NEW YORK STATE BAR ASSOCIATION
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October 9, 2012

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report on the Allocation of Basis Adjustments Under Section 743(b) to Contingent Liabilities

Dear Messrs. Mazur, Shulman and Wilkins:

I am pleased to submit the attached report of the Tax Section of the New York State Bar Association. The report addresses the question of whether and under what circumstances a partnership should be required to allocate basis adjustments under section 743(b) to contingent liabilities.

The current regulations under sections 704(c) and 752 expressly provide that contingent liabilities, or obligations of the partnership that are not classified as liabilities for purposes of section 752, qualify as "property" for purposes of section 704(c). The report recommends that Treasury and the IRS issue guidance confirming that contingent liabilities also qualify as "property" for purposes of determining basis adjustments to partnership property under section 743(b) and for purposes of allocating such adjustments among the partnership property under section 755.

The purpose of the recommended guidance is to more closely harmonize the treatment of contingent liabilities in taxable asset acquisitions with the treatment of such liabilities in taxable transfers of partnership interests. We believe greater conformity in this area is consistent with the purpose of section 743(b), which generally conveys a cost basis to the transferee partner in its share of the partnership assets if the partnership has a valid section 754 election in effect. We also believe it is consistent with the purposes of sections 743(d) and 704(c)(1)(C), which seek to prevent the shifting of built-in losses in the partnership assets to the transferee partner after the transfer.

The report illustrates the various disconformities under current law by comparing the consequences to a buyer of assuming contingent liabilities in a direct purchase of assets with the consequences to a buyer of a partnership interest in a partnership that owns the same assets and contingent liabilities. As demonstrated by several examples, the mere form of the transaction may result in significant timing differences to the buyer, including an immediate basis step up in amortizable assets of the partnership even though the basis step up is attributable solely to a contingent liability that may never be paid.

The report examines these differences in three examples: (i) a purchase of assets encumbered by a contingent liability, (ii) a purchase of a partnership interest from a partner who contributed a trade or business subject to a contingent liability to the partnership, and (iii) a purchase of a partnership interest after the partnership incurs (rather than assumes from a partner) a contingent liability.

To minimize these timing differences, the report recommends that future guidance disregard contingent liabilities under sections 743(b) and 755 until they are satisfied, either in whole or in part. If this recommendation is adopted, the report also recommends guidance regarding the timing, calculation, and allocation of the later basis adjustments under sections 743(b) and 755 attributable to the ultimate satisfaction of these liabilities, suggesting three alternative approaches.

We appreciate your consideration of our recommendations.

Respectfully submitted,

Andrew W. Needham
Chair

Enclosures

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