The Real Estate Roundtable

March 13, 2013

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

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

Re: Possible Changes to Section 752 Regulations

Dear Assistant Secretary Mazur and Chief Counsel Wilkins:

The Real Estate Roundtable understands that the Treasury Department ("Treasury") and the Internal Revenue Service (the "Service") may propose changes to the regulations under Section 752 that would significantly alter the manner in which liabilities have been allocated to partners for over 20 years.

Specifically, we understand that the proposed changes may (a) prevent a partner who has entered into a so-called "bottom guaranty" of a partnership liability from being allocated the guaranteed portion of the liability as a recourse liability under the Section 752 regulations, and (b) limit the allocation of a partnership liability to any entity or individual partner as a recourse liability under the Section 752 regulations to the extent of such entity's or individual's net worth.

We understand that Treasury and the Service may propose "bright-line" rules along these lines, or alternatively may propose a list of factors to be taken into account in applying the anti-abuse rule of Treas. Reg. § 1.752-2(j) that would include the fact that a guarantee is of the bottom portion of the debt or the fact that the regarded entity's net worth is insufficient to satisfy the guarantee as factors indicating that the arrangement should be disregarded.

As discussed below, we urge Treasury and the Service to reconsider these significant changes to the Section 752 regulations.

The proposed changes would drastically alter the Section 752 allocation rules with respect to partnership recourse liabilities. Under these rules, a partnership liability is characterized as a recourse liability to the extent that a partner bears the "economic risk of loss" for the liability. A partner is considered to bear the economic risk of loss for a partnership liability if, upon a deemed liquidation of the partnership where all of the partnership's assets are worthless, the partner would be obligated to make a payment because the liability becomes due and payable (the "Constructive Liquidation Test"). Subject to the application of the Section 752 anti-abuse rule and rules related to entities that are disregarded as separate from their owners for Federal income tax purposes, the Constructive Liquidation Test assumes that a partner will satisfy its payment obligations without regard to the partner's net worth. The Constructive Liquidation Test is intended to allow a partnership to allocate its liabilities without making a difficult or impossible assessment as to the likelihood that a partner's obligation will in fact become due and payable or whether a partner will in fact have the net worth to satisfy its obligation. It provides an administrable regime and prevents the government from being "whipsawed" as a result of differing assessments of the likelihood that an obligation will come due or that a partner will have the financial ability to pay it.

We assume that the proposal to disregard a bottom guarantee of a partnership liability is premised on the belief that such a liability is not likely to become due and payable. The assumption that a bottom guarantee is less likely to become due and payable than a full guarantee may not be correct depending on the facts and circumstances, including the debt/equity ratio and volatility associated with assets securing the liability. A bottom guarantee of a debt in a heavily leveraged structure may be more risky than a full guarantee of the entire debt in a less heavily leveraged structure. These are exactly the types of difficult assessments that the Constructive Liquidation Test is designed to avoid. If bottom guarantees of partnership liabilities are disregarded, these liabilities will be allocated among the partners as nonrecourse liabilities. This result does not comport with the undeniable fact that the bottom guarantor is exposed to more economic risk than other non-guaranteeing partners. We also note that Treas. Reg. § 1.704-2(m), *Example 1(vii)* addresses the consequences of a bottom guarantee with respect to the computation of "minimum gain" under the Section 704(b) regulations and does not suggest in any way that such a guarantee is abusive or should be disregarded.

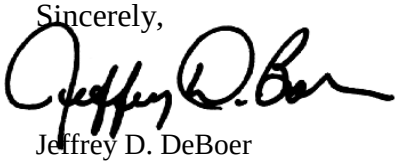
Similarly, when a tax regarded entity or individual enters into a payment obligation with respect to a partnership liability, all of that entity's or individual's assets are fully exposed and, as a result, such obligations are generally not entered into in connection with an abusive transaction. Imposing a net worth requirement on tax regarded entities and individuals would impose a heavy administrative burden on partnerships that is inconsistent with the purpose and intent of the Constructive Liquidation Test. Further, to the extent that an entity is formed or is utilized to shield inappropriately a taxpayer's assets with respect to a payment obligation, the Section 752 anti-abuse rules already limit the extent to which the obligation will be respected.

These changes to the Section 752 allocation rules would have a severe chilling effect on the transfer of real estate to business partnerships, including UPREIT and partnership roll-up transactions in which the partners contributing property have negative capital accounts and receive no cash in connection with the transaction. To the extent these partners are not allocated liabilities because their payment obligations are disregarded under the proposed changes to the partnership liability allocation rules, such a transaction would result in the recognition of taxable gain to the contributing partner.

We urge Treasury and the Service to reconsider whether these changes to the longstanding and administrable rules regarding the allocation of partnership liabilities are necessary or appropriate. Merely proposing regulations along the lines described herein would have an extraordinary chilling effect on ordinary business transactions. If Treasury and the Service continue to believe these changes should be considered, we would urge Treasury and the Service to solicit public comments on the topic before issuing proposed regulations, as was done in Notice 2000-29 with respect to partnership options and in Notice 2006-14 with respect to possible changes to the regulations under Section 751(b).

We would be happy to discuss these issues with you further.

Sincerely,



Jeffrey D. DeBoer
President and Chief Executive Officer

cc: Curtis G. Wilson, Internal Revenue Service
Clifford Warren, Internal Revenue Service
Lisa M. Zarlenga, US Department of the Treasury
Jenny Alexander