For the Nuclear Regulatory Commission.

Christopher G. Miller,

Director, Division of Intergovernmental Liaison and Rulemaking, Office of Federal and State Materials and Environmental Management Programs.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–119305–11]

RIN 1545–BK29

Section 707 Regarding Disguised Sales, Generally

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 707 of the Internal Revenue Code (Code) relating to disguised sales of property to or by a partnership and under section 752 relating to the treatment of partnership liabilities. The proposed regulations address certain deficiencies and technical ambiguities in the section 707 regulations and certain issues in determining partners' shares of liabilities under section 752. The proposed regulations affect partnerships and their partners.

DATES: Written or electronic comments and requests for a public hearing must be received by April 30, 2014.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–119305–11), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–119305–11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal site at *http://www.regulations.gov* (indicate IRS and REG–119305–11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deane M. Burke, (202) 317–5279; concerning submissions of comments and requests for a public hearing, Oluwafunmilayo (Funmi) Taylor, (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information related to these proposed regulations under section 707 is reported on Form 8275, Disclosure Statement, and has been reviewed in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and approved by the Office of Management and Budget under control number 1545–0889. Comments concerning the collection of information and the accuracy of estimated average annual burden and suggestions for reducing this burden should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the burden associated with this collection of information should be received by March 31, 2014.

The collection of information in these proposed regulations is in proposed §§ 1.707–5(a)(3)(ii) and 1.707–5(b)(2)(iii)(B) (regarding the reduction of a liability presumed to be anticipated) and § 1.707–5(a)(7)(ii) (regarding a liability incurred within two years prior to a transfer of property). This information is required by the IRS to ensure that sections 707(a)(2)(B) and 752 of the Code and applicable regulations are properly applied respectively either to transfers between a partner and a partnership or for allocations of partnership liabilities. The respondents will be partners and partnerships.

The collection of information in these proposed regulations under section 752 has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by March 31, 2014. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in § 1.752–2(b)(3)(iii)(C). This information is required to ensure proper allocations of partnership liabilities. This information will be used to determine the extent to which certain partners or related persons bear the economic risk of loss with respect to partnership liabilities. The collection of information is mandatory. The likely reporters are small and large businesses or organizations and trusts.

Estimated total annual reporting burden: 8 million hours.

The estimated annual burden per respondent varies from 6 minutes to 2 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 8 million.

Estimated frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 707 relating to disguised sales of property to or by a partnership and under section 752 relating to the treatment of partnership liabilities.

Section 707(a)(2)(B) of the Code generally provides that, under regulations prescribed by the Secretary, related transfers to and by a partnership that, when viewed together, are more properly characterized as a sale or exchange of property, will be treated either as a transaction between the partnership and one who is not a partner or between two or more partners acting other than in their capacity as partners. The legislative history of section 707(a)(2)(B) indicates Congress adopted the provision to prevent parties from characterizing a sale or exchange of property as a contribution to the partnership followed by a distribution from the partnership, thereby deferring or avoiding tax on the transaction. *See* H.R. Rep. No. 432, pt. 2, 98th Cong. 2nd Sess. 1216, 1218 (1984).

On September 30, 1992, final regulations under section 707(a)(2) (TD 8439, 1992–2 CB 126) relating to disguised sales of property to and by partnerships were published in the **Federal Register** (57 FR 44974 as corrected on November 30, 1992, by 57 FR 56443) (existing regulations). Since publication of the existing regulations, the IRS and the Treasury Department have become aware of certain issues in interpreting or applying the regulations. On November 26, 2004, a notice of proposed rulemaking under section 707(a)(2)(B) (REG–149519–03, 2004–2 CB 1009) was published in the **Federal Register** (69 FR 68838) to add rules for disguised sales of partnership interests and to amend the existing regulations by revising, to a limited extent, the rules relating to disguised sales of property. The IRS and the Treasury Department noted in the preamble to those proposed regulations an awareness of certain deficiencies and technical ambiguities in the existing regulations under §§ 1.707–3, 1.707–4, and 1.707–5, and requested comments on the scope and content of revisions to the existing regulations, but received none. The notice of proposed rulemaking was subsequently withdrawn on January 21, 2009, in Announcement 2009–4, 2009–1 CB 597. The IRS and the Treasury Department have, however, continued to study these issues, and set forth in the following section is a discussion of those areas in the existing regulations that the IRS and the Treasury Department have identified as requiring clarification or revision and the proposed changes to those areas.

In addition, regulations under section 752 address the treatment of partnership recourse and nonrecourse liabilities. The IRS and the Treasury Department believe it is appropriate to reconsider the rules under section 752 regarding the payment obligations that are recognized under § 1.752–2(b)(3), the satisfaction of payment obligations under § 1.752–2(b)(6), and the methods available for allocating excess nonrecourse liabilities under § 1.752–3(a)(3). Also discussed in the following section is an explanation of those areas in the section 752 regulations that the IRS and the Treasury Department have identified as requiring revision and the proposed changes to those areas.

Explanation of Provisions

1. Debt-Financed Distributions

Section 1.707–3 of the existing regulations generally provides that a transfer of property by a partner to a partnership followed by a transfer of money or other consideration from the partnership to the partner will be treated as a sale of property by the partner to the partnership if, based on all the facts and circumstances, the transfer of money or other consideration would not have been made but for the transfer of the property and, for non-simultaneous transfers, the subsequent transfer is not dependent on the entrepreneurial risks of the partnership. Notwithstanding this general rule, the existing regulations provide several exceptions.

One such exception in § 1.707–5(b) of the existing regulations generally provides that a distribution of money to a partner is not taken into account for purposes of § 1.707–3 to the extent the distribution is traceable to a partnership borrowing and the amount of the distribution does not exceed the partner's allocable share of the liability incurred to fund the distribution (the ''debt-financed distribution exception''). Under a special rule in the existing regulations, if a partnership transfers to more than one partner pursuant to a plan all or a portion of the proceeds of one or more liabilities, the debt-financed distribution exception is applied by treating all of the liabilities incurred pursuant to the plan as one liability. Thus, partners who are allocated shares of multiple liabilities are treated as being allocated a share of a single liability, to which any distributee partner's distribution of debt proceeds relates, rather than a share of each separate liability.

To illustrate the application of this rule, the proposed regulations add an example to the existing regulations to demonstrate that if more than one partner receives all or a portion of the debt proceeds of multiple liabilities that are treated as a single liability under the special rule, the debt proceeds will not be treated as consideration in a disguised sale to the extent of the partner's allocable share of the single liability.

In addition, the IRS and the Treasury Department are aware that there is uncertainty as to whether, for purposes of § 1.707–5(b)(2), the amount of money transferred to a partner that is traceable to a partnership liability is reduced by any portion of such amount that is also excluded from disguised sale treatment under one or more of the exceptions in § 1.707–4 (for example, because the transfer of money is also properly treated as a reasonable guaranteed payment). The IRS and the Treasury Department believe that the treatment of a transfer should first be determined under the debt-financed distribution exception, and any amount not excluded from § 1.707–3 under the debt-financed distribution exception should be tested to see if such amount would be excluded from § 1.707–3 under a different exception in § 1.707–4. This ordering rule ensures that the application of one of the exceptions in § 1.707–4 does not minimize the application of the debt-financed distribution exception.

2. Preformation Expenditures

Section 1.707–4(d) of the existing regulations provides an additional exception for reimbursements of preformation expenditures to the general rule in § 1.707–3. Under § 1.707–4(d), transfers to reimburse a partner for certain capital expenditures and costs incurred are not treated as part of a sale of property under § 1.707–3 (the ''exception for preformation capital expenditures'').

The proposed regulations amend the exception for preformation capital expenditures to address three issues. First, the proposed regulations provide how the exception for preformation capital expenditures applies in the case of multiple property transfers. The exception for preformation capital expenditures generally applies only to the extent that ''the reimbursed capital expenditures do not exceed 20 percent of the fair market value of such property at the time of the contribution.'' This fair market value limitation, however, does not apply if the fair market value of the contributed property does not exceed 120 percent of the partner's adjusted basis in the contributed property at the time of the contribution. The references to ''such property'' and ''contributed property'' in § 1.707–4(d) are intended to refer to the single property for which the expenditures were made. Accordingly, in the case of multiple property contributions, the proposed regulations provide that the determination of whether the fair market value limitation and the exception to the fair market value limitation apply to reimbursements of capital expenditures is made separately for each property that qualifies for the exception.

Second, the proposed regulations clarify the scope of the term ''capital expenditures'' for purposes of §§ 1.707–4 and 1.707–5. For purposes of §§ 1.707–4 and 1.707–5, the term ''capital expenditures'' has the same meaning as the term ''capital expenditures'' has under the Code and applicable regulations, except that it includes capital expenditures taxpayers elect to deduct, and does not include deductible expenses taxpayers elect to treat as capital expenditures. The IRS and the Treasury Department are aware that taxpayers are uncertain whether the term capital expenditures includes only expenditures that are required to be capitalized under the Code. The purpose of the exception for preformation capital expenditures is to permit a partnership to reimburse a contributing partner for expenditures incurred with respect to contributed property. The IRS and the Treasury Department considered whether a contributing partner's capital expenditures for this purpose should be reduced by the benefit of the tax deduction the contributing partner received prior to contribution of the property either because the capital expenditure was currently deductible by the contributing partner or recovered through amortization or depreciation deductions. The proposed regulations, however, do not adopt such an approach because the approach would be too burdensome to administer.

Finally, the proposed regulations provide a rule coordinating the exception for preformation capital expenditures and the rules regarding liabilities traceable to capital expenditures. Section 1.707–5 provides special rules for disguised sales relating to liabilities assumed or taken subject to by a partnership. Under § 1.707–5(a)(1) of the existing regulations, a partnership's assumption of or taking property subject to a qualified liability in connection with a partner's transfer of property to the partnership is treated as a transfer of consideration to the partner only if the property transfer is otherwise treated as part of a sale. A liability constitutes a qualified liability of the partner to the extent the liability meets one of the four definitions of qualified liabilities under § 1.707–5(a)(6). One of the enumerated qualified liabilities is a liability that is allocable under the rules of § 1.163–8T to capital expenditures with respect to the property transferred to the partnership (the ''capital expenditure qualified liability'').

The IRS and the Treasury Department are aware that taxpayers are uncertain about whether a partner may qualify under the exception for preformation capital expenditures if those expenditures were funded with a capital expenditure qualified liability. For example, taxpayers are uncertain about whether a partner can finance its capital expenditures through a borrowing that is exempted as a qualified liability and can also be reimbursed for those expenditures without triggering sale treatment. The IRS and the Treasury Department believe that the exception for preformation capital expenditures applies only to the extent the distribution is in reimbursement of such expenditures. Thus, the proposed regulations provide that to the extent a partner funded a capital expenditure through a borrowing and economic responsibility for that borrowing has shifted to another partner, the exception for preformation capital expenditures should not apply because there is no outlay by the partner to reimburse.

3. Qualified Liabilities in a Trade or Business

As previously mentioned, the existing regulations generally exclude qualified liabilities from disguised sale treatment. The legislative history of section 707(a)(2)(B) with respect to liabilities provides that Congress was ''concerned with transactions that attempt to disguise a sale of property and not with non-abusive transactions that reflect the various economic contributions of the partners. . . . For example . . . the transaction will be treated as a sale or exchange of property . . . to the extent the partner has received a loan related to the property in anticipation of the transaction and responsibility for repayment of the loan is transferred to the other partners.'' *See* H.R. Rep. No. 432, pt. 2, 98th Cong. 2nd Sess. 1216, 1220–1221 (1984).

The existing regulations under § 1.707–5(a)(6) provide four types of liabilities that are qualified liabilities. In addition to the capital expenditure qualified liabilities discussed previously, the existing regulations include as a qualified liability a liability incurred in the ordinary course of the trade or business in which property transferred to the partnership was used or held, but only if all of the assets that are material to that trade or business are transferred to the partnership (''ordinary course qualified liability''). There is no requirement that these two types of liabilities encumber the transferred property to be treated as qualified liabilities.

The remaining two types of qualified liabilities are liabilities incurred more than two years before the transfer (or written agreement to transfer), and liabilities incurred within two years of the transfer (or written agreement to transfer) but not in anticipation of the transfer. Liabilities incurred by a partner within two years of the transfer, other than capital expenditure and ordinary course qualified liabilities, are presumed to be incurred in anticipation of the transfer unless the facts and circumstances clearly establish otherwise. With respect to both of these types of qualified liabilities, there is a requirement that the liability encumber the transferred property.

The IRS and the Treasury Department believe the requirement that the liability encumber the transferred property is not necessary to carry out the purposes of section 707(a)(2)(B) when a liability was incurred in connection with the conduct of a trade or business, provided the liability was not incurred in anticipation of the transfer and all of the assets material to that trade or business are transferred to the partnership. Accordingly, the proposed regulations add an additional definition of qualified liability to account for this type of liability. As under the existing regulations regarding liabilities other than capital expenditure and ordinary course qualified liabilities, if the partner incurred the liability within two years of the transfer of assets to the partnership, (i) the liability is presumed under § 1.707–5(a)(7)(i) to have been incurred in anticipation of the transfer unless the facts and circumstances clearly establish that the liability was not incurred in anticipation of the transfer, and (ii) the treatment of the liability as a qualified liability under the new definition must be disclosed to the IRS under § 1.707–8.

4. Anticipated Reduction

Under the existing regulations, for purposes of the rules under section 707, a partner's share of a liability assumed or taken subject to by a partnership is determined by taking into account certain subsequent reductions in the partner's share of the liability. Specifically, a subsequent reduction in a partner's share of a liability is taken into account if (i) at the time that the partnership incurs, assumes, or takes property subject to the liability, it is anticipated that the partner's share of the liability will be subsequently reduced; and (ii) the reduction is part of a plan that has as one of its principal purposes minimizing the extent to which the distribution or assumption of, or taking property subject to, the liability is treated as part of a sale (the ''anticipated reduction rule''). The IRS and the Treasury Department are aware that there is uncertainty as to when a reduction is anticipatory because it is generally anticipated that all liabilities will be repaid. Consistent with the overall approach of the existing regulations under section 707, the IRS and the Treasury Department believe that a reduction that is subject to the entrepreneurial risks of partnership operations is not an anticipated reduction, and the proposed regulations adopt this approach.

In addition, the proposed regulations provide that if within two years of the partnership incurring, assuming, or taking property subject to the liability, a partner's share of the liability is reduced due to a decrease in the partner's or a related person's net value (as described in Part 8.a of the Explanation of Provisions section of this preamble), then the reduction will be presumed to be anticipated, unless the facts and circumstances clearly establish that the decrease in the net value was not anticipated. Any such reduction must be disclosed in accordance with § 1.707–8.

5. Tiered Partnerships

The existing regulations in § 1.707–5(e), and § 1.707–6(b) by applying rules similar to § 1.707–5(e), currently provide only a limited tiered-partnership rule for cases in which a partnership succeeds to a liability of another partnership. Under those rules, if a lower-tier partnership succeeds to a liability of an upper-tier partnership, the liability in the lower-tier partnership retains the same characterization as either a qualified or a nonqualified liability that it had as a liability of the upper-tier partnership. Similarly, if an upper-tier partnership succeeds to a liability of a lower-tier partnership, the liability in the upper-tier partnership retains the same characterization as either a qualified or a nonqualified liability that it had as a liability of the lower-tier partnership that incurred the liability. Moreover, the existing regulations provide that a similar rule applies to other related party transactions involving liabilities to the extent provided by guidance in the Internal Revenue Bulletin. *See,* for example, Rev. Rul. 2000–44, 2000–2 CB 336.

The proposed regulations add additional rules regarding tiered partnerships. First, the proposed regulations clarify that the debt-financed distribution exception applies in a tiered partnership setting. Second, the proposed regulations provide rules regarding the characterization of liabilities attributable to a contributed partnership interest. Section 752(d) provides that in the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships. Accordingly, a partner that contributes an interest in a partnership (lower-tier partnership) to another partnership (upper-tier partnership) must take into account its share of liabilities from the lower-tier partnership in applying the rules under § 1.707–5. The IRS and the Treasury Department believe it is appropriate to treat the lower-tier partnership as an aggregate for purposes of determining whether the upper-tier partnership's share of the liabilities of the lower-tier partnership are qualified liabilities. Thus, these proposed regulations provide that a contributing partner's share of liabilities from a lower-tier partnership are treated as qualified liabilities to the extent the liability would be a qualified liability had the liability been assumed or taken subject to by the upper-tier partnership in connection with a transfer of all of the lower-tier partnership's property to the upper-tier partnership by the lower-tier partnership.

6. Treatment of Liabilities in Assets-Over Merger

Section 1.752–1(f) provides for netting of increases and decreases in a partner's share of liabilities resulting from a single transaction. Under that rule, increases and decreases in partnership liabilities associated with a merger or consolidation are netted by the partners in the terminating partnership and the resulting partnership to determine the effect of a merger under section 752. The IRS and the Treasury Department believe that similar netting rules should apply with respect to the disguised sale rules and, accordingly, the proposed regulations extend the principles of § 1.752–1(f) to determine the effect of the merger under the disguised sale rules.

7. Disguised Sales of Property by a Partnership to a Partner

For disguised sales of property by a partnership to a partner, the existing regulations under § 1.707–6 provide that rules similar to those in § 1.707–5 (for disguised sales of property by a partner to a partnership) apply to determine the extent to which an assumption of or taking property subject to a liability by a partner, in connection with a transfer of property by a partnership, is considered part of a sale. More specifically, the existing regulations provide that if the partner assumes or takes property subject to a liability that is not a qualified liability, the amount treated as consideration transferred to the partnership is the amount that the liability assumed or taken subject to by the partner exceeds the partner's share of that liability immediately before the transfer. Thus, if a transferee partner had a 100 percent share of a liability immediately before a transfer in which the transferee partner assumed the liability, then no sale is treated as occurring between the partnership and the partner with respect to the liability assumption, irrespective of the period of time during which the partnership liability is outstanding and the period of time in which the partnership liability is allocated to the partner.

The IRS and the Treasury Department are studying these rules and believe it may be inappropriate to take into account a transferee partner's share of a partnership liability immediately prior to a distribution if the transferee partner did not have economic exposure with respect to the partnership liability for a meaningful period of time before appreciated property is distributed to that partner subject to the liability. Thus, the IRS and the Treasury Department are considering, and request comments on, whether the rules under § 1.707–6 should be amended to provide that a transferee partner's share of an assumed liability immediately before a distribution is taken into account for purposes of determining the consideration transferred to the partnership only to the extent of the partner's lowest share of the liability within some meaningful period of time, for example, 12 months.

8. Partner's Share of Partnership Liabilities

A. Recourse Liabilities

The existing regulations under section 1.752–2 provide that a partner's share of a recourse partnership liability equals the portion of the liability, if any, for which the partner or related person bears the economic risk of loss. A partner generally bears the economic risk of loss for a partnership liability to the extent the partner, or a related person, would be obligated to make a payment if the partnership's assets were worthless and the liability became due and payable. Subject to an anti-abuse rule and the disregarded entity net value requirement of § 1.752–2(k), § 1.752–2(b)(6) assumes that all partners and related persons will actually satisfy their payment obligations, irrespective of their actual net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation (the ''satisfaction presumption''). Thus, for purposes of allocating partnership liabilities, § 1.752–2 adopts an ultimate liability test under a worst-case scenario. Under this test, the regulations would generally allocate an otherwise nonrecourse liability of the partnership to a partner that guarantees the liability even if the lender and the partnership reasonably anticipate that the partnership will be able to satisfy the liability with either partnership profits or capital.

The IRS and the Treasury Department have considered whether the approach of the existing regulations under § 1.752–2 is appropriate given that, in most cases, a partnership will satisfy its liabilities with partnership profits, the partnership's assets do not become worthless, and the payment obligations of partners or related persons are not called upon. The IRS and the Treasury Department are concerned that some partners or related persons have entered into payment obligations that are not commercial solely to achieve an allocation of a partnership liability to such partner. The IRS and the Treasury Department believe that section 79 of the Tax Reform Act of 1984 (Pub. L. 98–369), which overruled the decision in *Raphan* v. *United States,* 3 Cl. Ct. 457 (1983) (holding that a guarantee by a general partner of an otherwise nonrecourse liability of the partnership did not require the partner to be treated as personally liable for that debt), and directed the Treasury Department to prescribe regulations under section 752 relating to the treatment of guarantees and other payment obligations, was intended to ensure that bona fide, commercial payment obligations would be given effect under section 752.

Accordingly, the proposed regulations provide a rule that obligations to make a payment with respect to a partnership liability (excluding those imposed by state law) will not be recognized for purposes of section 752 unless certain factors are present. These factors, if satisfied, are intended to establish that the terms of the payment obligation are commercially reasonable and are not designed solely to obtain tax benefits. Specifically, the rule requires a partner or related person to maintain a commercially reasonable net worth during the term of the payment obligation or be subject to commercially reasonable restrictions on asset transfers for inadequate consideration. In addition, the partner or related person must provide commercially reasonable documentation regarding its financial condition and receive arm's length consideration for assuming the payment obligation. The rule also requires that the payment obligation's term must not end prior to the term of the partnership liability and that the primary obligor or any other obligor must not be required to hold money or other liquid assets in an amount that exceeds the reasonable needs of such obligor. The rule would also prevent certain so-called ''bottom-dollar'' guarantees from being recognized for purposes of section 752.

Moreover, the IRS and the Treasury Department are concerned that some partners or related persons might attempt to use certain structures or arrangements to circumvent the rules included in these proposed regulations with respect to bottom-dollar guarantees. For example, a financial intermediary might artificially convert a single mortgage loan into senior and junior tranches using a wrap-around mortgage or other device with a principal purpose of creating tranches for partners to guarantee that result in exposure tantamount to a bottom-dollar guarantee. Accordingly, the proposed regulations revise the anti-abuse rule under § 1.752–2(j) to address the use of intermediaries, tiered partnerships, or similar arrangements to avoid the bottom-dollar guarantee rules. The IRS and the Treasury Department request comments on whether other structures or arrangements might be used to circumvent the rules regarding bottom-dollar guarantees, and whether the final regulations should broaden the anti-abuse rule further to address any such structures or arrangements.

The IRS and the Treasury Department also acknowledge that the proposed regulations relating to guarantees and indemnities draw lines that, among other things, preclude recognition of a payment obligation for a portion, rather than 100 percent, of each dollar of a partnership liability to which the payment obligation relates (a so-called vertical slice of the partnership liability) (see § 1.752–2(f) *Example 12* in the proposed regulations). The IRS and the Treasury Department request comments on whether, and under what circumstances, the final regulations should permit recognition of such a payment obligation. In addition, the IRS and the Treasury Department request comments on whether the special rule under § 1.752–2(e) (and related § 1.752–2(f) *Example 7*) should be removed from the final regulations or revised to require that 100 percent of the total interest that will accrue on a partnership nonrecourse liability be guaranteed.

As was previously noted, the satisfaction presumption assumes that all partners and related persons will actually satisfy their payment obligations, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation. The satisfaction presumption does not apply, however, to the payment obligations of disregarded entities. Instead, the payment obligation of a disregarded entity for which a partner is treated as bearing the economic risk of loss is taken into account only to the extent of the net value of the disregarded entity, as determined under § 1.752–2(k). The preamble to the proposed regulations under § 1.752–2(k) requested comments regarding whether the rules for disregarded entities should be extended to the payment obligations of other entities. Some commenters opposed extending the rules to other entities, while other commenters suggested that the anti-abuse rule in § 1.752–2(j) could be expanded to cover certain situations involving thinly capitalized entities. One commenter suggested that the anti-abuse rule should apply if a substantially undercapitalized subsidiary of a consolidated group of corporations or a substantially undercapitalized passthrough entity (other than a disregarded entity) is utilized as the partner (or related obligor) for a principal purpose of limiting its owner's risk of loss in respect of existing partnership liabilities, and obtaining tax benefits for its owners (or other members of the consolidated group) that would not be available but for the additional tax basis in the partnership interest that results from the satisfaction presumption. Although the final regulations under § 1.752–2(k) did not extend the rules for disregarded entities to other entities, the IRS and the Treasury Department indicated that they would continue to study the issue of extending the net value approach for disregarded entities to other entities.

After further consideration, the IRS and the Treasury Department believe that there are circumstances in addition to those involving disregarded entities under which the satisfaction presumption is not appropriate. Thus, the proposed regulations turn off the satisfaction presumption by extending the net value requirement of § 1.752–2(k) to all partners or related persons, including grantor trusts, other than individuals and decedent's estates for payment obligations associated with liabilities that are not trade payables. In situations in which the satisfaction presumption is turned off, the proposed regulations provide that the partner's or related person's payment obligation is recognized only to the extent of the partner's or related person's net value as of the allocation date. A partner or related person that is not a disregarded entity is treated as a disregarded entity for purposes of determining net value under § 1.752–2(k). The IRS and the Treasury Department request comments on whether it would be clearer if all the net value requirement rules were consolidated in § 1.752–2(k).

The IRS and the Treasury Department considered further extending the net value requirement of § 1.752–2(k) to partners and related persons that are individuals and decedent's estates, but decided not to require such persons to comply with the net value requirement of § 1.752–2(k) because of the nature of personal guarantees. However, applying this less restrictive standard to individuals and decedent's estates may disadvantage other entities that enter into partnerships with individuals or decedent's estates. Thus, the IRS and the Treasury Department request comments on whether the final regulations should extend the net value requirement of § 1.752–2(k) to all partners and related persons. The IRS and the Treasury Department also request comments on the application of the net value requirement of § 1.752–2(k) to tiered partnerships.

Finally, in determining the amount of any obligation of a partner to make a payment to a creditor or a contribution to the partnership with respect to a partnership liability, § 1.752–2(b)(1) reduces the partner's payment obligation by the amount of any reimbursement that the partner would be entitled to receive from another partner, a person related to another partner, or the partnership. The IRS and the Treasury Department have considered whether a right to be reimbursed for a payment or contribution by an unrelated person (for example, pursuant to an indemnification agreement from a third party) should be taken into account in the same manner and have concluded that any source of reimbursement that effectively eliminates the partner's payment risk should cause a payment obligation to be disregarded. Therefore, the proposed regulations change the rule in § 1.752–2(b)(1) to reduce the partner's payment obligation by the amount of any right to reimbursement from any person.

B. Nonrecourse Liabilities

The existing regulations under § 1.752–3 contain rules for determining a partner's share of a nonrecourse liability of a partnership, including the partner's share of excess nonrecourse liabilities under § 1.752–3(a)(3). Section 1.752–3(a)(3) provides various methods to determine a partner's share of the excess nonrecourse liabilities. Under one method, a partner's share of excess nonrecourse liabilities is determined in accordance with the partner's share of partnership profits. For this purpose, the partnership agreement may specify the partners' interests in partnership profits so long as the interests so specified are reasonably consistent with allocations (that have substantial economic effect under the section 704(b) regulations) of some other significant item of partnership income or gain (the ''significant item method''). Alternatively, excess nonrecourse liabilities may be allocated among the partners in the manner that deductions attributable to those liabilities are reasonably expected to be allocated (the ''alternative method''). Similar to the significant item method, under § 1.704–2(e)(2), the partnership agreement may allocate nonrecourse deductions in a manner that is reasonably consistent with allocations that have substantial economic effect of some other significant partnership item attributable to the property securing the nonrecourse liability.

The IRS and the Treasury Department believe that the allocation of excess nonrecourse liabilities in accordance with the significant item method and the alternative method may not properly reflect a partner's share of partnership profits that are generally used to repay such liabilities because the allocation of the significant item may not necessarily reflect the overall economic arrangement of the partners. Therefore, the proposed regulations remove the significant item method and the alternative method from § 1.752–3(a)(3).

The IRS and the Treasury Department, however, are aware of the difficulty in determining a partner's interest in partnership profits in other than very simple partnerships and, therefore, recognize the need to have a bright-line measure of a partner's interest in partnership profits. The IRS and the Treasury Department considered several alternatives and believe that, for this purpose, an appropriate proxy of a partner's interest in partnership profits, and one that can provide the needed certainty, is a partner's liquidation value percentage, determined upon formation of the partnership and redetermined upon the most recent occurrence of an event described in § 1.704–1(b)(2)(iv)(f)(*5*), whether or not the capital accounts of the partners are adjusted under § 1.704–1(b)(2)(iv)(f) in connection with such event. A partner's liquidation value percentage is the ratio (expressed as a percentage) of the liquidation value of the partner's interest in the partnership to the liquidation value of all of the partners' interests in the partnership. The proposed regulations adopt the liquidation value percentage approach.

For purposes of the proposed rule, the liquidation value of a partner's interest in a partnership is the amount of cash the partner would receive with respect to the interest if, immediately after formation of the partnership or the occurrence of the event described in § 1.704–1(b)(2)(iv)(f)(*5*), as the case may be, the partnership sold all of its assets for cash equal to the fair market value of such property (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in § 1.752–7), paid an unrelated third party to assume all of its § 1.752–7 liabilities in a fully taxable transaction, and then liquidated. The proposed regulations also provide an example illustrating the new liquidation value approach in place of *Example 2* in § 1.752–3(c) illustrating the alternative method. As the proposed example illustrates, a change in the partners' shares of partnership liabilities as a result of an event described in § 1.704–1(b)(2)(iv)(f)(*5*) is taken into account in determining the tax consequences of the event that gave rise to such change.

The IRS and the Treasury Department are aware that the liquidation value approach may not precisely measure a partner's interest in partnership profits but believe that the approach is a better proxy than the significant item and alternative methods and is still administrable. The IRS and the Treasury Department request comments on other methods that reasonably measure a partner's interest in partnership profits that are not overly burdensome. In addition, the IRS and the Treasury Department request comments on whether exceptions should be provided to exclude certain events from triggering a redetermination of the partners' liquidation values.

Proposed Applicability Dates

The regulations under section 707 are proposed to apply to transactions with respect to which all transfers occur on or after the date these regulations are published as final regulations in the **Federal Register**. The regulations under § 1.752–2 are proposed to apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after the date these regulations are published as final regulations in the **Federal Register**. The regulations under § 1.752–3 are proposed to apply to liabilities incurred or assumed by a partnership on or after the date these regulations are published as final regulations in the **Federal Register**. The IRS and the Treasury

Department anticipate that the final regulations under section 752 will permit a partnership to apply the provisions contained in the final regulations to all of its liabilities as of the beginning of the first taxable year of the partnership ending on or after the date these regulations are published as final regulations in the **Federal Register**.

The proposed regulations also provide transitional relief for any partner whose allocable share of partnership liabilities under § 1.752–2 exceeds its adjusted basis in its partnership interest on the date the proposed regulations are finalized. Under this transitional relief, the partner can continue to apply the existing regulations under § 1.752–2 for a seven-year period to the extent that the partner's allocable share of partnership liabilities exceeds the partner's adjusted basis in its partnership interest on the date the proposed regulations are finalized. The amount of partnership liabilities subject to transitional relief will be reduced for certain reductions in the amount of liabilities allocated to that partner under the transition rules and, upon the sale of any partnership property, for any excess of tax gain (including section 704(c) gain) allocated to the partner less the partner's share of amount realized.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal in that it requires partners that are business entities and trusts to provide information they already maintain or can easily obtain to their respective partnership. Moreover, it should take a partner no more than 2 hours to satisfy the information requirement in these regulations. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by a person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs & Special Industries), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Sections 1.707–2 through 1.707–9 also issued under 26 U.S.C. 707(a)(2)(B).

§ 1.704–2 [Amended]

■ **Par. 2.** Section 1.704–2 is amended by:

■ a. Removing the language ''and (vii)'' in paragraph (d)(2)(ii).

■ b. Removing the language ''*Example* (1)(viii) and (ix)'' in paragraph (i)(2) and adding the language ''*Example* (1)(vii) and (viii)'' in its place.

■ c. Removing the language ''*Example* (1)(viii)'' in paragraph (i)(5) and adding the language ''*Example* (1)(vii)'' in its place.

■ d. Removing *Example* 1(vii) in paragraph (m) and redesignating *Examples* 1(viii) and (ix) as *Examples* 1(vii) and (viii) respectively.

■ e. Removing the language ''*Example* (1)(viii)'' in newly redesignated *Example* (1)(viii) in paragraph (m) and adding the language ''*Example* (1)(vii)'' in its place.

■ **Par. 3.** Section 1.707–0 is amended by:

■ a. Adding entries for §§ 1.707–4(d)(1), (d)(2), (d)(3), and (f).

■ b. Adding an entry for § 1.707–5(b)(3).

■ c. Redesignating the entry for § 1.707–5(f) as § 1.707–5(g) and adding a new entry for § 1.707–5(f).

The additions read as follows:

§ 1.707–0 Table of contents.

* * * * *

§ 1.707–4 Disguised sales of property to partnership; special rules applicable to guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures.

* * * * *

(d) * * *

(1) In general.

(2) Special rule for certain qualified liabilities.

(3) Scope of capital expenditures.

* * * * *

(f) Ordering rule cross reference.

* * * * *

§ 1.707–5 Disguised sales of property to partnership; special rules relating to liabilities.

* * * * *

(b) * * *

(3) Ordering rule.

* * * * *

(f) Netting liabilities in assets-over merger or consolidation.

* * * * *

■ **Par. 4.** Section 1.707–4 is amended by:

■ a. Adding the language ''(1) *In general.''* after the heading for paragraph (d).

■ b. Redesignating paragraph (d)(1) as paragraph (d)(1)(i).

■ c. Redesignating paragraph (d)(2) as paragraph (d)(1)(ii).

■ d. Redesignating paragraph (d)(2)(i) as paragraph (d)(1)(ii)(A).

■ e. Redesignating paragraph (d)(2)(ii) as paragraph (d)(1)(ii)(B).

■ f. Revising the second sentence in newly redesignated paragraph (d)(1)(ii)(B) and adding a new sentence at the end of newly redesignated paragraph (d)(1)(ii)(B).

■ g. Adding new paragraphs (d)(2), (d)(3), and (f).

The additions and revisions read as follows:

§ 1.707–4 Disguised sales of property to partnership; special rules applicable to guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures.

* * * * *

(d) * * *

(1) *In general.* * * *

(ii) * * *

(B) * * * However, the 20 percent of fair market value limitation of this paragraph (d)(1)(ii)(B) does not apply if the fair market value of the contributed property does not exceed 120 percent of the partner's adjusted basis in the contributed property at the time of the contribution. This paragraph (d)(1)(ii)(B) shall be applied on a property-by-property basis.

(2) *Special rule for certain qualified liabilities.* For purposes of paragraph (d)(1) of this section, if the capital expenditures were funded by a liability defined in § 1.707–5(a)(6)(i)(C) that is assumed or taken subject to by the partnership in connection with a transfer of property to the partnership by a partner, a transfer of money or other consideration by the partnership to the partner is not treated as made to reimburse the partner for such capital expenditures to the extent the transfer of money or other consideration by the partnership to the partner exceeds the partner's share of the liability (as determined under § 1.707–5(a)(2)).

(3) *Scope of capital expenditures.* For purposes of this section and § 1.707–5, the term *capital expenditures* has the same meaning as the term *capital expenditures* has under the Code and applicable regulations, except that it includes capital expenditures taxpayers elect to deduct, and does not include deductible expenses taxpayers elect to treat as capital expenditures.

* * * * *

(f) *Ordering rule cross reference.* For payments or transfers by a partnership to a partner to which the rules under this section and § 1.707–5(b) apply, see the ordering rule under § 1.707–5(b)(3).

■ **Par. 5.** Section 1.707–5 is amended by:

■ a. Removing the language ''or would be treated as a recourse liability under that section if it were treated as a partnership liability for purposes of that section'' at the end of paragraph (a)(2)(i).

■ b. Removing the language ''or would be a nonrecourse liability of the partnership under § 1.752–1(a)(2) if it were treated as a partnership liability for purposes of that section'' at the end of paragraph (a)(2)(ii).

■ c. Revising paragraph (a)(3).

■ d. Revising paragraph (a)(6)(i)(C).

■ e. Removing the language ''and'' at the end of paragraph (a)(6)(i)(D) and adding the language ''or'' in its place.

■ f. Adding paragraph (a)(6)(i)(E).

■ g. Revising paragraph (a)(7)(ii).

■ h. Adding a sentence at the end of paragraph (b)(1).

i. Removing the language ''property'' in paragraph (b)(2)(i)(A) and adding the language ''consideration'' in its place.

■ j. Revising paragraph (b)(2)(iii).

■ k. Adding paragraph (b)(3).

■ l. Designating the text of paragraph (e) after its subject heading as paragraph (e)(1).

■ m. Adding paragraph (e)(2).

■ n. Redesignating paragraph (f) as paragraph (g) and adding new paragraph (f).

■ o. Revising *Example 10* in newly redesignated paragraph (g).

■ p. Redesignating *Example 11* in newly redesignated paragraph (g) as *Example 14* and adding new *Examples 11, 12, and 13.*

The additions and revisions read as follows:

§ 1.707–5 Disguised sales of property to partnership; special rules relating to liabilities.

(a) * * *

(3) *Reduction of partner's share of liability*—(i) For purposes of this section, a partner's share of a liability, immediately after a partnership assumes or takes property subject to the liability, is determined by taking into account a subsequent reduction in the partner's share if—

(A) At the time that the partnership assumes or takes property subject to the liability, it is anticipated that the transferring partner's share of the liability will be subsequently reduced;

(B) The anticipated reduction is not subject to the entrepreneurial risks of partnership operations; and

(C) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the assumption of or taking property subject to the liability is treated as part of a sale under § 1.707–3.

(ii) If within two years of the partnership assuming or taking property subject to the liability, a partner's share of the liability is reduced due to a decrease in the net value of the partner or related person for purposes of § 1.752–2(k), the reduction will be presumed to be anticipated, unless the facts and circumstances clearly establish that the decrease in the net value was not anticipated. Any such reduction must be disclosed in accordance with § 1.707–8.

* * * * *

(6) * * *

(i) * * *

(C) A liability that is allocable under the rules of § 1.163–8T to capital expenditures (as described under § 1.707–4(d)(3)) with respect to the property;

* * * * *

(E) A liability that was not incurred in anticipation of the transfer of the property to a partnership, but that was incurred in connection with a trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business (see paragraph (a)(7) of this section for further rules regarding a liability incurred within two years of a transfer presumed to be in anticipation of the transfer); and

* * * * *

(7) * * *

(ii) *Disclosure of transfers of property subject to liabilities incurred within two years of the transfer.* A partner that treats a liability assumed or taken subject to by a partnership in connection with a transfer of property as a qualified liability under paragraph (a)(6)(i)(B) of this section or under paragraph (a)(6)(i)(E) of this section (if the liability was incurred by the partner within the two-year period prior to the earlier of the date the partner agrees in writing to transfer the property or the date the partner transfers the property to the partnership) must disclose such treatment to the Internal Revenue Service in accordance with § 1.707–8.

(b) * * *

(1) * * * For purposes of paragraph (b) of this section, an upper-tier partnership's share of the liabilities of a lower-tier partnership that are treated as a liability of the upper-tier partnership under § 1.752–4(a) shall be treated as a liability of the upper-tier partnership incurred on the same day the liability was incurred by the lower-tier partnership.

(2) * * *

(iii) *Reduction of partner's share of liability*—(A) For purposes of paragraph (b)(2) of this section, a partner's share of a liability immediately after a partnership incurs the liability is determined by taking into account a subsequent reduction in the partner's share if—

(*1*) At the time that the partnership incurs the liability, it is anticipated that the partner's share of the liability that is allocable to a transfer of money or other consideration to the partner will be reduced subsequent to the transfer;

(*2*) The anticipated reduction is not subject to the entrepreneurial risks of partnership operations; and

(*3*) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the partnership's distribution of the proceeds of the borrowing is treated as part of a sale.

(B) If within two years of the partnership incurring the liability, a partner's share of the liability is reduced due to a decrease in the net value of the partner or a related person for purposes of § 1.752–2(k), the reduction will be presumed to be anticipated, unless the facts and circumstances clearly establish that the decrease in the net value was not anticipated. Any such reduction must be disclosed in accordance with § 1.707–8.

(3) *Ordering rule.* The treatment of a transfer of money or other consideration under paragraph (b) of this section is determined before applying the rules under § 1.707–4.

* * * * *

(e) * * *

(2) If an interest in a partnership that has one or more liabilities (the lower-tier partnership) is transferred to another partnership (the upper-tier partnership), the upper-tier partnership's share of any liability of the lower-tier partnership that is treated as a liability of the upper-tier partnership under § 1.752–4(a) is treated as a qualified liability under § 1.707–5(a)(6)(i) to the extent the liability would be a qualified liability under § 1.707–5(a)(6)(i) had the liability been assumed or taken subject to by the upper-tier partnership in connection with a transfer of all of the lower-tier partnership's property to the upper-tier partnership by the lower-tier partnership.

(f) *Netting liabilities in assets-over merger or consolidation.* When two or more partnerships merge or consolidate under section 708(b)(2)(A), as described in § 1.708–1(c)(3)(i), any increases or decreases in partnership liabilities associated with the merger or consolidation are netted by a partner in the terminating partnership and the resulting partnership for purposes of applying §§ 1.707–3 through 1.707–5 to transfers of money or other consideration by the terminating partnership to the partner.

(g) * * *

Example 10. Treatment of debt-financed transfers of consideration by partnership. (i) K transfers property Z to partnership KL in exchange for an interest in KL on April 9, 2014. On September 13, 2014, KL incurs a liability of $20,000. On November 17, 2014, KL transfers $20,000 to K, and $10,000 of this transfer is allocable under the rules of § 1.163–8T to proceeds of the partnership liability incurred on September 13, 2014. The remaining $10,000 is paid from other partnership funds. Assume that, under section 752 and the corresponding regulations, the $20,000 liability incurred on September 13, 2014, is a recourse liability of KL and K's share of that liability is $10,000 on November 17, 2014.

(ii) Because a portion of the transfer made to K on November 17, 2014, is allocable under § 1.163–8T to proceeds of a partnership liability that was incurred by the partnership within 90 days of that transfer, K is required to take the transfer into account in applying the rules of this section and § 1.707–3 only to the extent that the amount of the transfer exceeds K's allocable share of the liability used to fund the transfer. K's allocable share of the $20,000 liability used to fund $10,000 of the transfer to K is $5,000 (K's share of the liability ($10,000) multiplied by the fraction obtained by dividing—

(A) The amount of the liability that is allocable to the distribution to K ($10,000); by

(B) The total amount of such liability ($20,000)).

(iii) Therefore, K is required to take into account only $15,000 of the $20,000 partnership transfer to K for purposes of this section and § 1.707–3. Under these facts, assuming the within-two-year presumption is not rebutted, this $15,000 transfer will be treated under the rule in § 1.707–3 as part of a sale by K of property *Z* to KL.

Example 11. Treatment of debt-financed transfers of consideration and transfers characterized as guaranteed payments by a partnership. (i) The facts are the same as in *Example 10,* except that the entire $20,000 transfer to K is allocable under the rules of § 1.163–8T to proceeds of the partnership liability incurred on September 13, 2014. In addition, the partnership agreement provides that K is to receive a guaranteed payment for the use of K's capital in the amount of $10,000 in each of the three years following the transfer of property Z. Ten thousand dollars of the transfer made to K on November 17, 2014, is pursuant to this provision of the partnership agreement. Assume that the guaranteed payment to K constitutes a reasonable guaranteed payment within the meaning of § 1.707–4(a)(3).

(ii) Under these facts, the rules under both § 1.707–4(a) and § 1.707–5(b) apply to the November 17, 2014 transfer to K by the partnership. Thus, the ordering rule in § 1.707–5(b)(3) requires that the § 1.707–5(b) debt-financed distribution rules apply first to determine the treatment of the $20,000 transfer. Because the entire transfer made to K on November 17, 2014, is allocable under § 1.163–8T to proceeds of a partnership liability that was incurred by the partnership within 90 days of that transfer, K is required to take the transfer into account in applying the rules of this section and § 1.707–3 only to the extent that the amount of the transfer exceeds K's allocable share of the liability used to fund the transfer. K's allocable share of the $20,000 liability used to fund the transfer to K is $10,000 (K's share of the liability ($10,000) multiplied by the fraction obtained by dividing—

(A) The amount of the liability that is allocable to the distribution to K ($20,000); by

(B) The total amount of such liability ($20,000)).

(iii) The remaining $10,000 amount of the transfer to K that exceeds K's allocable share of the liability is tested to determine whether an exception under § 1.707–4 applies. Because $10,000 of the payment to K is a reasonable guaranteed payment for capital under § 1.707–4(a)(1)(ii), the $10,000 transfer will not be treated as part of a sale by K of property *Z* to the partnership under § 1.707–3, unless the facts and circumstances establish that the transfer is not a guaranteed payment for capital but is part of a sale.

Example 12. Treatment of debt-financed transfers of consideration by partnership made pursuant to plan. (i) O transfers property X, and P transfers property Y, to partnership OP in exchange for equal interests therein on June 1, 2014. On October 1, 2014, the partnership incurs two liabilities: Liability 1 of $8,000 and Liability 2 of $4,000. On December 15, 2014, the partnership transfers $2,000 to each of O and P pursuant to a plan. The transfers made to O and P on December 15, 2014 are allocable under § 1.163–8T to the proceeds of either Liability 1 or Liability 2. Assume that the liabilities incurred on October 1, 2014 are each a recourse liability of the partnership under § 1.752–2 and that O's and P's share of Liability 1 is $4,000 each and Liability 2 is $2,000 each on December 15, 2014.

(ii) Because the partnership transferred pursuant to a plan a portion of the proceeds of the two liabilities to O and P, paragraph (b)(1) of this section is applied by treating Liability 1 and Liability 2 as a single $12,000 liability. Pursuant to paragraph (b)(2)(ii)(A) of this section, each partner's allocable share of the $12,000 liability equals the amount obtained by multiplying the sum of the partner's share of Liability 1 and Liability 2 ($6,000) ($4,000 for Liability 1 plus $2,000 for Liability 2) by the fraction obtained by dividing—

(A) The amount of the liability that is allocable to the distribution to O and P pursuant to the plan ($4,000); by

(B) The total amount of such liability ($12,000).

(iii) Therefore, O's and P's allocable share of the $12,000 liability is $2,000 each. Accordingly, because a portion of the proceeds of the $12,000 liability are allocable under § 1.163–8T to the $2,000 transfer made to each of O and P within 90 days of incurring the liability, and the $2,000 transfer does not exceed O or P's $2,000 allocable share of that liability, each is required to take into account $0 of the $2,000 transfer for purposes of this section and § 1.707–3. Under these facts, no part of the transfers to O and P will be treated as part of a sale of property X by O or property Y by P.

Example 13. Treatment of debt-financed transfers of consideration by partnership with liability allocated according to partners' liquidation value percentages. (i) X transfers property A, which has a fair market value of $90,000 and an adjusted tax basis of $5,000, to partnership XY in exchange for an interest therein on March 29, 2014. At the time of the contribution, partnership XY's only asset is property B with a fair market value of $120,000 and adjusted tax basis of $70,000. On March 30, 2014, the partnership incurs a liability of $30,000. On March 31, 2014, the partnership transfers $30,000 to X, and $30,000 of this transfer is allocable under the rules of § 1.163–8T to proceeds of the partnership liability incurred on March 30, 2014. Assume that, under section 752 and the corresponding regulations, the $30,000 liability incurred on March 30, 2014 is a nonrecourse liability of the partnership and that partnership XY allocates its excess nonrecourse liabilities under § 1.752–3(a)(3) in accordance with the partners' liquidation value percentages as defined in § 1.752–3(a)(3).

(ii) Under paragraph (a)(2)(ii) of this section, X's share of partnership XY's $30,000 nonrecourse liability is determined by applying the same percentages used to determine X's share of XY's excess nonrecourse liabilities under § 1.752–3(a)(3). Because the distribution to X is an event described in § 1.704–1(b)(2)(iv)(f)(*5*), X's liquidation value percentage must be redetermined under § 1.752–3(a)(3) as of March 31, 2014, irrespective of whether the capital accounts of the partners of partnership XY are adjusted under § 1.704–1(b)(2)(iv)(f). X's liquidation value percentage is 33.3% ((X's liquidation value of $60,000 immediately after the distribution) divided by (partnership XY's aggregate liquidation value of $180,000 immediately after the distribution)). Accordingly, under paragraph (a)(2)(ii) of this section, X's share of the $30,000 liability is $10,000 on March 31, 2014.

(iii) Because the transfer made to X on March 31, 2014 is allocable under § 1.163–8T to proceeds of a partnership liability that was incurred by the partnership within 90 days of that transfer, X is required to take the transfer into account in applying the rules of this section and § 1.707–3 only to the extent that the amount of the transfer exceeds X's allocable share of the liability used to fund the transfer. X's allocable share of the $30,000 liability used to fund the $30,000 transfer to X is $10,000 (X's share of the liability ($10,000) multiplied by the fraction obtained by dividing—

(A) The amount of the liability that is allocable to the distribution to X ($30,000); by

(B) The total amount of such liability ($30,000)).

(iv) Therefore, X is required to take into account $20,000 of the $30,000 partnership transfer to X for purposes of this section and § 1.707–3.

* * * * *

■ **Par. 6.** Section 1.707–8 is amended by revising paragraph (a) to read as follows:

§ 1.707–8 Disclosure of certain information.

(a) *In general.* The disclosure referred to in § 1.707–3(c)(2) (regarding certain transfers made within two years of each other), §§ 1.707–5(a)(3)(ii) and 1.707–5(b)(2)(iii)(B) (regarding the reduction of a liability presumed to be anticipated), § 1.707–5(a)(7)(ii) (regarding a liability incurred within two years prior to a transfer of property), and § 1.707–6(c) (relating to transfers of property from a partnership to a partner in situations analogous to those listed above) is to be made in accordance with paragraph (b) of this section.

* * * * *

Par. 7. Section 1.707–9 is amended by revising paragraphs (a)(1) and (b) to read as follows:

§ 1.707–9 Effective dates and transitional rules.

(a) * * *

(1) *In general.* Except as provided in paragraph (a)(3) of this section, §§ 1.707–3 through 1.707–5 apply to any transaction with respect to which all transfers occur on or after [effective date of final rule] and § 1.707–6 applies to any transaction with respect to which all transfers that are part of a sale of an item of property occur after April 24, 1991. For any transaction with respect to which all transfers that are part of a sale of an item of property occur after April 24, 1991, but before [effective date of final rule], §§ 1.707–3 through 1.707–5 as contained in 26 CFR edition revised April 1, 2013 (TD 8439) apply.

* * * * *

(b) *Section 1.707–8 disclosure of certain information.* The disclosure provisions described in § 1.707–8 apply to any transaction with respect to which all transfers occur on or after [effective date of final rule]. Otherwise, for any transaction with respect to which all transfers that are part of a sale of property occur after September 30, 1992, but before [effective date of final rule], § 1.707–8 as contained in 26 CFR edition revised April 1, 2013 (TD 8439) applies.

* * * * *

■ **Par. 8.** Section 1.752–0 is amended by:

■ a. Removing the entries for §§ 1.752–2(b)(5) and (b)(6).

■ b. Revising the entries for § 1.752–2(j)(3) and (j)(4).

■ c. Adding entries for § 1.752–2(k), (k)(1), (2), (3), (4), (5), and (6).

■ d. Adding an entry for § 1.752–2(l).

■ e. Redesignating the entry for § 1.752–3(b) as § 1.752–3(c) and adding a new entry for § 1.752–3(b).

■ f. Adding an entry for § 1.752–3(d).

The revisions and additions read as follows:

§ 1.752–0 Table of contents.

* * * * *

§ 1.752–2 Partner's share of recourse liabilities.

* * * * *

(j) * * *

(3) Plan to circumvent or avoid the obligation.

(4) Arrangements intended to avoid certain requirements of paragraph (b).

* * * * *

(k) Effect of a disregarded entity.

(1) In general.

(2) Net value of a disregarded entity.

(3) Multiple liabilities.

(4) Reduction in net value of a disregarded entity.

(5) Information to be provided by the owner of a disregarded entity.

(6) Examples.

(l) Effective/applicability dates.

(1) In general.

(2) Transitional rules.

§ 1.752–3 Partner's share of nonrecourse liabilities.

* * * * *

(b) Allocation of a single nonrecourse liability among multiple properties.

(c) Examples.

(d) Effective/applicability dates.

* * * * *

Par. 9. Section 1.752–2 is amended by:

■ a. Revising the first sentence in paragraph (b)(1).

■ b. Revising paragraph (b)(3).

■ c. Removing paragraphs (b)(5) and (b)(6).

■ d. Adding a sentence at the end of paragraph (f), revising *Example 3,* reserving *Example 9,* and adding new *Examples 10, 11, and 12.*

■ e. Revising paragraph (j)(4).

■ f. Revising the first sentence of paragraph (k)(1).

■ g. Revising paragraphs (k)(2)(i)(A) and (l).

The revisions and additions read as follows:

§ 1.752–2 Partner's share of recourse liabilities.

* * * * *

(b) * * *

(1) * * * Except as otherwise provided in this section, a partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another person. * * *

* * * * *

(3) *Obligations recognized*—(i) *In general.* The determination of the extent

to which a partner or related person has an obligation to make a payment under paragraph (b)(1) of this section is based on the facts and circumstances at the time of the determination. Notwithstanding the prior sentence, a payment obligation will not be recognized if it fails to satisfy paragraphs (b)(3)(ii) and (iii) of this section. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying this section, including:

(A) Contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors, to other partners, or to the partnership;

(B) Obligations to the partnership that are imposed by the partnership agreement, including the obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership; and

(C) Payment obligations (whether in the form of direct remittances to another partner or a contribution to the partnership) imposed by state law, including the governing state partnership statute.

(ii) *Recognition requirements.* An obligation of a partner or related person to make a payment with respect to a partnership liability described under paragraph (b)(3)(i)(A) or (B) of this section is not recognized under paragraph (b)(3) of this section unless all of the requirements of this paragraph (b)(3)(ii)(A) through (G) are satisfied. To the extent that an obligation of a partner or related person to make a payment with respect to a partnership liability is not recognized under paragraph (b)(3) of this section, paragraph (b) of this section is applied as if the obligation did not exist.

(A) The partner or related person is—

(*1*) Required to maintain a commercially reasonable net worth throughout the term of the payment obligation; or

(*2*) Subject to commercially reasonable contractual restrictions on transfers of assets for inadequate consideration.

(B) The partner or related person is required periodically to provide commercially reasonable documentation regarding the partner's or related person's financial condition.

(C) The term of the payment obligation does not end prior to the term of the partnership liability.

(D) The payment obligation does not require that the primary obligor or any other obligor with respect to the partnership liability directly or indirectly hold money or other liquid assets in an amount that exceeds the reasonable needs of such obligor.

(E) The partner or related person received arm's length consideration for assuming the payment obligation.

(F) In the case of a guarantee or similar arrangement, the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied. For purposes of this paragraph (b)(3)(ii)(F), the terms of a guarantee or similar arrangement will be treated as modified by any right of indemnity, reimbursement, or similar arrangement regardless of whether that arrangement would be recognized under paragraph (b)(3) of this section. However, the preceding sentence does not apply to a right of proportionate contribution running between partners or related persons who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable.

(G) In the case of an indemnity, reimbursement agreement, or similar arrangement, the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that, any amount of the indemnitee's or other benefitted party's payment obligation is satisfied. The indemnity, reimbursement agreement, or similar arrangement only satisfies this paragraph (b)(3)(ii)(G) if, before taking into account the indemnity, reimbursement agreement, or similar arrangement, the indemnitee's or other benefitted party's payment obligation is recognized under paragraph (b)(3) of this section or would be recognized under paragraph (b)(3) of this section if such person were a partner or related person. For purposes of this paragraph (b)(3)(ii)(G), the terms of an indemnity, reimbursement agreement, or similar arrangement will be treated as modified by any further right of indemnity, reimbursement, or similar arrangement regardless of whether that further arrangement would be recognized under paragraph (b)(3) of this section. However, the preceding sentence does not apply to a right of proportionate contribution running between partners or related persons who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable.

(iii) *Satisfaction of obligation*—(A) *In general.* Except as provided in paragraph (b)(3)(iii)(B) of this section, for purposes of determining the extent to which a partner or related person has a payment obligation or bears the economic risk of loss for a partnership liability under paragraph (b)(1) of this section, it is assumed that such partner or related person who has an obligation to make a payment actually performs its obligation, irrespective of its actual net value, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation. See paragraph (j) of this section.

(B) *Net value requirement.* In determining the extent to which a partner or related person other than an individual or a decedent's estate bears the economic risk of loss under paragraph (b)(1) of this section for a partnership liability other than a trade payable, a payment obligation is recognized only to the extent of the net value of the partner or related person as of the allocation date (as defined in paragraph (k)(2)(iv) of this section) that is allocated to the partnership liability. A partner or related person's net value is determined under the rules of paragraph (k) of this section. This paragraph (b)(3)(iii)(B) applies to a payment obligation of a partner or related person that is disregarded as an entity separate from its owner under sections 856(i) or 1361(b)(3) or §§ 301.7701–1 through 301.7701–3 of this chapter or is a trust to which subpart E, part I, subchapter J, chapter 1 of the Code applies (a disregarded entity), even if the owner of the disregarded entity is an individual or a decedent's estate. A partner or related person that is not a disregarded entity is treated as a disregarded entity for purposes of determining net value of the partner or related person under paragraph (k) of this section.

(C) *Information to be provided regarding net value.* A partner that may be treated as bearing the economic risk of loss for a partnership liability based upon an obligation under paragraph (b)(1) of this section (a § 1.752–2(b)(1) payment obligation) of a person, including the partner, other than an individual or a decedent's estate, must provide information to the partnership as to that person's net value that is appropriately allocable to the partnership's liabilities on a timely basis.

* * * * *

(f) *Examples.* * * * For purposes of *Examples 1* through *7,* unless otherwise provided, assume that any obligation of a partner or related person to make a payment with respect to the partnership liability satisfies the requirements under paragraphs (b)(3)(ii), (b)(3)(iii), and (k) of this section where applicable.

* * * * *

Example 3. Guarantee by limited partner; partner satisfaction of obligation. E and F form a limited partnership. E, the general partner, contributes $2,000 and F, the limited partner, contributes $8,000 in cash to the partnership. E and F are both business entities (as defined in § 301.7701–2(a) of this chapter). The partnership agreement allocates losses 20% to E and 80% to F until F's capital account is reduced to zero, after which all losses are allocated to E. The partnership purchases depreciable property for $25,000 using its $10,000 cash and a $15,000 recourse loan from a bank. E's net value, determined under paragraphs (k)(2) through (k)(4) of this section, at all times exceeds the $15,000 loan amount, but F guarantees payment of the $15,000 loan to the extent the loan remains unpaid after the bank has exhausted its remedies against the partnership (including causing E to make any contributions required of a general partner under state law). In a constructive liquidation, the $15,000 liability becomes due and payable. All of the partnership's assets, including the depreciable property, are deemed to be worthless. The depreciable property is deemed sold for a value of zero. Capital accounts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	E	F
Initial contribution ..	$2,000	$8,000
Loss on hypothetical sale	(17,000)	(8,000)
	($15,000)	-0-

E, as a general partner, would be obligated by operation of law to make a net contribution to the partnership of $15,000. Under paragraph (b)(3)(iii)(B) of this section, E has net value to satisfy its payment obligation as of the allocation date. Because E has net value to the extent of its obligation, it is assumed that F would not have to satisfy F's guarantee. The $15,000 mortgage is treated as a recourse liability because one or more partners bear the economic risk of loss. E's share of the liability is $15,000, and F's share is zero.

* * * * *

Example 9. [Reserved]

* * * * *

Example 10. Guarantee of first and last dollars. (i) A, B, and C are equal members of limited liability company, ABC, that is treated as a partnership for federal tax purposes. ABC borrows $1,000 from Bank. A guarantees payment of up to $300 of the ABC liability if any amount of the full $1,000 liability is not recovered by Bank. B guarantees payment of up to $200, but only if the Bank otherwise recovers less than $200. Both A and B waive their rights of contribution against each other. A's and B's guarantees satisfy the requirements set forth in paragraphs (b)(3)(ii)(A) through (E) and paragraph (b)(3)(iii) of this section.

(ii) Because A is obligated to pay up to $300 if, and to the extent that, any amount of the $1,000 partnership liability is not recovered by Bank, A's guarantee satisfies the requirement under paragraph (b)(3)(ii)(F) of this section. Therefore, A's payment obligation is recognized under paragraph (b)(3) of this section. The amount of A's economic risk of loss under paragraph (a)(1) of this section is $300. However, because B is obligated to pay up to $200 only if and to the extent that the Bank otherwise recovers less than $200 of the $1,000 partnership liability, B's guarantee does not satisfy the requirement under paragraph (b)(3)(ii)(F) of this section and B's payment obligation is not recognized. Therefore, B bears no economic risk of loss under paragraph (a)(1) of this section for ABC's liability. As a result, $300 of the liability is allocated to A under paragraph (a)(1) of this section and the remaining $700 liability is allocated to A, B, and C under § 1.752–3.

Example 11. Indemnification of guarantees. (i) The facts are the same as in *Example 10,* except that, in addition, C agrees to indemnify A up to $50 that A pays with respect to its guarantee, and agrees to indemnify B fully with respect to its guarantee. C's indemnity satisfies the requirements set forth in paragraphs (b)(3)(ii)(A) through (E) and paragraph (b)(3)(iii) of this section.

(ii) The determination of whether C's indemnity satisfies the requirement under paragraph (b)(3)(ii)(G) of this section is made without regard to whether C's indemnity itself causes A's guarantee not to be recognized. Because A's obligation would be recognized but for the effect of C's indemnity and C is obligated to pay A up to the full amount of C's indemnity if A pays any amount on its guarantee of ABC's liability, C's indemnity of A's guarantee satisfies the requirement under paragraph (b)(3)(ii)(G) of this section. The amount of C's economic risk of loss under paragraph (a)(1) of this section for its indemnity of A's guarantee is $50.

(iii) Because C's indemnity of A's guarantee satisfies the requirement under paragraph (b)(3)(ii)(G) of this section, it is treated as modifying A's guarantee such that A is treated as liable for $250 only to the extent any amount beyond $50 of the partnership liability is not satisfied. Thus, A is not liable if, and to the extent, any amount of the partnership liability is not otherwise satisfied, and, as a result, A's guarantee is not recognized under paragraph (b)(3)(ii)(F) of this section. Therefore, A bears no economic risk of loss under paragraph (a)(1) of this section for ABC's liability.

(iv) Because B's obligation is not recognized under paragraph (b)(3) of this section, C's indemnity of B's guarantee does not satisfy the requirement under paragraph (b)(3)(ii)(G) of this section, and C's payment obligation to B is not recognized. Therefore, C bears no economic risk of loss under paragraph (a)(1) of this section for its indemnity of B's guarantee. As a result, $50 of the liability is allocated to C under paragraph (a)(1) of this section and the remaining $950 liability is allocated to A, B, and C under § 1.752–3.

Example 12. Partial guarantee of partnership liability. (i) A, B, and C are equal members of limited liability company, ABC, that is treated as a partnership for federal tax purposes. ABC borrows $1,000 from Bank. A guarantees payment of 25 percent of each dollar of the $1,000 liability that is not recovered by Bank. A's guarantee satisfies the requirements set forth in paragraphs (b)(3)(ii)(A) through (E) and paragraph (b)(3)(iii) of this section.

(ii) If $250 of the $1,000 partnership liability is not recovered by Bank, A is only obligated to pay $62.50 ($250 × .25) pursuant to the terms of the guarantee. Because A is not obligated to pay up to the full amount of its payment obligation ($250) to the extent that $250 is not recovered by Bank, A's guarantee does not satisfy the requirement under paragraph (b)(3)(ii)(F) of this section, and A's payment obligation is not recognized. As a result, the ABC liability is allocated to A, B, and C under § 1.752–3.

* * * * *

(j) * * *

(4) *Arrangements intended to avoid certain requirements of paragraph (b).* An obligation of a partner or related person to make a payment with respect to a partnership liability is not recognized under paragraph (b) of this section if the facts and circumstances indicate that the partnership liability is part of a plan or arrangement involving the use of tiered partnerships, intermediaries, or similar arrangements to convert a single liability into more than one liability with a principal purpose of circumventing the rules of paragraphs (b)(3)(ii)(F) and (G) of this section.

* * * * *

(k) * * *

(1) * * * In determining the extent to which a partner bears the economic risk of loss for a partnership liability other than a trade payable, an obligation under paragraph (b)(1) of this section (§ 1.752–2(b)(1) payment obligation) of a business entity that is disregarded as an entity separate from its owner under sections 856(i) or 1361(b)(3) or §§ 301.7701–1 through §§ 301.7701–3 of this chapter or a trust to which subpart E, part I, subchapter J, chapter 1 of the Code applies (disregarded entity) is taken into account only to the extent of the net value of the disregarded entity as of the allocation date (as defined in paragraph (k)(2)(iv) of this section) that is allocated to the partnership liability as determined under the rules of this paragraph (k). * * *

(2) * * *

(i) * * *

(A) The fair market value of all assets owned by the disregarded entity that may be subject to creditors' claims under local law (including the disregarded entity's enforceable rights to contributions from its owner, and the fair market value of an interest in any partnership, but excluding the disregarded entity's direct or indirect interest in the partnership for which the net value is being determined and the net fair market value of property pledged to secure a liability of the partnership under paragraph (h)(1) of this section); less

* * * * *

(l) *Effective/applicability dates*—(1) *In general.* Paragraph (a) and paragraphs (h)(3) and (k) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to that date. The rules applicable to liabilities incurred or assumed (or pursuant to a written binding contract in effect) prior to October 11, 2006, are contained in § 1.752–2 in effect prior to October 11, 2006, (see 26 CFR part 1 revised as of April 1, 2006). Paragraphs (b)(1) first sentence, (b)(3), (f), (f) *Examples 3, 10, 11,* and *12,* (j)(4), (k)(1) first sentence, and (k)(2)(i)(A) of this section apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after [effective date of final rule], other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date.

(2) *Transitional rules*—(i) *In general.* If a partner has a share of a recourse partnership liability under paragraph (b) of this section immediately prior to [effective date of final rule] (Transition Partner), the partnership (Transition Partnership) may choose not to apply paragraphs (b)(1) first sentence, (b)(3), (f), (f) *Examples 3, 10, 11,* and *12,* (j)(4), (k)(1) first sentence, and (k)(2)(i)(A) of this section to the extent the amount of the Transition Partner's share of liabilities under paragraph (b) of this section immediately prior to the effective date exceeds the amount of the Transition Partner's adjusted basis in its partnership interest as determined under § 1.705–1 at such time (Grandfathered Amount). The Transition Partnership may continue to apply the rules under § 1.752–2 in effect prior to [effective date of final rule], with respect to a Transition Partner for liabilities described in paragraph (b) of this section to the extent of the Transition Partner's adjusted Grandfathered Amount for the seven-year period beginning [effective date of final rule]. A Transition Partner's Grandfathered Amount is reduced (not below zero), but never increased, by—

(A) Upon the sale of any property by the Transition Partnership, an amount equal to the excess of any tax gain allocated to the Transition Partner by the Transition Partnership (including amounts allocated under section 704(c) and applicable regulations) over the product of the total amount realized by the Transition Partnership from the property sale multiplied by the Transition Partner's liquidation value percentage as determined under § 1.752–3(a)(3), and

(B) An amount equal to any decrease in the Transition Partner's share of liabilities to which the rules of this paragraph (l)(2)(i) apply, other than by operation of paragraph (l)(2)(i)(A) of this section.

(ii) *Special rules*—(A) *Ownership changes in Transition Partner.* A Transition Partner that is a partnership, S corporation, or disregarded entity ceases to qualify as a Transition Partner if the direct or indirect ownership of that Transition Partner changes by 50 percent or more.

(B) *Section 708(b)(1)(B) terminations.* The termination of a Transition Partnership under section 708(b)(1)(B) and applicable regulations does not affect the Grandfathered Amount of a Transition Partner that remains a partner in the new partnership (as described in § 1.708–1(b)(4)), and the new partnership is treated as a continuation of the Transition Partnership for purposes of this paragraph (l)(2).

■ **Par. 10.** Section 1.752–3 is amended by:

■ a. Removing the third and fourth sentences in paragraph (a)(3) and adding four new sentences in their place.

■ b. Revising *Example 2* in paragraph (c).

■ c. Adding paragraph (d).

The revisions and additions read as follows:

§ 1.752–3 Partner's share of nonrecourse liabilities.

(a) * * *

(3) * * * The partnership agreement may specify the partners' interests in partnership profits for purposes of allocating excess nonrecourse liabilities provided the interests so specified are in accordance with the partners' liquidation value percentages. A partner's liquidation value percentage, which is determined upon the formation of a partnership and redetermined upon any event described in § 1.704–1(b)(2)(iv)(f)(*5*), irrespective of whether the capital accounts of the partners are adjusted under § 1.704–1(b)(2)(iv)(f), is the ratio (expressed as a percentage) of the liquidation value of the partner's interest in the partnership divided by the aggregate liquidation value of all of the partners' interests in the partnership. Any change in the partners' shares of partnership liabilities as a result of an event described in § 1.704–1(b)(2)(iv)(f)(*5*) is taken into account in determining the tax consequences of the event that gave rise to such change. For purposes of this paragraph (a)(3), the liquidation value of a partner's interest in a partnership is the amount of cash the partner would receive with respect to the interest if, immediately after the formation of the partnership or the occurrence of an event described in § 1.704–1(b)(2)(iv)(f)(*5*), as the case may be, the partnership sold all of its assets for cash equal to the fair market value of such assets (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in § 1.752–7), paid an unrelated third party to assume all of its § 1.752–7 liabilities in a fully taxable transaction, and then liquidated. * * *

(c) * * *

Example 2. Excess nonrecourse liabilities allocated according to partners' liquidation value percentages. (i) On January 1, 2012, X and Y each contribute $100 to a limited liability company classified as a partnership for U.S. tax purposes (XY) in exchange for equal interests in XY. XY's organizing agreement provides that it will maintain members' capital accounts in accordance with section 704 and the regulations thereunder, and will make liquidating distributions in accordance with positive capital account balances. XY has a calendar year taxable year. On the same day, XY borrows $50 from a person unrelated to either X or Y. Under the rules of this section, the liability is a nonrecourse liability. XY purchases Land A for $50 and Land B for $200. The partners agree to allocate excess nonrecourse liabilities in accordance with the partners' liquidation value percentages as defined in paragraph (a)(3) of this section.

(ii) Under paragraph (a)(3) of this section, the liquidation value percentage for each of partners X and Y is 50% ((each partner's liquidation value immediately after the formation of $100) divided by (XY's aggregate liquidation value immediately after the formation of $200)). Therefore, X and Y each has a $25 share of the $50 liability and each is treated as contributing $25 to XY under section 752(a).

(iii) On September 1, 2015, XY owns the following assets: (1) Land A with a fair market value of $40 and an adjusted tax basis of $50; (2) Land B with a fair market value of $800 and an adjusted tax basis of $200; and (3) Land C with a fair market value of $400 and an adjusted tax basis of $390. The outstanding principal on the partnership liability is $40. Thus, X and Y each own an interest in XY with a fair market value of $600 and an adjusted tax basis of $320. The partners continue to agree to allocate excess nonrecourse liabilities in accordance with the partners' liquidation value percentages as defined in paragraph (a)(3) of this section. On September 1, 2015, XY distributes Land C to X. Assume XY has no items of income, gain, loss, deduction, or credit in its taxable year ending December 31, 2015.

(iv) The distribution of Land C to X is an event described in § 1.704–1(b)(2)(iv)(f)(*5*) and, thus, under paragraph (a)(3) of this section, X's liquidation value percentage must be redetermined under paragraph (a)(3) of this section as of September 1, 2015, irrespective of whether the capital accounts of the partners of XY are adjusted under § 1.704–1(b)(2)(iv)(f). X's liquidation value percentage is 25% ((X's liquidation value immediately after the distribution of $200) divided by (XY's aggregate liquidation value immediately after the distribution of $800)). Accordingly, X's share of the $40 liability is reduced from $20 to $10 on September 1, 2015, while Y's share of the liability is increased from $20 to $30. Thus, X is treated as receiving a distribution of $10 from XY under section 752(b), and Y is treated as contributing $10 to XY under section 752(a). Because the distribution of $10 to X does not exceed X's $320 adjusted basis in its interest in XY, X recognizes no gain. Pursuant to section 732(a)(2), X's basis in Land C is $310.

* * * * *

(d) *Effective/applicability dates.* The third, fourth, fifth, and sixth sentences of paragraph (a)(3) of this section and paragraph (c) *Example 2* of this section apply to liabilities that are incurred or assumed by a partnership on or after [effective date of final rule], other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to that date.

■ **Par. 11.** Section 1.752–5 is amended by revising the second and third sentences of paragraph (a) to read as follows:

§ 1.752–5 Effective dates and transitional rules.

(a) * * * However, § 1.752–3(a)(3) seventh, eighth, and ninth sentences, (b), and (c) *Example 3,* do not apply to any liability incurred or assumed by a partnership prior to October 31, 2000. Nevertheless, § 1.752–3(a)(3) seventh, eighth, and ninth sentences, (b), and (c) *Example 3,* may be relied upon for any liability incurred or assumed by a partnership prior to October 31, 2000 for federal taxable years ending on or after October 31, 2000. * * *

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2014–01637 Filed 1–29–14; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF JUSTICE

28 CFR Parts 35 and 36

[CRT Docket No. 124; AG Order No. 3410–2014]

RIN 1190–AA59

Office of the Attorney General; Amendment of Americans with Disabilities Act Title II and Title III Regulations to Implement ADA Amendments Act of 2008

AGENCY: Department of Justice, Civil Rights Division.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Department of Justice (Department) is issuing this Notice of Proposed Rulemaking (NPRM) to amend its Americans with Disabilities Act (ADA) regulations in order to incorporate the statutory changes to the ADA set forth in the ADA Amendments Act of 2008 (ADA Amendments Act or the Act), which took effect on January 1, 2009. Congress enacted the ADA Amendments Act in order to revise the ADA definition of ''disability'' and to ensure that the definition is broadly construed and applied without extensive analysis. In this NPRM, the Department is proposing to add new sections to its title II and title III ADA regulations at 28 CFR parts 35 and 36, respectively, to provide detailed definitions of ''disability'' and to make consistent changes in other sections of the regulations. The ADA Amendments Act authorizes the Attorney General to issue regulations consistent with the Act that implement the definitions of ''disability'' in sections 3 and 4 of the Act, including the rules of construction set forth in section 3. The Department invites written comments from members of the public on this proposed rule.

DATES: All comments must be submitted on or before March 31, 2014.

ADDRESSES: You may submit comments, identified by RIN 1190–AA59 (or Docket ID No. 124), by any one of the following methods:

- *Federal eRulemaking portal: www.regulations.gov.* Follow the Web site's instructions for submitting comments.
- *Regular U.S. mail:* Disability Rights Section, Civil Rights Division, U.S. Department of Justice, P.O. Box 2885, Fairfax, VA 22031–0885.
- *Overnight, courier, or hand delivery:* Disability Rights Section, Civil Rights Division, U.S. Department of Justice, 1425 New York Avenue, NW., Suite 4039, Washington, DC 20005.

FOR FURTHER INFORMATION CONTACT: Zita Johnson-Betts, Deputy Chief, Disability Rights Section, Civil Rights Division, U.S. Department of Justice, at (202) 307–0663 (voice or TTY); this is not a toll-free number. Information may also be obtained from the Department's toll-free ADA Information Line at (800) 514–0301 (voice) or (800) 514–0383 (TTY).

You may obtain copies of this NPRM in an alternative format by calling the ADA Information Line at (800) 514–0301 (voice) and (800) 514–0383 (TTY). This NPRM is also available on the ADA Home Page at *www.ada.gov.*

SUPPLEMENTARY INFORMATION: The regulatory definitions of ''disability'' in the title II and title III regulations are identical, and the preamble will discuss the revisions to both regulations concurrently. Because the ADA Amendments Act's revisions to the ADA have been codified into the U.S. Code, the NPRM will reference the revised U.S. Code provisions except in those cases where citation to a specific ADA Amendments Act provision is necessary in order to avoid confusion on the part of the reader.

This NPRM was submitted to the Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs for review prior to publication in the **Federal Register**.

Electronic Submission of Comments and Posting of Public Comments

You may submit electronic comments to *www.regulations.gov.* When submitting comments electronically, you must include ''DOJ–CRT 2010–0112'' in the subject field and you must include your full name and address. Electronic files should avoid the use of special characters or any form of encryption and should be free of any defects or viruses.

Please note that all comments received are considered part of the public record and made available for public inspection online at *www.regulations.gov.* Submission postings will include any personal identifying information (such as your name, address, etc.) included in the text of your comment. If you include personal identifying information (such as your name, address, etc.) in the text of your comment but do not want it to be posted online, you must include the phrase ''PERSONAL IDENTIFYING INFORMATION'' in the first paragraph of your comment. You must also include all the personal identifying information you want redacted along with this phrase. Similarly, if you submit confidential business information as part of your comment but do not want it to be posted online, you must include the phrase ''CONFIDENTIAL BUSINESS