Related-Party Wash Sale Transactions: An Evaluation of the Current State of the Law and Recent Legislative Proposals

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Taxpayers who sell stock or securities at a loss are generally prohibited from recognizing the loss under the wash sale rules of Code Sec. 1091(a) if they acquire substantially identical stock or securities within a specified "window period" that begins 30 days before the sale and ends 30 days after the sale. Some taxpayers have sought to avoid this rule by selling the depreciated stock or securities at a loss and repurchasing substantially identical stock or securities through a related party. The consequences of these "related-party wash sales" have long been a matter of debate, but have recently reentered the tax zeitgeist as a result of Sec. 138152 of H.R. 5376, the "Build Back Better Act",[1] which would expand the wash sale rules to explicitly cover related-party transactions.

This article analyzes the current state of the law with respect to related-party wash sale transactions and the Build Back Better Act wash sale proposals. To that end, the article provides: (1) a brief background on the current wash sale rules; (2) a discussion of the prior application (or non-application) of the wash sale rules to related-party transactions by the courts; (3) an overview and analysis of Internal Revenue Service ("IRS") guidance on related-party wash sale transactions; and (4) a review of the Build Back Better Act's proposed amendments to the wash sale rules.

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I. Background

The wash sale rules were enacted in 1921 to prevent taxpayers from harvesting losses by selling a depreciated stock or security (the "loss position") and then reacquiring the same or a substantially identical stock or security (the "replacement position") within a short time period.[2] The 1921 statutory language is essentially the same language that exists today. The general rule of Code Sec. 1091(a) provides the following:

> In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a

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> period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange on which the entire amount of gain or loss was recognized by law), or has entered into a contract or option to so acquire, substantially identical stock or securities, then no deduction shall be allowed under section 165 unless the taxpayer is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of such business.[3]

If a loss is disallowed under this rule, Code Sec. 1091(d) provides for a corresponding increase in the basis of the replacement position.[4] As a result, the wash sale rules generally result in a deferral of the loss, rather than a permanent disallowance.[5] Similarly, Code Sec. 1223(3) provides for a transfer of the loss position's accrued holding period to the replacement position.[6]

There is nothing in Code Sec. 1091 or the accompanying regulations that requires taxpayers to consider transactions entered into by related taxpayers when applying the wash sale rules, and the courts have consistently interpreted the term "taxpayer" to not include related parties.[7] Indeed, in numerous other Code sections that apply to transactions involving financial instruments, Congress has clearly expressed when transactions entered into by related taxpayers should be considered.[8] Thus, general tenets of statutory construction suggest that the wash sale rules apply only on a taxpayer-by-taxpayer basis—not across related parties.

II. Case Law

A. Cases Considering Related-Party Wash Sales

Various cases from the 1930s involving sales and purchases by related taxpayers (*e.g.*, husband and wife, father and son) also appear to indicate that the wash sale rules do not apply across related parties. In those related-party wash sale cases, the courts concluded that the wash sale rules do not apply when one taxpayer sells stock or securities at a loss and another related taxpayer, for example, the selling taxpayer's spouse or son, purchases substantially identical stock or securities within the window period.[9] Critical to the holdings in these cases, however, was the fact that the purchase and sale transactions were respected as transactions entered into by two different taxpayers. Indeed, in cases in which it was determined that the taxpayer did not relinquish dominion and control over the shares that were disposed of—because, for example, the taxpayer controlled the account through which the related taxpayer purchased the new shares and the related taxpayer did not have the financial wherewithal to execute the trade on its own—the courts applied the wash sale rules to disallow losses on the basis that the purchase and sale transactions were in substance entered into by the same taxpayer.[10] Thus, the critical distinction may rest on whether the purchase and sale transactions were entered into by the same taxpayer. If not, these common-law authorities suggest that the wash sale rules should not apply to transactions entered into by related taxpayers.

B. Cases Involving Indirect Related-Party Sales

Also of note is a related line of authority in which the IRS successfully argued that Code Sec. 267(a)(1) should apply to disallow losses realized on the sale of stock by one taxpayer when a related taxpayer simultaneously purchases identical stock.[11] For example, in *McWilliams v. Commissioner*,[12] a husband ordered a broker on several occasions to sell certain stock for the account of himself or his wife, and to buy the same number of shares of the same stock for the other, at as nearly the same price as possible, and did so for the express purpose of establishing a tax loss. The sales were negotiated on a stock exchange and the identities of the counterparties were unknown. Notwithstanding the fact that the transactions were effectuated with third parties *via* the stock exchange, the Supreme Court treated the sale by one spouse and the purchase by the other as an indirect sale between the two related parties and disallowed the loss under the predecessor to Code Sec. 267(a)(1).[13] In *McWilliams* and similar cases that followed, the wash sale rules were often put forth, and rejected, as a means of disallowing the loss, further supporting the conclusion that the courts do not believe the wash sale rules apply across related parties.[14]

But could this mean that Code Sec. 267(a)(1) will always disallow losses in the context of related-party wash sale transactions? We think not. In these indirect related-party sale cases, the tax motivation and temporal proximity of the sale and purchase transactions appears to have been decisive. In situations in which the sale and purchase were not tax-motivated or non-simultaneous, the transaction was not treated as an indirect sale to which Code Sec. 267(a)(1) could be applied. For example, in *United States v. Norton*,[15] the court concluded that Code Sec. 24(b) (the predecessor to Code Sec. 267(a)(1)) could not be applied because 28 days had elapsed between the sale and the repurchase. In its opinion, the court stated:

> The Supreme Court [in *McWilliams v. Commissioner*] commented on the difficulty arising from the omission from the statute of any period of time during which

the acquisition by one member of the related group of the same stock sold by another member would bring the disallowance of a loss into play; but the Court did not there need to pass on that question other than to say that such omission did not prevent the Court from construing the statute to apply to the simultaneous sale and purchase transactions there involved. Nor do we have to decide where the line should be drawn in any case other than the one before us. Normally there can be a sale from A to B only at a single point of time, whether that sale be direct or indirect. The Supreme Court has held that such a sale and purchase exist when an order is given simultaneously for sale by A and purchase by B, to be executed on the stock exchange contemporaneously. That is what was done with respect to Norton's other sales. It has not been held, and we do not think it can be, that such sale and purchase exists when A sells on the market and no action is taken or contemplated for 28 days, at which time B determines to buy the same amount of stock and does so at a different price. The fact that there is a complete break in the control by the members of the related group prevents this purchase from being a sale between A and B, either direct or indirect. Of course, Congress could extend the wash sales prohibitions to purchases by related persons if it saw fit to do so, but it has not accomplished this result in Section 24(b). Dealing only with the facts here, we must hold that a sale of fungible stocks by Norton on August 30th, followed by the purchase by his mother 28 days later at a lower price was not a sale or exchange of property directly or indirectly between son and mother, within the contemplation of Section 24(b).[16]

Although the courts have not provided express boundaries for when a sale and repurchase should be treated as an indirect sale, the fact that Code Sec. 267(a)(1) was only applied in the case of simultaneous or near-simultaneous sales and purchases implies this bar may be quite high.[17] The 28-day period in *Norton* certainly suggests that to trigger an indirect sale the purchase and sale must occur much closer together than for wash sales, where a purchase and sale can occur up to 30 days apart. It is also possible that determining whether an indirect sale has occurred is based on factors other than the temporal proximity of the purchase and sale, such as the volatility of the asset in question and the circumstances surrounding the purchase and sale (*e.g.*, whether there was a *bona fide* business purpose for the transactions). Lastly, we note that in the related-party wash sale transactions described previously, the IRS attempted to apply the wash sale rules rather than Code Sec. 267(a)(1) (or its predecessor), which suggests that the IRS, at least at that time, did not believe Code Sec. 267(a)(1) could be applied in those contexts.

III. IRS Guidance

As demonstrated above, the statute seems to be best interpreted as contemplating a taxpayer-by-taxpayer application of the wash sale rules and has generally been interpreted in that manner by the courts. Nevertheless, on two separate occasions IRS guidance has attempted to apply the wash sale rules across related parties. The two pieces of guidance are quite different, both in their technical underpinning and their implications. We evaluate each below.

A. The Special Ruling

In a 1946 Special Ruling (the "Special Ruling"), the Deputy Commissioner responded to a request for guidance on the interaction between Code Sec. 118 (the predecessor to Code Sec. 1091) and the rules applicable to partnerships. In the response, the Deputy Commissioner stated:

> [G]ains and losses from the sales or exchanges of capital assets by the partnership will be treated as the partnership member's sale of his interest in the identical property as though made directly by him. Where such stock or securities (as capital assets) are sold by the partnership at a loss, and within 30 days before or after the date of sale, a member of the partnership has acquired or has entered into a contract or option to acquire substantially identical stock or securities through use of his own funds independent of any interest he has in the funds of the partnership, the wash sale provision of section 118 of the Code would be applicable to such member.[18]

In other words, the Special Ruling concludes that if a partner acquires a replacement position to a loss position sold by the partnership, the wash sale rules disallow the partnership loss flowing through to the partner. This conclusion appears to be premised on treating the partnership as an aggregate of its partners for purposes of the wash sale rules (*i.e.*, stock and securities sold by the partnership are treated as having been sold by the partnership's partners).[19]

1. Practical Issues Associated with the Special Ruling

The Special Ruling does not indicate there was an abusive purpose for the sale of the loss security by the partnership and the acquisition of a replacement position by the partner, which may mean that the Special Ruling's conclusions are intended to represent a rule of general application. Taken to an extreme, this would require that

partners have knowledge of the stocks and securities sold by the partnership, the dates of the sales, the proceeds of the sales, and other information such as the holding period and basis of each stock or security sold. Perhaps in 1946 partners and partnerships were normally closely associated and could be reasonably expected to know this type of information. Clearly, that is not the case today for many investment and trading partnerships, and implementing this type of analysis would be impeded by a host of legal, administrative, and commercial issues.[20]

Without more comprehensive guidance, the application of aggregate principles in the wash sale context would also create a number areas of uncertainty. For example, it is not clear how the rules would be applied to tiered partnership structures. One possible interpretation is that each entity would apply an aggregate approach when determining taxable income, with the tier immediately above reapplying the aggregate approach to redetermine taxable income. This approach would be quite cumbersome and would render Schedule K-1 information from investment partnerships largely useless because each succeeding tier would take into account additional transactions when applying the wash sale rules on an aggregate basis. We are not aware of any tiered partnership structures that apply the wash sale rules in this manner. Another issue would be the possibility of fractional share wash sales. For example, assume Partnership sells 1 share of Stock A at a loss and allocates the loss 50 percent to its two partners, X and Y. Within the wash sale period, X purchases 1 share of Stock A. Applying aggregate principles, X has sold ½ of a share of Stock A—should that create a wash sale with the 1 share of Stock A that X purchased? One can reasonably question the practicality of the Special Ruling given the number of similar scenarios in which the proper interplay of the wash sale rules and the aggregate approach espoused in the Special Ruling would be unclear.

2. Does the Special Ruling Reach the Correct Conclusion?

Given the constant tension between aggregate and entity principles and the evolution of the treatment of partnerships between 1946 and today, it is not clear that the position taken in the Special Ruling is still tenable under general tax principles (if it ever was).[21] That is, an aggregate approach is the exception, not the general rule, and it generally does not apply without a specific rule mandating such treatment.[22] There is no such rule in the wash sale context. Also, as noted previously, the statutory framework of Code Sec. 1091 contemplates a taxpayer-by-taxpayer application of the wash sale rules. Partnerships are taxpayers, as are partners, and the two should not be conflated when applying Code Sec. 1091.[23]

It warrants keeping in mind the informal origin of the Special Ruling—it is a letter written by the Deputy Commissioner that was later published in the Internal Revenue Bulletin. The Special Ruling has no precedential value and cannot be cited as law, and we are not aware of other situations in which the IRS has attempted to apply the wash sale rules on an aggregate basis. It is, therefore, entirely possible that the Special Ruling does not represent the IRS's current position on this matter. Given market practice is to not apply the wash sale rules in the manner suggested by the Special Ruling, the lack of litigation on this issue may further suggest that this is the case.

A strong case can be made that the Special Ruling reaches the wrong conclusion, and we believe a court would be unwilling to embrace the byzantine complexity that would follow from adopting its aggregate approach.[24] We note that the IRS could seek to invoke the abuse-of-entity rule in Reg. §1.701-2(e) to achieve a similar result as the one contemplated in the Special Ruling, but the partnership anti-abuse rule is controversial[25] and has rarely been applied.[26] We are not aware of the IRS ever asserting that the abuse-of-entity rules applies to wash sales, which may suggest that the IRS believes the abuse-of-entity rule should not be applied in this context.[27]

B. The IRA Ruling

In Rev. Rul. 2008-5 (the "IRA Ruling"),[28] the situation considered, and the IRS's analysis, was much different. In the IRA Ruling, individual A owned 100 shares of X Company stock with a basis of $1,000. On December 20, 2007, A sold the 100 shares of X Company stock for $600. On December 21, 2007, A caused an IRA (within the meaning of Code Sec. 408) or Roth IRA (within the meaning of Code Sec. 408A), established for the exclusive benefit of A, or A's beneficiaries, to purchase 100 shares of X Company stock for its then fair market value. Individual A executed the sale and purchase with unrelated market participants and is not a dealer in stock or securities.

The IRS concluded in the IRA Ruling that the wash sale rules should apply to disallow A's $400 loss on the sale of X Company stock. In reaching this conclusion, the IRS relied on *Security First National Bank of Los Angeles v. Commissioner*.[29] The IRA Ruling offers limited analysis of the *Security First* opinion or its applicability to the facts of the IRA Ruling. Closer examination of the case is useful, therefore, in attempting to understand the underlying rationale of the IRA Ruling.

In *Security First*, the taxpayer, an individual, formed a trust to own and operate a library. The taxpayer transferred real and personal property to the trust but retained the right to revest in himself title to the trust's assets at any

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time. The taxpayer subsequently sold bonds at a loss to his wholly owned corporation. On the same day, and as part of the taxpayer's overall plan, the trust purchased the bonds from the taxpayer's wholly owned corporation.

The first issue addressed by the court was whether the trust's income was taxable to the taxpayer. The court concluded that, because the taxpayer retained the right to revest in himself title to the trust's property and had the power to distribute to himself the trust's income, all of the trust's income was taxable to the taxpayer under Code Sec. 219(g) of the Revenue Act of 1926,[30] the predecessor to current Code Sec. 676 (treating grantors as the owner of any portion of a trust when the grantor can revest in itself title to the trust's assets).[31]

The court also concluded that because of the taxpayer's dominion and control over the trust's assets, there was not a sufficient distinction between the trust acquiring and holding the bonds and the taxpayer acquiring and holding the bonds to permit him a deduction for the loss under section 214(a)(5), the predecessor to Code Sec. 1091. In addressing the application of the wash sale rules to the sale of the bonds, the court acknowledged that the taxpayer did not himself sell and then re-acquire substantially identical property. The court conceded this fact weakened the case for applying the wash sale rules but concluded that the "rule of strict construction should not be unduly pressed to permit easy evasion of a taxing statute ... [A] trust like this one could be used to accomplish the very thing which Congress intended to frustrate."[32] The court went on to state that the "difference between acquisition by [the taxpayer] personally and acquisition by the trust amounts only to a refinement of title and may be disregarded so far as section 214(a)(5) is concerned."[33]

Like the courts in the related-party wash sale cases described above, the court in *Security First* seemed to focus on the taxpayer's dominion and control over the trust's asset. In addressing wash sales, however, the court did not explicitly state that the transactions at issue should be viewed as having been entered into by one taxpayer. Thus, one could potentially interpret *Security First* as applying the wash sale rules to transactions involving different taxpayers so long as there is sufficient dominion and control over the assets of the related taxpayer. This broad interpretation of the case would be a departure from the other related-party wash sale cases described above in which the courts applied the wash sale rules to transactions entered into by related taxpayers only when they determined that the transactions were in substance entered into by the same person. This characterization of *Security First* also ignores the fact that the court in *Security First* determined that the taxpayer had sufficient dominion and control over the trust's assets to cause the income generated by those assets to be taxed to the taxpayer. Thus, under the grantor trust rules in effect at the time, the taxpayer was effectively treated as the owner of the trust's assets. Under that view, and certainly under the grantor trust rules that exist today, the trust in *Security First* would be disregarded and the taxpayer would be viewed as selling and repurchasing the bonds from his wholly owned corporation directly. Characterized that way, the transactions at issue would be covered by the plain language of Code Sec. 1091(a) and there would be no need for a related-party wash sale rule. Thus, it is possible to read *Security First* consistently with the other related-party wash sale cases as applying the wash sale rules to transactions entered into by the same taxpayer—and not as establishing a broad related-party wash sale rule that can apply when one taxpayer has dominion and control over the assets of another taxpayer but not sufficient dominion and control to be treated as the tax owner of the related party's assets.[34]

1. Does the IRA Ruling Reach the Correct Conclusion?

If the wash sale rules apply only to single-taxpayer transactions, then the conclusion in the individual retirement account (IRA) Ruling makes sense only if an individual and his or her IRA are considered the same taxpayer. The IRA Ruling does not address this issue. All that the IRA Ruling says to this point is, "even though an individual retirement account is a tax-exempt trust, A has nevertheless acquired, for purposes of Code Sec. 1091, 100 shares of X Company stock on December 21, 2007, by virtue of the purchase." Accordingly, any argument that A and A's IRA do not have separate taxpayer identities is underdeveloped in the IRA Ruling and may be contrary to current law.

The special rules for IRAs support treating an IRA as separate from its owner. The Code Sec. 4975 prohibited transaction rules apply to transactions between an IRA and the IRA owner. Specifically, Code Sec. 408(e)(1) provides that generally an IRA is exempt from tax. This exemption from tax will cease to apply, however, if an individual engages in a transaction with his or her IRA that is prohibited by Code Sec. 4975.[35] Arguably, a taxpayer may not enter into a transaction with itself. Thus, an IRA should be considered separate from its owner. Furthermore, distributions from IRAs are taxable to the recipient under Code Sec. 72, and an IRA is subject to tax under Code Sec. 511 on unrelated business income.[36] These characteristics suggest that an IRA is treated as separate from its owner for tax purposes. If the IRA and its owner were considered to be the same taxpayer, there presumably would not be a need to tax distributions from the IRA to the IRA owner, as income from the IRA's assets would already be taxable to the individual.

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The conclusion that an IRA is separate from its owner is further supported by the Tax Court's decision in *Taproot Administrative Services, Inc. v. Commissioner*.[37] In that case, the taxpayer was a corporation that had elected to be taxed as an S corporation. The sole shareholder of the taxpayer's stock for the year of issue was a custodial Roth IRA account for the benefit of a natural person. The IRS took the position, in line with a previously issued Revenue Ruling,[38] that the Roth IRA was not an eligible shareholder under Code Sec. 1361(b)(1)(B) and the taxpayer was therefore not eligible for S corporation status and was subject to tax as a C corporation. The taxpayer argued that the individual owner of the IRA was properly regarded as the shareholder for purposes of determining S corporation eligibility, on the basis that the IRA should be viewed as a grantor trust that is disregarded as separate from its owner. The court rejected the taxpayer's contention and in concluding that "[a]n IRA exists on its own—separate from its beneficiary" the court noted that (1) IRAs are subject to tax under subchapter D, not under the rules for grantor trusts found in subchapter J; (2) the owners of grantor trusts are taxed on the income of the trust, whereas the owners of an IRA are not taxed on the IRA's income; and (3) IRAs may themselves be subject to tax under the rules for unrelated business taxable income.

All of this suggests that IRAs and their owners are separate taxpayers which further suggests that the IRS may be overreaching in the IRA Ruling when it concludes that Code Sec. 1091(a) should apply to transactions entered into by an individual and the individual's IRA. Accordingly, notwithstanding the IRA Ruling, taxpayers have a strong argument in the authors' view that the wash sale rules of Code Sec. 1091 apply only to transactions entered into by a single taxpayer and not to the transaction described in the IRA Ruling. Furthermore, given the IRA Ruling's case law support for its conclusion, the IRA Ruling does not appear to provide very strong authority for the more general existence of a related-party wash sale rule. Thus, based on the weight of existing authority, it appears that Code Sec. 1091 does not apply to transactions entered into by different taxpayers, even if the taxpayers are related (*e.g.,* a shareholder and a wholly owned corporation).

2. Related Parties and Tax Planning—Implications of the IRA Ruling

In the IRA Ruling, the IRS states that the taxpayer's basis in the IRA is not increased under Code Sec. 1091(d). Although no analysis is provided in support of this conclusion, it is hardly surprising. The IRA itself is not a replacement position to the stock or securities sold and would not be subject to a basis adjustment under Code Sec. 1091(d); rather, the stock or security acquired by the IRA that triggered the wash sale is the position for which a basis adjustment would be allowed. The application of Code Sec. 1091(d) to the replacement position held by the IRA is not discussed, but a basis adjustment would appear to be allowed under the statutory language of Code Sec. 1091(d). Unfortunately, that is little consolation to the individual in the IRA Ruling, because losses realized by an IRA generally do not provide a tax benefit.

But what if the situation were reversed? Suppose an IRA sold a depreciated stock or security at a loss and the owner of the IRA acquired a substantially identical stock or security. Would the individual be entitled to a basis step-up in their taxable account? The answer to this question hinges on whether the IRA's loss would otherwise have been considered "deductible," as required by Code Sec. 1091(d).[39] IRAs are not generally subject to tax and, for this reason, losses in an IRA generally do not provide a tax benefit, as noted above.[40] However, that is not the same as saying the losses are nondeductible. This is made evident by Code Sec. 267(d)(1) and (3). Code Sec. 267(d)(1) provides that if a loss is not *deductible* to the transferor by reason of Code Sec. 267(a)(1) and the transferee later sells the property at a gain, the gain is only recognized to the extent it exceeds the previously disallowed loss. Code Sec. 267(d)(3) provides that this exception to gain recognition does not apply to the extent of any loss sustained by the transferor that (if allowed) would not be taken into account in determining a tax imposed under Code Sec. 1 or 11 or a tax computed as provided by either of such sections. Thus, Code Sec. 267(d) contemplates a tax-exempt party having "deductible" losses—if that were not the case Code Sec. 267(d)(3) would be superfluous.[41] The unrelated business taxable income provisions applicable to IRAs also make it clear that the concept of "taxable income" is relevant to IRAs.[42] And if taxable income is a relevant concept, then deductions, which are included in the calculation of taxable income, are also relevant.[43] The unrelated business taxable income provisions applicable to IRAs also mean that the IRA tax exemption is not all encompassing and there are situations in which IRAs are subject to tax and losses provide a tax benefit.[44] For these reasons, losses on the sale or exchange of stocks and securities by an IRA are "deductible" notwithstanding the IRA's general exemption from taxation. Therefore, if one accepts the IRS's conclusion that the wash sale rules apply across an IRA and the taxpayer controlling the IRA, then a step-up in basis should be possible for a taxpayer buying a replacement position to a loss position sold by an IRA.

As previously discussed, we believe that the IRA Ruling reaches the wrong conclusion as to the applicability of the wash sale rules. But we also acknowledge that taxpayers generally can rely on the IRS's position in a revenue

ruling.[45] Thus, a person that controls an IRA with depreciated securities could conceivably sell the depreciated securities out of the IRA, buy substantially identical stock or securities in their non-IRA taxable brokerage account, and assert (based on the principles of the IRA Ruling) that the transaction was a wash sale subject to Code Sec. 1091(a).[46] Because the IRA Ruling does not address whether Code Sec. 1091(d) would allow a step-up in the basis of the replacement position, the taxpayer could then take the position that the plain language of Code Sec. 1091(d) allows such a basis step-up and would not be taking a position that conflicts with the IRA Ruling's analysis.

By employing this type of strategy, taxpayers could essentially create tax benefits by importing losses from nontaxable retirement accounts into taxable brokerage accounts.[47] In addition, because the losses would generally not provide a tax benefit inside the retirement account, there is very little tax risk associated with implementing this type of strategy.[48] Thus, in addition to our critique of the IRA Ruling's technical conclusions, we'd also note that it creates a problematic situation in which uninformed taxpayers could have losses permanently disallowed while well-advised taxpayers might be expected to use its principles to their benefit in a way that disadvantages the fisc.

IV. The Build Back Better Act Wash Sale Proposals

As noted at the outset of this article, related-party wash sale transactions have recently reentered the tax conversation as a result of the Build Back Better Act's wash sale proposals that would include, among other changes, the addition of comprehensive related-party wash sale rules. Below we briefly describe the proposed legislation, evaluate its proposals, and consider any implications it may have on the current state of the law.

A. Overview of the Proposals

Sec. 138152(a) of the Build Back Better Act would amend the wash sale rules to cover "specified assets"—a term that is expansively defined to include:

- Any share of stock in a corporation;
- Any partnership or beneficial ownership interest in a widely held or publicly-traded partnership or trust;
- Any note, bond, debenture, or other evidence of indebtedness;
- Any foreign currency;
- Any commodity that is actively traded;
- Any interest rate, currency, equity, or actively traded commodity notional principal contract;
- Any evidence of an interest in, or a derivative financial instrument in, any of the foregoing, including any option, forward contract, futures contract, short position, and any similar financial instrument in such a security, actively traded commodity, or currency; and
- Except as otherwise provided by the Secretary, any digital representation of value recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.[49]

Except as provided in regulations, the term "specified asset" would also include contracts or options to acquire or sell any specified assets.

The proposal contains an exception for foreign currency and commodities losses that are either:

- Directly related to the business needs of a trade or business of the taxpayer (other than the trade or business of trading foreign currencies or commodities); or
- Part of a hedging transaction (as defined by Code Sec. 1221(b)(2)).

Most relevant to our discussion is a proposal that would disallow losses on the sale of a specified asset if a related party acquires a replacement position. For this purpose, a related party would be broadly defined to include:

- The taxpayer's spouse;
- Dependents of the taxpayer and persons to whom the taxpayer is a dependent;
- Any individual, corporation, partnership, trust, or estate that controls (within the meaning of Code Sec. 954(d)(3)), or is controlled by, the taxpayer, the taxpayer's spouse, or any dependents of the taxpayer or persons to whom the taxpayer is a dependent;
- To the extent the Secretary provides in regulations or other guidance, any individual who bears a relationship to the taxpayer described in Code Sec. 267(b) if such a taxpayer is an individual;
- Any individual retirement plan, Archer MSA, or health savings account of the taxpayer, the taxpayer's spouse, or any dependents of the taxpayer or persons to whom the taxpayer is a dependent;
- Any account under a Code Sec. 529 qualified tuition program or a Coverdell education savings account if taxpayer's spouse or any dependents of the taxpayer or persons to whom the taxpayer is a dependent is the designated beneficiary of the account or has the right to make decisions with respect to the investment of any amount in such account; and
- Any Code Sec. 401(a) plan, Code Sec. 403(a) annuity plan, Code Sec. 403(b) annuity contract, or Code Sec. 457(b) deferred compensation plan, if the taxpayer, the taxpayer's spouse, or any dependents of the

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> taxpayer or persons to whom the taxpayer is a dependent has the right to make any decision with respect to the investment of any amount in such account.

The proposal would also authorize the Secretary to issue regulations or additional guidance to prevent the avoidance of the wash sale rules through the use of related parties.

If substantially identical specified assets are acquired by the taxpayer or the taxpayer's spouse during the period beginning 30 days before the sale and ending on the close of the taxpayer's first tax year after the sale, the basis of the acquired specified assets would be increased by the amount of the disallowed loss.[50] In the case of any acquisition of substantially identical specified assets by a related party other than the taxpayer's spouse, the basis of the substantially identical specified assets would not be adjusted to include the disallowed loss.[51] Importantly, and as described below, this basis adjustment rule does not seem to be limited to adjusting basis in the replacement property that triggers the wash sale. The proposal does not include conforming modifications to the holding period adjustment rules under Code Sec. 1223(3) to incorporate the "specified asset" language and does not indicate whether holding period adjustments would be made in cases when a basis adjustment is not allowed.[52]

The Joint Committee on Taxation estimated that these changes, together with changes to the constructive sale rules of Code Sec. 1259, would generate $16.8 billion of incremental revenue over a 10-year period.

B. Evaluation of the Related-Party Wash Sale Proposal

Our analysis of the proposed legislation focuses on the proposed related-party wash sale rule.[53] This rule appears to be intended to amend the wash sale rules so that they apply across related parties, rather than on a taxpayer-by-taxpayer basis. In addition, Congress appears to have been concerned that taxpayers might otherwise use the wash sale rules to shift losses among related parties, and for this reason, a basis adjustment is only allowed in situations where the taxpayer or the taxpayer's spouse acquires the replacement position. While the goal of the legislation is understandable, the complete disallowance of the loss without a basis adjustment in the context of related-party transactions seems unduly harsh and creates a significant trap for the unwary.[54]

It is also not clear whether drafters of the legislation fully considered the implications of certain related-party definitions and attribution rules that were incorporated by cross-reference to Code Sec. 954(d)(3). The legislation generally seems to treat as related parties members of a nuclear family and entities or accounts controlled by them. Thus, a taxpayer is considered related to their dependent child but not related to their nondependent grandparents. However, in contrast to this general "nuclear family approach," the attribution rules could result in a taxpayer being treated as a related party with an entity wholly owned by their grandparent.[55] Why should an entity owned by the grandparent, but not the grandparent themselves, be considered related? Another oddity is that the relevant Code Sec. 958(b) attribution rules incorporate a number of adjustments to the Code Sec. 318 attribution rules that do not have a clear policy rationale in the context of the wash sale rules.[56]

Also problematic is the mechanics of the basis adjustment rule, which seems to create opportunities to circumvent the wash sale rules that did not exist previously. Consider the following example:

> *Facts*: On October 15, 2022, Party A sells specified asset X with a basis of $100 for $25, its fair market value. On October 16, 2022, Party B, a non-spousal related party, buys specified asset X for $25 and continues to hold it. On October 17, 2022, Party A buys specified asset X for $25 and immediately sells it for $25.
>
> *Analysis*: Assuming the October 15, 2022 sale by Party A and the October 16, 2022 purchase by Party B is not treated as an indirect sale by Party A to Party B, the purchase by Party B will create a wash sale. As a result, the $75 loss Party A realized on October 15, 2022 is disallowed. Because Party B is not Party A's spouse, Party B is not entitled to increase its basis in specified asset X by the amount of the disallowed loss. Party A's purchase of specified asset X on October 17, 2022 does not create a wash sale because the October 15, 2022 sale and October 16, 2022 purchase were already treated as a wash sale.[57] However, under the basis adjustment rule, Party A's basis in the specified asset X acquired on October 17, 2022 is increased by the amount of the loss disallowed in the wash sale (*i.e.*, basis is increased from $25 to $100). When Party A then sells the October 17, 2022 lot, a $75 loss is realized. Thus, Party A is able to take the loss on specified asset X by increasing its exposure for less than a day (and never eliminating the Party A/B economic exposure), and related Party B maintains its cost basis of $25.

This loophole could not have been intended. It would allow well-advised taxpayers to easily circumvent the wash sale rules while still creating a significant trap for the unwary.

The legislation also suffers from a lack of coordination with existing rules and case law. For example, in

the context of a direct or indirect related-party sale both Code Sec. 1091 and Code Sec. 267(a) could apply and it is not entirely clear which set of rules should take precedence. In addition, Code Sec. 1223(3) was not amended to conform to the new legislation. As a result, it is not clear that a holding period adjustment would be allowable in cases involving the sale and repurchase of a specified asset other than a stock or security, nor is it clear that a holding period adjustment would apply when a loss is disallowed as a result of a related party acquiring a replacement position.

If the Build Back Better Act proposals move forward, we hope that due consideration will be given to these issues and other issues raised by the tax professional community.

C. Implications as to Current Law

One might ask whether these amendments to Code Sec. 1091 should be interpreted as a clarification of current law, an adjustment to the current rules, or a new related-party regime entirely. The legislative history does not address this question and the legislative text states that no inferences should be drawn.[58] In addition, the Joint Committee on Taxation's revenue estimate is not broken out between the changes to the constructive sale rules, the expansion of the wash sale rules to cover specified assets, and the related-party wash sale provisions, and as a result, one cannot say with certainty whether the Joint Committee on Taxation viewed the proposal as a substantive change. It is, therefore, difficult to read much into the Build Back Better Act proposal as an expression of what is, or what is not, the current law.[59]

V. Conclusion

As described above, the IRS has applied the wash sale rules across related parties in both informal and formal guidance. Although the technical underpinning of this guidance is not entirely clear, we note that Code Sec. 1091(a) applies to a taxpayer and the term "taxpayer" has been consistently interpreted by the courts as a single taxpaying entity or individual. Thus, the statute does not contemplate applying the wash sale rules across related parties. The relevant judicial decisions accord with this conclusion. Therefore, we believe that the wash sale rules do not currently apply across related parties, notwithstanding IRS guidance to the contrary.

ENDNOTES

* The authors would like to thank Tracy Stone and Matt Busta for their thoughtful review of an earlier draft of this article.

The information in this article 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 authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

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1 References to H.R. 5376 in this article refer to the "manager's amendment" released on November 3, 2021.

2 HR Rep. No. 350, 67th Cong., 1st Sess. 11 (1921); S. Rep. No. 275, 67th Cong., 1st Sess. 14 (1921). *See also* GCM 39551 (1986); GCM 38369 (1980). The wash sale rules were enacted in response to reports that taxpayers were selling securities at a loss in the morning and repurchasing the same securities that afternoon. *See* Hearings on HR 8245, Committee on Finance, 67th Cong., 1st Sess. 51–52, 235–236 (1921).

3 *See also* Reg. §1.1091-1(a).

4 *See also* Reg. §1.1091-2.

5 There can, however, be situations where the disallowance is permanent. For example, if a taxpayer dies and the taxpayer's heirs take fair market value basis in the replacement position under Code Sec. 1014(a)(1), the loss would be permanently disallowed. The proposed changes to the wash sale rules contemplated in the Build Back Better Act would result in a permanent loss disallowance if the wash sale transaction involved non-spousal related parties. These rules are discussed, *infra*.

6 *See also* Reg. §1.1223-1(d).

7 *See, e.g., PSB Holdings, Inc.*, 129 TC 131, Dec. 57,159 (2007) (treating members of the same consolidated return as separate "taxpayers"). *See also* Code Sec. 7701(a)(14) (defining "taxpayer" as any person subject to any internal revenue tax) and note 9, *infra*.

8 *See, e.g.*, Code Sec. 163(l) (disallowing an issuer's interest deductions with respect to debt when the debt is payable in (or by reference to the value of) equity held by a related party); Code Sec. 1092(d)(4) (treating positions entered into by certain related parties as offsetting positions for purposes of the straddle rules); Code Sec. 1259(c)(1) (treating certain transactions entered into by a related person as triggering a constructive sale of a taxpayer's appreciated financial positions). *See also R.W. Norton*, CA-5, 58-1 USTC ¶9188, 250 F2d 902 (1958) (acknowledging that Congress could have extended the wash sale provisions to transactions involving related taxpayers but chose not to).

Courts generally assume that Congress has acted intentionally or purposely in the disparate inclusion or exclusion of words or phrases and are generally unwilling to supply language that has been omitted by Congress. *See e.g., Russello*, 464 US 16, 23, 104 SCt 296 (1983) (quoting *Wong Kim Bo*, CA-5, 472 F2d 720, 722 (1972)) ("'[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.'"); *Helvering v. Stockholms Enskilda Bank*, SCt, 35-1 USTC ¶9007, 293 US 84, 93, 55 SCt 50, 54, 79 L.Ed. 211 (1934) ("[T]axing acts 'are not to be extended by implication beyond the clear import of the language used,' and that doubts are to be resolved against the government and in favor of the taxpayer.").

9 *See, e.g., Grummey*, 26 BTA 894, Dec. 7719 (1932) (concluding that a husband and wife are not the same taxpayer for federal tax purposes, even if they file a joint return, and thus taxpayer's stock loss was not disallowed under the wash sale rules when the taxpayer's spouse purchased substantially identical stock within the window period); *Cole v. Helburn*, DC, 3 USTC ¶1081, 4 FSupp. 230 (W.D. Ky 1933) (holding that taxpayer's son's purchase of substantially identical stock within window period did not cause the wash sale rules to apply to father).

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[10] *See, e.g., W.E. Brochon*, 30 BTA 404, Dec. 8511 (1934) (holding that husband's loss on stock sale should be disallowed when husband purchased identical stock within the window period on wife's behalf through his brokerage account and wife had no money of her own to execute trade); *Morse*, 34 BTA 943, Dec. 9463 (1936) (concluding that husband's loss on stock sale should be disallowed under the wash sale rules because wife's account, through which identical shares were repurchased, was in substance the husband's account and thus the same taxpayer entered into both the sale and repurchase transactions); *E.W. Mitchell Est.*, 37 BTA 161, Dec. 9923 (1938) (same).

In *Security First National Bank of Los Angeles*, 28 BTA 289, Dec. 8098 (1933), the court concluded that the wash sale rules applied when a taxpayer sold stock to a controlled corporation and repurchase the stock from the corporation *via* a wholly owned trust. Although not entirely clear, it appears that the court viewed the trust as disregarded from the individual taxpayer, such that the transaction amounted to a sale/repurchase that would be within the plain language of Code Sec. 1091(a). Because Rev. Rul. 2008-5, IRB 2008-3, 271 relies heavy on the *Security First* decision we discuss this case further below.

[11] *See J.P. McWilliams*, SCt, 47-1 USTC ¶9289, 331 US 694, 67 SCt 1477 (1947); *J.B. Sethar*, 28 TC 1222, Dec. 22,584 (1957); *R.W. Norton*, CA-5, 58-1 USTC ¶9188, 250 F2d 902 (1958); *J.H. Merritt*, 47 TC 519, Dec. 28,350 (1967); *E.E. Hassen*, 63 TC 175, Dec. 32,841 (1974).

[12] SCt, 47-1 USTC ¶9289, 331 US 694, 67 SCt 1477 (1947).

[13] Code Sec. 267(a)(1) provides that "[n]o deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between [related parties]."

[14] *See McWilliams*, SCt, 47-1 USTC ¶9289, 331 US 694, 701-702, 67 SCt 1477 (1947); *R.W. Norton*, CA-5, 58-1 USTC ¶9188, 250 F2d 902, 908–909 (1958). In the context of these cases, the wash sale rules would have been more taxpayer-favorable, because the basis adjustment rule of Code Sec. 1091(d) typically ensures there will be a future deduction, whereas Code Sec. 267(d) only provides a future deduction if the loss property is later sold at a gain. *See also J.B. Sethar*, 28 TC 1222, 1224, Dec. 22,584 (1957) (indicating that the transaction was entered into to generate a tax loss while avoiding the application of the wash sale rules).

[15] CA-5, 58-1 USTC ¶9188, 250 F2d 902 (1958).

[16] *Id.* at 908–909.

[17] *Id.* at 909 ("Normally there can be a sale from A to B only at a single point of time, whether that sale be direct or indirect.").

[18] Special Ruling, October 11, 1946, IRB 1946-21 (Oct. 21, 1946).

[19] The Special Ruling indicates that the wash sale rules apply to the member rather than the partnership. Thus, the partnership itself does not experience the disallowance of a loss, notwithstanding the fact that the partnership is the entity selling the loss position. By indicating that the wash sale rules apply to the member purchasing the replacement position (rather than the partnership selling the loss position), it would seem that aggregate principles could not be applied to trigger a wash sale in the other direction. In other words, if a partner sold a loss position and the partnership acquired substantially identical stock or securities, the partnership would not have a loss to disallow (the loss would be the partner's) and the wash sale rules would not apply.

[20] For example, investment and trading partnerships may be reluctant to make their trading history available to partners due to concerns that this information might be used by other parties to replicate their investment strategies.

[21] Prior to 1954, the taxation of partnerships was not entirely clear and the relevant statutory framework was far more open to being interpreted as contemplating a general aggregate system than Subchapter K in its current form.

[22] For example, Reg. §1.1248-1(a)(4) provides that "if a foreign partnership sells or exchanges stock of a corporation, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporation." If partners were generally treated as having sold a proportionate amount of stock sold by an underlying partnership, this regulation would not have been necessary. This strongly suggests that partners should not be treated as selling stock or securities sold by an underlying partnership for purposes of the wash sale rules. *See also* Code Sec. 1092(d)(4)(C) (providing for aggregate treatment of partnerships for purposes of the straddle rules).

[23] Code Sec. 7701(a)(14) ("the term 'taxpayer' means any person subject to any internal revenue tax"). Although a partnership is not subject to income tax, it is subject to other internal revenue taxes such as federal unemployment tax (Code Sec. 3301) and old-age survivors and disability insurance tax (Code Sec. 3111) and is therefore a "taxpayer." *See* LTR 8443084 (Jul. 25, 1984).

[24] There may be certain situations in which courts might look more favorably on the position described in the Special Ruling. For example, if a partner owned 99 percent of a partnership and used the partnership to execute wash sale transactions and avoid Code Sec. 1091, a court might be more inclined to apply aggregate principles.

[25] *See, e.g.*, Lipton, *Controversial Partnership Anti-Abuse Prop. Regs. Raise Many Questions*, 81 J. TAX'N 68 (Aug. 1994); Lipton, *IRS Improves Partnership Anti-Abuse Regs., but Major Problems Remain*, 82 J. TAX'N 132 (Mar. 1995); *Subchapter K Antiabuse Reg. Sparks Heated Reactions*, 63 TAX NOTES 933 (23 May 1994); Lipton, *The Partnership Anti-Abuse Regs. Revisited: Is There Calm After The Storm?*, 83 J. TAX'N 68 (Aug. 1995); McKee, Nelson, and Whitmire, *Federal Taxation of Partnerships and Partners*, 1.05 Subchapter K Anti-Abuse Rule. A full discussion of the validity of the partnership anti-abuse rule is beyond the scope of this article.

[26] *See* Rev. Rul. 99-57, 1999-2 CB 678 (aggregate treatment applies upon disposition of corporate partner stock); Notice 2002-50, 2002-2 CB 98 (aggregate treatment asserted for purposes of applying Code Sec. 267(d) to listed transaction); Notice 96-39, 1996-2 CB 209 (continued assertion of the abuse-of-entity-treatment rule to the decision in *Brown Group, Inc.*, CA-8, 96-1 USTC ¶50,055, 77 F3d 217 (1996)); FSA 200205021 (Oct. 26, 2001) (foreign partnership has substance, not interposed to effectuate tax abuse; therefore, Reg. §1.701-2(e) not applicable); FSA 200026009 (Mar. 23, 2000) (citation of Notice 96-39's application of Reg. §1.701-2(e) to fact pattern of *Brown Group*); CCA 201917007 (Apr. 26, 2019) (IRS asserts ability to apply Reg. §1.701-2(e) to disregard special allocations of Code Sec. 367(d)(2) income and treat partnership as aggregate of partners).

[27] Notwithstanding its name, it is not clear that the partnership anti-abuse only applies to situations involving abusive intent. *Compare* 60 FR 23-01 ("[T]he Commissioner's authority to treat a partnership as an aggregate of its partners is not dependent on the taxpayer's intent in structuring the transaction."); Reg. §1.701-2(f), Ex. 1 (indicating aggregate treatment applies "regardless of whether any party had a tax avoidance purpose") *with* FSA 200205021 (Oct. 26, 2001) (abuse of entity rule not applied to a transaction where the partnership was not interposed to effectuate tax abuse). If the partnership anti-abuse rule is a rule of general application, the fact that the rule has not been applied in the wash sale context would suggest that the IRS does not believe that it applies in that situation.

[28] 2008-3 IRB 271.

[29] 28 BTA 289, Dec. 8098 (1933).

[30] Code Sec. 219(g) of the Revenue Act of 1926 provided that "[w]here the grantor of a trust has, at any time during the taxable year, … the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

[31] Dominion and control over a trust's assets was also critical to the Supreme Court's landmark decision in *Helvering v. Clifford*, SCt, 40-1 USTC ¶9265, 309 US 331, 60 SCt 554 (1940), in which the Court relied on the general definition of gross income to expand the circumstances in which a grantor would be taxed on a trust's income beyond those specifically set forth in the statutory grantor trust rules in effect at the time. In *Clifford*, the taxpayer established a short-term irrevocable trust. The statutory rules in effect at the time applied only to revocable trusts. To reach its conclusion that the trust's income should be taxable to the grantor of the trust, the Court relied on all the facts and circumstances involved in the case and concluded that income from the trust's assets should be included in the taxpayer's gross income because the taxpayer "would keep direct command over all that he needed to remain in substantially the same financial situation as before." *Clifford*,

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SCt, 40-1 USTC ¶9265, 309 US at 336. The court found no substantial change in the taxpayer's dominion and control over the trust property and concluded that taxing the trust income to the taxpayer was justified. In response to the uncertainty created by the Supreme Court's facts and circumstances test established in *Clifford* for determining when a trust's income would be taxable to the grantor, Treasury issued the so-called *Clifford* regulations, which were subsequently codified in the current grantor trust rules of Code Secs. 671 through 678 of the Code. The legislative history to Code Secs. 671 through 678 suggests that the law in effect prior to the enactment of those sections (including Code Sec. 219(g)) treated the grantor of a trust that retained certain rights with respect to the trust's corpus or income as the owner of the trust's assets. *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 4089 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 4719 (1954). Thus, although Code Sec. 219(g) did not explicitly state that the grantor of a trust was treated as the tax owner of the trust's assets, if it was taxable on the trust's income, that may be the case.

[32] 28 BTA at 314 (citing *Carbon Steel Co. v. Lewellyn*, SCt, 251 US 501, 40 SCt 283 (1920)).

[33] *Id.* at 315.

[34] Indeed, never in its 90-year history has *Security First* been cited in support of a related-party wash sale rule. One would expect to see the case cited for this proposition if that is indeed what the case establishes. Further, since the issuance of the IRA Ruling, IRS officials have suggested that the purpose of the IRA Ruling was not to establish a related-party wash sale rule, but rather to point out that the taxpayer and the taxpayer's IRA or Roth IRA do not have separate taxpayer identities and therefore no real loss is sustained in the transaction. Even if one were to view *Security First* as establishing a related-party wash sale rule, the other related-party wash sale cases described above nonetheless provide taxpayers with support for applying the wash sale rules only to single-taxpayer transactions.

[35] The definition of "prohibited transaction" includes certain transactions entered into between a "plan" and a "disqualified person." *See* Code Sec. 4975(c)(1). A "plan" includes an IRA. *See* Code Sec. 4975(e)(1)(B). A "disqualified person" includes a fiduciary. *See* Code Sec. 4975(e)(2)(A). There are Department of Labor advisory letters holding that an individual is a "fiduciary" with respect to his or her IRA. *See* D.O.L. Advisory Opinions 2006-09A, 2000-10A.

[36] A "taxpayer" is defined in Code Sec. 7701(a)(14) as "any person subject to any internal revenue tax." Because an IRA may be subject to tax on its unrelated business income, the IRA could be considered a taxpayer.

[37] 133 TC 202, Dec. 57,950 (2009), *aff'd*, CA-9, 2012-1 USTC ¶50,256, 679 F3d 1109 (2012).

[38] *See* Rev. Rul. 92-73, 1992-2 CB 224.

[39] Code Sec. 1091(d) provides a basis step-up for "stock or securities the acquisition of which ... *resulted in the nondeductibility* ... of the loss from the sale or other disposition of substantially identical stock or securities." (emphasis added).

[40] *See* Code Sec. 408(e)(1).

[41] Statutes should not be interpreted in a way that renders some portion of the statute superfluous. *See, e.g., BNSF Ry. Co.*, CA-5, 775 F3d 743 (2015), citing *Colautti v. Franklin*, 439 US 379, 99 SCt 675 (1979).

[42] *See* Code Sec. 408(e)(1); Code Sec. 511(a)(1) ("There is hereby imposed for each taxable year ... a tax computed as provided in Code Sec. 11. In making such computation for purposes of this section, the term 'taxable income' as used in Code Sec. 11 shall be read as 'unrelated business taxable income'.").

[43] *See* Code Sec. 63(a) ("[T]he term 'taxable income' means gross income minus ... deductions allowed ...").

[44] *See generally* Code Sec. 408(e)(1); Code Sec. 511.

[45] *See, e.g., G.A. Rauenhorst*, 119 TC 157, Dec. 54,899 (2002) (The IRS may not argue against principles stated in a longstanding revenue ruling.); *Dover Corp.*, 122 TC 324, 350, Dec. 55,630 (2004) (same); *C.W. Walker*, 101 TC 537, 550, Dec. 49,460 (1993) (treating the IRS's position in a revenue ruling as a concession of a contrary IRS litigation position); Reg. §601.601(d)(2)(v)(e) (allowing taxpayers to generally rely upon published revenue rulings in determining the tax treatment of their own transactions; however, reliance on revenue rulings should be done with caution unless the facts and circumstances are substantially the same); Chief Counsel Directives Manual, §32.2.2.10 (Aug. 11, 2004) (same).

[46] It is possible that this type of transaction could be treated as an indirect sale between related parties if certain requirements are met. See discussion, *supra*. In such a case, the loss would be permanently disallowed because the IRA is a tax-indifferent party. *See* Code Sec. 267(d)(3).

[47] The Build Back Better Act proposals appear to acknowledge this possibility and include anti-loss importation rules to prevent abuse. See discussion, *infra*.

[48] There are two principal risks to this strategy. First, it is possible that Code Sec. 1091(d) does not apply in the context of a related-party wash sale, such that no basis step-up is received. Second, if the transaction were treated as an indirect sale from the IRA (a tax-indifferent party) to the individual, the loss would be disallowed under Code Sec. 267(a)(1) and Code Sec. 267(d)(3) would preclude any future gain reduction. Again, in the context of a nontaxable retirement account where losses provide no tax benefits, these possibilities would make the taxpayer no worse off.

[49] The manager's amendment changed a previous version of this bill to add the phrase. "Except as otherwise provided by the Secretary."

[50] Build Back Better Act, Sec. 138152(a).

[51] *Id.*

[52] *Cf.* Build Back Better Act, Sec. 138152(b).

[53] For previous commentary on the limited scope of the current wash sale rules, *see* Tompkins and Kunkel, *Cryptocurrencies and the Definition of a Security for Code Sec. 1091*, J. TAX'N FINANCIAL PRODUCTS, 18, 2 (2021). For a detailed discussion of other aspects of the legislative proposal and recommendations for changes, *see* New York State Bar Association, *Report No. 1456 – Comments on Wash Sale Provisions of the House Proposals for the Build Back Better Act* (Jan. 14, 2022).

[54] To address this issue, some have suggested that rules similar to Code Sec. 267(f) would provide a more appropriate means of deferring loss on related-party wash sale transactions. *See* New York State Bar Association, *Report No. 1456—Comments on Wash Sale Provisions of the House Proposals for the Build Back Better Act* (Jan. 14, 2022).

[55] Code Secs. 954(d)(3); 958(b); 318(a)(1)(A)(ii).

[56] For example, Code Sec. 958(b)(1) provides that for purposes of determining stock constructively owned by an individual under Code Sec. 318(a)(1)(A), stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered as owned by a citizen or by a resident alien individual.

[57] *See* Reg. §1.1091-1(d).

[58] *See* Sec. 138152(d) of the Build Back Better Act ("Nothing in this section or the amendments made by this section shall be construed to create any inference with respect to the proper treatment of related parties under Code Sec. 1091 of the Internal Revenue Code of 1986 with respect to sales, dispositions, and terminations before January 1, 2022."). Interestingly, this "no inference" language was not included in a previous Ways and Means proposal.

[59] Admittedly, it would be difficult to construe the entirety of the related-party proposal as a clarification of existing law. For example, if one accepts the (rather dubious) claim that the wash sale rules have always applied across related parties, the proposal still represents a change in that it allows a basis adjustment only in cases where the taxpayer or the taxpayer's spouse acquires a replacement position. As noted above, the current statute would allow a basis adjustment even in situations where the replacement position was acquired by a party other than the taxpayer or the taxpayer's spouse. Congress appears to have been concerned that a taxpayer might otherwise use the wash sale rules to shift basis among related parties, as posited earlier in this article. The proposal would also change the period during which a replacement position can be acquired and be eligible for a basis adjustment. These changes seem to be targeted adjustments to avoid loss importation and provide a longer period to acquire replacement positions (and thereby avoid a permanent loss disallowance) and probably do not speak directly to the broader relevance of the wash sale rules in related-party transactions under current law.

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