

February 27, 2013

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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Filed electronically: via the Federal eRulemaking portal at www.regulations.gov (IRS REG-130507-11)

Re: Comments on Proposed Regulations under Section 1.1411 Relating to the Net Investment Income Tax

The New York State Society of Certified Public Accountants, representing more than 28,000 CPAs in public practice, industry, government and education, submits the following comments to you regarding the above captioned proposed regulations. The NYSSCPA thanks the Internal Revenue Service for the opportunity to comment.

The NYSSCPA's Partnerships and LLCs Committee deliberated the provisions and drafted the attached comments. If you would like additional discussion with us, please contact Mark P. Stone, Chair of the Partnerships and LLCs Committee, at (516) 858-0009, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely, .


Gail M. Kinsella
President

Attachment

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON PROPOSED REGULATIONS UNDER SECTION 1.1411 RELATING
TO THE NET INVESTMENT INCOME TAX**

February 27, 2013

Principal Drafter

Mark S. Reid

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NYSSCPA Staff

Ernest J. Markezin
William R. Lalli

The New York State Society of Certified Public Accountants

Comments on

Proposed Regulations under Section 1.1411 relating to the Net Investment Income Tax

The New York State Society of Certified Public Accountants (NYSSCPA) is writing in response to the Notice of Proposed Rulemaking (REG-130507-11) that requests comments regarding proposed regulations that provide guidance under section 1411 of the Internal Revenue Code (Code).

The NYSSCPA commends Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) for their continued efforts to produce administrable guidance, for their concern for the potential administrative burden on owners of partnerships, and for their request for comments to help prevent an undue burden on taxpayers with respect to the proposed regulations under Section 1411. We offer the following comments in an attempt to assist with that effort.

Disposition of an Entire Interest in a Passive Activity (or Former Passive Activity)

Section 469(g)(1) provides special rules for treatment of suspended passive losses when the taxpayer disposes of his/her entire interest in a passive activity (or former passive activity) in a fully taxable transaction to an unrelated party during the year. Pursuant to Section 469(1)(A)(i) and (ii), this suspended loss is first offset against any net income or gain for such taxable year from all other passive activities, and the excess shall be treated as a loss which is not from a passive activity. The Notice of Proposed Rulemaking specifically asked for comments on how these suspended losses triggered by dispositions should be treated for purposes of the Section 1411 tax.

We believe that (1) such triggered suspended losses should be treated as losses taken into account in determining the taxpayer's net gain from the disposition of the activity described in Section 1411(c)(1)(A)(iii) and (2) any excess of such suspended losses from step (1) should be considered properly allocable deductions to gross income described in Sections 1411(c)(1)(A)(i) and (ii) so that, as closely as possible, the taxpayer's net investment income for purposes of the Section 1411 tax will mirror the net investment income included in the taxpayer's net taxable income.

Net Operating Losses

The proposed regulations provide that net investment income does not take into account a net operating loss deduction and state that the character of each of the various deduction items that comprise a net operating loss deduction is not generally tracked for purposes of Chapter 1 once the item becomes part of a net operating loss (NOL). The regulations state "Thus, when an item becomes part of a net operating loss that is carried to another year, it is generally no longer

allocable to a specific type of income....” The Notice of Proposed Rulemaking invited comments on this issue.

We believe that, while it is true that historically the various deduction items that comprise an NOL deduction are not generally tracked for purposes of Chapter 1, it would be possible to track the portion of an NOL allocable to a net investment loss without creating rules that would be unduly complex and not administrable. For example, a ratio could be developed for each loss year equal to the taxpayer’s net investment loss divided by the taxpayer’s NOL for that year and that ratio could be deemed to apply to the utilization of any NOL carry-back or carry-forward from that loss year (or this could be limited to carry-forwards to create more simplicity because taxpayers have the option to elect out of carry-back rules).

Another possibility is to use a “with and without” method for determining the portion of an NOL (by loss year) that is attributable to a net investment loss and that portion of the NOL could be deemed to apply to the utilization of any NOL carry-back or carry-forward from that loss year (or, again, this could be limited to carry-forwards to create more simplicity because taxpayers have the option to elect out of carry-back rules). We believe that whatever method is chosen for the final regulations, it is important that taxpayer fairness be kept in mind and that such fairness should be framed to avoid penalizing taxpayers by disallowing loss carry-forwards in this manner. We do not believe this rule needs to parallel the self-employment tax example provided in the Notice of Proposed Rulemaking.

Real Estate Professionals

The passive activity rules of Section 469(c)(7) and 1.469-9 provide special rules for real estate professionals. If the taxpayer meets these requirements, the taxpayer’s interests in rental real estate are no longer subject to Section 469(c)(2), and the rental real estate activities of the taxpayer will not be passive activities if the taxpayer materially participates in each of these activities. The proposed regulations would diverge from these rules such that gross income from such rental real estate will not be per se excluded from Section 1.1411(c)(1)(A)(i) even if the taxpayer otherwise meets the real estate professional rules under Section 469. Instead, the proposed regulations require an assessment of the real estate professional’s rental activity to determine whether it is a trade or business, and only if it is a trade or business will income from the activity be excluded from the Section 1411 tax.

We believe that this divergence from the normal rules adds undue complexity to the administration of the Code, an undue burden on the taxpayers and their professional preparers, and unfair treatment for taxpayers to whom this would apply. The regulations should be modified to define a trade or business in a manner consistent with (to follow) the normal Section 469 rules for real estate professionals, or to add a provision that allows the active rental activity of a real estate professional to be treated as part of that real estate professional’s trade or business.

Grouping Rules

The passive activity rules of Section 1.469-4 provide rules for defining an activity for purposes of the passive activity loss rules. The proposed regulations adopt the grouping rules of the passive activity regulations for purposes of Section 1411(c)(2)(A), in general, but diverge from the normal grouping rules under the passive activity regulations by not allowing the grouping of rental real estate activities with trade or business activities (reference to Section 6(B)(i)(b)(4) of the preamble). We believe that this divergence from the normal rules adds undue complexity to the administration of the Code, an undue burden on the taxpayers and their professional preparers, and an unfair application to taxpayers. The regulations should be modified to follow the normal Section 469 rules for taxpayers who have rental activities that are related to a trade or business activity and grouped by the taxpayer with that trade or business activity under the grouping rules of Section 469.

Dispositions of Interests in Partnerships and S Corporations

For purposes of Section 1411, Congress intended Section 1411(c)(4) to put a transfer of interest in a partnership or S Corporation stock in a similar position as if the partnership or S Corporation had disposed of all its properties, and the accompanying gain or loss from the disposition of such properties passed through to its owners (including the transferor). As stated in the Notice of Proposed Rulemaking, the gain or loss upon the sale of an interest in the entity and the allocable gain or loss from the entity upon a sale of the entity's underlying properties will not always match. Disparities may exist between (1) the transferor's adjusted basis in the partnership interest or S Corporation stock and the transferor's share of the entity's adjusted basis in the underlying properties; or (2) the sales price of the interest may not match the proportional share of the underlying properties' fair market value with respect to the interest sold.

We commend the Treasury's and IRS's recognition that, due to the construction of the statute, some parity must be achieved between an interest sale and an asset sale. However, we believe that the solution for this in the proposed regulations, to apply Section 1411(c)(4) on a property-by-property basis, goes beyond what the statute requires. The precise language of Section 1411(c)(4) of the statute relating to the exception for certain active interests in partnership and S Corporations (referred to as an "adjustment" to the net gain or loss from such disposition in proposed regulation Section 1.1411-7(a)(1)) is, "In the case of a disposition of an interest in a partnership or S Corporation - (A) gain from such disposition shall be taken into account under clause (iii) of paragraph (1)(A) only to the extent of the net gain which would be so taken into account by the transferor if all property of the partnership or S Corporation were sold for fair market value immediately before the disposition of such interest,..." We believe that the language of the statute contemplates not only a netting of gains and losses, but also a bulk (simultaneous) sale of assets. Measuring fair market value and gain on a property-by-property basis is not required by the statute although it clearly represents one possible approach.

We are concerned that the property-by-property approach in the proposed regulations would be too burdensome for many taxpayers with respect to the potential cost of compliance, complexity of compliance and timeliness of compliance. The approach proposed in the

regulations and the disclosure statement required by Section 1.1411-7(d) may require many taxpayers and partnerships to:

- (1) obtain outside valuations or appraisals by qualified professionals that can result in an expense to the taxpayer that could easily be thousands of dollars per transaction;
- (2) engage outside professionals to assist with the preparation and summarization of very detailed schedules of assets (basis, fair market value and gain/loss) at high cost;
- (3) file tax return attachments to report these transactions with more pages, in some cases, than the rest of their income tax return;
- (4) deal with the difficulty in completing the required analyses on a timely basis in accordance with the statutory filing deadlines, including extensions; and
- (5) provide significant K-1 attachments to their partners (in tiered-partnership situations) so that their partners can make these determinations on their tax returns or make further disclosures for partners in higher tier partnerships.

We believe this also will place a tremendous burden on an already capacity-strained tax preparer community. In many cases, it may be difficult, or near impossible, for the individual transferor partner to obtain sufficient information from the partnership for outside valuation and tax consultants to perform these detailed computations, and do so on a timely basis. There is additional added complexity in situations where a Section 754 election is in place, resulting in a previous Section 743(b) or 734(b) adjustment, or where a mandatory step-down (pursuant to Section 704(d)) has occurred in the past (and even more so where there are multiple tiers of partnerships that these adjustments are passing through). We believe a more global alternative is needed.

For a sale of an interest in a partnership or S Corporation stock that is ineligible for the exception of Section 1411(c)(4), the transferor's entire gain or loss (subject to other sections of the regulations) will be included in the Section 1411 computation. We believe that in such case, no adjustment or disclosure statement should be required (or allowed) other than adjustments made in arriving at the final amount of gain or loss actually included in taxable income (for example, the remaining basis relating to previous Section 743(b) adjustments).

For a sale of an interest in a partnership or S Corporation stock that is fully eligible for the exception of Section 1411(c)(4), we believe that none of the gain or loss should be required (or allowed) to be included in the Section 1411 computation. In conjunction with this, the disclosure statement should be required, modified as recommended below.

For a sale of an interest in a partnership or S Corporation stock that is partially eligible for the exception of Section 1411(c)(4), we believe that the adjustment to be computed under Section 1.1411-7(a)(1) and 1.1411(c) should be eligible for a safe harbor method based on a pro rata approach further described below rather than solely a property-by-property approach. The property-by-property approach places a significant undue burden on the taxpayer, which a pro rata safe harbor method would alleviate, but the taxpayer should always have the option to employ a property-by-property approach if he/she/it so chooses.

Pro rata safe harbor: We respectfully request the Treasury and IRS consider adding a safe harbor methodology based on a pro rata approach whereby the taxpayer's adjustment to be computed under Sections 1.1411(a)(1) and 1.1411(c) would be determined by a ratio of (1) the tax basis of the partnership or S Corporation assets used in a qualifying trade or business to (2) the total tax bases of all of the partnership or S Corporation assets.

We also believe that a *de minimus* exception should be included in the regulations (similar to that used under the Section 199 regulations) such that if the adjustment that was computed under Section 1.1411-7(a)(1) and 1.1411(c) was found to be more than 95% of the applicable gain or loss, the taxpayer could opt to treat this as 100%.

This same safe harbor approach could be utilized for determining a partner's interest in Section 1411 assets upon a distribution to which gain is recognized pursuant to Section 731.

Based on the above, we recommend that Treasury and IRS consider modifying the data collection requirements of paragraphs (3), (4), (5), and (6) of Section 1.1411-7(d) as follows:

- (3) The transferor's selling price of the partnership interest or S Corporation stock;
- (4) The transferor's outside tax basis in the partnership interest or S Corporation stock;
- (5) The transferor's gain or loss with respect to the transfer;
- (6) The percentage of partnership or S Corporation property (measured by relative tax basis within the partnership) held in (or attributable to) a trade or business not described in Section 1.1411-5;

We further recommend leaving paragraphs (1), (2), (7) and (8) of Section 1.1411-7(d) unchanged from the proposed regulations.

We believe this modified disclosure statement will provide sufficient information to determine which method (pro rata or actual) was utilized by the taxpayer, and for evaluating whether to request additional information for specific taxpayers via an information request, field audit or desk audit.

The above recommendations will significantly reduce the potential cost and complexity and increase timeliness of compliance for many taxpayers, and result in a more streamlined approach for all parties involved with respect to these provisions under Section 1.1411-7.

As an additional matter with respect to the issues associated with a sale of an interest in a partnership or S Corporation, we believe some examples should be provided to address sales of partial interests. In both contexts, there can be a complex interaction with liabilities that are allowed or required to be taken into account. In the partnership situations, for example, we believe it would be helpful to have some additional examples in the final regulations that would describe how to address the fact patterns in Revenue Ruling 84-53. Subchapter S corporations with loans from shareholders may face similar issues, and some examples related to partial sales in these situations would be beneficial.

Exceptions for Distributions from Qualified Plans; Exception for Self-employment Income and Issues Relating to Partner Retirements (Section 1402(a)(10) Payments)

Section 1411(c)(5) provides that net investment income does not include any distributions from specified qualified plans or arrangements. Section 1411(c)(6) provides that net investment income shall not include any item taken into account in determining self-employment income for such taxable year on which a tax is imposed by Section 1401(b). Neither of these two exclusions address payments described by Section 1402(a)(10) relating to retirement payments to partners (which are excluded from Section 1401(b) but which are not treated as payments from qualified plans). The statute does not discuss payments of this nature, and the Proposed Regulations suggest that they may be treated as net investment income. We respectfully request that the proposed regulations be revised to clarify that Section 1402(a)(10) payments are not subject to the Section 1411 tax so that payments to retired partners under Section 1402(a)(10) receive the same treatment for purposes of Section 1411 as payments from qualified plans.