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In this article, Santamaria examines the provisions of two bills introduced by Senate Finance Committee ranking member Ron Wyden, D-Ore., that would alter partnership tax rules.

The recently enacted One Big Beautiful Bill Act (OBBBA) contains a change to the partnership tax (that is, subchapter K) rules, amending section 707's disguised sale rules to clarify that those rules are self-executing.[1] Since the OBBBA is rightfully the focus of the tax world, other tax proposals — especially those put out by members of the minority and even the ranking member of a taxwriting committee — may go unnoticed. While these other proposals are unlikely to get enacted in the near or medium-term future, it still behooves taxpayers to study them and comment, since legislative proposals in the public domain tend to live in perpetuity, especially if they are released by a member of a taxwriting committee and include a revenue score.[2]

On June 17 the ranking member on the Senate Finance Committee Ron Wyden, D-Ore., released two bills that would significantly alter the partnership tax rules. Wyden introduced legislation intended "to improve the rules related to partners and partnerships" (S. 2095; the Wyden 2025 Partnership Act), alongside a second piece of legislation creating special rules for related-party basis-shifting transactions (S. 2094; the Wyden Basis-Shifting Act).[3] According to the press release, the Wyden 2025 Partnership Act would raise more than $727 billion — a significant number. Previously, on September 10, 2021, Wyden released a discussion draft of legislation intended to reform the taxation of passthrough entities (the Wyden 2021 Passthrough Discussion Draft).[4] The Wyden 2021 Passthrough Discussion Draft did not have a specific proposal addressing related-party basis shifting; however, it contained a majority of the proposals in the Wyden 2025 Partnership Act.

[1] The House-passed OBBBA and Senate Finance Committee print of the OBBBA would have made additional changes to subchapter K, including state and local tax-related changes to section 702's rules for determining the income of partners, section 703's rules for determining the income of a partnership, and section 704(d)'s basis limitation rules, which control a partner's ability to deduct its distributive share of deductions and losses from a partnership. The changes to section 704(d) would have also been applicable outside the state and local tax context. These proposals were not included in the OBBBA as enacted on July 4.

[2] Monisha Santamaria and Natalie Tucker, "Subchapter K in a Historic Tax Year: Preexisting Proposals as Menu Options," *Tax Notes Federal*, Oct. 21, 2024, p. 509.

[3] See Wyden's related release on closing loopholes allowing wealthy investors and mega-corporations to abuse partnerships to avoid taxes and a section-by-section summary of the Wyden 2025 Partnership Act and Wyden Basis-Shifting Act (June 17, 2025).

[4] Wyden also released a one-page overview and a section-by-section summary to accompany the Wyden 2021 Passthrough Discussion Draft. Wyden has released many other proposals affecting passthroughs and their owners, including carried interest legislation and a mark-to-market regime for billionaires. *See, e.g.*, Ending the Carried Interest Loophole Act (S. 3317, 118th Cong., 1st Sess.) and related release and one-page overview (Nov. 15, 2023); Billionaires Income Tax Act (S. 3367, 118th Cong., 1st Sess.) and related release, one-page overview, and section-by-section summary (Nov. 30, 2023).

While most taxpayers' reading piles are sky-high this summer, affected taxpayers may be well advised to add the Wyden 2025 Partnership Act and the Wyden Basis-Shifting Act to their stacks — and find time to study and comment before the political winds change. In the interim, and to lighten summer reading loads, this article provides a CliffsNotes version of both.

I. What's New and What's Out

A. What's New

The separate, stand-alone Wyden Basis-Shifting Act is all-new and can be viewed as novel. The Wyden 2025 Partnership Act includes a handful of proposals that were not in the Wyden 2021 Passthrough Discussion Draft. A list of the proposals that are in the Wyden 2025 Partnership Act but not the Wyden 2021 Passthrough Discussion Draft follows:

- a net investment income tax (NIIT) expansion to business income of high-income taxpayers (section 13 of the Wyden 2025 Partnership Act);
- a provision that would turn off the section 721(a) nonrecognition (and section 351 nonrecognition) rules for transfer of marketable securities to swap funds (section 14 of the Wyden 2025 Partnership Act);
- a provision addressing the treatment and character of worthless and abandoned partnership interests (section 15 of the Wyden 2025 Partnership Act); and
- the codification of the partnership antiabuse rules (section 16 of the Wyden 2025 Partnership Act).

Two of the above proposals in the Wyden 2025 Partnership Act appear borrowed from the unenacted Build Back Better Act (BBBA)[5]: the NIIT expansion proposal and the proposal addressing the treatment and character of worthless and abandoned partnership interests. The swap fund proposal is a revival of previously, but not recently, proposed legislation. The codification of partnership antiabuse rules has not been previously proposed as legislation — but the substance is in current Treasury regulations.

Each of the new proposals is discussed below.

B. Dropped Proposals

The Wyden 2025 Partnership Act does not include several proposals that were in the Wyden 2021 Passthrough Discussion Draft.

Notably, the elimination of the section 704(b) substantial economic effect rules is not in the Wyden 2025 Partnership Act.[6] As background, section 704(b) generally requires allocations of partnership items of income, gain, loss, deduction, or credit among the partners to have a substantial economic effect or be in accordance with the partners' interest in the partnership. The proposed changes to section 704(b) in the Wyden 2021 Passthrough Discussion Draft would have removed the substantial economic effect rules and made partners' interest in the partnership the exclusive standard. This change would appear to have required Treasury to undertake a sizable project to promulgate new section 704(b) regulations, which taxpayers would then need to learn and implement. The change also could have been seen to adversely affect low-income housing tax credit partnerships and tax equity partnerships, which often rely on certain substantial economic effect safe harbors. Taxpayers and tax advisers likely welcome this removal.

The dropped changes also include a change to section 701, purportedly meant to coordinate subchapter K with the Bipartisan Budget Act partnership audit rules; a change to section 705 expanding the alternative rule for determining a partner's basis in its interest; a change to section 752(c) concerning partnership liabilities; a change to section 163(j)(4)'s business interest limitation rules; the repeal of the publicly traded partnership rules; a regulated investment company change; and a change clearly providing that a trade or business for section 52(b) purposes includes section 212 activity.

[5] H.R. 5376, 117th Cong., 1st Sess., as reported in the House September 27, 2021, and as engrossed in the House November 19, 2021 (before being substantially modified by the Senate in August 2022).

[6] Wyden 2021 Passthrough Discussion Draft, section 2.

C. All New: The Related-Party Basis-Shifting Proposal

The Wyden Basis-Shifting Act — the stand-alone bill — seeks to address related-party basis shifting in a manner that is significantly different from previous related-party basis-shifting proposals (none of which were in legislative text). It would alter the section 731 partnership distribution rules and the section 743 basis adjustment rules. Importantly, unlike prior regulatory actions, the proposals would only apply to distributions and transfers that occur after the date of enactment (that is, none of the rules are retroactive).

1. Background.

Under subchapter K, the basis of partnership property (that is, asset basis or inside basis) may be adjusted because of a distribution of partnership property or the sale of a partnership interest and the rules adjusting asset basis generally preserve parity between the partner's basis in its partnership interest (that is, outside basis) and the partner's share of asset basis (that is, inside basis). Rules (under sections 734(b) and 743(b)) determine the amount of the basis adjustment, and additional rules (in section 755) determine the allocation of the basis adjustment among the partnership's assets. The operation of the rules (and the resulting basis adjustments to partnership property) may increase or decrease cost recovery deductions, gain, or loss. In the recent past, policymakers have expressed concerns that the current rules, which are mechanical in their operation, allow basis shifting in the related-party context and that basis shifting in the related-party context is decreasing money in federal coffers by tens of billions of dollars.[7] The Biden administration proposed both regulatory and legislative solutions.[8] The regulatory solutions were rolled back by the Trump administration.[9]

[7] *See*, *e.g.*, Julie Zauzmer Weil, "Closing Asset Loophole Could Add Billions to Tax Collections, IRS Says," *The Washington Post*, June 17, 2023; Richard Rubin, "IRS Crackdown Takes New Aim at Partnerships' Maneuvers," *The Wall Street Journal*, June 17, 2024; Rafi Schwartz, "IRS Seeks to Close Loophole Used by Ultra-Wealthy," *The Week*, June 18, 2024; "The IRS Is Cracking Down on a Tax Loophole for the Rich. The Effort Could Raise $50 Billion," CBS News (June 17, 2024); Lee A. Sheppard, "Restraining Partnership Basis Shifts," *Tax Notes Federal*, July 1, 2024, p. 9 ("Yup, a new Treasury initiative that can be understood only by subchapter K specialists was pitched as tax fairness with a potential $50 billion revenue gain.").

[8] In 2024 Treasury and the IRS announced forthcoming regulatory changes generally directed at basis shifting in the related-party context. Notice 2024-54, 2024-28 IRB 24. *See also*, *e.g.*, FS-2024-21; Treasury release announcing new initiative to close loopholes (June 17, 2024); IR-2024-9. Final regs, published in January, identified certain partnership related-party basis adjustment transactions as reportable transactions of interest and required certain taxpayers and material advisers to engage in disclosure and list maintenance requirements. T.D. 10028. Further, President Biden's green books contain a proposal to address certain basis shifting transactions in the related-party context. *See*, *e.g.*, Treasury, "General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals" (Mar. 11, 2024).

[9] In April the IRS issued Notice 2025-23, 2025-19 IRB 1428, announcing an intent to remove the final basis-shifting regulations (T.D. 10028) and thus eliminate the need for participants in the designated transactions and their material advisers to comply with disclosure and list maintenance requirements. Notice 2025-23 further provided immediate penalty relief. It further withdrew Notice 2024-54, which, as noted above, described proposed regulations that Treasury intended to issue on related-party partnership basis-shifting transactions.

2. The Wyden Basis-Shifting Act.

The Wyden Basis-Shifting Act makes changes to section 731[10] and section 743[11] to address "basis-shifting transactions involving related parties." At a high level, the changes to section 731 would immediately trigger gain upon certain related-party transactions in which distributed property is stepped up under section 732 or retained property is stepped up under section 734. The proposed section 731 changes can be viewed to implement a partial recognition approach, since the amount of the gain triggered would be based on the amount of the basis increase under section 732 or section 734, rather than on the fair market value of the distributed or retained property. At a high level, the change to section 743 would provide a step-in-the-shoes rule for certain related-party partnership interest transfers and prevent section 743(b) basis increases, in full or part, in those transactions. As noted above, the proposals would be prospective in their application — only applying to distributions and transfers that occur after the date of enactment.

The section 731 proposals and the section 743 proposal are discussed separately below.

3. Section 731 proposals.

The Wyden Basis-Shifting Act would require partners to recognize gain upon certain distributions, and it is useful to bifurcate the proposed changes to section 731 into a "partner gain rule" and "partnership gain rule." These rules would only apply if the distribution is made by an "applicable partnership."

a. Partner gain rule.

The partner gain rule in section 731 would require a distributee partner to recognize an additional amount of gain equal to the applicable basis increase. For those purposes, an applicable basis increase would be the aggregate increases in basis to one or more partnership properties under section 734(b)(1)(B) (that is, basis increases in property retained by the partnership).[12] The basis of distributed property in the hands of the distributee partner would be increased by the amount of gain recognized. Further, the character of the gain would be based on the character of the basis step-up property (that is, the retained property receiving a basis step-up under section 734(b)). A special ordering rule is provided in situations in which the distribution is of marketable securities.

While it initially may appear illogical to tax the distributee partner in situations involving section 734 basis increases (the partner recognizes gain and the partnership gets the asset basis step-up), it is possible that the Wyden Basis-Shifting Act takes this approach because the distributee partner's share of gain in the partnership assets is the gain that is being eliminated through the transaction and application of section 734. Consider a low-basis distributee partner that is distributed high-basis property (that is, property with an asset basis higher than the distributee partner's outside basis). The tax writers may view taxing the distributee partner as logical because the gain being eliminated (through the section 734 step-up in the nondistributed property) would have been allocated to the distributee partner if the partnership had sold the retained property immediately before the distribution. Of course, one can counter that this logic does not apply when the nondistributed property is nondepreciable and will be retained by the partnership, suggesting a possible need for a carveout. There are also policy questions regarding long-lived property.

[10]Under section 731, in general, distributions of property by a partnership to a partner are not taxable and distributions of money are taxable only to the extent that they exceed the basis of the partner's interest. There are certain, and significant, exceptions to these rules. Further, to preserve built-in gain or loss, the distributee-partner's basis for property included in a current distribution is generally equal to the partnership's basis in the distributed assets immediately before the distribution. However, if the partnership's basis in the distributed property exceeds the distributee-partner's predistribution basis in their partnership interest, the distributee-partner's basis in distributed assets is limited to its predistribution basis in their partnership interest. In this situation, if there is a section 754 election in effect, the partnership may increase the basis of retained property under section 734(b)(1)(B). The basis of property received in a liquidating distribution is generally computed with reference to the distributee-partner's basis in their partnership interest. It is possible that that the partnership may increase or decrease the basis of retained property in this situation.

[11]Section 743(a) provides that the basis of partnership property will not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner. However, under section 743(b), if the partnership makes a valid election under section 754 or if the partnership has a substantial built-in loss, the basis of partnership assets is adjusted for the transferee-partner only upon the transfer of a partnership interest.

[12]The determination would be made without regard to whether section 755 suspended any of the increase.

An example illustrates this concept. Assume A, B, and C own 50 percent, 25 percent, and 25 percent, respectively, of the interests in Partnership. A has an interest with a basis of $40 and an FMV of $50. B and C each have an interest with a basis of $20 and an FMV of $25. Partnership has two assets, each with an FMV of $50. Asset X (low-basis property) has a basis of $30. Asset Y (high-basis property) has a basis of $50. Partnership distributes Asset Y to A. Before the distribution, there is $20 of gain in Asset X ($50 FMV - $30 basis). If Asset X were sold before the distribution, A would be allocated $10 of the $20 gain. In effect, $10 of the gain is A's gain. Under current law, Asset Y is distributed to A, there is no gain recognition (because of the general section 731 policy to allow for tax-free distributions of property). Instead, the basis of Asset Y, which may never be sold by A, is stepped down, and Asset X is stepped up by $10 (so B and C do not bear A's gain in Asset X). Under the proposal, Asset Y is distributed to A, A would recognize $10 of gain (that is, an amount equal to the section 734 basis step). A would hold Asset Y with an asset basis of $50 ($40 (A's outside basis) + $10 (the gain recognized by A under the proposal)). Under the proposal, as well as under current law, the partnership would get a $10 section 734 basis increase adjustment (so Asset X would have an asset basis of $40 after the distribution and $10 of remaining built-in gain that would be allocated on sale equally to B and C). Thus, the rules can be viewed to implement a policy in which a partner is taxed on its portion of built-in gain in the partnership's remaining property when a partner receives property with a basis greater than the basis of its partnership interest.

The proposal, however, raises questions. As noted above, the proposal is inconsistent with Congress's prior and long-standing policy call to allow for tax-free distributions of property. Further, the proposed partner gain rule in the Wyden Basis-Shifting Act appears to assume that the proposed change to section 734 in the Wyden 2025 Partnership Act, under which the computation of section 734 basis adjustments would be significantly altered and section 734 basis adjustments would appear to become partner-specific, is not enacted.

b. Partnership gain rule.

The partnership gain rule in section 731(b) would require the partnership (which effectively means the nondistributee partners) to recognize an additional amount of gain equal to the section 732 basis increases (that is, basis increases in property distributed to a partner[13]). Under the proposal, the basis of property retained by the partnership would be that property's basis determined under section 734 (that is, the basis as stepped down under the general section 734 rules) increased by the amount of gain recognized. Further, the character of the gain would be based on the basis-step-up property (that is, the distributed property receiving a basis step-up under section 732).

Again, at first it appears illogical to tax the partnership in situations involving section 732 basis increases (the partnership recognizes gain and the partner gets the asset basis step-up). However, the taxwriters again likely discerned a potential rationale analogous to what is discussed above. In particular, the approach of taxing the partnership (which effectively means the nondistributee partners) in situations involving section 732 basis increases may have been adopted because the remaining partners' share of gain is actually the gain that is being eliminated through the transaction (that is, the distribution of low-basis property to a high-basis partner) and application of basis adjustment rules. An example is illustrative. Once again, assume A, B, and C own 50 percent, 25 percent, and 25 percent, respectively, of the interests in Partnership. A has an interest with a basis of $40 and an FMV of $50. B and C each have an interest with a basis of $20 and an FMV of $25. Partnership has two assets, each with an FMV of $50. Asset X (low-basis property) has a basis of $30. Asset Y (high-basis property) has a basis of $50. Partnership distributes Asset X to A in liquidation of A's interest. Under current law and the proposal, the basis of Asset X is stepped up from $30 to $40, and A, post-distribution, holds Asset X with a latent gain of $10 ($50 FMV - $40 basis), which is equal to A's pre-distribution share (50 percent) of the $20

[13]This situation arises in liquidating distributions when the partner's outside basis is greater than the aggregate asset basis of the distributed property.

gain in Asset X. B and C, however, no longer have any interest in Asset X — which means that B and C's combined $10 share of the $20 of gain in Asset X has been eliminated. That is why it may be logical (or at least defensible) for Partnership (that is, B and C) to recognize $10 of gain in this situation.

Moreover, the proposal appears to ensure that B and C are not double taxed. B and C's aggregated basis in their interests would be increased to $50 by the $10 of recognized gain. The initial $50 basis of retained Asset Y would be decreased to $40 under the general section 734 rules but would then be increased by the $10 of gain recognized by the partnership for a final basis of $50. The result is that the aggregated basis of B and C's interests is $50 and the basis of the retained Asset Y is also $50, preventing any double taxation. However, the proposal would significantly accelerate income for A and B (that is, the remaining partners that neither receive a distribution from Partnership nor sell or exchange their interests in Partnership). If Asset Y is nondepreciable, A and B would each not receive any benefit from the gain recognized under the proposal until the earlier of (1) a taxable exchange of its Partnership interest or (2) the sale of Asset Y.

This result, however, turns off current law deferral for continuing partners. Taxpayers also may want to explore how the proposal would operate in situations in which multiple partners receive distributions of property in liquidation of those partners' interests, including in a complete liquidation of a partnership.

c. Applicable partnership definition.

An applicable partnership is broadly defined as any partnership in which two or more partners are related persons immediately before or after the distribution. However, a small business exception is provided. The small business exception would require that the partnership meets the gross receipts test under section 448(c), with certain modifications, in the tax year and every tax year beginning after the date of enactment and before that tax year. In applying the section 448(c) test, the definition of tax shelters is modified to exclude syndicates (as defined in section 1256(e)(3)(B)). This is presumably to allow small business partnerships with losses to qualify for the exemption.[14] Further, in applying the section 448(c) test, which incorporates certain aggregation rules, including the section 52(b) aggregation rules, the proposal makes a modification. It would provide that when applying section 52(b), which aggregates "trades or businesses," the definition of trade or business would be by reference to section 469(c)(5) and (6). Section 469(c)(6) includes as a trade or business any activity for which expenses are allowable as a deduction under section 212.

The applicable partnership definition can be viewed as exceptionally broad. For example, it would appear to apply when two related persons control a 1 percent interest in the partnership. The small business definition raises technical questions, in particular, whether it would apply to a syndicate that would otherwise be treated as a tax shelter for section 448(c) purposes. Thus, taxpayers may want to comment on the applicable partnership definition and suggest modifications (for example, a requirement that related persons control the partnership).

4. Section 743 step-in-the-shoes rule.

The Wyden Basis-Shifting Act would create a new section 743(g). The new rule would limit any section 743(b) basis increase in an applicable transfer (that is, certain partnership interest transfers) to the total gain recognized in the applicable transfer and would provide a step-in-the-shoes rule with the transferee partner's basis adjustment. Under the proposal, the transferee partner's section 743(b) adjustment appears to be the transferor partner's section 743(b) adjustment plus the total gain recognized in the applicable transfer.

The term "applicable transfer" is defined as a transfer of a partnership interest if two or more

[14] A syndicate generally includes a partnership if more than 35 percent of the entity's losses during the tax year are allocated to (1) "limited partners" (in the case of a limited partnership) and (2) "limited entrepreneurs" (in the case of an entity other than a limited partnership (*e.g.*, a limited liability company)). This definition can cause many partnerships (*e.g.*, start-ups with losses) to be considered syndicates and thus tax shelters. *See generally* Santamaria, Eric Matuszak, and Cathy Creech, "Passthrough Predicaments: Observations on Applying Code Sec. 163(j) Small-Business Exception to Partnerships and Their Partners," 98 *Taxes* 29, 35 (Jan. 2020).

partners of the partnership are related persons (using the section 267(b) standard but without regard to section 267(b)(3) or section 707(b)(1)) before or after the transfer. There is a special rule preventing transfers at death from being applicable transfers.

Notably, the rule does not appear to require that the transferor and transferee partners be related to each other (or any other person in the partnership). An example is illustrative. Assume A, B, and C own 50 percent, 25 percent, and 25 percent, respectively, of the interests in Partnership. Assume A and B are related and C is not related to A or B. Assume C transfers its interest to D, which is not related to any of A, B, or C. C's transfer to D appears to be an applicable transfer. It is not obvious why that transfer should be considered a related partner transfer subject to special related-party rules. Further, the proposed section 743 step-in-the-shoes rule, unlike either of the section 731 proposals, does not have a small business exception. Thus, taxpayers may want to comment on the applicable transfer definition and suggest modifications.

a. What's borrowed (from the BBBA): NIIT expansion.

The Wyden 2025 Partnership Act expands the NIIT. As background, income above specific thresholds is generally subject to a combined 3.8 percent tax under the Federal Insurance Contributions Act (FICA) tax, the Self-Employment Contributions Act (SECA) tax, and the NIIT. Some income earned by limited partners is not subject to FICA tax, SECA tax, or NIIT.

Under section 13 of the Wyden 2025 Partnership Act and section 138201 of the BBBA, as passed by the House in November 2021, the NIIT would be expanded to apply to the income of high-income[15] individuals that is not otherwise subject to SECA or FICA tax regardless of whether they materially participate in a trade or business when generating that income.

[15]The high-income threshold would be $500,000 for married taxpayers filing jointly, $250,000 for married individuals filing separately, and $400,000 for other taxpayers.

b. What's old is new again: The swap fund proposal.

The Wyden 2025 Partnership Act includes a provision addressing swap funds, and the swap fund proposal would alter sections 351 and 721.

The changes would create a new section 351(e)(3) that would preclude section 351 nonrecognition on transfers of marketable securities to certain companies if the transfer would allow a person with blocks of marketable securities with significant unrealized appreciation to diversify those holdings. Transfers to companies that are required to be registered as an investment company under the Investment Company Act of 1940 (1940 Act) or are exempt from registration because of having qualified investors would be covered. Moreover, and more importantly, transfers to companies that allow persons who have blocks of marketable securities with significant unrealized appreciation to diversify those holdings would be covered. The second prong has the potential to cover a wide range of situations.

The swap fund proposal would make analogous changes to section 721(b) that would preclude section 721(a) treatment for gain realized on a transfer to certain partnerships. Namely, proposed section 721(b) would preclude section 721 nonrecognition on transfers of marketable securities to certain partnerships if the transfer would allow a person with blocks of marketable securities with significant unrealized appreciation to diversify those holdings. Transfers to partnerships that, if the partnership were incorporated, would be required to be registered as an investment company under the 1940 Act, or would be exempt from registration because of having qualified investors, would be covered. Further, and more importantly, transfers to partnerships that allow persons who have blocks of marketable securities with significant unrealized appreciation to diversify those holdings would be covered. The second prong has the potential to cover a wide range of situations.

The changes to sections 351 and 721 can be viewed as one-sided, as they apply only to gains and not losses (although this result is consistent with current sections 351(e) and 721(b)). This proposal is like a change previously introduced (in 2001 and 1999) by House Ways and Means ranking member Richard Neal, D-Mass.,[16] and the idea has recently been discussed by commentators.[17]

c. What's mostly borrowed (from the BBBA): Treatment and character of worthless and abandoned partnership interests.

The Wyden 2025 Partnership Act addresses the treatment and character of worthless and abandoned partnership interests. As background, the treatment of losses from a worthless or abandoned partnership interest is the subject of some consternation, particularly involving the character of the loss. Based on IRS guidance, there is a position that the loss is capital if the partner has a share of liabilities and it is ordinary if the partner does not have a share of liabilities.[18]

There are taxpayers that take a position that, because a partner's share of liabilities is included in the partner's basis in its partnership interest (that is, outside basis) and declaring a partnership interest worthless is not a disposition of the interest (and does not generate a deemed distribution under section 752(b)), the amount of a worthlessness loss is ordinary[19] and includes an amount equal to the partner's outside basis arising from an allocation of partnership debt.[20] However, some have questioned whether either result is proper, and others have noted the confusion created by current law. A BBBA provision would provide that if any partnership interest becomes worthless during the tax year, the loss will be considered as a loss from the sale or exchange of a capital asset recognized at the time of the identifiable event establishing worthlessness, regardless of liabilities.[21] Thus, under the BBBA, the loss from a worthless partnership interest would be capital except to the extent that section 751 applies. The Wyden 2025 Partnership Act provision addressing the treatment and character of worthless and abandoned partnership interests is a slight expansion of a proposal in the unenacted BBBA. It is substantially similar to the BBBA proposal but includes a change clarifying that abandonment is a type of worthlessness.

d. Codifying regulations: The partnership antiabuse rules.

The Wyden 2025 Partnership Act would codify the partnership antiabuse rules (both the intent of subchapter K and application of subchapter K antiabuse rules) found in reg. section 1.701-2. These antiabuse rules were promulgated as final regulations in the mid-1990s,[22] and their codification has previously been discussed extensively by certain tax practitioners.[23]

II. What Stayed

The Wyden 2025 Partnership Act includes a majority of the proposals that were in the Wyden 2021 Passthrough Discussion Draft. In particular, both propose:

- changing the section 704(b) allocation rules for some related-party partnerships (section 2 of the Wyden 2025 Partnership Act);
- making mandatory the use of section 704(c)'s remedial method for built-in gain property (section 3 of the Wyden 2025 Partnership Act);
- making mandatory revaluations under section 704 (subject to exceptions) (section 4 of the Wyden 2025 Partnership Act);
- making indefinite the section 704(c)(1)(B) and section 737 mixing bowl rule period

[16] H.R. 240, 197th Congress, 1st Sess. (2001); H.R. 2705, 106th Congress, 1st Sess. (1999). *See generally* Monte A. Jackel and James B. Sowell, "Transfers to Investment Companies: Complexity in a Conundrum," *Tax Notes*, Mar. 25, 2002, p. 1659 (n.146 and accompanying text).

[17] The idea was recently discussed in a Hamilton Project report. *See* Miles Johnson et al., "Modernizing Partnership Taxation" (Sept. 2024). *See also* Michael L. Schler, "The State of the Federal Income Tax System: Poor," *Tax Notes Federal*, June 2, 2025, p. 1643 ("Over time taxpayers often find techniques to take advantage of tax provisions in a manner that was not intended by Congress, which can result in enormous revenue costs to the government. . . . The techniques I would put in this category include . . . partnership swap funds.").

[18] *See* Rev. Rul. 93-80, 1993-2 C.B. 239.

[19] *MCM Investment Management LLC v. Commissioner*, T.C. Memo. 2019-158.

[20] Johnson, *supra* note 17.

[21] H.R. 5376, section 138142(a)(4), as passed by the House Nov. 19, 2021.

[22] T.D. 8588 (Dec. 1994); T.D. 8592 (Apr. 1995).

[23] *See, e.g.*, Jackel, "Codifying the Partnership Antiabuse Rule," *Tax Notes Federal*, Oct. 14, 2024, p. 257; Jackel, Alison L. Chen, and James M. Maynor Jr., "Time to Revoke the Partnership Antiabuse Regulation," *Tax Notes*, Jan. 29, 2018, p. 669; and Jackel, Chen, and Maynor, "Proving That the Partnership Antiabuse Reg Has No Place," *Tax Notes*, May 14, 2018, p. 1027.

(section 5 of the Wyden 2025 Partnership Act);

- repealing section 736's special rule for retiring and withdrawing partners (section 6 of the Wyden 2025 Partnership Act);
- clarifying that section 707's disguised sale rules (for example, regarding partnership interests) are self-executing (section 7 of the Wyden 2025 Partnership Act);
- repealing the capital expenditure exception in section 707's disguised rules (section 8 of the Wyden 2025 Partnership Act);
- changing section 708's continuation rule (section 9 of the Wyden 2025 Partnership Act);
- changing the section 751 hot asset rules (section 10 of the Wyden 2025 Partnership Act);
- changing the section 752 debt allocation rules (by generally allocating all partnership debt based on a partner's share of partnership profits) (section 11 of the Wyden 2025 Partnership Act); and
- changing section 734, section 743, and section 752 to make basis adjustments mandatory (subject to exceptions) (section 12 of the Wyden 2025 Partnership Act).

Two of these proposals — the one providing for changes to section 704(b) allocation rules for some related-party partnerships and the other addressing section 708's continuation rule — were changed meaningfully. Small business exceptions were added to other proposals, namely the proposed change generally making revaluations mandatory and the proposed change making basis adjustments mandatory.[24]

The other provisions that are both in the Wyden 2021 Passthrough Discussion Draft and the Wyden 2025 Partnership Act are either identical or only underwent minor changes.[25]

The changes to section 704(b) allocation rules for some related-party partnerships and changes to section 708's continuation rule are discussed below. The other provisions are not discussed in this article. [26]

A. Section 704(b) Related-Party Allocation Rule

Subchapter K allows for flexible income arrangements and contains various rules meant to align tax and economics. Section 704 contains those rules, particularly addressing the allocation of partnership items. The current rules allow for significant flexibility (such as different allocations of individual items of income), including in the related-party context.

Under section 2 of the Wyden 2025 Partnership Act, when some related parties — in particular, members of a controlled group (using the section 267(f) definition) — own more than 50 percent of a partnership (by capital or profits), partnership allocations would be made in proportion to net contributed capital for covered partners (that is, the related partners). To the extent that the actual economic allocations agreed to by the partners were not pro rata to net contributed capital, the proposal would create taxable transfers (akin to taxable capital shifts) between the partners to account for the disproportionate economics.

The Wyden 2025 Partnership Act, unlike the Wyden 2021 Passthrough Discussion Draft, affects only allocations to covered partners so that allocations to unrelated partners (that is, partners who are not related to the related partners who

[24]The proposal changing section 734, section 743, and section 752 to make basis adjustments mandatory uses the small business definition in the Wyden Basis-Shifting Act, discussed above. The small business exception for the revaluation proposal allows a small business partnership (which uses the section 448(c) gross receipts test) to elect out of the exception. Both appear somewhat novel configurations of small business exceptions.

[25]For example, the language of certain regulatory grants was altered. As another example, section 8 of the Wyden 2025 Partnership Bill, like the 2021 Passthrough Discussion Draft, would repeal the capital expenditure exception in section 707's disguised rules but provide a binding contract exception. The Wyden 2025 Partnership Bill, unlike the Wyden 2021 Passthrough Discussion Draft, requires the binding contract to be written. As another example, section 11 of the Wyden 2025 Partnership Bill, like the Wyden 2021 Passthrough Discussion Draft, would amend the section 752 debt allocation rules, including for existing debt, and resulting liabilities would, upon election, be payable in installments. The Wyden 2025 Partnership Bill would provide taxpayers with a six-year installment option, instead of the eight-year installment option in the Wyden 2021 Passthrough Discussion Draft.

[26]For a summary of the proposals in the Wyden 2021 Passthrough Discussion Draft, see KPMG, "Senate Finance Chairman Wyden Discussion Draft to Reform Taxation of Passthrough Entities" (Sept. 17, 2021), and Santamaria and Tucker, *supra* note 2.

together own a majority interest) are governed by the current section 704(b) rules. This change likely comes as welcome news to taxpayers. Further, changes were made to the definition of "net contributed capital" to account for situations in which a partnership assumed a partner's liability or a partner assumed a partnership's liability. This appears to be a logical technical modification.

However, the proposal could still be altered in several ways. It could also be modified to use a different (or alternative) relatedness threshold or standard. Taxpayers may want to suggest transition rules to exempt, or otherwise address, existing arrangements.

B. Section 708 'Historic Partner' Continuation Rule

Section 708 provides rules for when a partnership continues to exist for tax purposes. Under the general rule, a partnership continues to exist until it is terminated according to the code. The general continuation rule says that "a partnership shall be considered as terminated only if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership." Before the enactment of the Tax Cuts and Jobs Act, section 708 contained a "technical termination" rule, and its repeal created confusion regarding the operation of the general continuation rule.

Section 9 of the Wyden 2025 Partnership Act attempts to clarify section 708 by introducing a "historic partner" concept. In particular, proposed section 708 would provide that a partnership continues if any historic partner (or any person related to any of its partners) continues to carry on any part of the partnership's business. The Wyden discussion draft references sections 707 and 267 for a relatedness standard.

In contrast, Section 10 of the Wyden 2021 Passthrough Discussion Draft attempted to clarify section 708 by providing that the partnership continues if any person who was a partner in the partnership, and any person related to that person, continues to carry on any part of the partnership's business. Sections 707 and 267 were used as the relatedness standard.

It is noteworthy that section 9 of the Wyden 2025 Partnership Act does not define historic partner. One can query if a former partner who left the partnership 10 years, one year, or one day before the transaction would qualify. Taxpayers that need increased clarity regarding the section 708 continuation rules may want to comment that a definition of historic partner is desirable.

III. Conclusion

The Wyden 2025 Partnership Act and Wyden Basis-Shifting Act contain proposals that would make major changes to subchapter K and greatly affect partnerships and their partners. Affected taxpayers would be well advised to add these proposals to their sky-high reading piles — and find time to study and comment before political winds change. By providing a CliffsNotes version of key aspects of these acts, this article hopefully lightened the summer reading loads for affected taxpayers and their tax advisers.[27] ■

[27]The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only and does not necessarily represent the views or professional advice of KPMG LLP.