[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-126285-12]

RIN 1545-BL06

Partnerships; Start-up Expenditures; Organization and Syndication Fees

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations concerning the deductibility of start-up expenditures and organizational expenses for partnerships. The proposed regulations provide guidance regarding the deductibility of start-up expenditures and organizational expenses for partnerships following a technical termination of a partnership.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-126285-12), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-126285-12), Courier's Desk, Internal Revenue Service, 1111 Constitution

Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking portal at www.regulations.gov (IRS REG-126285-12)

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David H. Kirk or Rachel Smith at (202) 317-6852; concerning submissions of comments or to request a hearing, Oluwafunmilayo Taylor, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 708(b) of the Internal Revenue Code (Code).

1. Section 708: Continuation of Partnership

Section 708(a) generally provides that, for purposes of subchapter K of chapter 1 of subtitle A of Title 26, an existing partnership shall be considered as continuing if it is not terminated.

Section 708(b)(1) provides that, for purposes of section 708(a), a partnership shall be considered as terminated only if (A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or (B) 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.

Section 1.708-1(b)(4) of the Income Tax Regulations provides that if a partnership is terminated by a sale or exchange of an interest, the following is

deemed to occur: the partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; immediately thereafter, the terminated partnership distributes 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, either for the continuation of the business by the new partnership or for its dissolution and winding up.

2. Section 195 Start-up Expenditures

Section 195(a) provides that, except as otherwise provided in section 195, no deduction shall be allowed for start-up expenditures (as defined in section 195(c)(1)). Section 195(b)(1) provides that a taxpayer may elect to deduct start-up expenditures as provided in section 195(b)(1)(A) and (B).

Section 195(b)(1)(A) allows an electing taxpayer to deduct start-up expenditures in the taxable year in which the active trade or business begins. The amount that may be deducted under section 195(b)(1)(A) in that year is the lesser of (i) the amount of start-up expenditures with respect to the active trade or business, or (ii) $5,000, reduced (but not below zero) by the amount by which the start-up expenditures exceed $50,000.

Section 195(b)(1)(B) provides that any start-up expenditures that are not deductible under section 195(b)(1)(A) shall be allowed as a deduction ratably over the 180-month period beginning with the month in which the active trade or business begins. All start-up expenditures that relate to the active trade or business are considered in determining whether the start-up expenditures

exceed $50,000, including expenditures incurred on or before October 22, 2004. Section 902(a) of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 ("AJCA"), amended section 195(b)(1) for start-up expenditures paid or incurred after October 22, 2004. Prior to the AJCA amendment, section 195(b)(1) (former section 195(b)(1)) allowed taxpayers to elect to treat such expenditures as deferred expenses deductible ratably over a period of at least 60 months.

Section 1.195-1(b) provides that, for start-up expenditures paid or incurred after August 16, 2011(the effective date of §1.195-1(b)), a taxpayer is deemed to make an election under section 195(b) to amortize start-up expenditures for the taxable year in which the active trade or business to which the expenditures relate begins. However, taxpayers may apply all provisions of §1.195-1 to start-up expenditures paid or incurred after October 22, 2004, provided that the period of limitations on assessment of tax for the year the election under §1.195-1(b) is deemed made has not expired.

Section 195(b)(2) provides that in any case in which a trade or business is completely disposed of by the taxpayer before the end of the amortization period, any deferred expenses attributable to such trade or business that were not allowed as a deduction by reason of section 195 may be deducted to the extent allowable under section 165.

3. Section 709: Treatment of Organization and Syndication Fees

Section 709(a) provides that, except as otherwise provided in section 709(b), no deduction shall be allowed for any amounts paid or incurred to

organize a partnership or to promote the sale of (or to sell) an interest in the partnership. Section 709(b) provides that a partnership may elect to deduct organizational expenses, within the meaning of section 709(b)(3), as provided in section 709(b)(1)(A) and (B).

Section 709(b)(1)(A) allows an electing partnership to deduct organizational expenses in the year in which the partnership begins business. The amount that may be deducted under section 709(b)(1)(A) in that year is the lesser of (i) the amount of the organizational expenses of the partnership, or (ii) $5,000, reduced (but not below zero) by the amount by which the organizational expenses exceed $50,000.

Section 709(b)(1)(B) provides that any organizational expenses that are not deductible under section 709(b)(1)(A) shall be allowed as a deduction ratably over the 180-month period beginning with the month in which the partnership begins business. All organizational expenses incurred by the partnership are considered in determining whether the organizational expenses exceed $50,000, including expenses incurred on or before October 22, 2004. Prior to October 22, 2004, section 709(b) contained a rule similar to former section 195(b)(1).

Section 1.709-1(b)(2) provides that, for organizational expenses as defined in section 709(b)(3) and §1.709-2(a) paid or incurred after August 16, 2011 (the effective date of §1.709-1(b)(2)), a partnership is deemed to make an election under section 709(b) to amortize organizational expenses for the taxable year in which the partnership begins business. However, taxpayers may apply all provisions of §1.709-1 to organizational expenses paid or incurred after October

22, 2004, provided that the period of limitations on assessment of tax for the year the election under §1.709-1(b)(2) is deemed made has not expired.

Section 709(b)(2) provides that in any case in which a partnership is liquidated before the end of the amortization period, any deferred expenses attributable to the partnership that were not allowed as a deduction by reason of section 709 may be deducted to the extent allowable under section 165. See also §1.709-1(b)(3). However, there is no partnership deduction with respect to its capitalized syndication expenses. Id.

Explanation of Provisions

The Treasury Department and the IRS are aware that some taxpayers are taking the position that a technical termination under section 708(b)(1)(B) entitles a partnership to deduct unamortized start-up expenses and organizational expenses to the extent provided under section 165. The Treasury Department and the IRS believe this result is contrary to the congressional intent underlying sections 195, 708, and 709. Therefore, the proposed regulations amend §1.708-1 to provide that a new partnership formed due to a transaction, or series of transactions, described in section 708(b)(1)(B) must continue amortizing the section 195 and section 709 expenses using the same amortization period adopted by the terminating partnership.

The legislative purpose of sections 195 and 709 was to allow expenses incurred in the formation of a partnership to be deducted ratably over the period during which the partnership benefits from those initial expenses. Section 195 and 709 provide that this period begins with the commencement of business

(which must be an active trade or business in the case of section 195) and closes after 180 months, or when the business ceases, if earlier. The Treasury Department and the IRS believe that a technical termination under section 708(b)(1)(B) should not constitute a cessation of a trade or business to which the section 195 or section 709 expenses relate, nor does it otherwise constitute the type of disposition or liquidation that should trigger deduction of deferred section 195 or section 709 expenses.

Moreover, the Conference Report issued in conjunction with the enactment of AJCA treated start-up expenditures under section 195 and organizational expenditures under section 709 as analogous to other intangible business assets described in section 197, and accordingly determined that the period for the amortization of start-up expenditures and organizational expenditures should be consistent with the fifteen year amortization period for section 197 intangibles. H. Rep. No. 108-755, at 776-77 (October 07, 2004). Section 1.197-2(g)(2)(ii)(B) provides, generally, that in the case of a section 721 transaction in which an amortizable section 197 intangible is transferred to a partnership, the transferee partnership will continue to amortize its adjusted basis, to the extent it does not exceed the transferor's adjusted basis, ratably over the remainder of the transferor's 15-year amortization period. Section 1.197-2(g)(2)(iv)(B) provides that in applying §1.197-2(g)(2)(ii)(B) to a partnership that is terminated pursuant to section 708(b)(1)(B), the terminated partnership is treated as the transferor and the new partnership is treated as the transferee with respect to any section 197 intangible held by the terminated partnership

immediately preceding the termination. Consistent with Congress' intent of aligning the amortization of start-up and organizational expenditures with the treatment of section 197 intangibles, the new partnership resulting from a technical termination under section 708(b)(1)(B) should similarly continue to amortize the section 195 and section 709 expenses using the same amortization period adopted by the terminated partnership.

Practitioners suggested guidance on this issue to alleviate uncertainty regarding the proper treatment of these items when a partnership undergoes a technical termination. One alternative to the rule set forth above would allow the terminating partnership to immediately deduct any unamortized section 195 or section 709 items to the extent provided under section 165 on the effective date of the termination (as defined in §1.708-1(b)(3)(ii)). However, the Treasury Department and the IRS decline to adopt this alternative, which as noted above would be inconsistent with Congress' intent to treat section 195 and section 709 items consistently with section 197 intangibles, and which might provide incentives for taxpayers to structure transactions in order to inappropriately accelerate the deduction of section 195 or section 709 expenses shortly after those expenses are incurred.

Proposed Effective/Applicability Date

These regulations, when published in their final form in the **Federal Register**, will apply to technical terminations that occur on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is David H. Kirk, IRS Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.195-2 is added to read as follows:

§1.195-2 Technical termination of a partnership.

(a) In general. If a partnership that has elected to amortize start-up expenditures under section 195(b) and §1.195-1 terminates in a transaction (or a series of transactions) described in section 708(b)(1)(B) or §1.708-1(b)(2), the termination shall not be treated as resulting in a disposition of the partnership's trade or business for purposes of section 195(b)(2). See §1.708-1(b)(6) for rules concerning the treatment of these start-up expenditures by the new partnership.

(b) Effective/applicability date. This section applies to a technical termination of a partnership under section 708(b)(1)(B) that occurs on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Par. 3. Section 1.708-1 is amended by adding paragraph (b)(6) to read as follows:

§1.708-1 Continuation of partnership.

* * * * *

(b) * * *

(6) Treatment of certain start-up or organizational expenses following a technical termination--(i) In general. If a partnership that has elected to amortize start-up expenditures under section 195(b) or organizational expenses under section 709(b)(1) terminates in a transaction (or a series of transactions) described in section 708(b)(1)(B) or paragraph (b)(2) of this section, the new partnership must continue to amortize those expenditures using the same amortization period adopted by the terminating partnership. See section 195 and §1.195-1 for rules concerning the amortization of start-up expenditures and section 709 and §1.709-1 for rules concerning the amortization of organizational expenses.

(ii) Effective/applicability date. This paragraph (b)(6) applies to a technical termination of a partnership under section 708(b)(1)(B) that occurs on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

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Par. 4. Section 1.709-1 is amended by:

1. Designating the text in paragraph (b)(3) as paragraph (b)(3)(i) , adding a heading to newly designated paragraph (b)(3)(i) and adding paragraph (b)(3)(ii);

2. Adding a sentence at the end of paragraph (b)(5).

The additions read as follows:

§1.709-1 Treatment of organization and syndication costs.

* * * * *

(b) * * *

(3) Liquidation of partnership--(i) In general. * * *

(ii) Technical termination of a partnership. If a partnership that has elected to amortize organizational costs under section 709(b) terminates in a transaction (or a series of transactions) described in section 708(b)(1)(B) or §1.708-1(b)(2), the termination shall not be treated as resulting in a liquidation of the partnership for purposes of section 709(b)(2). See §1.708-1(b)(6) for rules concerning the treatment of these organizational costs by the new partnership.

* * *

(5) * * * Paragraph (b)(3)(ii) of this section applies to a technical termination of a partnership under section 708(b)(1)(B) that occurs on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Heather C. Maloy

Deputy Commissioner for Operations Support.

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