INTERNAL REVENUE SERVICE

NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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District Director

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:
Date of Conference:

LEGEND:

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

D9 =

D10 =

D11 =

D12 =

Year 1 =

A =

B =

X =

Y =

Z =

P1 =

P2 =

P3 =

n1 =

n2 =

n3 =

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n47 =

n48 =

n49 =

n50 =

n51 =

n52 =

n53 =

n54 =

TR1 =

TR2 =

TR3 =

TR4 =

TR5 =

TR6 =

REIT =

ISSUE(S):

(1) Whether the transactions resulting in the reconfiguration of P1 into an umbrella partnership real estate investment trust effectuated a disguised sale of a portion of the Original Partners interests in P1 to P3 and REIT?

(2) Alternatively, should the distribution of the Loans from P1 to P2 be treated as a distribution of the Loans to the Original Partners?

CONCLUSION(S):

The transactions resulting in the reconfiguration of P1 into an umbrella partnership real estate investment trust effectuated a disguised sale of a portion of the Original Partners' interests in P1 to P3 and REIT. Alternatively, the transactions resulting in the reconfiguration of P1 into an umbrella partnership real estate investment trust effectuated a disguised sale of a portion of P2's partnership interest in P1 to P3 and REIT.

The distribution of the Loans from P1 to P2 should be treated as a distribution to the Original Partners.

FACTS:

Prior to D1, A was the principal shareholder of X, a real estate management corporation in the business of leasing and managing large regional shopping centers in the United States. The shopping centers were originally owned by separate partnerships with various partners.

On D1, P1 was formed by A, X, other members of A's family, and other executives and investors (the "Original Partners"). The P1 partnership agreement contemplated that P1 would lend n1 dollars to the Original Partners, except X.

On D1, TR1 and TR2 made a nonrecourse loan (the "TR Loan") to P1 in the principal amount of n2 dollars, of which n3 dollars was loaned in cash, n4 dollars was deposited into escrow, and n5 dollars was deducted in advance from the principal amount of the loan as original issue discount.

The TR Loan terms contemplated P1's loan of n1 dollars to the Original Partners, except X, and provided that the funds received by P1, other than the n4 dollars deposited into the escrow fund, were to be loaned to the Original Partners, except X. The TR Loan required interest to be paid on the D2 of each month with an interest rate of n6% annually through D3, and at n7% annually from D4 with the principal amount outstanding due in n8 installments dating from D4 through D5.

On D1, TR1 and TR2 paid n9 dollars to P1 in exchange for an option (the "TR Option") to acquire a n10% limited partnership interest in P1. The TR Option agreement contemplated P1's loan of n1 dollars to the Original Partners, except X. The TR Option could not be exercised prior to D6 and was to expire on D4. The exercise price of the TR Option was an amount not less than n11 dollars, equal to the sum of the principal amount of the TR Loan outstanding and the aggregate amount of all capital distributions previously made, and less n12 dollars. The initial exercise price of the TR Option was n13 dollars.

On D1, P1 used the n1 cash proceeds received from the TR Loan and TR Option to make secured term loans (the " Loans") to each of the Original Partners except X (the " Borrowers"), in proportion to each partner's percentage in P1.

N14% of each Borrower's share of the Loans, a total of n15 dollars, was paid into an escrow fund and n16% of each Borrowers share of the Loans, a total of n17 dollars, was retained by P1 and credited to the Borrower's capital accounts as contributions to capital. The provide that interest on the Loans is to be paid monthly out of the funds deposited into the escrow fund. The Loans had a fixed annual interest rate of n18% payable monthly in arrears. Prepayment of the Loans is not permitted except in limited circumstances.

The Borrowers and X pledged as security for the Loans: (1) their partnership interests in P1; (2) their interest in the escrow fund; (3) all other monies and property deposited by or received for their account, such monies and property held by P1; and (4) distributions made prior to a certain date, such distributions to be deposited into the escrow fund.

P1 pledged as security for the TR Loan: (1) its interest in the shopping centers and the parcels of land adjacent to or related to such shopping centers; (2) its beneficial interest in the TR6, a trust established on D1 having A as its sole Trustee and P1 as its sole beneficiary; (3) the capital stock of Y, a corporation wholly owned by P1; (4) the Loans; (5) its interest in the TR Loan escrow fund; (6) its security interest in the partnership interests of the Borrowers and X; and (7) any other security given to P1 by the Borrowers as security for the Loans.

On D7, TR3 purchased an n19% interest in the TR Option and the TR Loan from TR1 and TR2.

In Year 1, A, P1, the Original Partners, TR1, TR2, and TR3 decided to reconfigure P1 as an umbrella partnership with an initial public offering of a Real Estate Investment Trust (the "Reconfiguration"). The parties implemented a plan to sell shares of REIT to the public, admit REIT, TR1, and TR2 as general partners in P1 and qualify

REIT as a Real Estate Investment Trust.

On D8 P2 was formed. The Original Partners contributed n20% of their P1 partnership interests to P2 in return for n21% of the P2 partnership interests valued at n22 dollars. TR4 made a contribution of n23% of its n24% interest in the B shopping center valued at n25 dollars in exchange for an n26% limited partnership interest in P2. The grantor of TR4 is a close personal friend of A. Z, a corporation wholly owned by TR5 (an Original Partner), a revocable trust owned by A, contributed a note in the amount of n27 dollars to P2 in exchange for a n28% general partnership interest in P2.

Fourteen days later, on D9, P2 contributed its n29% interest in the B shopping center, originally contributed to P2 by TR4 to P1. TR4 contributed its remaining n8% interest in the B shopping center to P1 in exchange for an n30% limited partnership interest in P1.

On D10, TR1, TR2, and TR3 released their security interests in the Loans and the Borrower's P1 partnership interests as collateral for the TR Loan in consideration for A and other members of the Original Partners guaranties in favor of TR1, TR2, and TR3 as security for the TR Loan.

On D10, P1 transferred the Loans, with a fair market value of n31 dollars and a book value of n1 dollars to P2. Each Borrower pledged its interest in P2 to P2 and agreed that such partnership interest, together with its interest in the restated escrow fund, and all other monies and property deposited by it or received for its account, would be held by P2 as security for the Loans. All operating distributions from P2 to any Borrower were required to be deposited into the restated escrow funds.

On D11, REIT made its initial public offering of stock as a Real Estate Investment Trust, selling n32% of its shares to the public.

On D9 REIT transferred n33 dollars and n34 of its shares to P3, a partnership formed by TR1 and TR2, and P3 transferred n35% of its interest in the TR Loan and its n36% interest in the TR Option to REIT. REIT transferred N37 dollars and n38 of its shares to TR3, and TR3 transferred its n19% interest in the TR Loan and its n19% interest in the TR Option to REIT.

On D9 REIT contributed to P1: (1) the TR Option; (2) its interest in the TR Loan; (3) payment of n39 dollars in expenses incurred by P1 during REIT's initial public offering, in exchange for a n40% general partnership interest in P1.

On D9 P3 contributed its remaining portion of the TR Loan, valued at n41 dollars, to P1 in exchange for a n42% general partnership interest in P1. As a result of these transactions the TR Loan, which represented a n53 dollar liability to P1 was retired.

On D12, as part of the Reconfiguration, REIT purchased a n43% interest in P1 from P3, leaving REIT with a n44% interest in P1 and P3 with an n45% interest in P1.

After the Reconfiguration, REIT was held n32% by the public, n46 by TR3, n47% by P3, and n48% by the Original Partners.

After the Reconfiguration, P1 was held n49% by REIT, n45% by P3, n50% by P2, n51% by the Original Partners. The Original Partner's interest in P1 included its n51 direct interest in P1 and its n21% interest in P2's n50% interest in P1 and its n48% interest in REIT's n49% interest in P1. The Original Partner's aggregate partnership interest in P1 was n52%.

Pursuant to the Reconfiguration the escrow fund was restated. For each of the Borrowers, a sub-escrow account was established as part of the restated escrow fund. Each sub-escrow account was allocated a portion of the funds which were deposited in the restated term loan escrow account at its inception. For each of the Borrowers, the amount deposited in the sub-escrow account at its inception was sufficient to pay the interest owed by that borrower to P2 for one month. On the D2 day of each month, a withdrawal is made from each sub-escrow account of the amount needed to pay the interest for one month to P2 for that Borrower. On the same day P2 distributes n45% of its available cash to all of its partners.

LAW AND ANALYSIS:

Issue One: Disguised Sale of a Partnership Interest

Background of section 707(a)(2)(B)

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property, such transfers shall be treated either as occurring between the partnership and one who is not a partner, or as a transaction between two or more partners acting other than in their capacity as members of the partnership.

The legislative history of section 707(a)(2)(B) indicates that the provision was adopted as a result of Congress' concern that taxpayers were deferring or avoiding tax on sales of partnership property, including sales of partnership interests, by characterizing sales as contributions of property, including money, followed or preceded by a related partnership distribution. *See* S. Prt. No. 169, (Vol. I), 98th Cong., 2d Sess. 225 (1984)(hereinafter "S. Prt."); H.R. Rep. No. 432, (Pt. 2) 98th Cong., 2d Sess. 1218 (1984) (hereinafter "H.R. Rep."). Specifically, Congress was concerned about court decisions that allowed tax-free treatment in cases which were economically indistinguishable from sales of property to a partnership or another partner. *See* S. Prt. at 225; H.R. Rep. at 1218 (discussing *Jupiter Corp. v. United States*, No. 83-842 (Ct. Cl. 1983) and *Communications Satellite Corp. V. United States*, 223 Ct. Cl 253 (1980) both of which involved the disguised sale of a partnership interest). Congress believed that these transactions should be treated for tax purposes in a manner consistent with their underlying economic substance. *See* S. Prt. at 225; H.R. Rep. at 1218.

In the legislative history to section 707(a)(2)(B), Congress explained that pursuant to section 721, gain or loss is generally not recognized on the contribution of property to a partnership in return for a partnership interest, and pursuant to section 731 distributions of money from a partnership to a partner are generally tax-free to the extent of the adjusted basis of the recipient partner's interest in the partnership. *See* S. Prt. at 224; H.R. Rep. at 1217. Congress referred to Treasury regulations issued under section 721 and 731 in its discussion of disguised sales. *See* S. Prt. at 224; H.R. Rep. at 1217. The section 721 regulations provide that, if the transfer of property by a partner to a partnership results in the receipt by the partner of money or other consideration, including a promissory obligation fixed in amount and time for payment, the transaction will be treated as a sale or exchange rather than a contribution (Treas. Reg. sec. 1.721-1(a)). *See* S. Prt. at 224; H.R. Rep. at 1217. These regulations require that the substance of the transaction, rather than its form, will govern in such cases. *See* S. Prt. at 224; H.R. Rep. at 1217. The regulations issued under section 731 provide that if a contribution of property is made to a partnership and (1) within a short time before or after such contribution other property is distributed to the contributing partner and the contributed property is retained by the partnership, or (2) within a short time after such contribution to the partnership, contributed property is distributed to another partner, tax free distribution treatment may not apply (Treas. Reg. sec. 1.731-1(c)(3)). *See* S. Prt. at 225; H.R. Rep. at 1217-1218. The regulations deny tax-free treatment if a purported distribution was, in fact, made to effect an exchange of property between two or more of the partners or between the partnership and a partner. *See* S. Prt. at 224-225; H.R. Rep. at 1217-1218.

Congress expressed its concern that the regulations issued under section 721 and 731 may not always prevent de facto sales of property to a partnership or another partner from being structured as a contribution to the partnership, followed or preceded by a tax-free distribution from the partnership. *See* S. Prt. a 225; H.R. Rep. at 1218. Congress specifically discussed case law that permitted results which were economically indistinguishable from a sale of all or part of the property despite the regulations described above and enacted section 707(a)(2)(B) to expressly prohibit such transactions. *See Jupiter Corp. v. United States*, No. 83-842 (Ct. Cl. 1983); *Communications Satellite Corp. v. United States*, 223 Ct. Cl. 253 (1980); S. Prt. at 225; H.R. Rep. at 1218.

<u>Legal Analysis</u>

The Reconfiguration can be viewed as a disguised sale of a partnership interest in either of two ways. As discussed below, P2's ownership of the Loans and interest in P1 lacked economic substance and should be disregarded for Federal income tax purposes. Accordingly, the true economic substance of the Reconfiguration is a disguised sale by the Original Partners of interests in P1 to P3 and REIT. However, even if P2's ownership of the Loans and P1 interest were respected, the Reconfiguration still would represent a disguised sale by P2 of interests in P1 to P3 and REIT.

P2's Ownership of the Loans and P1 Interests Should be Disregarded

To be respected, a transaction must have economic substance separate and distinct from the economic benefit achieved solely by tax reduction. If a taxpayer seeks to claim tax benefits which were not intended by Congress, by means of transactions that serve no economic purpose other than tax savings, the doctrine of economic substance is applicable. *United States v. Wexler*, 31 F.3d 117, 122, 124 (3d Cir. 1994); *Yosha v. Commissioner*, 861 F.2d 494, 498-99 (7th Cir. 1988) *aff'g Glass v. Commissioner*, 87 T.C. 1087 (1986); *Goldstein v. Commissioner*, 364 F.2d 734 (2d Cir. 1966), *aff'g* 44 T.C. 284 (1964); *Weller v. Commissioner*, 31 T.C. 33 (1958), *aff'd*, 270 F.2d 294 (3d Cir. 1959); *ACM Partnership v. Commissioner*, T.C. Memo. 1997-115, *aff'd in part and rev'd in part* 157 F.3d 231 (3d Cir. 1998). Whether a transaction has economic substance is a factual determination. *United States v. Cumberland Pub. Serv. Co.*, 338 U.S. 451, 456 (1950). This determination turns on whether the transaction is rationally related to a useful nontax purpose that is plausible in light of the taxpayer's conduct and useful in light of the taxpayer's economic situation and intentions. The utility of the stated purpose and the rationality of the means chosen to effectuate it must be evaluated in accordance with commercial practices in the relevant industry. *Cherin v. Commissioner,* 89 T.C. 986, 993-94 (1987); *ACM Partnership, supra*.

In determining whether a transaction has economic substance so as to be respected for tax purposes, both the objective economic substance of the transaction and the subjective business motivation must be determined. *ACM Partnership*, 157 F.3d at 247; *Horn v. Commissioner*, 968 F.2d 1229, 1237 (D.C. Cir. 1992); *Casebeer v. Commissioner*, 909 F.2d 1360, 1363 (9th Cir. 1990); *Rice's Toyota World, Inc. v. Commissioner*, 81 T.C. 184 (1983), *aff'd in part and rev'd in part*, 752 F.2d 89 (4th Cir. 1985). The two inquiries are not separate prongs, but are interrelated factors used to analyze whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes. *ACM Partnership*, 157 F.3d at 247; *Casebeer*, 909 F.2d at 1363.

When P2 was formed, the Original Partners contributed interests in P1 to P2, Z contributed a note in the amount of n27 dollars to P2 in exchange for a n28% general partnership interest in P2, and TR4 contributed its interest in the B shopping center (which was contributed to P1 fourteen days later) to P2 in exchange for an n26% limited partnership interest in P2. Z and TR4 were the only partners other than the Original Partners who were partners in P2. Z is a corporation wholly owned by TR5 (an Original Partner), which is a revocable trust wholly owned by A, an Original Partner. TR4 is a revocable trust wholly owned by a close personal friend of A. As among the Original Partners, their interests in P2 were held in the same proportions as their interests in P1.

The insertion of P2 into the Reconfiguration cannot avoid the result that the substance of the Reconfiguration was a sale of a portion of the Original Partners' P1 partnership interests to P3 and REIT. P2's only purpose in the Reconfiguration was to assist the Original Partners in deferring the tax they would have to realize upon a distribution of the Loans. The transfers by Z and TR4 were nominal in comparison to the value of P2 and were made by parties who either were controlled by or had close personal relations with the Original Partners. Absent the participation by Z and TR4, the ownership of P2 was the mirror image of the ownership of P1. The accommodation transfers by Z and TR4 were intended merely to provide P2's ownership of the Loans with some modicum of substance and do not support treating P2 as the true owner of the Loans or the interests in P1. *See Estate of Kamborian*, 469 F.2d 219 (accommodation transfer disregarded in applying section 351); *Professional Services*, 79 T.C. 888 (the transfer of a note to an entity wholly-owned by a taxpayer/debtor has been held to cause debt to be disregarded in an abusive transaction).

The release of the Loans as security for the TR Loans and the subsequent distribution of the Loans to P2, rather than the Original Partners, was an attempt to defer the tax the Original Partners would have to recognize upon a distribution of the Loans to them. As both the borrower and the predominant lender of the Loans, the Original Partners were essentially required to repay themselves the amount due on the loans. P1's distribution of the Loans to P2 was in substance a distribution to the Original Partners. P2's ownership of the Loans should be disregarded and the distribution of the Loans to P2 should be treated as distributions to the Original Partners. *See Merryman*, 873 F.2d 879 (5th Cir. 1989) (court disregarded sale-leaseback to partnership with certain partners who were unrelated to the transferor); *Shaffer Terminals, Inc*., 16 T.C. 356 (1951), *aff'd*, 194 F.2d 539 (9th Cir. 1952) (sale-leaseback to commonly controlled partnership was disregarded); *Unger*, 61-1 USTC ¶ 9163 (sale-leaseback to taxpayer's mother was disregarded); Valley Camp Coal Co. v. Commissioner, T.C. Memo 1967-225 (in substance the taxpayer was the purchaser of the property, the corporation the taxpayer formed was merely a conduit through which the taxpayer paid the purchase price).

The circular manner in which monthly interest is paid on the Loans reinforces the conclusion that P2's ownership of the Loans should be disregarded. Pursuant to the Reconfiguration, the Loan escrow account was restated and a sub escrow account was established for each of the Original Partners. Each sub-escrow account was allocated a portion of the funds deposited in the term loan escrow account at its inception sufficient to pay the interest for one month owed by that borrower. On D2 of each month, a withdrawal was made from each sub-escrow account of the amount needed to pay the interest for one month to P2 for that Borrower. On the same day, a deposit of the same amount was made to each sub-escrow account, which was treated as a distribution from P2. This circular flow of funds leaves both the Original Partners and P2 in the same position as if no monthly interest payment has been made, which supports the conclusion that P2's ownership of the Loans should be disregarded. *See Allen v. Commissioner*, 925 F.2d 348 (1991) (the circular flow of funds through three organizations as a result of the money circle scheme left each of them in essentially the same position as if no contribution had been made).

Disguised Sale by the Original Partners to P3 and REIT

The substance of the Reconfiguration is similar to the substance of the transactions in *Jupiter* and *Communications Satellite*, cases cited by Congress as part of the reason for enacting section 707(a)(2)(B) to prohibit disguised sales of partnership interests. When P1 distributed the Loans to P2, the Original Partners no longer had an obligation to repay P1 the borrowed funds. Although in form the Original Partners still had an obligation to P2 to repay the borrowed funds, the borrowers essentially owed the funds to themselves because they were directly or indirectly both the borrower and the lender of the funds. When P1 distributed the Loans in partial liquidation of P2's (and hence, the Original Partners') interests in P1, and the holders of the TR Loan converted their debt interest into an equity interest in P1 by contributing the TR Loan to P1, a permanent shift in the equity ownership of P1 occurred. The Reconfiguration was in substance a sale by the Original Partners of a portion of their equity interest in P1 to P3 and REIT undertaken through related contributions to and distributions from P1, the kind of transaction that section 707(a)(2)(B) is intended to prevent.

In order to re-characterize a transfer of property to a partnership as a transaction between two or more partners acting other than in their capacity as members of the partnership, section 707(a)(2)(B) requires that three elements be satisfied:

First, there must be a direct or indirect transfer of money or other property by a partner to a partnership. On D9, P3 made a contribution of its interest in the TR Loan, valued at n41 dollars to P1 in exchange for a n42% general partnership interest in P1, and REIT contributed its interest in the TR Option, its interest in the TR Loan, and n39 dollars as payment for expenses incurred by P1 during REIT's initial public offering to P1 in exchange for a n40% general partnership interest in P1. For purposes of the application of the section 707(a)(2)(B) disguised sale rules, both P3 and REIT are treated as partners of P1.

Second, it must be shown that there is a related direct or indirect transfer of money or other property by the partnership to such partner or another partner. On D10, TR1, TR2, and TR3 released their security interests in the Loans and the Borrower's P1 partnership interests as collateral for the TR Loan. Also on D10, P1 transferred the Loans, with a fair market value of n31 and a book value of n1, to P2. Because P2's ownership of the Loans should be ignored for Federal income tax purposes, the Original Partners should be treated as receiving their pro rata share of the Loans distributed to P2 (which effectively resulted in the cancellation of that portion of the Loans).

Third, the transfers described in the previous two paragraphs, when viewed together, must be properly characterized as a sale or exchange of property. Therefore, to satisfy the third requirement of section 707(a)(2)(B) it must be shown that the transfers by REIT and P3 to P1 and the transfer by P1 of the Loans was in substance a sale or exchange of P1 partnership interests between the Original Partners and P3 and REIT.

Prior to the Reconfiguration P3 held no partnership interests in P1. Pursuant to the Reconfiguration, on D9, P3 acquired a direct interest in P1 by contributing its interest in the TR Loan, valued at n41 dollars, to P1 in exchange for a n42% general partnership interest in P1. On D12, P3 sold n43% of its interest in P1 to REIT, which left P3 with an n45% interest in P1 after the Reconfiguration.

Prior to the Reconfiguration, REIT held no partnership interests in P1 and was, in fact, wholly owned by P1. Pursuant to the Reconfiguration, on D9, REIT contributed to P1: (1) the TR Option, acquired that same day from P3 and TR3; (2) its interest in the TR Loan, also acquired that same day from P3 and TR3; and (3) n39 dollars as payment for expenses incurred by P1 during REIT's initial public offering to P1 in exchange for a n40% general partnership interest in P1. REIT then purchased a n43% partnership interest in P1, leaving it with a n44% interest in P1 after the Reconfiguration.

Prior to the Reconfiguration, the Original Partners directly held n54% of the partnership interests in P1. After the Reconfiguration, the Original Partners directly held n51% of the partnership interests in P1 and indirectly held n21% of P2's n50% interest in P1 and n48% of REIT's n49% interest in P1, so that the Original Partners aggregate partnership interest in P1 was n52%. After the Reconfiguration, the Original Partners, in substance, were no longer liable on the Loans.

P1's distribution of the Loans resulted in a n1 dollar decrease in P1 partnership assets. P3 and REIT's related transfers of their interests in the TR Loan, representing an n53 liability to P1 resulted in the elimination of a P1 partnership liability in the amount of n53 dollars. The effect of these related transfers was equivalent to REIT and P3 transferring cash to the Original Partners in exchange for interests in P1, which the Original Partners then used to pay off the Loans owed to P1, which P1 then used to pay off the TR Loan owed to P3 and REIT.

Accordingly, the transfers between P1, P3, and REIT are more properly treated as a sale or exchange of a portion of the Original Partner's P1 partnership interests to REIT and P3, a result that treats the transfers in a manner consistent with their underlying economic substance.

Therefore, we conclude that for purposes of the disguised sale rules under section 707(a)(2)(B), the Reconfiguration was a sale or exchange a portion of the Original Partners' P1 partnership interests to REIT and P3.

Disguised Sale by P2 to P3 and REIT

Even if P2's ownership of the Loans is respected for Federal income tax purposes, the Reconfiguration still should be treated as a disguised sale of a P1 partnership interest by P2 to P3 and REIT. All of the requirements of section 707(a)(2)(B) are satisfied as between P2, on the one hand, and P3 and REIT, on the other.

First, there was a transfer of property (the TR loan and TR Option) by partners (P3 and REIT) to a partnership (P1).

Second, there was a related transfer of property (the Loans) by the partnership (P1) to another partner (P2).

Third, these transfers, when viewed together, are properly viewed as a sale or exchange of property. The substance of the transaction as between P2, and P3 and REIT, was a transfer of a portion of P2's interest in P1 to P3 and REIT in exchange for a third-party note (i.e., P2 became entitled to payments on the Term Loan).

Absence of Regulations Regarding Disguised Sales of Partnership Interests

Although the Service has not promulgated regulations for disguised sales of partnership interests under section 707(a)(2)(B) (Income Tax Regulation Section 1.707-7 is reserved), it may enforce section 707(a)(2)(B) in the context of a disguised sale of a partnership interest in the absence of regulations. *See Pittway Corp. v. United States*, 102 F.3d 932 (7th Cir. 1996) (although the statute provided "to the extent provided in regulations" the plain language of the statue directs a single conclusion); *Estate of Neuman*, 106 T.C 216 (1996) (regulations contemplated under section 2663(2) is not a necessary precondition to the imposition of the generation-skipping transfer tax on transfers involved in the case); Rev. Rul. 91-47 (Service enforced section 108(e)(4), which applies "to the extent provided in regulations" before the regulations were issued). The plain language of the statute, as confirmed by the legislative history, imposes liability on the taxpayer in this case.

Issue Two: Distribution of Notes to the Original Partners

As discussed above, P2's ownership of the Loans should be disregarded for Federal income tax purposes. Accordingly, even if the Reconfiguration is not treated as a disguised sale of a partnership interest under section 707(a)(2)(B), the Loans still should be treated as having been distributed to the Original Partners, thus resulting in a deemed distribution of cash to the Original Partners and gain recognition to the extent of cash deemed to be received in excess of the Original Partners' basis in their partnership interests. § 1.731-1(c)(2).

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.