

**MEMO# 19308**

November 3, 2005

# **INSTITUTE COMMENT LETTER ON PROPOSED REGULATIONS ON DISGUISED PARTNERSHIP SALES**

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19308] October 28, 2005 TO: TAX COMMITTEE No. 35-05 RE: INSTITUTE COMMENT LETTER ON PROPOSED REGULATIONS ON DISGUISED PARTNERSHIP SALES The attached Institute letter requests an exception for qualified master-feeder structures (as defined in Rev. Proc. 2001-36) from regulations relating to the disguised sale of partnership interests. Treasury issued proposed regulations last November under Code section 707(a)(2)(B) to prevent taxpayers from using favorable nonrecognition rules for contributions to and distributions from partnerships to avoid current taxation of transactions that are, in substance, sales of partnership interests ("Proposed Regulations")<sup>1</sup>. The Proposed Regulations adopt a similar approach to that applied by Treasury in its 1992 final regulations addressing disguised sales of property.<sup>2</sup> Under the Proposed Regulations, a sale of a partnership interest is deemed to occur where a partner transfers consideration to a partnership and the partnership transfers consideration to a different partner if, based on all facts and circumstances: (1) the transfer of consideration by the partnership to the selling partner would not have been made but for the transfer of consideration to the partnership by the purchasing partner (the "but for" test); and (2) in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.<sup>3</sup> 1 Go to <http://www.irs.gov/pub/irs-drop/149519-03.pdf> to read the Proposed Regulations. 2 See Treas. Reg. 1.707-1 through 8. 3 For example, if A and B are 50-50 partners in the AB partnership and A wishes to sell one-half of its partnership interest to C for \$100,000, a direct sale by A of that interest to C would be a taxable event to A. Alternatively, C could contribute \$100,000 to the partnership to acquire a partnership interest, and the partnership could distribute \$100,000 to A in a partial liquidation of A's partnership interest. The end result would be the same as a direct sale by A to C, but A could avoid recognizing any gain (assuming A's basis in the partnership is at least \$100,000). 2 Like the final regulations regarding disguised sales of property, the Proposed Regulations presume that transfers made within two years of each other are a sale unless the facts and circumstances clearly establish that the transfers do not constitute a sale. The Proposed Regulations would require disclosure of all transfers occurring within a seven-year period, rather than just during the two-year presumption period. The Proposed Regulations also would modify the regulations on disguised sales of property to extend the existing two-year disclosure period to seven years for potential property sales. The Proposed Regulations provide an exception for "service partnerships," such as law firms and

accounting firms.<sup>4</sup> This exception was included because “partners frequently enter and exit service partnerships and, in most cases, those transactions are factually unrelated to each other and should not be treated as a disguised sale of a partnership interest.”<sup>5</sup> The Institute’s comment letter requests that the Proposed Regulations provide a similar exception for master-feeder structures with respect to both the Proposed Regulations on disguised sales of partnership interests and the final regulations on disguised sales of property. Contributions and distributions that occur in the context of a master-feeder structure clearly are not the kinds of transactions that the disguised sales regulations were intended to address. As with service partnerships, the ongoing contributions and distributions are factually unrelated to each other and should not be treated as disguised sales. Although the presumption of a disguised sale in the context of a master-feeder structure is easily rebutted, an exception should be provided because the disclosure requirements serve no useful purpose and are unduly burdensome. Please provide any comments to the attached draft by 5:00 p.m. EST on Thursday, November 10, 2005 to Lisa Robinson at 202-326-5835 or lrobinson@ici.org. If you believe that it would be useful to have a conference call regarding the draft letter, you may also contact Lisa Robinson on or before November 10, 2005. Lisa Robinson Associate Counsel Attachment (in .pdf format) 4 See Prop. Treas. Reg. 1.707-7(g). 5 See Preamble to Proposed Regulations.

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