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One Elk Street, Albany, New York 12207 • PH 518.463.3200 • www.nysba.org

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June 25, 2013

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

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

Daniel I. Werfel
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: New York State Bar Association Tax Section Report Addressing Proposed Treasury Regulation § 1.108-9

Dear Messrs. Mazur, Werfel and Wilkins:

I am pleased to submit the enclosed New York State Bar Association Tax Section report, which comments on the proposed regulations (the "Proposed Regulations") addressing how the section 108(a) rules excluding from taxable income cancellation of indebtedness ("COD") income occurring in a Title 11 case (the "Title 11 Exception") or when the taxpayer is insolvent (the "Insolvency Exception") apply when the entity legally liable for the cancelled indebtedness is a grantor trust or a disregarded entity for U.S. federal income tax purposes. The Proposed Regulations provide that, in applying these exceptions, (i) the term "taxpayer" refers to the regarded owner(s) of the grantor trust or disregarded entity, (ii) the Title 11 Exception applies only if the regarded owner(s) are under the jurisdiction of the court in a Title 11 case, and (iii) the Insolvency Exception applies only to the extent of the insolvency of the regarded owner(s).

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We commend the Treasury Department and the Internal Revenue Service for this critical guidance. We generally agree with the Proposed Regulations' approach, which is consistent with the treatment of a disregarded entity as a part of its regarded owner, rather than a separate person, and with the treatment of a partner, rather than the partnership, as the relevant taxpayer for purposes of applying the section 108(a) exclusions (which is provided for by section 108(d)(6)). In addition, while our report focuses on disregarded entities given the current prevalence of limited liability companies, we agree with the need for guidance in the case of grantor trusts that realize COD income, and, unless the context otherwise requires, references in our report to a disregarded entity should be understood to refer to a grantor trust as well.

We recommend that final regulations clarify several aspects of the Proposed Regulations and address certain related issues:

1. Final regulations should clarify that, for purposes of section 108(d)(1), indebtedness of a disregarded entity constitutes indebtedness of the regarded owner.

2. Final regulations should explain how debt of a disregarded entity is taken into account in measuring the regarded owner's insolvency for purposes of the Insolvency Exception. In Rev. Rul. 92-53, the Internal Revenue Service articulated three principles for applying the Insolvency Exception to nonrecourse debt: (i) nonrecourse debt always is taken into account in measuring a taxpayer's insolvency to the extent of the fair market value ("FMV") of the property securing such debt, (ii) the amount by which a nonrecourse debt exceeds the FMV of the property securing such debt is taken into account in measuring a taxpayer's insolvency to the extent that such excess nonrecourse debt is cancelled, and (iii) excess nonrecourse debt is not taken into account in measuring a taxpayer's insolvency to the extent it is not cancelled.

Final regulations should apply the principles of Rev. Rul. 92-53 to a disregarded entity's recourse indebtedness in measuring the insolvency of the disregarded entity's regarded owner, except to the extent that the regarded owner (i) provides credit support for the disregarded entity's indebtedness or (ii) is liable for that indebtedness under applicable law (*e.g.*, because the disregarded entity is a limited partnership and the regarded owner directly holds the general partnership interest). If the regarded owner does not provide credit support, and is not liable under applicable law, for the disregarded entity's indebtedness, the disregarded entity's recourse liabilities should be taken into account in measuring the regarded owner's insolvency (i) up to the gross FMV of the disregarded entity's assets and (ii) thereafter only to the extent that such indebtedness is cancelled. If such cancelled excess indebtedness were not taken into account, then its cancellation would create COD income for the regarded owner, but its existence would not be taken into account in measuring the regarded owner's insolvency, which would frustrate the purpose of the Insolvency Exception.

3. The Title 11 Exception excludes a taxpayer's COD income from taxable income if the taxpayer is under the jurisdiction of the court and the discharge is granted by the court or occurs pursuant to a plan approved by the court. Because the meaning of the phrase "under the jurisdiction of the court" is critical to the application of the Title 11 Exception, final regulations should define this phrase.

Mr. Mazur
Mr. Werfel
Mr. Wilkins
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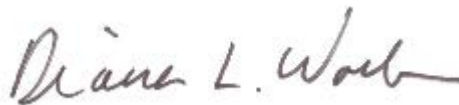
We recommend that final regulations treat a regarded owner of a disregarded entity as “under the jurisdiction of the court in [a Title 11] case” if (i) the regarded owner itself is a debtor in the applicable Title 11 case, or (ii) the bankruptcy court asserts jurisdiction over the regarded owner during the disregarded entity’s Title 11 case and discharges such owner from any *bona fide* liability that such owner may have with respect to the disregarded entity’s discharged indebtedness that gives rise to COD income. Further, we recommend that final regulations limit a “*bona fide* liability” for the above purposes to a discharged obligation for which (i) the regarded owner’s liability has been previously established (by contract or otherwise), (ii) the regarded owner is liable for all (or substantially all) of the discharged obligation, and (iii) qualifying for the Title 11 Exception was not a principal purpose of the regarded owner’s undertaking such liability. The text of section 108(d)(2), applicable policy and precedent support these recommendations.

4. Final regulations should adopt the same approach as the Proposed Regulations for purposes of applying the other three COD income exclusions in section 108(a), *i.e.*, the exclusions for qualified farm indebtedness, qualified real property business indebtedness and qualified principal residence indebtedness. All of the reasoning in support of the approach reflected in the Proposed Regulations applies equally to the other exclusions.

5. The Proposed Regulations are proposed to apply to discharges of indebtedness occurring on or after the date on which final regulations are published. The need is acute for definitive guidance on the application of the Insolvency Exception and the Title 11 Exception in the case of the discharge of a disregarded entity’s indebtedness. Permitting retroactive application of final regulations — at least where a taxpayer applies the rules consistently with respect to all of its disregarded entities — with respect to discharges of indebtedness that preceded the effective date of the final regulations would be appropriate here. We thus recommend that final regulations adopt this approach.

We very much appreciate your consideration of these recommendations and would be happy to discuss them with you or provide additional assistance.

Respectfully submitted,



Diana L. Wollman
Chair

Enclosure

cc: Craig Gerson
Attorney Advisor (Tax Legislative Counsel)
Department of the Treasury

David Haglund
Branch 1 Chief (Office of Associate Chief Counsel (Passthroughs
and Special Industries))
Internal Revenue Service

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Mr. Wilkins
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James Hogan
Chief Branch 4 (Office of the Associate Chief Counsel (Passthroughs
and Special Industries))
Internal Revenue Service

Lee Kelley
Deputy Tax Legislative Counsel (Office of Tax Policy)
Department of the Treasury

Benjamin H. Weaver, Attorney (Office of the Associate Chief Counsel (Passthroughs
and Special Industries))
Internal Revenue Service

Curtis G. Wilson
Associate Chief Counsel (Passthroughs and Special Industries)
Internal Revenue Service

Lisa Zarlenga
Tax Legislative Counsel
Department of the Treasury