

Final regs: Transfers to partnerships with related foreign partners

The IRS recently issued final regulations that address transfers of appreciated property by U.S. persons to partnerships that have partners who are related foreign persons — that is, foreign persons related to the transferor. The regs generally override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under Internal Revenue Code Section 721(a). They also largely finalize the 2017 proposed regs, with some modifications and clarifications.

Definition of a related person

The IRS has determined that a modification to the definition of related person is appropriate to limit the application of these rules in certain situations. Specifically, a new paragraph has been added that provides, for purposes of determining whether a person is a related person with respect to a U.S. transferor, that Sec. 267(b) is applied without regard to Sec. 267(c)(3).

This modification to the definition of related person provides relief when certain foreign individual partners of a partnership would be treated as a related person with respect to a domestic corporation because of Sec. 267(c)(3).

Consistent allocation method

The regs provide the requirements of the gain deferral method. Among the requirements, a Sec. 721(c) partnership must adopt the remedial allocation method and apply the consistent allocation method with respect to Sec. 721(c) property.

The consistent allocation method provides that, for each tax year of a Sec. 721(c) partnership in which there's remaining built-in gain in Sec. 721(c) property, the partnership must allocate each book item of income, gain, deduction and loss with respect to the property to the U.S. transferor in the same percentage for the tax year. However, it doesn't require the allocations to be in the same percentage among *all* tax years in which the gain deferral method is applied. The method, therefore, prevents a U.S. transferor from rendering the remedial allocation method ineffective by, for example, having the partnership allocate a higher percentage of book depreciation to the U.S. transferor than the U.S. transferor's percentage share of income or gain with respect to the Sec. 721(c) property.

Upon a variation of a U.S. transferor's interest in a Sec. 721(c) partnership, book items with respect to Sec. 721(c) property that are allocated under the interim closing method will be treated as allocated in the same percentage for purposes of applying the consistent allocation method in a single tax year. An exception is if the variation results from a transaction undertaken with a principal purpose of avoiding the tax consequences of the gain deferral method.

The modification to the consistent allocation method when the interim closing method is applied is intended to clarify that a U.S. transferor continues to comply with the consistent allocation method following certain economic events that don't close the tax year of the Sec. 721(c) partnership. Given the high thresholds required to be subject to these rules, the IRS has determined that allowing the partnership to choose the proration method is inappropriate for the consistent allocation method. A Sec.

t 305-774-2945
f 305-774-1504
e info@AbitOs.com



201 Alhambra Circle, Suite 701
Coral Gables, FL 33134

www.AbitOs.com

721(c) partnership should have the resources and capabilities to comply with the more precise interim closing method without incurring an undue burden.

Reporting

The final regs include the reporting requirements provided in the 2017 proposed regs regarding both gain deferral contributions and the annual reporting requirements with respect to Sec. 721(c) property to which the gain deferral method applies. The 2017 regs required much of the reporting to be on statements attached to returns.

Since the issuance of the 2017 regs, however, the IRS has updated and added new schedules to Form 8865, "Return of U.S. Persons With Respect to Certain Foreign Partnerships," to facilitate compliance with these reporting requirements. The agency has also issued new Form 8838-P, "Consent To Extend the Time To Assess Tax Pursuant to the Gain Deferral Method." The purpose of these changes is to include the information that previously was reported on the statements. The final regs require the use of these forms and schedules.

The final regs also clarify the duration for which the U.S. transferor must extend the period of limitations on the assessment of tax. One regulation clarifies the relevant periods to which Form 8838-P applies by measuring each period by the number of months occurring after the relevant date. Accordingly, the final regs measure each period by a fixed term that's determinable on the date of contribution.

Technical terminations

Sec. 708(b) generally provides that a partnership will terminate if it ceases to do business. Before the enactment of the Tax Cuts and Jobs Act (TCJA), former Sec. 708(b)(1)(B) provided another way for a partnership to terminate. That is, a partnership could terminate if, within any 12-month period, 50% or more of the total interest in partnership capital and profits was sold or exchanged — commonly referred to as a "technical termination."

The regs provided that a technical termination results in a deemed contribution of all the terminated partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to both the purchasing partners and the remaining partners. However, the TCJA repealed former Sec. 708(b)(1)(B) for all partnership tax years beginning after December 31, 2017; therefore, technical terminations no longer apply.

The 2017 regs provided rules regarding technical terminations in two contexts:

1. They provided that a partnership won't be treated as a Sec. 721(c) partnership following a deemed contribution that occurs as a result of a technical termination.
2. They treated certain technical terminations as successor events for purposes of the acceleration event exceptions provided in the regs.

The rules in the 2017 regs regarding technical terminations are retained in the final regs. Although the TCJA repealed former Sec. 708(b)(1)(B), the applicability date for the final regs relates back to the applicability date provided in the 2017 regs, which is before the effective date provided in the TCJA.

Accordingly, the rules provided in the final regs regarding technical terminations will have limited applicability; they'll apply only to technical terminations occurring on or after the applicability date

t 305-774-2945
f 305-774-1504
e info@AbitOs.com

201 Alhambra Circle, Suite 701
Coral Gables, FL 33134

www.AbitOs.com



provided in the 2017 regs but before the effective date for the repeal of former Sec. 708(b)(1)(B) provided in the TCJA.

Applicability dates

The final regs generally apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, that result from an entity classification election filed on or after August 6, 2015. However, various elections may affect applicability. Consult your CPA for more information and any other questions you might have about the final regs. •

t 305-774-2945
f 305-774-1504
e info@AbitOs.com

201 Alhambra Circle, Suite 701
Coral Gables, FL 33134

www.AbitOs.com

