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RE: Notice 2015-54, Transfers of Property to Partnerships with Related Foreign Partners and Controlled Transactions Involving Partnerships

Dear Messrs. Koskinen, Wilkens, Bowen and Jeruchim:

The American Institute of CPAs (AICPA) submits the following comments in response to Notice 2015-54 (the "Notice") issued on August 6, 2015 concerning transfers of property to partnerships with related foreign partners and controlled transactions involving partnerships. These comments were developed jointly by the AICPA Partnership Taxation and International Taxation Technical Resource Panels and approved by the AICPA Tax Executive Committee.

In issuing the Notice, the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) announced their intent to issue regulations under Internal Revenue Code (IRC) section 721(c)[1] to ensure that, when a United States (U.S.) person transfers certain property to a partnership that has related foreign partners, income or gain attributable to the property will be taken into account by the U.S. transferor either immediately or periodically. The Notice also announces the intent of Treasury and the IRS to issue regulations under sections 482 and 6662 applicable to controlled transactions involving partnerships to ensure the appropriate valuation of such transactions. These comments only address the intended regulations under section 721(c). We may provide additional comments on the intended regulations under sections 482 and 6662 at a later time.

[1] All section references in this letter are to the Internal Revenue Code of 1986, as amended, or the Treasury regulations promulgated thereunder.

BACKGROUND

The Notice and the forthcoming regulations override the general non-recognition treatment provided by section 721(a) when a "U.S. Transferor" transfers "Section 721(c) Property" to a "Section 721(c) Partnership." The Notice defines a U.S. Transferor as a United States person within the meaning of section 7701(a)(30), other than a domestic partnership. The Notice defines Section 721(c) Property as any property with "Built-in Gain" except:

(i) cash equivalents; or

(ii) any asset that is a security within the meaning of section 475(c)(2), without regard to section 475(c)(4); or

(iii) any item of tangible property with Built-in Gain that does not exceed $20,000.

The Notice defines a Section 721(c) Partnership as a partnership to which a U.S. Transferor contributes Section 721(c) Property, and, after the contribution and any transactions related to the contribution:

(i) a "Related Foreign Person" is a direct or indirect partner in the partnership; and

(ii) the U.S. Transferor and one or more "Related Persons" own more than fifty percent of the interests in partnership capital, profits, deductions or losses.

A Related Person is a person that is related within the meaning of section 267(b) or section 707(b)(1) to the U.S. Transferor, and a Related Foreign Person is a Related Person (other than a partnership) that is not a U.S. person.

Gain that would otherwise require recognition by virtue of the general rule set forth in the Notice is avoided if a Section 721(c) Partnership applies the "Gain Deferral Method" with respect to its Section 721(c) Property. To qualify for applying the Gain Deferral Method, a taxpayer must meet the following requirements:

(i) the Section 721(c) Partnership must adopt the remedial allocation method described in Treas. Reg. § 1.704-3(d) with respect to all Section 721(c) Property contributed to the Section 721(c) Partnership pursuant to the same plan by a U.S. Transferor and all other U.S. Transferors that are Related Persons; and

(ii) during any taxable year in which there is remaining Built-in Gain with respect to an item of Section 721(c) Property, the Section 721(c) Partnership must allocate all items of section 704(b) income, gain, loss, and deduction with respect to that Section 721(c) Property in the same proportion; and

(iii) the Section 721(c) Partnership must comply with new and existing reporting requirements; and

(iv) the U.S. Transferor must recognize any remaining pre-contribution Built-in Gain upon the occurrence of certain "Acceleration Events"; and

(v) the Section 721(c) Partnership adopts the Gain Deferral Method for all Section 721(c) Property subsequently contributed to the partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons within certain time periods.[2]

An Acceleration Event is any transaction that either reduces the amount of remaining Built-in Gain that a U.S. transferor would recognize under the Gain Deferral Method if the transaction had not occurred or could defer the recognition of Built-in Gain. Additionally, an Acceleration Event is deemed to occur with respect to all Section 721(c) Property of a Section 721(c) Partnership in which any party fails to comply with all of the requirements for applying the Gain Deferral Method.

<u>AICPA RECOMMENDATIONS</u>

1. The regulations should not apply to any situation where gain realized on the transfer of Section 721(c) Property to a Section 721(c) Partnership, when recognized, is includible in the gross income of a U.S. person.

Prior to 1997, sections 1491 through 1494 imposed an excise tax on certain transfers of appreciated property by a U.S. person to a foreign partnership, generally equal to 35 percent of the amount of gain inherent in the property. However, Congress repealed these sections as part of the Taxpayer Relief Act of 1997[3] and in its place enacted section 721(c), which provides the United States Secretary of the Treasury ("Secretary") with authority to override the application of the non-recognition provision of section 721(a) in certain situations. Specifically, section 721(c) provides the following authority:

> (c) The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a partnership if such gain, ***when recognized***, will be includible in the gross income **of *a person other than a United States person***. (Emphasis added.)

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[2] Specifically, section 4.03(5) of the Notice requires the adoption of the Gain Deferral Method for all Section 721(c) Property subsequently contributed to the Section 721(c) Partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons until the earlier of: (i) the date that no Built-in Gain remains with respect to any Section 721(c) Property to which the Gain Deferral Method first applied; or (ii) the date that is 60 months after the date of the initial contribution of Section 721(c) Property to which the Gain Deferral Method first applied.

[3] Pub. L. No. 105-34, 111 Stat. 787.

Because of this specific language, it appears that Treasury and the IRS do not have the authority to issue regulations under section 721(c) that trigger gain (on the transfer of Section 721(c) Property to a partnership) which is includible in the gross income of a ***U.S. person***.

Under the Notice, the non-recognition provision of section 721(a) will not apply when a U.S. Transferor contributes an item of Section 721(c) Property to a Section 721(c) Partnership, unless the Gain Deferral Method is applied with respect to the Section 721(c) Property. This treatment applies regardless of whether the gain, when recognized, is includible in the gross income of a U.S. person.

The following examples illustrate this issue:

Example 1:

USP, a domestic corporation, wholly owns FS, a foreign corporation. USP and FS form a new partnership, PRS, in Year 1. FS contributes cash of $2 million, and USP contributes appreciated property with a fair market value of $2 million and an adjusted tax basis of zero. PRS selects the traditional allocation method as described in Treas. Reg. § 1.704-3(b) with respect to the appreciated property.

Absent the Notice, if PRS were to sell the appreciated property in Year 2 for $2 million, PRS must, under the principles of section 704(c), allocate the taxable gain of $2 million to USP. USP should not recognize gain under section 721(c) on the date of its contribution because the $2 million of gain, when recognized in Year 2, is recognized by USP, not by FS.

However, under the Notice, USP is required to recognize the pre-contribution Built-in Gain of $2 million in Year 1. PRS did not chose to apply the remedial allocation method pursuant to Treas. Reg. § 1.704-3(d), which is required to qualify for the Gain Deferral Method.

Example 2:

USP, a domestic corporation, wholly owns FS, a foreign corporation. USP and FS form a new partnership, PRS, in Year 1. FS contributes cash of $2 million, and USP contributes a depreciable asset, Asset 1, with a fair market value of $2 million and an adjusted tax basis of $.5 million. Asset 1 is depreciated using the straight-line method and, at the time of contribution, has two years remaining on its cost recovery schedule.[4] PRS selects the traditional method with curative

[4] For simplification purposes, this example will ignore the application of any cost recovery conventions and assumes that there are annual book and tax depreciation of $1 million and $.25 million, respectively.

allocations as described in Treas. Reg. § 1.704-3(c) limited to items of gain from the sale of Asset 1.
Absent the Notice and assuming PRS has no other items of income or loss for the first two years, at the end of Year 2, USP and FS's book and tax capital accounts are as follows:[5]

	USP		**FS**	
	Book	Tax	Book	Tax
Initial Contribution	$ 2.0	$ 0.5	$ 2.0	$ 2.00
Year 1 Depreciation	($0.5)	$ 0.0	($0.5)	($0.25)
Year 2 Depreciation	($0.5)	$ 0.0	($0.5)	($0.25)
Ending Capital	$ 1.0	$ 0.5	$ 1.0	$1.50

If PRS sells Asset 1 for $2 million on the first day of year 3, it recognizes $2 million of book gain and $2 million of tax gain. PRS allocates the book gain equally among USP and FS. Because PRS selected the traditional method with curative allocations limited to items of gain from the sale of Asset 1, the taxable gain from the sale of Asset 1 is used to correct FS's book and tax capital account distortion of $.5 million created by the ceiling rule. As such, PRS allocates $0.5 million of tax gain to FS and $1.5 million of tax gain to USP as shown below. The tax gain of $1.5 million recognized by USP in Year 3 precisely equals the amount of pre-contribution Built-in Gain inherent in Asset 1.

However, under the Notice, USP is required to recognize the pre-contribution Built-in Gain of $1.5 million on the date of its contribution in Year 1 because PRS does not adopt the remedial allocation method pursuant to Treas. Reg. § 1.704-3(d) as required by the Gain Deferral Method.[6]

	USP		**FS**	
	Book	Tax	Book	Tax
Year 3 Beginning	$ 1.0	$ 0.5	$ 1.0	$ 1.5
Year 3 Sale	$ 1.0	$ 1.5	$ 1.0	$ 0.5
Ending Capital	$ 2.0	$ 2.0	$ 2.0	$ 2.0

As illustrated by the examples above, the gain recognition treatment of a U.S. Transferor as proposed by the Notice applies regardless of whether any gain, when recognized, is includible in the gross income of the U.S. Transferor. The AICPA believes that Treasury and the IRS do not have authority to issue regulations to provide such treatment that violates the statutory language of section 721(c). The Notice attempts to address the issue resulting from the fact that section 704(c) and the regulations thereunder create income and deductions under the elective remedial allocation method as described in Treas. Reg. § 1.704-3(d). Therefore, on an inbound transfer of appreciated property, remedial allocations are potentially used to create income for the foreign

[5] All figures are in millions.
[6] All figures are in millions. .

partner, often not subject to U.S. taxation, and deductions for the U.S. partner. Through the Notice, the IRS attempts to remediate that result by effectively requiring the use of the remedial allocation method for outbound transactions where the partnership allocates the created income to the U.S. partner and the created deductions to the foreign partner. As noted above, section 721(c) may not provide the IRS with the authority to level the playing field.

Accordingly, the AICPA recommends that section 721(c) regulations exclude all situations where gain realized on the transfer of Section 721(c) Property to a Section 721(c) Partnership, when recognized, is includible in the gross income of a U.S. person.

2. **The regulations should not require the use of the remedial allocation method for purposes of section 721(c). Alternatively, if Treasury does intend to require the use of the remedial method, an amendment to Treas. Reg. § 1.704-3(d)(5)(ii) is necessary to permit the IRS to require the use of the remedial allocation method solely in order to qualify for the Gain Deferral Method described in the Notice.**

Section 4.02 of the Notice provides that the non-recognition provision of section 721(a) will not apply unless the Section 721(c) Partnership complies with the requirements of the Gain Deferral Method with respect to the Section 721(c) Property. One requirement is for the partnership to adopt the remedial allocation method (described in Treas. Reg. § 1.704-3(d) for Built-in Gain) with respect to all Section 721(c) Property contributed to the partnership pursuant to the same plan.

Section 704(c) requires a partnership to allocate income, gain, loss, and deductions with respect to property contributed to a partnership in a manner which takes into account any variation between the adjusted tax basis of the property and its fair market value at the time of the contribution. As such, the purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution gain or loss.[7] Treasury Reg. §§ 1.704-3(b), (c), and (d) provide three allocation methods that are generally considered reasonable in order to take into account the Built-in Gain or Loss at the time of the contribution. One of these methods is the remedial allocation method, under which a partnership may eliminate distortions caused by the ceiling rule (as described in Treas. Reg. § 1.704-3(b)(1))[8] by making remedial allocations of income, gain, loss, or deduction to the noncontributing partners equal to the full amount of the limitation caused by the ceiling rule, and offsetting those allocations with remedial allocations of income, gain, loss, or deduction to the contributing partner.[9]

Under Treas. Reg. § 1.704-3(a)(10) ("anti-abuse rule") an allocation method (or combination of methods) is not reasonable if the contribution of property and the corresponding allocation of tax

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[7] Treas. Reg. § 1.704-3(a)(1).

[8] Under the ceiling rule, the total income, gain, loss, or deduction allocated to the partners for a taxable year with respect to a property cannot exceed the total partnership income, gain, loss, or deduction with respect to that property for the taxable year.

[9] T.D. 8585, 1995-1 C.B. 120.

items with respect to the property are made with a view of shifting the tax consequences of Built-in Gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. Treasury Reg. § 1.704-3(d)(5)(ii) provides that in exercising its authority under the anti-abuse rule to make adjustments, if a partnership's allocation method is not reasonable, the IRS will ***not*** require a partnership to use the remedial allocation method or any other method involving the creation of notional tax items (emphasis added). It would seem that the requirement in the Notice to use the remedial allocation method is contrary to the language contained in Treas. Reg. § 1.704-3(d)(5)(ii). The Notice, in section 2.03, references the inability of the IRS to force the use of the remedial allocation method, as described Treas. Reg. § 1.704-3(d)(5)(ii), although this reference is without explanation.

One could argue that in issuing the Notice, the IRS is not exercising its authority under the anti-abuse rule, but is instead exercising its authority under section 721(c). However, section 721(c) simply provides authority to issue regulations that section 721(a) will not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, is includible in the gross income of a non-U.S. person. As such, it does not provide authority to force a partnership to select a certain allocation method — that is the purview of the anti-abuse rule, which specifically denies the IRS the ability to require the use of the remedial allocation method.

The AICPA recommends that Treasury and the IRS remove the requirement to use the remedial allocation method from the section 721(c) regulations. If Treasury does desire to maintain this requirement, we recommend amending Treas. Reg. § 1.704-3(d)(5)(ii) to permit the **IRS to require the use of the remedial allocation method solely in order to qualify for the Gain Deferral Method described in the Notice.**

3. The regulations should provide relief to taxpayers who fail to comply with the reporting requirements provided they exercised reasonable due diligence and acted in good faith.

As stated above, under the Notice, the non-recognition provision of section 721(a) will not apply unless all of the requirements of the Gain Deferral Method are applied with respect to the Section 721(c) Property. One of the requirements of the Gain Deferral Method is the compliance with certain existing and new reporting requirements. Any non-compliance with the required reporting requirements is considered an Acceleration Event with respect to all Section 721(c) Property of a Section 721(c) Partnership. Accordingly, the U.S. Transferor must recognize gain in an amount equal to the remaining Built-in Gain that would have been allocated to the U.S. Transferor if the Section 721(c) Partnership had sold the item of Section 721(c) Property immediately before the occurrence of the Acceleration Event for its fair market value.

The Notice provides that if a Section 721(c) Partnership is a foreign partnership, a U.S. Transferor must continue to fulfill existing reporting requirements under sections 6038, 6038B, and 6046A and the regulations thereunder with respect to the contribution of the Section 721(c) Property to the Section 721(c) Partnership. In addition, Treasury and the IRS intend to require the taxpayer to comply with new reporting requirements, which include:

(i) providing supplemental information for contributions of Section 721(c) Property to Section 721(c) Partnerships on Schedule O, Transfers of Property to a Foreign Partnership, of Form 8865;

(ii) reporting information (such as a description of the section 721(c) property; information regarding the amount of income, gain, deduction, or loss with respect to the section 721(c) property; and a description of any acceleration events) concerning Section 721(c) Property subject to the Gain Deferral Method (regardless of whether the Section 721(c) Partnership is a domestic or foreign partnership); and

(iii) requiring certain U.S. Transferors that contribute Section 721(c) Property to a Section 721(c) Partnership that is a foreign partnership to comply with information return filing requirements described in Treas. Reg. § 1.6038-3 to the extent not required under current regulations.

The myriad of reporting requirements required of U.S. Transferors will prove difficult to navigate and invites the chance of a misstep even if the taxpayer exercises reasonable care. Any misstep is treated as an Acceleration Event with respect to all Section 721(c) Property of a Section 721(c) Partnership. The AICPA believes this penalty is too severe as it could trigger the recognition of large unanticipated gains in situations where a taxpayer exercised reasonable due diligence and acted in good faith.

The AICPA recommends that the section 721(c) regulations provide relief to taxpayers who fail to comply with the reporting requirements but exercise reasonable due diligence and act in good faith.

4. The regulations should provide additional exceptions to the definition of an Acceleration Event with respect to (i) certain non-abusive technical terminations of a Section 721(c) Partnership, (ii) distributions of previously contributed Section 721(c) Property to the contributing U.S. Transferor, and (iii) the domestic incorporation of a Section 721(c) Partnership.

(i) Certain Non-Abusive Technical Terminations of a Section 721(c) Partnership

Section 708(b)(1)(B) provides for a "technical termination" under which a partnership shall be considered terminated if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits. Such sale or exchange includes a sale or exchange to another member of the partnership.[10]

If a partnership is terminated by a sale or exchange of an interest, the partnership is deemed to have contributed all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership. The terminated partnership is also treated as though it distributed interests in the new partnership to the purchasing partner and the other remaining partners (in proportion to their respective interests in the terminated partnership) in liquidation of the terminated partnership.[11] The new partnership must compute depreciation for property depreciable under section 168 as if the property were newly acquired, which includes using the applicable first-year convention.[12] Additionally, the partnership will adjust section 704(b) book depreciation in an identical manner after a technical termination.[13]

Requiring a partnership to compute depreciation as if the property were newly acquired will slow down the cost recovery of depreciable property because of the increased recovery period over which any remaining basis is recovered. The Notice defines an Acceleration Event with respect to an item of Section 721(c) Property as any transaction that would either reduce the amount of remaining Built-in Gain that a U.S. Transferor would recognize under the Gain Deferral Method if the transaction had not occurred or could ***defer*** the recognition of the Built-in Gain (emphasis added). Therefore, a technical termination of a Section 721(c) Partnership that holds depreciable Section 721(c) Property would fall under the definition of an Acceleration Event because it has the effect of deferring the recognition of the U.S. Transferor's Built-in Gain.[14]

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[10] Treas. Reg. § 1.708-1(b)(2).
[11] Treas. Reg. § 1.708-1(b)(4).
[12] See section 168(i)(7)(B) providing that the MACRS depreciation carryover rules for transactions described in sections 721 or 731 do not apply to a termination of a partnership under section 708(b)(1)(B).
[13] Treas. Reg. § 1.704-1(b)(2)(iv)(*g*)(*3*). However, the new partnership may continue to amortize a section 197 intangible using the same recovery period and rates as the terminated partnership. *See* section 197(f)(2) providing no exclusion for partnership terminations. *See also* Treas. Reg. § 1.197-2(g)(2)(iv)(*B*).
[14] For example, a U.S. corporation, USP and its sub, FS, a foreign corporation, are equal partners of partnership PRS. PRS holds Section 721(c) Property that was contributed by USP. PRS uses the remedial allocation method as described in Treas. Reg. § 1.704-3(d) with respect to the property. The property generates annual book depreciation of $200,000 (until it's fully depreciated) that is allocated equally between USP and FS. Assuming the property does not generate any tax depreciation, a $100,000 remedial deduction is allocated to FS while an offsetting $100,000 of remedial income (which represents the recognition of Built-in Gain) is allocated to USP every year. However, if PRS were to technically terminate, the remaining book basis of the property is depreciated over a longer period because the property is treated as a newly purchased asset, causing a reduction in annual book depreciation generated by the property. Assuming the property generates $150,000 of annual book depreciation after a technical termination of PRS, only $75,000 of remedial income is allocated to USP (as opposed to the $100,000 of remedial income prior to the technical termination of PRS). Therefore, a technical termination of a partnership that holds depreciable Section 721(c) property can have the effect of deferring the recognition of Built-in Gain by the contributing partner.

If any sale or exchange of an interest that results in a technical termination of a Section 721(c) Partnership is treated as an Acceleration Event, it could have a negative impact on potential sales or exchanges of Section 721(c) Partnership interests even if there are legitimate business reasons for the transaction, such as the sale or exchange of an interest to an unrelated third party.

The AICPA believes that the section 721(c) regulations should treat technical terminations as Acceleration Events only in certain limited circumstances. To accomplish this result, the regulations could include an anti-abuse rule stating that a technical termination is treated as an Acceleration Event only if the principal purpose of triggering the technical termination of a Section 721(c) Partnership is to defer the recognition of Built-in Gain, and the sale or exchange of the interest in the Section 721(c) Partnership triggering the technical termination is between related parties (as defined in sections 267(b) and 707(b)(1)). Having such an anti-abuse rule will allow for the continuation of legitimate business transactions while ensuring that the overall purpose of the regulations is not circumvented through the use of related party transactions.

(ii) Distribution of a Previously Contributed Section 721(c) Property to the Contributing U.S. Transferor

A distribution of previously contributed Section 721(c) Property back to the contributing U.S. Transferor could also defer the recognition of Built-in Gain and qualify under the definition of an Acceleration Event. This result would occur because remedial allocations would no longer apply to the Section 721(c) Property in the hands of the U.S. Transferor. The U.S. Transferor would have the ability to defer recognition of the Built-in Gain until they disposed of the property in a taxable transaction.

As discussed in the Notice, Congress recognized that taxpayers could use a partnership to shift gain to a foreign person, and consequently, enacted section 721(c). Treating a distribution of previously contributed Section 721(c) Property back to the contributing U.S. Transferor as an Acceleration Event is not sound tax policy, as the distribution is not an attempt to shift any Built-in Gain inherent in the Section 721(c) Property to a Related Foreign Person. Instead, the transfer of the Section 721(c) Property back to the U.S. Transferor will place the parties back in a situation similar to what would have existed had the original contribution of the Section 721(c) Property never occurred.

The AICPA recommends that the section 721(c) regulations specifically provide that a distribution of previously contributed Section 721(c) Property to the contributing U.S. Transferor, does not violate the principles of section 721(c), and is therefore, not treated as an Acceleration Event.

(iii) ***Domestic Incorporation of a Section 721(c) Partnership***

Section 4.05(3) of the Notice provides that "an Acceleration Event will not occur if (i) a U.S. Transferor transfers an interest in a Section 721(c) Partnership to a domestic corporation in a transaction to which either section 351(a) or section 381(a) applies, or (ii) a Section 721(c) Partnership transfers an interest in a lower-tier partnership that owns section 721(c) Property to a domestic corporation in a transaction to which section 351(a) applies, provided that in both cases the parties continue to apply the Gain Deferral Method by treating the transferee domestic corporation as the U.S. Transferor for all purposes of this notice." Additionally, section 4.05(4) of the Notice provides that "an Acceleration Event will not occur if a Section 721(c) Partnership transfers Section 721(c) Property to a domestic corporation in a transaction to which section 351(a) applies." The Notice further provides that the stock in a transferee corporation received by a Section 721(c) Partnership from such a transaction will not be subject to the Gain Deferral Method.

Noticeably absent from the list of exceptions to an Acceleration Event is the domestic incorporation of a Section 721(c) Partnership. Under Revenue Ruling 84-111, a partnership may incorporate in any of the following three situations:

(i) transferring all of its assets to a newly-formed corporation in exchange for all of the outstanding stock of the corporation and the assumption by the corporation of the partnership's liabilities followed by its termination through the distribution of all of the stock to the partners in proportion to their partnership interests;

(ii) distributing all of its assets and liabilities to its partners in proportion to their partnership interests in a transaction that constitutes a termination of the partnership, and then immediately thereafter, (1) the partners transfer all of the assets received from the partnership to a newly-formed corporation in exchange for all of the outstanding stock of the corporation and (2) the corporation assumes the partnership's liabilities that had previously been assumed by the partners; and

(iii) the partners transfer their partnership interests to a newly-formed corporation in exchange for all the outstanding stock of the corporation (which as a result, terminates the partnership and all of its assets and liabilities become assets and liabilities of the corporation).

Unlike Revenue Ruling 84-111, in which the partnership ceases to exist after the completion of the transactions in each of the described situations, the exceptions to an Acceleration Event suggest that the partnership continues to exist after the transfers. For example, in situations where a U.S. Transferor transfers an interest in a Section 721(c) Partnership to a domestic corporation, the Notice requires that the parties continue to apply the Gain Deferral Method by treating the transferee domestic corporation as the U.S. Transferor for all purposes of the Notice. If all of the interests in the Section 721(c) Partnership were transferred to the domestic corporation, the partnership would cease to exist and the Gain Deferral Method could not apply, potentially causing an Acceleration Event.

The AICPA acknowledges that the exceptions in the Notice for transfers of interests in Section 721(c) Partnerships and transfers of Section 721(c) Property to a domestic corporation could lead to the conclusion that the domestic incorporation of a Section 721(c) Partnership would not constitute an Acceleration Event. However, we believe the language contained in the Notice is unclear and that the regulations should contain a provision that specifically states this fact in order to avoid any ambiguity that may hinder the domestic incorporation of Section 721(c) Partnerships.

5. **The regulations should expand the exception for tangible property with Built-in Gain that does not exceed $20,000 to include tangible property with Built-in Gain that does not exceed $250,000, provided the total built in gain on all contributed property is less than $5 million.**

The Notice provides that the section 721(c) regulations will include a de *minimis* rule providing that section 721(a) will continue to apply if during the U.S. Transferor's taxable year (1) the sum of the Built-in Gain with respect to all Section 721(c) Property contributed in that year to the Section 721(c) Partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons does not exceed $1 million, and (2) the Section 721(c) Partnership is not applying the Gain Deferral Method with respect to a prior contribution of Section 721(c) Property by the U.S. Transferor or another U.S. Transferor that is a Related Person.

The Notice also provides an exclusion for tangible property with Built-in Gain that does not exceed $20,000. This exclusion is presumably based on Treas. Reg. § 1.704-3(e)(1) ("Small Disparity Rule").[15] In 2010, when commenting on Notice 2009-70 and the section 704(c) layering rules, the AICPA recommended increasing the gross disparity threshold used in the Small Disparity Rule to $250,000.[16] We continue to believe that such an expansion is appropriate to avoid unnecessary complexity and provide consistency with the statutory thresholds under sections 734 and 743. We also believe that the $250,000 per item of property exclusion should also apply in the section 721(c) regulations provided the total Built-in Gain on all contributed property in that year is less than $5 million.

In general, the tax planning necessary to transfer Built-in Gain property to foreign affiliates is usually not undertaken unless the Built-in Gain is in excess of $5 million. Accordingly, we

[15] Treasury Reg. § 1.704-3(e)(1)(i) provides that if a partner contributes one or more items of property to a partnership within a single taxable year of the partnership, and the disparity between the book value of the property and the contributing partner's adjusted tax basis in the property is a small disparity, the partnership may (A) use any reasonable section 704(c) method; (B) disregard the application of section 704(c) to the property; or (C) defer the application of section 704(c) to the property until the disposition of the property. Treasury Reg. § 1.704-3(e)(1)(ii) states that a disparity between book value and adjusted tax basis is a small disparity if the book value of all properties contributed by one partner during the partnership taxable year does not differ from the adjusted tax basis by more than 15 percent of the adjusted tax basis, and the total gross disparity does not exceed $20,000.
[16] AICPA Comments: Notice 2009-70: Section 704(c) Layers Relating to Partnership Mergers, Divisions and Tiered Partnerships, April 30, 2010.

recommend that the section 721(c) regulations should expand the definition of "Excluded Property" to read:

> Excluded Property is (i) cash equivalents, (ii) any asset that is a security within the meaning of section 475(c)(2), without regard to section 475(c)(4), (iii) any item of tangible property with Built-in Gain that does not exceed $20,000 and (iv) any item of tangible property with Built-in Gain that does not exceed $250,000 as long as the sum of the Built-In Gain with respect to all Section 721(c) Property contributed in that year to the Section 721(c) Partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons does not exceed $5 million.

6. Postpone the effective date of the regulations until the temporary or final section 721(c) regulations are published in the federal register and Treasury and the IRS have addressed the uncertainties contained in the Notice.

The Notice provides that the general rules set forth by the Notice apply to transfers occurring on or after August 6, 2015 with certain exceptions.[17] Although the definition of "transfers" is not provided by the Notice, as written, it appears to apply to both actual and deemed transfers of Section 721(c) Property that occur after August 6, 2015. As a result, a Section 721(c) Partnership formed many years ago could potentially find itself subject to the rules of the Notice if the partnership technically terminates after August 6, 2015. This outcome would occur because, as mentioned above, under Treas. Reg. § 1.708-1(b)(4), a terminated Section 721(c) Partnership is deemed to contribute all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated Section 721(c) Partnership distributes interests in the new partnership to its partners in proportion to their respective interest in the terminated partnership in liquidation of the terminated Section 721(c) Partnership. However, if the new partnership constitutes a Section 721(c) Partnership (*e.g.*, the contributed assets by the terminated Section 721(c) Partnership includes Section 721(c) Property) and it does not apply the Gain Deferral Method, a U.S. Transferor, who transferred the Section 721(c) Property to the terminated partnership many years ago, may recognize gain on the deemed transfer of Section 721(c) Property.

The AICPA has identified many uncertainties with respect to the rules described in the Notice. Until these issues are clarified, it is unfair to apply the requirements of the Notice to transfers –

[17] Section 6 of the Notice states that the regulations described in sections 4.01 through 4.06(1), 4.07, and 4.08 of this notice will apply to transfers occurring on or after August 6, 2015, and to transfers occurring before August 6, 2015 resulting from entity classification elections made under Treas. Reg. § 301.7701-3 that are filed on or after August 6, 2015, and that are effective on or before August 6, 2015. The reporting requirements described in sections 4.06(2) (relating to reporting regulations to be issued) and 4.06(3) (relating to the extension of the statute of limitations), and the regulations described in section 5 of this notice (regarding controlled transactions involving partnerships) will apply to transfers and controlled transactions occurring on or after the date of publication of the regulations described in those sections.

both deemed and actual – that occur after August 6, 2015. Therefore, we recommend postponement of the effective date of the Notice until the section 721(c) regulations are published in the federal register.

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please feel free to contact me at (801) 523-1051 or tlewis@sisna.com; Noel Brock, Chair, AICPA Partnership Taxation Technical Resource Panel, at (619) 300-1207 or noel@noelpbrock.com; or Jonathan Horn, Senior Technical Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204 or jhorn@aicpa.org.

Respectfully submitted,

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