The Renewed Need for Guidance Addressing Partnership 754 Election Revocations

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The section 754 election of the Internal Revenue Code allows partnerships to make basis adjustments to avoid potentials for double taxation that can arise following transfers of partnership interests and distributions of partnership property. Once made, a 754 election applies to all future tax years and is revocable only with the consent of the Internal Revenue Service (Service). One subsection of the Treasury Regulations addresses when the Service might approve or deny a partnership's request to revoke a 754 election. Despite the process contemplated in this regulation, until recently, partnerships could default out of a 754 election without Service approval through a technical termination. The lack of recorded application of the regulation implies that partnerships have largely not needed to rely on—and the Service has not needed to apply—the 754 election revocation regulation. The repeal of technical terminations under the 2017 Tax Cuts and Jobs Act, however, foreclosed the ability of partnerships to default out of a 754 election, creating not only a renewed permanence of 754 elections but also a new need for guidance concerning requests for revocation. In anticipation of both partnerships' and the Service's need to rely more heavily on requests for 754 election revocation, this Note provides potential factors the Service might use to consider such requests and highlights other ways partnerships might still effect a 754 election revocation without Service approval.

* J.D., University of California, Irvine School of Law, 2020. Many thanks to Professor Omri Marian for his support and guidance, to Professor Victor Fleischer for introducing me to the wild and wonderful world of partnership taxation, and to the SB/SE division of the Laguna Niguel office of the I.R.S. for fostering my exploration into this issue. This Note has benefited from the edits and feedback of Sumouni Basu, as well as the editors and Executive Board of the *UC Irvine Law Review*.

INTRODUCTION

In contrast with corporations, the income of which is taxed separately from that of its owners,[1] partnerships are not taxed as separate entities.[2] The basic premise of partnership taxation under subchapter K of the Internal Revenue Code (Code) is that each partner is individually taxed on her portion of partnership earnings under a system of passthrough taxation.[3] Carrying out this seemingly simple concept of a single level of tax while minimizing opportunities for abuse requires complex mechanics, and partnership tax is often considered one of the most notoriously complicated areas of tax law.[4]

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1. I.R.C. § 11(a).
2. § 701.
3. §§ 702, 704; Duffie v. United States, 600 F.3d 362, 365 (5th Cir.) (describing a partnership as "a conduit through which income passes to its partners, who are responsible for reporting their pro rata share of tax on their individual income tax returns"), *cert. denied*, 562 U.S. 897 (2010).
4. Andrea Monroe, *A People's Subchapter K*, *in* CONTROVERSIES IN TAX LAW: A MATTER OF PERSPECTIVE 133, 136 (Anthony C. Infanti ed., 2015) (describing subchapter K as a system of "enormous complexity"); Blake D. Rubin & Andrea R. Macintosh, *A Code Sec. 754 Paradox: Basis Step-Up Triggers Gain Recognition in Contribution Transactions*, 2 J. PASSTHROUGH ENTITIES 11, 11–13 (1999) (detailing a complicated trap for the unwary that can arise when a 754 electing partnership takes deductions on nonrecourse debt-encumbered property that can result in a cascade of adjustments); Donald J. Weidner, *Transfers of Partnership Interests and Optional Adjustments to Basis*, 10 N.M. L. REV. 51, 51 (1979) (describing subchapter K as giving rise to "much confusion and complexity").

Beyond the garden-variety complexities that exist in the world of partnership taxation,[5] the recent revocation of partnership technical terminations under the 2017 Tax Cuts and Jobs Act (TCJA) created a new wrinkle in partnership tax. The prior technical termination provision of section 708(b)(1) afforded a partnership the ability to treat the partnership as terminated if fifty percent or more of the total interest in partnership capital and profits changed hands in any given year.[6] Through this provision, a partnership could strategically use a changing of the guard (either in reality or on paper) to hit the reset button and be born anew, unhindered by previously made elections.[7] However, following the revocation of 708(b)(1), a partnership that previously made an election under section 754 can no longer use a technical termination to default out of the election.[8] As a result, the 754 election, which was previously considered permanent on paper but navigable in practice,[9] gained a new degree of permanence. Without the ability to strategically use a technical termination to default out of a 754 election, partnerships seeking to revoke such elections will almost certainly be required to turn increasingly to the Internal Revenue Service (Service) for approval.[10]

Although the Code has sanctioned revocation of a 754 election by approval of the Service since codification of the partnership tax regime, it provides only that an election "may be revoked . . . subject to such limitations as may be provided by regulations prescribed by the Secretary."[11] Partnerships that turn to the Treasury Regulations for guidance on the circumstances under which an election may be revoked and what prescribed limitations exist will find little to rely on. The regulatory guidance on revocation of a 754 election is thin and outdated, with only one short subsection, 1.754-1(c)(1), addressing the substantive issue of revocation.[12]

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5. For an example of one such garden-variety complexity, see, for example, Daniel L. Simmons, *The Tax Consequences of Partnership Break-Ups: A Primer on Partnership Sales and Liquidations*, 66 TAX LAW. 653 (2013) (describing the two forms of reducing or eliminating a partner's interest in a partnership as an "excruciatingly complex analysis").

6. I.R.C. § 708(b)(1)(B) (2012), *amended by* I.R.C. § 708(b)(1) (2018).

7. *See infra* Part II.

8. *See infra* Part II. This might be more accurately described not as presenting a new wrinkle but rather as ironing out an old wrinkle that had previously provided potential for abuse. *See infra* Part II.

9. *See* Rubin & Macintosh, *supra* note 4, at 13 (advising of the possibility "to do some creative planning with tiered partnerships to finesse [a 754 election] problem").

10. Arguably, a partnership could use actual termination and formation of a new partnership to remove the election. However, a partnership is considered terminated "only if 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." § 708(b)(1). Furthermore, partnerships could seek to use the provisions on merger or consolidation and division of a partnership to strategically take on tax attributes of another partnership. *See* § 708(b)(2).

11. § 754.

12. For example, regulation section 1.754-1(c)(1) states that a request for revocation should be filed with "the district director for the internal revenue district in which the partnership return is required to be filed." Treas. Reg. § 1.754-1(c)(1) (as amended in 2000). The district director position, however, has not existed since the reorganization of the Service that took place under the Restructuring and Reform Act of 1998. *See* Charles O. Rossotti, *Customer-izing the IRS*, STRATEGY + BUS., Apr. 1, 2001, at 5–6, 11; *see also infra* Part IV.

While the Treasury Department is currently in the process of creating a form for processing 754 election revocation requests,[13] partnerships searching for guidance from prior applications of the 754 revocation regulation will confront an absent record. The regulation's substantive provision on revocation appears entirely unused by partnerships and the Service alike.[14] There appear to be no cases, technical advice memoranda, or private letter rulings applying the section 1.751-1(c)(1) provision addressing revocation. Sources that do cite to the broader provisions of regulation section 1.754-1 consist largely of private letter rulings, which have no precedential effect.[15] These rulings broadly fall into three categories—none of which are particularly illuminative for partnerships seeking information on revoking an election. The first category of rulings grants a partnership's request for extension to file a late 754 election. These rulings, however, are more appropriately considered applications of section 1.754-1(b), which addresses the time and method of making a 754 election,[16] and section 301.9100-1(c), which provides the Service the discretion to grant a partnership a reasonable extension to file a 754 election.[17] The second category of rulings denies a partnership's request for extension to file a late 754 election.[18] Finally, the third category of rulings allows a partnership to revoke a 754 election under the one-time revocation allowance permitted in 1999 under section 1.754-1(c)(2).[19] None of these decisions, however, address or rely on section 1.751-1(c)(1)'s general provision on obtaining approval of a 754 election revocation request. This lack of a record of application may be concerning to a partnership facing a legitimate need to revoke a 754 election. While the 754 election makes for good tax policy by foreclosing the unique potentials for double taxation that arise in the partnership setting,[20] its mechanics can be both administratively burdensome and costly to electing partnerships.

The removal of partnership technical terminations thus creates a new complication not only for partnerships but also for the Service. Partnerships will

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13. On September 10, 2020, the IRS posted in the Federal Register seeking comments on a new form, Form 15254, with which partnerships would submit 754 election revocation requests. Proposed Collection; Comment Request for Form 15254, 85 Fed. Reg. 55,936 (Sept. 10, 2020).

14. For example, former Arthur Anderson partners Glenn E. Dance and John J. Rooney noted that "there are few revoked Code Sec. 754 elections" but provided no examples of any recorded instances of revocation and cited only to the section 754 regulations. Glenn E. Dance & John J. Rooney, *One-Time Opportunity to Revoke Code Sec. 754 Election*, 3 J. PASSTHROUGH ENTITIES 4, 4, 8 n.3 (2000).

15. I.R.C. § 6110(k)(3); *see also Understanding IRS Guidance - A Brief Primer*, IRS, https://www.irs.gov/newsroom/understanding-irs-guidance-a-brief-primer [https://perma.cc/7LHX-Y75N] (Sept. 24, 2020).

16. Treas. Reg. § 1.754-1(b) (as amended in 2000).

17. Treas. Reg. § 301.9100-1(c) (1997); *see* I.R.S. Priv. Ltr. Rul. 201709009 (Nov. 29, 2016); I.R.S. Priv. Ltr. Rul. 201704015 (Oct. 18, 2016); I.R.S. Priv. Ltr. Rul. 201519023 (Jan. 20, 2015).

18. *See* I.R.S. Priv. Ltr. Rul. 201002026 (Sept. 25, 2009); I.R.S. Priv. Ltr. Rul. 200917018 (Jan. 16, 2009); I.R.S. Priv. Ltr. Rul. 200626003 (Feb. 28, 2006).

19. *See* I.R.S. Priv. Ltr. Rul. 200123049 (Mar. 12, 2001); I.R.S. Priv. Ltr. Rul. 200120023 (Feb. 13, 2001).

20. *See infra* Section I.A.

now need to calibrate the decision to make a 754 election without the option to default out of it via a technical termination and without any practical sense of the likelihood of the Service approving a request for revocation. Additionally, and importantly, the Service should create a process and systematic approach for receiving, assessing, and responding to partnership requests to revoke 754 elections.[21]

This Note offers preliminary considerations of what information will be necessary for the proper evaluation of a request to revoke an outstanding 754 election and proceeds in five parts. Part I describes the 754 election, its history, and mechanics. Part II provides a brief background on the repeal of partnership technical terminations under the TCJA and highlights other ways partnerships may seek to effect 754 election revocation without the Service's approval. Part III assesses concerns the Service might have with allowing revocation of 754 elections and explores the mechanisms that currently exist to curb or prohibit such abuse. Part IV details current guidance on requesting revocation of a 754 election. In light of these preexisting guidelines, Part V concludes by detailing factors the Service should assess when reviewing a partnership's request for 754 election revocation and exploring what process the Service might use to handle such requests for revocation.

I. THE 754 ELECTION

Partnership capital accounts provide the mechanism through which a partnership ensures each partner is properly taxed on his or her portion of partnership income, gain, or loss. Each partner's ownership interest in the partnership, or partnership interest, has three important values that are tracked through partnership capital accounts. The first value is the partner's book capital account, which measures a partner's economic interest in the partnership and reflects an approximation of what a partner would receive on liquidation of the partnership.[22] The second value is "outside basis," which reflects a partner's basis in her partnership interest.[23] The third value is the partner's tax capital account,

21. Although the Service is in the process of creating such an approach with the introduction of a 754 election revocation request form, Form 15254, the request for comment published to the Federal Register noted that this form will use the "same data collected from partnerships on the Form 1065 U.S. Return of Partnership Income and will be used to contact the partnership and make a determination regarding whether the Section 754 revocation request will be approved or denied." As such, the Service's proposed approach does not appear to provide it with information beyond that which is already available to the Service. Proposed Collection; Comment Request for Form 15254, 85 Fed. Reg. 55,936 (Sept. 10, 2020).

22. *See* Andrea Monroe, *What We Talk About When We Talk About Tax Complexity*, 5 MICH. BUS. & ENTREPRENEURIAL L. REV. 193, 194 n.3 (2016). This is a generalized description, as book capital accounts are not regularly updated to reflect market changes in the value of partnership property in the absence of an event triggering revaluation. *See* Treas. Reg. § 1.704-1(b)(2)(iv)(f) (2019).

23. *See* Donald J. Weidner, *Optional Adjustments to Basis of Partnership Property on Transfer of Partnership Interests*, 25 ANN. TAX CONF. 9, 22 (1979).

which reflects the partner's contribution to "inside basis."[24] Tax capital accounts for a partner's contribution to the basis with which a partnership holds partnership property.

A. The Need for a 754 Election

To provide a simple example of partnership capital account rules and the issue that underscores the policy behind the 754 election, consider the following: *A* and *B* form AB Partnership with each partner contributing $3,000 cash in exchange for an equal fifty percent interest in the partnership's capital, profits, and losses. The partnership receives *A* and *B*'s contributed property (here, the cash) with transferred basis from each contributing partner,[25] and *A* and *B* each take their partnership interest with both an inside and an outside basis of $3,000 under section 722.[26] The opening balance sheet of AB Partnership will be as follows:

	Assets	
	Adjusted Basis	*Book Value*
Cash	$6,000	$6,000
Total	$6,000	$6,000

Liabilities
$0

	Capital Accounts		
	Tax Capital (Share of Inside Basis)	*Book Capital*	*Outside Basis*
A	$3,000	$3,000	$3,000
B	$3,000	$3,000	$3,000
Total	$6,000	$6,000	$6,000

Notably, the inside basis and outside basis capital accounts for both *A* and *B* are in perfect parity. This inside-outside-basis equivalence is fundamental to the structure of partnership taxation.[27] However, it becomes easily distorted as illustrated below.

Continuing on with this example, in year one, shortly after formation, AB partnership uses *A* and *B*'s combined cash contributions to purchase property for $6,000. This property skyrockets in value to $18,000 and *B* decides to sell her partnership interest to *C* for $9,000 before the close of this first year. Upon the sale of *B*'s interest to *C*, *B* recognizes $6,000 of gain under section 741.[28] In turn, upon purchasing *B*'s interest, section 742 provides that *C*'s basis in her partnership

24. *See id.*

25. I.R.C. § 723.

26. Section 722 directs outside basis to be calculated as the amount of contributed money, plus the adjusted basis of any contributed property and any gain recognized under section 721(b). § 722. Additionally, where liabilities are present, section 752 provides for adjustments to outside basis. § 752.

27. Philip F. Postlewaite, *Optional Basis Adjustments Under Subchapter K: Trap for the Unwary, Tax Planning Tool, or Both? Should They Be Mandatory?*, 15 FLA. TAX REV. 105, 108 (2014).

28. § 741.

interest is determined under the general basis rules found in part II of subchapter O of the Code.[29] As such, *C* takes her partnership interest with a purchase price outside basis of $9,000.[30] Furthermore, if AB Partnership does not file a 754 election, under the general rule of section 743(a), the basis of partnership property is not adjusted as the result of the transfer of *B*'s partnership interest to *C*.[31] As such, *C* steps into *B*'s shoes for the purposes of inside basis and, following the transfer of *B*'s partnership interest to *C*, AB Partnership's balance sheet will appear as follows:

	Assets		
	Adjusted Basis	*Book Value*	
Property	$6,000	$18,000	
Total	$6,000	$18,000	

Liabilities
$0

	Capital Accounts		
	Tax Capital (Share of Inside Basis)	*Book Capital*	*Outside Basis*
A	$3,000	$9,000	$3,000
C	$3,000	$9,000	$9,000
Total	$6,000	$18,000	$12,000

Here, while the inside basis and outside basis of *A*'s capital account remains balanced, there is a $6,000 difference between *C*'s inside basis and outside basis. If AB partnership then sells the partnership property for its fair market value of $18,000, *A* and *C* will each be attributed half of the $12,000 gain resulting from the sale. Following the sale of the property, *A*'s and *C*'s tax capital and book capital accounts will both reflect $9,000. *A*'s outside basis in her partnership interest will also be $9,000 following the sale of the appreciated property. *C*'s outside basis in her partnership interest, however, will be $15,000, incorporating both the $9,000 *C* paid to purchase her partnership interest and the $6,000 of gain attributed to *C* from the sale of the partnership property. In effect, the gain in partnership property—attributable first to *B*, then to *C*—has been taxed twice; once when *B* sold her interest to *C* and again when the partnership sold the property itself.[32]

An opportunity to resolve this instance of double taxation will present itself when *C* sells her interest in the partnership. For example, if immediately following the sale of the partnership property *C* were to sell her partnership interest for its

29. § 742.
30. § 1012.
31. § 743(a).
32. BNA's popular tax portfolio succinctly notes that without an adjustment, "the sale of a partnership interest can lead to double taxation. The transferor partner is taxed on the sale of the interest, reflecting the built-in gain in partnership property, and the transferee partner is taxed on the transferee's share of partnership gain from the sale of a partnership asset due to the same built-in gain." Lisa M. Starczewski, *Partnerships — Allocation of Liabilities; Basis Rules*, 714-4th Tax Mgmt. Portfolios (BNA), at VII.A(1) (2020).

market value of $9,000, *C* would claim a loss of $6,000. However, the possibility to address an instance of double taxation at the time of an eventual sale of a partnership interest does not necessarily resolve the issues of timing and character of income that can be raised by an inside-outside-basis disparity, such as that highlighted in the above example.[33]

Moreover, while the potential for short-term double taxation might inflame taxpayer senses and highlight the benefit of the resolution offered by the section 754 election, there is another side to inside-outside-basis disparities. Just as an inside-outside-basis disparity presents an opportunity for a duplication of taxable gain, so does it present an opportunity for duplication of taxable losses and loss gaming. While taxpayers are less likely to find offense with the potential to duplicate losses, it is precisely this potential that both Congress and the Service find concerning because of its ability to reduce the revenue.[34]

Returning to the example above to illustrate, if AB Partnership purchased property for $6,000 which quickly declined in value to $2,000 before *B* sold her interest to *C* in year one, an opportunity to duplicate losses arises. First, *B* would claim a $2,000 loss on the sale of her partnership interest to *C* (for which *C* would only be willing to pay $1,000). If AB Partnership then sold the property following *B*'s sale of her interest to *C*, *C* would be attributed half of the loss from the sale of partnership property. As such, without a 754 election, both *B* and *C* have an opportunity to claim the tax loss. Again, this instance of double taxation should ultimately be resolved when *C* sells her partnership interest. While Congress and the Service are primarily concerned with loss gaming because of its potential negative impact on revenue, a partnership wishing to avoid these issues altogether may file an election under section 754 of the Code.

B. History of the 754 Election

The 754 election has been part and parcel of the Code's partnership taxation provisions since subchapter K was first codified in 1954.[35] Prior to the enactment of subchapter K, the Code lacked any sort of basis adjustment provisions for instances involving sales or transfers of partnership interests or involving distributions of partnership property.[36] In cataloguing the introduction of section 754 to the Code, Professor Philip Postlewaite notes that the original approach

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33. Edward J. Buchholz, *New Regulations Amend Partnership Basis Step-Up Provisions Under Code Secs. 734, 743 and 755*, 3 J. PASSTHROUGH ENTITIES 39, 39 (2000) (noting that inside-outside-basis disparities can lead to double taxation, change in the character of income, increased or decreased loss or gain to a purchasing partner or remaining partners upon disposition of partnership property, or accelerated recognition by some partners of income or gain attributable to other partners).

34. Monroe, *supra* note 22, at 204–05 (noting that "[s]hifting transactions, particularly loss shifting transactions, have thus remained a persistent problem in partnership taxation" and that Congress has enacted specific Code sections, such as 704(c)(1)(C), to prevent loss shifting).

35. S. REP. NO. 83-1622, at 89–100 (1954), *as reprinted in* 1954 U.S.C.C.A.N. 4621, 4721–33; H.R. REP. NO. 83-1337, at 65–72 (1954), *as reprinted in* 1954 U.S.C.C.A.N. 4017, 4091–99.

36. Postlewaite, *supra* note 27, at 113.

proposed by the American Bar Association (ABA) and the American Law Institute (ALI) would have made the basis adjustments accessible through a 754 election the default, with the exception being an election to opt out.[37] Ultimately, the House reversed this proposed approach and made basis adjustments the exception available through election rather than the norm.[38]

The House had two prominent reasons for reversing the scheme originally proposed by the ABA and the ALI. First, at the time subchapter K was codified, "Congress did not believe that the revenue stakes in partnership tax were particularly high."[39] Second, the House Committee on Ways and Means (Committee) believed few partnerships would opt in to the basis adjustment scheme available through a 754 election given the additional administrative burden it would impose.[40]

Recent data reveals that Congress was mistaken about the revenue implicated by partnership transactions.[41] In 2013, approximately 3.5 million partnerships and 4.3 million S corporations filed tax returns.[42] More recently, in 2017, 3.9 million partnerships filed tax returns on behalf of an estimated total of 27.5 million partners accounting for a total net income of over $810 billion.[43] It appears, however, that Congress was correct when it predicted that few partnerships would opt in to 754's basis adjustment scheme. In 2013, of the approximately 3.5 million partnership filers, the Service recorded less than 200,000 partnerships with a 754 election on file.[44]

C. Basis Adjustments Accessible with a 754 Election

The 754 election makes available the adjustments to basis found in sections 743(b) and 734(b) of the Code.[45] These adjustments resolve potential disparities between a partnership's inside basis and outside basis that result from transfers of partnership interests or distributions of partnership property. Once a partnership

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37. *Id.* at 114.

38. *Id.*

39. Monroe, *supra* note 4, at 136.

40. Postlewaite, *supra* note 27, at 114 n.15.

41. Monroe, *supra* note 4, at 138.

42. *SOI Tax Stats - Partnership Statistics by Entity Type*, IRS, at tbl.9a, https://www.irs.gov/statistics/soi-tax-stats-partnership-statistics-by-entity-type [https://perma.cc/65MH-WBE2] (Sept. 10, 2020) (approximating 3.46 million partnership filers). To review information in the table, download the Microsoft Excel spreadsheet. *See also Hearing on How Tax Reform Will Grow Our Economy and Create Jobs: Hearing Before the H. Comm. on Ways & Means*, 115th Cong. 282 (2017) [hereinafter *Hearing*] (statement of G. William Hoagland, Senior Vice President, Bipartisan Policy Center) (approximating 3.6 million partnership filers).

43. *SOI Tax Stats – Partnership Statistics by Entity Type*, *supra* note 42, at tbls.9a, 9b & 9c. To review information in the tables, download the Microsoft Excel spreadsheets.

44. INTERNAL REVENUE SERV., PUB. 5035 (REV. 9-2015), PARTNERSHIP RETURNS LINE ITEM ESTIMATES 2013, at 1, 5 (2013), http://www.irs.gov/pub/irs-soi/13palineitemestimates.pdf [https://perma.cc/N7M4-E3J4]. Professor Monroe notes that this represented roughly 5.5% of partnership filers for the 2013 tax year. Monroe, *supra* note 22, at 211 n.67.

45. I.R.C. § 754.

makes a 754 election, both section 743(b) and 734(b) adjustments must be made "to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years."[46] As such, partnerships that choose to make basis adjustments for transfers of partnership property and partnership interests via a 754 election opt in to an all-or-nothing scheme.

1. Section 743(b): Transfers of Partnership Interests

Section 743(b) addresses situations involving transfers of partnership interests.[47] Under this section, a partnership calculates adjustments for the transferee partner's basis in partnership property to account for built-in gain or loss that is already incorporated into the purchase price paid by the transferee partner when she purchases her interest in the partnership.[48] Although these adjustments do not impact a purchasing partner's capital account, they will ultimately be integrated into the purchasing partner's share of income, gain, or loss when partnership property is subsequently disposed of.[49] This ensures that a sale of partnership interest does not give rise to a double tax on gain or loss to a purchasing partner that can result from a later sale or disposition of partnership property.

2. Section 734(b): Distributions of Partnership Property

Section 734(b) addresses situations involving current and liquidating distributions of partnership property.[50] Unlike transfers of partnership interests, which always create the short-term potential for built-in loss to be taxed twice in the absence of a 754 election, there is less opportunity for loss gaming with respect to distributions of partnership property. This is because a loss arising from a distribution of partnership property is taxable only in the event of a liquidating distribution in termination of a partner's interest in the partnership.[51] When a partnership distributes property to a partner in a current distribution, the Code prohibits both the partnership and the distributee partner from recognizing loss on the distribution.[52] Alongside this prohibition of loss, a distributee partner receives a current distribution of partnership property with carryover basis from the partnership—the basis with which the partnership held the property just prior to distribution.[53] This carryover basis, however, cannot exceed the partner's adjusted outside basis in her partnership interest just before the distribution.[54]

46. § 754.
47. § 743(b).
48. *Id.* For a detailed explanation of the calculation of basis adjustment under section 743(b), see Starczewski, *supra* note 32, at VII.B.
49. Postlewaite, *supra* note 27, at 120.
50. § 734(b).
51. § 731(a)(2).
52. § 731(a)(2)–(b).
53. § 732(a).
54. *Id.*

To illustrate the current distribution carryover basis rule, suppose *A* has a seventy-five dollar outside basis in her interest in AB Partnership, and AB Partnership makes a current distribution of partnership property to *A* which has a $100 basis. *A* will receive the property with a basis of seventy-five dollars under the carryover basis rule.[55] A current distribution of property can thus result in an overall loss of basis, an undesirable outcome given that basis tracks already-taxed dollars that have been invested into a capital asset, the loss of which can result in an artificially inflated tax incidence. With a 754 election in place, the 743(b) adjustment allows a partnership to increase its basis in partnership property following a distribution that results in a loss of partnership basis as demonstrated above. [56] This adjustment restores basis (albeit to other partnership property) to a partnership that would otherwise be potentially lost as a result of a current distribution. In the above example, the 743(b) adjustment would allow AB Partnership a twenty-five dollar total upward basis adjustment in its retained partnership property.

In contrast, when a partner receives a distribution of property in a liquidating distribution, she generally receives that property with substitute basis.[57] That is, the liquidated partner disregards the partnership's basis in the property and instead applies her outside basis in the partnership just before the distribution to the distributed property.[58] Unlike current distributions, a partner can recognize loss as the result of a liquidating distribution, but only in certain circumstances.[59] As such, distributions of partnership property, even where loss is allowed, give rise to less concern for abuse than transfers of partnership interests.[60]

II. REPEAL OF PARTNERSHIP TECHNICAL TERMINATIONS UNDER THE TCJA

Section 708(b)(1)(B), which formerly provided for partnership technical terminations, treated a partnership as terminated if within any twelve-month period, there was a sale or exchange of fifty percent or more of the total interest in partnership capital and profits.[61] The corresponding regulations provided that if a technical termination took place, two transactions were deemed to occur.[62] In the first deemed transaction, all of a partnership's assets and liabilities were treated as

55. *Id.*
56. § 734(b)(1).
57. § 732(b).
58. § 731(a)(2).
59. §§ 731(a)(2), 732(c).
60. Professor Postlewaite notes that where distributions of partnership property were involved, the Treasury was presumably concerned with the possibility for taxpayers to "arbitrage tax rates by obtaining capital gains for the distributee partner and a decrease in ordinary income for the remaining partners in the partnership." Postlewaite, *supra* note 27, at 141 n.95. Professor Postlewaite further notes, however, that "[t]his concern should have been reduced by the existence of section 751(b) which would apply in many of such settings, forcing a basis increase or decrease because it treats some or all of the transaction as a sale." *Id.*
61. I.R.C. § 708(b)(1)(B) (2012), *amended by* I.R.C. § 708(b)(1) (2018).
62. Treas. Reg. § 1.708-1(b)(4) (as amended in 2014); H.R. REP. NO. 115-466, at 415 (2017) (Conf. Rep.).

if they had been contributed to a new partnership in exchange for an interest in the new partnership.[63] In the second deemed transaction, interests in the new partnership were distributed to any and all existing and purchasing partners.[64]

A review of the legislative record reveals that Congress had 754 elections in mind when it repealed the technical termination provision under the TCJA.[65] In a May 2017 hearing, the Committee considered a statement from the Bipartisan Policy Center.[66] While this statement largely addressed ways of structuring the new 199A partnership deduction, it also noted the need to make "[v]arious conforming changes . . . to ensure proper inclusion of capital contributions into [a] partner's capital account."[67] Among the suggested conforming changes were recommendations to extend the current requirements for mandatory basis adjustments of 743(b) and 734(b), which make the optional adjustments under 754 mandatory in certain circumstances, and to repeal the existing rule allowing for technical terminations.[68]

Later, in November of 2017, the House Report on the TCJA hinted that it had 754 elections in mind when it expressed the following concern:

> [P]artnership technical terminations are being used electively to change partnership-level elections and attributes in a way which otherwise would not be permitted. Following these elective terminations, the partnership remains in existence and can continue to do business, but with refreshed tax attributes. Because of the perceived abuse of the technical termination rule, the Committee believes its repeal will improve tax administration and increase taxpayer compliance.[69]

The December 2017 Conference Report that followed the House bill conclusively demonstrates that concern about abusive revocations of 754 elections explicitly informed the repeal of technical terminations.[70] This report pointed out that a technical termination is "not necessarily the end of the partnership's existence, but rather the termination of some tax attributes."[71] In addition, the report specifically noted the section 754 election to adjust basis when it stated that following a technical termination, "[p]artnership-level elections generally cease to apply."[72] This legislative history makes clear that the use of technical terminations to remove partnership-level elections, and the 754 election in particular, were central to Congress's repeal of the technical termination provision under the TCJA.

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63. Treas. Reg. § 1.708-1(b)(4) (as amended in 2014).
64. *Id.*
65. The Tax Cuts and Jobs Act achieved this by repealing former Internal Revenue Code section 708(b)(1)(B). H.R. REP. NO. 115-409, at 272–73 (2017).
66. *Hearing*, *supra* note 42, at 281–90.
67. *Id.* at 289.
68. *Id.*
69. H.R. REP. NO. 115-409, at 273.
70. H.R. REP. NO. 115-466, at 416 (2017) (Conf. Rep.).
71. *Id.* at 415.
72. *Id.* at 416 & n.820.

The repeal of technical terminations effectively shut one window through which a partnership could previously default out of 754 election. Indeed, the Service has noted that "[s]ection 754 election revocation requests have increased since technical terminations were repealed under [the] TCJA."[73] However, partnerships wishing to proceed without a 754 election are not devoid of options and both the Service and lawmakers should be aware that even with the removal of technical terminations, other ways to remove a 754 election still exist outside of Service-approved revocation.

A. Potential Ways to Remove a 754 Election Without Service Approval

Even with the repeal of technical terminations, there are a number of other strategies partnerships can seek to employ to effect revocation of a 754 election. Along the lines of technical terminations, partnerships may turn to formal termination, merger or consolidation, or division rather than rely on requesting Service-approved revocation.[74] Each of these options appears to present both unique opportunities and challenges. However, given the lack of guidance and recorded application of Service-approved revocation requests, partnerships may be inclined to turn to these familiar strategies, rather than wait for the Service to respond to a request for revocation.

First, a partnership could attempt to use formal termination and formation of a new partnership free from a 754 election. A number of things make this an unwieldy strategy for abuse. Unlike with a technical termination, formal termination requires both the winding up of a partnership business and creation of a new partnership tax entity. Additionally, under section 708, the Code considers a partnership terminated "only if 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."[75] While enforcement of this provision may be administratively impractical, there is some outstanding case law that does, on the one hand, evidence the Service's ability to police this subsection of the Code. For example, a partnership failed the formal termination requirement where it continued to hold currency in an inactive bank account after filing a certificate of cancellation and final return with the secretary of state's office.[76] In another case, a partnership failed the formal termination requirement where only one partner of a two-person partnership ceased partnership activities.[77] In two other cases, partnerships failed the formal termination requirement where they abandoned their primary purposes but

73. Proposed Collection; Comment Request for Form 15254, 85 Fed. Reg. 55,936, 55,936 (Sept. 10, 2020).

74. I.R.C. § 708(b)(1), (b)(2)(A), (b)(2)(B).

75. § 708(b)(1).

76. 7050, Ltd. v. Comm'r, 95 T.C.M. (CCH) 1413, 1417 (2008).

77. Austin v. United States, 461 F.2d 733, 733 (10th Cir. 1972).

continued to hold partnership property for investment.[78] On the other hand, partnerships may find comfort in the existence of a record of application, which effectively provides a warning of practices to avoid when seeking to ensure a proper partnership termination.

Second, a partnership could seek to use the provision addressing mergers or consolidations in section 708(b)(2)(A).[79] This section treats whichever partnership whose members own over fifty percent of the capital and profits of the consolidated or merged partnership as the continuing partnership following a merger or consolidation.[80] A partnership could attempt to revoke a 754 election by strategically merging with a partnership without a 754 election such that the 754 election-free partnership was considered the continuing partnership under the Code.

Third, and similar to partnership mergers or consolidations, a partnership could seek to use the provision addressing division of a partnership in 708(b)(2)(B).[81] This section treats whichever resulting partnership has over fifty percent of the capital and profits of the prior partnership as a continuing partnership following a merger.[82] A partnership could attempt to revoke a 754 election in a variety of ways using this provision. For example, a partnership could strategically divide into two resulting partnerships with a perfectly even split, such that neither partnership is treated as continuing, giving both a fresh start without the election.[83]

These provisions all appear to be more cumbersome ways to revoke a 754 election than the previous option of using a technical termination. Unlike technical terminations, which required only the sale or exchange of partnership interests, these demand some actual change in the form and structure of a partnership, through actual termination, consolidation, merger, or division. Additionally, unlike the case with requesting revocation, these provisions have some historic application. For example, the Service has consistently applied the asset-over-form doctrine to partnership mergers to determine whether a resulting partnership can be considered a continuation of one or more of the merging partnerships.[84] Under the asset-over-form doctrine, the Service privileges the dollar value of contributed assets over the ultimate form of a resulting partnership in a partnership merger and treats whichever merging partnership contributed the greatest dollar value of assets

78. Ginsburg v. United States, 396 F.2d 983, 988 (Ct. Cl. 1968); Hoagland v. Comm'r, 30 T.C.M. (CCH) 1326 (1971).

79. § 708(b)(2)(A).

80. *Id.*

81. § 708(b)(2)(B).

82. *Id.*

83. Treas. Reg. § 1.708-1(d)(1) (as amended in 2014).

84. Treas. Reg. § 1.708-1(c)(3)(i) (as amended in 2014); *see* Michael S. Lux, *Recent Developments & Observations*, 3 J. PASSTHROUGH ENTITIES 15, 16 (2000) (noting the Service's application of the Assets-Over-Form doctrine to partnership mergers in Rev. Rul. 90-17, 1990-1 C.B. 119, Rev. Rul. 77-458, 1977-2 C.B. 220, and Rev. Rul. 68-289, 1968-1 C.B. 314).

as the continuing partnership.[85] As such, these strategies may be more difficult to execute than technical terminations, both because they involve additional partnership involvement and because of the existence of a record of the Service's ability to police their execution. This does not, however, remove these strategies from the realm of possibility. As such, although Congress likely intended for partnerships to rely on requesting revocation of 754 elections when it removed the technical termination provision from the Code, both Congress and the Service should keep in mind that other forms of strategic abuse continue to exist to remove a 754 election outside of requesting revocation from the Service.[86]

On the other hand, if the repeal of technical terminations proves effective at combatting abuse, partnerships will turn to the Code for guidance on 754 election revocation.[87] This avenue for 754 election removal has been contemplated since the 754 election was enacted in 1954. In 1956, the Treasury Department provided the only regulatory guidance that substantively addresses revocation of a 754 election, section 1.754-1(c)(1). The total lack of any record of application of this subsection may bely either the degree to which partnership technical terminations previously provided an effective means of defaulting out of the election, the degree to which the Service is hesitant to allow for revocation of a 754 election, or some combination of the two. Before turning to the regulation, we look briefly at concerns the Service may have with granting 754 election revocations as well as preexisting limits of abuse.

III. CONCERNS WITH ALLOWING 754 ELECTION REVOCATION

The Service's primary concern with allowing for revocation of a 754 election will likely focus on the potential for loss duplication that arises with transfers of partnership interests.[88] As such, the Service should exercise caution when considering requests for 754 election revocation, even if few partners may find themselves attracted to the idea of selling their partnership interests at a loss. Furthermore, the absence of a 754 election does not create unlimited potential for loss duplication.

A. Existing Limits for Abuse

A number of limits for abuse have been built in to the Code to prevent loss gaming through basis even in the absence of a 754 election, with the built-in loss rules serving as the primary preventative fixture. These rules make the basis adjustments otherwise opted into via the 754 election mandatory in situations

85. Treas. Reg. § 1.708-1(c)(3)(i).

86. Indeed, a disproportionate increase in partnership mergers, consolidations, and divisions may reflect a continuing ability on the part of partnerships to effect revocation of section 754 elections without approval from the Service.

87. I.R.C. § 754.

88. *See supra* Section I.C.1.

involving substantial built-in loss or substantial basis reductions.[89] Under the substantial built-in loss rule provided for in section 743, 743(b) basis adjustments must be made, even in the absence of an election, when a partnership has a substantial built-in loss immediately after the transfer.[90] Under section 743(d), a substantial built-in loss exists if there is either an overall loss of over $250,000 across a partnership's property,[91] or if a purchasing partner would be allocated a loss of over $250,000 if the partnership assets were sold at fair market value immediately after the transfer of a partnership interest.[92] The TCJA added the second partner-specific prong of 743(d)'s built-in loss rule.[93] The addition of a "transferee partner level test"[94] demonstrates continued congressional concern with loss gaming in this area and acknowledges the reality that partnership agreements may disproportionately allocate gain or loss among partners.[95]

While the reach of section 743's built-in loss provision is restricted from securitization partnerships under section 743(f)'s exception,[96] the built-in loss rule provides a functional limit to the extent with which losses can be duplicated in the absence of a 754 election. Additionally, there is potential for mandatory application of the section 743(b) adjustments under section 732(d) and the regulations thereunder. However, this transactional imposition applies only to very narrow situations.[97]

Similarly to the substantial built-in loss rule of section 743, under the substantial basis adjustment rule provided for in section 734, 734(b) basis adjustments must be applied, even in the absence of an election, when there is a substantial basis reduction with respect to a distribution in liquidation of a distributee partner's interest.[98] A substantial basis reduction exists if the liquidated partner's loss and the amount with which the liquidated partner increases the basis distributed property upon liquidation amounts to over $250,000.[99] These rules requiring mandatory application of 743(b) and 734(b) were added to the Code under the Clinton administration because "[t]he electivity of adjustments under sections

89. §§ 734(a), 743(a).

90. § 743(a).

91. § 743(d)(1)(A).

92. § 743(d)(1)(B).

93. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13502, 131 Stat. 2054, 2141.

94. Starczewski, *supra* note 32, at VII.A(1)(a)(1).

95. Tax Cuts and Jobs Act § 13502.

96. § 743(f).

97. The regulations specify application of this mandatory rule only when a partner receives their partnership interest via transfer and (1) the fair market value of all partnership property (other than money) exceeded 110% of its adjusted basis to the partnership; (2) an allocation of basis under section 732(c) upon a liquidation of the partner's interest immediately after the transfer of the partnership interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization to property subject to such an allowance; and (3) a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed. Treas. Reg. § 1.732-1(d)(4) (as amended in 2018).

98. § 734(a).

99. § 734(d); *see also* Starczewski, *supra* note 32, at VII.A(1)(a)(1).

734(b) and 743(b) provide substantial opportunities for taxpayer abuse" primarily relating to the "duplication of losses."[100]

B. Policy Note

Although the potential for duplication of losses will follow any revocation of a 754 election, this may merely reflect the policy decision Congress made when it adopted subchapter K. As described above, the legislative history of subchapter K and the 754 election reveal that, despite both the ABA and ALI's proposals to make basis adjustments mandatory, Congress opted for elective adjustments instead.[101] While a number of politicians and scholars have pointed to the potential abuse arising from the elective nature of section 754, the elective structure of basis adjustment remains a well-established pillar of subchapter K.[102] On the one hand, this history may reveal that Congress will simply allow for inside-outside-basis disparities and their potential to create duplicated gains or losses for tax purposes rather than impose mandatory basis adjustments on all partnerships.

On the other hand, the addition of the anti-abuse rules under the Clinton administration and the repeal of technical terminations may evince congressional intent to strengthen the section 754 regime through increased imposition. Along these lines, the language of section 754 grants the Treasury Department broad discretion in the realm of revocation,[103] and many have interpreted the text of the Code as providing the presumption that, once made, a 754 election is permanent, with grant of revocation being the exception rather than the norm.[104]

IV. CURRENT GUIDANCE ON REQUESTING REVOCATION OF A 754 ELECTION

The current guidance addressing revocation of a 754 election is provided in section 1.754-1(c)(1) of the Treasury Regulations. This section reads:

> A partnership having an election in effect under this section may revoke such election with the approval of the district director for the internal revenue district in which the partnership return is required to be filed. A partnership which wishes to revoke such an election shall file with the district director for the internal revenue district in which the partnership

100. U.S. DEP'T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2001 REVENUE PROPOSALS 155 (2000).

101. *See supra* Section I.B.

102. Postlewaite, *supra* note 27, at 108–12; Philip F. Postlewaite, Thomas E. Dutton & Kurt R. Magette, *A Critique of the ALI's* Federal Income Tax Project—Subchapter K: Proposals on the Taxation of Partners, 75 GEO. L.J. 423, 445 (1986). *But see* Monte A. Jackel & Robert G. Honigman, *The Proposed Abusive Tax Shelter Shutdown Act of 2001: The Mandatory Code Secs. 743 and 734 Adjustment Provisions Are Misguided, Overbroad and Just Plain Poor Tax Policy*, 4 J. PASSTHROUGH ENTITIES 5, 7 (2001).

103. Section 754 provides that "[s]uch election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary." § 754.

104. Section 754 provides that an election, "shall apply with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years." *Id.*

> return is required to be filed an application setting forth the grounds on which the revocation is desired. The application shall be filed not later than 30 days after the close of the partnership taxable year with respect to which the revocation is intended to take effect and shall be signed by any one of the partners. Examples of situations which may be considered sufficient reason for approving an application for revocation include a change in the nature of the partnership business, a substantial increase in the assets of the partnership, a change in the character of partnership assets, or an increased frequency of retirements or shifts of partnership interests, so that an increased administrative burden would result to the partnership from the election. However, no application for revocation of an election shall be approved when the purpose of the revocation is primarily to avoid stepping down the basis of partnership assets upon a transfer or distribution.[105]

This section of the regulation has existed in its current form since 1956,[106] and while it addresses a broad general scope of what may be entailed with requesting revocation of a 754 election, some points are made more clearly than others. It is worth reviewing the few details that are certain from the regulation as currently written before addressing the regulation's more opaque aspects.

First, a partnership may revoke a 754 election with approval from the Service.[107] Second, a partnership must submit an application requesting revocation in order to obtain this approval.[108] Third, such a request must be filed within the thirty days following the close of the partnership tax year for which revocation is requested.[109] And finally, an application requesting revocation must be filed with the "IRS Submission Processing Center where [the] partnership's return is filed."[110]

This final point does not conform strictly to the regulation, which provides that an application requesting 754 election revocation be submitted "with the district director for the internal revenue district in which the partnership return is required to be filed."[111] However, this provision is outdated because it predates the 1998 restructuring of the Service, during which the District Director position was removed.[112] Following this restructuring, Treasury Notice 2003-19 provided

105. Treas. Reg. § 1.754-1(c)(1) (as amended in 2000).

106. Although the larger section of regulation section 1.754-1(c) was amended to add subsection (c)(2) in 1999, this created a limited revocation allowance to partnerships for their tax years that included December 15, 1999 following changes to the regulations that may have made 754 elections less desirable than they had previously been. Treas. Reg. § 1.754-1(c)(2); *see* Adjustments Following Sales of Partnership Interests, 64 Fed. Reg. 69,903, 69,905 (Dec. 15, 1999) (to be codified at 26 C.F.R. pts. 1, 602).

107. Treas. Reg. § 1.754-1(c)(1).

108. *Id.*

109. *Id.*

110. *Where to File Certain Elections, Statements, Returns and Other Documents*, IRS, https://www.irs.gov/filing/where-to-file-certain-elections-statements-returns-and-other-documents [https://perma.cc/7KUE-7SZ9] (Sept. 20, 2020) (replacing Treasury Notice 2003-19).

111. Treas. Reg. § 1.754-1(c)(1).

112. *See* Rossotti, *supra* note 12, at 5–6, 11.

updated guidance on where certain filings should be submitted.[113] This notice has since been replaced with an IRS web page.[114]

The regulation further provides two important guideposts: a permissive guidepost that informs when a revocation request may be considered proper, and a restrictive guidepost that informs when a request will be considered improper. These guideposts remain elusive, however, because of the brevity of the regulation and the lack of any record of application in practice.[115] For example, the regulation outlines four potentially permissible reasons for revocation by outlining examples that may—but do not necessarily—provide a sufficient basis for approving an application for revocation. The regulation outlines four scenarios that may be sufficient reason to revoke a 754 election if they would result in an increased administrative burden to the electing partnership.[116] The scenarios are (1) a change in the nature of the partnership business, (2) a substantial increase in the assets of the partnership, (3) a change in the character of the partnership assets, or (4) an increased frequency of retirements or shifts of partnership interests.[117] As for the restrictive guidepost, the regulation provides that no application for revocation shall be approved when its purpose is primarily to avoid stepping down the basis of partnership assets upon a transfer or distribution.[118] In this way, the regulatory guidance provides a sense of what the Service may consider sufficient reason to revoke a 754 election, as well as what the Service seeks to ensure is not the motivating force behind a request for revocation of a 754 election.

Beyond their broad generality, these regulatory guideposts raise a few issues. First, while the reading of the permissive guidepost—that all of the situations listed require both the general factual circumstances outlined and an increased administrative burden resulting to the partnership as a result of the 754 election—comports with both general textualist principles and purposive principles of statutory interpretation,[119] it has not yet been tested before a court.[120] As such, the Service may wish to provide clarification on its reading of the regulation. Second, the regulation fails to address what constitutes a sufficient increase in administrative burden to warrant revocation of a 754 election.[121] And third, the regulation provides no indication of how the Service will be able to identify when a step-down in basis is the primary purpose of a request, or perhaps more difficult, distinguish this from a fortuitous circumstance that happens to coincide with increased administrative burden.

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113. I.R.S. Notice 2003-19, 2003-14 C.B. 703 (directing partnerships to file request to revoke 754 elections with the Service's Ogden Submission Processing Center).

114. *Where to File Certain Elections, Statements, Returns and Other Documents*, *supra* note 110.

115. *See* Dance & Rooney, *supra* note 14.

116. Treas. Reg. § 1.754-1(c)(1).

117. *Id.*

118. *Id.*

119. *See* Kevin M. Stack, *Interpreting Regulations*, 111 MICH. L. REV. 355, 391–408 (2012).

120. *See* Dance & Rooney, *supra* note 14.

121. Treas. Reg. § 1.754-1(c)(1).

This brings us to a number of items that the regulation does not provide for but the Service would be wise to address. The Service should identify who will make decisions regarding requests for revocation. As noted above, the restructuring overhaul that took place at the end of the 1990s resulted in the removal of the District Director position.[122] While the IRS website clarifies where a request for 754 election revocation should be filed, it does not identify the decision maker who will ultimately respond to the request.[123] Additionally, the Service should make clear what a proper request for 754 election revocation should include given that the regulation does not provide such details and the Service does not currently have a form in place for this process.[124]

V. A Possible Process for Handling Revocation Requests

Although the language of Treasury Regulation section 1.754-1(c)(1) specifies that partnerships wishing to revoke a 754 election may file "an application setting forth the grounds on which the revocation is desired," the Service does not currently have a standardized application or form for this request.[125] As such, an appropriate route for handling requests for 754 election revocations may begin by publishing a revenue procedure that details what partnerships should include in a proper application requesting 754 election revocation.

A. The Application

A proper 754 election revocation request application should establish relevant identifying and contact information and require confirmation that the application is timely and is being filed in the appropriate district.[126] To avoid requests that merely provide conclusory statements citing the text of the regulation, the Service should require each requesting partnership set forth the particular grounds on which it bases its revocation request and require documentation that sufficiently substantiates those grounds. In keeping with the regulation, the Service should assess two factors when considering 754 election revocation requests: (1) increased administrative burden to the requesting partnership, and (2) the potential for step-down in basis.

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122. Rossotti, *supra* note 12, at 5–6, 11.

123. *Where to File Certain Elections, Statements, Returns and Other Documents*, *supra* note 110.

124. *See Forms for Partnerships*, section in *Tax Information for Partnerships*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/forms-for-partnerships [https://perma.cc/WS3U-C8WX] (Oct. 22, 2020).

125. Treas. Reg. § 1.754-1(c)(1).

126. *See id.*; *Where to File Certain Elections, Statements, Returns and Other Documents*, *supra* note 110.

1. Increased Administrative Burden

The Service has defined taxpayer administrative burden as "the time and money taxpayers spend to comply with their federal tax obligations."[127] Because regulation section 1.754-1(c)(1) provides that revocation may be proper where increased administrative burden is an issue, the application should require documentation of a requesting partnership's historic administrative burden of accounting for section 734 and 743 adjustments and either documentation or an estimation of the increased burden the partnership has incurred or will incur as a result of changed circumstances. The Service must consider what increase in administrative burden is sufficient to render the partnership's request reasonable under section 754.

There are a number of ways the Service can go about assessing this factor. The Service may consider assessing administrative burden by comparing historic and projected costs of 754 election compliance in light of a partnership's overall revenue. For example, the Service could look at a requesting partnership's historic cost of compliance with 754 election adjustments and compare these with the partnership's projected future costs of compliance. The Service could then contextualize these costs as a factor in light of overall partnership operations. For example, a partnership may provide historic receipts of accounting costs incurred in connection with 734 and 743 adjustments in the context of the partnership's other operating expenses and overall revenue, as well as projected future costs and revenue. The Service may additionally or alternately assess these costs in comparison to analogous costs the Service would expect to see for a similarly situated partnership.

2. Partnership Cannot Request to Avoid Stepping Down Basis

Because the regulation specifies that a revocation request will not be "approved when the purpose of the revocation is primarily to avoid stepping down the basis of partnership assets upon a transfer or distribution,"[128] the application should enable the Service to assess how basis of partnership assets would be calculated upon a transfer of a partnership interest or distribution of partnership property both with the 754 election in effect and without the 754 election in effect. To make this assessment, the application must require the partnership to submit its balance sheets, thereby enabling the Service to assess the inside basis and book value of the partnership's assets, as well as liabilities and all partner capital accounts. Basis in excess of book value should present the Service with a red flag. The Service would

127. *Taxpayer Burden Reduction (TBR)*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/taxpayer-burden-reduction-tbr [https://perma.cc/D6QU-P4PG] (Sept. 19, 2020) (containing quote in video). Although the partnership is not the taxpayer, it is the entity expending time and money on compliance.

128. Treas. Reg. § 1.754-1(c)(1).

also be wise to impose a mandated reporting period following the grant of a 754 election revocation request.

The regulatory language may present a hurdle for the Service because of its focus on primary purpose. While proving primary purpose may be difficult for the Service to achieve, the regulation does not provide that a revocation request may only be disallowed when its primary purpose is a step-down in basis. As such, when denying a revocation request, the Service may be able to lean more heavily on an insufficient increase in administrative burden, rather than rely solely on a primary purpose argument regarding basis step-downs. Furthermore, while Service decisions on 754 election revocation requests would be subject to judicial review,[129] a court will likely set aside such a decision only where it finds the decision arbitrary and capricious.[130]

B. Administrative Details

One minor consideration the Service should address that could have a significant administrative impact is whether an application requesting revocation of a section 754 election should require a signature. Although the signature requirement has been removed from making a 754 election under proposed regulation 1.754,[131] section 1.754-1(c)(1) still requires a signature for a request for 754 election revocation. This variance may cause confusion and may result in partnerships filing revocation requests, only to be followed by subsequent requests seeking relief under section 9100 to excuse the lack of signature.[132]

A more important consideration the Service should address is who the decision maker should be for applications requesting 754 election revocation. Former IRS Commissioner Charles Rossotti described the 1998 restructuring of the Service as one that overhauled a large complicated administrative structure based on internal technical disciplines and geographic locations and replaced it with customer-facing business units.[133] Former Commissioner Rossotti termed this the "customer-izing" of the Service.[134] As part of this restructuring, the District Director position was removed and replaced with the current Territory Manager position.[135] As such, transposing the current regulations onto the current structure of the Service would delegate 754 election revocation requests to Territory Managers. However, this delegation on its own, without further guidance, may

129. 5 U.S.C. § 704.

130. § 706.

131. Prop. Treas. Reg. § 1.754-1(b)(1), 82 Fed. Reg. 47,408, 47,409 (Oct. 12, 2017).

132. *See, e.g.*, *New Partnership Section 754 Election Regulations*, THETAXBOOK (Nov. 6, 2017), https://www.thetaxbook.com/view_update.asp?1=2872 [https://perma.cc/VME9-H3GM] (describing the Treasury's proposal to remove the signature requirement from the 754 election process following receipt of "numerous requests for 9100 relief with respect to unsigned IRC section 754 election statements, especially where tax returns have been filed electronically").

133. Rossotti, *supra* note 12, at 3–4, 8.

134. *Id.* at 1–2.

135. *Id.* at 11.

recreate one of the problems of the Service's previous structure, which "allowed each local office to handle issues differently" such that "[a] taxpayer in California could conceivably get different answers to a question than a taxpayer in Maine."[136]

Rather than imposing the new structure of the Service upon the outdated regulations, the Service should consider tasking 754 election revocation requests to the attorneys in the Associate Chief Counsel, Passthroughs & Special Industries division.[137] This would consolidate all 754 election revocation request decisions to attorneys who focus solely on passthrough issues, something that may be missing if they are left with individual Territory Managers. However, even with an estimated 200,000 partnerships with 754 elections in place in 2013,[138] this is likely an impractical approach.

A more pragmatic alternative might involve the attorneys with Passthroughs & Special Industries creating guidelines for Territory Managers. These guidelines could provide scenarios in which revocation requests can be easily approved or denied. Any gray area cases could then be passed on to Passthroughs & Special Industries for further review and final decision. Such a strategy may provide for more consistent outcomes.

CONCLUSION

There are numerous reasons why the Service should attend to the renewed need for guidance addressing partnership 754 election revocations. Congress clearly articulated its concern that partnerships were abusing technical terminations as a self-help mechanism to effect revocation of 754 elections without Service approval when it repealed the technical termination provision under the TCJA.[139] However, while Congress removed one such self-help mechanism through the repeal of technical terminations, other self-help mechanisms still exist through which partnerships may seek to effect revocation without Service approval.[140] In order to curb such abuse, the Service should provide clear guidance of the process through which a partnership may request revocation of a 754 election, the substantiating documentation required for the Service to render a decision, as well as a guideline of when revocation may be considered appropriate.

136. *Id.* at 4.

137. Associate Chief Counsel, Passthroughs & Special Industries, employs approximately eighty attorneys in the IRS National Office in Washington, D.C. and provides taxpayer advice regarding income taxation of passthrough entities. *Legal Divisions*, LEGAL CAREERS CHIEF COUNSEL, https://www.jobs.irs.gov/resources/job-descriptions/legal-divisions [https://perma.cc/4CGM-59WF] (last visited Nov. 28, 2020).

138. *See supra* Section I.B.

139. *See supra* Part II.

140. *See supra* Section II.A.