DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9788]

RIN 1545–BM84

Liabilities Recognized as Recourse Partnership Liabilities Under Section 752

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations concerning how liabilities are allocated for purposes of section 707 of the Internal Revenue Code (Code) and when certain obligations are recognized for purposes of determining whether a liability is a recourse partnership liability under section 752. These regulations affect partnerships and their partners. The text of these temporary regulations serves as part of the text of proposed regulations (REG–122855–15) published in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective date:* These regulations are effective on October 5, 2016.

Applicability dates: For dates of applicability, see §§ 1.707–9T(a)(4) and 1.752–2T(l)(2).

FOR FURTHER INFORMATION CONTACT: Concerning the final and temporary regulations, Caroline E. Hay or Deane M. Burke, (202) 317–5279.

SUPPLEMENTARY INFORMATION: In addition to these final and temporary regulations, the Treasury Department and the IRS are publishing in the Rules and Regulations section in this issue of the **Federal Register**, final regulations under section 707 concerning disguised sales and under section 752 regarding the allocation of excess nonrecourse liabilities of a partnership to a partner, and, in the Proposed Rules section in this issue of the **Federal Register**, proposed regulations (REG–122855–15) that incorporate the text of these temporary regulations, withdraw a portion of a notice of proposed rulemaking (REG–119305–11) to the extent not adopted by the final regulations, and contain new proposed regulations addressing (1) when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 and (2) when partnership liabilities are treated as recourse liabilities under section 752.

Paperwork Reduction Act

The collection of information related to these final and temporary regulations under section 752 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.

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.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**.

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

1. Overview

This Treasury decision contains final and temporary regulations that amend the Income Tax Regulations (26 CFR part 1) under sections 707 and 752 of the Code. On January 30, 2014, the Treasury Department and the IRS published a notice of proposed rulemaking in the **Federal Register** (REG–119305–11, 79 FR 4826) to amend the then existing regulations under section 707 relating to disguised sales of property to or by a partnership and under section 752 concerning the treatment of partnership liabilities (the 2014 Proposed Regulations). The 2014 Proposed Regulations provided certain technical rules intended to clarify the application of the disguised sale rules under section 707 and also contained rules regarding the sharing of partnership recourse and nonrecourse liabilities under section 752.

A public hearing on the 2014 Proposed Regulations was not requested or held, but the Treasury Department and the IRS received written comments.

Based on a comment received on the 2014 Proposed Regulations requesting that guidance provided under section 752 regarding a partner's share of partnership liabilities apply instead solely for disguised sale purposes, the Treasury Department and the IRS have reconsidered the rules under § 1.707–5(a)(2) of the 2014 Proposed Regulations for determining a partner's share of partnership liabilities for purposes of section 707. Accordingly and as recommended by that commenter, this Treasury decision contains temporary regulations under section 707 (the 707 Temporary Regulations) that require a partner to apply the same percentage used to determine the partner's share of excess nonrecourse liabilities under § 1.752–3(a)(3) (with certain limitations) in determining the partner's share of partnership liabilities for disguised sale purposes. This Treasury decision also contains temporary regulations under section 752 (the 752 Temporary Regulations) providing guidance on the treatment of ''bottom dollar payment obligations.'' Cross-referencing proposed regulations providing additional opportunity for comment are contained in the related notice of proposed rulemaking (REG–122855–15) published in the Proposed Rules section in this issue of the **Federal Register**. The Summary of Comments and Explanation of Provisions section of the preamble of this Treasury decision discusses the changes for determining a partner's share of partnership liabilities for disguised sale purposes and also the rules relating to certain ''bottom dollar payment obligations.''

The Treasury Department and the IRS are also publishing final regulations under section 707 (the 707 Final Regulations) in a separate Treasury decision (TD 9787) published in the Rules and Regulations section in this issue of the **Federal Register** that adopt the remaining provisions of the 2014 Proposed Regulations under section 707. That Treasury decision also contains final regulations under section 752 (the 752 Final Regulations) concerning the allocation of a partnership's excess nonrecourse liabilities as explained in the Summary of Comments and Explanation of Provisions sections of that Treasury decision.

Finally, after considering comments on the 2014 Proposed Regulations under section 752, the Treasury Department and the IRS are withdrawing proposed § 1.752–2 and are issuing new proposed regulations (the 752 Proposed Regulations) contained in the related notice of proposed rulemaking (REG–122855–15) published in the Proposed Rules section in this issue of the **Federal Register**.

2. Summary of Applicable Law

In determining a partner's share of a partnership liability for disguised sale purposes, the existing regulations under section 707 prescribe separate rules for a partnership's recourse liability and a partnership's nonrecourse liability. Under § 1.707–5(a)(2)(i), a partner's share of a partnership's recourse liability equals the partner's share of the liability under section 752 and the regulations thereunder. A partnership liability is a recourse liability under section 707 to the extent that the obligation is a recourse liability under § 1.752–1(a)(1). Under § 1.707–5(a)(2)(ii), a partner's share of a partnership's nonrecourse liability is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under § 1.752–3(a)(3). Generally, a partner's share of the excess nonrecourse liability is determined in accordance with the partner's share of partnership profits taking into account all facts and circumstances relating to the economic arrangement of the partners. A partnership liability is a nonrecourse liability under section 707 to the extent that the obligation is a nonrecourse liability under § 1.752–1(a)(2). In addition, the existing regulations under section 707 provide that a partnership liability is a recourse or nonrecourse liability to the extent the liability would be recourse under § 1.752–1(a)(1) or nonrecourse under § 1.752–1(a)(2), respectively, if the liability was treated as a partnership liability for purposes of section 752 (§ 1.752–7 contingent liabilities).

Section 1.752–1(a)(1) provides that a partnership liability is a recourse liability to the extent that a partner or related person bears the economic risk of loss (EROL) for that liability under § 1.752–2. Section 1.752–2(a) provides 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 EROL. Section 1.752–1(a)(2) provides that a partnership liability is a nonrecourse liability to the extent that no partner or related person bears the EROL for that liability under § 1.752–2. A partner generally bears the EROL for a partnership liability if the partner or related person has an obligation to make a payment under § 1.752–2(b). A partner generally has an obligation to make a payment to the extent that the partner or related person would have to make a payment if, upon a constructive liquidation of the partnership, the partnership's assets were worthless and the liability became due and payable (constructive liquidation test). Section 1.752–2(b)(6) presumes partners and related persons will satisfy their payment obligations irrespective of their net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation.

Summary of Comments and Explanation of Provisions

1. Partner's Share of Partnership Liabilities for Purposes of Section 707

The withdrawn portions of the 2014 Proposed Regulations included proposed changes to § 1.752–2 that were intended to ensure that only genuine commercial payment obligations, including guarantees and indemnities, affected the allocation of partnership liabilities. Although the 2014 Proposed Regulations received some unfavorable comments, one commenter expressed support for the overall objective of those proposed rules. According to the commenter, the clear effect of the 2014 Proposed Regulations under section 752 was to make it more likely that liabilities would be treated as nonrecourse liabilities, and thus allocable under § 1.752–3. The commenter noted that such an effect seems appropriate as an economic matter, because, contrary to the constructive liquidation test in § 1.752–2(b)(1), lenders, borrowers, and credit support providers generally do not expect that the assets of the partnership will become worthless. Rather, lenders, borrowers and credit support providers generally expect borrowers (including partnerships) to satisfy their obligations (in the case of a partnership, with partnership profits). However, the commenter expressed concerns with the proposed section 752 rules. The commenter suggested that the regulations adopt a more narrowly tailored approach that treats all liabilities as nonrecourse liabilities for section 707 disguised sale purposes only.

Other commenters also suggested that changes to the liability allocation rules be limited to the context of disguised sales under section 707 to specifically address the abuses that concern the Treasury Department and the IRS. One abuse relating to disguised sales within the meaning of § 1.707–3 concerns the debt-financed distribution exception under § 1.707–5(b). Under this exception, a distribution of money to a partner by a partnership is not taken into account for purposes of § 1.707–3 to the extent that 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 legislative history to section 707, upon which the debt-financed distribution exception in § 1.707–5(b) is based, contemplates a contributing partner borrowing through the partnership rather than engaging in a disguised sale when the partner, in substance, retains liability for repayment of the borrowed amounts. See H.R. Rep. No. 861, 98th Cong., 2d Sess. 859 (1984). This exception, however, has been abused through leveraged partnership transactions in which the contributing partners or related persons enter into payment obligations that are not commercial solely to achieve an allocation of the partnership liability to the partner, with the objective of avoiding a disguised sale. See, for example, *Canal Corp.* v. *Commissioner,* 135 T.C. 199, 216 (2010) (''We have carefully considered the facts and circumstances and find that the indemnity agreement should be disregarded because it created no more than a remote possibility that [the indemnitor] would actually be liable for payment.'').

After considering the comments on the 2014 Proposed Regulations suggesting that the regulations be narrowly tailored to address abuse concerns relating to disguised sales, the Treasury Department and the IRS have concluded that, for disguised sale purposes only, it is appropriate for partners to determine their share of any partnership liability, whether recourse or nonrecourse under section 752, in the manner in which excess nonrecourse liabilities are allocated under § 1.752–3(a)(3), as limited for disguised sale purposes in the 752 Final Regulations. For purposes of the disguised sale rules, this allocation method reflects the overall economic arrangement of the partners more accurately than the current regulations or the 2014 Proposed Regulations. 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. This is true whether: (1) A partner's liability is assumed by a partnership in connection with a transfer of property to the partnership or by a partner in connection with a transfer of property by the partnership to the partner; (2) a partnership takes property subject to a liability in connection with a transfer of property to the partnership or a partner takes property subject to a liability in connection with a transfer of property

by the partnership to the partner; or (3) a liability is incurred by the partnership to make a distribution to a partner under the debt-financed distribution exception in § 1.707–5(b). Accordingly, under the 707 Temporary Regulations, a partner's share of any partnership liability for disguised sale purposes is the same percentage used to determine the partner's share of the partnership's excess nonrecourse liabilities under § 1.752–3(a)(3), as limited for disguised sale purposes under the 752 Final Regulations.

Commenters also suggested that a partner's share of a partnership liability for disguised sale purposes should not include any portion of the liability for which another partner bears the EROL, as these liabilities would not be allocated to a partner without EROL under general principles of subchapter K. The Treasury Department and the IRS agree with the commenter that this change should not create a liability allocation not otherwise allowed under general subchapter K principles. Therefore, the 707 Temporary Regulations provide that a partner's share of a partnership liability for disguised sale purposes does not include any amount of the liability for which another partner bears the EROL for the partnership liability under § 1.752–2.

The liability allocation approach for disguised sale purposes in the 707 Temporary Regulations does not conflict with Congress's directive relating to section 752, which had been raised as a potential concern by some commenters with respect to the 2014 Proposed Regulations. Section 79 of the Deficit Reduction Act of 1984 (Pub. L. 98–369) 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 liability) and directed the Secretary of the Treasury to amend the regulations under section 752 to reflect the overruling of the *Raphan* decision. At issue in the *Raphan* case was debt allocation under section 752; accordingly, Congress's directive related to regulations under section 752 only. As noted, the 707 Temporary Regulations treat all partnership liabilities, whether recourse or nonrecourse, as nonrecourse liabilities solely for purposes of section 707. Thus, the approach adopted in the 707 Temporary Regulations does not conflict with the approach directed by Congress after the *Raphan* case.

Finally, in addition to the rule for determining a partner's share of a § 1.752–1(a) partnership liability for disguised sale purposes, the 707 Temporary Regulations reserve with respect to the treatment of § 1.752–7 contingent liabilities for disguised sale purposes. The 2014 Proposed Regulations proposed removing the ''would be treated'' language in § 1.707–5(a)(2)(i) and (ii) of the existing regulations relating to contingent liabilities. The 707 Temporary Regulations replace the proposed provisions with the previously discussed rule for determining a partner's share of a partnership liability as defined in § 1.752–1(a). Because the 2014 Proposed Regulations would have removed language relating to § 1.752–7 contingent liabilities, some commenters suggested that the regulations specifically clarify how contingent liabilities are treated for purposes of the disguised sale rules. The Treasury Department and the IRS agree that clarification of the treatment of § 1.752–7 contingent liabilities for disguised sale purposes is warranted.

In many cases, § 1.752–7 contingent liabilities may constitute qualified liabilities that would not be taken into account for purposes of determining a disguised sale. However, some commenters noted that there may be circumstances in which certain transfers of § 1.752–7 contingent liabilities to a partnership may be abusive. Thus, the Treasury Department and the IRS will continue to study the issue of the effect of contingent liabilities with respect to section 707, as well as other sections of the Code, in connection with future guidance projects.

2. Determining Whether a Liability Is a Recourse Liability of a Partnership

The 752 Temporary Regulations amend § 1.752–2 to address certain payment obligations of a partner or related person. The Treasury Department and the IRS continue to have concerns that partners and related persons are entering into payment obligations that are not commercial solely to achieve an allocation of a partnership liability.

Under the 2014 Proposed Regulations, a partner's or related person's payment obligation with respect to a partnership liability would not have been recognized under § 1.752–2(b)(3) unless seven factors (recognition factors) were satisfied. Two of the seven recognition factors imposed certain additional requirements on contractual obligations outside a partnership agreement, such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors, other partners, or to the partnership (guarantee and indemnity recognition factors). In the case of a guarantee or similar arrangement, the 2014 Proposed Regulations would have required the partner or related person to 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. In the case of an indemnity, reimbursement agreement, or similar arrangement, the 2014 Proposed Regulations would have required the partner or related person to 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 benefited party's payment obligation is satisfied. The terms of the guarantee, indemnity, or reimbursement agreement would be treated as modified by any right of indemnity, reimbursement agreement, or similar arrangement. However, a right of proportionate contribution running between partners or related persons who were co-obligors with respect to a payment obligation for which each of them was jointly and severally liable would not modify a guarantee, indemnity, or reimbursement agreement. If the partner's or related person's payment obligation failed to satisfy any of the recognition factors, the payment obligation was not recognized and the partner would not bear EROL for the partnership liability. In addition to the guarantee and indemnity recognition factors, a partner's or related person's payment obligation with respect to a partnership liability would not be recognized under an anti-abuse rule in the 2014 Proposed Regulations if the facts and circumstances indicated that the partnership liability was part of a plan or arrangement involving the use of tiered partnerships, intermediaries, or similar arrangements to convert a single liability into multiple liabilities with a principal purpose of circumventing the guarantee and indemnity recognition factors.

The Treasury Department and the IRS continue to believe that certain obligations, such as certain so-called ''bottom-dollar guarantees,'' should generally not be recognized as payment obligations under § 1.752–2(b)(3) because they generally lack a significant non-tax commercial business purpose. No commenters suggested that bottom-dollar guarantees were relevant to loan risk underwriting. Accordingly, the 752 Temporary Regulations retain the

restriction on certain guarantees and indemnities and provide that these payment obligations are not recognized under § 1.752–2(b)(3). In addition, these regulations remove the *Example* in § 1.752–2(j)(4) to comport with the provisions in the 752 Temporary Regulations relating to bottom dollar payment obligations. However, after considering the comments received on the 2014 Proposed Regulations, the 752 Temporary Regulations provide for an exception as well as an anti-abuse rule to address arrangements that are not intended to be subject to this rule.

A. General Rule: Bottom Dollar Payment Obligations

Although the 752 Temporary Regulations retain the restriction relating to certain guarantees and indemnities, these temporary regulations refine the description of non-commercial obligations in response to comments. Commenters expressed concerns with the 2014 Proposed Regulations' description of so-called ''bottom-dollar guarantees and indemnities.'' Commenters thought the language was confusing. In addition, with respect to the anti-abuse rule in the 2014 Proposed Regulations, one commenter believed that ''tranches'' of debt could be used to effect arrangements that are economically similar to ''bottom-dollar guarantees'' and recommended that the regulations strengthen the anti-abuse rule. This commenter suggested that two or more liabilities be treated as a single liability if: (1) The liabilities are incurred pursuant to a common plan, as part of a single transaction, or as part of a series of related transactions; (2) the liabilities have the same counterparty or counterparties (or substantially the same group of counterparties); or (3) the guarantee or similar arrangement would fail the guarantee recognition factor if the liabilities were treated as a single liability; and (4) multiple liabilities (rather than a single liability) were incurred with a principal purpose of avoiding the guarantee recognition factor.

In response to comments, the 752 Temporary Regulations clarify the description of so-called ''bottom-dollar guarantees and indemnities'' by consolidating these non-commercial obligations under one term: Bottom-dollar payment obligations. In addition, instead of having an anti-abuse rule to address arrangements that use tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements, the 752 Temporary Regulations define these arrangements as bottom dollar payment obligations if certain factors, taking into account the commenter's suggestion, exist. Therefore, under the 752 Temporary Regulations, the term ''bottom dollar payment obligation'' includes (subject to certain exceptions): (1) Any payment obligation other than one in which 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 (A) any amount of the partnership liability is not otherwise satisfied in the case of an obligation that is a guarantee or other similar arrangement, or (B) any amount of the indemnitee's or benefited party's payment obligation is satisfied in the case of an obligation which is an indemnity or similar arrangement; and (2) an arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred (A) pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and (B) with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation. Any payment obligation under § 1.752–2, including an obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership as described in § 1.704–1(b)(2)(ii)(*b*)(*3*), may be a bottom dollar payment obligation if it meets the requirements set forth above.

The preamble of the 2014 Proposed Regulations requested comments on whether and under what circumstances regulations should permit recognition of a payment obligation for a portion, rather than 100 percent, of each dollar of a partnership liability to which the payment relates (a ''vertical slice'' of a partnership liability). The commenters believed that regulations under section 752 should recognize a vertical slice of a partnership liability because these payment obligations represent the same economic risk as a guarantee, for example, of the entire partnership liability.

The Treasury Department and the IRS agree with the commenters that certain obligations, including a vertical slice of a partnership liability, should not cause a payment obligation to be a bottom dollar payment obligation and, thus, not recognized under § 1.752–2(b)(3). In addition, the Treasury Department and the IRS have determined that, as long as a partner or related person is or would be liable for the full amount of a payment obligation, such obligation is not a bottom dollar payment obligation merely because a maximum amount is placed on the partner's or related person's obligation. Accordingly, the 752 Temporary Regulations specifically except certain payment obligations within those parameters, including obligations with joint and several liability, from being treated as bottom dollar payment obligations.

B. Exception From Treatment as a Bottom Dollar Payment Obligation

In addition to comments relating to the description of ''bottom-dollar guarantees'' and the anti-abuse rule in the 2014 Proposed Regulations, commenters expressed concerns that the guaranty and indemnity recognition factors would deprive a partner from being allocated a liability even in situations where there is real EROL. One commenter described the 2014 Proposed Regulations as prejudging all payment obligations to be remote and fictitious if the obligations did not cover 100 percent of any shortfall in repayment. The commenter believed EROL could exist even if 100 percent of the liability was not covered.

Another commenter appreciated the merits of a bright-line rule that would look to every dollar of a liability, but thought that the 100 percent threshold was too high. This commenter recommended that a payment obligation should be respected if a partner or related person (i) 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, less than 80 percent of the partnership liability is not otherwise satisfied and (ii) either (A) the taxpayer or the IRS clearly establishes that the credit support materially decreased the partnership's borrowing costs with respect to the liability or materially enhanced the other terms of the borrowing, or (B) the partners (or persons related to one or more of the partners), in the aggregate, are or would be liable up to the full amount of their payment obligations if, and to the extent that, any amount of the partnership liability is not otherwise satisfied. The commenter believed that this lower threshold incorporates the idea that a person may have meaningful risk with respect to the underlying liability, while protecting the legitimate interests of the government in ensuring that the lower threshold is not abused by taxpayers.

The Treasury Department and the IRS recognize that, in certain circumstances, it might be appropriate to treat a partner as bearing EROL with respect to a

payment obligation that would be characterized as a bottom dollar payment obligation under the general rule. What otherwise would be a bottom dollar payment obligation can be distinguished in a situation where the partners have allocated the risk among themselves, and the person making the bottom dollar payment obligation is liable for at least 90 percent of the person's payment obligation (because the person is not entitled to indemnification or reimbursement for more than 10 percent of the person's payment obligation). For example, if one partner (Partner A) guarantees 100 percent of a partnership liability and another partner (Partner B) indemnifies Partner A for the first one percent of Partner A's obligation, Partner A's obligation would be characterized as a bottom dollar payment obligation under the general rule because Partner A would not be liable to the full extent of the guarantee if any amount of the partnership liability is not otherwise satisfied (because Partner A would be reimbursed due to Partner B's indemnity). To address this concern, the 752 Temporary Regulations provide an exception if a partner or related person has a payment obligation that would be recognized (initial payment obligation) under § 1.752–2T(b)(3) but for the effect of an indemnity, reimbursement agreement, or similar arrangement. Such bottom dollar payment obligation is recognized under § 1.752–2T(b)(3) if, taking into account the indemnity, reimbursement agreement, or similar arrangement, the partner or related person is liable for at least 90 percent of the initial payment obligation. This obligation, like any other payment obligation, must otherwise be recognized under § 1.752–2, including under the anti-abuse rules in § 1.752–2(j).

C. Anti-Abuse Rule

Some commenters noted that partners could manipulate contractual arrangements to achieve a federal income tax result that is not consistent with the economics of an arrangement. For example, a partner could deliberately fail one of the recognition factors in the 2014 Proposed Regulations (including the guarantee or indemnity recognition factor) to cause a partnership liability to be treated as nonrecourse even when one partner has true EROL. Just as the 752 Temporary Regulations provide an exception for certain obligations that meet the definition of a bottom dollar payment obligation but give rise to EROL, the 752 Temporary Regulations also provide an anti-abuse rule in § 1.752–2T(j)(2) that the Commissioner may apply to ensure that if a partner actually bears EROL for a partnership liability, partners may not agree among themselves to create a bottom dollar payment obligation so that the liability will be treated as nonrecourse.

Section 1.752–2(j)(2) of the existing regulations currently provides that, irrespective of the form of a contractual obligation, a partner is considered to bear the EROL with respect to a partnership liability, or a portion thereof, to the extent that: (A) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain a loan; (B) the contractual obligations of the partner or related person eliminate substantially all the risk to the lender that the partnership will not satisfy its obligations under the loan; and (C) one of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests. The 752 Temporary Regulations expand § 1.752–2(j)(2) to include situations in which a partner is considered to bear the EROL irrespective of a bottom dollar payment obligation.

D. Disclosure Requirement

The 752 Temporary Regulations require the partnership to disclose to the IRS all bottom dollar payment obligations with respect to a partnership liability on a completed Form 8275, Disclosure Statement, attached to the partnership return for the taxable year in which the bottom dollar payment obligation is undertaken or modified. That disclosure must identify the payment obligation with respect to which disclosure is made including the amount of the payment obligation and the parties to the payment obligation. If a bottom dollar payment obligation meets the exception, the partnership must also disclose to the IRS on Form 8275 the facts and circumstances that clearly establish that a partner or related person is liable for up to 90 percent of the partner's or related person's initial payment obligation and, but for an indemnity, reimbursement agreement, or similar arrangement, the partner's or related person's payment obligation would have been recognized.

Effective/Applicability Date

With respect to changes under § 1.707–5, the 707 Temporary Regulations apply to any transaction with respect to which all transfers occur on or after January 3, 2017. In addition, with respect to the changes under § 1.752–2, the 752 Temporary Regulations apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken with respect to a partnership liability on or after October 5, 2016, 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.

The 2014 Proposed Regulations provided for an effective date similar to the one in these final and temporary regulations. A commenter recommended that partnerships be permitted to elect to apply all, but not less than all, of the provisions of the final regulations to all of its liabilities and payment obligations with respect to its liabilities after the effective date of the final regulations. These 752 Temporary Regulations adopt that change; therefore, partnerships may apply all the provisions contained in the 752 Temporary Regulations to all of their liabilities as of the beginning of the first taxable year of the partnership ending on or after October 5, 2016.

Commenters on the 2014 Proposed Regulations also recommended that partnership liabilities or payment obligations that are modified or refinanced continue to be subject to the provisions of the existing regulations to the extent of the amount and duration of the pre-modification (or refinancing) liability or payment obligation. The 752 Temporary Regulations do not adopt this recommendation as the terms of the partnership liabilities and payment obligations could be changed, which would affect the determination of whether or not an obligation is a bottom dollar payment obligation.

The 752 Temporary Regulations do, however, provide transition 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 temporary regulations are finalized. Under this transitional relief, the partner can continue to apply the existing regulations under § 1.752–2 with respect to a partnership liability 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 October 5, 2016. 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 tax gain (including

section 704(c) gain) allocated to the partner less that partner's share of amount realized.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact 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.

Although the temporary regulations under sections 707 and 752 respond to comments received in response to the 2014 Proposed Regulations, the Treasury Department and the IRS have determined that the regulations would benefit from additional notice and comment instead of being published as final regulations. In addition, decisions made in the final regulations under section 707 contained in a separate Treasury decision (TD 9787) published in the Rules and Regulations section in this issue of the **Federal Register** interact with the changes in the 707 Temporary Regulations regarding how liabilities are allocated for disguised sale purposes. Finally, pursuant to authority under section 7805(b) of the Code, the temporary regulations under sections 707 and 752 are necessary to address particular abuses as described in the Summary of Comments and the Explanation of Provisions section of the preamble of this Treasury decision. For these reasons, good cause also exists pursuant to 5 U.S.C. 553 to issue temporary regulations.

For applicability of the Regulatory Flexibility Act, please refer to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Caroline E. Hay and Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs & Special Industries), IRS. However, other personnel from the Treasury Department and the IRS 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 * * *

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

■ **Par. 2.** Section 1.707–5 is amended by revising paragraph (a)(2) and Examples 2, 3, 7, and 8 in paragraph (f) to read as follows:

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

(a) * * *

(2) [Reserved]. For further guidance, see § 1.707–5T(a)(2).

* * * * *

(f) * * *

Example 2. [Reserved]. For further guidance, see § 1.707–5T(f) *Example 2.*

Example 3. [Reserved]. For further guidance, see § 1.707–5T(f) *Example 3.*

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Example 7. [Reserved]. For further guidance, see § 1.707–5T(f) *Example 7.*

Example 8. [Reserved]. For further guidance, see § 1.707–5T(f) *Example 8.*

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■ **Par. 3.** Section 1.707–5T is added to read as follows:

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

(a)(1) [Reserved]. For further guidance, see § 1.707–5(a)(1).

(2) *Partner's share of liability*—(i) *In general.* For purposes of § 1.707–5, a partner's share of a liability of a partnership, as defined in § 1.752–1(a) (whether a recourse liability or a nonrecourse liability) is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under § 1.752–3(a)(3) (as limited in its application to this paragraph (a)(2)), without including in such partner's share any amount of the liability for which another partner bears the economic risk of loss for the partnership liability under § 1.752–2.

(ii) *Partner's share of § 1.752–7 liability.* [Reserved].

(a)(3) through (e) [Reserved]. For further guidance, see § 1.707–5(a)(3) through (e).

(f) *Example 1* [Reserved]. For further guidance, see § 1.707–5(f) *Example 1.*

Example 2. Partnership's assumption of recourse liability encumbering transferred property. (i) C transfers property Y to a partnership in which C has a 50 percent interest. At the time of its transfer to the partnership, property Y has a fair market value of $10,000,000 and is subject to an $8,000,000 liability that C incurred and guaranteed, immediately before transferring property Y to the partnership, in order to finance other expenditures. Upon the transfer of property Y to the partnership the partnership assumed the liability encumbering that property. Under section 752 and the regulations thereunder, immediately after the partnership's assumption of the liability encumbering property Y, the liability is a recourse liability of the partnership and C's share of that liability is $8,000,000.

(ii) Under the facts of this example, the liability encumbering property Y is not a qualified liability. Accordingly, the partnership's assumption of the liability results in a transfer of consideration to C in connection with C's transfer of property Y to the partnership. Notwithstanding C's share of the liability for section 752 purposes, for disguised sale purposes, C's share of the liability immediately after the partnership's assumption is $4,000,000 (50 percent of $8,000,000) under paragraph (a)(2) of this section (which determines a partner's share of a liability using the percentage under § 1.752–3(a)(3)). Therefore, the amount of consideration to C is $4,000,000 (the excess of the liability assumed by the partnership ($8,000,000) over C's share of the liability for purposes of § 1.707–5(a) immediately after the assumption ($4,000,000)). See § 1.707–5(a)(1) and paragraph (a)(2) of this section.

Example 3. Subsequent reduction of transferring partner's share of liability. (i) The facts are the same as in *Example 2.* In addition, property Y is a fully leased office building, the rental income from property Y is sufficient to meet debt service, and the remaining term of the liability is ten years. It is anticipated that, three years after the partnership's assumption of the liability, C's share of the liability under paragraph (a)(2) of this section will be reduced to $2,000,000 because of a shift in the allocation of partnership profits pursuant to the terms of the partnership agreement which provide that C's share of the partnership profits will be 25 percent at that time. Under the partnership agreement, this shift in the allocation of partnership profits is dependent solely on the passage of time.

(ii) Under § 1.707–5(a)(3), if the reduction in C's share of the liability was anticipated at the time of C's transfer, was not subject to the entrepreneurial risks of partnership operations, and was part of a plan that has as one of its principal purposes minimizing the extent of sale treatment under § 1.707–3 (that is, a principal purpose of allocating a larger percentage of profits to C in the first three years when profits were not likely to be realized was to minimize the extent to which C's transfer would be treated as part of a sale), C's share of the liability immediately after the partnership's assumption is treated as equal to C's reduced share of $2,000,000. Therefore, the amount of consideration to C is $6,000,000 (the excess of the liability assumed by the partnership ($8,000,000) over

C's share of the liability for purposes of § 1.707–5(a) immediately after the assumption ($2,000,000)), taking into account the anticipated reduction in C's share of the liability pursuant to the terms of the partnership agreement. See § 1.707–5(a)(1) and (3) and paragraph (a)(2) of this section.

Examples 4 through *6* [Reserved]. For further guidance, see § 1.707–5(f) *Examples 4* through *6.*

Example 7. Partnership's assumptions of liabilities encumbering properties transferred pursuant to a plan. (i) Pursuant to a plan, G and H transfer property 1 and property 2, respectively, to an existing partnership in exchange for a one-third interest each in the partnership. At the time the properties are transferred to the partnership, property 1 has a fair market value of $10,000 and an adjusted tax basis of $6,000, and property 2 has a fair market value of $10,000 and an adjusted tax basis of $4,000. At the time properties 1 and 2 are transferred to the partnership, a $6,000 nonrecourse liability (liability 1) is secured by property 1 and a $9,000 recourse liability of H (liability 2) is secured by property 2. Properties 1 and 2 are transferred to the partnership, and the partnership takes property 1 subject to liability 1 and assumes liability 2. After the transfer of liability 2 to the partnership, H bears the economic risk of loss for the entire amount of liability 2 under § 1.752–2. G and H incurred liabilities 1 and 2 immediately prior to transferring properties 1 and 2 to the partnership and used the proceeds for personal expenditures. The liabilities are not qualified liabilities. For disguised sale purposes, assume that G's and H's share of liability 1 is $2,000 each in accordance with paragraph (a)(2) of this section (which determines a partner's share of a liability using the percentage under § 1.752–3(a)(3) without including in such partner's share any amount of the liability for which another partner bears the economic risk of loss for the liability under § 1.752–2). Also, in accordance with paragraph (a)(2) of this section, G's share of liability 2 is zero and H's share of liability 2 is $3,000.

(ii) G and H transferred properties 1 and 2 to the partnership pursuant to a plan. Accordingly, pursuant to § 1.707–5(a)(1) and (4), the partnership's taking property 1 subject to liability 1 is treated as a transfer of only $4,000 of consideration to G (the amount by which liability 1 ($6,000) exceeds G's share of liabilities 1 and 2 ($2,000)), and the partnership's assumption of liability 2 is treated as a transfer of only $4,000 of consideration to H (the amount by which liability 2 ($9,000) exceeds H's share of liabilities 1 and 2 ($5,000)). Under the rule in § 1.707–3, G is treated as having sold $4,000 of the fair market value of property 1 in exchange for the partnership's taking property 1 subject to liability 1, and H is treated as having sold $4,000 of the fair market value of property 2 in exchange for the partnership's assumption of liability 2.

Example 8. Partnership's assumption of liability pursuant to a plan to avoid sale treatment of partnership assumption of another liability. (i) The facts are the same as in Example 7, except that—

(A) Liability 2 is a nonrecourse liability;

(B) H transferred the proceeds of liability 2 to the partnership; and

(C) H incurred liability 2 in an attempt to reduce the extent to which the partnership's taking of property 1 subject to liability 1 would be treated as a transfer of consideration to G (and thereby reduce the portion of G's transfer of property 1 to the partnership that would be treated as part of a sale).

(ii) Because the partnership assumed liability 2 with a principal purpose of reducing the extent to which the partnership's taking of property 1 subject to liability 1 would be treated as a transfer of consideration to G, liability 2 is ignored in applying § 1.707–5(a)(1). See § 1.707–5(a)(4). Accordingly, the partnership's taking of property 1 subject to liability 1 is treated as a transfer of $4,000 of consideration to G (the amount by which liability 1 ($6,000) exceeds G's share of liability 1 ($2,000)). Under § 1.707–5(d), the partnership's assumption of liability 2 is not treated as a transfer of any consideration to H because the amount of liability 2 that the partnership is treated as assuming is reduced by the money H transferred to the partnership ($9,000).

Examples 9 through *13* [Reserved]. For further guidance, see § 1.707–5(f) *Examples 9* through *13.*

(g) *Expiration date.* This section expires on October 4, 2019.

■ **Par. 4.** Section 1.707–9 is amended by adding paragraphs (a)(4) and (5) to read as follows:

§ 1.707–9 Effective dates and transitional rules.

(a) * * *

(4) *Section 1.707–5(a)(2) and (f) Examples 2, 3, 7, and 8.* Section 1.707–5(a)(2) and (f) *Examples 2, 3, 7,* and *8,* as contained in 26 CFR part 1 revised as of April 1, 2016, apply to any transaction with respect to which any transfers occur before January 3, 2017. For any transaction with respect to which all transfers occur on or after January 3, 2017, see § 1.707–9T(a)(5).

(5) [Reserved]. For further guidance, see § 1.707–9T(a)(5).

* * * * *

■ **Par. 5.** Section 1.707–9T is added to read as follows:

§ 1.707–9T Effective dates and transitional rules (temporary).

(a)(1) through (a)(4) [Reserved]. For further guidance, see § 1.707–9(a)(1) through (4).

(5) *Section 1.707–5T(a)(2) and (f) Examples 2, 3, 7, and 8.* Section 1.707–5T(a)(2) and (f) *Examples 2, 3, 7,* and *8* apply to any transaction with respect to which all transfers occur on or after January 3, 2017. For any transaction with respect to which any transfers occur before January 3, 2017, see § 1.707–5(a)(2) and (f) *Examples 2, 3, 7,* and *8* as contained in 26 CFR part 1, revised as of April 1, 2016.

(b) [Reserved]. For further guidance, see § 1.707–9(b).

(c) *Expiration date.* This section expires on October 4, 2019.

■ **Par. 6.** Section 1.752–2 is amended by:

■ 1. Revising paragraph (b)(3).

■ 2. Adding *Examples 9, 10,* and *11* to paragraph (f).

■ 3. Revising paragraph (j)(2).

■ 4. Removing paragraph (j)(4).

■ 5. Redesignating paragraph (l) as (l)(1) and revising the heading to paragraph (l).

■ 6. Adding paragraphs (l)(2) and (3).

The revisions and additions read as follows:

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

* * * * *

(b) * * *

(3) [Reserved]. For further guidance, see § 1.752–2T(b)(3).

* * * * *

(f) * * *

Example 9. [Reserved].

Example 10. [Reserved]. For further guidance, see § 1.752–2T(f) *Example 10.*

Example 11. [Reserved]. For further guidance, see § 1.752–2T(f) *Example 11.*

* * * * *

(j) * * *

(2) [Reserved]. For further guidance, see § 1.752–2T(j)(2).

* * * * *

(l) *Effective/applicability dates.* * * * * * * * *

(2) [Reserved]. For further guidance, see § 1.752–2T(l)(2).

(3) [Reserved]. For further guidance, see § 1.752–2T(l)(3).

■ **Par. 7.** Section 1.752–2T is added to read as follows:

§ 1.752–2T Partner's share of recourse liabilities (temporary).

(a) through (b)(2) [Reserved]. For further guidance, see § 1.752–2(a) through (b)(2).

(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 § 1.752–2(b)(1) is based on the facts and circumstances at the time of the determination. To the extent that the obligation of a partner or related person to make a payment with respect to a partnership liability is not recognized under this paragraph (b)(3), § 1.752–2(b) is applied as if the obligation did not exist. 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 as described in § 1.704–1(b)(2)(ii)(*b*)(*3*) (taking into account § 1.704–1(b)(2)(ii)(*c*)); and

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

(ii) *Special rules for bottom dollar payment obligations*—(A) *In general.* For purposes of § 1.752–2, a bottom dollar payment obligation (as defined in paragraph (b)(3)(ii)(C) of this section) is not recognized under this paragraph (b)(3).

(B) *Exception.* If a partner or related person has a payment obligation that would be recognized under this paragraph (b)(3) (initial payment obligation) but for the effect of an indemnity, reimbursement agreement, or similar arrangement, such bottom dollar payment obligation is recognized under this paragraph (b)(3) if, taking into account the indemnity, reimbursement agreement, or similar arrangement, the partner or related person is liable for at least 90 percent of the partner's or related person's initial payment obligation.

(C) *Definition of bottom dollar payment obligation*—(*1*) *In general.* Except as provided in paragraph (b)(3)(ii)(C)(*2*) of this section, a *bottom dollar payment obligation* is a payment obligation that is the same as or similar to a payment obligation or arrangement described in this paragraph (b)(3)(ii)(C)(*1*).

(*i*) With respect to a guarantee or similar arrangement, any payment obligation other than one in which 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.

(*ii*) With respect to an indemnity or similar arrangement, any payment obligation other than one in which 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 benefited party's payment obligation that is recognized under this paragraph (b)(3) is satisfied.

(*iii*) An arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation as described in paragraph (b)(3)(ii)(C)(*1*)(*i*) or (*ii*) of this section.

(*2*) *Exceptions.* A payment obligation is not a bottom dollar payment obligation merely because a maximum amount is placed on the partner's or related person's payment obligation, a partner's or related person's payment obligation is stated as a fixed percentage of every dollar of the partnership liability to which such obligation relates, or there is 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.

(*3*) *Benefited party defined.* For purposes of § 1.752–2, a *benefited party* is the person to whom a partner or related person has the payment obligation.

(D) *Disclosure of bottom dollar payment obligations.* A partnership must disclose to the Internal Revenue Service a bottom dollar payment obligation (including a bottom dollar payment obligation that is recognized under paragraph (b)(3)(ii)(B) of this section) with respect to a partnership liability on a completed Form 8275, Disclosure Statement, or successor form, attached to the return of the partnership for the taxable year in which the bottom dollar payment obligation is undertaken or modified, that includes all of the following information:

(*1*) A caption identifying the statement as a disclosure of a bottom dollar payment obligation under section 752.

(*2*) An identification of the payment obligation with respect to which disclosure is made.

(*3*) The amount of the payment obligation.

(*4*) The parties to the payment obligation.

(*5*) A statement of whether the payment obligation is treated as recognized for purposes of this paragraph (b)(3).

(*6*) If the payment obligation is recognized under paragraph (b)(3)(ii)(B) of this section, the facts and circumstances that clearly establish that a partner or related person is liable for up to 90 percent of the partner's or related person's initial payment obligation and, but for an indemnity, reimbursement agreement, or similar arrangement, the partner's or related person's initial payment obligation would have been recognized under this paragraph (b)(3).

(iii) *Special rule for indemnities and reimbursement agreements.* An indemnity, reimbursement agreement, or similar arrangement will be recognized under this paragraph (b)(3) only if, before taking into account the indemnity, reimbursement agreement, or similar arrangement, the indemnitee's or other benefited party's payment obligation is recognized under this paragraph (b)(3), or would be recognized under this paragraph (b)(3) if such person were a partner or related person.

(b)(4) through (e) [Reserved]. For further guidance, see § 1.752–2(b)(4) through (e).

(f) *Examples 1* through *9* [Reserved]. For further guidance, see § 1.752–2(f) *Examples 1* through *9.*

Example 10. Guarantee of first and last dollars. (i) A, B, and C are equal members of a 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.

(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 is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) 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 § 1.752–2(b)(1) is $300.

(iii) 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 is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is not recognized under paragraph (b)(3)(ii)(A) of this section. Accordingly, B bears no economic risk of loss under § 1.752–2(b)(1) for ABC's liability.

(iv) In sum, $300 of ABC's liability is allocated to A under § 1.752–2(a), 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 $100 that A pays with respect to its guarantee and agrees to indemnify B fully with respect to its guarantee.

(ii) The determination of whether C's indemnity is recognized under paragraph (b)(3) 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 is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is recognized under paragraph (b)(3) of this section. The amount of C's economic risk of loss under § 1.752–2(b)(1) for its indemnity of A's guarantee is $100.

(iii) Because C's indemnity is recognized under paragraph (b)(3) of this section, A is treated as liable for $200 only to the extent any amount beyond $100 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 the exception in paragraph (b)(3)(ii)(B) of this section does not apply. As a result, A's guarantee is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and is not recognized under paragraph (b)(3)(ii)(A) of this section. Therefore, A bears no economic risk of loss under § 1.752–2(b)(1) for ABC's liability.

(iv) Because B's obligation is not recognized under paragraph (b)(3)(ii) of this section independent of C's indemnity of B's guarantee, C's indemnity is not recognized under paragraph (b)(3)(iii) of this section. Therefore, C bears no economic risk of loss under § 1.752–2(b)(1) for its indemnity of B's guarantee.

(v) In sum, $100 of ABC's liability is allocated to C under § 1.752–2(a) and the remaining $900 liability is allocated to A, B, and C under § 1.752–3.

(g) through (j)(1) [Reserved]. For further guidance, see § 1.752–2(g) through (j)(1).

(2) *Arrangements tantamount to a guarantee*—(i) *In general.* Irrespective of the form of a contractual obligation, the Commissioner may treat a partner as bearing the economic risk of loss with respect to a partnership liability, or a portion thereof, to the extent that—

(A) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan;

(B) The contractual obligations of the partner or related person significantly reduce the risk to the lender that the partnership will not satisfy its obligations under the loan, or a portion thereof; and

(C) With respect to the contractual obligations described in paragraphs (j)(2)(i)(A) and (B) of this section—

(*1*) One of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests; or

(*2*) Another partner, or a person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation described in paragraphs (j)(2)(i)(A) and (B) of this section to be disregarded under paragraph (b)(3) of this section.

(ii) *Economic risk of loss.* For purposes of this paragraph (j)(2), partners are considered to bear the economic risk of loss for a liability in accordance with their relative economic burdens for the liability pursuant to the contractual obligations. For example, a lease between a partner and a partnership that is not on commercially reasonable terms may be tantamount to a guarantee by the partner of the partnership liability.

(j)(3) through (l)(1) [Reserved]. For further guidance, see § 1.752–2(j)(3) through (l)(1).

(2) Paragraph (b)(3), paragraph (f) *Examples 10* and *11,* and paragraph (j)(2) of this section apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken with respect to a partnership liability on or after October 5, 2016, 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. Partnerships may apply paragraph (b)(3), paragraph (f) *Examples 10* and *11,* and paragraph (j)(2) of this section to all of their liabilities as of the beginning of the first taxable year of the partnership ending on or after October 5, 2016. The rules applicable to liabilities incurred or assumed (or subject to a written binding contract in effect) prior to October 5, 2016 are contained in § 1.752–2 in effect prior to October 5, 2016 (see 26 CFR part 1 revised as of April 1, 2016).

(3) If a partner has a share of a recourse partnership liability under § 1.752–2(a) as a result of bearing the economic risk of loss under § 1.752–2(b) immediately prior to October 5, 2016 (Transition Partner), the partnership (Transition Partnership) may choose not to apply paragraph (b)(3), paragraph (f) *Examples 10* and *11,* and paragraph (j)(2)(i)(C)(*2*) of this section to the extent the amount of the Transition Partner's share of liabilities under § 1.752–2(a) as a result of bearing the economic risk of loss under § 1.752–2(b) immediately prior to October 5, 2016 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). A Transition Partner that is a partnership, S corporation, or a business entity disregarded as an entity separate from its owner under section 856(i) or 1361(b)(3) or §§ 301.7701–1 through 301.7701–3 of this chapter ceases to qualify as a Transition Partner if the direct or indirect ownership of that Transition Partner changes by 50 percent or more. The Transition Partnership may continue to apply the rules under § 1.752–2 in effect prior to October 5, 2016, with respect to a Transition Partner for payment obligations described in § 1.752–2(b) to the extent of the Transition Partner's adjusted Grandfathered Amount for the seven-year period beginning October 5, 2016. 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)(3). However, a Transition Partner's Grandfathered Amount is reduced (not below zero), but never increased by—

(i) Upon the sale of any property by the Transition Partnership, an amount equal to the excess of any gain allocated for federal income tax purposes 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 percentage interest in the partnership; and

(ii) An amount equal to any decrease in the Transition Partner's share of liabilities to which the rules of this paragraph (l)(3) apply, other than by operation of paragraph (l)(3)(i) of this section.

(m) *Expiration date.* This section expires on October 4, 2019.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

Approved: August 29, 2016.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2016–23388 Filed 10–4–16; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9787]

RIN 1545–BK29

Section 707 Regarding Disguised Sales, Generally

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 707 and 752 of the Internal Revenue Code (Code). The final regulations under section 707 provide guidance relating to disguised sales of property to or by a partnership and the final regulations under section 752 provide guidance relating to allocations of excess nonrecourse liabilities of a partnership to partners for disguised sale purposes. The final regulations affect partnerships and their partners.

DATES: *Effective date:* These regulations are effective on October 5, 2016.

Comment date: Comments will be accepted until January 3, 2017.

Applicability dates: For dates of applicability, see §§ 1.707–9(a)(1) and 1.752–3(d).

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–122855–15), 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–122855–15), 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–122855–15).

FOR FURTHER INFORMATION CONTACT: Deane M. Burke or Caroline E. Hay at (202) 317–5279 (not a toll-free number).

SUPPLEMENTARY INFORMATION: In addition to these final regulations, the Treasury Department and the IRS are publishing temporary regulations concerning a partner's share of partnership liabilities for purposes of section 707 (the 707 Temporary Regulations) and the treatment of certain payment obligations under section 752 (the 752 Temporary Regulations) in the Rules and Regulations section in this issue of the **Federal Register**, and, in the Proposed Rules section in this issue of the **Federal Register**, proposed regulations (REG–122855–15) that incorporate the text of the temporary regulations, withdraw a portion of a notice of proposed rulemaking (REG–119305–11) to the extent not adopted by the final regulations, and contain new proposed regulations (the 752 Proposed Regulations) addressing (1) when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 and (2) when a partnership's liabilities are treated as recourse liabilities under section 752.

Paperwork Reduction Act

The collection of information contained in these final regulations 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.

The collection of information in these final regulations under section 707 is in § 1.707–5(a)(7)(ii) (regarding a liability incurred within two years prior to a transfer of property) and is reported on Form 8275, Disclosure Statement. This information is required by the IRS to ensure that section 707(a)(2)(B) of the Code and applicable regulations are properly applied to transfers between a partner and a partnership.

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

1. Overview

This Treasury decision contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 707 and 752 of the Code related to a notice of proposed rulemaking published on January 30, 2014 in the **Federal Register** (REG–119305–11, 79 FR 4826) to amend regulations under sections 707 and 752 (the 2014 Proposed Regulations). A public hearing on the 2014 Proposed Regulations was not requested or held, but the Treasury Department and the IRS received written comments. After full consideration of the comments, the final regulations contained in this Treasury decision substantially adopt the 2014 Proposed Regulations under section 707 with revisions to certain proposed rules in response to comments. The revisions to the 2014 Proposed Regulations under section 707 adopted in these final regulations are discussed in the Summary of Comments and Explanation of Revisions section of this preamble. In addition, after considering comments on the 2014 Proposed Regulations under section 752, this Treasury decision adopts as final regulations provisions of the 2014 Proposed Regulations that amend § 1.752–3, revised in response to the comments received. Finally, these final regulations adopt provisions of the 2014 Proposed Regulations revising § 1.704–2(d)(2)(ii) and (m) *Example 1,* to comport with the provisions in the 752 Proposed Regulations and the 752 Temporary Regulations relating to ''bottom dollar payment obligations.''

However, based on a comment received on the 2014 Proposed Regulations requesting that guidance regarding a partner's share of partnership liabilities apply solely for disguised sale purposes, the Treasury Department and the IRS have reconsidered the rules under § 1.707–5(a)(2) of the 2014 Proposed Regulations for determining a partner's share of partnership liabilities for purposes of section 707. Accordingly, in a separate Treasury decision (TD 9788), the Treasury Department and the IRS are also publishing the 707 Temporary Regulations that require a partner to apply the same percentage used to determine the partner's share of excess nonrecourse liabilities under § 1.752–3(a)(3) (with certain limitations) in determining the partner's share of partnership liabilities for disguised sale purposes. That Treasury decision also contains the 752 Temporary Regulations providing guidance on the treatment of ''bottom dollar payment obligations.'' Cross-referencing proposed regulations providing additional opportunity for comment are contained in the related notice of proposed rulemaking (REG–122855–15) published in the Proposed Rules section in this issue of the **Federal Register**.

Finally, after considering comments on the 2014 Proposed Regulations under section 752, the Treasury Department