Report 1297

NEW YORK STATE BAR ASSOCIATION
TAX SECTION

REPORT ON GUIDANCE IMPLEMENTING REVENUE RULING 91-32

January 21, 2014

REPORT ON GUIDANCE IMPLEMENTING REVENUE RULING 91-32

This report ("Report")[1] responds to a request from the Department of the Treasury ("Treasury") for comments relating to the current project at Treasury and the Internal Revenue Service (the "Service") to issue guidance under Section[2] 864 implementing Revenue Ruling 91-32 ("RR 91-32").[3]

Section 741 generally provides that, in the case of a sale or exchange of a partnership interest, the selling partner recognizes gain or loss and (except as otherwise provided in Section 751) such gain or loss is considered gain or loss from the sale or exchange of a capital asset. In broad terms, a foreign person is generally subject to U.S. federal income tax on capital gain only if the gain is considered effectively connected with a trade or business in the United States ("ECI").[4] The Code does not include a specific statutory framework for determining what portion (if any) of the gain recognized on the sale of a partnership interest is ECI.[5] However, RR 91-32 addresses the tax

1 The principal drafter of this Report was Edward E. Gonzalez. Substantial contributions were made by David Schnabel and Joseph Soltis, and helpful comments were received from Kimberly S. Blanchard, Robert Cassanos, Thomas Giegerich, Stephen E. Shay and Eric Sloan. This Report reflects solely the views of the Tax Section of the New York State Bar Association and not those of the New York State Bar Association Executive Committee or the House of Delegates.

2 Except as otherwise specified, all "Section" references are to the Internal Revenue Code of 1986, as amended (the "Code").

3 *See* Joint Treasury, IRS 2013-2014 Priority Guidance Plan.

4 *See* Sections 871, 881 and 882; *but see* Section 897 (if a foreign person has gain or loss from the disposition of a United States real property interest, the foreign person is generally required to take the gain or loss into account as if the foreign person were engaged in a trade or business within the United States and as if such gain or loss were effectively connected with that trade or business) and Section 871(a)(2) (30% tax on capital gain recognized by a nonresident alien individual present in the United States for 183 days or more during the taxable year in certain situations).

5 The General Explanation of the Administration's Fiscal Year 2014 Revenue Proposals (the "Green Book") describes a proposal to provide that gain or loss from the sale of a partnership interest is ECI to the extent attributable to the transferor partner's distributive share of the partnership's unrealized gain

(cont'd)

consequences of the disposition of a foreign partner's interest in a partnership that conducts a trade or business through a fixed place of business or has a permanent establishment in the United States (an "ECI Partnership").[6]

This report is divided into four parts. Part I describes our primary recommendation. Part II includes a brief summary of some of the statutory provisions that are relevant to the taxation of a foreign person that sells an interest in an ECI

(cont'd from previous page)

or loss that is attributable to ECI property. The proposal would authorize the Secretary to specify the extent to which a distribution from a partnership is treated as a sale or exchange of an interest in the partnership and to coordinate with other provisions of the Code. The proposal would also impose a 10% withholding obligation on the transferee of a partnership interest, absent certain certifications from the transferor. The Green Book cites the fact that some nonresident [alien] individuals and foreign corporations may take a position contrary to RR 91-32 due to the lack of a Code provision treating gain from the sale of a partnership interest as ECI; the Green Book proposal is intended to implement the policy of RR 91-32 and dispel any notion that the sale of an interest in a partnership that has ECI assets is exempt from United States federal income taxation. *See* General Explanation of the Administration's Fiscal Year 2014 Revenue Proposals, [*available at* http://www.treasury.gov/resource-center/taxpolicy/Documents/General-Explanations-FY2013.pdf]. A similar provision is contained in a discussion draft bill by Senator Baucus. *See* STAFF OF THE JOINT COMMITTEE ON TAXATION TECHNICAL EXPLANATION OF THE SENATE COMMITTEE ON FINANCE CHAIRMAN'S STAFF DISCUSSION DRAFT OF PROVISIONS TO REFORM INTERNATIONAL BUSINESS TAXATION, November 19, 2013, p. 78 (*available at* http://www.finance.senate.gov).

6 RR 91-32 has been the subject of substantial commentary, some of which of which has questioned the validity of RR 91-32. *See, e.g.,* Kim Blanchard, *Special Problems of Foreign Partner,* Practising Law Institute, Partnership Tax Practice Series, Chapter 302; Alan Roy Hollander, *Is a Sale of a Partnership Interest 'Attributable' to the Partnership's Place of Business? The Missing Analysis in Rev. Rul. 91-32*, 52 Tax Notes 1321 (September 9, 1991); William W. Bell and David B. Shoemaker, *Revenue Ruling 91-32: Right Result for the Wrong Reasons*, Journal of Partnership Taxation, Volume 9, Number 1, Spring 1992; Edwin J. Reavey & Richard M. Elliot, *Sales of U.S. Partnership Interests by Foreign Partners: New Rules After Rev. Rul. 91-32*, 91 TNT 50-27 (1991). Moreover, there is currently litigation before the U.S. Tax Court relating to RR 91-32. *See Grecian Magnesite, Mining, Industrial and Shipping Co., S.A. v. Commissioner*, TC No. 19215-12. Consistent with the request made by Treasury, this Report does not express a view as to the authority of the Treasury and the Service to issue RR 91-32 or other guidance implementing RR 91-32, including as to whether there is authority, upon a sale of an interest in an ECI Partnership, to require a non-U.S. person to recognize an amount of ECI that exceeds the amount of income and gain generally recognized upon the sale of the interest for U.S. federal income tax purposes.

Partnership. Part III includes a detailed description of RR 91-32. Part IV sets forth our recommendations with respect to the guidance project.

I. Primary Recommendation

We recommend that guidance implementing RR 91-32 provide that the source (domestic or foreign) and nature (ECI or non-ECI) of the income or gain recognized by a foreign person selling an interest in an ECI Partnership be determined using aggregate principles and be based upon the source and nature of the gain that would be recognized if the ECI Partnership were to sell all of its assets and liquidate. The guidance should also address whether the amount of ECI recognized by the foreign partner can exceed the aggregate amount of income and gain generally recognized under Section 741 or Section 751 on the sale. Treasury and the Service should consider including guidance relating to how various provisions of Subchapter K apply in the context of an ECI Partnership, including the impact of an inside-outside basis disparity of a foreign person selling an interest in such a partnership.

II. Basic Tax Rules Applicable to Non-U.S. Persons

As noted above, in broad terms a foreign person is generally subject to U.S. federal income tax on capital gain from the sale of personal property only if the gain is ECI. There is generally a two-part test for determining whether gain is ECI. First, the source of the gain is determined under Section 865. Second, the gain is tested under Sections 864(c)(2) and (3) (if the gain is domestic source) or under Section 864(c)(4) (if the gain is foreign source) to determine whether it is ECI. In practice, the rules of Section 865 themselves use the principles of Section 864 to determine source.[7]

A. <u>Basic Rules for Determining the Source of Gain</u>.

Under the general rule of Section 865(a), income from the sale of personal property is generally sourced by reference to the residence of the seller. Accordingly, income from the sale of personal property by a United States resident is generally considered domestic source, and income from the sale of personal property by a nonresident is generally considered foreign source. Section 865 includes a variety of exceptions to this general rule, including exceptions for inventory, depreciable personal property, intangibles and goodwill, and sales attributable to an office or other fixed place of business in the United States maintained by the seller.[8]

Section 865(i)(5) provides that, in the case of a partnership (except as provided in regulations), Section 865 is applied at the partner level. No regulations have been issued under Section 865(i)(5).[9]

---

7 *See* Section 865(e)(3).

8 For purposes of the rule for sales through U.S. offices or places of business, the principles of Section 864(c)(5) apply in determining whether a taxpayer has an office or other fixed place of business and whether a sale is attributable to that office or other fixed place of business. *See* Section 865(e)(3). This rule also makes clear that it is the sale, not the property, that is attributed to the U.S. office.

9 The legislative history states that in determining the source of income derived from sales of personal property, "it is intended that, consistent with the attribution of a U.S. trade or business under section 875, a U.S. office or other fixed place of business of the partnership will be attributed to its partners." It also states that Section 865 may be applied at the partnership level "in cases where it is not administratively possible to apply the rules at the partner level," such as in the case of a publicly traded partnership with hundreds of partners. S. Rep. No. 100-445 100th Cong, 2d Sess. 237 (1988).

Section 865(j) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of Section 865.

B. <u>Basic Rules for Determining When Gain is ECI</u>.

1. <u>Domestic Source Gain</u>.

Section 864(c)(2) applies to domestic source gain from the sale of capital assets (and income that is "FDAP"). Section 864(c)(2) does not give a specific bright-line test for determining if the income is ECI. Instead, it provides that "in determining whether income . . . is [ECI], the factors taken into account include whether (A) the income, gain or loss is derived from assets used or held for use in the conduct of such trade or business, or (B) the activities of such trade or business were a material factor in the realization of the income, gain or loss." The flush language in Section 864(c)(2) states that, when making the determinations in (A) and (B) above, "due regard shall be given to whether or not such assets or such income, gain, or loss was accounted for through such trade or business."

Section 864(c)(3) provides that domestic source income, gain, or loss (other than income, gain or loss to which Section 864(c)(2) applies) is treated as ECI.

2. <u>Foreign Source Gain</u>.

There are limited circumstances in which foreign source gain can be ECI. In general, income, gain or loss from foreign sources is ECI with respect to a foreign person if the person has an office or other fixed place of business within the United States to which the income, gain, or loss is attributable and such income, gain, or loss (i) consists of rents or royalties for the use of intangible property, (ii) consists of dividends, interests or guarantee fees, or (iii) is derived from the sale or exchange, through such office or other fixed place of business, of inventory.[10]

C. <u>Certain Code Provisions Specifically Directed to Sales of Partnership Interests</u>.

Section 741 provides that, in the case of a sale or exchange of a partnership interest, gain or loss shall be recognized to the transferor partner and the gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset (except as otherwise provided in Section 751).

Section 751(a), which was enacted at the same time as Section 741, provides that the amount of consideration received by a transferor partner in exchange for all or part of his interest in the partnership attributable to certain types of assets that generally produce ordinary income shall be considered as an amount realized from the sale or exchange of property other than a capital asset. Under Treasury Regulation Section 1.751-1(a)(2) (as modified in 1999), (i) a selling partner has ordinary income or loss equal to the amount of ordinary income or loss from Section 751 property that the partner would have been allocated if the partnership sold all of its assets for cash in a fully taxable transaction immediately prior to the sale (or other transfer) by the partner and (ii) the difference between the capital gain or loss that the selling partner would recognize under Section 741 without application of Section 751 and the amount of ordinary income or loss determined as set forth in clause (i) is capital gain or loss. Thus, under Treasury Regulation Section 1.751-1(a)(2), a selling partner can recognize ordinary income in

[10] Section 864(c)(4). Certain exceptions also apply to foreign corporations subject to tax under part I or part II of subchapter L.

excess of the "outside" gain in its partnership interest.[11] Section 751, therefore, applies an aggregate theory for purposes of determining the amount of ordinary gain.[12]

Section 897(g)[13] generally provides that, under regulations prescribed by the Secretary,[14] the amount of any consideration received by a foreign person in exchange for all or part of its interest in a partnership shall, to the extent attributable to United States real property interests, be considered as an amount received from the sale or exchange in the United States of such property. Section 367(a)(4) treats a transfer by a United States person of an interest in a partnership to a foreign corporation that is described in Section

---

11 *See* Treas. Reg. Section 1.751-1(g), Example 1. Indeed, a selling partner's ordinary income under Section 751(a) can exceed the total amount realized on the sale (determined without regard to Section 751(a) and the regulations thereunder).

12 Section 751(f) provides, moreover, that in determining the Section 751 property in the case of an upper tier partnership whose interests are transferred, the upper tier partnership shall be treated as owning its proportionate share of the property of any partnership in which it is a partner.

13 The legislative history states that "in order to impose a tax on gains from the sale of U.S. real estate, it is also necessary to impose a similar tax on gains from the disposition of interests in entities which hold substantial U.S. real property. Otherwise, a foreign investor could, as under present law, avoid tax on the gain by holding the real estate through a corporation, partnership, or trust and disposing of his interest in that entity rather than having the entity itself sell the real estate." H.R. Rep. No. 96-1167 96th Cong, 2d Sess. 511 (1980).

14 Treasury Regulation Section 1.897-7T provides that (i) pursuant to Section 897(g), an interest in a partnership in which, directly or indirectly, fifty percent or more of the value of the gross assets consist of U.S. real property interests, and ninety percent or more of the value of the gross assets consist of U.S. real property interests plus any cash or cash equivalents shall, for purposes of Section 1445, be treated as entirely a U.S. real property interest, (ii) for purposes of Section 897(g), such interest shall be treated as a U.S. real property interest only to the extent that the gain on the disposition is attributable to U.S. real property interests (and not cash, cash equivalents or other property), and (iii) consequently, a disposition of any portion of such partnership interest shall be subject to partial taxation under Section 897(a) and full withholding under Section 1445(a).

367(a)(1) as a transfer to such corporation of such person's *pro rata* share of the assets of the partnership.[15]

III. Summary of RR 91-32

RR 91-32 addresses the tax consequences of a foreign partner's sale of an interest in a partnership that conducts a trade or business through a fixed place of business or a permanent establishment in the United States.

A. Basic Facts of RR 91-32.

RR 91-32 addresses a basic fact pattern and two detailed illustrations. The base case, Situation 1, considers a foreign partner ("FP1") in a partnership ("PS1") engaged in a trade or business through a fixed place of business in the United States.[16] PS1 owns appreciated real and personal property located in a foreign country. PS1 also owns appreciated personal property located in the United States that is used or held for use in its trade or business within the United States ("ECI Property"). The ruling notes that PS1 does not trade in stock, securities or commodities, and none of the ECI Property is a United States real property interest.

Situation 2 adds to Situation 1 the fact that FP1 has a distributive share of 25% of the income, gain, loss, deduction and credit of PS1. FP1's adjusted basis in its partnership interest is $375,000, and FP1 sells its partnership interest for $475,000.

---

[15] Courts have considered the applicability of aggregate principles in various situations where there was no published guidance. *See e.g.*, *Holiday Village Shopping Ctr. v. United States*, 5 Cl. Ct. 566 (1984); *Petroleum Corp of Texas v. United States*, 939 F.2d 1165 (5th Cir 1991); *Coggin Automotive Corp v. Commissioner*, 292 F.3d 1326 (11th Cir. 2002); *Mango v. Commissioner*, T.C.M. 2013-49.

[16] RR 91-32 states that PS1 is not a publicly traded partnership within the meaning of Section 7704.

PS1's assets consist of ECI Property that has a total built-in gain of $300,000, non-U.S. real property that has a total built-in gain of $500,000, non-U.S. machinery that has a total built-in loss of $400,000, and $300,000 of cash.

In Situation 3, FP2 is an alien individual resident in Country Y and a partner in partnership PS2, which has a permanent establishment in the United States. Country Y and the United States are parties to a tax treaty that is identical to the Draft United States Model Income Tax Treaty (June 16, 1981) (the "Treaty"). PS2's assets consist of immovable and movable property in Country Y and movable property in the United States, which are assets of the permanent establishment.

B. Holdings of RR 91-32.

RR 91-32 holds that:

> *Situation 1*
> Gain or loss of a foreign partner that disposes of its interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States will be United States source ECI gain or will be ECI loss that is allocable to United States source ECI gain, to the extent that the partner's distributive share of unrealized gain or loss of the partnership would be attributable to ECI (United States source) property of the partnership. The gain or loss attributable to the ECI property of the partnership is an amount that bears the same ratio to gain or loss realized by the foreign partner from the disposition of its partnership interest as the foreign partner's distributive share of partnership net ECI gain or loss would have borne to the foreign partner's distributive share of the partnership net gain or loss if the partnership had itself disposed of all of its assets at fair market value at the time the foreign partner disposes of its partnership interest.
>
> *Situation 2*
> FP1's gain from the disposition of his partnership interest that is attributable to ECI (United States source) property of the partnership is an amount that bears the same ratio to $100,000 (FP1's gain from the disposition of its partnership interest) as $75,000 (FP1's distributive share of the partnership's ECI (United States source) gain) bears to $100,000 (the sum of FP1's distributive share of the partnership's net ECI gain and net non-ECI gain). Accordingly, the portion of

> FP1's gain from the disposition of his partnership interest that is attributable to the ECI property of PS1 equals $75,000.
>
> *Situation 3*
> Under the Treaty, gain of a foreign partner that disposes of its interest in a partnership that has a United States permanent establishment is gain that is attributable to a permanent establishment and is subject to United States tax under the Treaty, to the extent that the partner's potential distributive share of unrealized gain of the partnership is attributable to the partnership's permanent establishment.

C. Reasoning of RR 91-32.

According to RR 91-32, the determination of the source and character of a foreign partner's income from the disposition of a partnership interest depends upon the application of Sections 864, 865, 875 and 741 of the Code.

Foreign Partner is Engaged in a U.S. Trade or Business. Under Section 875(1), a foreign partner in a partnership engaged in a trade or business in the United States is itself considered to be so engaged. Accordingly, because PS1 is engaged in a trade or business in the United States, FP1 is also so engaged since he is a partner in PS1.

Gain is U.S. Source (in Part). Under Section 865(e)(2), income from the sale of personal property by a nonresident is domestic source if the nonresident has a fixed place of business in the United States and if the income is attributable to such fixed place of business. According to RR 91-32:

> [a] foreign partner of a partnership that is engaged in a trade or business through a fixed place of business in the United States itself has a fixed place of business in the United States, since the foreign partner is considered to be engaged in such trade or business pursuant to Section 875(1). Income from the disposition of a partnership interest by the foreign partner will be attributable to the foreign partner's fixed place of business in the United States. *See* Section 865(e)(3); *cf. Unger v. Commissioner*, T. C. Memo. 1990-15, 58 TCM 1157, 1159. Accordingly,

> to the extent provided below, income from FP1's disposition of his partnership interest will be sourced in the United States.

An Interest in an ECI Partnership Is Itself an "ECI Asset." RR 91-32 concludes that an interest in an ECI Partnership is itself an "ECI asset." According to RR 91-32:

> Section 864(c)(2) of the Code provides that certain gain or loss from sources within the United States from the sale or exchange of a capital asset is gain that is effectively connected with the conduct of a United States trade or business ("ECI gain"), or is loss that is allocable to ECI gain ("ECI loss"). Factors considered in determining whether the gain or loss is ECI gain or ECI loss within the meaning of Section 864(c)(2) include whether the gain or loss is derived from an asset that is used or held for use in the conduct of a trade or business in the United States, or whether the activities of that trade or business were a material factor in the realization of the gain or loss. The rules of [Treasury Regulation] Section 1.864-4(c)(2) apply to determine whether an asset is used or held for use in the conduct of a trade or business within the United States, while the rules of [Treasury Regulation] Section 1.864-4(c)(3) apply to determine the character of gain or loss realized directly from the active conduct of the trade or business.
>
> Since a foreign partner's gain or loss from the disposition of its interest in a partnership is not gain or loss realized directly from the active conduct of a trade or business within the United States, the character of the foreign partner's gain or loss must be determined pursuant to the rules of [Treasury Regulation] Section 1.864-4(c)(2). By virtue of its interest in the partnership, the foreign partner is considered to be engaged in a trade or business through the partnership's fixed place of business in the United States. Moreover, the value of the trade or business activity of the partnership affects the value of the foreign partner's interest in the partnership. Consequently, an interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States is an ECI asset of a foreign partner. *See* [Treasury Regulation] Section 1.864-4(c)(2) of the regulations.

ECI Partnerships that Hold Non-ECI Assets. RR 91-32 notes that an ECI Partnership may own property that, if disposed of by the partnership, would produce foreign source income that would generally not be subject to United States tax. According to RR 91-32:

> Characterizing the entire amount of gain or loss from a foreign partner's disposition of a partnership interest as United States source ECI gain or ECI loss would effectively subject to the tax jurisdiction of the United States items that may not be described in Section 864(c) of the Code, a result which Congress did not intend. *See* S. Rep. No. 1707, 89th Cong., 2d Sess. 17 (1966). Furthermore, treating the gain or loss realized by a foreign partner from the disposition of an interest in a partnership that is engaged in a United States trade or business entirely as United States source ECI gain or ECI loss may be conceptually inconsistent with other sections of the Code. For example, Section 897(g) of the Code, which governs the treatment of a foreign partner's disposition of an interest in a partnership that has a United States real property interest, generally treats as ECI gain or ECI loss the amount that is attributable to a United States real property interest of the partnership. This provision evidences the view of Congress that a foreign partner's gain or loss from the disposition of an interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States need not always be treated as ECI gain or ECI loss from United States sources in its entirety.

Portion of Gain Treated as ECI. Having concluded that it would not always be appropriate to treat as ECI all of a foreign partner's gain on the sale of an interest in an ECI Partnership, RR 91-32 applies a mixture of aggregate principles and entity principles in calculating the ECI of the selling partner. RR 91-32 explains that:

> in applying Sections 864(c) and 865(e) of the Code, it is appropriate to treat a foreign partner's disposition of its interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States as a disposition of an aggregate interest in the partnership's underlying property for purposes of determining the source and ECI character of the gain or loss realized by the foreign partner. The determination of the source and the ECI character of gain or loss of a foreign partner from the disposition of a partnership interest will therefore be determined in the manner described below.
>
> A foreign partner's gain or loss from the disposition of an interest in a partnership that is engaged in a trade or business through a fixed place of business in the United States will be ECI (United States source) gain or loss to the extent such gain or loss is attributable to ECI (United States source) property of the partnership. The gain or loss attributable to the ECI property of the partnership is an amount that bears the same ratio to gain or loss realized by the foreign partner from the disposition of its partnership interest as the foreign partner's distributive share of partnership net ECI gain or loss would have borne to the foreign partner's

> distributive share of partnership net gain or loss if the partnership had itself disposed of all of its assets at fair market value at the time the foreign partner disposes of its partnership interest. In computing the foreign partner's distributive share of net gain or loss of the partnership, net ECI gain or loss and net non-ECI gain or loss are computed separately. Thus, net non-ECI loss will not offset ECI gain, and net ECI loss will not offset net non-ECI gain.

Losses. According to RR 91-32, if a foreign partner realizes a loss on the disposition of its partnership interest, and if its distributive share of ECI gain or loss from the deemed disposition of ECI assets by the partnership would be a net ECI gain, then none of the loss realized by the foreign partner on the disposition of the partnership interest is an ECI loss. If, however, a foreign partner realizes a gain on the disposition of its partnership interest, and if its distributive share of ECI gain or loss from the deemed disposition of ECI assets by the partnership would be a net ECI loss, then none of the gain realized by the foreign partner on the disposition of the partnership interest is ECI gain.

Presumption. According to RR 91-32, a foreign partner's gain on the disposition of an ECI Partnership will be presumed to be U.S. source ECI gain in its entirety, and a foreign partner's loss on such a disposition will be presumed to be foreign source non-ECI loss in its entirety, unless the partner is able to produce upon request information showing the distributive share of net ECI and net non-ECI gain or loss that such partner would have been allocated if the partnership sold all of its assets. The ruling states that this presumption is a specific application of the general principle that the burden of proof is on the taxpayer.

ECI Partnerships That Own U.S. Real Property Interests. In applying RR 91-32, the ECI Property of an ECI Partnership excludes any United States real property interests held by the partnership, and the rules of Section 897(g) govern the treatment of amounts received from the disposition of an interest in a partnership that are attributable to a United States real property interest of the partnership. In addition, RR 91-32 provides that Section 897(g) is applied before the rules in RR 91-32 are applied.

Application of Draft U.S. Model Income Tax Treaty (June 16, 1981). RR 91-32 notes that gain from the disposition of movable property by a resident of the United States treaty partner is generally exempt from United States tax under the Treaty, but that this rule does not apply if such gain is from the alienation of movable property that are assets of a permanent establishment in the United States. According to RR 91-32:

> A foreign partner of a partnership that has a permanent establishment in the United States is treated as itself having a permanent establishment. *Donroy, Ltd. v. United States*, 301 F.2d 200 (9th Cir. 1962); *see* Rev. Rul. 85-60, 1985-1 C.B. 187. More particularly, "the office or permanent establishment of a partnership is the office of each of its partners, whether general or limited." *Unger v. Commissioner*, T.C. Memo. 1990-15, 58 TCM 1157, 1159, citing *Donroy, Ltd. v. United States, supra.* Accordingly, FP2 is considered to have a permanent establishment in the United States because he is a partner in PS2.
>
> The determination whether gain from the alienation of movable property is attributable to a permanent establishment in the United States is generally made by applying principles analogous to those governing whether an item is effectively connected with the conduct of a trade or business in the United States, though the "attributable to" concept of the Treaty is more limited in its scope than the "effectively connected" concept of the Code. *See* Rev. Rul. 81-78, 1981-1 C.B. 604. The principles applied are substantially similar, however, when the amounts at issue are those that would be described in Section 864(c)(2) of the Code if the Treaty were not applied. Accordingly, for the reasons discussed in *Situation 1*, a disposition of an interest in a partnership that has a permanent establishment in the United States will be treated as resulting in gain that is attributable to the permanent establishment to the extent provided below.

RR 91-32 concludes:

> It is appropriate under the Treaty to look to a foreign partner's interest in the assets of the partnership to determine the amount of the foreign partner's gain from the disposition of its partnership interest that is attributable to a United States permanent establishment….[17] Gain of FP2 from the disposition of its interest in PS2 will thus be subject to United States tax only to the extent such gain is attributable to the unrealized gain of the partnership's assets attributable to the partnership's permanent establishment, and loss will be allocable to FP2's gain from sources within the United States that is attributable to a permanent establishment of FP2. Such gain or loss is to be determined in the manner described in *Situation 1*.

IV. Guidance Relating to the Treatment of a Foreign Partner That Sells an Interest in an ECI Partnership

A. Three Basic Approaches.

As with the treatment of partnerships under the Code in general, the guidance could adopt one of three basic approaches in prescribing the tax consequences to a foreign partner that sells an interest in an ECI Partnership—a pure entity approach, a pure aggregate approach or a combination of the two.

1. Pure Entity Approach.

Under a pure entity approach, the gain (or loss) to a foreign partner that sells an interest in an ECI Partnership would be considered ECI only if the sale of the interest itself is effectively connected with a trade or business of the partner, as distinguished from any trade or business of the partnership attributed to the partner under Section 875(1). We expect that, if this approach were adopted, a foreign partner would ordinarily not have ECI upon a sale of an interest in an ECI Partnership in most cases. As a result,

[17] As support, RR 91-32 cites to Commentary on Article 1 of the OECD Model Double Taxation Convention on Income and Capital, paragraphs 2-5 (1977).

we assume that guidance implementing RR 91-32 would not adopt a pure entity approach.

2. <u>Pure Aggregate Approach</u>.

Under a pure aggregate approach, the selling partner would have ECI upon a sale of an interest in an ECI Partnership equal to the ECI the selling partner would have had if (immediately prior to the sale) the partnership sold all of its assets. Thus, the source and nature of the income and gain treated as recognized by a foreign person selling an interest in an ECI Partnership would be determined by reference to the source and nature of the income and gain under Sections 864 and 865 that would have been recognized if the ECI Partnership sold all of its assets. This result would not depend on whether the selling partner is (or is treated as) engaged in a trade or business within the United States by reason of Section 875 or otherwise, although in the treaty context the gain may be treated as attributable to the permanent establishment of the partnership that is attributed to the partner.[18]

3. <u>Mixture of Entity and Aggregate Principles</u>.

A third approach (which we refer to as a "hybrid approach") would be to determine the tax consequences to a foreign partner of selling an interest in an ECI Partnership using a combination of entity and aggregate principles and limit the ECI gain

[18] Two possible analytical frameworks could be used under what we describe as the pure aggregate approach. Under the first approach, the source and nature of the partner's gain could be determined as if the partner owned and sold its share of the assets of the partnership. If this approach were adopted, additional rules would be needed to determine the selling partner's share and tax basis in each partnership asset. Under the second approach, the source and nature could be determined by reference to the income and gain the partner would be allocated if the partnership sold all of its assets for their fair market value and the partnership liquidated.

to the aggregate amount of income and gain realized from the sale of the partnership interest under the basic application of Sections 741 and 751(a).[19]

There are a variety of ways to implement a hybrid approach. One approach (the "pro rata approach") would be to determine the amount of income and gain recognized by the partner under the basic rules applicable under Sections 741 and 751(a) and to characterize a pro rata portion as ECI or non-ECI based on either the value of the partnership's ECI assets or the net gain inherent in those assets.[20] Either the same overall pro rata portion could be applied to both the 751(a) ordinary income and the 741 gain or separate determinations could be made for each type of asset (that is, the portion of the 751(a) income that is treated as ECI could be based on the value or gain inherent in the relevant hot assets and the portion of the 741 gain that is treated as ECI could be based on the value or gain inherent in the partnership's other assets).

An alternative approach (the "lesser of approach") would be to treat the selling partner as having ECI equal to the lesser of (i) the aggregate amount of income or gain under Sections 741 and 751(a) and (ii) the amount of ECI that the partner would have had

---

19 If guidance adopts a hybrid approach, it seems appropriate for the limit on the ECI to be based on the aggregate amount of gross income recognized under Sections 741 and 751(a). For example, suppose that (i) a partner has a $10 tax basis in its interest in an ECI Partnership, (ii) the partner sells the interest for $10, (iii) under the Section 751(a) regulations, on the sale the partner has $5 of ordinary income and $5 of capital loss and (iv) upon a sale of assets by the ECI Partnership, the partner would have been allocated $5 of ECI and $5 of non-ECI loss. If guidance adopts a hybrid approach, it seems appropriate for the limit on the ECI in this example to be $5. However, it would also be possible to limit the ECI to the <u>net</u> amount of income and gain recognized under Section 741 and 751(a). In this event, the ECI in the preceding example would be $0.

20 An advantage of the pro rata approach over the lesser of approach is that the pro rata approach would more readily take into account the holding period of the selling partner in its interest in the ECI Partnership.

if the partnership sold all of its assets. A variation on this alternative would be to adopt a "lesser of" approach but to apply it separately to the partnership's "hot" assets and "cold assets." Under this variation, the ECI would equal the sum of (i) the lesser of (A) the aggregate amount of income under 751(a) and (B) the amount of ECI that the partner would be allocated in respect of its hot assets if the partnership sold all of its assets and (ii) the lesser of (A) the aggregate amount of residual gain under Section 741 (after taking into account Section 751(a)) and (B) the amount of ECI that the partner would be allocated in respect of its cold assets if the partnership sold all of its assets.

Putting to one side the impact of the hot assets, we expect that the pro rata approach and the lesser of approach would generally result in the recognition of the same amount of ECI so long as (i) the calculation is based on the amount of inherent gain (as opposed to value) in the ECI assets and the non-ECI assets and (ii) the selling partner's share of the partnership's inside tax basis is equal to the selling partner's tax basis in its partnership interest. However, the results of the approach could diverge where there is an inside-outside basis disparity. We discuss the significance of inside-outside basis disparities in Part IV.F.2 below.

B. <u>Relevance of the Partner's Outside Gain</u>.

Under the pure aggregate approach, a foreign seller's ECI would generally equal the amount of ECI the partner would have realized if the partnership sold all of its assets, even if the amount of ECI exceeded the aggregate amount of income and gain recognized as a general matter under Sections 741 and 751(a) (that is, the amount of income and gain that would be recognized by a U.S. person owning an identical interest). As a result, a foreign partner selling an interest in an ECI Partnership could have ECI that exceeds the partner's economic (and tax) gain inherent in its partnership interest. While this can also occur under a basic application of the 751 regulations in a purely domestic context, it is not clear whether guidance should permit a foreign partner's ECI gain (or loss) to exceed the aggregate amount of gross income and gain (or loss) realized as a general matter for federal income tax purposes. By contrast, under a Hybrid Approach, the amount of ECI gain (or loss) would generally be capped at the amount of income and gain generally recognized under Sections 741 and 751(a). We note, in this regard, that Section 897(g) and the regulations thereunder appear to adopt a hybrid approach (rather than a pure aggregate approach).

Netting of ECI and non-ECI.

If a foreign partner's ECI is capped at the amount of income and gain recognized under Sections 741 and 751(a), a foreign partner of an ECI Partnership could in effect offset built-in ECI gains of the partnership with built-in non-ECI losses of the partnership by selling an interest in the partnership rather than by having the partnership sell its assets.

To illustrate, assume in each of the examples below that (i) A owns a 50% interest in an ECI Partnership, (ii) there is no inside-outside basis disparity, and (iii) there are no hot assets that trigger Section 751(a) and no U.S real property interests.

> Example 1 (ECI Gain and Non-ECI Loss). Partnership has ECI assets with a built-in gain of $200 and non-ECI assets with a built-in loss of $100. A has $50 of built-in gain inherent in its partnership interest.

If the partnership sold all of its assets, A would be allocated \$100 of ECI gain and \$50 of non-ECI loss. Accordingly, A would pay tax on \$100 of ECI as the \$50 non-ECI loss could not be used to offset the ECI gain.

If A sold its partnership interest, as a general matter A would have \$50 of gain under Section 741. If A were a foreign person and a pure aggregate approach applied, A would have \$100 of ECI and \$50 of non-ECI loss. If A were a foreign person and one of the Hybrid Approaches described above applied, A would have \$50 of ECI.

While the hybrid approach helped the taxpayer in the example above, in the loss context it could hurt the taxpayer.

Example 2 (ECI Loss and Non-ECI Gain). Partnership has ECI assets with a built-in loss of \$200 and non-ECI assets with a built-in gain of \$100. A has \$50 of built-in loss inherent in its partnership interest.

If the partnership sold all of its assets, A would be allocated \$100 of ECI loss (which presumably could be used by A to offset any unrelated ECI gain) and \$50 of non-ECI gain (which presumably would not be taxable in the U.S.).

If A sold its partnership interest, as a general matter A would have \$50 of loss under Section 741. If A were a foreign person and a pure aggregate approach applied, A would have \$100 of ECI loss (which presumably could be used by A to offset any unrelated ECI gain) and \$50 of non-ECI gain (which presumably would not be taxable in the U.S.). If A were a foreign person and one of the hybrid approaches described above applied, A would have only \$50 of ECI loss.

Buyer Step Up.

If a hybrid approach is adopted and the seller's ECI is capped at the income and gain generally recognized under Sections 741 and 751(a), the buyer of the interest in an ECI Partnership may nevertheless receive a full step up in the tax basis of the ECI assets.

Example 3. Same as Example 1 but assume a hybrid approach applies.

If the partnership has a Section 754 election in place, the buyer of A's interest in the ECI Partnership would have a special basis adjustment under Section 743(b) that would (in effect) give the buyer a \$100 step up in the tax basis of the ECI

> assets and a $50 step down in the tax basis of the non-ECI. This is true even though A recognized only $50 of ECI on the sale.

While linking the buyer's step up to the seller's taxable gain has some intuitive appeal, the two systems in fact work independently. Similar results would occur in a purely domestic context where the selling partner is a tax exempt entity (to the extent the gain is not "unrelated business taxable income") or the selling partner is considered an instrumentality of a state that is not subject to U.S. federal income tax.

<u>Potential Anti-Abuse Rule</u>.

We recommend that, if guidance adopts a hybrid approach that generally limits the ECI to the income and gain recognized as a general matter under Sections 741 and 751(a), Treasury and the IRS consider the inclusion of an anti-abuse rule to address certain situations where Treasury and the IRS consider it inappropriate to allow a selling partner to effectively use non-ECI losses to offset ECI gains. An example might be where a foreign person contributes to a partnership a combination of ECI assets with a built-in gain and non-ECI asses with a built-in loss and then sells the interest in the partnership (as part of a plan but in what is considered a separate transaction for tax purposes). Application of such an anti-abuse rule could take into account other factors as well, including (i) whether the taxpayer and its affiliates own all (or substantially all) of the interests in the partnership and (ii) whether the non-ECI assets are portfolio assets that are not germane to the U.S. business.

C. Application of Section 864(c) and 865 to Asset Sales by ECI Partnerships.

In order to apply the pure aggregate approach or a hybrid approach to a sale of an interest in an ECI Partnership, it is necessary to understand how much ECI would be recognized by the ECI Partnership upon a sale of its assets. Accordingly, it would be appropriate and helpful for the guidance to address how various provisions in Sections 864(c) and 865 apply to a sale of assets by an ECI Partnership, including a sale of various intangibles subject to Section 197.[21]

D. Valuation Issues.

Where an ECI Partnership also owns non-ECI assets, the amount of ECI will depend on the gain inherent in the ECI assets and (under the hybrid approach) the non-ECI assets, and this will require a valuation of such assets.[22] The determination would need to take into account the rules applicable under Section 864.[23]

RR 91-32 includes a presumption that all of the income and gain recognized under the sale is ECI and states that this presumption is an application of the general rule

[21] Apart from the computation aspect, such guidance may also inform how those provisions should apply to a sale of an interest in an ECI Partnership. We note, in this regard, that the reasoning of RR 91-32 has been the subject of substantial commentary and criticism. *See* Note 6.

[22] It is not entirely clear whether the valuation issues would be more difficult under a hybrid approach or a pure aggregate approach. While a hybrid approach would require a valuation of both the ECI assets and the non-ECI assets, the fundamental question would generally be the amount of built-in gain inherent in the U.S. business *relative to* the built-in gain inherent in any non-ECI Assets. By contrast, under a pure aggregate approach, the absolute amount of gain inherent in the U.S. business would be determinative. We note that in any case a buyer of the interest will need to value all of the assets in order to determine its Section 743 adjustment if there is a Section 754 election in place.

[23] We note that there may be investment-type assets that could present issues regarding the proper allocation between domestic and foreign assets. It may be unclear whether some assets (for example, investments of excess cash) are held in connection with an active business. Issues could arise regarding liquid assets that are held in connection with the business of the partnership when such assets are held for both the foreign and domestic business.

that the burden of proof in tax cases is upon the taxpayer. While there is some appeal for such a presumption where the ECI is determined under a hybrid approach, the use of a presumption is somewhat less compelling (and may work to the disadvantage of the Service) if the guidance adopts a pure aggregate approach since the ECI under such an approach could exceed the amount of income and gain recognized under Sections 741 and 751(a).

In order to ease the valuation issues, it would be helpful to taxpayers if guidance included certain valuation conventions—such as, allowing the taxpayer to apply a presumption that the enterprise value of the U.S. and non-U.S. business were proportionate to the net income (or EBITDA) they had generated over some period assuming it was consistent with the rules applicable under Section 864.

Moreover, it would be helpful to selling foreign partners if the guidance required ECI Partnerships to provide certain information to selling partners.[24]

E. Exception for Small Interests.

It would be appropriate and helpful if the Treasury and the Service considered the inclusion of special rules for transfers of small interests in ECI Partnerships, including both partnerships that are not publicly traded and partnerships that are publicly traded but not treated as corporations (such as master limited partnerships ("MLPs")). For example, the special rules could apply to interests that represent less than 5% of the profits and capital of the partnership and that have a value not more than $250,000 so long as certain

[24] Cf. Treas. Reg. Section 1.732(d)-1(d)(5).

conditions are met (*e.g.*, the transfer is not being effected in connection with other transfers that represent more than 25% (or some other percentage) of the interests in the partnership and the transfer, when aggregated with other transfers over some period, does not exceed 5%. The special rules could, for example, (i) include a presumption that all of the selling partner's income and gain is ECI, (ii) in the absence of another valuation, allow the parties to determine the value of the ECI-assets and the non-ECI assets based on the income (or EBITDA) they have generated over some period, or (iii) include a presumption that a good faith valuation by the partnership is correct.

We note that, under Treasury Regulation Section 1.897-1(c)(2)(iv), a small interest in a MLP may be excluded from the definition of United States real property interest, such that a sale of such an interest is not treated as ECI under Section 897. Treasury and the Service may wish to consider whether sales of such interests should similarly be excluded from ECI under Sections 871(b) and 882.

F. Application of Various Provisions of Subchapter K.

The taxation of a foreign seller (or buyer) of an interest in an ECI Partnership raises an assortment of issues under Subchapter K of the Code. While it would be appropriate and helpful for Treasury and the Service to provide guidance on each of these issues, we recognize that some of them may be beyond the scope of the current guidance project. Some of these issues may, however, affect the approach taken in the current guidance.

1. Application of Section 743.

If a person buys a partnership interest from an existing partner, the buying partner receives a tax basis in the purchased partnership interest equal to the amount paid (plus any share of partnership liabilities). Although generally there is no adjustment to the partnership's tax basis in its assets, the partnership adjusts the tax basis of its assets with respect to the buying partner. This adjustment is "personal" to the buying partner and has no effect on the other partners. In very broad terms, the adjustment is apportioned among the assets of the partnership so as to eliminate the income or loss the selling partner would be allocated if the partnership sold all of its assets for their fair market value immediately after the purchase. Even if the aggregate adjustment is zero, the buying partner may receive an offsetting positive adjustment (or "step-up") in one partnership asset and a negative adjustment (or "step-down") in another partnership asset. As a result, there is some coordination between Sections 743 and 751(a), and the buyer's Section 743 adjustment in hot assets will generally correspond to the amount of ordinary income recognized by the selling partner under Section 751(a).

The various provisions in Subchapter K relating to hot asset gain (or loss) could provide a framework for the treatment of ECI gain (or loss) in the case of an ECI Partnership. In this event, the rules would seek to cause a buying partner's step-up (or step-down) in ECI assets to correspond to the selling partner's ECI gain (or loss). While this would generally be the result under a pure aggregate approach, it would not always be the result under the hybrid approach, because under the hybrid approach the selling partner's ECI would be capped at the selling partner's outside gain (plus any Section

751(a) income) but the buying partner's step-up in ECI assets would not be subject to that cap.

2. Effect if the Selling Partner Has an Inside-Outside Tax Basis Difference.

It would be helpful for guidance to address how the selling partner's ECI is computed (under either a pure aggregate approach or the hybrid approach) where the selling partner has an inside-outside basis disparity because there were no Section 743 adjustments at the time of its acquisition.

> Example 4: Assume that (i) A (a foreign person) buys from an existing partner a 10% interest in an ECI Partnership that does not have a Section 754 election in place at a time when there is $100 of built-in gain in ECI assets of the partnership and no built-in gain in the non-ECI assets of the partnership, (ii) the non-ECI assets thereafter appreciate by $10 and the ECI assets hold their value (no further appreciation or depreciation) and (iii) A then sells the partnership interest and recognizes $10 of outside gain.

It is not clear how A's ECI would be determined under either a pure aggregate approach or a hybrid approach. If the partnership sold all of its assets and then distributed the proceeds in liquidation, A would have (i) $10 of ECI gain on the sale by the partnership (even though none of this gain accrued while A was a partner), (ii) $1 of non-ECI gain, and (iii) a $10 capital loss under Section 731(a) as a result of the liquidating distribution. It would seem appropriate on these simple facts for the entire $10 capital loss to be treated entirely as an ECI loss. Moreover, it seems appropriate for A to recognize no net ECI on the sale of A's partnership interest.

Alternatively, assume that there was a large non-ECI gain inherent in the partnership assets at the time the foreign person acquired the interest and the ECI assets increased in value after the interest was acquired.[25]

> Example 5: Assume that (i) A (a foreign person) buys from an existing partner a 10% interest in an ECI Partnership that does not have a Section 754 election in place at a time when there is $100 of built-in gain in the non-ECI assets of the partnership and no built-in gain in the ECI assets of the partnership, (ii) the ECI assets thereafter appreciate by $10 and the non-ECI assets hold their value (no further appreciation or depreciation) and (iii) A then sells the partnership interest and recognizes $10 of outside gain.

Again, it is not clear how A's ECI would be determined. If the partnership sold all of its assets and then distributed the proceeds in liquidation, A would have (i) $10 of non-ECI gain on the sale by the partnership, (ii) $1 of ECI gain, and (iii) a $10 capital loss as a result of the liquidating distribution. It would seem appropriate on these simple facts for the entire $10 capital loss to be treated as a non-ECI loss. Moreover, it seems appropriate for A to recognize $1 of ECI on the sale of A's partnership interest.[26]

One approach to the issues raised by Examples 4 and 5 would be to compute the ECI as if the Partnership had a Section 754 election in place at the time the foreign person selling the interest first acquired the interest. *Cf.* Section 732(d). However, adjustments would need to be made if the resulting Section 743 adjustment would have been amortized or allocated to assets that have since been sold.

[25] It may be appropriate in such contexts to compute the ECI gain as if a Section 754 election was in effect. *Cf.* Section 732(d).

[26] Similar issues could arise if the partnership had a built-in loss in its ECI assets or non-ECI assets (but not both) at the time it is purchased by A and no Section 743 adjustment were applicable.

It would also be appropriate for guidance to address whether a foreign partner with an existing Section 743 adjustment could alter the mix of ECI and non-ECI by first transferring the interest to an affiliate in a non-recognition transaction. While the regulations under Sections 743 and 755 are designed to some extent to preserve hot asset gain, they are not similarly designed to preserve ECI. We note, moreover, that it may not be possible (or appropriate in light of the likely complexity) for regulations under Section 755 to attempt to simultaneously preserve both the amount of hot asset gain and the amount of ECI in all cases.

3. Distributions to Foreign Partners.

In lieu of selling its interest in an ECI Partnership to a third party or another partner, a foreign partner could exit the partnership by receiving a taxable cash distribution from the partnership or a tax-deferred in-kind distribution from the partnership.

Taxable Distributions. If a partner receives a distribution of cash (or, in some cases, a distribution of marketable securities) from a partnership that exceeds the partner's tax basis in the partnership, the partner generally recognizes gain under Section 731(a). The flush language of Section 731 specifies that such gain is considered gain or loss from the sale or exchange of the partnership interest of the distributee partner. It would be appropriate and helpful for guidance to confirm whether the portion (if any) of such gain that is treated as ECI is determined under the same principles that apply to a sale of an interest in an ECI Partnership.

Tax-Deferred Distributions. If a partner receives a distribution of property from a partnership (including a distribution in liquidation of the partner's interest), the partner generally does not recognize any income or gain as a result of the distribution, except as provided in Section 751(b) and except in certain cases involving distributions of marketable securities. For example, suppose that a partnership operates a U.S. business directly and operates a non-U.S. business through a foreign corporation, and the partnership distributes the stock of the foreign corporation to a foreign partner in liquidation of the foreign partner's interest in the partnership. Alternatively, assume that the partnership distributes the U.S. business to one of the other partners.

Although Subchapter K has a variety of provisions designed to ensure that these transactions do not shift (or eliminate) hot asset gain, they are not designed to preserve ECI gain.[27]

4. <u>Actual Application of Sections 751(a) and 751(b)</u>.

In general, the sale of an interest in an ECI Partnership will trigger the application of Section 751(a), which (as noted above) provides that the amount of consideration received by a transferor partner in exchange for all or part of his interest in the partnership attributable to certain types of assets that generally produce ordinary income shall be considered as an amount realized from the sale or exchange of property other than a capital asset. It would be appropriate and helpful for any guidance to describe how

[27] Note that similar issues can arise in the case of gain in United States real property interests held by partnerships. Also note that Treasury Regulation Section 1.705-2 includes special basis rules to address gain that would be subject to Section 1032.

Sections 864 and 865 apply to any hot asset gain (or loss) recognized under Section 751(a)[28] or Section 751(b).[29]

G. Withholding.

There does not appear to be a clear basis for applying withholding tax to a foreign person selling an interest in an ECI Partnership (except to the extent required under Section 1445). We note, in this regard, that Section 1446 (which provides for withholding on a foreign partner's share of a partnership's effectively connected taxable income) does not appear to require withholding in the case of a sale of a partnership interest as 1446 defines "effectively connected taxable income … as the . . . taxable income of the *partnership* which is effectively connected, with the conduct of a trade or business in the United States." Section 1446(c) (emphasis added). While the reach of Section 1441 is broader in some respects, Section 1441(c) expressly provides that "[n]o deduction or withholding under subsection (c) should be required in the case of any item of income . . . which is effectively connected with the conduct of a trade or business in the United States and which is included in the gross income of the recipient under Section 871(b)(2) for the taxable year."

---

[28] As noted above, under Treasury Regulation Section 1.751-1(a)(2), (i) a selling partner has ordinary income or loss equal to the amount of ordinary income or loss from Section 751 property that the partner would have been allocated if the partnership sold all of its assets for cash in a fully taxable transaction immediately prior to the sale (or other transfer) by the partner and (ii) the difference between the capital gain or loss that the selling partner would recognize under Section 741 without application of Section 751 and the amount of ordinary income or loss determined as set forth in clause (i) is capital gain or loss.

[29] We note that one difference between Section 751(a) and Section 751(b) is that Section 751(b) currently may create an actual taxable exchange of assets whereas Section 751(a) generally does not.

H. Legislation.

As noted above, legislation has been proposed that would address some of the issues discussed in this Report. Given the complexities of some of the issues (*e.g.*, in-kind distributions from ECI Partnerships, withholding, the interaction with Section 897 and the application to PTPs) and the fact that subchapter K includes a number of provisions specifically directed at preserving hot asset gain (but no provisions specially directed at preserving ECI in the partnership context), we would support legislative action in this area.