Passthrough Partner

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Transfer of Partnership Interest for Services Revisited—Part II

This is the second part of a two-part column that collectively attempts to summarize what constitutes a “profits interest,” the current state of affairs concerning “profits interests,” the requirements of the Proposed Regulations1 and accompanying Notice 2005-432 containing a proposed revenue procedure that would be issued when the Proposed Regulations are finalized (collectively the “Proposed Authority”), contrast the current status based on Rev. Proc. 93-273 and Rev. Proc. 2001-434 (the “Revenue Procedures”) with that of the Proposed Authority and highlight some of the concerns with respect to the Proposed Authority. In the author’s view, the Proposed Authority is largely unworkable in many, if not most, cases involving traditional personal service partnerships and those partnerships that may choose to offer both capital interests and profits interests. For these, the result of the Proposed Authority would be worse than returning to the days of Diamond5 and Campbell.6 The comfort of GCM 36346 which indicated the IRS would be unlikely to argue the application of Code Sec. 83 would no longer exist. However, the Proposed Authority should be workable for most partnerships in which capital is a material income-producing factor and only offering profits interests as compensatory incentives.

As discussed in Part I, as a result of the aggregate of interest concepts that permeate partnership taxation, partnerships have much greater flexibility than corporations in capital structure and the ability to tailor the tax and economics to the specific business needs and economic reality of the venture. In the corporate setting, with the exception of incentive stock options,7
the compensation of a service provider in any form of stock\textsuperscript{9} will ultimately result in the recipient recognizing gross income in connection therewith. However, a partnership can grant a partnership interest in future income and appreciation to a service provider with respect to services rendered and/or to be rendered to or for the benefit of the partnership without taxation. Such interest is known as a “profits interest.” Under Rev. Proc. 93-27, “[a] profits interest is a partnership interest other than a capital interest.”\textsuperscript{9} A “capital interest” is defined as “an interest that would give the holder a share of the proceeds if the partnership’s assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership.”\textsuperscript{10}

Part I also notes that while compensatory partnership interests are literally granted on a daily basis, the tax consequences and rationale are among the most unsettled in the partnership area. There is a head-on collision of the concepts of Code Sec. 83, aggregate partnership tax principles and practical reality. The issues have never been dealt with legislatively, are rather opaque, and have been thoroughly confused by inconsistent and less than stellar analysis by the courts. However, in the recent case of Crescent Holdings,\textsuperscript{11} the Tax Court did not further muddle the waters in finding that an unvested partnership capital interest constituted property to which Code Sec. 83 and Reg. §1.83-1(a)(1) applied and, in a case of first impression, finding the undistributed income associated with the unvested capital interest was allocable to the transferor of the unvested capital interest and not the holder of the unvested capital interest. The taxation of compensatory partnership profits interests has enjoyed a workable truce under the Revenue Procedures, although there are aspects for which guidance would be welcome.\textsuperscript{12} This truce or equilibrium was destabilized in May 2005 with the issuance of the Proposed Authority. The whole concept of partnership profits interests then became caught up in the politics of “carried interests” for hedge fund and venture fund managers.\textsuperscript{13}

This Part II examines the Proposed Authority that attempts to join two alien paradigms—Code Sec. 83 with its entity focus and the aggregate interest concept as embedded in Reg. §721-1(b)(1)—and expresses concerns resulting from the collision of these two largely incompatible paradigms. The Proposed Authority would revoke the Revenue Procedures and apply Code Sec. 83 to all compensatory partnership interests (capital and profits) with an elective mechanism that attempts to preserve the result of no taxation on the issuance of a profits interest if the liquidation value paradigm is adopted for all compensatory partnership interests. However, this is achieved with a great deal of complexity and potential collateral “costs” which are likely to be unacceptable to most traditional service partnerships. In the event the Proposed Regulations were to be finalized in current form, virtually every partnership involving personal services will be required to review its governing documents; many will be required to revise their agreements; and many will be required to rethink future service provider incentives.

Interestingly, the New York State Bar Association Tax Section (“NYSBA Tax Section”) stated that their understanding of the impetus for the Proposed Authority was not a concern on the part of the IRS, Treasury or Congress that the current arrangement was not working reasonably well, but rather it grew out of a general regulatory project involving partnership options (both compensatory and noncompensatory) and the conclusion that regulations governing compensatory options should not be issued until there were regulations governing compensatory partnership interests.\textsuperscript{14} The IRS and Treasury strained mightily to overlay Code Sec. 83 in a manner that permitted the existing practice of the issuance of profits interests meeting the requirements specified in the Revenue Procedures to remain tax-free.

Under the Proposed Authority, a compensatory partnership interest (whether capital or profits) is subject to the valuation and vesting rules generally applicable under Code Sec. 83. Via a cumbersome process, the Proposed Authority generally permits a partnership and all of its partners to elect to report the fair market value of compensatory partnership...
interests transferred in connection with services at the liquidation value. However, if the election is made, compensatory capital interests must be valued using the liquidation value as well. This will often overstate the value of the capital interest. According to the NYSBA Tax Section, the complexity of the Proposed Authority with respect to the use of the liquidation value stems from the IRS’s concern that it did not have the statutory authority to require the use of liquidation value for compensatory partnership interests and the potential for the government to be whipsawed by inconsistent positions of the parties as to valuation (low value for recipient reporting income and high value for existing partners’ deduction purposes).  

As discussed in Part I, under the Revenue Procedures, generally the liquidation value may be used to value compensatory profits interests while normal valuation rules are permitted to be used to value compensatory capital interests.

The Proposed Regulations and Revenue Procedure

The general rule under Code Sec. 83 is that a service provider who receives property in connection with the performance of services must include in gross income the fair market value of the property minus the amount (if any) that the service provider pays for the property at the time of vesting unless a Code Sec. 83(b) election (“83(b) Election”) is made. Further, the Proposed Authority does not distinguish between capital and profits interests when applying Code Sec. 83. Proposed Reg. §1.83(e), which defines property for purposes of Code Sec. 83, would be amended to include the following statement: “… property includes a partnership interest.” The preamble to the Proposed Regulations indicates that the IRS and the Treasury were concerned that distinguishing between profits and capital interests allowed taxpayers to exploit any differences in the tax treatment of partnership profits interests and partnership capital interests, although no examples or specifics of an “improper exploitation” were given.

Under the Proposed Regulations, if the partnership interest is subject to a substantial risk of forfeiture, the taxpayer is not considered a partner for federal tax purposes and the value of the interest is not includible in gross income until such risk lapses. Therefore, any appreciation between the time of issuance and the time of vesting increases the tax liability of the service provider, and any distributions that are received are treated as additional compensation. The service provider can make an 83(b) Election with respect to a partnership interest subject to vesting that is transferred in connection with services. Under this election, the service provider is deemed to become a partner and includes in gross income the difference between the fair market value of the partnership interest at the time of the transfer and the amount (if any) paid for the property in the tax year in which the partnership interest is transferred.

With respect to a compensatory profits interest, the Proposed Authority departs from Rev. Proc. 2001-43, where a service provider who receives a partnership profits interest that is transferred in connection with the performance of services is treated as a partner even if no 83(b) Election is made and the interest is substantially nonvested.

To help combat uncertainty in determining the fair market value of the partnership interest and to facilitate the issuance of profits interests without triggering a federal tax liability, the Proposed Regulations provide that “a partnership and all of its partners may elect a safe harbor under which the fair market value of a partnership interest transferred in connection with the performance of services is treated as being equal to the liquidation value of that interest.” The Proposed Revenue Procedure refers to this election as the “Safe Harbor Election.” Per Proposed Reg. §1.83-3(l) and the Proposed Revenue Procedure Section 3.03, to qualify for the Safe Harbor Election, the partnership, partners and service provider must take certain steps:

- A partner who has responsibility for filing federal income taxes for the partnership must prepare a document stating that the partnership is making the Safe Harbor Election described in the Proposed Revenue Procedure that will apply irrevocably to all partnership interests transferred in connection with the performance of services while the Safe Harbor Election remains in effect. This document must specify the effective date of the Safe Harbor Election that is not prior to the execution of the Safe Harbor Election, and the document must be attached to the tax return for the partnership in the taxable year of the effective date of the Safe Harbor Election.

- The partnership must include details of the Safe Harbor Election in the partnership agreement or a separate document executed by each partner meeting certain requirements stating “the
Partnership is authorized and directed to elect the safe harbor.23 To meet the requirements of the Safe Harbor Election, the partnership agreement must also state that the partnership and each partner (including service providers receiving a compensatory partnership interest) agree to comply with all requirements for the Safe Harbor Election with respect to all compensatory partnership interests transferred while the Safe Harbor Election is in effect. For the separate document to meet the requirements of the Safe Harbor Election, each partner must agree to comply with all requirements for the Safe Harbor Election with respect to all compensatory partnership interests transferred while the Safe Harbor Election is in effect.24

The Proposed Revenue Procedure obsoletes Rev. Proc. 93-27 and Rev. Proc. 2001-4325 and clarifies the rules for the Safe Harbor Election under Proposed Reg. §1.83-3(l). The Proposed Revenue Procedure applies to any compensatory interest in a partnership that is transferred to a service provider by such partnership in connection with services provided to the partnership26 (either before or after the formation of the partnership) but does not presently apply to the provision of services to another entity for the benefit of the partnership. The Proposed Revenue Procedure refers to this interest as the “Safe Harbor Partnership Interest.” However, the Safe Harbor Partnership Interest cannot be (1) related to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease, (2) transferred in anticipation of a subsequent disposition,27 or (3) an interest in a publicly traded partnership within the meaning of Code Sec. 7704(b).28

Once a Safe Harbor Election is made, the election is binding on the partnership, all of its partners, and the service provider.29 A Safe Harbor Election is terminated automatically if any of the conditions for making the Safe Harbor Election are no longer met, the interest is no longer one for which a Safe Harbor Election can be made or “the partnership, a partner, or service provider reports income tax effects of a Safe Harbor Partnership Interest in a manner inconsistent with the requirements of this revenue procedure, including a failure to provide appropriate information returns.”30 The partnership can affirmatively terminate a Safe Harbor Election by:

Preparing a document, executed by a partner who has responsibility for federal income tax reporting by the partnership, indicating that the partnership, on behalf of the partnership and each of its partners, is revoking its safe harbor election under Rev. Proc. 200X-XX and the effective date of the revocation, provided that the effective date may not be prior to the date the election to terminate is executed.31

Once a Safe Harbor Election is terminated, the partnership (or any successor partnership)32 may not again make a Safe Harbor Election for “any taxable year beginning before the fifth calendar year after the calendar year during which such termination occurs without the consent of the Commissioner.”33 Moreover, the partnership must keep a copy of the Safe Harbor Election submitted to the IRS and the original of each document submitted by each partner to the partnership if the election is made; the failure to do so results in automatic termination.34 It is unclear as to when the automatic termination occurs.

The Proposed Revenue Procedure also dictates the effect of making a Safe Harbor Election. When the Safe Harbor Election is made, “the fair market value of a Safe Harbor Partnership Interest is treated as being equal to the liquidation value of that interest.”35 Liquidation value is defined as:

the amount of cash that the recipient of the Safe Harbor Partnership Interest would receive if, immediately after the transfer, the partnership sold all of its assets (including goodwill, going concern value, and any other intangibles associated with the partnership’s operations) for cash equal to the fair market value of those assets and then liquidated.36

However, if there is a plan that the interest will be forfeited at the time an 83(b) Election is made, the interest is not a Safe Harbor Partnership Interest and a Safe Harbor Election is not available. The Proposed Revenue Procedure provides that if a Safe Harbor Partnership Interest is disposed of within two years of acquisition, there is a rebuttable presumption that forfeiture was intended.37

If an 83(b) Election has been made with respect to a partnership interest for which a Safe Harbor Election has been made and that interest is subsequently forfeited, a new requirement of a forfeiture allocation is imposed for allocations to have substantial economic effect or be in accordance with the partners’ interests:
the service provider must include as ordinary income in the taxable year of the forfeiture an amount equal to the excess, if any, of (1) the amount of income or gain that the partnership would be required to allocate to the service provider under proposed § 1.704-1(b)(4)(xii)(b) if the partnership had unlimited items of gross income and gain, over (2) the amount of income or gain that the partnership actually allocated to the service provider under proposed § 1.704-1(b)(4)(xii).³⁸

In absence of such forfeiture allocation, allocations while the interest is substantially nonvested will not be deemed to be in accordance with the partner’s interest in the partnership. Even if there is a forfeiture allocation, if at the time an 83(b) Election is made there is a plan that a substantially nonvested interest will be forfeited, the protection of Proposed Reg. §1.704-1(b)(4)(xii)(b) will not apply.³⁹ If a forfeiture allocation is not provided for or if it is not applicable because of a plan to forfeit the substantially nonvested interest, each partner’s distributive share of partnership items is determined under Reg. §1.704-1(b)(3).

Finally, the Proposed Revenue Procedure describes the tax consequences to the service provider and the partnership:

- If the Safe Harbor Election has been made by the partnership and a partnership interest (capital or profits) is issued which is substantially vested day one, the service provider recognizes compensation income equal to the liquidation value of the interest less the amount paid for the interest (if any) upon the transfer.⁴⁰

- If the Safe Harbor Election has been made by the partnership, a partnership interest (capital or profits) is substantially nonvested day one, no 83(b) Election is made and the service provider holds the interest until it substantially vests, the service provider recognizes compensation income equal to the liquidation value of the interest less the amount paid for the interest (if any) on the date the interest substantially vests.⁴¹

- If the Safe Harbor Election has been made by the partnership, a partnership interest (capital or profits) is substantially nonvested day one, and the service provider makes an 83(b) Election, “the service provider recognizes compensation income on the date of transfer equal to the liquidation value of the interest, determined as if the interest were substantially vested, pursuant to the rules of § 83(b) and § 1.83-2, less any amount paid for the interest.”⁴²

- If the partnership has not made the Safe Harbor Election, the measurement dates are as provided above, but the recognition of compensation income is equal to the fair market value of the interests (not the liquidation value) less any amount paid for the interest.

The partnership receiving the services “generally is entitled to a deduction equal to the amount included as compensation in the gross income of the service provider under Code Sec. 83(a), (b), or (d)(2), but only to the extent the amount meets the requirements of Code Sec. 162 or 212.”⁴³ Assuming the partnership has made the Safe Harbor Election, this amount is described as the liquidation value of the interest less any amount paid for the interest. The Proposed Revenue Procedure also clarifies the timing of the deduction.⁴⁴ As a general rule, the deduction is allowed “for the taxable year of the partnership in which or with which ends the taxable year of the service provider in which the amount is included in gross income as compensation.”⁴⁵ As an exception, the partnership may make the deduction according to its method of accounting if the deduction relates to the transfer of substantially vested property.⁴⁶

The Proposed Regulations are silent with respect to allocations of a partnership’s deductions for the tax year a compensatory partnership interest is issued or vests, reasoning that Code Sec. 706(d)(1) and the corresponding regulations “adequately ensure[] that partnership deductions that are attributable to the portion of the partnership’s taxable year prior to a new partner’s entry into the partnership are allocated to the historic partners.”⁴⁷ At least one well known commentator doubts if Code Sec. 706(d)(1) prevents allocations of deductions to the service partner, particularly if such allocations bring such service partner’s capital account balance into the economic deal of the partners and partnership.⁴⁸

The Proposed Regulations amend the existing Regulations to require that the service provider’s capital account be increased by the amount the service provider takes into income under Code Sec. 83 as a result of receiving a partnership interest in connection with the performance of services, plus the amount (if any) paid for that partnership interest.⁴⁹ The IRS and Treasury expressly refute (at least in their view) that the partnership may reallocate capital between historic partners and the service provider under the substantial economic effect safe harbor under Code Sec. 704(b) regulations. When a Safe Harbor Election is made under the Proposed Revenue Procedure, the
capital account of the service provider is increased by the fair market value of the Safe Harbor Partnership Interest, which, under the Proposed Regulation, equals its liquidation value.

A more uncertain issue on which the IRS and Treasury requested comments is the forfeiture of certain compensatory partnership interests. Specifically, the issue arises when a substantially nonvested compensatory partnership interest for which an 83(b) Election has been made is forfeited. The Proposed Authority states that allocations of partnership items while the interest is substantially nonvested cannot have economic effect. In such case, Proposed Reg. §1.706-3(b) provides that the partnership must make certain forfeiture allocations in accordance with the partners’ interest in the partnership. Those allocations will be treated as being in accordance with the partners’ interest if (1) “the partnership agreement requires that the partnership make forfeiture allocations if the interest for which the section 83(b) Election is made is later forfeited,” and (2) “all material allocations and capital account adjustments under the partnership agreement not pertaining to substantially nonvested partnership interests for which a section 83(b) Election has been made are recognized under section 704(b).”

The method for making forfeiture allocations is determined under Proposed Reg. §1.704-1(b)(4)(xi)(c). That section provides:

Forfeiture allocations are allocations to the service provider (consisting of a pro rata portion of each item) of gross income and gain or gross deduction and loss (to the extent such items are available) for the taxable year of the forfeiture in a positive or negative amount equal to—

(1) The excess (not less than zero) of the—

(i) Amount of distributions (including deemed distributions under section 752(b) and the adjusted tax basis of any property so distributed) to the partner with respect to the forfeited partnership interest (to the extent such distributions are not taxable under section 731); over

(ii) Amounts paid for the interest and the adjusted tax basis of property contributed by the partner (including deemed contributions under section 752(a)) to the partnership with respect to the forfeited partnership interest; minus

(2) The cumulative net income (or loss) allocated to the partner with respect to the forfeited partnership interest.

The Proposed Regulations require that the character of the income and gain be in the same proportion as the income and gain of the partnership in the year of forfeiture. The remaining basis of the forfeited partnership interest in the hands of the forfeiting partner will generally give rise to a capital loss.

Proposed Code Sec. 721 applies to partnerships on the transfer or substantial vesting of compensatory partnership interests in connection with the performance of services with the result that the partnership does not recognize gain. The IRS and Treasury believe such a rule is consistent with the underlying principle of Code Sec. 721 “to defer recognition of gain and loss when persons join together to conduct a business.” Proposed Reg. §1.83-6(b) also amends the current Regulations to add that Code Sec. 721 is an exception to the rule that a transferor of property in connection with the performance of services recognizes gain equal to the difference between the value of the property and the transferor’s basis in that property. Finally, the non-recognition rule on the transfer or substantial vesting a compensatory partnership interest in connection with the performance of services does not apply to “an eligible entity, as defined in §301.7701-3(a) of the Procedure and Administration Regulations, that becomes a partnership under §301.7701-3(f)(2) as a result of the transfer or substantial vesting of the interest.” This may be theoretically correct as the services would be provided to the other partner when the services are performed prior to the formation of the partnership but represents a continuing trap for the taxpayer service provider.

Concerns

Trying to meld Code Sec. 83—which has a fundamental foundation of entity taxation—with that of partnerships—which mixes entity and aggregate concepts and pass-through taxation—is a monumental task. The history of the development of the state of affairs concerning compensatory partnership interests as discussed in Part I clearly indicates that originally Treasury and the IRS did not intend for Code Sec. 83 to apply to transfers of profits interests either on grant to a new partner or movement among partners providing services and receiving such profits interest as a result
of such services. Nevertheless, the courts determined that the terminology of “property” in Code Sec. 83 included profits interests, then stumbled around trying to resolve the valuation aspects, and often determined that a profits interest had only speculative value. The truce declared by the IRS through the Revenue Procedures has worked fairly well, although additional guidance in some areas would be welcome. Unfortunately, the effort of the IRS undertaken with the best of intentions to reconcile what may be unreconcilable appears to diminish some of the partnership’s flexibility and perhaps create more problems than it solves for traditional service partnerships and for partnerships that envision issuing both compensatory profits and capital interests. The Proposed Authority moves the taxpayers and the IRS back to the pre-Rev. Proc. 93-27 period except Code Sec. 736 are not partners for state law purposes or second, a separate legally binding agreement with each such partner. While many assume that putting language in the partnership agreement that binds all partners will solve the problem, that assumption is not necessarily correct. The partnership agreement will bind all state law partners and if properly drafted can bind all holders of financial interests. However, under state law, if a partner is a disregarded entity, the fact the entity is bound does not bind the owner, but for federal income tax purposes, the owner is the partner. This would also be true if the partner were a grantor trust, a qualified subchapter S subsidiary, or a qualified REIT subsidiary. The partnership may not even be aware if the ownership of such entities change. Former partners receiving payments under Code Sec. 736 are not partners for state law purposes but are partners for tax purposes. The agreeability of a former partner being paid over time and bitter about the withdrawal to sign such a document may be problematic.

2. The failure of the partnership or any partner to comply with the Safe Harbor Election requirements on an ongoing basis results in loss of the ability to use liquidation value. As discussed earlier in this Part II, the requirements to maintain a valid Safe Harbor Election are rather complicated and fraught with opportunities for fatal foot-faults. Having successfully made the Safe Harbor Election, events beyond the control of the partnership and contrary to the partnership agreement can void the Safe Harbor Election for everyone. For example, all partners must continue to be subject to the binding agreements associated with the Safe Harbor Election and honor them. However, for partners that are disregarded entities such as single-member LLCs, grantor trusts, qualified subchapter S subsidiaries or qualified REIT subsidiaries, the partnership may not even be aware of an ownership change and those new owners are the partners who must be bound and honor the agreements. The

| Code Sec. 83 does not carve profits interests of partnerships out of its coverage, although there is no indication that profits interests were contemplated at the time, and there is some indication that they were not. |
Safe Harbor Election is lost if any person who receives a compensatory partnership interest disposes of it within two years and in accordance with the regulatory presumption is found to have acquired such interest in anticipation of a subsequent disposition.\textsuperscript{64} If on audit the partnership is unable to provide original documents establishing that the partnership and each partner for tax purposes is bound, the Safe Harbor Election does not apply.\textsuperscript{65} These requirements create traps that will catch many partnerships that choose to make the Safe Harbor Election and their partners by surprise on an after-the-fact basis. The potential for error is high and gets higher as time goes on. Under the Proposed Regulations, the extensive strict requirements for maintaining the Safe Harbor Election can easily result in the loss of the Safe Harbor Election.\textsuperscript{68} Will foot faults actually cause the Safe Harbor Election to be automatically terminated for everyone?

3. To be treated as a partner, the service provider is required to make an 83(b) Election if the interest is subject to substantial risk of forfeiture. The requirement that the service provider make a timely 83(b) Election on receipt of a profits interest subject to a substantial risk of forfeiture if the value is to be measured at the time of grant is an inevitable byproduct of attempting to overlay Code Sec. 83 over the issuance of compensatory partnership interests. The election must be made within 30 days of the grant of the partnership interest, and if not timely elected, the value of the interest will be when the risk of forfeiture lapses and in the interim the holder of such an interest is not considered to be a partner. Any distributions such a service provider receives in the interim with respect to such unvested profits interest is simply compensation for services either as an employee, as an independent contractor or if the person is otherwise a partner, a guaranteed payment. The other partners receive allocations of all income, gain and loss associated with the unvested interest in the absence of an 83(b) Election.\textsuperscript{59} If the service provider timely makes the 83(b) Election, the value of the interest that is to be taken into income is determined on the date of grant, and the service provider is considered a partner with respect to such interest until there is a forfeiture.

Given the number of small partnerships which knowingly and unknowingly issue profits interests, the universe of nonelecting profits interests will be extraordinarily large. While an 83(b) Election is not particularly complicated, it does have to be done fairly quickly (within 30 days of grant).\textsuperscript{70} Often these partnerships will have limited use of tax advisors and will not be aware of the election or the timing of the election. The author anticipates that timely 83(b) elections will be a problem for a large percentage of such partnerships. The wisdom of the Revenue Procedures of not requiring an 83(b) Election for profits interest subject to substantial risk of forfeiture was great.

4. The requirement that the capital account credit and Code Sec. 83 income amounts be tied together raises at least two related levels of concern and one absurdity. The requirement that the capital account credit to the service provider and the Code Sec. 83 income amounts be tied together poses serious problems for service partnerships and makes the Proposed Authority's Safe Harbor Election largely unworkable for traditional service partnerships. The IRS's view that the partnership is unable to utilize special allocations of the deduction generated by the issuance of a compensatory interest to place the capital account of the service provider into balance with the arm's-length business deal economics compounds the concern.

If the capital accounts do not ultimately reflect what a partner is to receive upon a liquidation event, the partnership's ongoing allocations may not have substantial economic effect under Reg. §1.704. In addition, the partnership interest of a traditional service partnership is almost always a variable interest—it will be changed periodically to reflect the partnership's view of the value of the current services of the partner. As discussed below, with respect to variable interest service partnerships in which "fair market value" is neither given nor received when the interest varies, the approach of the Proposed Authority can result in the absurd situation where, in the absence of 83(b) Elections by two or more partners, traditional service partnerships may have no partners for federal income tax purposes.

For those traditional service partnerships for which there is no real market for the interests, what is the appropriate liquidation value? The NYSBA Tax Section comments phrased it this way:

First, it is not clear how the liquidation value of many traditional service partnerships should be determined, particularly where (i) the partnership's goodwill and other intangible assets have never been valued, (ii) the business has no value unless the service partners continue to provide services to the partnership as such, (iii) the potential for a sale of the partnership's business is
remote (or prohibited under applicable law), or (iv) there are no comparable sales because like partnerships have never been sold.\textsuperscript{71}

The current definition of liquidation value as found in the Proposed Authority requires the deemed sale of the partnership’s intangibles for fair market value to be taken into account.\textsuperscript{72} Liquidation value dispenses with minority discount, illiquidity discount and other valuation concepts that are focused on the interest of a partner versus an undivided percentage of the whole. The concept of liquidation value would appear to override nonlapse and other restrictions that would affect the value of the individual interest and ignore the variable aspect (\textit{i.e.}, increases and decreases based on current services) of a typical service provider’s interest in a service partnership.\textsuperscript{73}

The liquidation value as determined for federal tax purposes will most likely not comport to the business deal as to what a new or increasing partner is to receive upon the withdrawal from a service partnership. The application of the liquidation value approach to traditional service partnerships such as law, accounting, consulting and investment management in which there is almost no market for such interests and in which intangible values are often ignored to varying degrees among the parties for a partner (1) entering the partnership, (2) changing of profits percentage in the partnership over time, and (3) withdrawing from the partnership is more than merely problematic. The result is the tax law overriding the common business arrangement of the parties and/or allocations that may not satisfy Reg. \textsection{1.704}. Furthermore, in a service partnership, if the intangible value and cash basis receivables were sold the day after admission, a proportional share of the income and gain would be generated and allocated to the service partner. The imposition of tax on value attributed to such intangibles is in essence a double tax. The tax law should reflect the economic effect of the parties non-tax motivated business deal, not create a deal that is different from that of the parties.

Traditional concepts of fair market value under Code Sec. 83 have many of the same issues. However, a well drafted partnership or operating agreement using a traditional tax capital account (versus book capital account) method of value for entry and exit may well constitute a nonlapse restriction under Code Sec. 83(d) permitting the transferee to sell the interest only at a price determined by formula. Such tax capital account would reflect tax basis, which would not reflect unrealized gain in intangibles and in many cases, cash basis receivables and work in process. Under Code Sec. 83(d), such formula price should be deemed to be the fair market value unless the Secretary determines otherwise with the burden of proof placed on the Secretary.\textsuperscript{74} Therefore, the traditional concept of fair market value for the partnership interest versus liquidation value may better fit many traditional service partnerships.

Unfortunately, many partnership agreements—perhaps most of the smaller business and service partnership agreements—do not formally address the terms on entrance and exit and how interests may change over time. Indeed, there are a vast number of oral agreements in the real world of small business and small service partnerships. Generally, the business deal in such partnership is a partner does not contribute capital for all or a significant portion of intangible asset value and perhaps only book value for tangible assets and does not receive a distribution based on a fair market liquidation value as his or her interest declines or upon withdrawal.

Once understood, many partnerships, particularly service partnerships, will be loath to make the Safe Harbor Election as new capital service partners who are buying in for the formula price are unlikely to agree (1) to have taxable income equal to their share of the intangibles or other value which they will not economically receive or for which under the general tax rules applicable to partnerships will result in income and gain of such amount being allocated to them at that time,\textsuperscript{75} or (2) pay such higher value. This in turn means the liquidation value may not be used to establish the value for profits interests under the Proposed Authority and traditional concepts for determining fair market value must be used. In the context of a profits interest, it is likely that service providers of most service partnerships will take the position that the value is speculative and therefore worth zero and the IRS may well disagree (we are back to pre-Rev. Proc. 93-27) and the potential for substantial valuation litigation.

The difficulty of applying the Proposed Authority to a traditional service partnership is also illustrated by the literal application of the Proposed Authority creating the absurd possibility that many or most traditional service partnerships may not exist for federal tax purposes. Typically, a service partner ceases being a partner if he or she ceases to provide services and, under the typical scenario described above, will only receive the formula value that does not fully reflect...
intangible value either on admission or exit and will often be considered a forfeiture under the applicable rules. In such case, it is possible, perhaps probable, that such service provider’s interest will be subject to a substantial risk of forfeiture, and under Proposed Reg. §1.761-1(b) such person will not be considered to be a partner. Since this condition could well apply to all “partners,” in absence of 83(b) Elections, there would be no partnership. An absurd result, but one discussed by both Tax Sections.76

While generally supportive of utilizing liquidation value for nontraditional service partnerships,77 both the ABA Tax Section and the NYSBA Tax Section recommended not applying the Proposed Authority to traditional service partnerships.78 The short discussion above demonstrates the merit of such recommendation.

5. Forfeiture allocations. The Proposed Regulations provide that allocations of income, gain and loss to a service provider that makes an 83(b) Election cannot have substantial economic effect while the compensatory partnership interest is subject to substantial risk of forfeiture!79 The corollary may be that allocations to other partners do not have substantial economic effect during the period a compensatory partnership interest is not vested.

The Proposed Regulations provide that allocations to a service provider with an unvested compensatory partnership interest will be respected as in accordance with the partners’ interest in the partnership if an 83(b) Election has been made and the partnership agreement calls for forfeiture allocations in the event of forfeiture and the allocations would otherwise be respected.80 Under Proposed Reg. §1.704-1(b)(4)(xii), forfeiture allocations would allocate items of income or deduction to the forfeiting service provider in order to reverse the net effect of allocations made to such service provider prior to forfeiture.81 As a tax attorney, the author appreciates the theoretical tax symmetry that such an allocation would create and recognizes that the forfeiture allocations in essence will give the forfeiting service partner a deduction or loss for any accumulated income.82 In the vast majority of profits interests, the ultimate recipient of the profits interest income and loss are individuals providing services to or for the benefit of the partnership issuing the interest and are likely in similar income tax brackets to those of other partners. Partnerships generally provide tax distributions to the holders of profits interests to enable them to pay the tax on partnership income allocated to them. The net practical result is the forfeiting partner has a windfall equal to the tax distribution (less taxes on such distribution), and the remaining partners have an economic loss equal to the tax distribution to the forfeiting partner (less the tax that would have been imposed on such amount). In addition, the remaining partners will ultimately recognize the income and gain inherent in the accumulation and pay tax at such future time. In the Subchapter S context, the forfeiture of unvested S corporation stock received for services and with respect to which an 83(b) Election was made83 does not have a forfeiture allocation provision of any kind (optional or required).84 Such a shareholder would have received allocations of income while he or she held such stock. An anti-abuse rule would be much simpler to stop any “games” by the remaining partners rather than having complicated allocations, calculation of character of income to be allocated, and a negative economic loss to the remaining partners. The service provider forfeiting his or her interest can easily be deemed to have received any accumulated income and then contributed it to the partnership and, therefore, be entitled to a loss. If the forfeiture allocation was designed in part to permit such partner to receive a tax benefit on forfeiture for the accumulated income in excess of distributions that was allocated to such person while holding the partnership interest, such a construction would achieve the result.

6. Do changes in partners’ percentage interests constitute incremental issuance of new profits interests or capital interests? The Proposed Authority is unclear whether a change in the percentage interest in profits among partners is a transfer of a profits interest. Many assume this is not the case.85 Conceptually, however, if a service partner has an increase in his or her percentage interest in the profits of the partnership by virtue of providing services, is there not an issuance of a profits interest to such partner? Stated another way, if a service partner’s interest increases from one percent to two percent, is the one-percent increase an award of an additional profits interest? Has one or more of the other partners suffered a forfeiture?

As an economic and theoretical matter, one can argue that such a change is indeed the incremental grant or perhaps forfeiture of a profits interest. With respect to the grant of equity interests, Code Sec. 83 was designed with the corporate entity model in mind in which stock was either held or sold but not changed by its own terms. Nowhere in the legislative history, the Code section or the existing Regulations
is the application of Code Sec. 83 to partnerships mentioned. However, in the context of the aggregate theory of partnership taxation (as opposed to the entity theory) the aggregate efforts to generate the future income yield the future income—i.e., it is the aggregate labor of the partners that produce the profit. Being taxed on an increase in the profits percentage interest and then being taxed on the income earned amounts to a level of double taxation. The ABA Tax Section comments did not make the assumption that increases in the profits percentage was not the grant of a profits interest and discussed the difficulty of applying the Proposed Authority to inherently variable interests in service partnerships and the potential for double taxation. The ABA Tax Section identified three primary variations of common partnership profits percentage adjustments: (1) purely retroactive awards (relating to the year in reference to which the billings and/or hours, etc., are calculated); (2) mostly prospective awards (based upon the prior year, but relating to the calendar year in which the award is made); and (3) a combination of retroactive and prospective awards (based upon the prior year, but purporting to apply also to the current and potentially future years). In each of these situations, there was a varying degree of double taxation if both the tree and fruit were taxed.

The conclusion of the ABA Tax Section's comment on this aspect of profits interest is that there is nothing to indicate that the Congress intended to double tax all or an element of a service partner's income. From the author's perspective, it is likely that the treatment of a profits interest of a partnership as property for taxation at grant or award amounts to a double taxation of portions of the income earned by the service partners may well be at least part of the reason that the parenthetical language in Reg. §1.721-1(b) existed. Unfortunately, this regulatory language was disregarded by the courts. Many courts, however, on the specific facts of the case, find the value of a profits interest to be speculative. As discussed in Part I, the grant of interest in capital was considered to be taxable prior to the passage of Code Sec. 83, but the award of or change in percentage interest in profits was not.

7. The Proposed Authority does not address tiered and affiliated arrangements. The Proposed Authority omitted the Revenue Procedures’ concept of “for the benefit of” with respect to providing services in exchange for the profits interest in a partnership, thereby omitting the common situation of providing services to another entity that benefits the issuing partnership. It is very common for a service provider providing services to one affiliated entity that benefits the partnership to receive an interest in the partnership. The Treasury and the IRS, however, in the preamble to the Proposed Regulations requested comments on this aspect. The author has seen numerous comments to the IRS on the Proposed Authority supporting the extension of the services to include services provided to an affiliated entity for the benefit of the partnership issuing the interest.

8. Transition Rules. The Proposed Authority represents a major change to partnership taxation. The issuance of capital and/or profits interests to service partners is a common occurrence for a huge percentage of service and quasi-service partnerships. The application of the Proposed Authority to transfers of property on or after the date final regulations are published in the Federal Register is not realistic or remotely fair to the taxpayers or tax professionals. The transition rules for the effectiveness of the Proposed Authority should provide for both an extended time for existing partnerships to come into compliance and for new partnerships to comply as counsel, and tax advisors will have to understand and react to the new requirements. Partnership agreements will have to be amended and verbal partnership agreements will have to be written and documented to comply with the current version of the Proposed Authority. If the NYSBA Tax Section was correct in its understanding for the reasons for the Proposed Authority, there is not an abuse that must be shut down quickly or a fear there will be a massive revenue loss with compensatory interests being issued to “get under the wire.”

Recommendations for Current Partnership Agreements

Although it is unknown whether the Proposed Authority will be finalized or will continue to languish, it is prudent for partnership or operating agreements to contain contingent provisions in the event useful regulations are adopted to provide a mechanism for the partnership to (1) elect to have the partnership make the Safe Harbor Election or its equivalent, (2) authorize and direct the partner responsible for tax filings (or another partner that is a partner for federal income tax purposes if such partner is not) to make appropriate elections for the partnership necessary to implement a Safe Harbor Election or its equivalent once the partnership has acted to make the election,
(3) bind each partner by such provisions (and perhaps make partners liable to the other partners for damages if such partner (or the partner’s owner) breaches such agreement), (4) contain covenants from partners prohibiting them from taking actions or making elections that would disqualify the election; (5) make each partner or transferee obligated to execute separate binding agreements as may be required and requested by the partnership; and (6) provide information necessary or appropriate for the partnership to comply with the Safe Harbor (or its equivalent) and to cause any of its owners to do the same if requested by the partnership. In addition to having the mechanic to obtain partner approval for the partnership to make the election, the partnership agreement should have a mechanic for partner approval to revoke the election if it has been made. These provisions should be effective only upon approvals as specified in the partnership agreement. Depending on the final form of the regulations, many partnerships are likely to decline the opportunity to utilize the safe harbor for the reasons described herein. However, for those partnerships that do wish to elect, obtaining unanimous approval and executed agreements may be impossible, even when the Safe Harbor or equivalent is clearly beneficial to the partnership.

**Conclusion**

As a theoretical and intellectual tax policy matter, given the decisions of the courts to date, it is hard to argue that, as a technical matter, compensatory partnership interests, even a profits interest, is not a form of property. Code Sec. 83 does not carve profits interests of partnerships out of its coverage, although there is no indication that profits interests were contemplated at the time, and there is some indication that they were not. Nevertheless, the author believes the Proposed Authority creates more problems than it solves regarding compensatory partnership interests. The business and tax fabric of partnerships and their embedded aggregate concept of a joint undertaking for profit would indicate that a true profits interest (as opposed to a capital interest) given to a service provider for services to or for the benefit of the partnership is a different creature that perhaps should not be taxed, particularly in light of the long history of largely not taxing such interests or even subjecting them to 83(b) Elections and the fact the income and gain associated with the profits interest will be taxable as it materializes. Liquidation value, however, may well be an important and useful tool for partnerships for which capital is a material income-producing element and the interest of the service provider is likely to remain static. Determining liquidation value for traditional service partnerships without consideration of legitimate non-lapse restrictions or permitting the deduction for the “excessive value” to be allocated to the service provider to bring the capital account into line with the economics of the parties severely limits the usefulness of the Proposed Authority. In the author’s view, treating compensatory capital and profits interests the same and requiring the liquidation value election to apply to both is a mistake unless the deduction can be allocated to the service provider to cause the capital account balance to equal the business agreement and the net income to the service provider to reflect the business agreement. The author believes the NYSBA Tax Section was accurate when it stated: … [W]e believe that it simply does not make sense at this point to abolish the current system of effectively allowing almost all compensatory partnership profits interests to be valued based on their liquidation value due to a concern that the current system is somehow prohibited by a [C]ode provision enacted over thirty-five years ago.90

**Endnotes**

1. REG-105346-03, 70 FR 29675 (May 24, 2005).
7. Code Sec. 422.
8. While there are restricted stock rules and special rules applicable to options that may defer the timing of the realization of compensation income equal to the then fair market value of the stock. See Code Sec. 83(a) and (b).
10. Id., at Section 2.01. Although the Revenue Procedure does not expressly state that in the liquidation of the partnership the debts and obligations of the partnership must be paid to determine if there are proceeds received by the holder of an interest in the partnership, that is implicit in the concept of liquidation as the state law rights of creditors take preference over the rights of equity holders. The preamble gives a basis for a position for non-recognition at the partnership level under current law.
The preamble to the Proposed Regulations provides authority for the clarification of one open issue under the Revenue Procedures. The IRS and the Treasury acknowledge that consistent with the policies underlying Code Sec. 721, a partnership should not be required to recognize gain on the transfer of a compensatory partnership interest. Under Reg. §1.704-1(b)(4)(ii) (reverse Code Sec. 704(c) principles), the historic partners are generally required to recognize any income, gain or loss attributable to the partnership's assets as those assets are sold, depreciated or amortized. REG-105346-03, Explanation of Provisions, 6. Application of Section 721 to Partnership on Transfer (June 13, 2005).

The interest is "presumed to be transferred in accordance with Code Sec. 706(d)(1), William McKee suggests that the deduction as Code Sec. 83 uses one set of rules and Code Sec. 706(a) and Reg. §1.706-1(c) for guaranteed payments uses another. See I, Leigh Griffith, Passthrough Partner, Transfer of Partnership Interests (June 13, 2005).

Proposed Reg. §1.83-3(iii) and Proposed Rev. Proc., Section 3.01(2) and (3). Proposed Rev. Proc., Section 7. Even though these Rev. Procs. are obsoleted, the Proposed Revenue Procedure uses very similar language in describing a "Safe Harbor Partnership Interest." The language is "to the partnership, not to or for the benefit of the partnership." The IRS in the preamble requested for comments on the treatment of tiered or affiliated partnerships and the issuance of profits interests. The interest is "presumed to be transferred in anticipation of a subsequent disposition ... if the partnership interest is sold or disposed of within two years of the date of receipt of the partnership interest (other than a sale or disposition by reason of death or disability of the service provider) or is the subject, at any time within two years of the date of receipt, of a right to buy or sell regardless of when the right is exercisable (other than a right to buy or sell arising by reason of the death or disability of the service provider)." Proposed Rev. Proc., Section 3.02. This presumption can be rebutted with clear and convincing evidence. Id.

Proposed Rev. Proc., Section 3.02. Rev. Proc. 93-27 only excluded limited partner interests in publicly traded partnerships. This Proposed Revenue Procedure would exclude general partner interests as well. Such interests are generally not sold. Id., at Section 3.01. Id., at Section 3.04. Id. The written election to terminate the election must be attached to the tax return for the partnership for the tax year that includes the effective date of the election.

A successor partnership is any partnership that (1) "on the date of termination, is related (within the meaning of § 267(b) or § 707(b)) to the partnership whose Safe Harbor Election has terminated or, if the partnership whose Safe Harbor Election has terminated does not exist on the date of termination would be related if it existed on such date," or (2) "acquires (either directly or indirectly) a substantial portion of the assets of the partnership whose Safe Harbor Election has terminated." Id., at Section 3.05.

Id., at Section 3.06. Id., at Section 4.02. Id. Id., at Section 4.02. Proposed Reg. §1.704-1(b)(4)(xii)(e). Proposed Rev. Proc., Section 5.01. Id. Id. (emphasis added). Id., at Section 5.02. Current law has a conflict on the timing of the deduction as Code Sec. 83 uses one set of rules and Code Sec. 706(a) and Reg. §1.706-1(c) for guaranteed payments uses another. See I, Leigh Griffith, Passthrough Partner, Transfer of Partnership Interests Revisited: Part I, TAXES—THE TAX MAGAZINE, Dec. 2013, at 42–43. In the preamble to the Proposed Regulations, however, the IRS requested comments on alternative approaches for resolving the timing inconsistency between Code Sec. 83 and Code Sec. 707(c). REG-105346-03, Explanation of Provisions, 2. Timing of Partnership Deduction (June 13, 2005).


William S. McKee, William F. Nelson, Robert L. Whitmire, et al., FED TAX'N OF PARTNERSHIPS AND PARTNERS, at ¶5.02[8][f][iii] (3d ed. 1997 & 2005 Supp.). Because no regulations have been issued under Code Sec. 706(d)(1), William McKee suggests that it is not readily apparent that the IRS is confident with this rule. Id. He says "it is clear that the IRS believes that Code Section 706(d)(1) requires a form of 'closing the books' accounting to ensure that a deduction of compensation for services is allocated among historic partners." However, Code Sec. 706(d)(2)(B) places limits on the use of closing-of-the-books accounting where "payments of compensation for services made by partnership using the cash receipts and disbursements method of accounting are treated as 'allocable cash basis items.'" Id. Further, under Code Sec. 706(d)(2)(A), "each partner's distributive share of any allocable cash basis item must be determined under a daily prorating method of accounting." Id. The Proposed Authorities would provide that Code Sec. 706(d)(2)(A) does not apply to transfers of property in connection with the performance of services under a closing-of-the-books method by allowing the partnership to allocate those deductions. Id.


The IRS and the Treasury have requested the following:

Whether the regulations should require or allow partnerships to create notional tax items to make forfeiture allocations where the partnership does not have enough actual tax items to make such allocations.

Whether Code Sec. 83(b)(1) should be read to allow a forfeiting service provider to claim a loss with respect to partnership income that was previously allocated to the service provider and not offset by forfeiture allocations of loss and deduction and, if so, whether it is appropriate to require the other partners in the partnership to recognize income in the year of the forfeiture equal to the amount of the loss claimed by the service provider. In particular, comments are requested as to whether Code Sec. 83 or another section of the Code provides authority for such a rule. REG-105346-03, Explanation of Provisions, 4. Accounting for Compensatory Partnership Interests (June 13, 2005).


Id.

This statement of position is useful for the existing truce as whether the partners or partnership should recognize gain upon the issuance of compensatory partnership interests. This has been a question for which there was no authority. There is now at least a form of "authority" as the underlying principle of Code Sec. 721 would exist today.

REG-105346-03 Explanation of Provisions, 6. Application of Section 721 to Partnership on Transfer (June 13, 2005).


See Griffith, supra note 44, at 34–35.
The acknowledgement in the Proposed Regulation's preamble that no gain is recognized by the partnership under the general principles of Code Sec. 721 is very helpful to current "law."

See GCM 36346 (July 23, 1975) (this memorandum will be superseded by the finalization of the Proposed Regulations).

"Comments Concerning Partnership Equity for Services," ABA Tax Section, 2006 WL 4774960 (IRS) (Dec. 29, 2005). The author was member of the group providing such comments.

NYSBA Tax Section, supra note 14.

Partnerships that are not traditional service partnerships or partnerships in which capital is a material income producing factor, respectively.

ABA Tax Section, supra note 62, Part VII.A; NYSBA Tax Section, supra note 14, cover letter, at 2.


Id., at Section 3.06.

Id., at Section 3.03 & 3.04.

See Crescent Holdings, LLC, 141 TC No. 15, Dec. 59,705 (2013). In addition, if the service provider is already a partner, presumably such service provider would receive his or her share of the income, gain or loss attributable to the forfeitable interest in accordance with his or her nonforfeitable interest.

Code Sec. 83(b)(2).

NYSBA Tax Section, supra note 14, Part III.C.


It would make the Proposed Authority much more workable for traditional service partnerships if the liquidation value could be adjusted to reflect the nonlapse restrictions applicable to all partnership interests.

Code Sec. 83(d)(1).

If a Safe Harbor election is made, the liquidation value must be used for all commensatory partnership interests. The Proposed Regulations provide that the service partner will have income for the difference between the amount paid (including value of property contributed) and fair market value of the interest with liquidation value constituting fair market value if the Safe Harbor election is made.

NYSBA Tax Section, supra note 14, Part III. C: ABA Tax Section, supra note 62, Part VII.

NYSBA Tax Section, supra note 14, Part III. B. 2 recommended that liquidation value for compensatory interests be mandatory and that the IRS had regulatory authority to impose such a value. However, in Part III. C, the NYSBA Tax Section stated that "...we believe Treasury and the IRS have authority to and should exclude interest in traditional service partnerships form Section 83."

NYSBA Tax Section, supra note 14, Part III C; ABA Tax Section, supra note 62, Part VII.


As a technical matter, the Proposed Regulations did not amend the Treasury Regulations to permit the forfeiture allocations not to violate the requirements of allowing certain chargebacks without violating Code Sec. 168(h) (tax-exempt use property rules) and Code Sec. 514(c)(9)(E)(i) (exception for acquisition indebtedness from UBTI). See, for example, Reg. §1.514(c)-2(e) listing other chargeback exceptions to violations of Code Sec. 514.

As discussed in Part I, the §83 Regulations provide that a loss is allowed only for the difference between what the electing service provider paid for the property and the amount received at forfeiture. The accumulation of income may not give rise to either a deduction or a loss.

Reg. §1.1361-1(b)(3) provides that upon election under Code Sec. 83(b), a service provider receiving subchapter S stock subject to a substantial risk of forfeiture becomes a shareholder for purposes of Subchapter S.

The preamble to the Proposed Regulations highlights the similarity between the unvested compensatory partnership interest and the unvested compensatory S corporation stock. No policy reason is given for the distinction requiring the forfeiture allocations for partnerships and not S corporations.

The NYSBA Tax Section comments stated: “Although not entirely clear, we assume that such adjustments [partner’s share of profits may be increased or reduced in any given year as compared with the prior year] would not be treated as ‘transfers” or “forfeitures” of property under Section 83 ...” NYSBA Tax Section, supra note 14, Part III. C.

ABA Tax Section, supra note 62, Part VII. A.

Id.

See, for example, Crescent Holdings LLC, 141 TC No. 15, Dec. 59,705 (2013).

Proposed Reg. §1.721-1(b)(1) (June 3, 1971) was never finalized and was revoked by the Proposed Regulations. These 1971 proposed regulations provided that partnership capital interests were subject to Code Sec. 83, but did not include a similar rule for profits interests.

NYSBA Tax Section, supra note 14, Part III. B. 2. The ABA Tax Section Comments were not as blunt: “We recommend that the application of the Final Authorities to partnerships in respect of which capital is not a material income producing factor (as described in section 736) be reserved until a method of reconciling subchapter K and section 83 that avoids double taxation may be developed....” ABA Tax Section, supra note 62. Principal Recommendation 23.