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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9877]

RIN 1545-BM83

Liabilities Recognized as Recourse Partnership Liabilities under Section 752

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations addressing when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 of the Internal Revenue Code (Code), when partnership liabilities are treated as recourse liabilities under section 752, and how bottom dollar payment obligations are treated under section 752. These final regulations provide guidance necessary for a partnership to allocate its liabilities among its partners. These regulations affect partnerships and their partners.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §§1.704-1(b)(1)(ii)(a), 1.752-1(d)(2), and 1.752-2(l).

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

SUPPLEMENTARY INFORMATION:

Background

1. Overview

This Treasury decision contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 704 and 752 of the Code. On January 30, 2014, the Department of the Treasury (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 (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. On October 5, 2016, after consideration of, and in response to, the comments on the 2014 Proposed Regulations, the Treasury Department and the IRS published in the **Federal Register** (81 FR 69291) 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 for disguised sale purposes (T.D. 9787). Also on October 5, 2016, the Treasury Department and the IRS published in the **Federal Register** (81 FR 69282) final and temporary regulations under sections 707 and 752 (T.D. 9788) implementing a new rule concerning the allocation of liabilities for section 707 purposes (707 Temporary Regulations) and rules concerning the treatment of “bottom dollar payment obligations” (752 Temporary Regulations). Finally, in the **Federal Register** (81 FR 69301) on October 5, 2016, the Treasury Department and the IRS withdrew the 2014 Proposed Regulations under §1.752-2 and published new proposed regulations (REG-122855-15) cross-referencing the 707 Temporary Regulations (707 Proposed Regulations) and the 752 Temporary Regulations and 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 (752 Proposed Regulations). On November 17, 2016, the Treasury Department and the IRS published in the **Federal Register** (81 FR 80993 and 81 FR 80994) two correcting amendments to T.D. 9788 (the temporary regulations as so corrected, 707 Temporary Regulations).

In the **Federal Register** (83 FR 28397) on June 19, 2018, the Treasury Department and the IRS subsequently withdrew the 707 Proposed Regulations, and published proposed regulations (REG-131186-17) proposing to reinstate the regulations under section 707 concerning how partnership liabilities are allocated for disguised sale purposes that were in effect prior to the 707 Temporary Regulations. In addition to these final regulations under sections 704 and 752, the Treasury Department and the IRS are publishing in this issue of the **Federal Register** (INSERT XX FR XXXXX), final

regulations under section 707 that are the same as the regulations that were in effect prior to the 707 Temporary Regulations.

A public hearing on the 752 Proposed Regulations was not requested or held, but the Treasury Department and the IRS received written comments. After consideration of the comments, this Treasury decision adopts the rules in the 752 Temporary Regulations and the 752 Proposed Regulations with some changes. These changes, and comments received on the 752 Temporary Regulations and the 752 Proposed Regulations, are discussed in the Summary of Comments and Explanations of Revisions section of the preamble that follows.

2. Summary of Applicable Law

Section 752 separates partnership liabilities into two categories: recourse liabilities and nonrecourse liabilities. Section 1.752-1(a)(1) provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss (EROL) for that liability under §1.752-2. 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 to any person within the meaning of §1.752-2(b). For purposes of determining the extent to which a partner or related person has an obligation to make a payment, an obligation to restore a deficit capital account upon liquidation of the partnership under the section 704(b) regulations is taken into account (deficit restoration obligation). Further, for this purpose, §1.752-2(b)(6) of the existing regulations presumes that partners and related persons who have payment

obligations actually perform those obligations, irrespective of their net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation (the satisfaction presumption). However, the satisfaction presumption is subject to an anti-abuse rule in §1.752-2(j) pursuant to which a payment obligation of a partner or related person may be disregarded or treated as an obligation of another person if facts and circumstances indicate that a principal purpose of the arrangement is to eliminate the partner's EROL with respect to that obligation or create the appearance of the partner or related person bearing the EROL when the substance is otherwise. Under the existing rules, the satisfaction presumption is also subject to a disregarded entity net value requirement under §1.752-2(k) pursuant to which, for purposes of determining the extent to which a partner bears the EROL for a partnership liability, a payment obligation of a disregarded entity is taken into account only to the extent of the net value of the disregarded entity as of the allocation date that is allocated to the partnership liability.

Summary of Comments and Explanations of Revisions

1. Bottom Dollar Payment Obligations

A. Obligations treated as bottom dollar payment obligations

The 752 Temporary Regulations provide that a bottom dollar payment obligation is not recognized as a payment obligation for purposes of §1.752-2. The 752 Temporary Regulations provide that a bottom dollar payment obligation is the same as or similar to one of the following three types of payment obligations or arrangements: (1) 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; (2) 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 is recognized; and (3) 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. 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, 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. The 752 Temporary Regulations also provide an exception to the non-recognition rule of bottom dollar payment obligations. That is, a bottom dollar payment obligation is recognized when a partner or related person is liable for at least 90 percent

of the partner's or related person's initial payment obligation despite an indemnity, a reimbursement agreement, or a similar arrangement.

One commenter stated that the 752 Temporary Regulations are conceptually flawed, result in inconsistent answers, and are directly contrary to Congressional intent. That commenter explained that the prior regulations appropriately followed Congress's mandate that debt is allocated by a partnership to the partners who bear the EROL with respect to the debt. See Section 79 of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) overruling the decision in Raphan v. United States, 3 Cl. Ct. 457 (1983) (holding that a guarantee on a partnership liability by a general partner did not require that partner to be treated as personally liable for that liability and did not preclude the other partners who did not guarantee the loan from sharing in the step up in basis on account of the debt). The commenter argued that the 752 Temporary Regulations instead treat all guarantees as bottom dollar payment obligations which do not create EROL unless the partner is liable for the full amount of that partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied. The commenter asserted that, under the 752 Temporary Regulations, all guarantees below 90 percent of a payment obligation are ignored, even if the partnership and the partners believe that the guaranteeing partner bears the EROL with respect to the payment obligation.

As an example of these concerns, the commenter pointed to the different results in Examples 10 and 11 in §1.752-2T(f). In Examples 10 and 11, A, B, and C are equal members of a partnership, ABC. ABC borrows \$1,000 from Bank. In Example 10, A guarantees up to \$300 of the liability if any amount of the \$1,000 liability is not

recovered by Bank, while B guarantees payment of up to \$200, but only if Bank otherwise recovers less than \$200. In Example 11, C additionally agrees to indemnify A for up to \$100 that A pays with respect to A's guarantee. The comment explained that, in Example 10, \$300 of the liability is recognized and allocated (to A), but in Example 11, only \$100 is recognized and allocated (in the amount indemnified by C). The full \$300 payment obligation would have been recognized and allocated if made by one partner, but splitting it across two partners caused \$200 of the collective payment obligation to be ignored. This result is notwithstanding that \$300 of the same first-dollars of the \$1,000 partnership liability in the example was guaranteed by the partners.

Although recommending revocation of the 752 Temporary Regulations, this commenter recognized that prior regulations under section 752 allow partners that have no practical economic risk to be allocated debt. As a compromise, this commenter proposed that if the Treasury Department and the IRS are concerned with bottom dollar payment obligations that lack economic reality, the temporary regulations should be replaced with a rule that does not recognize obligations below a certain threshold. The commenter recommended, as an example, that obligations limited to the bottom one-third of a debt obligation not be recognized, but once the obligation is above that threshold, the entire obligation is recognized. The commenter argued that such a rule would provide greater certainty than the 752 Temporary Regulations and recognize that the guarantor has risk.

The 752 Temporary Regulations and these final regulations implement Congressional intent. Bottom dollar payment obligations do not represent real EROL

because those payment obligations are structured to insulate the obligor from having to pay their obligations. Moreover, bottom dollar guarantees are not relevant to loan risk underwriting generally. These obligations generally lack a significant non-tax commercial business purpose. Therefore, bottom dollar payment obligations should not be recognized as payment obligations. Despite the commenter's assertion that there could be some risk to partners with bottom dollar payment obligations, the Treasury Department and the IRS received no comments (including from this commenter) on the 752 Temporary Regulations or the 752 Proposed Regulations demonstrating that bottom dollar payment obligations have a significant non-tax commercial business purpose. Nor did any commenter propose an alternative that resolves the concerns raised in the preamble to the 752 Temporary Regulations that, under the prior section 752 regulations, partners and related persons entered into payment obligations that were not commercial solely to achieve an allocation of a partnership liability. The compromise proposal offered by this commenter would significantly lower the threshold for the amount required to be economically at risk from 90 percent of a partner's or related person's initial payment obligation to 33 percent without explaining why the lower threshold is more appropriate. Indeed, the compromise could still allow a partner with no practical economic risk to be allocated debt. These final regulations comport with Congress' directive in response to Raphan. Moreover, Examples 10 and 11 in §1.752-2(f) are not inconsistent with one another, but show how an otherwise recognized payment obligation can become a bottom dollar payment obligation when the initial payment obligor no longer bears the real EROL as a result of a subsequent

indemnity. For these reasons, the Treasury Department and the IRS do not adopt the commenter's suggestions.

The 752 Temporary Regulations further require taxpayers to disclose bottom dollar payment obligations by filing Form 8275, Disclosure Statement, or any successor form, with the return of the partnership for the taxable year in which a bottom dollar payment obligation is undertaken or modified. These final regulations clarify that identifying the payment obligation with respect to which disclosure is made includes stating whether the obligation is a guarantee, a reimbursement, an indemnity, or deficit restoration obligation.

B. Capital contribution and deficit restoration obligations

Generally, the regulations under section 752 provide a description of obligations recognized as payment obligations under §1.752-2(b)(1). The 752 Temporary Regulations further provide that all statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying §1.752-2, including obligations to the partnership that are imposed by the partnership agreement, such as the obligation to make a capital contribution and a deficit restoration obligation. See §1.752-2T(b)(3).

A commenter expressed concerns that, although it is clear that a capital contribution obligation and a deficit restoration obligation are types of payment obligations to which §1.752-2 applies, the definition of a bottom dollar payment obligation provides no guidance as to how to determine whether a capital contribution obligation or a deficit restoration obligation is a bottom dollar payment obligation. For example, a deficit restoration obligation does not relate to a particular partnership

liability and the proceeds of the deficit restoration obligation may be paid to creditors of the partnership or distributed to other partners. See §1.704-1(b)(2)(ii)(b)(3). These final regulations thus revise the definition of a bottom dollar payment obligation to specifically address capital contribution obligations and deficit restoration obligations. Section 1.752-2(b)(3)(ii)(C)(1)(iii) in these final regulations provides that a bottom dollar payment obligation includes, with respect to a capital contribution obligation and a deficit restoration obligation, any payment obligation other than one in which the partner is or would be required to make the full amount of the partner's capital contribution or to restore the full amount of the partner's deficit capital account.

C. Anti-abuse rule in §1.752-2(j)(2)

The 752 Temporary Regulations provide that irrespective of the form of the contractual obligation, the Commissioner may treat a partner as bearing the EROL with respect to a partnership liability, or portion thereof, to the extent that: (1) the partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan; (2) 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 portion thereof; and (3) with respect to the contractual obligations described in (1) or (2), (i) one of the principal purposes of using the contractual obligation 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 (ii) another partner, or person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation to be disregarded. See §1.752-2T(j)(2).

A commenter argued that because this anti-abuse rule is at the Commissioner's discretion, taxpayers are uncertain how to treat certain liabilities that would otherwise be bottom dollar payment obligations. One of the purposes of the 752 Temporary Regulations is to ensure that only genuine commercial payment obligations, including guarantees and indemnities, affect the allocation of partnership liabilities. Indeed, commenters to the 2014 Proposed Regulations noted that partners can manipulate contractual arrangements to achieve a federal income tax result that is not consistent with the economics of an arrangement. This is true both of a payment obligation that does not represent a real EROL as well as an agreement that purposefully creates the appearance of a bottom dollar payment obligation even if that taxpayer (or a person related to that taxpayer) bears the EROL. The anti-abuse rule, therefore, is appropriate. However, in response to comments regarding uncertainty caused because the anti-abuse rule in the 752 Temporary Regulations applied at the Commissioner's discretion, the final regulations remove the discretionary language consistent with the rule in the regulations under section 752 prior to the 752 Temporary Regulations.

D. Applicability date and transitional rule

The 752 Temporary Regulations for bottom dollar payment obligations generally 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. Under the 752 Temporary Regulations, a transitional rule applies to any partner whose allocable share of partnership liabilities under §1.752-2 exceeded its adjusted basis in

its partnership interest as determined under §1.705-1 on October 5, 2016 (Grandfathered Amount). To the extent of that excess, those partners may continue to apply the prior regulations under §1.752-2 with respect to a partnership liability for a seven-year period. The amount of partnership liabilities subject to transition relief decreases for certain reductions in the amount of liabilities allocated to that partner under the transitional rule 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.

A commenter explained that the rule in §1.704-2(g)(3) regarding conversions of recourse or partner nonrecourse liabilities into nonrecourse liabilities may overlap and potentially conflict with the transitional rule. This commenter noted that the transitional rule may be unnecessary, but, regardless, believes that the transitional rule should be coordinated with §1.704-2(g)(3).

Section 1.704-2(g)(3) provides that a partner's share of partnership minimum gain is increased to the extent provided in §1.704-2(g)(3) if a recourse or partner nonrecourse liability becomes partially or wholly nonrecourse. If a recourse liability becomes a nonrecourse liability, a partner has a share of the partnership's minimum gain that results from the conversion equal to the partner's deficit capital account (determined under §1.704-1(b)(2)(iv)) to the extent the partner no longer bears the economic burden for the entire deficit capital account as a result of the conversion. The determination of the extent to which a partner bears the economic burden for a deficit capital account is made by determining the consequences to the partner in the case of a complete liquidation of the partnership immediately after the conversion applying the

rules described in §1.704-1(b)(2)(iii)(c) that deem the value of partnership property to equal its basis, taking into account section 7701(g) in the case of property that secures nonrecourse indebtedness. If a partner nonrecourse debt becomes a nonrecourse liability, the partner's share of partnership minimum gain is increased to the extent the partner is not subject to the minimum gain chargeback requirement under §1.704-2(i)(4). The commenter asserts that §1.704-2(g)(3) increases a partner's share of minimum gain which increases the partner's capital account to reflect the same result as if nonrecourse deductions had been taken all along. The gain, if it would have been triggered as a result of a partner's negative section 704(b) account with no deficit reduction obligation, is deferred because under §1.704-2(g)(3), the partner's share of minimum gain increases. The commenter argues that §1.752-3(a)(1) or (2) would apply to allocate the nonrecourse liability to the partner and, therefore, the partner would still be allocated a share of the partnership liability eliminating the need for the transitional rule.

Notwithstanding the rule in §1.704-2(g)(3), the transitional rule is necessary to address certain situations when §1.704-2(g)(3) would not apply because, for example, before these regulations were finalized, a bottom dollar deficit restoration obligation is regarded for section 704 purposes, but is disregarded for section 752 purposes. In that case, a partner could recognize gain under section 731 without the transitional rule. Additionally, because §1.752-3(a)(1) and (2) do not apply in determining a partner's share of a partnership nonrecourse liability for disguised sale purposes, a disguised sale could occur if a partner's share of liabilities under §1.752-3(a)(3) does not cover the Grandfathered Amount.

To the extent that the transitional rule applies to a partner's share of a recourse partnership liability as a result of the partner bearing the EROL under §1.752-2(b), the partner's share of the liability can continue to be determined under §1.752-2 and is not converted into a nonrecourse liability under §1.752-3. In this situation, because a recourse or partner nonrecourse liability does not become partially or wholly nonrecourse as a result of the transitional rule, the rule in §1.704-2(g)(3) would not apply until the expiration of the seven-year period. If a partner does not want to apply the transitional rule in determining its share of a partnership liability because it believes that the rule in §1.704-2(g)(3) effectively defers any negative tax consequences that could occur when a recourse or partner nonrecourse liability becomes partially or wholly nonrecourse, the partner must then apply the rules under §1.752-2, as amended after October 5, 2016, in determining its share of a partnership liability.

This commenter also noted that the transitional rule should clarify whether it applies to refinanced liabilities. The bottom dollar payment obligation rules do not apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect before October 5, 2016. The preamble to the 752 Temporary Regulations explains that commenters on the 2014 Proposed Regulations had recommended that partnership liabilities or payment obligations that are modified or refinanced continue to be subject to the provisions of the previous regulations to the extent of the amount and duration of the pre-modification (or refinancing) liability or payment obligation. The preamble explains that 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, but instead provided transition relief. Under the transitional rule, if a debt entered into before October 5, 2016, is not refinanced, these final regulations do not apply. If the debt is refinanced, then these regulations apply, but the partner could instead choose to apply the transitional rule to the extent of the Grandfathered Amount. Although the transitional rule in the 752 Temporary Regulations applies to modified or refinanced obligations, these final regulations further clarify that the transitional rule applies to modified and refinanced liabilities.

2. Additional Guidance on Disregarding Purported Payment Obligations

A. Deficit restoration obligation factors

The 752 Proposed Regulations add a list of factors to §1.704-1(b)(2)(ii)(c) that are similar to the factors in the proposed anti-abuse rule under §1.752-2(j) (discussed in Section 2.B. of the Summary of Comments and Explanations of Revisions in this preamble), but specific to deficit restoration obligations, to indicate when a plan to circumvent or avoid an obligation exists. If a plan to circumvent or avoid an obligation exists, the obligation is disregarded for purposes of sections 704 and 752. Under proposed §1.704-1(b)(2)(ii)(c), the following factors 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.

The Treasury Department and the IRS are aware that a partner's transfer of its deficit restoration obligation to a transferee who agrees to the same deficit restoration obligation could run afoul of the third factor and cause the partner's deficit restoration obligation to be disregarded. However, under these final regulations, the weight to be given to any particular factor depends on the particular facts and the presence or absence of any particular factor is not, in itself, necessarily indicative of whether or not the obligation is respected. The fact that a transferee agrees to the same deficit restoration obligation should be taken into account when determining whether a plan to circumvent or avoid an obligation exists. In addition, these final regulations add an exception to this factor when a transferee partner assumes the obligation.

B. Anti-abuse factors under §1.752-2(j)(3)

The 2014 Proposed Regulations included a list of factors to determine whether a partner's or related person's obligation to make a payment with respect to a partnership liability (excluding those imposed by state law) would be recognized for purposes of section 752. In response to comments, the 752 Proposed Regulations moved the list of factors to an anti-abuse rule in §1.752-2(j)(3), other than the recognition factors concerning bottom dollar guarantees and indemnities, which are addressed in the 752 Temporary Regulations. Under the anti-abuse rule in the 752 Proposed Regulations, the following non-exclusive factors are weighed to determine whether a payment obligation should be respected: (1) the partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment,

(2) the partner or related person is not required to provide commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party, (3) the term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, (4) there exists a plan or arrangement in which the primary obligor or any other obligor with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonable foreseeable needs of such obligor, (5) the payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection, (6) in the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee, and (7) the creditor or other party benefiting from the obligation did not receive executed documentation with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation. The weight to be given to any particular factor depends on the particular case and the presence or absence of any particular factor, in itself, is not necessarily indicative of whether or not a payment obligation is recognized under §1.752-2(b).

A commenter expressed concerns with the listed factors asserting that they are drafted to make an obligation fail (that the debt will be nonrecourse) because an obligation is unlikely to satisfy all seven factors. The commenter also argued that the factors are subject to manipulation by taxpayers who desire nonrecourse debt

treatment. Finally, the commenter was concerned with the subjective and speculative inquiry regarding the fourth and sixth factors.

The seven factors are appropriate considerations in determining whether a plan to circumvent or avoid an obligation exists. The 2014 Proposed Regulations provided that a payment obligation with respect to a partnership liability was not recognized under §1.752-2(b)(3) unless all of the factors were met. At commenters' requests and due to concerns that the rule was too strict, the 752 Proposed Regulations moved the list of factors from the operative rule to the anti-abuse rule where they are now just factors to examine in determining whether a plan to circumvent or avoid an obligation exists. In response to the comment on the 752 Proposed Regulations, however, these final regulations add clarification to the fourth factor that amounts are not held in excess of the reasonably foreseeable needs of an obligor if the partnership purchases standard commercial insurance, such as casualty insurance. Additionally, these final regulations list certain types of commercially reasonable documentation (balance sheets and financial statements) as examples of documents a lender would typically require.

A commenter also requested that the final regulations clarify how the assumption rule in §1.752-1(d) relates to the factors in §1.752-2(j). Under §1.752-1(b), any increase in a partner's share of partnership liabilities, or any increase in a partner's individual liabilities by reason of the partner's assumption of partnership liabilities, is treated as a contribution of money by that partner to the partnership. Conversely, §1.752-1(c) provides that any decrease in a partner's share of partnership liabilities, or any decrease in a partner's individual liabilities by reason of the partnership's assumption of the individual liabilities of the partner, is treated as a distribution of money by the

partnership to that partner. The assumption rule in §1.752-1(d) applies to determine whether a partner has assumed a partnership liability (treated as a contribution under section 752(a)), or the partnership has assumed a partner liability (treated as a distribution under section 752(b)). Generally under §1.752-1(d), a person is considered to assume a liability only to the extent that (1) the assuming person is personally obligated to pay the liability; and (2) if a partner or related person assumes a partnership liability, the person to whom the liability is owed knows of the assumption and can directly enforce the partner's or related person's obligation for the liability, and no other partner or person that is a related person to another partner would bear the EROL for the liability immediately after the assumption. Sections 1.752-2 and 1.752-3 provide the rules for determining a partner's share of partnership recourse and nonrecourse liabilities.

The analysis for determining whether a partner or person that is a related person to a partner bears the EROL for a liability for purposes of the assumption rule in §1.752-1(d) should be the same analysis for determining whether a partner or related person bears the EROL under §1.752-2, including the factors in §1.752-2(j) for payment obligations. Therefore, these final regulations add a cross reference in §1.752-1(d) to clarify that an assumption will be treated as giving rise to a payment obligation only to the extent no other partner or a person related to another partner bears the EROL for the liability as determined under §1.752-2.

C. Reasonable expectation of ability to satisfy obligation

The satisfaction presumption in §1.752-2(b)(6) of the existing regulations is subject to a disregarded entity net value requirement under existing §1.752-2(k). The

2014 Proposed Regulations expanded the scope of the net value requirement and provided that, in determining the extent to which a partner or related person other than an individual or a decedent's estate bears the EROL for a partnership liability other than a trade payable, a payment obligation is recognized only to the extent of the net value of the partner or related person that, as of the allocation date, is allocated to the liability, as determined under §1.752-2(k). The 2014 Proposed Regulations also required a partner to provide a statement concerning the net value of a person with a payment obligation (a payment obligor) to the partnership. The preamble to the 2014 Proposed Regulations requested comments concerning whether the net value rule should also apply to individuals and estates and whether the regulations should consolidate these rules under §1.752-2(k).

Comments on the 2014 Proposed Regulations suggested that if the net value rule is retained, §1.752-2(k) should be extended to all partners and related persons other than individuals. A commenter expressed concerns that a partner who may be treated as bearing the EROL with respect to a partnership liability would have to provide information regarding the net value of a payment obligor, which is unnecessarily intrusive. Another commenter believed that if the rules requiring net value were extended to all partners in partnerships, the attempt to achieve more realistic substance would be accompanied by a corresponding increase in the potential for manipulation.

The preamble to the 752 Proposed Regulations explains that the Treasury Department and the IRS remain concerned with ensuring that a partner or related person be presumed to satisfy its payment obligation only to the extent that such partner or related person would be able to pay the obligation. After consideration of the

comments to the 2014 Proposed Regulations, however, the Treasury Department and the IRS agreed that expanding the application of the net value rules under §1.752-2(k) may lead to more litigation and may unduly burden taxpayers. Furthermore, net value as provided in §1.752-2(k) may not accurately take into account future earnings of a business entity, which normally factor into lending decisions. Therefore, the 752 Proposed Regulations proposed to remove §1.752-2(k) of the existing regulations and instead create a new presumption under the anti-abuse rule in §1.752-2(j).

Under the presumption in the 752 Proposed Regulations, 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 (Presumed Anti-abuse Rule). A payment obligor includes disregarded entities (including grantor trusts). If evidence of a plan to circumvent or avoid the obligation exists or is deemed to exist, the obligation is not recognized under §1.752-2(b) and therefore the partnership liability is treated as a nonrecourse liability under §1.752-1(a)(2).

Commenters argued that §1.752-2(k) should be retained, however, because it provides clarity and certainty to taxpayers. One commenter suggested that if the government believes that the Presumed Anti-abuse Rule is necessary, §1.752-2(k) should still be retained, or, alternatively, expanded to all partners and related persons other than individuals. This commenter noted that the Presumed Anti-abuse Rule creates uncertainty as it is not clear that taxpayers may proactively assert the Presumed Anti-abuse Rule. The commenter suggested that the final regulations clarify that motive

and intent are irrelevant in determining whether the Presumed Anti-abuse Rule applies and that no actual plan to circumvent or avoid an obligation needs to exist.

Expanding the application of §1.752-2(k) in the existing regulations would unduly burden taxpayers and would not accurately reflect economics. A more accurate reflection of economics is to determine whether a debtor will have the ability to make payments when due, not necessarily to whether the debtor has sufficient assets to satisfy an obligation currently. The Treasury Department and the IRS agree with the commenter, however, that the Presumed Anti-abuse Rule could create confusion and uncertainty. These final regulations, therefore, amend §1.752-2(k) and clarify how the satisfaction presumption in §1.752-2(b)(6) relates to §1.752-2(k) in these final regulations. Amended §1.752-2(k) applies to all partners of a partnership, including partners that are disregarded entities or grantor trusts.

Under these final regulations, it is assumed that all payment obligors actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate that at the time the partnership determines a partner's share of partnership liabilities under §§1.705-1(a) and 1.752-4(d) there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable. A partner or related person's ability to pay may be based on documents such as, but not limited to, balance sheets, income statements, cash flow statements, credit reports, and projected future financial results.

D. General applicability date

Except as provided in Section 1.D. of the Summary of Comments and Explanations of Revisions in this preamble relating to bottom dollar payments obligations, these final regulations apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, 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.

3. Additional Issues Concerning Partnership Liabilities That Are Outside the Scope of These Regulations

A commenter recommended guidance in determining a partner's amount at risk under section 465 for deficit restoration obligations. This commenter noted that under Hubert Enterprises, Inc. v. Commissioner, T.C. Memo. 2008-46, a deficit restoration obligation was not treated as giving a partner at risk basis because the obligation was contingent (because it was dependent upon the partner liquidating his interest) and the amount was uncertain (the deficit restoration obligation covered only the deficit in the partner's capital account at the time of liquidation and did not cover the entire debt obligation at issue). The commenter also recommended providing guidance under section 465 similar to that provided in these final regulations regarding when guarantees will be recognized. Providing guidance concerning section 465 is beyond the scope of these regulations. The Treasury Department and the IRS request comments, however, concerning whether guidance is needed to address issues under section 465.

The commenter recommended that these regulations incorporate standards to determine when a debt is recourse to a partnership under section 1001. The

commenter questioned whether that test under section 1001 is performed at the partnership or partner level. These final regulations provide guidance as to how liabilities are allocated to partners in a partnership and do not concern how liabilities are characterized to the partnership under section 1001. This comment is thus outside the scope of these regulations.

This commenter also suggested that the Treasury Department and the IRS consider whether the rules in section 357(d) should have been adopted for partnerships since section 357(d)(3) states that the Secretary may also prescribe regulations which provide that the manner in which a liability is treated as assumed under section 357(d) is applied, where appropriate, elsewhere in Title 26. Section 357(d)(1)(A) provides that a recourse liability (or portion thereof) shall be treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed to, and is expected to, satisfy such liability (or portion), whether or not the transferor has been relieved of such liability. Section 357(d)(1)(B) provides that except as provided in section 357(d)(2), a nonrecourse liability shall be treated as having been assumed by the transferee of any asset subject to such liability. This recommended change is beyond the scope of these regulations, which are concerned with whether a partnership debt is recourse or non-recourse to a partner in the partnership.

The 752 Proposed Regulations requested comments concerning exculpatory liabilities in response to comments received on the 2014 Proposed Regulations requesting guidance with respect to such liabilities. An exculpatory liability is a liability that is recourse to an entity under state law and section 1001, but no partner bears the EROL within the meaning of section 752. Thus, the liability is treated as nonrecourse

for section 752 purposes. The Treasury Department and the IRS, after acknowledging that exculpatory liabilities are beyond the scope of the 752 Proposed Regulations, sought additional comments regarding the proper treatment of an exculpatory liability under regulations under section 704(b) and the effect of such a liability's classification under section 1001. Further, the Treasury Department and the IRS requested additional comments addressing the allocation of an exculpatory liability among multiple assets and possible methods for calculating minimum gain with respect to such liability, such as the so-called "floating lien" approach (whereby all the assets in the entity, including cash, are considered to be subject to the exculpatory liability) or a specific allocation approach. The Treasury Department and the IRS continue to consider the comments received concerning exculpatory liabilities under sections 704 and 752.

Special Analyses

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal in that it requires partnerships (including partnerships that may be small entities) to provide information they already maintain or can easily obtain to the IRS. Moreover, it should take a partnership no more than 2 hours to satisfy the information requirement in these regulations. Accordingly, this rule will not have a significant economic impact on a substantial number of small entities

pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Paperwork Reduction Act

The collection of information contained in these final 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.

The collection of information in these final regulations under section 752 is in §1.752-2(b)(3)(ii)(D). This information is required by the IRS to ensure that section 752 of the Code and applicable regulations are properly applied for allocations of partnership liabilities. The respondents will be partners and partnerships.

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.

Drafting Information

The principal author of these regulations is Caroline E. Hay, Office of the Associate Chief Counsel (Passthroughs and Special Industries). 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 * * *

Par. 2. Section 1.704-1 is amended by:

1. Adding two sentences to the end of paragraph (b)(1)(ii)(a).
2. Adding a sentence to the end of paragraph (b)(2)(ii)(b)(3) introductory text.
3. Removing the undesignated paragraph following paragraph (b)(2)(ii)(b)(3).
4. Adding paragraphs (b)(2)(ii)(b)(4) through (7).
5. Revising paragraph (b)(2)(ii)(c).

The additions and revisions read as follows:

§1.704-1 Partner's distributive share.

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(a) * * * Furthermore, the last sentence of paragraph (b)(2)(ii)(b)(3) of this section and paragraphs (b)(2)(ii)(b)(4) through (7) and (b)(2)(ii)(c) of this section apply to partnership taxable years ending on or after **INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**. However, taxpayers may apply the last sentence of paragraph (b)(2)(ii)(b)(3) of this section and paragraphs (b)(2)(ii)(b)(4) through (7) and (b)(2)(ii)(c) of this section for partnership taxable years ending on or after October 5, 2016. For partnership taxable years ending before **INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER**, see §1.704-1 as contained in 26 CFR part 1 revised as of April 1, 2019.

* * * * *

(2) * * *

(ii) * * *

(b) * * *

(3) * * * Notwithstanding the partnership agreement, an obligation to restore a deficit balance in a partner's capital account, including an obligation described in paragraph (b)(2)(ii)(c)(1) of this section, will not be respected for purposes of this section to the extent the obligation is disregarded under paragraph (b)(2)(ii)(c)(4) of this section.

(4) For purposes of paragraphs (b)(2)(ii)(b)(1) through (3) of this section, a partnership taxable year shall be determined without regard to section 706(c)(2)(A).

(5) The requirements in paragraphs (b)(2)(ii)(b)(2) and (3) of this section are not violated if all or part of the partnership interest of one or more partners is purchased (other than in connection with the liquidation of the partnership) by the partnership or by

one or more partners (or one or more persons related, within the meaning of section 267(b) (without modification by section 267(e)(1)) or section 707(b)(1), to a partner) pursuant to an agreement negotiated at arm's length by persons who at the time such agreement is entered into have materially adverse interests and if a principal purpose of such purchase and sale is not to avoid the principles of the second sentence of paragraph (b)(2)(ii)(a) of this section.

(6) The requirement in paragraph (b)(2)(ii)(b)(2) of this section is not violated if, upon the liquidation of the partnership, the capital accounts of the partners are increased or decreased pursuant to paragraph (b)(2)(iv)(f) of this section as of the date of such liquidation and the partnership makes liquidating distributions within the time set out in the requirement in paragraph (b)(2)(ii)(b)(2) of this section in the ratios of the partners' positive capital accounts, except that it does not distribute reserves reasonably required to provide for liabilities (contingent or otherwise) of the partnership and installment obligations owed to the partnership, so long as such withheld amounts are distributed as soon as practicable and in the ratios of the partners' positive capital account balances.

(7) See Examples (1)(i) and (ii), (4)(i), (8)(i), and (16)(i) of paragraph (b)(5) of this section for issues concerning paragraph (b)(2)(ii)(b) of this section.

(c) Obligation to restore deficit--(1) Other arrangements treated as obligations to restore deficits. If a partner is not expressly obligated to restore the deficit balance in such partner's capital account, such partner nevertheless will be treated as obligated to restore the deficit balance in his capital account (in accordance with the requirement in

paragraph (b)(2)(ii)(b)(3) of this section and subject to paragraph (b)(2)(ii)(c)(2) of this section) to the extent of—

(A) The outstanding principal balance of any promissory note (of which such partner is the maker) contributed to the partnership by such partner (other than a promissory note that is readily tradable on an established securities market), and

(B) The amount of any unconditional obligation of such partner (whether imposed by the partnership agreement or by state or local law) to make subsequent contributions to the partnership (other than pursuant to a promissory note of which such partner is the maker).

(2) Satisfaction requirement. For purposes of paragraph (b)(2)(ii)(c)(1) of this section, a promissory note or unconditional obligation is taken into account only if it is required to be satisfied at a time no later than the end of the partnership taxable year in which such partner's interest is liquidated (or, if later, within 90 days after the date of such liquidation). If a promissory note referred to in paragraph (b)(2)(ii)(c)(1) of this section is negotiable, a partner will be considered required to satisfy such note within the time period specified in this paragraph (b)(2)(ii)(c)(2) if the partnership agreement provides that, in lieu of actual satisfaction, the partnership will retain such note and such partner will contribute to the partnership the excess, if any, of the outstanding principal balance of such note over its fair market value at the time of liquidation. See paragraph (b)(2)(iv)(d)(2) of this section. See Examples (1)(ix) and (x) of paragraph (b)(5) of this section.

(3) Related party notes. For purposes of paragraph (b)(2) of this section, if a partner contributes a promissory note to the partnership during a partnership taxable

year beginning after December 29, 1988, and the maker of such note is a person related to such partner (within the meaning of §1.752-4(b)(1)), then such promissory note shall be treated as a promissory note of which such partner is the maker.

(4) Obligations disregarded--(A) General rule. A partner in no event will be considered obligated to restore the deficit balance in his capital account to the partnership (in accordance with the requirement in paragraph (b)(2)(ii)(b)(3) of this section) to the extent such partner's obligation is a bottom dollar payment obligation that is not recognized under §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. See paragraphs (b)(2)(ii)(f), (b)(2)(ii)(h), and (b)(4)(vi) of this section for other rules regarding 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 (in accordance with the requirement in paragraph (b)(2)(ii)(b)(3) of this section), the obligation is disregarded and paragraph (b)(2) of this section and §1.752-2 are applied as if the obligation did not exist.

(B) Factors indicating plan to circumvent or avoid obligation. In the case of an obligation to restore a deficit balance in a partner's capital account upon liquidation of a partnership, paragraphs (b)(2)(ii)(c)(4)(B)(i) through (iv) of this section provide a non-exclusive list of factors that may indicate a plan to circumvent or avoid the obligation. For purposes of making determinations under this paragraph (b)(2)(ii)(c)(4), the weight to be given to any particular factor depends on the particular case and the presence or absence of any particular factor is not, in itself, necessarily indicative of whether or not

the obligation is respected. The following factors are taken into consideration for purposes of this paragraph (b)(2):

(i) The partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation.

(ii) 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.

(iii) 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 other than when a transferee partner assumes the obligation.

(iv) The terms of the obligation are not provided to all the partners in the partnership in a timely manner.

* * * * *

Par. 3. Section 1.752-0 is amended by:

1. Adding entries for §1.752-1(d)(1) and (2).
2. Adding entries for §1.752-2(b)(3)(i) and (ii), (b)(3)(ii)(A) through (C), (b)(3)(ii)(C)(1) through (3), (b)(3)(ii)(D), and (b)(3)(iii).
3. Adding entries for §1.752-2(j)(2)(i) and (ii).
4. Adding entries for §1.752-2(j)(3)(i) through (ii).
5. Revising the entries for §1.752-2(j)(3) and (4).
6. Adding entries for §1.752-2(k) and (k)(1) and (2).
7. Adding an entry for §1.752-2(l).

The revisions and additions read as follows:

§1.752-0 Table of contents.

* * * * *

§1.752-1 Treatment of partnership liabilities.

* * * * *

(d) * * *

- (1) In general.
- (2) Applicability date.

* * * * *

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

* * * * *

(b) * * *

(3) * * *

- (i) In general.
- (ii) Special rules for bottom dollar payment obligations.
 - (A) In general.
 - (B) Exception.
 - (C) Definition of bottom dollar payment obligation.
 - (1) In general.
 - (2) Exceptions.
 - (3) Benefited party defined.
 - (D) Disclosure of bottom dollar payment obligations.
- (iii) Special rule for indemnities and reimbursement agreements.

* * * * *

(j) * * *

(2) * * *

- (i) In general.
- (ii) Economic risk of loss.
- (3) Plan to circumvent or avoid an obligation.
 - (i) General rule.
 - (ii) Factors indicating plan to circumvent or avoid an obligation.
- (4) Example.
- (k) No reasonable expectation of payment.
 - (1) In general.
 - (2) Examples.

(l) Applicability dates.

* * * * *

Par. 4. Section 1.752-1 is amended by:

1. Redesignating paragraphs (d)(1) and (2) as paragraphs (d)(1)(i) and (ii), respectively, and revising newly redesignated paragraph (d)(1)(ii).
2. Redesignating the text of paragraph (d) following its subject heading as paragraph (d)(1), revising the heading for paragraph (d), and adding a heading to newly redesignated paragraph (d)(1).
3. Adding paragraph (d)(2).

The revisions and additions read as follows:

§1.752-1 Treatment of partnership liabilities.

* * * * *

(d) Assumption of liability—(1) In general. * * *

(ii) If a partner or related person assumes a partnership liability, the person to whom the liability is owed knows of the assumption and can directly enforce the partner's or related person's obligation for the liability, and no other partner or person that is a related person to another partner would bear the economic risk of loss for the liability under §1.752-2 immediately after the assumption.

(2) Applicability date. Paragraph (d)(1)(ii) of this section applies to liabilities incurred or assumed by a partnership on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. The rules applicable to liabilities incurred or assumed prior to **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, are contained in §1.752-1 in effect prior to **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, (see 26 CFR part 1 revised as of April 1, 2019).

* * * * *

Par. 5. Section 1.752-2 is amended by:

1. Revising paragraphs (b)(3) and (6).
2. Adding a sentence to the end of paragraph (f) introductory text.
3. Designating Example 1 through 11 of paragraph (f) as paragraph (f)(1)

through (f)(11), respectively.

4. Revising newly designated paragraphs (f)(9) through (11).
5. Revising paragraphs (j)(2) and (3).
6. Adding paragraph (j)(4).
7. Revising paragraphs (k) and (l).

The revisions and additions read as follows:

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

* * * * *

(b) * * *

(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, a reimbursement agreement, or a 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) With respect to an obligation to make a capital contribution or 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)), any payment obligation other than one in which the partner is or would be required to make the full amount of the partner's capital contribution or to restore the full amount of the partner's deficit capital account.

(iv) 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), (ii), or (iii) 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 (including whether the obligation is a guarantee, a reimbursement, an indemnity, or an obligation to restore a deficit balance in a partner's capital account).

(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, a reimbursement agreement, or a 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, a reimbursement agreement, or a 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.

* * *

(6) Deemed satisfaction of obligation. For purposes of determining the extent to which a partner or related person has a payment obligation and the economic risk of loss, it is assumed that all partners and related persons who have obligations to make

payments (a payment obligor) actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate—

(i) A plan to circumvent or avoid the obligation under paragraph (j) of this section,

or

(ii) That there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable as described in paragraph (k) of this section.

* * * * *

(f) Examples. * * * Unless otherwise provided, for purposes of paragraph (f)(1) through (9) of this section (Examples 1 through 9), assume that any obligation of a partner or related person to make a payment is recognized under paragraph (b)(3) of this section.

* * * * *

(9) [Reserved].

(10) 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.

(11) Example 11. Indemnification of guarantees. (i) The facts are the same as in paragraph (f)(10) of this section (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.

* * * * *

(j) * * *

(2) Arrangements tantamount to a guarantee--(i) In general. Irrespective of the form of a contractual obligation, a partner is considered to bear 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.

(3) Plan to circumvent or avoid an obligation--(i) General rule. An obligation of a partner or related person to make a payment is not recognized under paragraph (b) of this section if the facts and circumstances evidence a plan to circumvent or avoid the obligation.

(ii) Factors indicating plan to circumvent or avoid an obligation. In the case of a payment obligation, other than an obligation to restore a deficit capital account upon liquidation of a partnership, paragraphs (j)(3)(ii)(A) through (G) of this section provide a non-exclusive list of factors that may indicate a plan to circumvent or avoid the payment obligation. The presence or absence of a factor is based on all of the facts and circumstances at the time the partner or related person makes the payment obligation or if the obligation is modified, at the time of the modification. For purposes of making determinations under this paragraph (j)(3), the weight to be given to any particular factor depends on the particular case and the presence or absence of a factor is not necessarily indicative of whether a payment obligation is or is not recognized under paragraph (b) of this section.

(A) The partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, including, for example, restrictions on transfers for inadequate consideration or distributions by the partner or related person to equity owners in the partner or related person.

(B) The partner or related person is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party, including, for example, balance sheets and financial statements.

(C) The term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, if the purpose of limiting the duration of the payment obligation is to terminate such payment obligation prior to the occurrence of an event or events that increase the risk of economic loss to the guarantor or benefited party (for example, termination prior to the due date of a balloon payment or a right to terminate that can be exercised because the value of loan collateral decreases). This factor typically will not be present if the termination of the obligation occurs by reason of an event or events that decrease the risk of economic loss to the guarantor or benefited party (for example, the payment obligation terminates upon the completion of a building construction project, upon the leasing of a building, or when certain income and asset coverage ratios are satisfied for a specified number of quarters).

(D) There exists a plan or arrangement in which the primary obligor or any other obligor (or a person related to the obligor) with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonably foreseeable needs of such obligor (but not taking into account standard commercial insurance, for example, casualty insurance).

(E) The payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection.

(F) In the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee.

(G) The creditor or other party benefiting from the obligation did not receive executed documents with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation.

(4) Example. The following example illustrates the principles of paragraph (j) of this section.

(i) In 2020, A, B, and C form a domestic limited liability company (LLC) that is classified as a partnership for federal tax purposes. Also in 2020, LLC receives a loan from a bank. A, B, and C do not bear the economic risk of loss with respect to that partnership liability, and, as a result, the liability is treated as nonrecourse under §1.752-1(a)(2) in 2020. In 2022, A guarantees the entire amount of the liability. The bank did not request the guarantee and the terms of the loan did not change as a result of the guarantee. A did not provide any executed documents with respect to A's guarantee to the bank. The bank also did not require any restrictions on asset transfers by A and no such restrictions exist.

(ii) Under paragraph (j)(3) of this section, A's 2022 guarantee (payment obligation) is not recognized under paragraph (b)(3) of this section if the facts and circumstances evidence a plan to circumvent or avoid the payment obligation. In this case, the following factors indicate a plan to circumvent or avoid A's payment obligation: (1) the partner is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, such as restrictions on transfers for inadequate consideration or equity distributions; (2) the partner is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party; (3) in the case of a guarantee or similar arrangement, the terms of the liability are the same as they would have been without the guarantee; and (4) the creditor did not receive executed documents with respect to the payment obligation from the partner or related person at the time the obligation was created. Absent the existence of other facts or circumstances that would weigh in favor of respecting A's guarantee, evidence of a plan to circumvent or avoid the obligation exists and, pursuant to paragraph (j)(3)(i) of this section, A's guarantee is not recognized under paragraph (b) of this section. As a result, LLC's liability continues to be treated as nonrecourse.

(k) No reasonable expectation of payment --(1) In general. An obligation of any partner or related person to make a payment is not recognized under paragraph (b) of this section if the facts and circumstances indicate that at the time the partnership must determine a partner's share of partnership liabilities under §§1.705-1(a) and 1.752-4(d) there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable. Facts and circumstances to consider in determining a commercially reasonable expectation of payment include factors a third party creditor would take into account when determining whether to grant a loan. For purposes of this section, a payment obligor includes an entity disregarded as an entity separate from its owner under section 856(i), section 1361(b)(3), or §§301.7701-1 through 301.7701-3 of this chapter (a disregarded entity), and a trust to which subpart E of part I of subchapter J of chapter 1 of the Code applies

(2) Examples. The following examples illustrate the principles of paragraph (k) of this section.

(i) Example 1. Undercapitalization. (A) In 2020, A forms a wholly owned domestic limited liability company, LLC, with a contribution of \$100,000. A has no liability for LLC's debts, and LLC has no enforceable right to a contribution from A. Under §301.7701-3(b)(1)(ii) of this chapter, LLC is treated for federal tax purposes as a disregarded entity. Also in 2020, LLC contributes \$100,000 to LP, a limited partnership with a calendar year taxable year, in exchange for a general partnership interest in LP, and B and C each contributes \$100,000 to LP in exchange for a limited partnership interest in LP. The partnership agreement provides that only LLC is required to restore any deficit in its capital account. On January 1, 2021, LP borrows \$300,000 from a bank and uses \$600,000 to purchase nondepreciable property. The \$300,000 is secured by the property and is also a general obligation of LP. LP makes payments of only interest on its \$300,000 debt during 2021. LP has a net taxable loss in 2021, and, under §§1.705-1(a) and 1.752-4(d), LP determines its partners' shares of the \$300,000 debt at the end of its taxable year, December 31, 2021. As of that date, LLC holds no assets other than its interest in LP.

(B) Because LLC is a disregarded entity, A is treated as the partner in LP for federal income tax purposes. Only LLC has an obligation to make a payment on account of the \$300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, paragraph (k) of this section is applied to the LLC and not to A. LLC has no assets with which to pay if the payment obligation becomes due and payable. Because there is no commercially reasonable expectation that LLC will be able to satisfy its payment obligation, LLC's obligation to restore its deficit capital account is not recognized under paragraph (b) of this section. As a result, LP's \$300,000 debt is characterized as nonrecourse under §1.752-1(a)(2) and is allocated among A, B, and C under §1.752-3.

(ii) Example 2. Disregarded entity with ability to pay. (A) The facts are the same as in paragraph (k)(2)(i) of this section (Example 1), except LLC also holds real property worth \$475,000 subject to a \$200,000 liability. Additionally, LLC reasonably projects to earn \$20,000 of net rental income per year from such real property.

(B) Because LLC is a disregarded entity, A is treated as the partner in LP for federal income tax purposes. Only LLC has an obligation to make a payment on account of the \$300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, paragraph (k) of this section is applied to the LLC and not to A. Because there is a commercially reasonable expectation that LLC will be able to satisfy its payment obligation, LLC's obligation to restore its deficit capital account is recognized under paragraph (b) of this section. As a result, LP's \$300,000 debt is characterized as recourse under §1.752-1(a)(1) and is allocated to A under §1.752-2.

(l) Applicability dates. (1) Paragraphs (a) and (h)(3) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to that date. The rules applicable to liabilities incurred or assumed (or pursuant to a written binding contract in effect) prior to October 11, 2006, are contained in §1.752-2 in effect prior to October 11, 2006, (see 26 CFR part 1 revised as of April 1, 2006). Paragraphs (b)(6), (j)(3) and (4), and (k) of this section apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, 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. However, taxpayers may apply paragraphs (b)(6), (j)(3) and (4), and (k) 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 pursuant to a written binding contract in effect) prior to **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, are contained in §1.752-2 in effect prior to **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, (see 26 CFR part 1 revised as of April 1, 2019).

(2) Paragraphs (b)(3), (f)(10) and (11), and (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 paragraphs (b)(3), (f)(10) and (11), and (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), and such liability is modified or refinanced, the partnership (Transition Partnership) may choose not to apply paragraphs (b)(3), (f)(10)

and (11), and (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). See also §1.704-2(g)(3). A liability is modified or refinanced for purposes of this paragraph (l) to the extent that the proceeds of a partnership liability (the refinancing debt) are allocable under the rules of §1.163-8T to payments discharging all or part of any other liability (pre-modification liability) of that partnership or there is a significant modification of that liability as provided under §1.1001-3. 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 prior to January 1, 2018, 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.

§1.752-2T [Amended]

Par. 6. In §1.752-2T, paragraphs (a) through (b), (c)(1) through (2), (d) through (k), (l)(1) through (3), and (m)(1) are removed and reserved.

Deputy Commissioner for Services and Enforcement.

Approved:

Assistant Secretary of the Treasury (Tax Policy).