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Please Address Reply to:

Executive Director
DEBORAH O. McKINNON

August 16, 2024
Submitted Electronically IRS and REG-124593-23

CC: PA: 01: PR (REG-124593-23)
Room 5203, Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: COMMENTS OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL (“ACTEC”) ON PROPOSED REGULATIONS THAT WOULD IDENTIFY CERTAIN PARTNERSHIP RELATED-PARTY BASIS ADJUSTMENT TRANSACTIONS AS TRANSACTIONS OF INTEREST

A notice of proposed rulemaking, “Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest,” at 89 Fed. Reg. 51476 (issued June 18, 2024) (the “Notice”) requested comments on proposed regulations issued under section 6011 of the Code[1] (“Proposed Regulations”).[2] Section 6011(a) provides, “When required by the regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations.”

The Proposed Regulations identify “Related-Party Basis Adjustment Transactions” as transactions of interest and would require taxpayers that participate in Related-Party Basis Adjustment Transactions and substantially similar transactions to disclose such transactions in accordance with regulations issued under section 6011. Furthermore, the Proposed Regulations would require material advisors with respect to Related-Party Basis Adjustment Transactions disclose such transactions and maintain lists in accordance with sections 6111 and 6112, respectively.

In this comment letter, ACTEC focuses on the overbreadth of the Proposed Regulations in their application to family entities, trusts and estates, and estate

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[1] Unless otherwise stated, references in these Comments to “section(s)” or to “Code” are to the Internal Revenue Code of 1986, as amended. References in these Comments to “§” are to relevant sections of the Treasury regulations promulgated under the Code.

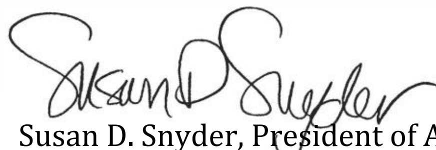
[2] The Proposed Regulations can be found at the following link: https://www.federalregister.gov/documents/2024/06/18/2024-13282/certain-partnership-related-party-basis-adjustment-transactions-as-transactions-of-interest

planning. We commend Treasury and the IRS for their stated goal of identifying potentially abusive transactions, and we appreciate the opportunity to comment on the Proposed Regulations.

ACTEC is a nonprofit association of lawyers and law professors. Its more than 2,400 members are called "Fellows" and practice throughout the United States, Canada, and other foreign countries, with extensive experience in the preparation of wills and trusts, estate planning, and administration of trusts and estates of decedents, minors, and incompetents. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar association activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of transfer tax and charitable planning, as well as with respect to related income tax considerations. These comments were prepared by members of ACTEC's Business Planning Committee and Fiduciary Income Tax Committee. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC's comments regarding the Proposed Regulations are set forth in the attached memorandum. If you or your staff would like to discuss the contents of this memorandum with the ACTEC Fellows who created it, please contact Steve Gorin, Chair of ACTEC's Business Planning Committee (314-552-6151, SGorin@thompsoncoburn.com), Kevin Matz, Vice-Chair of ACTEC's Washington Affairs Committee (212-745-9546, Kevin.matz@afslaw.com), or Deborah McKinnon, ACTEC Executive Director (202-684-8460, domckinnon@actec.org).

Respectfully submitted,



Susan D. Snyder, President of ACTEC
ACTEC President 2024–2025

Comments of the American College of Trust and Estate Counsel ("ACTEC") on Proposed Regulations under Code Section 6011 Concerning Partnership Related Party Basis Adjustment Transactions

A notice of proposed rulemaking, "Certain Partnership Related-Party Basis Adjustment Transactions as Transactions of Interest," at 89 Fed. Reg. 51476 (issued June 18, 2024) (the "Notice") requested comments on proposed regulations issued under section 6011 of the Code[1] ("Proposed Regulations").[2] Section 6011(a) provides, "When required by the regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations."

The Proposed Regulations identify "Related-Party Basis Adjustment Transactions" as transactions of interest and would require taxpayers that participate in Related-Party Basis Adjustment Transactions and substantially similar transactions to disclose such transactions in accordance with regulations issued under section 6011. Furthermore, the Proposed Regulations would require material advisors with respect to Related-Party Basis Adjustment Transactions disclose such transactions and maintain lists in accordance with sections 6111 and 6112, respectively.

In this comment letter, we focus on the overbreadth of the Proposed Regulations in their application to family entities, trusts and estates, and estate planning. We commend Treasury and the IRS for their stated goal of identifying potentially abusive transactions, and we appreciate the opportunity to comment on the Proposed Regulations.

Background – Flexibility of Subchapter K

Subchapter K, which governs the taxation of partnerships, was adopted as part of the Internal Revenue Code of 1954. In adopting Subchapter K, "the principal objectives have been simplicity, flexibility, and equity between the partners."[3] Serving as a backstop to these principal objectives are several existing statutes which limit partners' ability to manipulate the partnership form for tax-motivated purposes.

The general rule is that gain or loss on the disposition of partnership property is governed by the partnership agreement.[4] One of the primary limitations on the flexibility of partnerships relates to allocations with respect to contributed gain or loss property. Under this limitation, items of income, gain, loss, or deduction with respect to property contributed to a partnership by a partner must be allocated "so as to take account of the variation between the basis of property to the partnership and its fair market value at the time of contribution."[5] This limitation is part of a broader statutory and regulatory framework under section 704 requiring that partnership

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[3] H.R. Rep. No. 1337, 83d Cong., 2d Sess. 65 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954).

[4] Section 704(a).

[5] Section 704(c)(1)(A).

allocations either be in accordance with the partner's interest in the partnership or have substantial economic effect.[6] There are several additional provisions under Subchapter K and elsewhere in the Code that provide limitations on the ability of partners to use the partnership form.[7]

Significant in the limitations on the use of partnerships are the partnership anti-abuse regulations.[8] The anti-abuse regulations generally contain three primary limitations: (1) abuses which violate the "intent of Subchapter K;" (2) "abuses of Subchapter K;" and (3) an "abuse of entity rule" which allows the IRS to treat a partnership as an aggregate of its partners rather than an entity, in whole or in part.[9] Under each of these limitations, the IRS is granted broad authority to recast transactions, disregard partnerships, or undertake other steps to avoid abuses.

Particularly relevant to Related-Party Basis Adjustment Transactions, each of which involve an adjustment to the basis of property under the provisions of Subchapter K, the partnership's annual income tax return, Form 1065, already requires disclosure when basis adjustments are made.[10] As such, the IRS already obtains reporting whenever basis adjustments are made and has regulatory authority to limit the ability of partners' use of partnerships for purposes limited under the anti-abuse regulations (in addition to other limitations in Subchapter K and elsewhere such as the codified economic substance doctrine of section 7701(o)).

Another key principle of Subchapter K pertains to distributions. Generally, partnership distributions are intended to be tax-free, reflecting "a Congressional policy of deferring recognition of gain or loss by partners and partnerships whenever possible – a policy of maximum nonrecognition."[11] However, to preserve the potential for gain or loss, Subchapter K includes detailed rules for adjusting the basis of property distributed to partners as well as the remaining partnership interests, if any, of the distributee partner.[12] As with other partnership tax limitations, there also are Congressional limitations on this general policy of nonrecognition. Primarily, those limitations are contained within the disguised sales, mixing bowl rules, and hot asset rules.[13]

Under the basis adjustment rules, the basis of property (other than money) distributed by a partnership to a partner in a non-liquidating distribution is normally the same as the partnership's basis in that property.[14] In no event will the distributee's basis in the property exceed its outside basis reduced by any money distributed in the same transaction.[15] The basis of property (other than money) distributed by a partnership to a partner in a liquidating distribution is an amount equal to the distributee partner's outside basis reduced by any money distributed in the same transaction.[16] If the basis in the distributed property will be different (whether higher or lower) than the partnership's basis in that property because the distributee partner's outside basis is different than

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[6] Section 704(b).
[7] See, e.g., Sections 267, 704(d), 707(b)(1), 751, 761(b), 465, 469, 482, and 7701(o). See also the general partnership anti-abuse regulations at Treas. Reg. § 1.701-2.
[8] Treas. Reg. § 1.701-2.
[9] McKee, Nelson & Whitmire, *Federal Taxation of Partnerships & Partners*, ¶ 1.05 (WG&L 2024).
[10] See IRS Form 1065, Schedule B, Lines 10a-d.
[11] Cunningham, Laura E. and Noël B. Cunningham, *The Logic of Subchapter K: A Conceptual Guide to the Taxation of Partnerships* (6th ed. 2020).
[12] Sections 731, 732, 733, and 734.
[13] In addition, section 752 (treatment of partnership liabilities) may cause a partner to recognize gain upon a distribution or contribution of property subject to a liability or a transfer of a partnership interest.
[14] Section 732(a).
[15] Section 733.
[16] Section 732(b).

the partnership's basis in that property, section 732(c) sets forth the procedure for allocating that difference.

Under the disguised sale rules, subject to certain exceptions including those for normal operating distributions and certain debt-financed distributions, when a partner contributes gain property to a partnership and receives money or other property from the partnership within two years, generally the partner is treated as having sold the contributed property for the distributed property in a taxable sale or exchange.[17] Note that the two-year period is based on a rebuttable presumption that treats distributions before the two-year period expires as being part of a disguised sale or, alternatively, distributions after the two-year period as not being part of a disguised sale.[18]

There are two mixing bowl rules. Under one of the mixing bowl rules, when built-in gain (or loss) property contributed by a partner is distributed within seven years of contribution to another partner, the distribution is treated as a sale at fair market value on the date of distribution triggering gain (or loss) to the contributing partner.[19] Under the second of the mixing bowl rules, when other property is distributed to the partner who contributed built-in gain (or loss) property within the previous seven years, gain (or loss) is recognized based on certain calculations provided for by regulation.[20] Both mixing bowl rules contain exceptions to sale treatment for certain distributions.[21]

Under the hot-asset rules affecting partnership distributions, any time there is a non-pro rata distribution from a partnership of unrealized receivables[22] or substantially appreciated inventory items[23] (i.e., section 751(b) property) to a partner there is a deemed taxable exchange of section 751(b) property for other property between the distributee-partner and the partnership.[24]

The rules and exceptions described above aim to support Congressional policies promoting flexibility and equity among partners, maximizing nonrecognition, and preventing abuse. Since the basis of assets received in distributions may be adjusted, or gain or loss may be recognized, discrepancies between the inside basis of partnership assets and the outside basis of partners in their partnership interests can arise if an inside basis adjustment is not made. Consequently, partnerships have the option to elect to adjust the inside basis of their assets in such events.[25] This election, once made, is irrevocable.[26] However, if there is a substantial basis reduction, meaning a net overall negative basis adjustment exceeding $250,000, the adjustment is mandatory.[27]

In addition to basis adjustments resulting from partnership distributions, basis adjustments can result upon the occurrence of other events, such as sales or nonrecognition transfers due to a partner's death or when a partner's interest is purchased, retired, or redeemed in the ordinary course of business succession planning. These sales and transfers often result in an inside-outside basis

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[17] Section 707(a)(2)(B).
[18] Treas. Reg. § 1.707-3.
[19] Section 704(c)(1)(B).
[20] Section 737 and Treas. Reg. § 1.737-1.
[21] Treas. Regs. §§ 1.704-4 and 1.737-2.
[22] Section 751(c); Treas. Reg. § 1.751-1(c).
[23] Sections 751(b)(3), 751(d); Treas. Reg. § 1.751-1(d); Prop. Reg. § 1.751-1(d)(1).
[24] Section 751(b); Treas. Reg. § 1.751-1(b).
[25] Sections 734(b), 754, 755.
[26] Treas. Reg. § 1.754-1(c).
[27] Sections 734(a), (d).

disparity for the transferee partner.[28] Similar to basis adjustments made by reason of distributions, these adjustments are elective.[29] This election, however, becomes mandatory when the partnership has a substantial built-in loss, meaning the partnership's adjusted basis in its property exceeds the fair market value by more than $250,000, or if the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to fair market value immediately after the transfer.[30]

Due to the elective nature of these basis adjustments, the substantial recordkeeping required, and the irrevocable nature of these elections, there are times when the partnership will elect not to make a basis adjustment election. In those cases, it is possible that a transferee partner will receive a distribution of partnership property causing the transferee partner to receive the distributed property with a basis different than fair market value at the time of the transfer, thus distorting the tax consequences. As a result, if a partner receives its interest by transfer (such as by purchase or by reason of death of a transferor partner) during the two years prior to a distribution, the partner may elect to adjust the basis of the property received as if the election had been made.[31] As with the basis adjustments described above, this election is mandatory in certain events.[32]

Burdens Imposed by the Proposed Regulations

Under the Proposed Regulations, Related-Party Basis Adjustment Transactions are those transactions where either:

(1) the partnership distributes property to a person who is a related partner[33] in a current or liquidating distribution where the partnership increases the basis of one or more of its remaining properties due to a section 734(b) adjustment;

(2) the partnership distributes property to a person who is a related partner in liquidation of the person's partnership interest, causing the basis of one or more distributed properties to be increased due to application of section 732(b);

(3) a partnership distributes property to a person who is a related partner (in a transaction which would be described in (4) below) causing the basis of one or more distributed properties to be increased as a result of a section 732(d) election; or

(4) a partner transfers an interest in a partnership to a related partner in a nonrecognition transaction[34] resulting in the basis of one or more partnership properties to be increased as a result of a section 743(b) adjustment.[35]

The Proposed Regulations provide that such transactions are defined as a Related-Party Basis Adjustment Transaction only if an applicable $5 million threshold is met, which is defined as the sum by which all basis increases resulting from Related-Party Basis Adjustment

[28] Section 743.
[29] Sections 743(b), 754, 755.
[30] Sections 743(a) and (d).
[31] Section 732(d).
[32] Treas. Reg. § 1.732-1(d)(4).
[33] The term "related partner" is defined in Prop. Reg. § 1.6011-18(b)(9).
[34] The term "nonrecognition transaction" is defined in Prop. Reg. § 1.6011-18(b)(2).
[35] Prop. Reg. § 1.6011-18(c)(1) and (2).

Transactions during the taxable year (without netting for losses) exceeds by at least $5 million the gain recognized from such transactions to be paid by any of the related partners.[36]

Although the "supplementary information" preamble to the Proposed Regulations describes Related-Party Basis Adjustment Transactions as resulting in post-transaction cost recovery allowances or dispositions by taxable sale or exchange, there is no language in the Proposed Regulations to this effect or any limitation of the reporting obligations to Related-Party Basis Adjustment Transactions where these events occur.

In addition, Prop. Reg. § 1.6011-18(a) provides that a transaction that is the same as, or substantially similar to, a Related-Party Basis Adjustment Transaction is a transaction of interest for the purposes of Treas. Reg. § 1.6011-(4)(b)(2) and sections 6111 and 6112. Treas. Reg. § 1.6011-4(c)(4) broadly defines "substantially similar" as any transaction that is expected to obtain the same or similar tax consequences and that is either factually similar or based on the same or similar tax strategy. The Proposed Regulations define a "substantially similar" transaction as including (without limitation) (i) Related-Party Basis Adjustment Transactions that do not involve a related partner but are facilitated by a tax-indifferent party and (ii) transaction in which a partner transfers an interest in a partnership to a related partner in a recognition transaction and the $5 million threshold is met.[37]

By designating Related-Party Basis Adjustment Transactions, as well as transactions substantially similar to them, as transactions of interest for the purposes of Treas. Reg. § 1.6011-4(b)(2), the Proposed Regulations, if finalized, will require taxpayers who have participated in Related-Party Basis Adjustment Transactions, and importantly, transactions substantially similar to Related-Party Basis Adjustment Transactions, as well as those taxpayers who enter into such transactions after the Proposed Regulations are finalized, to disclose such transactions to the IRS, past or future, unless the statute of limitations for all tax years in which the transactions were entered has lapsed.

Treas. Reg. §§ 1.6011-4(d) and (e) provide that the disclosure statement Form 8886, *Reportable Transaction Disclosure Statement*, must be attached to the taxpayer's Federal tax return for each taxable year for which a taxpayer participates in a reportable transaction, and a copy of the Form 8886 must be sent to the Office of Tax Shelter Analysis ("OTSA") at the same time the Form 8886 is filed with the tax return. Taxpayers who have participated in Related-Party Basis Adjustment Transactions, or substantially similar, transactions and filed their respective Federal tax returns in years preceding the finalization of the Proposed Regulations, but for whom the statute of limitations has not yet lapsed for assessment for such respective tax year(s), must file Form 8886 with OTSA disclosing such transaction within 90 calendar days from the date the Proposed Regulations are finalized.[38] Given the large number of partnership returns filed[39] and the number of distributions, transfers, and other transactions that would have been undertaken by these partnerships, this presents a potential substantial burden on taxpayers with the possibility of subjecting partners to significant liability for failure to comply.

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[36] Prop. Reg. § 1.6011-18(c)(3).

[37] Prop. Reg. § 1.6011-18(d)

[38] Prop. Reg. § 1.6011-4(e)(2)(i).

[39] For the year 2021, approximately 4.5 million partnership income tax returns were filed representing 30.6 million partners. https://www.irs.gov/statistics/soi-tax-stats-partnership-statistics-by-sector-or-industry.

Taxpayers who are required to disclose Related-Party Basis Adjustment Transactions, or substantially similar transactions, but fail, to disclose such transactions under Treas. Reg. § 1.6011-4 are subject to penalties under section 6707A. Section 6707A(b) provides that the amount of the penalty is 75% of the decrease in tax shown on the return as a result of the reportable transaction, or which would have resulted from such transaction if such transaction were respected for Federal tax purposes, subject to minimum and maximum penalty amounts. The minimum penalty amount is $5,000 in the case of a natural person and $10,000 in any other case. For a transaction of interest, the maximum penalty amount is $10,000 in the case of a natural person and $50,000 in any other case.

Additional penalties may also apply. Section 6662A imposes a 20% accuracy-related penalty on any understatement[40] attributable to an adequately disclosed reportable transaction. Further, if the taxpayer is required, but does not adequately disclose participation in a reportable transaction in accordance with the regulations under section 6011, the imposed penalty increases to 30% of any understatement.

Additionally, a material advisor with respect to Related-Party Basis Adjustment Transactions, or substantially similar transactions, is subject to reporting requirements. A material advisor is any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in Treas. Reg. § 301.6111-3(b)(3) for the material aid, assistance, or advice.[41] Material advisors must disclose transactions on Form 8918, *Material Advisor Disclosure Statement*,[42] and such disclosure statement for a reportable transaction must be filed with OTSA by the last day of the month that follows the end of the calendar year in which the advisor becomes a material advisor with respect to a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur.[43] A material advisor who fails to file a timely disclosure, or files an incomplete or false disclosure statement, is subject to a penalty of $50,000.[44]

Furthermore, a material advisor with respect to any reportable transaction must maintain a list identifying each person to whom the advisor was a material advisor with respect to such transaction and containing such other information as the Secretary may by regulations require.[45] A material advisor may be subject to a penalty for failing to maintain a list under section 6112(a) and failing to make the list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of such request. The penalty, under section 6708(a), for failing to provide such list is $10,000 per day for the failure to provide such list after the 20th day.[46] Here, material advisors are given some reprieve, as no penalty will be imposed with respect to the failure on any day if such failure is due to reasonable cause.[47]

[40] As defined in section 6662A(b)(1).
[41] Treas. Reg. § 301.6111-3(b)(1).
[42] Treas. Reg. § 301-6111-3(d) and (e).
[43] Treas. Reg. § 301-6111-3(e).
[44] Section 6707(a).
[45] Section 6112(a) and § 301.6112-1(e).
[46] Section 6708.
[47] Section 6708(a)(2).

<u>Principal Concerns of Overbreadth</u>

Principal issues with the Proposed Regulations, especially as they are applied to family business entities, are described below:

First, the Proposed Regulations convert Code-approved transactions that occur in the ordinary lifecycle of a business that do not have as a principal purpose tax avoidance into a transaction of interest. Many family businesses will fail and be liquidated following their formation or following a generational transition (i.e., the death of the senior generation).[48] For those family businesses that survive, traditional succession and transition planning often requires that the interests of the senior generation be purchased or retired. By their nature, these family businesses will be owned by related parties. Consequently, these family businesses will become subject to the reporting requirements under the Proposed Regulations even though tax avoidance played no role in the liquidation of the business. There are numerous existing Code and regulatory provisions that prescribe the allocation of basis, including to the distributed property and when those distributions give rise to gain. The existing Code, and regulatory-approved allocations, maintain Congressional intent for flexibility and equity between the partners while significantly limiting partners' ability to manipulate the partnership form for tax-motivated purposes. Due to existing reporting obligations and anti-abuse statutes and regulations, partnerships already report basis adjustments when filing income tax returns. Partners remain subject to adjustments under, for example, the partnership anti-abuse regulations as well as being subject to mixing bowl, disguised sale, and other limitations. Nevertheless, if the IRS and Treasury have determined that partnerships are being used for basis shifting abuse, then we urge Treasury to exclude from the definition of transactions of interest, basis adjustments where:

(1) basis shifts between assets of "like kind" (i.e., capital asset to capital asset or ordinary income asset to ordinary income asset – as the rules under sections 743 and 755 already require);

(2) basis shifts among non-depreciable or other non-cost recovery property; and

(3) the property receiving a basis increase is not sold within two years of liquidation. If the property is sold within two years, then disclosure would be required for the year of the sale, similar to the two-year rules under sections 453(e)(2) and 1031(f).

The second issue with the Proposed Regulations is that they stray from the Congressional intent of simplicity by subjecting family business owners and their advisors to substantial reporting obligations and penalties when a much less onerous method of disclosure is available. Under the Proposed Regulations, numerous family businesses and their advisers may be subjected to a burdensome reporting regime designed to target abusive transactions when the transaction— i.e., the simple distribution of partnership property—may not be tax motivated. Moreover, the Proposed

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[48] *See* Shepherd, D. & Zacharakis, A. (2000). Structuring Family Business Succession: An Analysis of the Future Leader's Decision Making. *Entrepreneurship Theory and Practice*, 24, 25-39 (noting that approximately 70% of family businesses fail to survive generational transition); *see also* Institute, Commerce. "What Percentage of Businesses Fail Each Year? (2024 Data)." *Commerce Institute*, 8 July 2024 (noting that according to 2024 data from the U.S. Bureau of Labor Statistics, 20.4% of businesses fail in their first year after opening, 49.4% fail in their first 5 years, and 65.3% fail in their first 10 years).

Regulations require reporting every year that a basis increase affects a taxpayer's income.[49] This could result in requiring taxpayers to report transactions decades after the relevant basis adjustment. For example, if a partner receives an increase in basis to depreciable residential property, the reporting obligation could extend 27 years during the entire depreciable term of the property. The period for reporting could be even longer for the sale of a capital asset that previously received a basis adjustment. If Treasury has determined that partnerships are being used for basis shifting abuse, then we urge Treasury to adopt a similar one-time disclosure mechanism for Related-Party Basis Adjustment Transactions, or substantially similar transactions, similar to what was adopted for "drop and swap" or "swap and drop" transactions under section 1031—that is, the addition of questions 11 and 12 to Schedule B of Form 1065, *U.S. Return of Partnership Income*. This one-time reporting could be in addition to the disclosure described above when property receiving a basis increase is sold within two years after liquidation. This is discussed in more detail later in these comments.

The third issue with the Proposed Regulations is the imposition of an unrealistic obligation on partners and partnerships to track past transactions that were carried out according to Code-approved provisions.[50] As written, taxpayers are required to analyze all partnership distributions and all transfers of partnership interests to determine whether a basis adjustment was made and whether that basis adjustment affected, or continues to affect, an open tax period. If the Treasury has determined that partnerships are being used for basis shifting abuse, then we urge Treasury to apply the selected disclosure mechanism for Related-Party Basis Adjustment Transactions, or substantially similar transactions, on a prospective basis only and not require disclosure for any transaction occurring before the effective date of the regulations.

In short, for the reasons stated above, we urge Treasury to:

(1) Exclude from the definition of a transaction of interest any basis adjustments where: (a) basis shifts between assets of like character, (b) basis shifts from one non-depreciable asset to another non-depreciable asset or where the basis adjustment does not provide a shorter depreciable period, and (c) where the property receiving an increase in basis is not sold within 2 years following the basis adjustment;

(2) Rather than requiring reporting as a listed transaction by the filing of a Form 8886 to the OTSA, to modify IRS Form 1065 to require taxpayers to disclose related party basis adjustments as part of the partnership's annual income tax return filing; and

(3) Apply any filing obligations on a prospective basis only, and not require reporting with respect to basis adjustments made before the date of the Proposed Regulations.

<u>Exception for Death-Related Basis Adjustment Transactions</u>

In describing Partnership Related-Party Basis Adjustment Transactions, the Preamble to the Proposed Regulations points to "related persons using partnerships to engage in transactions that inappropriately exploit the basis adjustment provisions of subchapter K." The Preamble states

[49] Prop. Reg. § 1.6011-18(e)(5) and (g)(2).
[50] Prop. Reg. § 1.6011-4(e)(2)(i).

that these transactions of interest are "partnership transactions involving related parties in which basis adjustments were created to artificially generate or regenerate Federal income tax benefits," specifically including distributions of partnership property or transfers of partnership interests, which result in a basis increase to property held by a partnership, partner, or former partner (all of whom are "related"). Despite the clear intention to identify situations where taxpayers intentionally manipulate the rules under subchapter K to create disparities between inside and outside basis or inappropriately exploit the basis rules thereunder, the definition of the targeted transactions (Partnership Related-Party Basis Adjustment Transactions) is so broad that it includes actions by persons that are caused by the death of a partner or that are common in the administration of a decedent's estate (and trusts created by a decedent).

When a partner dies (an event that would not be seen as an intentional act meant to "exploit" the provisions of subchapter K), the partnership interest owned by a decedent (or a decedent's revocable trust) will get a basis adjustment under section 1014(a), which generally provides that the basis of property (i.e., the partnership interest) acquired from a decedent will be the fair market value of such property. As the Treasury Regulations provide, "The basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death or at the alternate valuation date, increased by his estate's or other successor's share of partnership liabilities, if any, on that date."[51] Thus, the basis of a partnership interest owned by a decedent (or any other trust includible in the decedent's gross estate for estate tax purposes) will be adjusted under section 1014(a) to be equal to the fair market value of the partnership interest (net of partnership liabilities and as modified by valuation adjustments) plus the estate's (or includible trust's) share of partnership liabilities.

Generally, if, at the time of death, the fair market value of the decedent's partnership interest exceeds the deceased partner's share of the partnership's basis in those assets (inside basis), then, assuming neither a section 754 election nor mandatory inside basis adjustment[52] applies, then under section 1014(a), the partnership interest will have a higher outside basis (due to a "step-up" in basis) than the deceased partner's share of the inside basis of the partnership assets.[53] Often, estate planners will try to avoid making a section 754 election because once made, the election is irrevocable, and inside basis adjustments under section 743(b) only apply to the transferee of a partnership interest (i.e., acquired from a decedent), and not to the common basis of the partnership assets.[54] Thus, a section 754 election, at the death of a decedent, requires the partnership to maintain a separate set of calculations of distributive share (income, gain, loss, and deduction including depreciation/appreciation) for each such transferee that reflects the section 743(b) inside basis adjustments.

To avoid having to maintain separate calculations for each transferee, in the administration of a decedent's estate (or trust), the partnership may prefer to make distributions of partnership

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[51] Treas. Reg. § 1.742-1. Basis is reduced to the extent the value is attributable to partnership assets that constitute income in respect of a decedent. *See* sections 691(e) and 753.

[52] Section 743(d) (substantial built-in loss).

[53] More precisely, the "basis to the transferee partner of his interest in the partnership," under section 1014(a), is greater than "his proportionate share of the adjusted basis of the partnership property." *See* section 743(b)(1).

[54] *See* Treas. Reg. § 1.743-1(j)(1).

property in lieu of making the section 754 election (and corresponding inside basis adjustment under section 743(b)). For example, a partnership may be required, under the terms of the governing partnership agreement (or operating agreement, in the case of a limited liability company) to redeem the interest of a deceased partner because the remaining partners do not wish to have the decedent's beneficiaries as partners. In addition, a fiduciary may be required to transfer the decedent's partnership interest to a beneficiary to satisfy a bequest under the terms of the decedent's last will and testament (or revocable trust) or to fund a trust created for the benefit of the decedent's heirs. As illustrated below, these types of actions in the common administration of a decedent's estate (or trusts) would be considered transactions of interest, resulting in the imposition of potentially years of undue disclosure and recordkeeping requirements on taxpayers, participants, and material advisors, and subjecting them to possible penalties.

The following is a simplified example of how common basis adjustment transactions can occur in the administration of an estate (or trust) when a partner dies.

> **<u>Example 1</u>:** A, an individual, dies owning a 1/3rd interest in the capital and profits of ABC Partnership. B and C are related partners, collectively owning the remaining 2/3rds of the partnership. Prior to A's death, A's partnership interest had an outside basis of $3 million and a capital account balance of $10 million, and the assets of ABC Partnership had an aggregate adjusted basis of $9 million and fair market value of $30 million. A's "proportionate share" [55] of ABC Partnership's inside basis in the assets is $3 million. Under section 1014(a), the outside basis of A's partnership interest, now held by A's estate, will be increased to $10 million. ABC Partnership does not have a section 754 election in place.
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> The partnership agreement provides that, upon the death of a partner, the partnership will redeem the deceased partner's interest in the partnership by distributing assets equal to the fair market value of the interest ($10 million) at the time of death. To that end, ABC partnership distributes $10 million of ABC Partnership's assets (not including any money) to A's estate. As such, when the property is distributed to the estate, the assets will have an adjusted basis and fair market value of $10 million. The distribution of the assets results in an increase in the adjusted bases of the distributed assets of $7 million to $10 million (equal to the increased basis under section 1014(a)). The resulting basis of $10 million would result in either of two circumstances: (i) the transferee (estate) received the properties within two years of the date of death and the transferee made an election under section 732(d) to treat the properties as if an adjustment under 743(b) had been in effect; or (ii) the properties were distributed in liquidation of the estate's interest under section 732(b). The distribution of the partnership assets described in Example 1 above, whether under section 732(b) or 732(d) would be considered a transaction of interest under Prop. Reg. § 1.6011-18(c)(1)(ii) and (iii) respectively.

[55] As defined and calculated pursuant to section 743(b)(1).

Example 2: Same facts as Example 1, except under the terms of the deceased partners Last Will and Testament (or revocable trust), the executor (or trustee) of the estate is required to transfer, as a specific bequest, the decedent's partnership interest in ABC Partnership to a beneficiary of the estate (or beneficiary of the trust) that is a related party. One year after the decedent's death, in the course of administering the decedent's estate (or trust), the executor (or trustee) transfers the partnership interest to the beneficiary and ABC Partnership makes a section 754 election. As a result, the transfer of the partnership interest to the beneficiary will result in a $7 million net increase of the inside basis of the partnership under section 743(b)(1) and (c) of the Code.

The transfer of the partnership interest is not considered a recognition event,[56] and the basis to the beneficiary is the adjusted basis of the partnership interest in the hands of the decedent's estate (or trust) immediately before the distribution ($10 million, but the estate's "proportionate share" of ABC Partnership's inside basis is $3 million).[57] Section 743(b) provides, when a section 754 election is in effect for the taxable year, an inside basis adjustment will occur "in the case of a transfer of an interest in a partnership by sale or exchange."[58] Section 761(e) provides, "Except as otherwise provided in regulations, for purposes of … section 743 (relating to optional adjustment to basis of partnership property), and… any other provision of this subchapter specified in regulations prescribed by the Secretary, any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange."[59] As such, in this Example 2, the transfer of the partnership interest to the beneficiary would be considered "a nonrecognition transaction," pursuant to which "the basis of one or more partnership properties is increased under section 743(b)(1) and (c) of the Code, and the $5 million threshold … is met." This would be considered a transaction of interest under Prop. Reg. § 1.6011-18(c)(2).

For estate planning purposes, grantors will often gift property to an irrevocable trust, and the grantor will retain a power over the trust that causes the grantor to be treated as the owner of the trust for income tax purposes under subpart E of part I of subchapter J of chapter 1 (the trust is often referred to as a "grantor trust"). Commonly, the grantor will not hold a power over the grantor trust that would result in the inclusion of the grantor trust's assets in the grantor's gross estate for estate tax purposes (chapter 11 of the Code). This type of trust is sometimes referred to as an "intentionally defective grantor trust" or "IDGT." When grantor trust status is terminated, the trust

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[56] *See* section 663(a)(1). This also assumes the estate or trust does not elect to treat the distribution as a sale to the beneficiary and recognize gain or loss on the distribution. Section 643(e)(3).

[57] Section 643(e)(1).

[58] Section 743(b).

[59] Section 761(e)(2) and (3). No regulations have been issued to rebut the presumption of section 761(e) under these circumstances. Further, it is not clear how "distribution" in section 761(e)(3) should be interpreted. The Treasury Regulations refer to a deemed distribution under section 708(b)(1)(B) referring to terminations and continuation of partnerships (including mergers, consolidations, and divisions of partnerships), but section 708(b)(1)(B) is no longer in the Code. *See* Treas. Reg. § 1.761-1(e) and P.L. 115-97, Sec. 13504(a) (2017).

becomes a separate taxable entity (non-grantor trust), and the "owner" of the trust assets for income tax purposes changes from the grantor to the non-grantor trust.

The IRS has ruled that when grantor trust status is terminated during the grantor's lifetime, the grantor is deemed to have transferred the trust property to a separate taxable entity. If the transferred property is subject to debt in excess of the adjusted basis in the property, then the grantor, as the transferor, will recognize gain to the extent of the such excess.[60] If grantor trust status is terminated due to the grantor's death, clearly the grantor-decedent is no longer considered the owner of the trust property for income tax purposes. The IRS has ruled that upon the death of the grantor, the trust springs into existence as a separate taxpayer.[61] Thus, the trust assets are deemed to be transferred to the new taxpayer, but it is not clear what type of transfer it is, and whether, under some circumstances, it could be considered a taxable sale or exchange if debt in excess of basis exists. Revenue Ruling 2023-2[62] asserts that there is no basis adjustment under section 1014 to the assets of an IDGT on the death of a grantor. In the ruling, by the date of the grantor's death, the fair market value of the asset had appreciated. At that time, the trust liabilities did not exceed the basis of the trust assets and neither the individual nor the trust held a note on which the other was the obligor. In coming to the conclusion that the basis of the assets after the death of the individual "is the same as the basis of Asset immediately prior to A's death,"[63] the IRS reasoned the basis of the trust assets are not adjusted under section 1014 because the assets were "not acquired or passed from a decedent as defined in § 1014(b)."[64] The IRS has not determined whether a deemed transfer to what was an IDGT, would, due to the grantor's death, be considered a taxable sale or exchange if debt is in excess of basis.

Further, even if trust liabilities do not exceed the basis of the trust assets, the IRS has held that, when the grantor of a revocable trust dies, the deemed transfer of a partnership interest to the trust, caused by that death, requires an inside basis adjustment under section 743(b) if the partnership has a section 754 election in place.[65] The ruling provides:[66]

> Before A's death, A had powers over T of the types described in sections 676 and 677 of the Code, and T was therefore a grantor trust. Additionally, T held a partnership interest. Under the principles of Rev. Rul. 77-402 , A is considered to have been the partner during this period for federal income tax purposes. Further, at the time of A's death T ceased to be a grantor trust. The partnership interest is thus considered to have been transferred from A to T at that time. As a result, a transfer of a partnership interest occurred upon the death of a partner.

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[60] Rev. Rul. 77-402, 1977-2 C.B. 222. *See also* Treas. Regs. §§ 1.1001-2(a)(1) and 1.1001-2(c), Ex. 5.

[61] Rev. Rul. 57-51, 1957-1 C.B. 171. *See also* Rev. Rul. 79-84, 1979-1 C.B. 223 (Upon the death of the grantor, there is a deemed transfer of a partnership interest to the revocable trust that owned the interest at death for section 743(b) purposes because the partnership had a section 754 election in place.) and Treas. Reg. § 1.671-4(h) ("Following the death of the decedent, the trust or portion of a trust that ceases to be treated as owned by the decedent, by reason of the death of the decedent, may no longer report under this section.").

[62] Rev. Rul. 2023-2, 2023-16 I.R.B. 658.

[63] *Id.*

[64] *Id.*

[65] Rev. Rul. 79-84, 1979-1 C.B. 223.

[66] *Id.*

The phrase "upon the death of a partner" is a direct reference to the same phrase in section 743(b). Prop. Reg. § 1.6011-18(b)(2) defines a "nonrecognition transaction" as defined within the meaning of section 7704(a)(45) of the Code "other than a transfer on the death of a partner." Further, as noted above, Section 761(e) provides, "Except as otherwise provided in regulations, for purposes of … section 743 (relating to optional adjustment to basis of partnership property), and… any other provision of this subchapter specified in regulations prescribed by the Secretary, any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange."[67] A clarification of whether a deemed transfer to an IDGT, upon the death of a grantor, would be considered a "nonrecognition transaction" (and how debt in excess of basis assets will be treated for these purposes), would be appreciated.

> **Example 3:** An irrevocable trust (the "Trust") owns a 1/3rd interest in the capital and profits of ABC Partnership. A, an individual, created the Trust and gifted the 1/3rd partnership interest to the Trust during A's lifetime. The Trust is a grantor trust, but A does not hold a power over the Trust that would result in the inclusion of the Trust's assets in A's gross estate for estate tax purposes (an IDGT). During A's lifetime, A is deemed to be the owner for Federal income tax purposes of the Trust's 1/3rd interest in ABC Partnership under subpart E of part I of subchapter J of chapter 1. B and C are related partners, collectively owning the remaining 2/3rds of the partnership.
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> A dies, and the Trust becomes a non-grantor trust. Prior to A's death, the Trust's partnership interest had an outside basis of $10 million, and the Trust's "proportionate share" of ABC Partnership's inside basis in the assets is $3 million. Assume, for purposes of this Example 3, at the time of A's death, ABC Partnership does not have a "substantial built-in loss" under section 734(b)(2) and the Trust does not have any liabilities. ABC Partnership has a section 754 election in place. Pursuant to Revenue Ruling 2023-2, the Trust, now a separate taxpayer from A and A's estate, is now the owner of the 1/3rd partnership interest with an outside basis of $10 million, the same as the basis of in the partnership interest immediately prior to A's death.
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> Based upon the authorities discussed above, there is a deemed transfer by A to the Trust, as a separate taxpayer, of the partnership interest. That transfer could be considered a "nonrecognition event" under Prop. Reg. § 1.6011-18(b)(2) and a transfer that would require an adjustment of inside basis under section 743(b)(1) and (c) of the Code of $7 million. As such, the death of A, would cause this deemed transfer to be considered a transaction of interest under Prop. Reg. § 1.6011-18(c)(2). Further, if the Trust provides that the assets of the Trust will distribute all of its assets to A's children, but the transfer from the Trust to the children does not

[67] Section 761(e)(2) and (3). No regulations have been issued to rebut the presumption of section 761(e) under these circumstances. Further, it is not clear how "distribution" in section 761(e)(3) should be interpreted. The Treasury Regulations refer to a deemed distribution under section 708(b)(1)(B) referring to terminations and continuation of partnerships (including mergers, consolidations, and divisions of partnerships), but section 708(b)(1)(B) is no longer in the Code. *See* Treas. Reg. § 1.761-1(e) and P.L. 115-97, Sec. 13504(a) (2017).

occur until A's children and the partnership execute the appropriate documentation, is the subsequent transfer considered a transaction of interest under Prop. Reg. § 1.6011-18(c)(2)?

Suppose instead that the Trust were a revocable trust generating estate tax on A's death. To avoid personal liability for estate tax, the trustee waits until a closing letter or transcript indicates that the IRS does not intend to examine the return or until a closing agreement terminates an examination. After all estate tax liability is settled, the trustee reviews the composition of the trust's assets, including the partnership interest, and agrees with the beneficiaries on a plan of distribution. The transfer from the Trust to A's children occurs when A's children and the partnership execute the appropriate documentation. The transfer to A's children resulted from A's death, but it may occur several years after A's death. Is this transfer considered a transaction of interest under Prop. Reg. § 1.6011-18(c)(2)?

As illustrated above, distributions of partnership property and transfers of partnership interests that occur because of a partner's death or are necessitated in the normal and ordinary administration of the deceased partner's estate (or trusts) often fall within the definitions of transactions of interest under Prop. Reg. § 1.6011-18. Again, the death of a partner cannot reasonably be seen as an intentional act meant to "exploit" the provisions of subchapter K. As a result, ACTEC believes that death-related transfers of partnership property and partnership interests should not be considered transactions of interest under Prop. Reg. § 1.6011-18.

Finally, when an irrevocable trust terminates due to a beneficiary's death, the transfer of a partnership interest or a related distribution to the trust's remainder beneficiaries, which usually occurs after a reasonable period of administration, generally should also qualify for an exception to a transaction of interest.

ACTEC respectfully recommends the following:

Distributions of partnership property to transferees of an interest in a partnership owned (or deemed owned for Federal income tax purposes) by a decedent at the time of death that occur during the administration of the decedent's estate (and any trusts created by such decedent) should be exempt from the definition in Prop. Reg. § 1.6011-18(c)(1). This would include distributions of partnership property, during post-mortem administration, to transferees of an interest in a partnership owned by a trust for the benefit of the decedent that terminates by reason of that death whether basis adjustments are made under sections 743(b) or 732(d).

Transfers of an interest in a partnership owned (or deemed owned for Federal income tax purposes) by a decedent at the time of death that occur during the administration of the decedent's estate (and any trusts created by such decedent) should be exempt from the definition set forth in Prop. Reg. § 1.6011-18(c)(2). This would include transfers, during post-mortem administration, of partnership interests to transferees of a partnership interest owned by a trust for the benefit of the decedent that terminates by reason of that death.

Please clarify that (i) any deemed transfer to what had been a grantor trust, including to a former IDGT is a "transfer on the death of a partner," (ii) a transfer on the death of a beneficiary

of a trust that is a partner is a "transfer on the death of partner," and (iii) a "transfer on the death of partner" is neither a "nonrecognition transaction," as currently stated in Prop. Reg. § 1.6011-18(b)(2), nor a "recognition transaction" under Prop. Reg. § 1.6011-18(b)(6). Please also clarify that a "transfer on the death of a partner" includes any transfer during administration of a trust or estate, after the death of a grantor, beneficiary, or direct owner.

Provide disclosure with the filing of the partnership tax return

Schedule B (Other information) to Form 1065 (U.S. Return of Partnership Income) contains many questions designed to gather information about a partnership's activities. Rather than treating certain partnership Related-Party Basis Adjustment Transactions as transactions of interest, implicating all the disclosure requirements discussed herein, the IRS may add to Schedule B one or more questions designed to gather substantially similar information that is sought through the Proposed Regulations.

The IRS has previously addressed analogous situations in this same manner. When the IRS sought information regarding so-called "drop and swap" or "swap and drop" transactions and so-called "TIC" transactions, the IRS requested additional information on Schedule B of Form 1065. Regarding drop and swap or swap and drop transactions, a question (currently line 11) was added to Schedule B, asking the partnership to check a box "if, during the current or prior tax year, the partnership distributed any property received in a like-kind exchange or contributed such property to another entity (other than disregarded entities wholly owned by the partnership throughout the tax year)." Regarding TIC transactions, a question (currently line 12) was added to Schedule B, asking, "[a]t any time during the tax year, did the partnership distribute to any partner a tenancy-in-common or other undivided interest in partnership property?"

Similarly, any question(s) regarding certain partnership Related-Party Basis Adjustment Transactions could be added to the other basis adjustment questions under line 10 of Schedule B. Those questions could also instruct the partnership to attach statements or new IRS Forms, reporting the information that the proposed regulations would require.

Given that sections 732, 734, 743 and 754 have been an integral part of our tax system for decades and are intended to generate fair tax results, taxpayers entering into transactions that trigger those provisions often will not perceive what they are doing as potentially abusive. In their reporting requirements, the Proposed Regulations do not differentiate between potentially abusive and non-abusive transactions. ACTEC believes that imposing a short time period on non-abusive transactions constitutes a trap for the unwary. ACTEC recommends that only transactions identified as potentially abusive incur the special reporting the Proposed Regulations contemplate and that other transactions should be reported along with the rest of the partnership's activity on Form 1065. The Proposed Regulations could authorize the IRS to identify, by Notice or Revenue Procedure, additional particular fact settings as potentially abusive and add them to the list of reportable transactions.

$5 Million Threshold

To be identified as a transaction of interest under the Proposed Regulations, the transaction must be described in Prop. Reg. § 1.6011-18(c) or be substantially similar to transactions described in such subsection. Prop. Reg. § 1.6011-18(c)(1)&(2) identify certain distributions by a partnership and certain transfers of partnership interests that would be considered transactions of interest. A transaction is described in Prop. Reg. § 1.6011-18(c)(1)&(2) only if it meets "the $5 million threshold."

Prop. Reg. § 1.6011-18(c)(3) provides that the $5 million threshold is met if, for any taxable year, "the sum of all basis increases resulting from" the transactions described in Prop. Reg. § 1.6011-18(c)(1), (2), & (d), "exceeds by at least $5 million the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party, in the case of a transaction described in paragraphs (d)(1) and (2) of this section) to such transactions." The Preamble clarifies that multiple subject transactions by the same partner or partnership during a taxable year are aggregated for purposes of determining whether the $5 million threshold is met.

Prop. Reg. § 1.6011-18(c)(3) also provides that the sum of all basis increases resulting from such transactions is determined "without netting for any basis adjustment in the same transaction or another transaction that reduces basis." This requirement may result in certain basis adjustment transactions being considered transactions of interest that do not provide significant tax savings and do not exploit the basis adjustment provisions of subchapter K. For example, a partner may receive a liquidating distribution of non-depreciable property under section 732(b) when the partnership's basis in the distributed property is relatively low and the distributee partner has a relatively high outside basis. Under section 732(b), the distributed property's basis is increased. Under either section 734(b)(2) or (d), the partnership will be required to decrease the basis of one or more of its remaining properties in a manner that offsets the benefit from the basis increase in the distributed property. If the partnership is only able to decrease the basis of assets with the same recovery period for depreciation deduction purposes as the distributed property, there will be no exploitation of the basis adjustment provisions. Thus, the proposed regulations should be modified to allow netting of the basis adjustment.

In addition, Prop. Reg. § 1.6011-18(d) provides a nonexclusive list of transactions that would be considered substantially similar (within the meaning of Treas. Reg. § 1.6011-4(c)(4)) to transactions described in Prop. Reg. § 1.6011-18(c). At least with respect to the transaction described in Prop. Reg. § 1.6011-18(d)(2), substantially similar transactions also must meet the $5 million threshold. However, it is not clear whether the transaction described in Prop. Reg. § 1.6011-18(d)(1) or other substantially similar transactions must reach the $5 million threshold to be included under Prop. Reg. § 1.6011-18(d). It is unclear from the Proposed Regulations whether a transaction that is substantially similar includes a transaction the size of the basis adjustment of which does not meet, but is close to, the $5 million threshold. To avoid unduly expanding the number of transactions that are considered transactions of interest, we request that Treasury specify that any substantially similar transaction under Prop. Reg. § 1.6011-18(d) meet the $5 million threshold.

Clarification in Defining Tax-Indifferent Party

Prop. Reg. § 1.6011-18(d)(1) describes a transaction that is considered substantially similar to a transaction of interest under paragraph (c) of this section. Under this subparagraph (d)(1), a transaction is considered a transaction of interest if it is described in paragraph (c) "except that the partners of the partnership are not related and one or more partners of the partnership is a tax-indifferent party that facilitates, by receiving a distribution of property from the partnership or otherwise, an increase in the basis of partnership property or an increase in the basis of property held by another partner in the partnership."

Prop. Reg. § 1.6011-18(b)(11) defines a tax-indifferent party as "a person that is either not liable for Federal income tax because of its tax-exempt or, in certain cases, foreign status or to which gain from a transaction described in paragraph (c) of this section would not result in Federal income tax liability for the person's taxable year within which such gain is recognized."

Prop. Reg. § 1.6011-18(f)(1)(i) requires the disclosure of the names and identifying numbers of all tax-indifferent parties involved in a transaction of interest under this section.

The Preamble explains that transactions of interest may be designed so that the negative tax consequences arising from the transaction of interest are absorbed by the tax-indifferent party. The Preamble illustrates this by including an example in which partnership property is distributed to a tax-indifferent party, resulting in a decrease in the property's basis in the hands of the tax-indifferent party but resulting in a basis increase to depreciable property held by the partnership.

ACTEC requests confirmation that the definition of a tax-indifferent party in Prop. Reg. § 1.6011-18(b)(11) does not include a party who is protected from Federal income tax liability for the year in which gain is recognized simply due to that party holding a capital loss carryover under section 1212(b). Such clarification would help to ensure that the disclosure requirements under these Proposed Regulations do not extend beyond their intended application. A partner may hold a capital loss carryover due to transactions unrelated to the partnership. Further, the other partners may have no knowledge that a partner may eliminate an adverse tax consequence arising from a basis adjustment transaction through utilization of a capital loss carryover. Moreover, it may be more likely that the other partners are unaware of the capital loss carryover if the tax-indifferent party is unrelated, as contemplated by Prop. Reg. § 1.6011-18(d)(1).