Transfers of Property to Partnerships with Related Foreign Partners and Controlled Transactions Involving Partnerships

Notice 2015-54

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue regulations under section 721(c) to ensure that, when a U.S. person transfers certain property to a partnership that has foreign partners related to the transferor, income or gain attributable to the property will be taken into account by the transferor either immediately or periodically. This notice also announces that the Treasury Department and the IRS intend to issue regulations under sections 482 and 6662 applicable to controlled transactions involving partnerships to ensure the appropriate valuation of such transactions.

Section 2 of this notice provides relevant background. Section 3 of this notice outlines the reasons the Treasury Department and the IRS intend to exercise their regulatory authority to issue the regulations described in this notice. Section 4 of this notice describes regulations that the Treasury Department and the IRS intend to issue under section 721(c) that will override the general nonrecognition treatment provided by section 721(a) unless certain conditions are satisfied. Section 5 of this notice describes regulations that the Treasury Department and the IRS intend to issue that will address the application of sections 482 and 6662 to controlled transactions involving partnerships. Section 6 of this notice provides the effective dates of the regulations described in this notice. Section 7 of this notice requests comments and provides contact information for purposes of submitting comments.

SECTION 2. BACKGROUND

.01 Repeal of Sections 1491 through 1494

Until they were repealed as part of the Taxpayer Relief Act of 1997 (the 1997 Act), sections 1491 through 1494 imposed an excise tax on certain transfers of appreciated property by a U.S. person to a foreign partnership, which generally was 35 percent of the amount of gain inherent in the property. Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997, Part Two: Taxpayer Relief Act of 1997 (H.R. 2014) (Dec.19, 1997). As the Joint Committee explained, Congress believed that the imposition of enhanced information reporting obligations (including sections 6038, 6038B, and 6046A) with respect to foreign partnerships would eliminate the need for sections 1491 through 1494. Id.

Notwithstanding these enhanced information reporting requirements, the 1997 Act granted the Secretary regulatory authority in section 721(c) to override the application of the nonrecognition provision of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) if the gain, when recognized, would be includible in the gross income of a person other than a U.S. person. In the

1997 Act, Congress also enacted section 367(d)(3), which provides the Secretary regulatory authority to apply the rules of section 367(d)(2) to transfers of intangible property to partnerships in circumstances consistent with the purposes of section 367(d). Id. Regulations have never been issued pursuant to section 721(c) or section 367(d)(3).

.02 Sections 367 and 721

Congress enacted section 367 (and its predecessor) in order to prevent U.S. persons from avoiding U.S. tax by transferring appreciated property to foreign corporations using nonrecognition transactions. Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170) (Dec. 31, 1984). The outbound transfer of intangible property raises additional issues that Congress also sought to address. Specifically, section 367(d) was enacted to prevent U.S. persons from transferring intangibles offshore in order to achieve deferral of U.S. tax on the profits generated by the intangibles. H.R. REP. NO. 98-432, at 1311–15 (1984). Under section 367(d), a U.S. person that transfers intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or section 361 (a section 351 exchange or a section 361 exchange, respectively) is treated as having sold such property in exchange for payments that are contingent upon the productivity, use, or disposition of such property, and receiving amounts that reasonably reflect the amounts that would have been received annually in the form of such payments over the useful life of such property, or, in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition. Section 367(d)(2)(A). The amounts taken into account must be commensurate with the income attributable to the intangible. Id.

The regulations under sections 367(a) and 367(d) contain special rules for transfers to foreign corporations in a section 351 exchange or section 361 exchange under certain circumstances involving partnerships. Specifically, in the case of a transfer of property to a foreign corporation by a partnership in which a U.S. person is a partner, §§1.367(a)-1T(c)(3)(i)(A) and 1.367(d)-1T(a) treat the partnership's transfer as if the U.S. partner had transferred its proportionate share of the partnership's assets (determined under sections 701 through 761) directly to the foreign corporation. In the case of a transfer of a partnership interest to a foreign corporation by a U.S. person, §§1.367(a)-1T(c)(3)(ii)(A) and 1.367(d)-1T(a) treat the U.S. partner as if it had transferred its proportionate share of the property of the partnership (determined under sections 701 through 761) directly to the foreign corporation. In both cases, if section 367(a) requires gain recognition, the regulations provide rules for making basis adjustments to take into account the gain recognized.

Section 721(a) provides a general rule that no gain or loss is recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership. Because section 367 only applies to the transfer of property to a foreign corporation, absent regulations under section 721(c) or section 367(d)(3), a U.S. person generally does not recognize gain on the contribution of appreciated property to a partnership with foreign partners.

.03 Section 704

Section 704(c)(1)(A) requires partnerships to allocate income, gain, loss, and deduction with respect to property contributed by a partner to the partnership so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of contribution.

Section 1.704-3(a)(1) provides that the purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution gain or loss. Section 704(c) allocations must be made using any reasonable method consistent with that purpose. §1.704-3(a)(1). Section 1.704-3 describes three methods of making section 704(c) allocations that are generally reasonable, including the remedial allocation method. Id. Under the remedial allocation method, a partnership may eliminate distortions caused by the ceiling rule (as described in §1.704-3(b)(1)) by making remedial allocations of income, gain, loss, or deduction to the noncontributing partners equal to the full amount of the limitation caused by the ceiling rule, and offsetting those allocations with remedial allocations of income, gain, loss, or deduction to the contributing partner. T.D. 8585, 1995-1 C.B. 120. If a partnership's section 704(c) allocation method is unreasonable, the Secretary can make adjustments by exercising his authority under the anti-abuse rule at §1.704-3(a)(10); however, the IRS does not require a partnership to use the remedial allocation method. §1.704-3(d)(5)(ii).

Section 704(a) and (b) provide that a partner's distributive share of income, gain, loss, deduction, or credit shall be determined under the partnership agreement unless the partnership agreement does not provide rules for such allocation or the allocation does not have substantial economic effect. Section 1.704-1(b)(1)(iii) provides that an allocation that is respected under section 704(b) and the regulations promulgated thereunder may still be reallocated under other provisions, such as section 482. See also Rodebaugh v. Commissioner, T.C. Memo. 1974-36 (holding that the Commissioner could make allocations under section 482 that differed from the formula set forth in the partnership agreement), aff'd, 518 F.2d 73 (6th Cir. 1975).

.04 Sections 482 and 6662 and the Regulations Thereunder

Section 482 provides, in part, that the Secretary may make allocations between or among two or more organizations, trades, or businesses (whether or not incorporated or affiliated and whether or not organized in the United States) that are owned or controlled directly or indirectly by the same interests in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses. Section 1.482-1(a)(2) provides that the IRS may make allocations between or among the members of a controlled group if a controlled taxpayer has not reported its true taxable income. In such a case, the IRS may allocate income, deductions, credits, allowances, basis, or any other item or element affecting taxable income.

Section 1.482-1(b)(1) provides that, in determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). §1.482-1(b)(1). For purposes of section 482, §1.482-1(i)(7) and (8) provide that controlled transactions include contributions. Section 1.482-1(c)(1) provides that the arm's length result of a controlled transaction must be determined under the method (or application of a method) that, under the facts and circumstances, provides the most reliable measure of an arm's length result.

Determining the degree of comparability between controlled and uncontrolled transactions includes the following analyses: (i) a functional analysis of the economically significant activities undertaken or to be undertaken; (ii) a consideration of the resources that are employed, or to be employed, in conjunction with the activities undertaken; and (iii) a comparison of the significant contractual terms and risks of the two transactions. §1.482-1(d)(3). The contractual terms, including the allocation of risks specified or implied by those terms, will be respected if such terms are consistent with the substance of the underlying transactions, including the actual conduct of the controlled taxpayers. §1.482-1(d)(3)(ii)(B) and (iii)(B). In the absence of a written agreement between the controlled taxpayers or when the contractual terms are inconsistent with the substance of the underlying transaction, the IRS may impute a contractual agreement between the controlled taxpayers that is consistent with the substance of the transaction. Id.

In determining true taxable income, the combined effect of two or more separate (controlled or uncontrolled) transactions (whether before, during, or after the taxable year under review) may be considered if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the arm's length consideration for the controlled transactions. §1.482-1(f)(2)(i).

The IRS will evaluate the results of a transaction as actually structured by the taxpayer unless the terms of the transaction lack economic substance. §1.482-1(f)(2)(ii)(A). However, the IRS may consider the alternative transactions available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances. Id. The IRS may adjust the consideration charged in the controlled transaction based on the cost or profit of an alternative as adjusted to account for material differences between the alternative and the controlled transaction, but will not restructure the transaction as if the alternative had been adopted by the taxpayer. Id.

Section 1.482-7 provides the specific methods to be used to evaluate whether a cost sharing arrangement as defined in §1.482-7 produces results consistent with an arm's length result. §1.482-1(b)(2)(i). Section 1.482-7(g)(1) provides for specified and unspecified methods for purposes of evaluating the arm's length amount charged in a platform contribution transaction. Sections 1.482-4 and 1.482-9, as appropriate, provide specified and unspecified methods to be used to determine arm's length results of arrangements, other than cost sharing arrangements covered by §1.482-7, for sharing the costs and risks of developing intangibles. §1.482-1(b)(2)(iii). These other arrangements expressly include partnerships. Id. In the case of such other arrangements, the principles, methods, comparability, and reliability considerations set forth in §1.482-7 are relevant in determining the best method, including an unspecified method, as appropriately adjusted in light of the differences in the facts and circumstances between such arrangements and a cost sharing arrangement. §§1.482-4(g) and 1.482-9(m)(3).

In the case of any transfer or license of intangible property (within the meaning of section 936(h)(3)(B)), the consideration charged by the transferor with respect to such transfer or license must be commensurate with the income attributable to the intangible. Section 482 (second sentence); §1.482-4(a) (third sentence) and (f)(2) and (6); and §1.482-7(i)(6). If such consideration does not satisfy the commensurate with income requirement, the Commissioner may make periodic adjustments to such consideration in a subsequent taxable year without regard to whether the taxable year of the original transfer remains open for statute of limitations purposes. §§1.482-4(f)(2)(i) and 1.482-7(i)(6)(i). If an intangible is transferred in a controlled transaction in exchange for annual royalty payments, the Commissioner may make periodic adjustments to such payments as necessary to ensure an arm's length royalty amount is paid in each taxable year. §1.482-4(f)(2)(i). If an intangible is transferred in a controlled transaction for a lump sum, §1.482-4(f)(6) provides that the lump sum must be commensurate with the income attributable to the intangible. Section 1.482-4(f)(6) also explains how to determine a periodic adjustment for a particular taxable year with respect to that lump sum.

Section 6664(c) provides generally that a penalty may not be asserted under section 6662 with respect to a portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion. However, when the IRS determines that a penalty otherwise would apply as the result of a net section 482 transfer price adjustment, as defined in section 6662(e)(3), or as the result of a gross valuation misstatement, as defined in section 6662(h)(2), section 6662(e)(3)(D) provides that, for purposes of section 6664(c), the taxpayer is not treated as having reasonable cause for a portion of an underpayment attributable to a net section 482 adjustment unless the taxpayer meets the requirements of section 6662(e)(3)(B)(i), (ii), or (iii) with respect to such portion. Those requirements are further described in §1.6662-6(d) and generally require a taxpayer to select and apply a specified or unspecified method that the taxpayer could reasonably conclude met the relevant measure of reliability set forth in §1.6662-6(d). Those requirements also include a requirement to maintain sufficient contemporaneous documentation to establish the taxpayer's reasonable conclusion.

SECTION 3. REASONS FOR EXERCISING REGULATORY AUTHORITY

The Treasury Department and the IRS are aware that certain taxpayers purport to be able to contribute, consistently with sections 704(b), 704(c), and 482, property to a partnership that allocates the income or gain from the contributed property to related foreign partners that are not subject to U.S. tax. Many of these taxpayers choose a section 704(c) method other than the remedial method and/or use valuation techniques that are inconsistent with the arm's length standard.

In 1997 Congress recognized that taxpayers might use a partnership to shift gain to a foreign person and consequently enacted sections 721(c) and 367(d)(3). Based on the experience of the IRS with the taxpayer positions described above, the Treasury Department and the IRS have determined that it is appropriate to exercise the regulatory authority granted in section 721(c) to override the application of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) in certain circumstances in which the gain, when recognized, ultimately would be includible in the gross income of a foreign person. Although Congress also provided specific authority in section 367(d)(3) to address transfers of intangibles to partnerships, the Treasury Department and the IRS have concluded that acting pursuant to section 721(c) is more appropriate because the transactions at issue are not limited to transfers of intangible property.

Although section 704(b) provides partnerships a measure of flexibility to make special allocations of partnership income, the Treasury Department and the IRS believe that in some cases partnership transactions involving special allocations lead to inappropriate results. The Treasury Department and the IRS also are aware that certain taxpayers may be valuing property contributed to partnerships, or the property or services involved in related controlled transactions, in a manner contrary to section 482. As a result, partnership interests or consideration received in related controlled transactions also may be incorrectly valued, thereby reducing the amount of income or gain allocated to U.S. partners. For example, a partnership agreement might provide a domestic partner with a fixed preferred interest in exchange for the contribution of an intangible that is assigned a value that is inappropriately low, while specially allocating a greater share of the income from the intangible to a related foreign partner. Even though the IRS has broad authority under section 482 to make allocations to properly reflect the economics of a controlled transaction, administrative challenges arise, for example, when the IRS must make adjustments years after a transaction occurred. Because taxpayers have better access to information about their businesses and risk profiles, the IRS may be at a disadvantage in evaluating the transactions. Therefore, along with providing rules under section 721(c), the Treasury Department and the IRS intend to augment the section 482 rules as they apply to controlled transactions involving partnerships.

The Treasury Department and the IRS believe that remedial allocations can have the effect, in part, of ensuring that pre-contribution gain from contributed property is properly taken into account by the contributing partner. Further, allocating all section

704(b) book items (e.g., gain, income, loss, and deduction) associated with the contributed property in a consistent manner with respect to the contributing partner and any related foreign partner can help to ensure that the built-in gain associated with contributed property is properly taken into account by the contributing partner and that income is not inappropriately separated from related deductions. Accordingly, the Treasury Department and the IRS have determined that it is appropriate to allow for the continued application of section 721(a) to transfers to partnerships with related foreign partners only when the conditions described in section 4.03 of this notice are satisfied.

SECTION 4. REGULATIONS TO ADDRESS CERTAIN TRANSFERS OF PROPERTY TO PARTNERSHIPS WITH RELATED FOREIGN PARTNERS

.01 Definitions

(1) U.S. Transferor

A U.S. Transferor is a United States person within the meaning of section 7701(a)(30) (U.S. person), other than a domestic partnership.

(2) Built-in Gain

With respect to an item of property contributed to a partnership, Built-in Gain is the excess section 704(b) book value of the property over the contributing partner's adjusted tax basis in the property at the time of the contribution (and does not include gain created when a partnership revalues partnership property).

(3) Section 721(c) Property

Section 721(c) Property is property, other than Excluded Property, with Built-in Gain.

(4) Excluded Property

Excluded Property is (i) cash equivalents, (ii) any asset that is a security within the meaning of section 475(c)(2), without regard to section 475(c)(4), and (iii) any item of tangible property with Built-in Gain that does not exceed $20,000.

(5) Section 721(c) Partnership

A partnership (domestic or foreign) is a Section 721(c) Partnership if a U.S. Transferor contributes Section 721(c) Property to the partnership, and, after the contribution and any transactions related to the contribution, (i) a Related Foreign Person is a Direct or Indirect Partner in the partnership, and (ii) the U.S. Transferor and one or more Related Persons own more than fifty percent of the interests in partnership capital, profits, deductions or losses.

(6) Related Person

A Related Person is a person that is related (within the meaning of section 267(b) or section 707(b)(1)) to a U.S. Transferor.

(7) Related Foreign Person

A Related Foreign Person is a Related Person (other than a partnership) that is not a U.S. person.

(8) Direct or Indirect Partner

A Direct or Indirect Partner is a person (other than a partnership) that owns an interest in a partnership directly or indirectly through one or more partnerships.

(9) Gain Deferral Method

The Gain Deferral Method is the method described in section 4.03 of this notice.

(10) Acceleration Event

An Acceleration Event has the meaning provided in section 4.05 of this notice.

.02 General Rule – Current Gain Recognition

The Treasury Department and the IRS intend to issue regulations providing that section 721(a) will not apply when a U.S. Transferor contributes an item of Section 721(c) Property (or portion thereof) to a Section 721(c) Partnership, unless the Gain Deferral Method described in section 4.03 of this notice is applied with respect to the Section 721(c) Property. The regulations will include a de minimis rule providing that section 721(a) (if otherwise applicable) will continue to apply (without regard to whether the requirements of the Gain Deferral Method are satisfied) if during the U.S. Transferor's taxable year (1) the sum of the Built-In Gain with respect to all Section 721(c) Property contributed in that year to the Section 721(c) Partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons does not exceed $1 million, and (2) the Section 721(c) Partnership is not applying the Gain Deferral Method with respect to a prior contribution of Section 721(c) Property by the U.S. Transferor or another U.S. Transferor that is a Related Person.

.03 Gain Deferral Method

The requirements for applying the Gain Deferral Method are as follows:

(1) The Section 721(c) Partnership adopts the remedial allocation method described in §1.704-3(d) for Built-in Gain with respect to all Section 721(c) Property

contributed to the Section 721(c) Partnership pursuant to the same plan by a U.S. Transferor and all other U.S. Transferors that are Related Persons.

(2) During any taxable year in which there is remaining Built-In Gain with respect to an item of Section 721(c) Property, the Section 721(c) Partnership allocates all items of section 704(b) income, gain, loss, and deduction with respect to that Section 721(c) Property in the same proportion (for example, if income with respect to an item of Section 721(c) Property is allocated 60 percent to the U.S Transferor and 40 percent to a Related Foreign Person in a taxable year, then gain, deduction, and loss with respect to that Section 721(c) Property must also be allocated 60 percent to the U.S. Transferor and 40 percent to the Related Foreign Person).

(3) The reporting requirements described in section 4.06 of this notice are satisfied.

(4) The U.S. Transferor recognizes Built-in Gain with respect to any item of Section 721(c) property upon an Acceleration Event described in section 4.05 of this notice.

(5) The Gain Deferral Method is adopted for all Section 721(c) Property subsequently contributed to the Section 721(c) Partnership by the U.S. Transferor and all other U.S. Transferors that are Related Persons until the earlier of: (i) the date that no Built-in Gain remains with respect to any Section 721(c) Property to which the Gain Deferral Method first applied; or (ii) the date that is 60 months after the date of the initial contribution of Section 721(c) Property to which the Gain Deferral Method first applied.

.04 Tiered Partnerships

The regulations described in this notice will apply to transactions involving tiered partnerships in a manner consistent with the purpose of these rules as described in section 3 of this notice. Thus, for example, (i) if a U.S. Transferor is a Direct or Indirect Partner in a partnership and that partnership contributes Section 721(c) Property to a lower-tier partnership, or (ii) if a U.S. Transferor contributes an interest in a partnership that owns Section 721(c) Property to a lower-tier partnership, then the rules described in this notice will apply as though the U.S. Transferor contributed its share of the Section 721(c) Property directly.

.05 Rules Regarding Acceleration Events

(1) Acceleration Event defined

Except as otherwise provided in this section 4.05, an Acceleration Event with respect to an item of Section 721(c) Property is any transaction that either would reduce the amount of remaining Built-in Gain that a U.S. Transferor would recognize under the Gain Deferral Method if the transaction had not occurred or could defer the recognition of the Built-in Gain. Furthermore, an Acceleration Event is deemed to occur with respect to all Section 721(c) Property of a Section 721(c) Partnership for the taxable year of the Section 721(c) Partnership in which any party fails to comply with all of the requirements for applying the Gain Deferral Method.

(2) Gain recognized upon an Acceleration Event

Upon an Acceleration Event with respect to an item of Section 721(c) Property, a U.S. Transferor must recognize gain in an amount equal to the remaining Built-in Gain that would have been allocated to the U.S. Transferor if the Section 721(c) Partnership had sold the item of Section 721(c) Property immediately before the Acceleration Event for its fair market value. The regulations will provide for corresponding adjustments to the basis of the Section 721(c) Property and the U.S. Transferor's partnership interest to reflect the recognition of the remaining Built-In Gain. An Acceleration Event with respect to an item of Section 721(c) Property may require a U.S. Transferor to recognize only a portion of the remaining Built-in Gain. For example, if a U.S. Transferor sold only part of its interest in a Section 721(c) Partnership, the U.S. Transferor would have an Acceleration Event only to the extent of the Section 721(c) Property attributable to the partnership interest sold.

(3) Transfer of partnership interest to a domestic corporation

An Acceleration Event will not occur if (i) a U.S. Transferor transfers an interest in a Section 721(c) Partnership to a domestic corporation in a transaction to which either section 351(a) or section 381(a) applies, or (ii) a Section 721(c) Partnership transfers an interest in a lower-tier partnership that owns Section 721(c) Property to a domestic corporation in a transaction to which section 351(a) applies, provided that in both cases the parties continue to apply the Gain Deferral Method by treating the transferee domestic corporation as the U.S. Transferor for all purposes of this notice.

(4) Special rules for certain transfers of Section 721(c) Property described in section 351(a)

An Acceleration Event will not occur if a Section 721(c) Partnership transfers Section 721(c) Property to a domestic corporation in a transaction to which section 351(a) applies.

If a Section 721(c) Partnership transfers Section 721(c) Property (or an interest in a partnership that owns Section 721(c) Property) to a foreign corporation in a transaction described in section 351(a), an Acceleration Event will not occur to the extent the Section 721(c) Property is treated as being transferred by a U.S. person (other than a domestic partnership) pursuant to §1.367(a)-1T(c)(3)(i) or (ii).

The stock in a transferee corporation received by a Section 721(c) Partnership in a transaction described in this section 4.05(4) will not be subject to the Gain Deferral Method.

.06 Reporting Requirements

(1) Reporting required for taxable years beginning in 2015

If a Section 721(c) Partnership is a foreign partnership, a U.S. Transferor (or a domestic partnership in which a U.S. Transferor is a Direct or Indirect Partner) must fulfill any reporting requirements imposed under sections 6038, 6038B, and 6046A and the existing regulations thereunder with respect to the contribution of the Section 721(c) Property to the Section 721(c) Partnership. The IRS intends to modify Schedule O, Transfer of Property to a Foreign Partnership, of Form 8865 (Return of U.S. Persons

With Respect to Certain Foreign Partnerships), or its instructions, for taxable years beginning in 2015 to require supplemental information for contributions of Section 721(c) Property to Section 721(c) Partnerships.

(2) Reporting regulations to be issued

The Treasury Department and the IRS intend to issue regulations describing additional reporting requirements for a U.S. Transferor for each taxable year in which the Gain Deferral Method applies. The regulations will not require any new filings for taxable years that end before the date of publication of the regulations.

The regulations will require taxpayers to report certain information concerning Section 721(c) Property subject to the Gain Deferral Method (regardless of whether the Section 721(c) Partnership is a domestic or foreign partnership). The Treasury Department and the IRS anticipate that the requested information will include a description of the Section 721(c) Property; information regarding the amount of income, gain, deduction, or loss with respect to the Section 721(c) Property; and a description of any Acceleration Events. The new information reporting requirements will be coordinated with the information reporting requirements under sections 6038, 6038B, and 6046A, including amending the regulations under those sections or relevant IRS forms and instructions, as necessary.

The regulations will require certain U.S. Transferors that contribute Section 721(c) Property to a Section 721(c) Partnership that is a foreign partnership to comply with the information return filing requirements described in §1.6038-3 to the extent not required under current regulations.

(3) Extension of statute of limitations

The Treasury Department and the IRS intend to issue regulations providing that, as an additional requirement for applying the Gain Deferral Method, a U.S. Transferor (and, in certain cases, a Section 721(c) Partnership) must extend the period on limitations of assessment of tax with respect to all items related to the Section 721(c) Property contributed to the Section 721(c) Partnership through the close of the eighth full taxable year following the taxable year of the contribution. The regulations will not require the extension of the period of limitations for taxable years that end before the date of publication of the regulations.

.07 Examples

The following examples illustrate the rules described in section 4 of this notice. For simplicity of presentation, assume that there are no other controlled transactions that are related to the transactions described in the examples. See section 5 of this notice.

Example 1. *(i) Facts.* USP, a domestic corporation, wholly owns FS, a foreign corporation. USP and FS form a new partnership, PRS. FS contributes cash of $1.5 million to PRS, and USP contributes the following three assets: a patent with an arm's length price of $1.2 million and an adjusted basis of zero; a security (within the meaning of section 475(c)(2)) with an arm's length price of $100,000 and an adjusted basis of

$20,000; and a machine with an arm's length price of $200,000 and an adjusted basis of $600,000.

(ii) Analysis. Because the patent has Built-in Gain, it is Section 721(c) Property. Although the security also has Built-in Gain, it is Excluded Property because it is an asset described in section 475(c)(2). The machine has a built-in loss and is therefore not Section 721(c) Property. Thus, because USP is a U.S. person and not a domestic partnership, USP is a U.S. Transferor that has contributed Section 721(c) Property. FS is related to USP under section 267(b) and is not a U.S. person. Accordingly, FS is a Related Foreign Person to USP. USP and FS collectively own more than 50% of the interests in the capital, profits, deductions, and losses of PRS. Therefore, PRS is a Section 721(c) Partnership. The de minimis rule described in section 4.02 of this notice does not apply because the sum of the Built-In Gain for all Section 721(c) Property is $1.2 million, which exceeds the $1 million de minimis threshold. The built-in loss in the machine does not factor into determining whether the contribution is below the de minimis threshold. As a result, under section 4.02 of this notice, section 721(a) does not apply to USP's contribution of the patent to PRS, unless the Gain Deferral Method is applied.

Example 2. *(i) Facts*. In Year 1, USP, a U.S. Transferor, contributes Section 721(c) Property (Asset 1) with Built-in Gain of more than $1 million to a Section 721(c) Partnership in which FS, a Related Foreign Person, is also a partner. The partnership allocates all items of income, gain, deduction, and loss with respect to Asset 1 60% to

USP and 40% to FS and adopts the remedial allocation method with respect to Asset 1. The parties comply with the applicable reporting requirements under sections 6038, 6038B, and 6046A and the regulations thereunder. The parties properly apply the Gain Deferral Method with respect to Asset 1 in Years 1 through 3.

In an unrelated transaction in Year 4, USP contributes Section 721(c) Property (Asset 2) with a Built-in Gain of $100,000 to the partnership. The partnership allocates all items of income, gain, and loss with respect to Asset 2 20% to USP and 80% to FS, but allocates deductions with respect to Asset 2 90% to USP and 10% to FS. The partnership adopts the remedial allocation method with respect to Asset 2.

(ii) Analysis. In Year 4, although Asset 2 has Built-in Gain of less than $1 million, the de minimis rule will not apply because the parties are applying the Gain Deferral Method with respect to Asset 1. Because the deductions with respect to Asset 2 are allocated in a different proportion than the other section 704(b) items with respect to Asset 2, the requirements for satisfying the Gain Deferral Method are not met with respect to Asset 2, and USP must recognize the Built-in Gain with respect to Asset 2. Furthermore, because the Gain Deferral Method does not apply to Asset 2, which was contributed within 60 months of Asset 1 (the Section 721(c) Property to which the Gain Deferral Method was first applied), an Acceleration Event is deemed to occur with respect to Asset 1 under section 4.05(1) of this notice, and USP must recognize any remaining Built-In Gain with respect to Asset 1.

Example 3. The facts are the same as in Example 2 except that USP does not contribute Asset 2. In Year 3, the partners amend the partnership agreement so that all items of income, gain, deduction, and loss with respect to Asset 1 are now allocated 30% to USP and 70% to FS. Assume the amendment is accompanied by any consideration required by section 482 and has substantial economic effect as required by section 704(b). Because each section 704(b) item with respect to Asset 1 continues to be allocated in the same proportion to each partner, the Gain Deferral Method will continue to apply so long as the other requirements of the Gain Deferral Method are satisfied.

Example 4. (i) Facts. In Year 1, USP, a U.S. Transferor, contributes Section 721(c) Property (Asset 1) with Built-in Gain of more than $1 million to a Section 721(c) Partnership (PRS) in which FS, a Related Foreign Person, and USX, an unrelated U.S. person, are also partners. The parties properly apply the Gain Deferral Method with respect to Asset 1. In Year 3, USP transfers all of its assets, including its interest in PRS, to USS, a domestic corporation, in a transaction to which section 381(a) applies. In Year 9 (a year in which there is remaining Built-In Gain with respect to Asset 1), PRS distributes Asset 1 to FS.

(ii) Analysis - Section 381(a) transfer to a domestic corporation. Although USP will no longer recognize any remaining Built-In Gain with respect to Asset 1 under the Gain Deferral Method following the transfer to USS, USS is a successor U.S. Transferor. Therefore, provided the requirements of the Gain Deferral Method continue

to be satisfied, including treating USS as the U.S. Transferor, the transfer of USP's interest in PRS to USS is not an Acceleration Event.

(iii) Analysis - Distribution of Section 721(c) Property. Although section 704(c)(1)(B) does not apply to the distribution, the distribution is an Acceleration Event because USS will not recognize any remaining Built-In Gain with respect to Asset 1 under the Gain Deferral Method following the distribution. Therefore, USS must recognize gain in an amount equal to the remaining Built-in Gain that would have been allocated to USS if PRS had sold Asset 1 immediately before the distribution for its fair market value.

Example 5. *(i) Facts.* The facts are the same as in Example 4 except that in Year 3, instead of USP transferring its assets to USS, PRS instead contributes Asset 1 to FC, a foreign corporation, in a transfer described in section 351(a). There is no distribution in Year 9.

(ii) Analysis. For purposes of section 367(a) and (d), each partner in PRS that is a U.S. person is treated as having transferred its share of the Section 721(c) Property directly to FC (see §1.367(a)-1T(c)(3)(i)). An Acceleration Event occurs, but not to the extent of USP's and USX's shares of the Section 721(c) Property. The FC stock received by PRS in the transaction is not subject to the Gain Deferral Method.

.08 Anti-Abuse Rule

If a U.S. Transferor engages in a transaction (or series of transactions) with a principal purpose of avoiding the application of the regulations described in this notice, then, for purposes of those regulations, the transaction (or series of transactions) may be disregarded or the arrangement may be recharacterized (including disregarding an intermediate entity) in accordance with its substance.

SECTION 5. RULES REGARDING CONTROLLED TRANSACTIONS INVOLVING PARTNERSHIPS

.01 Regulations to Be Issued Regarding Controlled Transactions Involving Partnerships

The Treasury Department and the IRS intend to issue regulations regarding the application to controlled transactions involving partnerships of certain rules in §1.482-7 that are currently applicable to cost sharing arrangements. In particular, the Treasury Department and the IRS intend to issue regulations that provide specified methods for such controlled transactions based on the specified methods in §1.482-7(g) as appropriately adjusted in light of the differences in the facts and circumstances between such partnerships and cost sharing arrangements. Additionally, the regulations will provide periodic adjustment rules that are based on the principles of §1.482-7(i)(6) for controlled transactions involving partnerships. The regulations will provide that, in the event of a trigger based on a significant divergence of actual returns from projected returns for controlled transactions involving a partnership, the IRS may make periodic adjustments to the results of such transactions under a method based on §1.482-7(i)(6)(v), as appropriately adjusted, as well as any necessary corresponding adjustments to section 704(b) or section 704(c) allocations.

The Treasury Department and the IRS also are considering issuing regulations under §1.6662-6(d) to require additional documentation for certain controlled transactions involving partnerships. These regulations may require, for example, documentation of projected returns for property contributed to a partnership (as well as attributable to related controlled transactions) and of projected partnership allocations, including projected remedial allocations covered by section 4 of this notice, for a specified number of years.

.02 Application of Current Law to Transactions Described in this Notice

Under existing law, section 482 and related penalties apply to controlled transactions involving partnerships, including the transactions described in this notice. For example, where U.S. and foreign persons under common control enter into a partnership, the amounts of their contributions to, and distributions from, the partnership are subject to adjustment in order to reflect arm's length results. Also subject to adjustment are partnership allocations, including allocations under section 704(c), and the relative magnitudes of the partners' partnership interests in light of their respective contributions and the related controlled transactions. Accordingly, the amount of a remedial allocation pursuant to section 4 of this notice for controlled taxpayers that choose the Gain Deferral Method, or the amount of gain recognized if section 721(a) does not apply, potentially will be subject to adjustment by the IRS under section 482. In addition, when the conduct of partners, a partnership, or related controlled taxpayers is not reflected in, or is inconsistent with, the terms of the partnership agreement or any related agreements of the controlled taxpayers, the IRS may for purposes of an adjustment impute terms in the partnership or related agreements that are consistent with the substance of the transaction. The imputation of terms may be appropriate, for example, when a partner provides services to the partnership but neither the partnership agreement nor any other agreement reflects the provision of such services.

For purposes of the best method analysis under §1.482-1(c), the principles, methods, comparability, and reliability considerations set forth in §1.482-7 are relevant to controlled transactions involving partnerships, as appropriately adjusted in light of the differences in the facts and circumstances between such arrangements and a cost sharing arrangement. Thus, depending on the facts and circumstances, an unspecified method based on a method specified in §1.482-7(g)(1), as appropriately adjusted, may provide the most reliable measure of the arm's length results of controlled transactions involving a partnership.

To the extent that controlled transactions involving a partnership, including contributions of tangible and intangible property and the provision of services by the controlled partners or their affiliates, are interrelated, an aggregate analysis of their combined effects is necessary under §1.482-1(f)(2)(i) if the aggregate analysis provides the most reliable means of determining the arm's length results for the controlled transactions.

When intangible property within the meaning of section 936(h)(3)(B) is contributed to a partnership, the IRS may consider making periodic adjustments under §1.482-4(f)(2) in years subsequent to the contribution, without regard to whether the taxable year of the original transfer remains open for statute of limitations purposes.

For purposes of making periodic adjustments in open years, the IRS may consider the consequences of what would have been appropriate adjustments to the commonly controlled partners' interests in the partnership, or to any partnership allocations under section 704(b) or 704(c), in light of their respective contributions and the associated controlled transactions, even when those occurred in closed years. Furthermore, the IRS may consider the application of the periodic adjustment rules regardless of whether, under the regulations described in section 4 of this notice, section 721(a) applies to the initial contribution of intangible property to the partnership. Where section 721(a) is inapplicable, the IRS may consider the application of the equivalent royalty rule under §1.482-4(f)(6) to determine periodic adjustments to the recognition of gain on the contribution of the intangible property to the partnership.

In the absence of a basis, including the requirement of contemporaneous documentation, for establishing that the taxpayer reasonably concluded its valuation methods used for controlled transactions involving a partnership met the relevant measure of reliability set forth in §1.6662-6(d), penalties potentially would apply under section 6662(e) or (h).

SECTION 6. EFFECTIVE DATES

The regulations described in sections 4.01 through 4.06(1), 4.07, and 4.08 of this notice will apply to transfers occurring on or after August 6, 2015, and to transfers occurring before August 6, 2015, resulting from entity classification elections made under §301.7701-3 that are filed on or after August 6, 2015, and that are effective on or before August 6, 2015. The reporting requirements described in section 4.06(2) and (3) of this notice and the regulations described in section 5 of this notice will apply to transfers and controlled transactions occurring on or after the date of publication of the regulations described in those sections.

No inference is intended regarding the treatment of transactions described in this notice under current law, and the IRS may challenge such transactions under applicable Code provisions, Treasury regulations, and judicial doctrines. For example, the IRS may challenge a partnership's adopted section 704(c) method (for purposes of §1.704-3(a)(1)) under the anti-abuse rule in §1.704-3(a)(10).

SECTION 7. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the regulations described in section 4.06 of this notice (concerning reporting requirements). Specifically, comments are requested on whether the regulations should provide rules similar to those in the recently finalized regulations under sections 367(a) and 6038B regarding failures to file gain recognition agreements or to satisfy other reporting obligations, including the standards for relief therein. See T.D. 9704, 2014-50 I.R.B. 922. Comments also are requested on whether an Acceleration Event should exclude a distribution of Section 721(c) Property to an unrelated foreign partner beyond the seven-year limitation of section 704(c)(1)(B). Finally, comments are also requested regarding the regulations described in section 5 of this notice that will provide specified valuation methods and periodic adjustment rules for controlled transactions involving partnerships based on §1.482-7(g) and (i)(6), and the extent to which the documentation requirements described in §1.6662-6(d)(2)(iii) should be expanded to include specific requirements for transactions involving partnerships.

Written comments may be submitted to the Internal Revenue Service, CC:PA:LPD (Notice 2015-54), Room 5207, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Comments also may be hand-delivered Monday through Friday between the hours of 8:00 a.m. to 4:00 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Attn: CC:PA:LPD:PR (Notice 2015-54). Comments also may be submitted electronically to notice.comments@irscounsel.treas.gov. Please include "Notice 2015-54" in the subject line of any electronic submission. Comments will be available for public inspection and copying. The principal authors of this notice are Ryan A. Bowen and Kenneth A. Jeruchim of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS also participated in its development. For further information regarding this notice contact Mr. Bowen (section 4) at (202) 317-6937 or Mr. Jeruchim (section 5) at (202) 317-6939 (not a toll-free call).