The attached comments are being submitted by Citigroup to S. 4026, the Tax Technical Corrections Act of 2006. These comments relate specifically to Section 6 of S. 4026, involving Section 470 of the Internal Revenue Code. Please contact me if you have any questions.

Regards

Jeff Levey
Vice President, Director
Tax Legislative and Regulatory Policy
Citigroup Global Government Affairs

October 31, 2006

The Honorable Charles Grassley
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

The Honorable Max Baucus
Ranking Member
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Chairman Grassley and Sen. Baucus:

I am writing, on behalf of Citigroup Inc. in response to your request for comments on S. 4026, the Tax Technical Correction Act of 2006, which you introduced on September 29, 2006.

I. INTRODUCTION.

Citigroup Inc. is pleased to offer its comments on proposed Section 6 of H.R. 6264 and S. 4026, the Tax Technical Corrections Act of 2006 (the "TTCA"). Section 6 would revise section 470 of the Internal Revenue Code (as added to the Code by the American Jobs Creation Act of 2004, P.L. 108-357), principally by adding a new section 470(e), addressing the application of section 470's principles to partnerships.

Citigroup appreciates the importance of section 470 as it applies to leasing, and we also understand and accept the importance of ensuring that the Code does not countenance the development of highly-structured partnership arrangements that replicate all or most of the tax benefits of "LILO" and "SILO" lease structures. At the same time, Citigroup remains concerned that an overbroad provision aimed at forestalling the development of structured partnership successors to "LILOs" and "SILOs" could cause adverse unintended consequences for many *operating* partnerships — partnerships that actively conduct one or more trades or businesses — that have nothing in common with "LILO" and "SILO" leasing practices.

This issue is particularly important to Citigroup because one of our largest overseas affiliates is organized as a partnership for U.S. tax purposes, with a majority U.S. partner and minority foreign partners (which in turn are Citigroup subsidiaries that are taxed as "controlled foreign corporations"). The affiliate has thousands of employees, billions of dollars in annual revenue, in capital, and in assets (comprised predominantly of securities positions, but also including property described in section 470(c)(2)), and thousands of customers. At worst, an overbroad prophylactic partnership provision would deny Citigroup a deduction for depreciation and amortization of the affiliate's section 470(c)(2) assets, despite the fact that the partnership is actively engaged in a customer-driven business that bears no resemblance to LILO/SILO fact patterns. At best, an overbroad provision would introduce difficult interpretational and compliance issues for the IRS, for Citigroup, and for thousands of other operating partnerships across the U.S. economy.

The comments that follow are designed to honor the concerns that motivated Congress to introduce section 470 in 2004, and to preserve the general framework of Section 6 of the TTCA, as it is currently drafted. The overall purpose of our comments is to focus the language of Section 6 as it applies to operating partnerships more closely on the nature of the relationship between taxable and tax-exempt *partners* that can give rise to the same concerns that Congress addressed in section 470 with respect to a taxable *lessor* and a tax-exempt *lessee*.

Section II of this memorandum describes our overall theme in a little more detail. Section III then lays out our specific suggestions, and briefly summarizes our reasoning. Finally, we have attached for your convenience a copy of current Section 6 of the TTCA, marked to show our suggested changes.

II. TRANSLATING SECTION 470 PRINCIPLES INTO THE PARTNERSHIP CONTEXT.

We believe that section 470, as it applies to its core subject (leasing), is premised on three principles that together define a "true" lease. Section 470 then develops rules to ensure that the relationship between a tax-exempt lessee and a taxable lessor does not to any significant extent vitiate any of these principles.

The three principles that section 470 uses to define a "true" lease when the lessee is a tax-exempt entity are as follows. First, the lessor must make a substantial investment of capital in the leased property. Second, the lessor must look to the lessee's rental obligations for one significant portion of the lessor's economic returns. And third, the lessor must also look to the residual value of the leased property for another significant portion of its economic returns.

Section 470(d) responds to these three principles with three basic operating rules. First, the lessor must make and maintain a significant investment in the leased property. (Section 470(d)(2).) Second, the lessee must not "monetize" (beyond relatively insignificant levels) its *obligation* to pay rent to the lessor, or its *option* to repurchase the leased property.[1] (Section 470(d)(1).) Third, the lessee must not assume any significant risk of loss relating to the residual value of the leased property (whether through a lessor "put" option or otherwise). (Section 470(d)(3).)

We believe that these principles and operating rules help put the operation of section 470(d)(1), in particular, into context, as can be illustrated by some common LILO/SILO fact patterns. To take one example, a loan from a tax-exempt lessee to a taxable lessor might be viewed as undercutting the first principle outlined above (that the lessor have an at-risk investment in the leased property); section 470(d)(1) accordingly addresses this fact pattern. A tax-exempt lessee's "defeasance" of its rental obligations to the taxable lessor might be viewed as undercutting the second principle (that the lessor look to the *lessee* for a significant portion of its return); section 470(d)(1) therefore addresses this fact pattern as well. And finally, a lessee fixed price option to purchase the leased property, *combined* with a "defeasance" arrangement, was seen by Congress as putting too much practical pressure on the third principle (that the lessor look to the residual value of the leased property for a significant portion of its return); section 470(d)(1) therefore also addresses this case.

Despite all the complexity of the "LILO" and "SILO" arrangements that impelled Congress to enact section 470, those transactions, like all leases, essentially boil down to simple bilateral agreements between a (taxable) lessor and a (tax-exempt) lessee. Accordingly, section 470(d)(1)(A) applies, first, to set-asides or other arrangements that run directly to the benefit of

---

[1] As a strictly logical matter, the inclusion of the monetization of a lessee option to purchase the leased property probably does not necessarily follow from the three principles summarized earlier. The inclusion is best explained as reflecting a deep skepticism on the part of Congress that a tax-exempt lessee would ever *not* exercise a "defeased" purchase option, given the importance of the leased property in many cases to the lessee's operations.

the lessor, or to any lender *to the lessor* (because that is what it means to be a "lender" in a leveraged lease transaction). The party providing these set-asides of course is the tax-exempt lessee, because that is the counterparty to the lessor (and the lessor's lender). Similarly, section 470(d)(1)(A) also applies to set-asides by the lessee that directly satisfy its own obligations under the lease – but again those obligations (and the destination of the lease rental payments) are to the lessor (the only counterparty to the lease), or to the lessor's lender. In either case, the presupposition is that there is a lessor investment or a lessee obligation to pay rent, the economic significance of which to the lessor is undercut by the arrangements entered into by the lessee.[2]

Section 470(e)(2)(A), as proposed by the TTCA, is patterned closely on current section 470(d)(1)(A), but we believe that partnerships are much more complex bundles of agreements than are leases. As a result, the partnership analogy to section 470(d)(1)(A) is more complex (and less inclusive) than how Section 6 of the TTCA in its current form might be read. First, partnerships that operate businesses engage in a wide range of transactions with suppliers, customers, counterparties, lenders and other third parties that have no direct analogy to the narrower sphere of activity embodied in a lease. Second, a partnership is simultaneously an entity (conducting business with third parties, for example) and a multilateral agreement among its partners (through partnership allocations). Third, a lender in a leasing arrangement is by definition lending to the owner of the property – the lessor. By contrast, a lender to a partnership indirectly is lending to *all* partners, including tax-exempt as well as taxable partners. Some aspects of this complex web of relationships can be analogized to a tax-exempt lessee monetizing its lease obligations, but many others cannot.

The difficulty, then, is to identify within the complex web of relationships that define a modern partnership (relationships between the partnership and its suppliers, customers and counterparties; relationships among the partners in allocating the returns from the partnership's business; relationships between a partnership and its lenders, etc.) those relationships that are analogous to a tax-exempt lessee setting aside "funds" for the benefit of the lessor, or the lender to the lessor. For example, we submit that, if a partnership borrows money from a third party to acquire depreciable property that the partnership operates directly in a manufacturing business, and posts collateral to the lender to secure the loan, that partnership is not, without more, engaged in a transaction that should fall within the scope of new section 470(e)(2)(A), regardless of the nature of the collateral, because the loan is made indirectly to tax-exempt as much as taxable partners.

Our suggested language seeks principally to clarify the application of new section 470(e)(2)(A) by focusing on those relationships that in fact are analogous to a tax-exempt lessee monetizing its obligations to a taxable lessor. As revised, the language looks to whether a tax-exempt partner has an obligation to a taxable partner (either directly or indirectly through the partnership), which obligation in turn has been "monetized" through any set-aside or similar arrangement. We believe that this clarification focuses new section 470(e)(2)(A) on the correct problem, while preserving its broad application (e.g., through fungibility of money principles) to prevent abuse.

III. PROPOSED REVISIONS TO STATUTORY LANGUAGE.

[All references to page and line numbers are to the official print of H.R. 6264 S. 4026]

---

2 In the case of a fixed-price lessee purchase option, the lessee's collateralization of that option was viewed by Congress as undercutting the economic uncertainty of the exercise of the option.

1. Amend page 14, line 6, to read:

> "such property is not described in paragraph (A) or (B), and, except as provided in regulations prescribed . . ."

Reason: New section 470(e)(2) is difficult to parse because the operative tests do not clearly relate back to the depreciable property described in new section 470(e)(1)(C). This amendment, and the following one, clarify this relationship. Neither changes the fungibility of money concept embodied in new section 470(e)(2)(A): that is, the "set aside" rule applies with respect to any set aside, even if the set aside serves as collateral (for example) for non-depreciable property, so long as there exists some obligation on the part of the tax-exempt partner relating to depreciable property (as described below). The *consequence* of failing the test, however, is relevant only to depreciable property described in new section 470(e)(1)(C).

2. Amend page 14, line 14, to read as follows:

> "respect to any property described in subparagraph (1)(C) owned by the partnership . . ."

Reason: See above.

3. Page 14, strike lines 22 through 25, and Page 15, strike lines 1 and 2. Replace with the following:

> "if the purpose or effect of the transaction described in clause (i) or (ii) is directly or indirectly to satisfy any obligation (whether current, future or contingent) of a tax-exempt partner relating to such property and owed to the partnership, any taxable partner of the partnership, any lender to the partnership, or any lender to a taxable partner of the partnership . . . "

Reason: This suggestion is designed to implement the fundamental point made in Part II, which is that the analogy to section 470(d)(1) here requires identifying an *obligation* that a tax-exempt partner has to a taxable partner that relates to property described in section 470(e)(1)(C), which obligation is directly or indirectly satisfied through the monetization transaction described in section 470(e)(2)(A)(i) or (ii). (Options are addressed in proposed section 470(e)(3), below.) The idea here is that simple co-ownership, even with preferred returns or the like, does not by itself give rise to an "obligation" of the tax-exempt partner (the lessee equivalent) that is being directly or indirectly monetized for the benefit of the taxable partner (the lessor equivalent).

It is intended, for example, that a simple purchase-money mortgage by which a partnership acquires property from a third party seller would in general fall outside the scope of revised section 470(e)(2)(A), both because there would be no set-aside of, similar arrangement with respect to "funds", and because the obligation of *both* partners to repay the purchase money indebtedness to the third party is not an obligation of *one* partner to the other partner. On the other hand, a tax-exempt partner's obligation (whether contingent or current) to fund a capital account deficit, for example, *is* an obligation that indirectly runs to the benefit of the taxable partner; if the parties require the tax-exempt partner to monetize that obligation, then section 470(e)(2)(A) would be triggered.

4. Page 16, strike lines 1 through 6, and replace with the following:

"(C) ARRANGEMENTS. – The arrangements referred to in this subparagraph include:

(i) a loan by a tax-exempt partner to the partnership, any taxable partner, or any lender to the partnership or a taxable partner,

(ii) to the extent of all tax-exempt partners' share thereof, a loan by the partnership to any taxable partner or any lender to a taxable partner, and

(iii) any arrangement referred to in subsection (d)(1)(B) that has the effect of a transaction described in clause (i) or (ii)."

Reason: This revision, like item 3, above, is intended to focus section 470(e)(2)(A) on those partnership arrangements that in fact are analogous to section 470(d)(1)(A) – that is, transactions in which a tax-exempt partner monetizes, whether directly or indirectly through the partnership vehicle, an obligation of that tax-exempt partner to a taxable partner. In addition, section 470(e)(2)(C) as currently written is difficult to parse, as it appears to contemplate, for example, a loan by a partnership to itself. The discussion in Part II and under item 3, above, applies with equal force here.

5. Strike page 16, line 18 through page 17, line 3 and substitute the following:

"TEST. – Funds shall not be taken into account in applying subparagraph (A) to property described in subparagraph (1)(C) if such funds bear no connection to the economic relationships among the partners (whether reflected in the partnership agreement or otherwise) with respect to items of income, gain, loss, expense or credit attributable to such property. For this purpose, funds described in section 956(c)(2)(J) or section 956(c)(2)(K) shall be deemed not to bear any connection to the economic relationships among the partners with respect to property described in subparagraph (1)(C)."

Reason: New section 470(e)(2)(D)(ii) is very difficult, if not impossible, for a taxpayer to apply, because as currently drafted it simply provides that a taxpayer shall not take into account funds if those funds "bear no connection to the economic relationships among the partners." But everything that a partnership does bears some connection to the economic relationships among the partners: every item of income, or deduction, etc. is shared on some basis among the partners. We believe that a more useful way to reformulate the test would be that funds should be excluded if they do not affect the economic deal with respect to the depreciable property being tested. The proposed replacement language reflects this understanding. Clause (ii) was dropped, because it was believed that the phrase "(whether reflected in the partnership agreement or otherwise)" more succinctly makes the same point. Finally, the last sentence of the proposed revision addresses explicitly the "self-funding" transactions that all financial institutions employ to acquire ownership or possession of securities in the ordinary course of business. Because the financial institution gives and receives equivalent value (or posts collateral on commercial terms directly in connection with a financial transaction), the transactions cannot be used to accomplish any of the monetization results that are the purpose of section 470(d) and new section 470(e).

As reformulated, this test will be useful primarily for any operating partnership in respect of the funding of its ongoing day-to-day operations. It would be very extraordinary, for example, for partners to be able to demonstrate that a funding arrangement in place at the outset of a partnership, or contemplated by the partnership agreement (or other operative documents), did not affect the economic relationships of the partners in respect of the partnership's section 470(e)(1)(C) property. This relatively narrow scope is appropriate, in light of the fact that new section 470(e)(2)(D)(ii) is intended as an exception from an anti-abuse rule.

For the reasons summarized above, we believe that the reformulated test will apply only in clearly delineated cases. If, however, there is residual concern that the contours of the proposed test need to be defined more sharply, consideration could be given to limiting the application of the test only to funds used by a partnership in connection with the conduct of an active trade or business. The Internal Revenue Code contains several "active trade or business" tests that might serve as a model. For example, one could fashion a rule that permitted partnerships to rely on the "no connection" test only in cases where no more than 20 percent of the partnership's gross income constituted "foreign personal holding company income" under the principles of section 954(c) (as modified by sections 954(h) and (i)) if the partnership hypothetically were organized as a controlled foreign corporation.[3]

6. Examples. If our understanding of the purpose and scope of new section 470(e)(2)(D)(ii) is correct, then the revised statutory language can be illustrated in the legislative history with examples along the following lines:

Example 1. Partnership ABC has two partners, T (a taxable partner) and TE (a tax-exempt partner). Partnership ABC has been engaged in an active trade or business for many years, and owns many properties, both depreciable and nondepreciable. All items of partnership income are allocated 50-50 between T and TE. In 2007, Partnership ABC arranges for long-term nonrecourse financing, secured by a revolving pool of receivables generated by Partnership ABC in the ordinary course of its business, and guaranteed by a third-party financial guarantor. The lenders in the nonrecourse financing are unrelated third parties. Partnership ABC does not amend its partnership agreement in light of the nonrecourse financing, and there is no understanding between T and TE with regard to

[3] Because section 954(c) and its implementing Treasury regulations address different concerns than does section 470, care would need to be taken to ensure that a cross-reference to the principles of section 954(c) would not bring with it rules and limitations that would be irrelevant to the test suggested in the text. For example, in applying the hypothetical "if the partnership were a controlled foreign corporation," what should be done about same-country limitation? Similarly, section 954(c)(1)(D) (dealing with foreign currency gains) probably is unnecessary in the section 470 contest. And finally, section 954(c) includes a number of temporary provisions, including section 954(h) and (i), both of which modify section 954(c)(1), and section 954(c)(6). To preserve the intended application of the cross reference here, we would suggest that the principles of section 954(c) would be defined as those principles that would apply in 2006 to a hypothetical controlled foreign corporation that was a calendar year taxpayer.

the sharing of the economics from their respective investments in Partnership ABC that is not reflected in the partnership agreement.

Under these facts, the nonrecourse financing does not affect the economic relationships among the partners with respect to any item of depreciable property owned by the Partnership. Accordingly, and without regard to whether the arrangement otherwise would be described in section 470(e)(2)(A), the nonrecourse financing is not taken into account for purposes of section 470(e)(2)(A), by virtue of section 470(e)(2)(D)(ii).

Example 2. Partnership DEF has two partners, T (a taxable partner) and TE (a tax-exempt partner). Partnership DEF is engaged in an active trade or business that it has conducted for many years. Under the DEF partnership agreement, TE has an obligation to invest additional funds in Partnership DEF under certain defined circumstances. To ensure that TE performs its obligation, the DEF partnership agreement provides that DEF will withhold 50 percent of the profits otherwise distributable to TE and set those funds aside in a portfolio of U.S. Treasury securities, the interest income on which will be allocated to TE and distributed currently to TE. DEF is permitted to withdraw assets from the portfolio and apply them to TE's capital contribution obligations if TE does not otherwise satisfy its obligation within 10 days of the obligation's arising.

Under these facts, the portfolio of Treasury securities constitutes a set-aside of funds that bears a connection to the economic relationships among the partners, because the existence of the portfolio gives T security that TE in fact will satisfy its contingent "capital call" obligation. Accordingly, partnership DEF may not rely on section 470(e)(2)(D)(ii). Moreover, under these facts the partnership has monetized an obligation that TE has to the partnership; accordingly, if the value of the portfolio of Treasury securities exceeds Partnership DEF's allowable partnership amount, the requirements of section 470(e)(2)(A) will not be satisfied, and section 470 will apply to Partnership DEF.

Example 3. Partnership GHI has two partners, T (a taxable partner) and TE (a tax-exempt partner). Partnership GHI has been engaged for many years in an active trade or business as a full-service investment banking firm, including dealing in a wide range of securities. Partnership GHI therefore is a dealer in securities, within the meaning of section 475(c)(1). In the conduct of its business, Partnership GHI maintains large positions in securities (as defined in section 475(c)(2)), the identity and quantities of which fluctuate daily, in response to customer demands and Partnership GHI's hedging and other business requirements. Partnership GHI also owns substantial depreciable and amortizable assets described in section 470(c)(2).

To finance its purchases of U.S. Treasury securities in the ordinary course of its activities as a dealer in securities, Partnership GHI engages in "sale-repurchase" ("repo") transactions, in each of which Partnership GHI "sells" a Treasury security to a "buyer" for cash in an amount equal to or slightly less than the fair market value of the Treasury security, and Partnership GHI simultaneously agrees to "repurchase" that Treasury security the next business day, for a price equal to the cash received on the first day, plus an additional amount equal to one day's interest on that amount. (The arrangement might also be defined to cover a specified longer term.) The "buyer" might be either a third party or an affiliate of GHI that in either case seeks to invest cash on a short-term basis. The "repo" arrangement is documented under industry-standard documentation. Under the terms of their repo agreement, Partnership GHI and the "buyer" of the Treasury securities agree to roll over the financing from day to day, unless and until either party terminates the transaction. The value of the Treasury securities is marked to market daily, and the net amount of cash transferred to Partnership GHI in turn is adjusted daily, such that the cash held by Partnership GHI in respect of the repo transaction never exceeds the fair market value of the Treasury securities "sold" to the repo "buyer."

Under these facts, the repo arrangement between Partnership GHI and the repo "buyer" constitutes a transaction described in section 956(c)(2)(K). Partnership GHI raises funds through the repo transaction, but at the same time Partnership GHI gives up possession of marketable securities having an equal or greater value. Because Partnership GHI employs the repo transaction in the ordinary course of its trade or business as a dealer in securities, for example to finance its purchases of U.S. Treasury securities, and because the conditions of section 956(c)(2)(K) are satisfied, therefore, without regard to whether the arrangement otherwise would be described in section 469(e)(2)(A), the repo financing is not taken into account for purposes of section 470(e)(2)(A), by virtue of section 470(e)(2)(D)(ii).

Example 4. The facts are the same as those of Example 3, except that, in addition to the financing described therein, Partnership GHI and TE enter into an arrangement described as a one-year sale-repurchase transaction, but in which TE extends \$2 million to Partnership GHI in exchange for \$1 million in Treasury securities, and Partnership GHI unconditionally promises to repurchase those securities one year in the future for \$2 million, plus interest thereon. The arrangement falls outside the scope of section 956(c)(2)(K), because the cash received by Partnership GHI exceeds the value of the Treasury securities delivered by Partnership GHI. Moreover, the arrangement is not consistent with market practices among participants in the active repo financing markets.

Under these facts, the arrangement will be viewed as a \$1 million sale-repurchase transaction, and an unsecured loan of \$1 million by TE to Partnership GHI. The unsecured loan by TE falls outside the ordinary course of Partnership GHI's business and presumptively affects the economic relationships among the partners. Accordingly, unless Partnership GHI can otherwise demonstrate that the funds in fact do not affect the relationship between T and TE, Partnership GHI cannot rely on section 470(e)(2)(D)(ii) to exclude those funds from the possible application of section 470(e)(2)(A).

7. Amend page 17, line 14, to read as follows:

"respect to any property described in subparagraph (1)(C) owned by the partnership …"

Reason: This revision clarifies that those options to which new section 470(e)(3)(A) is addressed are options that relate to depreciable property owned by the partnership. Financial institutions routinely employ options over *financial* assets in the ordinary course of their trade or business. If a financial institution is organized as a partnership, it would be common for that partnership to enter into such *financial* options with its partners, as well as other customers. We believe that such options over financial assets, by way of example, have no relationship to the intended scope of new section 470(e)(3)(A). The proposed language confirms this result.

8. Amend p. 18, line 24, by removing the period and adding at the end thereof:

", other than a tax-exempt controlled entity (as defined in section 168(h)(6)(F))."

Reason: A tax-exempt controlled entity is itself a *taxpayer*. Whatever the purpose for the inclusion of such entities in determining the scope of section 168, in light of the fact that they are taxpayers, there does not appear to be any reason that we can determine for including these entities as possible devices by which a partnership could be employed to accomplish LILO/SILO-type results.

9. Remaining Issues. The suggestions made above do not address a fundamental issue with the current draft of new section 470(e), which is the *consequence* of failing the two-part test. Imagine, for example, that a tax-exempt partner in a $1 billion partnership improperly monetizes a $100 obligation to a taxable partner outside the partnership. What consequence should follow from that $100 monetization? As currently drafted, new section 470(e) appears to contemplate that all of the $1 billion partnership's depreciable assets would be tainted. We respectfully submit, however, that this consequence is wholly disproportionate to the problem.

The issue does not arise in the context of actual leases, because there section 470 is applied on a lease-by-lease basis. As a result, the improper monetization of one lease taints only the property subject to that lease.

We believe that some sort of proportionality rule is required in the partnership context. That rule need not be a dollar-for-dollar tainting. One can imagine, for example, a rule that provides that every $1 of improper monetization requires that $5 of depreciable property be subject to section 470.

A similar issue arises in respect of the differing interests of taxable and tax-exempt partners in partnership property. Improper monetization of a *lease* implies that the taxable lessor has an impermissibly small true economic interest in the leased property; as a result, section 470 applies to the entirety of the leased property. In the partnership context, by contrast, a taxable partner might (by way of example) bear 90 percent of the economic risk and reward with respect to the depreciable property accrued by the partnership. If a tax-exempt partner impermissibly monetizes an obligation to the taxable partner, the consequence of that monetization should be limited to the tax-exempt partner's interest in partnership property (in this example, 10 percent), because that represents the greatest extent to which the monetization might fairly be said to shift the attributes of the partnership's property to the taxable partner.

These two issues — the "cliff effect" of the current draft of new section 470(e), and the failure to recognize a taxable partner's genuine investment in partnership property — go to the same ultimate point, which is that the *consequence* of failing the monetization test needs to be linked in at least an approximate manner to the extent of that monetization. Without such a limitation, new section 470(e) could be criticized as imposing tax liabilities wholly disproportionate to any possible abuse.

IV. CONCLUSION

Citigroup appreciates the opportunity to submit these comments. Please find on the following pages a marked up version of the legislation that includes our proposed edits.

Sincerely

Jeffrey R. Levey

Vice President, Director

Tax Legislative and Regulatory Policy

Global Government Affairs

Citigroup Inc

[Citigroup Inc. Suggested Revisions]

SEC. 6. AMENDMENTS RELATED TO THE AMERICAN JOBS CREATION ACT OF 2004.

(a) AMENDMENTS RELATED TO SECTION 710 OF THE ACT.—

(1) Clause (ii) of section 45(c)(3)(A) is amended by striking "which is segregated from other waste materials and".

(2) Subparagraph (B) of section 45(d)(2) is amended by inserting "and" at the end of clause (i), by striking clause (ii), and by redesignating clause (iii) as clause (ii).

(b) AMENDMENTS RELATED TO SECTION 848 OF THE ACT.—

(1) Section 470 is amended by redesignating subsections (e), (f), and (g) as subsections (f), (g), and (h) and by inserting after subsection (d) the following new subsection:

"(e) EXCEPTION FOR CERTAIN PARTNERSHIPS.—

"(1) IN GENERAL.—In the case of any property which would (but for this subsection) be tax-exempt use property solely by reason of section 168(h)(6), such property shall not be treated as tax-exempt use property for purposes of this section for any taxable year of the partnership if—

"(A) such property is not property of a character subject to the allowance for depreciation,

"(B) any credit is allowable under section 42 or 47 with respect to such property, or

"(C) **such property is not described in paragraph (A) or (B), and,** except as provided in regulations prescribed by the Secretary under subsection (h)(4), the requirements of paragraphs (2) and (3) are met with respect to such property for such taxable year.

"(2) AVAILABILITY OF FUNDS.—

"(A) IN GENERAL.—The requirement of this paragraph is met for any taxable year with respect to any property **described in subparagraph (1)(C)** owned by the ~~partner ship~~**partnership** if (at all times during the taxable year) not more than the allowable partnership amount of funds are—

"(i) subject to any arrangement referred to in subparagraph (C), or

"(ii) set aside or expected to be set aside,

~~to or for the benefit of any taxable partner of the partnership or any lender, or to or for the benefit of any tax-exempt partner of the partnership~~**if the purpose or effect of the transaction described in clause (i) or (ii) is directly or indirectly** to satisfy any obligation ~~of such tax-exempt partners~~**(whether current, future or contingent) of a tax-exempt partner relating to such property and owed** to the partnership, any taxable partner of **the partnership, any lender to** the partnership, or any lender **to a taxable partner of the partnership**.

"(B) ALLOWABLE PARTNERSHIP AMOUNT.—For purposes of this subsection, the term 'allowable partnership amount' means, as of any date, the greater of—

"(i) the sum of—

"(I) 20 percent of the sum of the taxable partners' capital accounts determined as of such date under the rules of section 704(b), plus

"(II) 20 percent of the sum of the taxable partners' share of the recourse liabilities of the partnership as determined under section 752, or

"(ii) 20 percent of the aggregate debt of the partnership as of such date.

"(iii) NO ALLOWABLE PARTNERSHIP AMOUNT FOR ARRANGEMENTS OUTSIDE THE PARTNERSHIP.—The allowable partnership amount shall be zero with respect to any set aside or arrangement under which any of the funds referred to in subparagraph (A) are not partnership property.

"(C) ARRANGEMENTS.— The arrangements referred to in this subparagraph include**:**

"(i) a loan by a tax-exempt partner ~~or the partnership~~ to **the partnership,** any taxable partner, ~~the partnership,~~ or any lender **to the partnership or a taxable partner,**

"(ii) to the extent of all tax-exempt partners' share thereof, a loan by the partnership to any taxable partner or any lender to a taxable partner, and

"(iii) any arrangement referred to in subsection (d)(1)(B**) that has the effect of a transaction described in clause (i) or (ii**).

"(D) SPECIAL RULES.—

"(i) EXCEPTION FOR SHORT-TERM FUNDS.—Funds which are set aside, or subject to any arrangement, for a period of less than 12 months shall not be taken into account under subparagraph (A). Except as provided by the Secretary, all related set asides and arrangements shall be treated as 1 arrangement for purposes of this clause.

"(ii) ECONOMIC RELATIONSHIP TEST.—Funds shall not be taken into account ~~under subparagraph (A) if such funds—~~ **in applying subparagraph (A) to property described in subparagraph (1)(C) if such funds bear no connection to the economic relationships among the partners (whether reflected in the partnership agreement or otherwise) with respect to items of income, gain, loss, expense or credit attributable to such property. For this purpose, funds described in section 956(c)(2)(J) or section 956(c)(2)(K) shall be deemed not to bear any connection to the economic relationships among the partners with respect to property described in subparagraph (1)(C).**

~~"(I) bear no connection to the economic relationships among the partners, and~~

~~"(II) bear no connection to the economic relationships among the partners and the partnership.~~

"(iii) REASONABLE PERSON STANDARD.—For purpose of subparagraph (A)(ii), funds shall be treated as set aside or expected to be set aside only if a reasonable person would conclude, based on the facts and circumstances, that such funds are set aside or expected to be set aside.

"(3) OPTION TO PURCHASE.—

"(A) IN GENERAL.—The requirement of this paragraph is met for any taxable year with respect to any property **described in subparagraph (1)(C)** owned by the partnership if (at all times during such taxable year)—

"(i) each tax-exempt partner does not have an option to purchase (or compel distribution of) such property or any direct or indirect interest in the partnership at any time other than at the fair market value of such property or interest at the time of such purchase or distribution, and

"(ii) the partnership and each taxable partner does not have an option to sell (or compel distribution of) such property or any direct or indirect interest in the partnership to a tax-exempt partner at any time other than at the fair market value of such property or interest at the time of such sale or distribution.

"(B) OPTION FOR DETERMINATION OF FAIR MARKET VALUE.— Under regulations prescribed by the Secretary, a value of property determined on the basis of a formula shall be treated for purposes of subparagraph (A) as the fair market value of such property if such value is determined on the basis of objective criteria that are reasonably designed to approximate the fair market value of such property at the time of the purchase, sale, or distribution, as the case may be.".

(2) Subsection (g) of section 470, as redesignated by paragraph (1), is amended by adding at the end the following new paragraphs:

"(5) TAX-EXEMPT PARTNER.—The term 'tax-exempt partner' means, with respect to any partnership, any partner of such partnership which is a tax-exempt entity within the meaning of section 168(h)(6)**, <u>other than a tax-exempt controlled entity (as defined in section 168(h)(6)(F)</u>**).

"(6) TAXABLE PARTNER.—The term 'taxable partner' means, with respect to any partnership, any partner of such partnership which is not a tax-exempt partner.".

(3) Subsection (h) of section 470, as redesignated by paragraph (1), is amended—

(A) by striking ", and" at the end of paragraph (1) and inserting "or owned by the same partnership,",

(B) by striking the period at the end of paragraph (2) and inserting a comma, and

(C) by adding at the end the following new paragraphs:

"(3) provide for the application of this section to tiered and other related partnerships, and

"(4) provide for the treatment of partnership property (other than property described in subsection (e) (1) (A)) as tax-exempt use property if such property is used in an arrangement which is inconsistent with the purposes of this section determined by taking into account one or more of the following factors:

"(A) A tax-exempt partner maintains physical possession or control or holds the benefits and burdens of ownership with respect to such property.

"(B) There is insignificant equity investment in such property by any taxable partner.

"(C) The transfer of such property to the partnership does not result in a change in use of such property.

"(D) Such property is necessary for the provision of government services.

"(E) The deductions for depreciation with respect to such property are allocated disproportionately to one or more taxable partners relative to such partner's risk of loss with respect to such property or to such partner's allocation of other partnership items.

"(F) Such other factors as the Secretary may determine.".

(4) Paragraph (2) of section 470(c) is amended—

(A) by striking "and" at the end of subparagraph (A), by redesignating subparagraph (B) as subparagraph (C), and by inserting after subparagraph (A) the following new subparagraph:

"(B) by treating the entire property as tax-exempt use property if any portion of such property is treated as tax-exempt use property by reason of paragraph (6) thereof.", and

(B) by striking the flush sentence at the end.

(5) Subparagraph (A) of section 470(d)(1) is amended by striking "(at any time during the lease term)" and inserting "(at all times during the lease term)".

(c) AMENDMENTS RELATED TO SECTION 888 OF THE ACT.—

(1) Subparagraph (A) of section 1092(a)(2) is amended by striking "and" at the end of clause (ii), by redesignating clause (iii) as clause (iv), and by inserting after clause (ii) the following new clause:

"(iii) if the application of clause (ii) does not result in an increase in the basis of any offsetting position in the identified straddle, the basis of each of the offsetting positions in the identified straddle shall be increased in a manner which—

"(I) is reasonable, consistent with the purposes of this paragraph, and consistently applied by the tax payer, and

"(II) results in an aggregate increase in the basis of such offsetting positions which is equal to the loss described in clause (ii), and".

(2)(A) Subparagraph (B) of section 1092(a)(2) is amended by adding at the end the following flush sentence:

"A straddle shall be treated as clearly identified for purposes of clause (i) only if such identification includes an identification of the positions in the straddle which are offsetting with respect other positions in the straddle.".

(B) Subparagraph (A) of section 1092(a)(2) is amended—

(i) by striking "identified positions" in clause (i) and inserting "positions",

(ii) by striking "identified position" in clause (ii) and inserting "position", and

(iii) by striking "identified offsetting positions" in clause (ii) and inserting "offsetting positions".

(C) Subparagraph (B) of section 1092(a)(3) is amended by striking "identified offsetting position" and inserting "offsetting position".

(3) Paragraph (2) of section 1092(a) is amended by redesignating subparagraph (C) as subparagraph (D) and inserting after subparagraph (B) the following new subparagraph:

"(C) APPLICATION TO LIABILITIES AND OBLIGATIONS.—Except as otherwise provided by the Secretary, rules similar to the rules of clauses (ii) and (iii) of subparagraph (A) shall apply for purposes of this paragraph with respect to any position which is, or has been, a liability or obligation.".

(4) Subparagraph (D) of section 1092(a)(2), as redesignated by paragraph (3), is amended by inserting "the rules for the application of this section to a position which is or has been a liability or obligation, methods of loss allocation which satisfy the requirements of subparagraph (A)(iii)," before "and the ordering rules".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the American Jobs Creation Act of 2004 to which they relate.