

[4830-01-P]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9485]

RIN 1545-BF28

Contributed Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 704(c) of the Internal Revenue Code (Code) providing that the section 704(c) anti-abuse rule takes into account the tax liabilities of both the partners in a partnership and certain direct and indirect owners of such partners. These final regulations further provide that a section 704(c) allocation method cannot be used to achieve tax results inconsistent with the intent of subchapter K of the Code. The final regulations affect partnerships and their partners.

DATES: Effective Date: These final regulations are effective **(INSERT PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER)**.

Applicability Date: These final regulations are applicable for taxable years beginning after **(INSERT PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER)**.

FOR FURTHER INFORMATION CONTACT: Bryan A. Rimmke at  
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## SUPPLEMENTARY INFORMATION:

### **Background**

This document contains amendments to 26 CFR part 1 under section 704 of the Internal Revenue Code (Code). On May 19, 2008, a notice of proposed rulemaking (REG-100798-06, 2008-23 IRB 1135) was published in the **Federal Register** (73 FR 28765) in response to the Joint Committee on Taxation's recommendation that the partnership rules be strengthened to ensure that the allocation rules in the regulations under section 704(c) are not used to generate unwarranted benefits. See The Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations, (JCS-3-03) February 2003 at pg. 220. Because no requests to speak were submitted by August 18, 2008, no public hearing was held. Written comments, however, were received in response to the notice of proposed rulemaking. After consideration of these comments, the proposed regulations are adopted without change by this Treasury decision.

### **Summary of Comments and Explanation of Provisions**

The comments on the proposed regulations requested that examples be given to specifically describe the types of transactions to which these regulations apply. Additionally, the comments requested examples to describe the types of transactions which would not be abusive under this regulation but would be abusive under the general subchapter K anti-abuse rule found in §1.701-2. In light of the fact that these regulations are anti-abuse provisions and the factually intensive analysis needed to determine whether this regulation is applicable, the Treasury Department and the IRS decline to adopt these comments.

Additional comments requested that the Treasury Department and the IRS consider both a de minimis partner rule for direct partners similar to §1.704-1(b)(2)(iii) and a rule for indirect partners where the owners would need to be related to the look-through entity within the meaning of sections 267 or 707 in order to be considered indirect partners for the purposes of the regulation. For purposes of §1.704-1(b)(2)(iii), a de minimis partner is any partner, including a look-through entity, that owns less than 10 percent of the capital and profits of a partnership, and who is allocated less than 10 percent of each partnership item. The Treasury Department and the IRS have determined that neither a de minimis partner provision nor a related partner provision for indirect partners would conform to the intent of this anti-abuse provision and therefore decline to adopt such rules.

This Treasury decision adopts the proposed regulations without substantive change. Accordingly, the regulations amend §1.704-3(a)(10) to provide that, for purposes of applying the anti-abuse rule, both direct and indirect partners are considered. The final regulations provide that an indirect partner is any direct or indirect owner of a partnership, S corporation, or controlled foreign corporation (as defined in section 957(a) or 953(c)), or direct or indirect beneficiary of a trust or estate, that is a partner in the partnership, and any consolidated group of which the partner in the partnership is a member (within the meaning of §1.1502-1(h)). However, an owner of a controlled foreign corporation is treated as an indirect partner only with respect to the allocation of items that enter into the computation of a United States shareholder's inclusion under section 951(a) with respect to the controlled foreign corporation, enter into any person's income attributable to a United States shareholder's inclusion under

section 951(a) with respect to the controlled foreign corporation, or would enter into the computations described in this paragraph if such items were allocated to the controlled foreign corporation.

These final regulations further provide that the principles of section 704(c), together with the allocation methods described in §1.704-3, paragraphs (b), (c) and (d), apply only with respect to the contributions of property to the partnership. In that regard, the anti-abuse rule of §1.701-2(b) provides that, if a partnership is formed or availed of in connection with a transaction a principal purpose of which is to reduce substantially the present value of the partners' Federal tax liability in a manner inconsistent with the intent of subchapter K, the IRS may recast the transaction for Federal tax purposes as appropriate to achieve tax results that are consistent with the intent of subchapter K. Thus, even though a transaction may satisfy the literal words of the statute or regulations, the IRS may recast a transaction as appropriate to avoid tax results that are inconsistent with the intent of subchapter K, including but not limited to: (i) disregarding purported partnerships, in whole or part, so that partnership assets are treated as owned by the partner; (ii) disregarding one or more contributions or (iii) disregarding one or more purported partners. The final regulations also provide that, in determining if a purported contribution of property to a partnership should be recast to avoid results that are inconsistent with subchapter K, one factor that may be relevant is the use of the remedial method in which allocations of remedial items of income, gain, loss or deduction are made to one partner and allocations of offsetting remedial items are made to a related partner.

#### **Effective/Applicability Date**

These regulations apply to taxable years beginning after **(INSERT PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER)**. No inference should be drawn from this effective date with respect to prior law.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Drafting Information**

The principal author of these final regulations is Bryan A. Rimmke, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is 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 \* \* \*

Par. 2. Section 1.704-3 is amended by:

1. Adding four sentences to paragraph (a)(1) at the end of the last sentence and revising paragraph (a)(10).

2. Revising the first sentence of paragraph (f) and adding one sentence to the end of the paragraph.

The revisions and additions read as follows:

§1.704-3 Contributed property.

(a) \* \* \* (1) \* \* \* The principles of this paragraph (a)(1), together with the methods described in paragraphs (b), (c) and (d) of this section, apply only to contributions of property that are otherwise respected. See for example §1.701-2. Accordingly, even though a partnership's allocation method may be described in the literal language of paragraphs (b), (c) or (d) of this section, based on the particular facts and circumstances, the Commissioner can recast the contribution as appropriate to avoid tax results inconsistent with the intent of subchapter K. One factor that may be considered by the Commissioner is the use of the remedial allocation method by related partners in which allocations of remedial items of income, gain, loss or deduction are made to one partner and the allocations of offsetting remedial items are made to a related partner.

\* \* \* \* \*

(10) Anti-abuse rule--(i) In general. An allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. For purposes of this paragraph (a)(10), all references to the partners shall include both direct and indirect partners.

(ii) Definition of indirect partner. An indirect partner is any direct or indirect owner of a partnership, S corporation, or controlled foreign corporation (as defined in section 957(a) or 953(c)), or direct or indirect beneficiary of a trust or estate, that is a partner in the partnership, and any consolidated group of which the partner in the partnership is a member (within the meaning of §1.1502-1(h)). An owner (whether directly or through tiers of entities) of a controlled foreign corporation is treated as an indirect partner only with respect to allocations of items of income, gain, loss, or deduction that enter into the computation of a United States shareholder's inclusion under section 951(a) with respect to the controlled foreign corporation, enter into any person's income attributable to a United States shareholder's inclusion under section 951(a) with respect to the controlled foreign corporation, or would enter into the computations described in this sentence if such items were allocated to the controlled foreign corporation.

\* \* \* \* \*

(f) Effective/Applicability Dates. With the exception of paragraphs (a)(1), (a)(8)(ii), (a)(8)(iii), (a)(10), and (a)(11) of this section, this section applies to properties

contributed to a partnership and to restatements pursuant to §1.704-1(b)(2)(iv)(f) on or after December 21, 1993. \* \* \* Paragraphs (a)(1) and (a)(10) of this section are applicable for taxable years beginning after **(INSERT PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER)**.

Linda E. Stiff,  
Deputy Commissioner for Services and Enforcement.

Approved: May 28, 2010.

Michael Mundaca,  
Assistant Secretary of the Treasury (Tax Policy).

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