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Impact of Tax Reform on Partnerships/Recent Changes to Rules Governing Disguised Sale and Debt Allocations (PowerPoint)

Andrea M. Whiteway

Maximilian Pakaluk

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**IMPACT OF TAX REFORM ON
PARTNERSHIPS/RECENT CHANGES
TO RULES GOVERNING DISGUISED
SALE AND DEBT ALLOCATIONS**

63rd Annual William & Mary Tax Conference

**Andrea M. Whiteway & Maximilian Pakaluk
Ernst & Young LLP**



Tax Reform

- “Unified Framework for Fixing our Broken Code” released September 27, 2017
- The framework is intended to deliver:
 - Tax relief for middle-class families.
 - The simplicity of "postcard" tax filing for the vast majority of Americans.
 - Tax relief for businesses, especially small businesses.
 - Ending incentives to ship jobs, capital and tax revenue overseas.
 - Broadening the tax base and providing greater fairness for all Americans by closing special interest tax breaks and loopholes.

Tax Reform

➤ Individual

- Expands the zero-tax bracket - current seven brackets down to three — 12%, 25% and 35% (committees are given flexibility to add fourth rate on the wealthiest taxpayers).
- Doubles the standard deduction to \$12,000 for individuals and \$24,000 for married couples.
- Eliminates most itemized deductions (impacts 30% of taxpayers).
- Retains mortgage interest and charitable giving, and committees are encouraged to retain tax incentives for higher education, retirement and work.
- State and local deduction eliminated.
- Larger child tax credit — significantly increases from \$1,000 per child under 17 (under current law), but does not specify an amount to allow the committees to "adjust the dials" to help middle class, increasing family income limits so more families are eligible, and eliminating the "marriage tax penalty."
- Creates a \$500 tax credit for taxpayers with non-child dependents.
- Repeals the individual AMT.
- Repeals the "death tax."

Tax Reform

➤ Business.

- Small businesses — maximum tax rate will be 25% and will adopt measures to ensure personal income/wages are not recharacterized as profits.
- Corporate rates — cap on rate will be 20%, eliminates AMT, allows immediate expensing of new investments for at least five years, and partially limits interest deductibility.
- Committees will be looking to eliminate many of the other business credits — exempting business R&D and low-income housing credits.
- — Reducing the 35% corporate income tax rate to 20%
 - Allowing businesses to expense the cost of certain new investments (other than structures) for at least five years
 - Limiting net interest expense deductions for C corporations
 - Eliminating many of the other business credits including credits the Section 199 domestic production deduction — exempting business R&D and low-income housing—
- Replacing the worldwide taxation system with a territorial system that includes anti-base erosion measures
 - Imposing a one-time tax on accumulated foreign earnings, with a lower rate for illiquid assets

Tax Reform – Unaddressed

- Capital Gains Rate
- Carried Interest and methodology for determining “wage” like income
- Interest Deductibility outside the corporate context
- Like-Kind Exchanges
- FIRPTA
- Expensing – what is a structure?

Why Important

- Partner's basis in interest ("outside basis") includes a share of partnership liabilities
- Partner may receive cash distributions tax free to extent of outside basis
- Partner may deduct losses to extent of outside basis

Why Important

- Decreases in partner's share of partnership liabilities treated as deemed distribution of cash
- To the extent liability share reduction/ deemed distribution of cash exceeds outside basis, taxable gain

Why Important

- Partner's outside basis generally equals tax basis capital account plus share of liabilities
- If share of liabilities reduced below tax basis negative capital account, taxable gain triggered

Why Important

- Common causes of reduction in share of liabilities:
 - Reduction in partnership liabilities
 - Contribution of encumbered property
 - Change in debt terms
 - Admission of new partner
 - Sec. 704(c) “burn off”

Sec. 752 Mechanics

- Increase in partner's share of partnership liabilities, or increase in partner's individual liabilities by assumption of partnership liability, treated as deemed cash contribution
- Deemed cash contribution increases outside basis

Sec. 752 Mechanics

- Decrease in partner's share of partnership liabilities, or decrease in partner's individual liabilities by partnership assumption of individual liability, treated as deemed cash distribution
- Deemed cash distribution decreases outside basis; triggers gain to extent it exceeds outside basis

Sec. 752 Mechanics

- Increases and decreases in single transaction netted
- Net increase treated as cash contribution
- Net decrease treated as cash distribution

Sec. 752 Mechanics

Example: Property Contribution

- A contributes property with basis of \$60, subject to debt of \$100, for 50% interest in partnership
- Assume A's share of partnership liabilities post-contribution is \$50

Sec. 752 Mechanics

Example: Property Contribution

- A is deemed to receive a \$50 cash distribution (decrease in personal liabilities of \$100, increase in share of partnership liabilities of \$50)
- A's basis in partnership interest is \$10 (\$60 basis in property minus \$50 deemed cash distribution)

Recourse Liabilities

- Liability is recourse to extent partner or related person bears “economic risk of loss”
- Constructive liquidation (“neutron bomb”) test to determine whether partner/related person bears economic risk of loss

Recourse Liabilities

- Generally presumed that person will perform obligation regardless of actual financial ability
- Partner bears economic risk of loss where partner or related person is nonrecourse lender
- 10% exception

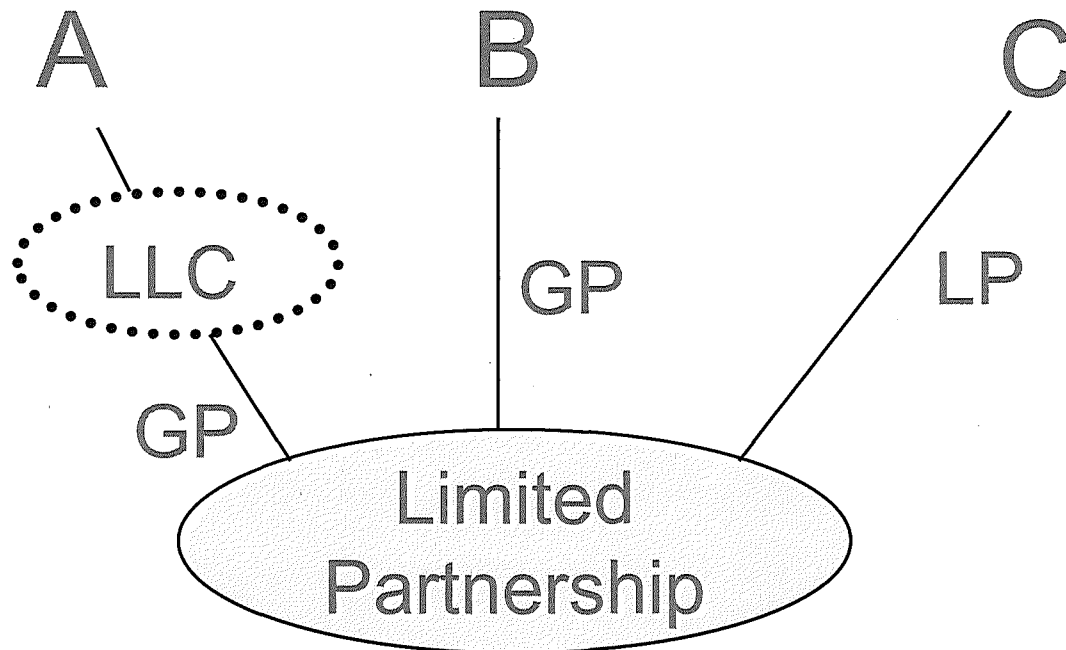
Nonrecourse Liabilities

- No partner or related person bears economic risk of loss
- Three tier allocation
 - Share of partnership minimum gain
 - Sec. 704(c) minimum gain
 - Profits

Nonrecourse Liabilities

- Interaction with choice of Sec. 704(c) method
- Rev. Rul. 95-41
- Sec. 704(c) “burn-off” causes debt shift as property is depreciated

Disregarded Entities



Recourse Liabilities
Nonrecourse Liabilities

Disregarded Entities

Final Regulations

- Effective for obligations incurred or assumed by partnership after October 10, 2006
- Payment obligations of A DE taken into account only to extent of “net value” of DE

Disregarded Entities

- “DE” includes single owner LLC, QRS and QSUB
- “Net value” = fair market value reduced by value of obligations other than obligation to pay partnership liability, regardless of priority

Disregarded Entities

- “Net value” does not include value of interest in partnership whose liabilities are being allocated (but does include value of other partnership interests)
- “Net value” generally determined “as of the date partnership determines shares of liabilities” -- year end

Disregarded Entities

- Not redetermined unless non-de minimis contribution to or distribution from DE, or change in obligations, or sale of asset
- Partner owning partnership interest through DE must report ownership and “net value appropriately allocable to partnership’s liabilities on a timely basis”

Final Regulations

- ▶ IRC Section 707
 - ▶ Reimbursement of preformation expenditures exception
 - ▶ Added new category of “qualified liability” if liability was not incurred in anticipation of the transfer of the property to a partnership, but was incurred in connection with a trade or business in which transferred property was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business
 - ▶ IRC Section 752
 - ▶ For purposes of allocating excess nonrecourse liabilities under Treas. Reg. §1.752-3, none of the IRC Section 704(c) fill-up method, the significant item method nor the alternative method apply for purposes of determining a partner’s share of a partnership liability for IRC Section 707 disguised sale purposes
 - ▶ These regulations were effective on 5 October 2016
-

Temporary Regulations under Section 707

- ▶ Treat all partnership liabilities, whether recourse or nonrecourse, as nonrecourse liabilities solely for purposes of IRC Section 707
- ▶ In determining partner's liability share for disguised sale purposes, partner required to apply the same percentage used to determine the partner's share of excess nonrecourse liabilities under Treas. Reg. §1.752-3(a)(3) (with certain limitations) but such share shall not exceed the partner's share of the partnership liability under IRC Section 752
- ▶ Effective date: Apply to any transaction with respect to which all transfers occur on or after 3 January 2017

Temporary Regulations under Section 707

- ▶ In determining partner's share of a partnership liability for disguised sale purposes do not include any amount of the liability for which another partner bears economic risk of loss under Treas. Reg. §1.752-2.
- ▶ Effective Date: Apply to any transaction with respect to which **all** transfers occur on or after January 3, 2017.

Temporary Regulations under Section 752

- ▶ “Bottom dollar payment obligation” will not be respected
- ▶ Definition includes (subject to 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

Temporary Regulations under Section 752

- ▶ (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

Temporary Regulations under Section 752

- ▶ Any payment obligation under Treas. Reg. §1.752-2 may be a bottom dollar payment obligation if it meets the requirements, including:
 - ▶ obligation to make a capital contribution
 - ▶ obligation to restore a deficit capital account upon liquidation of the partnership
- ▶ Exception to bottom dollar payment obligation treatment 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

Temporary Regulations under Section 752

- ▶ Certain payment obligations excepted from being treated as bottom dollar payment obligations:
 - ▶ obligations with joint and several liability;
 - ▶ 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;
 - ▶ vertical slice of a partnership liability

Temporary Regulations under Section 752

- ▶ Anti-abuse rule in §1.752-2T(j)(2)
 - ▶ 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.
- ▶ Disclosure required of 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

Temporary Regulations under Section 752

- ▶ Effective date: applies to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken with respect to a partnership liability on or after 5 October 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 all the provisions to all liabilities as of the beginning of the first taxable year of the partnership ending on or after 5 October 2016
- ▶ Notice 2017-38 - Treasury Department has included Temp. Reg. §1.752-2T as one of eight significant tax regulations that may impose an undue financial burden on taxpayers or add undue complexity to federal tax laws that is subject of further review

Temporary Regulations under Section 752: Transition Rule

- Seven-year transition period
 - During this period, if a partner (“Transition Partner”) has a share of recourse liabilities under current rules, partnership may choose not to apply new rules to an amount of partnership liabilities equal to the excess of the Transition Partner’s share of recourse liabilities over the Transition Partner’s adjusted basis in the partnership interest
 - Amount of liabilities to which transition rule applies is reduced to the extent built-in gain attributable to Transition Partner’s negative tax basis capital account is recognized

Temporary Regulations under Section 752: Transition Rule

- If Transition Partner is a partnership, S corporation or disregarded entity, 50 percent or more change in ownership of Transition Partner will terminate the transition period

Recourse Liabilities: Effective Date Issues

- ▶ Pre-effective date bottom guarantees – “base case” should be grandfathered until guarantee is modified or debt is refinanced subject to IRC Section 1001 significant modification
- ▶ Term of years bottom guarantee with automatic renewal in default of notice; no refinancing
- ▶ Term of years bottom guarantee, plus debt maintenance agreement requirement to enter into new bottom guarantee upon a refinancing
- ▶ Term of years bottom guarantee with right, but not obligation, to enter into bottom guarantee at election of partner upon a refinancing
- ▶ Pre-effective date bottom guarantee if significant modification or refinancing of debt
 - ▶ 7-year transition relief only to extent of negative capital account on effective date subject to reduction, but not increase
- ▶ Post-effective date bottom DRO

Proposed Regulations under Section 752

- ▶ List of factors added to an anti-abuse rule in Treas. Reg. § 1.752–2(j)
- ▶ Factors are weighed to determine whether a payment obligation is respected.
- ▶ Factors are nonexclusive list
- ▶ Presence or absence of any particular factor, in itself, is not necessarily indicative of whether or not payment obligation is recognized

Proposed Regulations under Section 752 - Factors

- ▶ Partner not subject to commercially reasonable contractual restrictions protecting payment likelihood
- ▶ Partner not required by lender to provide (either when entering into payment obligation or periodically) commercially reasonable financial condition documentation
- ▶ Term of obligation ends prior to term of partnership liability, or partner has a right to terminate its obligation, if purpose is to decrease risk of economic loss

Proposed Regulations under Section 752

- ▶ There exists a plan or arrangement in which obligor or related person holds money or other liquid assets in an amount exceeding reasonably foreseeable needs
- ▶ Obligation does not permit prompt pursuit of payment following a payment default
- ▶ Terms of liability substantially same had there been no guaranty
- ▶ Creditor did not receive executed documents

Proposed Regulations under Section 752

- ▶ Propose to remove § 1.752–2(k) (DRE Net Value Rule) and instead create a new presumption under the anti-abuse rule in § 1.752–2(j).
- ▶ Under the presumption, evidence of a plan to circumvent or avoid an obligation is deemed to exist if the facts and circumstances indicate that there is **not a reasonable expectation that the payment obligor will have the ability to make the required payments** if the payment obligation becomes due and payable.

Proposed Regulations under Section 752

- ▶ Effective Date: When Finalized

Proposed Regulations under Section 704

- ▶ A partner in no event will be considered obligated to restore the deficit balance in his capital account to the partnership to the extent such partner's obligation is a bottom dollar payment obligation that is not recognized under Treas. Reg. § 1.752-2(b)(3) or is not legally enforceable, or the facts and circumstances otherwise indicate a plan to circumvent or avoid such obligation.
- ▶ To the extent a partner is not considered obligated to restore the deficit balance in the partner's capital account to the partnership, the obligation is disregarded and Section 704(b) and Section 752 are applied as if the obligation did not exist.

Proposed Regulations under Section 704

- ▶ Factors specific to DROs that indicate a plan to circumvent or avoid an obligation:
 - ▶ (1) The partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation;
 - ▶ (2) the partner is not required to provide (either at the time the obligation is made or periodically) commercially reasonable documentation regarding the partner's financial condition to the partnership;
 - ▶ (3) the obligation ends or could, by its terms, be terminated before the liquidation of the partner's interest in the partnership or when the partner's capital account as provided in § 1.704-1(b)(2)(iv) is negative; and
 - ▶ (4) the terms of the obligation are not provided to all the partners in the partnership in a timely manner.

Proposed Regulations under Section 704

- ▶ Effective Date: DROs are subject to the bottom dollar payment obligation rules in the 752 Temporary Regulations effective immediately, **but** the 704(b) proposed regulations concerning DROs will be effective when published as final regulations

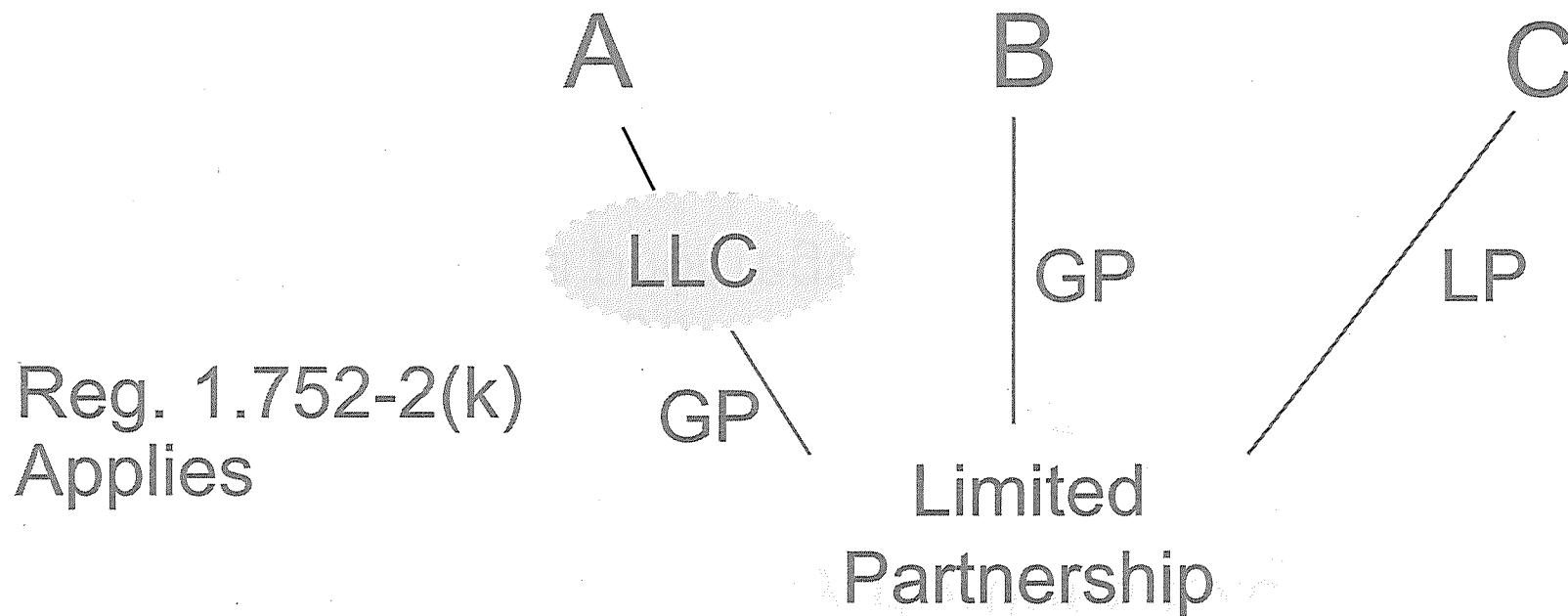
Ongoing Vitality of Regulations

- ▶ Executive Order issued by President Trump on April 21
 - ▶ Calling for Treasury to review all "significant tax regulations" issued on or after January 1, 2016, and to identify in an interim report those that impose undue financial burden, add undue complexity, or exceed statutory authority
- ▶ Notice 2017-38 identified eight specific regulations as unduly burdensome or complex, including regulations under Section 707 and Section 752 dealing with partnership liabilities.

Ongoing Vitality of Regulations

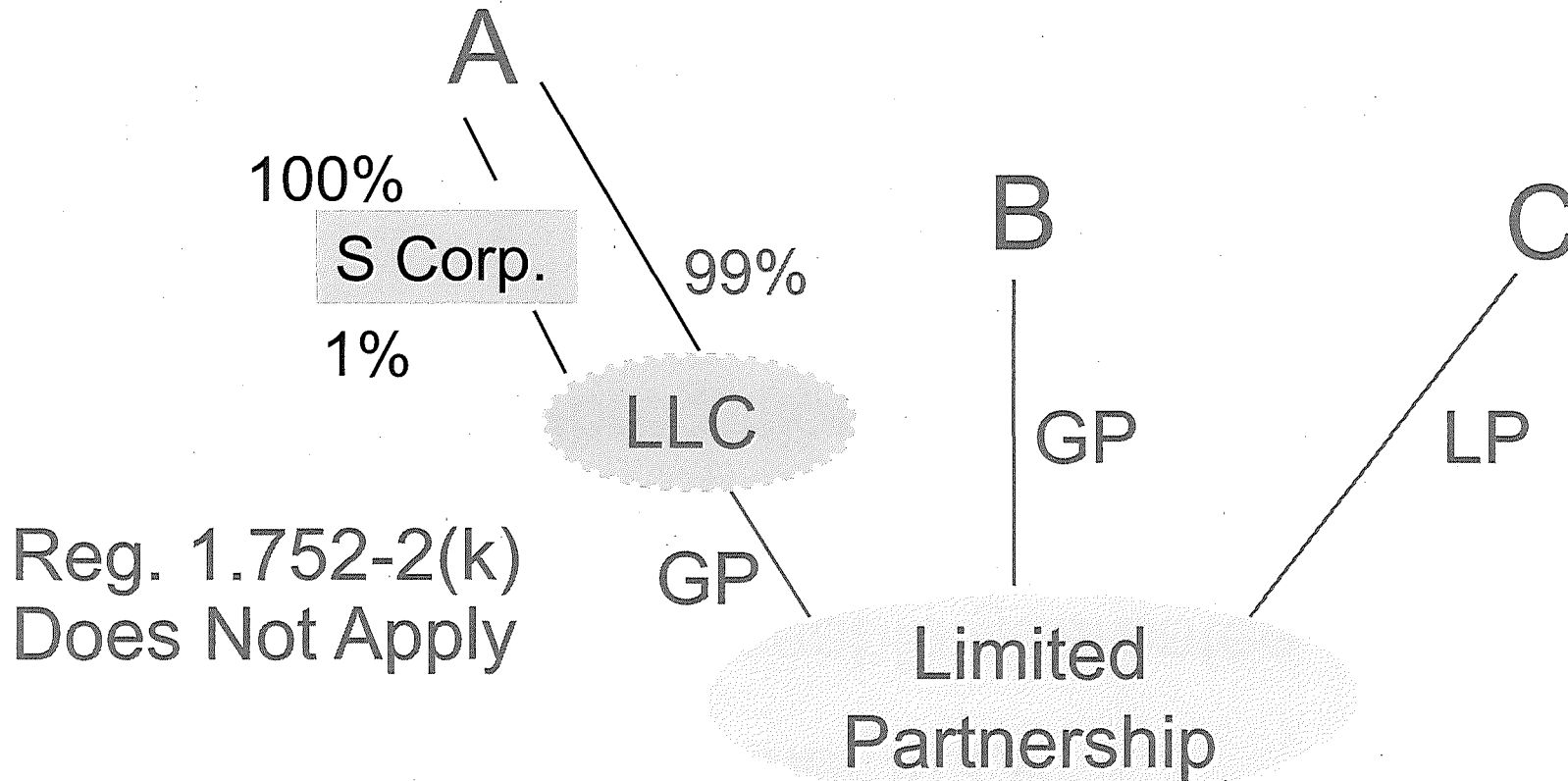
- ▶ Second Report to the President on Identifying and Reducing Tax Regulatory Burdens Executive Order 13789 (October 4)
 - ▶ Considering whether the proposed and temporary regulations relating to disguised sales should be revoked and the prior regulations reinstated
 - ▶ Temporary regulations on bottom-dollar guarantees are needed to prevent abuses and do not meaningfully increase regulatory burdens for the taxpayers affected.
 - ▶ Considering ways to rationalize and lessen the burden of partnership tax regulations governing liabilities and allocations more generally.

Ex. 1: Disregarded Entities



Recourse Liabilities
Nonrecourse Liabilities

Ex. 2: Disregarded Entities



Reg. 1.752-2(k)
Does Not Apply

Recourse Liabilities
Nonrecourse Liabilities

Ex. 3: Nonrecourse Debt; Regular Guarantee

- X is 1% limited partner in LP
- X enters into enforceable guarantee of \$10 of \$100 liability that is otherwise nonrecourse
- No right of subrogation or contribution

Ex. 3: Nonrecourse Debt; Regular Guarantee

- Does guarantee cause \$10 of debt to be allocated to X?
- Does it matter if X enters into the guarantee for the sole purpose of boosting outside basis?
- Sec. 465 at-risk issue

Ex. 4: Nonrecourse Debt; Bottom Guarantee

- X is 1% limited partner in LP
- X enters into enforceable “bottom” guarantee of \$10 of \$100 liability that is otherwise nonrecourse
- No right of subrogation or contribution

Ex. 4: Nonrecourse Debt; Bottom Guarantee

“X shall not be obligated to make any payment hereunder until all attempts to collect from Borrower, with due diligence and using reasonable means, have failed to produce gross proceeds to Lender (not taking into account any costs incurred by Lender in collecting such proceeds) of at least \$10. Such attempts shall include the exhaustion of all rights and remedies at law and in equity that Lender may have against Borrower and the Collateral securing the Loan.”

Ex. 4: Nonrecourse Debt; Bottom Guarantee

- Does bottom guarantee of collection cause \$10 of debt to be allocated to X?
- Does it matter if X enters into the guarantee for the sole purpose of boosting outside basis?
- What if GP has deficit restoration obligation?

Ex. 5: Recourse Debt; Regular Guarantee

- X is 1% limited partner in LP
- X enters into enforceable guarantee of \$10 of \$100 liability that is recourse
- No right of subrogation or contribution

Ex. 5: Recourse Debt; Regular Guarantee

- X's guarantee does not cause \$10 of the recourse debt to be allocated to him
- On constructive liquidation, GP presumed to pay the debt; guarantee presumed never to be called
- See Reg. § 1.752-2(f), Example 3.

Ex. 6: Recourse Debt; Indemnity

- X is 1% limited partner in LP
- X enters into enforceable indemnification agreement with GP pursuant to which X indemnifies GP for up to \$10 if GP is required to pay on the debt
- Recourse debt; no right of subrogation or contribution

Ex. 6: Recourse Debt; Indemnity

- X's indemnity does cause \$10 of the recourse debt to be allocated to him
- On constructive liquidation, GP presumed to pay the debt; X presumed to pay on the indemnity

Termination of Guarantee or Indemnity

- When can the guaranty or indemnity terminate?
 - Only when liability paid in full?
 - At will?
 - At will, but subject to appraisal requirement?
 - Term of years with renewal?
 - In UPREIT, upon conversion of OP units?

Ex. 7: Recourse Debt; Conventional DRO

- X is 1% limited partner in LP
- X enters into DRO -- upon liquidation, X is obligated to make capital contribution equal to lesser of \$10 or amount of deficit capital account balance

Ex. 7: Recourse Debt; Conventional DRO

- Partnership agreement complies with Reg. Sec. 704(b) safe harbor
- Partnership agreement amended to provide that all losses allocated to X until X's book capital account equals (\$10)

Ex. 7: Recourse Debt; Conventional DRO

Partnership “book” balance sheet at time DRO entered into:

Prop.	80	100	Rec. Liab.
		(.20)	X
		(19.80)	Others

Ex. 7: Recourse Debt; Conventional DRO

- After constructive liquidation, X would have (\$10) capital account and obligation to contribute \$10 to pay the debt
- Does DRO cause \$10 of recourse debt to be allocated to X?
- Sec. 465(e) issue - Hubert case

Ex. 8: Recourse Debt; Bottom DRO

- X is 1% limited partner in LP
- X enters into DRO -- upon liquidation, X is obligated to make capital contribution equal to lesser of \$10 or amount of deficit capital account balance

Ex. 8: Recourse Debt; Bottom DRO

Partnership “book” balance sheet at time DRO entered into:

Prop.	80	100 Rec. Liab.
		(.20) X
		(19.80) Others

Ex. 8: Recourse Debt; Bottom DRO

- Partnership agreement complies with Reg. Sec. 704(b) safe harbor
- Partnership agreement amended to provide that first \$70.20 of loss on disposition of property allocated to other partner(s); last \$9.80 of loss allocated to X

Ex. 8: Recourse Debt; Bottom DRO

- After constructive liquidation, X would have (\$10) capital account and obligation to contribute \$10 to pay the debt
- Does bottom DRO cause \$10 of recourse debt to be allocated to X?

Ex. 8: Recourse Debt; Bottom DRO

- Bottom DRO provides significantly lower economic risk for X than bottom guarantee of specific debt
- Bottom guarantee of specific debt exposes X to economic risk if specific property declines in value below the bottom guarantee amount

Ex. 8: Recourse Debt; Bottom DRO

- If no secured nonrecourse debt, bottom DRO exposes X to economic risk only if entire portfolio of properties declines in value below the bottom DRO amount

Ex. 8: Recourse Debt; Bottom DRO

- If secured nonrecourse debt and book value at least equal to nonrecourse debt, bottom DRO exposes X only if portfolio value in excess of nonrecourse debt declines below bottom DRO amount

Ex. 8: Recourse Debt; Bottom DRO

- Bottom guarantee of specific debt may be called if default on specific debt
- Bottom DRO may be called only if partnership actually liquidated

Ex. 9: Nonrecourse Debt; Conventional DRO

- X is 1% limited partner in LP
- X enters into DRO -- upon liquidation, X obligated to make capital contribution equal to lesser of \$10 or amount of deficit capital account balance

Ex. 9: Nonrecourse Debt; Conventional DRO

- Partnership agreement complies with Reg. Sec. 704(b) safe harbor
- Partnership agreement amended to provide that all losses allocated to X until X's book capital account equals (\$10)

Ex. 9: Nonrecourse Debt; Conventional DRO

Partnership “book” balance sheet at time DRO entered into:

Prop.	80	100 Nonrec. Liab.
		(.20) X
		(19.80) Others

Ex. 9: Nonrecourse Debt; Conventional DRO

- After constructive liquidation, X would have \$0 capital account and no obligation to make any capital contribution
- So DRO will not cause any nonrecourse debt to be allocated to X
- Different answer if book value of property securing nonrecourse debt exceeds debt

LLCs

- No member of an LLC is liable for debts of the entity merely by virtue of being a member
- Absent a guarantee or other special circumstances, a liability that is state law recourse to an LLC should be treated as nonrecourse for purposes of Sec. 752
- Like an “exculpatory” liability

LLCs: Guarantees

- Guarantee (but not bottom) of state law recourse liability should cause debt to be allocated to guarantor
- Guarantee (but not bottom) of state law nonrecourse liability should cause debt to be allocated to guarantor

LLCs: DROs

- DRO in LLC should not cause state law nonrecourse debt to be allocated to member with DRO
- Whether a DRO in an LLC will cause state law recourse debt to be allocated to member with DRO may depend on whether member has positive or negative capital account

Ex. 10: LLC; DRO; Recourse Debt; Negative CAs

- X is 1% member in LLC
- X enters into DRO -- upon liquidation, X obligated to make capital contribution equal to lesser of \$10 or amount of deficit capital account balance

Ex. 10: LLC; DRO; Recourse Debt; Negative CAs

- LLC agreement complies with Reg. Sec. 704(b) safe harbor
- LLC agreement amended to provide that all losses allocated to X until X's book capital account equals (\$10)

Ex. 10: LLC; DRO; Recourse Debt; Negative CAs

LLC “book” balance sheet at time DRO entered
into:

Prop.	80	100	Rec. Liab.
		(.20)	X
		(19.80)	Others

Ex. 10: LLC; DRO; Recourse Debt; Negative CAs

- DRO will not cause any portion of debt to be allocated to X
- Upon constructive liquidation:
 - “If the creditor's right to repayment of a partnership liability is limited solely to one or more assets of the partnership, gain or loss is recognized in an amount equal to the difference between the amount of the liability that is extinguished by the deemed disposition and the tax basis (or book value to the extent section 704(c) or section 1.704-1(b)(4)(i) applies) in those assets.”

Ex. 10: LLC; DRO; Recourse Debt; Negative CAs

- After constructive liquidation, X would have \$0 capital account and no obligation to make any capital contribution
- So DRO will not cause any state law recourse debt to be allocated to X if book capital accounts are negative

Ex. 11: LLC; DRO; Recourse Debt; Positive CAs

Same facts, except LLC balance sheet at time
DRO entered into as follows:

Prop.	120	100	Rec. Liab.
		.20	X
		19.80	Others

Ex. 11: LLC; DRO; Recourse Debt; Positive CAs

- After constructive liquidation, X would have (\$10) capital account and obligation to contribute \$10 to pay the debt
- So DRO should cause \$10 of state law recourse debt to be allocated to X if book capital accounts are positive

Ex. 12: LLC; CCO Tied to Value; Recourse Debt

Same LLC balance sheet as Ex. 10:

Prop.	80	100	Rec. Liab.
		(.20)	X
		(19.80)	Others

Ex. 12: LLC; CCO Tied to Value; Recourse Debt

- X agrees that, upon liquidation, to the extent the value of assets available to satisfy debt is less than \$10, X will make a capital contribution of up to \$10 irrespective of whether X has a deficit capital account balance

Ex. 12: LLC; CCO Tied to Value; Recourse Debt

- After constructive liquidation, X would have \$0 capital account
- Nevertheless, X would have obligation to make \$10 capital contribution
- But is CCO respected under new regulations?

Ex. 12: LLC; CCO Tied to Value; Recourse Debt

- Does capital contribution obligation tied to value cause \$10 of state law recourse debt to be allocated to X?

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