



Tax Notes Today: Latest News

IRS Issues Proposed Regs on Partnership Disguised Sales

Citations: REG-119305-11

Summary by taxanalysts

The IRS has issued proposed regulations (REG-119305-11) under [section 707](#) on disguised sales of property to or by a partnership, and under [section 752](#) on the treatment of partnership liabilities. The proposed regs address deficiencies and technical ambiguities in the current section 707 regs and issues regarding the determination of partners' shares of liabilities under section 752. Comments and hearing requests are due by April 30.

The current regs provide several exceptions from disguised sale treatment. The proposed regs add an example to demonstrate the application of a special rule under the debt-financed distribution exception that treats a partnership's transfer of shares of liabilities to multiple partners as a single liability. The preamble to the proposed regs also provides that the treatment of a transfer should first be determined under the debt-financed distribution exception and that any amount not excluded under the exception should be tested to see if that amount would be excluded under a different exception in [reg. section 1.707-4](#).

The proposed regs amend the exception for preformation capital expenditures to provide how the exception applies for multiple property transfers, to clarify the scope of the term "capital expenditures" for purposes of [reg. section 1.707-4](#) and [1.707-5](#), and to provide a rule coordinating the exception for preformation capital expenditures and the rules regarding liabilities traceable to capital expenditures.

The current regs provide for four types of qualified liabilities that are excluded from disguised sale treatment. Two types of qualified liabilities are those incurred more than two years before a transfer and those incurred within two years of a transfer but not in anticipation of the transfer. There is a requirement for both of those qualified liabilities that the liability encumber the transferred property. However, the IRS and Treasury believe that such a requirement isn't necessary to carry out the purposes of [section 707\(a\)\(2\)\(B\)](#) when a liability is incurred in connection with the conduct of a trade or business, if it isn't incurred in anticipation of the transfer and all of the assets material to that trade or business are transferred to the partnership. Thus, the proposed regs provide an additional definition of qualified liability to account for that type of liability.

The proposed regs modify the so-called anticipated reduction rule under the current regs to provide that a reduction subject to the entrepreneurial risks of partnership operations is not an anticipated reduction, and that a reduction generally will be presumed to be anticipated if, within two years of a partnership acquiring property subject to the liability, a partner's share of the liability is reduced because of a decrease in the partner's net value.

The proposed regs provide additional rules on tiered partnerships, clarifying that the debt-financed distribution exception applies to those partnerships and addressing the characterization of liabilities attributable to a contributed partnership interest. The regs also extend the principles of [reg. section 1.752-1\(f\)](#) to determine the effect of a merger under the disguised sale rules.

For purposes of determining a partner's share of a recourse partnership liability, the proposed regs provide that obligations to make a payment for a partnership liability generally won't be recognized under section 752 unless some factors are present showing that the terms of the payment obligation are commercially reasonable and not designed solely to obtain tax benefits. The rule prevents some bottom-dollar guarantees from being recognized for purposes of section 752. Accordingly, the regs revise the antiabuse rule under [reg. section 1.752-2\(j\)](#) to address the use of intermediaries, tiered partnerships, or similar arrangements to avoid the bottom-dollar guarantee rules. The regs also extend the disregarded entity net value requirement of [reg. section 1.752-2\(k\)](#) -- in lieu of the satisfaction presumption under [reg. section 1.752-2\(b\)\(6\)](#) -- to all partners or related persons, including grantor trusts, other than individuals and decedents' estates for payment obligations associated with liabilities that are not trade payables. The proposed regs remove from the current regs the significant item method and the alternative

method of determining a partner's share of excess nonrecourse partnership liability, and adopt a liquidation value percentage approach.

The regs generally are proposed to apply to transactions for which all transfers occur on or after the date the regs are finalized, and to liabilities incurred or assumed by a partnership and payment obligations imposed for a partnership liability on or after that date. The IRS and Treasury anticipate that the final regs under section 752 will allow a partnership to apply the provisions in those regs to all its liabilities as of the beginning of the first tax year of the partnership ending on or after the date the regs are published. The proposed regs also provide transitional relief for any partner whose allocable share of partnership liabilities under [reg. section 1.752-2](#) exceeds its adjusted basis in its partnership interest on the date the regs are finalized.

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