

US Inbound Taxation: Senate Finance Committee tax reform plan would overturn recent Tax Court decision

10 NOVEMBER 2017

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On November 9, the Senate Finance Committee released its tax reform plan, with provisions that differ substantially from the House's bill released on November 2. Of particular significance, the Committee's proposal includes a provision to overturn the Tax Court's recent decision in *Grecian Magnesite Mining, Industrial & Shipping Co., SA*, which Withers previously [discussed here](#). The Tax Court's decision was significant because it allowed foreign investors to potentially sell interests in US partnerships tax free to the extent that the partnership's holdings were not certain assets, such as US real estate.

In July of this year, the Tax Court, in *Grecian*, chose not to follow the "look-through" approach of IRS Revenue Ruling 91-32. In 1991 the IRS issued Revenue Ruling 91-32 and asserted that it would apply a "look-through" treatment to determine the taxability of a non-US person's gain from the sale/disposition of a US partnership interest. Under this approach, the IRS looked through the partnership to conclude that a non-US person was taxable on gain to the extent such gain was attributable to assets effectively connected to the partnership's US business. The IRS's ruling essentially adopted the same analysis Congress prescribed in IRC Section 751 for inventory and receivables, except that the IRS's ruling applied this approach to an additional category of assets (i.e., all effectively connected income-generating assets). The IRS's approach in Revenue Ruling 91-32 was widely debated in the tax professional community.

Under the Senate Finance Committee's recent proposal, gain or loss from the sale or exchange of a partnership interest would be effectively connected with a US trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The proposal requires that any gain or loss from the hypothetical asset sale by the partnership be allocated to interests in the partnership in the same manner as non-separately stated income and loss. In other words, the Senate's proposal would resurrect and codify the look-through treatment approach of IRS Revenue Ruling 91-32.

The Senate's proposal is not entirely surprising. The Obama administration had proposed several times to codify Revenue Ruling 91-32 in its annual "green book" budget proposals. Additionally, a number of US income tax treaties have incorporated the rationale of Revenue Ruling 91-32 in treaty provisions dealing with the sale of a partnership interest. It is worth noting that the House's bill does not contain any provision relating to Revenue Ruling 91-32 and therefore it remains to be seen whether the final version of any tax reform bill will include provisions relating to Revenue Ruling 91-32.

We will be closely monitoring tax reform proposals as the House and the Senate move forward in reconciling their respective plans. For general commentary on proposed tax reform plans, please scroll down and click the Read More link.

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