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October 5, 2020

Executive Director
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Washington, DC 20044

Submitted electronically at www.regulations.gov

Re: Treasury Notice 85 Fed. Reg. 49754 (8/14/20): Comments on Proposed Regulations under Code Section 1061

Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel (“ACTEC”) is pleased to submit the enclosed comments pursuant to Treasury Notice 85 Fed. Reg. 49754, published in the Federal Register on August 14, 2020. ACTEC commends Treasury and the IRS for their efforts in drafting such a well-organized package of proposed regulations under Code Section 1061, and we appreciate the opportunity to comment on the proposed regulations. ACTEC’s comments focus primarily on the application of the proposed regulations to trusts and estates, and to family offices.

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift and GST tax planning, fiduciary income tax planning, and compliance. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

If you or your staff would like to discuss the comments, please contact Kevin Matz, who co-chaired the task force that put together the comments, at (212) 806-6076 or kmatz@stroock.com, Todd Angkatavanich, who also co-chaired the task force that put together the comments, at (860) 725-3928 or todd.angkatavanich@ey.com, Don Kozusko, Chair of the ACTEC Washington Affairs Committee, at (202) 457-7211 or dkozusko@kozlaw.com, or Deborah McKinnon, ACTEC Executive Director, at (202) 684-8460 or domckinnon@actec.org.

Respectfully submitted,

Stephen R. Akers
ACTEC President 2020-2021

Attachments

Comments of the American College of Trust and Estate Counsel (“ACTEC”) on Proposed Regulations under Code Section 1061

Treasury Notice 85 Fed. Reg. 49754 (8/14/20) requested comments on proposed regulations issued under section 1061 of the Code¹ (the “Section 1061 Proposed Regulations”).² Enacted as part of the Tax Cuts and Jobs Act of 2017, section 1061 will in certain instances recharacterize net long-term capital gains with respect to “applicable partnership interests” (APIs) held for up to three years as short-term capital gains to be taxed at the higher, ordinary income tax rates. In addition, section 1061(d) causes an acceleration of the recognition of capital gains in connection with the direct or indirect transfer of an API to a “related person” (as defined here specifically by reference to section 318(a)(1)) and, in this context, likewise recharacterizes certain long-term capital gains as short-term capital gains.

In this comment letter, we focus on the application of the proposed regulations to trusts and estates and family offices. We commend Treasury and the IRS for their efforts in drafting such a well-organized package of proposed regulations, and we appreciate the opportunity to comment on the proposed regulations.

BACKGROUND

Section 1061 has the effect of recharacterizing certain net long-term capital gains with respect to applicable partnership interests as short-term capital gains. In general, it imposes a 3-year holding period to qualify for preferential long-term capital gains treatment on profits interests, including carried interests, received by general partners of private equity funds and other alternative asset management funds (for example, hedge, energy, infrastructure, real estate, credit and fund of funds). This provision recharacterizes certain gain generated from the sale of investments held for more than one year (but not more than 3 years) that would otherwise qualify as long-term capital gains, as short-term capital gains, taxed at higher, ordinary income rates.

Section 1061(c)(1) defines an “API” as any interest in a partnership that, directly or indirectly, is transferred to or held by a taxpayer in connection with the taxpayer (or any related person) performing substantial services in an “applicable trade or business” (ATB). Section 1061(c)(2), in turn, defines an ATB as any activity conducted on a regular, continuous, and substantial basis, through one or more entities that consists of, in whole or in part, (1) raising or returning capital and (2) investing in or disposing of “specified assets,” identifying such assets for investment or disposition, or developing such assets. Section 1061(c)(3) defines “specified asset” as securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivatives contracts with respect to any of the foregoing, and an interest in a partnership to the extent of such partnership’s proportionate interest in any of the foregoing.

Section 1061(d) causes an acceleration of the recognition of certain capital gains in connection with the direct or indirect transfer of an API to a “related party” and recharacterizes certain long-

¹ Unless otherwise stated, references herein to “section(s)” or to “Code” are to the Internal Revenue Code of 1986, as amended. References herein to “§” are to relevant sections of the Treasury regulations.

² The Section 1061 Proposed Regulations can be found at the following link: <https://www.federalregister.gov/documents/2020/08/14/2020-17108/guidance-under-section-1061>

term capital gains as short-term capital gains. For these purposes, the proposed regulations indicate that a “transfer” includes contributions, distributions, sales and exchanges and gifts. However, a related person for purposes of section 1061(d) has a different definition than related persons for purposes of section 1061(c)(1) and, in accordance with section 1061(d)(2), includes only members of the taxpayer’s family within the meaning of section 318(a)(1).

Under the so-called “API Operational Rules”, the proposed regulations provide that entities that are disregarded from their owners (referred to as “disregarded entities”) under any provision of the Code or regulations, which specifically include grantor trusts and qualified subchapter S subsidiaries, “are disregarded for purposes of [the] Regulations.” Thus, the summary to the proposed regulations provides that “if an API is held by or transferred to a disregarded entity, the API is treated as held by or transferred to the disregarded entity’s owner.”

To this end, Proposed Regulation section 1.1061-2(a)(1)(v), entitled “Grantor trusts and entities disregarded as separate from their owners,” provides that “a trust wholly described in subpart E, part I, subchapter J, chapter of the Code (that is, a grantor trust), a qualified subchapter S subsidiary described in section 1361(b)(3), and an entity with a single owner that is treated as disregarded as an entity separate from its owner under any provision of the Code or any part of 26 CFR (including § 301.7100-3 of this chapter) are disregarded for purposes of §§ 1.1061-1 through 1.1061-6.” While various examples are included in section 1.1061-2(a)(2), no examples are provided with respect to transfers to grantor trusts. Nevertheless, it follows that the scope of this exclusion would embrace the full scope of transactions between a grantor and that grantor’s grantor trust that would be disregarded pursuant to Rev. Rul. 85-13 and related guidance.³

The proposed regulations also make amendments to preexisting property holding period regulations to clarify how to bifurcate a partnership interest that consists of capital interest(s), API(s) or profits interests, issued at different times, and which require a divided holding period. The proposed regulations also provides guidance that may be relevant for holding periods related to add-on investments in portfolio companies structured as partnerships.

³ See Rev. Rul. 85-13, 1985-1 C.B. 184 and CCA 201343021 (Oct. 25, 2013). This would include the following transactions, among others: (i) the creation of a grantor trust funded with a gift of a API, (ii) a sale of an API between the grantor or the grantor trust, (iii) the exercise of a so-called “swap power” described in section 675(4)(C) to reacquire the trust corpus by substituting other property of an equivalent value, where such power is exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity, or (iv) a transfer by a grantor trust of an API to a grantor (for instance, in satisfaction of an annuity interest or an installment payment due under a promissory note).

DISCUSSION

- 1. In light of section 1061(d)'s specific reference to section 318(a)(1), Treasury should confirm that a gift to a non-grantor trust for the benefit of a taxpayer's spouse, children, grandchildren or parents should not be considered an "indirect transfer" that would trigger the application of section 1061(d).**

As discussed above, section 1061(d) causes an acceleration of the recognition of capital gains in connection with the direct or indirect transfer of an API to a "related person" and recharacterizes certain long-term capital gains as short-term capital gains. For these purposes, the proposed regulations indicate that a "transfer" includes contributions, distributions, sales and exchanges and gifts. Significantly, a related person for purposes of section 1061(d) has a different definition than related persons for purposes of section 1061(c)(1) and, in accordance with section 1061(d)(2), includes only members of the taxpayer's family within the meaning of section 318(a)(1), and does not include partnerships, estates, trusts or certain corporations (which, in contrast, are addressed in section 318(a)(2)).

Section 318(a)(1) provides as follows:

(a) GENERAL RULE For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) MEMBERS OF FAMILY

(A) In general. An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) his children, grandchildren, and parents.

(B) Effect of adoption

For purposes of subparagraph (A)(ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

Section 318(a)(2), meanwhile, provides as follows:

(2) ATTRIBUTION FROM PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS

(A) From partnerships and estates

Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) From trusts

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) **shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.**

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) From corporations

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.⁴

It is against this background that section 1061(d) uses the words “directly ***or indirectly***” (emphasis added) with respect to the scope of transfers to related persons within the meaning of section 318(a)(1) that will trigger its acceleration clause.

Section 1061(d) provides as follows:

(d) TRANSFER OF APPLICABLE PARTNERSHIP INTEREST TO RELATED PERSON

(1) IN GENERAL If a taxpayer transfers any applicable partnership interest, **directly or indirectly** (emphasis added), to a person related to the taxpayer, the taxpayer shall include in gross income (as short term capital gain) the excess (if any) of—

(A) so much of the taxpayer's long-term capital gains with respect to such interest for such taxable year attributable to

⁴ IRC § 318(a)(2) (emphasis added). The implication of the above highlighted language of section 318(a)(2)(B)(i) is that a determination of proportional deemed ownership of a non-grantor trust based on actuarial interests would apply to the extent of the transfer that is made during the year. Such a determination is not ascertainable, however, in the context of a fully discretionary trust in which the trustee is authorized to make distributions of income and/or principal to one or more beneficiaries to the exclusion of others. Accordingly, the objective of avoiding such an administratively infeasible rule further supports the conclusion that the “or indirectly” language of section 1061(d) should not be construed to apply to a transfer to a non-grantor trust for the benefit of a taxpayer's spouse, children, grandchildren or parents.

the sale or exchange of any asset held for not more than 3 years as is allocable to such interest, over

(B) any amount treated as short term capital gain under subsection (a) with respect to the transfer of such interest.

(2) **RELATED PERSON** For purposes of this paragraph, a person is related to the taxpayer if—

(A) the person is a member of the taxpayer's family within the meaning of section 318(a)(1), or

(B) the person performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.⁵

In light of the foregoing, Congress's use of the phrase "directly or indirectly" does not warrant disturbing the conclusion that a transfer to a non-grantor trust does *not* constitute an acceleration event for purposes of section 1061(d). Had Congress intended that section 1061(d) should cause acceleration in the case of transfers to trusts, it could have very simply added the language "and section 318(a)(2)" (or referred to section 318(a) instead of section 318(a)(1)) in the text of section 1061(d)(2)(A) in defining a "related person." The fact that Congress specifically made reference to family members defined in section 318(a)(1) but left out any reference to trusts in section 318(a)(2)(B) or any more general reference to section 318(a) when defining a "related person" appears to be a deliberate choice. It seems unlikely that the drafters would have chosen to exclude any reference to the constructive ownership rules of section 318(a)(2)(B) or section 318(a) more generally, and thus exclude trusts, only to then use much less clear language in the form of the "or indirectly" language in section 1061(d) in order to reach trusts for the benefit of family members.⁶

In addition, in other instances where the Code addresses taxpayers who make transfers "indirectly," what is contemplated is the use of an intermediary to achieve a tax result different from that available to the taxpayer if the transfer had been made directly.⁷

⁵ IRC § 1061(d) (emphasis added for "directly or indirectly").

⁶ Numerous sections of the Code contain references to section 318 or 318(a) generally. These include, among others, sections 302(c), 304(b)(1), 871(h)(3), 269A(b)(2), 306(b)(1)(A)(ii), 382(l)(3)(A), 664(g)(2), 958(b), 6038A(c)(2)(5), 6038(e)(2).

⁷ See, e.g., IRC §§ 267, 643(h), 672(f)(5), 707(b) and 1239. See also *Boehm v. Comm'r*, 28 T.C. 407 (1957), *aff'd*, 255 F.2d 684 (2d Cir. 1958) (holding that the sale of stock by a taxpayer to her father-in-law followed by a subsequent sale of such stock by the father-in-law to an entity wholly owned by the taxpayer for the same price on the same day constituted an indirect sale for the purposes of the precursor to current section 267) and *Davis v. Comm'r*, 88 T.C. 122 (1987), *aff'd* 866 F.2d 852 (6th Cir. 1989) (holding that a prearranged transaction where a third party purchased partnership property at a foreclosure sale and immediately sold such property to a new partnership created by the partners of the initial partnership was an indirect sale resulting in the disallowance of a deduction pursuant to section 707(b)(1)(B)).

Moreover, based on section 1061(c)(1) and Proposed Regulation section 1.1061-1(a), if a provider of services to an ATB transfers an API to a trust that is a "related person" (defined for this purpose by reference to section 267(b)), the partnership interest generally will remain an API indefinitely, and the trust indefinitely will be subject to ordinary income rates on allocations of gain from the disposition of partnership assets held for not more than three years. This is because, under section 267(b), a trust will be a "related person" as to any service provider who makes a gift to the trust or, alternatively, as to any service provider whose spouse, descendants, ancestors or siblings are beneficiaries of the trust. Accordingly, it is not necessary for Treasury to expand the definition of "related person" in section 1061(d) beyond those related persons specifically covered by section 318(a)(1) in order to carry out the purposes of section 1061.

For these reasons, we respectfully request that Treasury confirm that a transfer to a non-grantor trust does **not** constitute an acceleration event for purposes of section 1061(d).

In the alternative, if Treasury chooses not to adopt the approach recommended above, we would propose that an alternative approach be adopted. Under this alternative approach, a transfer of an API to a non-grantor trust would not cause the immediate acceleration of income as a transfer to a related party under section 1061(d). Rather, only upon a subsequent distribution of the API out of the non-grantor trust to a related person, as defined in section 318(a)(1), would an acceleration of income under section 1061(d) occur. Such an approach would appear to be in keeping with the spirit of the statute to cause income recognition upon a transfer to a related person individually, and consistent with the better interpretation of the phrase "or indirectly" as discussed above.

We also respectfully request that Treasury clarify that death is not a triggering event for purposes of section 1061(d) – which is a result that is further bolstered by the fact that an estate is not a related person within the meaning of section 318(a)(1). It would moreover seem to follow that the death of the holder of the API should eliminate the section 1061(d) taint, and we ask that Treasury clarify this as well.

In addition, we further respectfully request that clarification be provided that a trust's change in status from a grantor trust to a non-grantor trust (whether by death or by a "turning off" of such status during lifetime) will not trigger an acceleration event under section 1061(d) as a transfer to a related person. It would seem to follow, however, that, in circumstances that do not involve the death of the holder of the API interest (which is addressed in the preceding paragraph), if subsequently a non-grantor trust makes a distribution of an API to a related person within the meaning of section 318(a)(1) within the relevant 3-year period (tacking for this purpose the holding period of the grantor trust prior to the trust's conversion to non-grantor trust status), then such a distribution should be considered a transfer to a related person triggering income recognition under section 1061(d). We ask that Treasury clarify this as well.

Finally, we note that Proposed Regulation section 1.1061-5 treats a transfer, including by gift, of an API to a related person as a taxable event under section 1061(d). Absent the application of section 1061(d), such transaction may not have been a gain realization or recognition event. The proposed regulations create a fiction of a hypothetical sale of the underlying assets, as Proposed Regulation section 1.1061-5(a) states that this provision applies "regardless of whether gain is otherwise recognized on the transfer under the Internal Revenue Code" The imposition of hypothetical sale treatment triggers a capital gain that can be recharacterized under section 1061. Nevertheless, there does not appear to be a statutory basis for imposing

such hypothetical sale treatment. Under a literal reading of the statute, if there is no capital gain recognition event, then the recharacterization of gain as short term capital gain does not appear to be appropriate or warranted. If the underlying assets are not sold there is no actual “long term capital gain” that is realized or recognized. If there is no long term capital gain, there is nothing to recharacterize under section 1061. It does not seem appropriate to impose the hypothetical sale treatment absent express statutory authority.

2. The section 1061(b) exclusion for partnerships without third party investors is not properly implemented by the proposed regulations' exclusion for Passthrough Interest Direct Investment Allocations; while the section 1061(b) exclusion is well-defined in the Code language, it requires regulations in order to provide more detailed rules on which taxpayers can rely.

Section 1061(b) provides that “[t]o the extent provided by the Secretary, [section 1061(a)] shall not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors.” The proposed regulations reserve with respect to the application of section 1061(b). A third party investor is defined in section 1061(c)(5) as a person who holds an interest in the partnership which does not constitute property held in connection with an applicable ATB; and who does not provide substantial services for such partnership or for any applicable trade or business.

The preamble to the proposed regulations agrees that the section 1061 exclusion is intended to apply to partnerships in which the portfolio investments are made on behalf of the service providers and persons related to the services providers:

Comments have suggested that the exception is intended to apply to family offices, that is, portfolio investments made on behalf of the service providers and persons related to the services providers. The Treasury Department and the IRS generally agree with these comments and believe that the section 1061(b) exception effectively is implemented in the proposed regulations with the exception to section 1061 for Passthrough Interest Direct Investment Allocations. The Treasury Department and the IRS request comments on the application of this provision and whether the proposed regulations' exclusion for Passthrough Interest Direct Investment Allocations properly implements the exception.

ACTEC appreciates Treasury's and the IRS's conclusion that, for example, the exclusion should apply to family offices. By “family office,” we generally refer to an organization that manages or oversees the affairs of individuals and their families relating to tax, wealth transfer and succession planning, investment management, governance, estate planning, risk management and personal family needs.⁸ It would indeed be inconsistent with the purposes

⁸ In addition, we note that the term “family office” is defined in the following manner in the Investment Advisers Act of 1940 regulations at 17 C.F.R. § 275.202(a)(11)(G)-1:

(b) Family office. A family office is a company (including its directors, partners, members, managers, trustees, and employees acting within the scope of their position or employment) that:

underlying such an organization for its activities to come within the scope of section 1061. There are several thousand such organizations in the United States that do not manage the investments of third parties.

We submit that the proposed rules for Passthrough Interest Direct Investment Allocations do not adequately track the scope of the Code language in section 1061(b) and thus cannot serve to implement that exclusion. The proposed regulations describe Passthrough Interest Direct Investment Allocations in Prop. Reg. 1.1061-3(c)(5)(iii) as follows:

(iii) Passthrough Interest Direct Investment Allocations. Allocations are treated as Passthrough Interest Direct Investment Allocations if-- (A) The allocations solely are comprised of long-term capital gain and loss derived from assets (other than an API) directly held by the Passthrough Entity; and (B) Allocations are made in the same manner (as provided in paragraph (c)(3)(i) of this section) based on each direct owner's capital account as determined under paragraph (c)(3)(ii) of this section.

In addition, the preamble to the proposed regulations address Passthrough Interest Direct Investment Allocations in the following manner:

b. Passthrough Interest Direct Investment Allocations

Allocations are treated as Passthrough Interest Direct Investment Allocations if the allocations are comprised solely of long-term capital gains and losses derived from assets (other than an API) directly held by the Passthrough Entity and not through an allocation from a lower tier Passthrough Entity. Also, if a Passthrough Entity received Distributed API Property from a lower-tier entity and the property is no longer Distributed API Property because it has been held for more than three years, the property is included in the Passthrough Entity's direct investment at that time. Generally, allocations must be made in the same manner to each of the owners of the Passthrough Entity based on each owner's relative investment in the assets held by the Passthrough Entity. An allocation will not fail to qualify to be a Passthrough Interest Direct Investment Allocation if the Passthrough Entity is a partnership and allocations made to one

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event;

(2) Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and

(3) Does not hold itself out to the public as an investment adviser.

or more Unrelated Non-Service Partners have more beneficial terms than allocations to the API Holders if the allocations to the API Holders are made in the same manner. For example, if an Unrelated Non-Service Partner receives a priority allocation and distribution of 10 percent of net long-term capital gain and loss and the other partners, including the API Holders, share the remaining 90 percent of the net long-term capital gain from the Passthrough Entity's direct investments, allocations to the API Holders are Passthrough Interest Direct Investment Allocations. Further, allocations made in the same manner to some API Holders by a partnership will not fail to qualify to be treated as a Passthrough Interest Direct Investment Allocation as to those partners despite allocations being made to one or more service providers (or related parties) that are treated as APIs issued by the Passthrough Entity. For example, if (1) all of the partners of the Passthrough Entity are API Holders and one partner manages the Passthrough Entity's direct investments and receives a 20 percent interest in the net long-term capital gains from those investments that is treated as an API as to that partner and (2) the other API Holders share the remaining 80 percent of gain from those investments based on their relative investments in the Passthrough Entity, then (3) the allocation of the 80 percent of net long-term capital gain is a Passthrough Interest Direct Investment Allocation to those partners.

The treatment of Passthrough Interest Direct Investment Allocations, as expanded upon by Treasury in the above proposed regulations and preamble, seems to focus principally on the partners' capital accounts. That focus does not match the terms of section 1061(b), which as stated above, is intended to prevent section 1061(a) from applying to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors. Indeed, income or gain attributable to such an asset could readily fall outside of the proposed provision for Passthrough Interest Direct Investment Allocations.

It is possible that our concerns are attributable to a misunderstanding of the proposed rule on direct investment allocations since the examples given all presumably involve an investment on behalf of third party investors, such as in the example in the text above. Instead, for the sake of clarity, we believe that the proposed regulations under the section 1061(b) exclusion should address, at minimum, a simple case where there are no third-party investors. The example could illustrate how the exclusion would apply to a partnership formed only by a few business associates who want to manage their own investments and are not in the same family, or formed only by several family members and trusts, in each case using only their own funds and granting an extra share of profits to one of the partners who is a full time manager.

In light of the foregoing, we respectfully request that Treasury provides a rule specifically addressed to the section 1061(b) exclusion. Section 1061 calls for complex regulations and we believe that the exclusion requires separate rules rather than asking other parts of the regulations to serve double duty.

The special rules should confirm or otherwise address details such as:

1. Does a partner become a third party investor if the partner ceases to provide services to the partnership and does that event terminate the exclusion? The Code language in section 1061(c)(5) indicates that such a former partner does not become a third party investor since he or she has in the past rendered services.
2. What if there is a third party investor but the amount invested is not material (e.g., less than 10% of capital accounts)?
3. If there are third party investors is it possible to separate the allocations so that the third-party side of the partnership is governed by section 1061 but the rest is excluded?

Most importantly the regulations implementing the exclusion should have detailed and specialized rules for determining whether the investors are related to the service providers and thus are not third party investors. The proposed regulations for other subsections of section 1061 incorporate the related party rules of sections 267 and 707, but those rules were written for entirely different contexts. For example, the definition of family in those sections is somewhat narrow, excluding spouses of ancestors and lineal descendants, and excluding an entire side of what is usually considered “family,” the spouse’s ancestors and lineal descendants. Sections 267 and 707 are designed to curb plans to reduce income taxes by transactions that would otherwise trigger deductions and losses or avoid taxable exchanges. These rules do not naturally identify who would be considered an “outsider” in a family fund. Family offices commonly involve both sides of the family and spouses of both sides. Notably Code sections written to define a family entity such as a family partnership use a much broader definition of family. Chapter 14 of the Code uses in section 2704(c)(2) the following definition of family in defining an entity controlled by a family:

2704(c)(2) -- Definitions and special rules

The term “member of the family” means, with respect to any individual—

- (A) such individual’s spouse,
- (B) any ancestor or lineal descendant of such individual or such individual’s spouse,
- (C) any brother or sister of the individual, and
- (D) any spouse of any individual described in subparagraph (B) or (C).

It would be consistent with Congress’s objectives in enacting section 1061(b) to employ a definition for related parties that is similarly inclusive.