



# TaxNewsFlash

## United States

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### **Proposed regulations: Allocations of partnership liabilities for disguised sale purposes (section 707)**

The U.S. Treasury Department and IRS today released for publication in the Federal Register a notice of proposed rulemaking (REG-131186-17) regarding how liabilities are allocated for disguised sale purposes.

Today's [proposed regulations](#) [PDF 229 KB] if finalized, would replace temporary regulations issued in October 2016 with final regulations in effect prior to that time. In addition, these proposed regulations withdraw the proposed section 707 regulations issued in October 2016.

#### **Background**

The Treasury Department and IRS in October 2016 issued three packages containing final, temporary, and proposed regulations under sections 707 and 752 relating to: (1) disguised sales of property involving partnerships; (2) allocations of partnership liabilities; and (3) a variety of other partnership-related items.

- Final regulations under section 707 concerned disguised sales of property to or by a partnership, and under section 752 as to allocations of excess nonrecourse liabilities of a partnership to partners for disguised sale purposes.
- Temporary regulations under section 707 concerned how liabilities are allocated for disguised sale purposes, and under section 752 as to when certain obligations are recognized for purposes of determining whether a liability is a recourse partnership liability (i.e. bottom dollar liabilities).
- Proposed regulations amended the section 707 regulations by including a cross reference to the section 707 temporary regulations and making changes to certain examples. The proposed regulations also amended the section 752 anti-abuse rule with respect to recourse liabilities, establishing factors that tended to indicate a

plan to circumvent or avoid an obligation, and established similar factors under section 704 with respect to whether certain deficit restoration obligations would be respected.

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Today's proposed regulations were issued in response to an Executive Order to mitigate the burden imposed by regulations previously identified as either imposing an undue financial burden on taxpayers, or adding excessive complexity to the tax system. Read [TaxNewsFlash](#)

Today's proposed regulations affect the section 707 temporary and proposed regulations. No change is proposed to be made to the sections 707 and 752 final regulations, the section 752 temporary regulations relating to bottom dollar liabilities or the section 752 and section 704 proposed regulations.

### **Proposed changes**

The 2016 section 707 temporary regulations determined a partner's share of all partnership liabilities (both recourse and nonrecourse) for disguised sale purposes under the third tier of section 1.752-3(a)(3), in accordance with the partner's share of profits consistent with the 2016 final regulations in section 1.752-3(a)(3). By treating all partnership liabilities as nonrecourse liabilities for disguised sale purposes, the section 707 temporary regulations largely eliminated leveraged partnership transactions.

Today's proposed regulations plan to withdraw the section 707 temporary regulations and reinstate the prior disguised sale rules that prescribed separate rules for determining a partner's share of partnership's recourse and nonrecourse liability. For recourse liabilities, the proposed regulations would essentially return to the law that was in effect prior to the temporary regulations. That is, for purposes of analyzing the disguised sale rules, a recourse liability would be allocated consistent with the risk of loss as determined under section 752. Recourse liability allocations would dictate disguised sale treatment both for purposes of analyzing debt-financed distributions and shifts in non-qualified liabilities. Nonrecourse liabilities would be allocated as excess nonrecourse liabilities consistent with the third tier under the section 752 regulations. The excess nonrecourse liabilities would be allocated in accordance with the partner's share of profits.

The proposed regulations also withdraw the 2016 section 707 proposed regulations.

### **Proposed effective date**

Although the temporary regulations are not proposed to be removed until 30 days following the date these regulations are published as final regulations in the *Federal Register*, partnership and its partners may apply the rules in these proposed

regulations, in lieu of the temporary regulations, to any transaction with respect to which all transfers occur on or after January 3, 2017.

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