided by regulations prescribed by the Secretary, and

(8) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection."

Pursuant to section 702(7), Treasury Regulations list the following additional items:

"Recoveries of bad debts, prior taxes, and delinquency amounts (section 111); gains and losses from wagering transaction (section 165(d)); soil and water conservation expenditures (section 175); nonbusiness expenses as described in section 212; medical, dental, etc., expenses (section 213); expenses for care of certain dependents (section 214); alimony, etc., payments (section 215); amounts representing taxes and interest paid to cooperative housing corporations (section 216); intangible drilling and developments costs (section 263C); pre-1970 exploration expenditures (section 615); certain mining
exploration expenditures (section 617); income, gain, or loss to the partnership under section 751(b);..." >1.702-1(8)(I).

In addition, the regulations require separate reporting of items which are allocated to the partners in a manner which is different from the partnership taxable income and loss generally (i.e., special allocations). Treas. Reg. >1.702-1(8)(I).

Finally, the regulations state that-

"Each partner must also take into account separately his distributive share of any partnership item which is separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately." Treas. Reg. >1.702-1(8)(ii).

Section 702(c) requires each partner to report separately his or her share of the gross income of the partnership in any case where it is important to determine the gross income of the partner.

The precursor of the section 702(a) list (which originally included partially tax-exempt interest) was first included in the statute with the adoption of the Internal Revenue Code of 1954. At that time, it appeared that only a small number of items were required to be separately stated in order to arrive at the correct tax results. At the present time, there are reportedly over 200 items which, depending upon the circumstances may have to be stated separately, and there is little special significance to the very short list in the statute even in the regulations.

The language in Treasury Regulation Section 1.702-1(8)(ii), quoted above, covers all of the cases, and the separate listing in the statute or elsewhere in the regulations is superfluous.

While there is no direct harm with the current language, there are several reasons why simplification would be helpful:

(1) Simplification is a valued objective. Anything that can be done to shorten the Internal Revenue Code or the Treasury Regulations is per se <D> worthwhile. Although this simplification by itself is a relatively small step. If all of the provisions of the Code which are superfluous were identified in a similar manner and similarly shortened or repealed, a substantial reduction in size of the Code might be well achieved.

(2) As the statute is presently written, it is often necessary to amend the statutory language each time there is a substantive change made in one of the sections of the Code to which the list refers. For example, when the Code was amended to repeal certain provisions relating to partially tax-exempt interest, the reference to such provisions in section 702(a) also had to be repealed. As another example, whenever the holding period for long term capital gains is charged, paragraphs (1) and (2) of subsection 702(a) should be, and usually are, amended to conform. However, paragraph (1) was not amended in 1997, when section 1(h) was added to the Code to create a number of subclasses for long-term capital gains, each with a different tax rate. The change to subsection 702(a)(1) would not be not trivial and, if done correctly, would probably double the size of subsection 702(a).

Eliminating this specific list will eliminate the need to amend it each time a correlative provision of the tax law changes.

The repeal of subsection (c ) is consistent with the foregoing.
EXECUTIVE SUMMARY

1. Summary of the Recommendation

To simplify section 702(a) and repeal section 702(c) of the Internal Revenue Code of 1986 to eliminate the specific list of partnership items which must be separately stated. In lieu thereof, the statute would adopt the language currently in the regulation, to the effect that any partnership items must be separately if stating it separately would affect the tax liabilities of any partner.

Summary of the issues which the Recommendation Addresses

The Partnership Committee's Task Force on the Simplification of the Subchapter K has been formed and is operating for the purpose of promoting the simplification of the Internal Revenue Code. Simplification can be accomplished in part by repealing statutory provisions which have no useful purpose in the administration of current tax laws. Repeal of such statutory provisions will also promote simplification of the regulations, which often are quite complex notwithstanding the relative unimportance or apparent simplicity of the underlying statute.

Section 702(a) contains a list of 6 specific partnership items which need to be separately stated by a partner. It then authorizes the Secretary to expand the list. The regulations require that any item must be reported separately if doing so would change the tax liability of any partner. There are over 200 items which are required to be reported separately, where relevant. The list also included what is referred to as special allocations, as to which there is no numerical limitation.

Section 702(c) states that gross income must also be taken into account separately if it is necessary to determine the gross income of a partner.

The catch-all provision in the Regulations state that any partnership item shall be taken into account if doing so would affect the tax liability of any partner. The provision is all that is necessary.

Please explain how the proposed policy position will address the issue.

Eliminating the specific list of items in section 702(a) and repealing section 702(c) will simplify the tax law and the regulations, without any measurable impact on the administration of the tax laws, and without any perceivable cost to either taxpayers or the government.

Summary of any minority views of oppositions which have been identified.

None.

GENERAL INFORMATION FORM
1. **Summary of Recommendation**

The recommendation proposed to simplify the language of section 702(a) and to repeal section 702(c) of the Internal Revenue Code. The purpose is to simplify subchapter K of the code, which deals with the taxation of partnerships.

**Section 702(a):**

Section 702(a) lists six different categories of tax items which must be separately stated on a partnership's tax return. It then authorizes the Treasury Department to require additional items to be stated separately. The Treasury Department's regulations require items to be separately stated for a partner if that "would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately." Depending on the circumstances, this could require more than two hundred different items to be separately stated on a return.

Accordingly, the statutory provision listing six different specific provisions is unnecessary. Furthermore, it requires frequent amendments to reflect changes made in the definitions of the six specified items (e.g., several of the clauses need to be amended each time the holding periods for capital gains is charged).

The proposed amendment to the Code would eliminate the specific categories, and adopt the test in the Regulations, requiring any item to be separately stated on the partnerships return for a partner if stating it separately would change the income tax liability of that partner.

**Section 702(c):**

Section 702(c) states that a partner's distributive share of partnership income includes that partner's distributive share of the partnerships gross income whenever it is necessary to determine the gross income of the partner. Under both the current version of section 702(a) and the proposed revised version, gross income is an item that has to be separately stated if stating it separately would change the income tax liability of that partner. Section 707(c) is not needed to accomplish that result and is unnecessary.

2. **Approval by submitting Entity**

This is submitted contingent on Section of taxation approval at its January 15-16, 1999 Midyear Meeting.

3. **Has this or a similar recommendation been submitted to the House or Board previously?**

No

4. **What existing Association policies are relevant to this recommendation and how would they be affected by its adoption?**

None
5. What urgency exists which requires action at this meeting of the House?

None

6. Status of Legislation

None

7. Cost to Association

None

8. Disclosure of interest

No member of the originating Committee or the Council of the section of taxation is known to have a material interest in the Resolution by virtue of specific employment or engagement to obtain the result of the Resolution.

9. Referrals

All Sections and Divisions

10. Contact Persons

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