

Accounting

Section 752 regulations: IRS issues guidance on treatment of partnership liabilities



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The IRS on October 5, 2016 published final (TD 9787), temporary (TD 9788), and proposed regulations (REG-122855-12) providing guidance on the allocation of partnership liabilities under Section 752. The government also re-proposed certain Section 752 regulations by introducing a new anti-abuse rule.

Final Section 752 regulations: Non-recourse liabilities

The final Section 752 regulations generally will keep many of the nonrecourse liability allocation rules proposed in 2014. Partnerships will continue to be able to allocate excess nonrecourse liabilities based upon a “significant item” of partnership income or gain, or in accordance with the manner in which it is anticipated that nonrecourse deductions attributable to the nonrecourse liabilities will be allocated.

The rules for nonrecourse liabilities will be effective for all liabilities entered into after the date of publication except for any pending additional liabilities subject to a

current binding commitment.

Temporary Section 752 regulations: Recourse liabilities

Consistent with the proposed 2014 regulations, the temporary regulations no longer will recognize so-called “bottom-dollar” payment obligations for purposes of allocating recourse liabilities, meaning that a guarantee generally will be respected only if it means the guarantor bears the risk of loss for the first dollar of the liability. However, “vertical slice” guarantees, under which a guarantor bears the risk of loss for a portion of a liability, along with capped obligations and joint and several liabilities, will be respected.

Certain indemnification agreements also will be ignored when determining if a bottom-dollar guarantee exists. The final regulations also will contain an “anti-abuse” rule.

The final regulations will be effective on or after the date of publication and will contain the same seven-year transition rule proposed in 2014. They also will create a new disclosure requirement.

New proposed Section 752 regulations

The government also plans to withdraw and repropose the portions of the 2014 proposed regulations that were not otherwise finalized or is-

sued as temporary. The new proposed regulations will eliminate the “net value” requirement in the proposed

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regulations and, with respect to partners that are disregarded entities, in the existing regulations at Reg. sec. 1.752-2. That net value requirement provided that a payment obligation would be respected only to the extent the obligor had sufficient assets on hand to satisfy the obligation. The new proposed regulations instead will provide that all payment obligations will be presumed satisfied by obligors unless there is evidence of a plan to avoid satisfying the payment obligation.

The new proposed regulations also will expand the partnership liability anti-abuse rule at Reg. sec. 1.752-2(j) to allow the government to ignore a payment obligation that it deems “uncommercial.” The expanded anti-abuse rule will base its finding of commerciality on the six commerciality requirements in the 2014 proposed regulations:

- The partner or related person must maintain a commercially reasonable net worth for the entire term

of the payment obligation or must be subject to commercially reasonable restrictions on transfers of assets for nominal consideration;

- The partner or related person must periodically document its financial condition;

- The term of the payment obligation must not end before the term of the partnership liability;

- The payment obligation must not require that the partnership or any other obligor hold liquid assets that exceed the obligor’s reasonable needs;

- The partner or related person must receive arm’s-length consideration in exchange for assuming the payment obligation; and

- In the case of a guarantee, the partner or related person must be liable up to the full amount of the payment obligation if any amount of the partnership liability is not satis-

fied, and in the case of an indemnity, the partner or related person must be liable up to the full amount of the payment obligation if any payment is made by the indemnitee or other benefited party.

The re-proposed regulations will eliminate the requirement that arm’s-length consideration be paid to the obligor on the payment obligation, and will treat the restriction against bottom-dollar guarantees as an absolute prohibition under the temporary regulations. The remaining factors will continue to be reflected in a new non-exclusive factor list used to help partnerships determine whether a payment obligation is commercial under the facts and circumstances. Not one factor will be conclusive, and the government has indicated that it will consider all facts and circumstances when making a determination of whether a plan exists.

The proposed regulations would apply to liabilities incurred or assumed after the date that final regulations are published in the federal register.

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