Unitary Partnership Basis and Equitable Apportionment

Eric Sloan
Gibson Dunn

Monte Jackel

ABA Section of Taxation
May 2019 Meeting
Disclaimer

These slides were prepared by Eric Sloan and Monte Jackel and do not necessarily represent the views of any organization with which Monte was, is, or may in the future be affiliated.
Agenda

Some Basic Rules
Looking Outside
Looking Inside
Stress Testing
A Way Forward
Appendix: Outline of Rev. Rul. 84-53
Agenda

Some Basic Rules

Looking Outside
Looking Inside
Stress Testing
A Way Forward
Appendix: Outline of Rev. Rul. 84-53
Rev. Rul. 84-53: The Unitary Partnership Interest

• A partner has a unitary basis in its partnership interest.
  – See also Rev. Rul. 84-52 (partner has a unitary basis in its general partnership interest when converted into a limited partnership interest. Cites Rev. Rul. 84-53 as authority).

• Reg. § 1.704-1(b)(2)(iv)(b) provides:

  For purposes of [Reg. § 1.704-1(b)(2)(iv)], a partner who has more than one interest in a partnership shall have a single capital account that reflects all such interests, regardless of the class of interests owned by such partners (e.g., general or limited) and regardless of the time or manner in which such interests were acquired.

• Is Rev. Rul. 84-53 correct?
  – See outline in attached Appendix for detailed pros and cons.
  – Rev. Rul. 84-53 cites two authorities for its position on having a single partnership interest: Rev. Rul. 84-52 and Reg. § 1.61-6(a) which assumes that the regulation requires a fair market value apportionment. No authority so holds.
What Else Does Rev. Rul. 84-53 Hold?

- Determines basis allocable to the portion of a partnership interest sold based (somewhat) on Reg. § 1.61-6(a).

- Reg. § 1.61-6(a) provides that when a part of a larger property is sold, the cost or other basis of the entire property is “equitably apportioned” among the several parts for purposes of determining gain or loss with respect to the part sold.
  
  - Sale of each part is treated as a separate transaction for which gain or loss is computed separately.

  - Gain or loss is determined at the time of sale of each part and is not deferred until the entire property has been disposed of.

  - Examples in regulation do not address partnership interests.
Four situations, three of which are relevant.

- **Situation 1**: No liabilities, basis allocated in proportion to relative fair market values of interest sold and interest retained. (See Examples 4, 6 and 8).

- **Situation 2**: If partnership has liabilities, and seller’s share does not exceed seller’s basis, allocate “equity” basis in proportion to fair market values of interest sold and interest retained, then add liabilities that shift to basis. (See Example 5.)

- **Situation 4**: If partnership has liabilities, and seller’s share exceeds seller’s basis, then pro rate the seller’s basis in proportion to the liabilities that shift and liabilities that are retained. (See Examples 2 and 12.)
Y’s amount realized is $55 ($50 cash + $5 debt shift).
Y’s basis allocable to interest sold is $15 ((1/2 * $20 equity basis) + $5 debt shift).
Y recognizes $40 of gain ($55 amount realized – $15 basis allocable to interest sold).
Y’s remaining LLC interest has a FMV of $50 and an adjusted basis of $15 ($30 original basis – $15 basis allocable to interest sold), with embedded gain of $40 (including debt relief).
Example 2 – Liabilities In Excess of Basis

- Y’s amount realized is $60 ($50 cash + $10 debt shift).
- Y’s basis allocable to interest sold is $5 ($10/$20, ratio of debt shift to Y’s share of total debt) * $10 original basis).
- Y recognizes $55 of gain ($60 amount realized – $5 basis allocable to interest sold).
- Y’s remaining LLC interest has a FMV of $50 and an adjusted basis of $5 ($10 original basis – $5 basis allocable to interest sold), with embedded gain of $55 (including debt relief).
Uncertain Scope of Rev. Rul. 84-53

Does it apply to:

- **Taxable sales of the entire interest to more than one person?**
  - No, because no interest was retained.

- **Assets-over partnership divisions?**
  - No, because entire partnership interest of a divided partnership is distributed.

- **Part sale, part contribution of partnership interests under § 707(a)(2)(B)?**
  - Not clear because entire interest is being disposed of. Example 1 of both Reg. §§ 1.707-3(f) and 1.707-5(f) apportion the basis of the asset between the portion contributed and the portion sold.

- **Part sale, part charitable contributions under § 1011(b)?**
  - No, but basis is apportioned between the donated and sale portions under Reg. § 1.1011-2(b).

- **PTP interests?**
  - Holding period vs. basis. See Reg. § 1.1223-3(f), Example 6.
Agenda

Some Basic Rules

**Looking Outside**

Looking Inside

Stress Testing

A Way Forward

Appendix: Outline of Rev. Rul. 84-53
Focus: Inside–outside basis disparities.

In our examples:

- All partnerships comply with the alternate test for economic effect in Reg. § 1.704-1(b)(2)(ii)(d).
- Partnership interests are sold without discount or premium.
- Unless stated otherwise, outside basis includes share of liabilities under § 752.
Example 3 – Sale of an Entire Partnership Interest

- Y recognizes $40 of gain.
Example 4 – Sale of Part of a Partnership Interest

- Y recognizes $20 of gain and retains an interest with $20 gain (FMV $25, basis $5).
- Other considerations:
  - Holding period
  - Share of inside basis and § 704(c)
  - Capital accounts
  - Calculation of, and effect on, § 743(b) adjustments

Diagram:

- X: 50% ownership
- Y: 50% ownership, 25% interest
- Z: 25% interest
- LLC: 50% ownership
- Asset: FMV $100, AB $20
- FMV $50, AB $10
- $25
Agenda

Some Basic Rules
Looking Outside

Looking Inside
Stress Testing
A Way Forward

Appendix: Outline of Rev. Rul. 84-53
Example 5 – Sale of an Entire Partnership Interest

- Z succeeds to Y’s entire capital account.
Z succeeds to one-half of Y’s capital account.

Reg. § 1.704-1(b)(2)(iv)(l) (“The capital accounts of the partners will not be considered to be determined and maintained in accordance with the rules of [Reg. § 1.704-1(b)(2)(iv) unless, upon the transfer of all or a part of an interest in the partnership, the capital account of the transferor that is attributable to the transferred interest carries over to the transferee partner.”)
Example 7 – Sale of an Entire Partnership Interest

- If Asset has been revalued, Reg. § 1.704-3(a)(7) applies, and Z succeeds to Y's $40 share of the reverse § 704(c) layer.

- If not, § 704(b) governs.
Reg. § 1.704-3(a)(7)

• Reg. § 1.704-3(a)(7) provides:

If a contributing partner transfers a partnership interest, built-in gain or loss must be allocated to the transferee partner as it would have been allocated to the transferor partner. If the contributing partner transfers a portion of the partnership interest, the share of built-in gain or loss proportionate to the interest transferred must be allocated to the transferee partner. (Emphasis added.)

• This rule also applies in the case of built-in gain or loss attributable to “reverse” § 704(c) layers. Reg. § 1.704-3(a)(6)(i).

• Does not speak to “unbooked” appreciation or depreciation.
Example 8 – Sale of Part of a Partnership Interest

- If Asset has been revalued, Reg. § 1.704-3(a)(7) applies, and Z succeeds to one-half of Y’s $40 share of the reverse § 704(c) layer.

- If not, § 704(b) governs.
Agenda

Some Basic Rules
Looking Outside
Looking Inside

Stress Testing

A Way Forward

Appendix: Outline of Rev. Rul. 84-53
Example 9 – Tracking Partnership

- FMV of Y's entire LLC interest is $100. FMV of Y’s Class B interest is $75.
- Y’s outside basis is $25.
- How much basis is Y able to use? What is the meaning of “equitably apportioned”?
- How much § 704(b) capital moves to Z?
- How much built-in gain moves to Z?
Example 10 – Carried and Regular Interests

• A contributed $10 to LP and received a 1% regular interest and a 20% carried interest for services. LP acquires Asset for $1,000.
• More than two years later, when Asset has appreciated to $3,000, FMV of A’s entire LP interest is $430, and A sells one-half of its carry to B for $200, its FMV. Is there an assignment of income issue? See Rev. Rul. 84-115.
• How much of A’s outside basis can A use in the sale? Based on FMV of interest transferred (per Rev. Rul. 84-53)?
• How much built-in gain moves to B? Does it matter if the $2,000 of gain in Asset has been reflected in a § 704(c) layer?
• B’s outside basis is $200.
• What is B’s capital account? It must be zero if LP has not revalued Asset.
• What is B’s § 743(b) adjustment? There must be negative share of inside basis.
Example 11 – Preferred and Common Interests

- LLC’s assets have an FMV of $600.
- FMV of Y’s entire LLC interest is $350. Y’s preferred interest has a FMV of $100; its common interest has an FMV of $250.
- Y’s capital account is $150. The “subaccount” for its preferred interest is $100; the subaccount for its common interest is $50.
Example 12 – A Very Difficult Case (1 of 3)

- X and Y form LLC, with Y contributing Asset worth $100 (with $30 basis) in exchange for $90 of cash and 10 LLC units (a 10% interest in LLC).
- Cash distribution is funded by LLC borrowing that Y guarantees (not a bottom dollar guarantee), so no disguised sale. See Reg. § 1.707-5(b).
- Y has $70 built-in gain under § 704(c).
Y contributes 9 LLC units (a 9% interest in LLC and 90% of Y’s interest) to Y Sub.
How much 704(b) capital moves to Y Sub? Must it be $9?
How much 704(c) amount? $63 (90% of $70) vs. $9. Should it be $63? This would result in a share of inside basis of ($54). YSub would then have a $54 section 743(b) adjustment.
Why does it matter? See next slide.
Example 12 – A Very Difficult Case (3 of 3)

- LLC sells Asset to Z for $100.
- How is the $70 gain allocated? $63 to YSub and $7 to Y? YSub should have a 743(b) adjustment of $54 ($9 less $63) and gain of $9 net ($63 less $54). Should $7 of gain be allocated to Y on the sale? On repayment of note and distribution, should Y have additional gain of $54 (91 less 30+7) and should YSub have no additional gain ($9-$9)? The total gain would then be $70.
- What is each member’s outside basis? Should Y have a basis of $37 and YSub a basis of $9?
Agenda

Some Basic Rules
Looking Outside
Looking Inside
Stress Testing

A Way Forward

Appendix: Outline of Rev. Rul. 84-53
A Way Forward


- Use Rev. Rul. 84-53 principles to determine inside basis movements.

- Broader articulation: avoid creating/increasing inside-outside basis disparity.
  - Impact of discount or premium.
Agenda

Some Basic Rules
Looking Outside
Looking Inside
Stress Testing
A Way Forward

Appendix: Outline of Rev. Rul. 84-53
Appendix: Outline of Rev. Rul. 84-53

See attached.
I. In General

1. Revenue Ruling 84-53 (the “Ruling”) states that “Consistent with the provisions of Subchapter K of the Code, a partner has a single basis in a partnership interest....” An example is then given that the application of section 704(d) applies to the entire partnership interest.

A. The Ruling involved a taxpayer holding both a general and a limited partnership interest who, in alternative fact patterns, sells a portion of his general and/or limited partnership interest.

B. The Ruling (i) was issued before the current regulations under section 752 were issued and, therefore, the citations are to the old regulations under section 752, (ii) only deals with taxable sales and not with nonrecognition exchanges such as section 351 and 721, and (iii) was issued at a time when section 704(c)

---

1 1984-1 C.B. 159.
had just been changed to apply on a mandatory and not on a voluntary basis.

2. The Ruling:

A. Where Liabilities Do Not Exceed Basis: “In cases where the partner's share of all partnership liabilities does not exceed the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the transferor partner shall first exclude from the adjusted basis of such partner's entire interest an amount equal to such partner's share of all partnership liabilities, as determined under section 1.752-1(e) of the regulations. A part of the remaining adjusted basis (if any) shall be allocated to the transferred portion of the interest according to the ratio of the fair market value of the transferred portion of the interest to the fair market value of the entire interest. The sum of the amount so allocated plus the amount of the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest (under section 752(d) of the Code and section 1.1001-2 of the regulations) equals the adjusted basis of the transferred portion of the interest....”

B. Where Liabilities Exceed Basis: “On the other hand, if the partner's share of all partnership liabilities exceeds the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the adjusted basis of the transferred portion of the interest equals an amount that bears the same relation to the partner's adjusted basis in the entire interest as the partner's share of liabilities that is considered discharged
on the disposition of the transferred portion of the interest bears to the partner's share of all partnership liabilities, as determined under section 1.752-1(e).”

3. **Statutory Or Regulatory Authority For The Ruling.**

A. The Ruling cites reg. §1.61-6(a) which states in part that “When a larger property is sold, the cost or other basis shall be equitably apportioned among the several parts....”

2 The apportionment of the tax basis of a partnership interest is similar to the carve-out or basis stripping that has occurred with financial and other instruments. See, e.g., *Principal Life Insurance Co. v. U.S.*, 2014-1 USTC para. 50,281 (Ct. Fed. Cl. 2014):

“Courts have been relatively steadfast in applying the apportionment rules in Treas. Reg. §1.61-6(a) to all forms of property. With the exception of an outlier or two (discussed below), courts, including the Tax Court, have rejected the notion that the regulation governs only the subdivision of real property, concluding instead that real property is the main, but not the sole, focus of the regulation. See *Fisher*, 82 Fed. Cl. at 785 (discussing the history of the regulation). Rather, as its plain language suggests, the regulation applies to any "collection or bundle of rights with respect to . . . property" and "is not limited to the subdivision of real property." *Fasken v. Comm'r of Internal Revenue*, 71 T.C. 650, 656 (1979); *see also Norwest Corp. & Subs. v. Comm'r of Internal Revenue*, 111 T.C. 105, 139 (1998) (*Fasken* holds that Treas. Reg. §1.61-6(a) "is not limited to the severance of realty into two or more parcels, but applies with respect to parts of the bundle of rights comprising property"). Consistent with this view, the apportionment rules have been directed to a wide range of tangible and intangible property: shares of stock received in the demutualization of insurance companies, shares of stock purchased in bulk but sold in lesser parcels, water rights, oil leases, ground rents, materials used in shipbuilding, portions of a pipeline, antique furniture, revenue rights obtained in the purchase of a basketball team, gold coins, cement mixing equipment, and accounts
B. Although the regulation does require equitable apportionment of the tax basis and example 2 of the regulation illustrates this by using fair market values of the various components at the time of purchase of the larger property, the regulation text itself does not require apportionment by fair market values. It only requires equitable apportionment in some manner. Although using fair market values at the time of purchase is economically logical, it is not required by the text of the regulation.

C. The Ruling then makes the following statement which, although supported by example 2 of the regulation, is not supported by its text: “Under section 1.61-6(a) of the regulations, when a partner makes a taxable disposition of a portion of an interest in a partnership, the basis of the transferred portion of the interest generally equals an amount which bears the same relation to the partner's basis in the receivable. In some of these cases, the property was divided into interests described spatially, while in others the division was temporal. Careful adherence to this fractional, divisible view of property is important, as it avoids having the sale of a part of a larger property become an opportunity for income deferral. See Foster v. Comm'r of Internal Revenue, 80 T.C. 34, 216-17 (1983), aff'd in part, vacated in part on other grounds, 756 F.2d 1430 (9th Cir. 1985), cert. denied, 474 U.S. 1055 (1986); Fasken, 71 T.C. at 655-57; see also Stephen B. Cohen,"Apportioning Basis: Partial Sales, Bargain Sales and the Realization Principle," 34 San Diego L. Rev. 1693, 1703 (1997).” (Footnotes omitted).
partner's entire interest as the fair market value of the transferred portion of the interest bears to the fair market value of the entire interest. However, if such partnership has liabilities, special adjustments must be made to take into account the effect of those liabilities on the basis of the partner's interest.”

D. The Ruling also cites to Rev. Rul. 84-52\(^3\), and states: “Consistent with the provisions of Subchapter K of the Code, a partner has a single basis in a partnership interest, even if such partner is both a general partner and a limited partner of the same partnership.”

E. The cited ruling dealt with the conversion of a general partnership into a limited partnership and held that no gain or loss is recognized on the conversion except as mandated by section 752. That ruling states: “If, as a result of the conversion, there is no change in the partners' shares of X's liabilities under section 1.752-1(e) of the regulations, there will be no change to the adjusted basis of any partner's interest in X, and C and D will each have a single adjusted basis with respect to each partner's interest in X (both as limited partner and general partner) equal to the adjusted basis of each partner's respective general partner interest in X prior to the conversion.”

\(^3\) 1984-1 C.B. 157.
F. As can be seen, Rev.Ruls. 84-53 and 84-52 are circular in the sense that each ruling cites the other as authority for the position that there is only a single partnership interest held by a partner no matter what the separate components are called. That leaves, as its sole authority, reg. §1.61-6(a) as support for a mandated equitable apportionment based on fair market values at the time of purchase of the larger property which, as stated, is not supported by the text of the regulation.

G. The holding of the Ruling results in potential differences in result depending upon whether the taxpayer holds the separate components of a single larger property using one tax person (such as the individual or a single corporation) or using two or more tax persons (such as an individual and his wholly owned corporation) to hold the separate component interests.

H. The Ruling states that there were no differences in economic entitlement in the general partner interest as compared to the limited partner interest (other than the differences that flow from the state law characterization as a general partner and a limited partner under local law), as it is stated that the two partners were equal owners. However, the Ruling clearly indicates that acquiring different components of the single partnership interest at different times (the general partner interest upon formation of the partnership and the limited partnership interest several years later) does not result in more than one aggregate partnership interest.
I. Reg. §1.61-6(a), example 2, uses fair market values at the time of purchase where both components were acquired at the same time. The Ruling uses fair market values at the time of sale of a component where the components were acquired at different times.

J. The partnership at issue in the Ruling held a single mass of stocks and securities that were all purchased with cash at the time of formation. There were no contributions of property with built-in gain or built-in loss and there were no facts that tied specific stocks or securities to the general partner interest as compared to the limited partner interest.

4. Partner Capital Accounts.

A. Reg. §1.704-1(b)(2)(iv)(b) states in part: “[A] partner who has more than one interest in a partnership shall have a single capital account that reflects all such interests, regardless of the class of interests owned by such partner (e.g., general or limited) and regardless of the time or manner in which such interests were acquired”. This regulation supports the underlying theory of the Ruling because it says that the economic entitlements of a partner are measured by all of his component interests in the partnership.

B. Reg. §1.704-1(b)(2)(iv)(l) states in part that “[U]pon the transfer of all or part of an interest in a partnership, the capital account of the transferor that is attributable to the transferred interest carries over to the transferee partner.” There is no
indication in the regulation as to what “attributable” means in this context.

5. **Partner Holding Period.**

A. Under reg. §1.1223-3(a), a partner has a divided holding period in a partnership interest if either the partner acquired portions of an interest at different times or acquired portions of the interest in exchange for property transferred at the same time but resulting in different holding periods (such as under section 1223).

B. Example 5 of reg. §1.1223-3(f) illustrates the application of the Ruling to a partnership interest with a split holding period and example 6 illustrates a special holding period rule for publicly traded partnerships where the portion of the interest being transferred can be specifically identified for holding period purposes but the basis of the portion of the interest disposed of is still apportioned under the principles of the Ruling.

6. **The Stated Rationale Of The Split Holding Period Regulation.**


B. The final regulation preamble favorably cites the Ruling and states its rationale for a divided holding period rule:

“An aggregate approach to determining the holding period of an interest in a partnership would make it more likely that a
contribution of cash would not give rise to a short-term holding period. Under an aggregate approach, one could trace contributed funds into the partnership and determine whether a new holding period was created by reference to whether the funds were used for capital expenditures (in which circumstance, a short-term holding period generally would be appropriate) or for operating expenditures of the partnership (in which circumstance, no new holding period should be created). On the other hand, to the extent that a partnership interest is a capital asset that is distinct from the partnership's assets (an entity approach), its holding period and basis should be determined independently and should not be affected by the partnership's use of the contributed funds. In choosing the entity approach in the proposed regulations, Treasury and the IRS concluded that tracing funds to their ultimate use in the partnership is not an administrable means of determining whether a contribution to a partnership creates a new holding period.

C. The regulation preamble then states:

“Furthermore, the proposed regulations are consistent with general rules relating to the holding period of capital and section 1231 assets. Where a capital asset (including a capital asset held for one year or less) or property described in section 1231 is contributed to a partnership, section 1223(l) requires the tacking of the holding period in the partnership interest, whether the partners make pro rata contributions of property or instead make non-pro rata contributions that increase the proportionate interests of one or more partners....In addition, the proposed
regulations avoid inappropriate results that may occur if cash contributions are ignored after the formation of a partnership. If cash contributions were ignored, it would be possible for partners to form shelf partnerships with nominal cash contributions in order to start their holding period in the interests, where the majority of cash would not be contributed (and significant operating assets of the partnership would not be acquired) until some time in the future. This clearly would not be a proper result.”

D. The preamble to T.D. 8902 also rejects comments that requested that the Ruling be incorporated into the final regulations under section 1223. These comments were rejected:

“The proposed regulations contain an example which, consistent with Rev. Rul. 84-53, states that a partner has a single basis in its partnership interest. Certain commentators suggested that the principle that a partner has a single basis in its partnership interest should be set forth in regulations, rather than simply relying on Rev. Rul. 84-53. The rules set forth in these regulations address only holding period and character issues. In illustrating the operation of certain of these rules, the example accurately reflects current law. Treasury and the IRS believe that the inclusion of a separate rule providing that a partner has a single basis in its partnership interest is unnecessary and is beyond the scope of these regulations.”
E. The preamble to the proposed regulations under section 1223 make this reference to the Ruling and the reason for the issuance of the regulations:

“In view of the long-established principle that a partner has a single basis in a partnership interest (see Rev. Rul. 84-53 (1984-1 C.B. 159)), there is some confusion under current law as to how the principles of section 1223 apply to the sale of an interest, or a portion of an interest, in a partnership. The proposed regulations provide rules relating to the allocation of a divided holding period with respect to an interest in a partnership.”

II. Problems And Issues Pertaining To The Ruling.

1. Section 704(c). The Ruling applies entity principles in determining the portion of tax basis attributable to a sale of less than all of a partner’s partnership interest and apportions the basis based upon relative fair market values of the components of the interest at the time of the sale of the component interest.

A. The Ruling assumes that the fair market value of the portion disposed of exactly replicates the underlying values of the partnership’s properties. That is often not the case due to minority and marketability discounts for the portion of the interest that is sold. Thus, the administrability of the Ruling is not as simple as it appears from the text of the Ruling.
B. The application of entity principles ignores the principles of section 704(c) and can lead to a blended basis in the portion of the interest disposed of and the characteristics of section 704(c) can then be distorted.

C. For example, assume that Partner A contributes two properties to a partnership, one with a fair market value of 100 and a tax basis of 50 and the other with a fair market value of 50 and a tax basis of 100. A later sells one-half of his interest at a time when values of the partnership properties have not changed. The application of the Ruling would lead to a blending of tax basis and no gain or loss on sale.

D. Is this approach consistent with the principles of section 704(c)? Cf. reg. §1.704-3(a)(8)(i) (characteristics of section 704(c) property survives after a transfer in a nonrecognition transaction). The application of the loss property proposed regulations under section 704(c)(1)(C) also rely on aggregate section 704(c) principles. See prop. Reg. §1.704-3(f); see, also, section 311(b)(3) (special aggregate rule for corporate distributions of partnership interests).

2. Tracking to component interests acquired at different times.

A. It has been argued that when partnership interests are acquired at separately identifiable times and some tracking
mechanism is employed in a manner similar to stock (see reg. §1.1012-1(c)), that separate tax basis on the portion of the partnership interest disposed of can be employed.

B. This approach was rejected in the partnership interest holding period regulations as subverting the holding period rules of section 1223. It would also be inconsistent with the approach under subchapter C.\textsuperscript{4} Also, as stated earlier, the facts of the Ruling also reject such an approach.

C. Can a partnership interest have a divided holding period but also have a specifically identifiable tax basis? Would capital accounts under the section 704(b) regulations then have to allow a similar approach to maintain symmetry? The partnership holding period regulations opt for a blended holding period and a blended tax basis except in cases of publicly traded partnership interests where a separate holding period but a blended tax basis are authorized.

D. How can rules that are applied by reference to a partner’s outside tax basis in the partnership interest then be determined and applied if each separate component of an aggregate partnership interest are separate interests under

\textsuperscript{4} See, e.g., Rev. Rul. 85-164, 1985-2 C.B. 117 (using a blended basis and holding period for a transaction where multiple properties with different tax basis were transferred to a corporation for stock and securities and there was a designation of certain transferred properties to the stock received and also a designation of other transferred properties for the securities received. The designations were not respected).
subchapter K? See, for example, sections 704(d), 731(a), 732(b) and (c), 734(b) and 743(b), all of which reference a partner’s outside tax basis. If separate components were respected under these provisions, there could be differences in result depending upon which component was sold or redeemed. Is such selectivity authorized or administrable under subchapter K? Would such an approach be open to abuse?

E. What about a partner who has a negative tax capital account measured by using his entire tax basis and who then disposes of a portion of his partnership interest? Can the capital account of the partner first be recapitalized into a net zero (or nominal value) capital account and also a capital account containing all of the negative tax basis, so the minimum gain is not triggered at that time? Such an approach would lead to a low value retained partnership interest with very large tax liability attached to it. Would this be wise?

F. As mentioned earlier, what if the taxpayer first arranges his holdings such that part of his aggregate interest is first issued to a separate tax entity that he controls and the taxpayer retains the balance. Why should that situation differ from one where either the taxpayer holds all component interests or transfers part of his component interest at a later date but before the sale? Is this disparate treatment mandated by the so-called Moline Properties doctrine?

3. Tracking to specific partnership property.
A. Consider a partner with both a preferred interest in a partnership and a residual common interest who purports to then transfer his preferred interest to a different tax entity in either a taxable sale or a nonrecognition transaction.

B. Tracking the specific attributes of the preferred interest if it is separately sold would be contrary to the principles of the Ruling but would be consistent with the economics of the partnership. Does this work?

C. What if the partner first incorporates his preferred interest and his corporation later sells the preferred interest—does that work? If not, as mentioned earlier, what if in lieu of this transfer the partner first establishes his holding of partnership interests by issuing the preferred to a separate tax entity and the common to himself and then the separate tax entity disposes of the preferred interest—any difference? If so, why?

D. What if, instead of a preferred and common structure, the partner holds both a partnership interest that tracks the economic attributes of specific partnership properties and a residual interest that holds everything else. Can the tracking interest sale capture only the economic attributes of the tracking interest?

E. If so, can the split on the partnership properties result in 100% of the economic attributes of the property being tracked? What
about a 99-1 and 1-99 split? Cf. Rev. Rul. 55-39\(^5\) (where a 100% economic attribution resulted in a deemed distribution by the partnership to the partner).

\(^5\) 1955-1 C.B. 403.