



# Internal Revenue Service

DEPARTMENT OF THE TREASURY

## LB&I Process Unit

<b>Unit Name</b>	Transfers of Property to Partnerships with a Related Foreign Partner	
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# Process Overview

## Transfers of Property to Partnerships with a Related Foreign Partner

U.S. persons can transfer built-in gain (appreciated) property in a wide variety of nonrecognition transactions, such as contributions to partnerships in exchange for an interest in the partnership. In general, IRC 721(a) provides for nonrecognition treatment when a partner contributes appreciated property to a partnership. However, in certain cases, such nonrecognition treatment could allow a U.S. person to use a partnership to inappropriately shift the tax consequences of pre-contribution gain attributable to appreciated property to a related foreign partner. With certain partnerships, namely partnerships with partners that are related to one another, there is heightened potential for such a shift to occur.

Specifically, a U.S. Transferor may inappropriately shift pre-contribution gain to a related foreign partner. This may occur when the partnership to which property is contributed adopts an IRC 704(c) allocation method other than the remedial method and/or uses valuation techniques that are inconsistent with the arm's length standard. For example, when a U.S. partner contributes appreciated property with a zero tax basis, the disparity between the contributed property's Fair Market Value (FMV) and its tax basis at the time of contribution can limit the amount of tax depreciation or amortization that can be allocated to the related foreign partner. In other words, the maximum amount or ceiling of tax depreciation or amortization that can be allocated among the partners for zero basis property is zero (referred to as the ceiling rule). Therefore, if the contributed property's tax depreciation or amortization is zero, it follows that there is no tax depreciation or amortization to allocate to the related foreign partner. And, if the related foreign partner cannot be allocated its share of tax depreciation or amortization, then the tax consequences of the U.S. partner's pre-contribution gain can be partially shifted to the related foreign partner due to the ceiling rule limitation.

To address this issue, the Treasury Department issued regulations under IRC 721(c). The IRC 721(c) regulations generally provide that a U.S. Transferor must recognize gain upon the transfer of appreciated property (tangible or intangible property) to certain partnerships (domestic or foreign) whose partners include foreign persons related to the U.S. Transferor unless certain requirements are met. Specifically, the U.S. Transferor will immediately recognize gain unless it elects to apply the gain deferral method. The gain deferral method, in turn, generally allows the U.S. Transferor to recognize the pre-contribution gain over time, but the gain can be accelerated in certain instances.



**CONSULTATION:** This practice unit focuses on the transfers of property to partnerships with related foreign partners. Generally, if the partnership only has domestic partners, then IRC 721(c) will not apply, but IRC 704(c) may apply. Please consult with the Partnership Practice Network for IRC 704(c) issues or for ceiling rule issues.


# Detailed Explanation of the Process


## Transfers of Property to Partnerships with a Related Foreign Partner

### Analysis

IRC 721(a) provides a nonrecognition rule for the gain or loss on a contribution of property to the partnership in exchange for an interest in the partnership. However, under IRC 721(c), the Secretary may provide regulations to override this gain nonrecognition treatment in certain circumstances. The Treasury Department determined that it is appropriate to exercise the regulatory authority granted in IRC 721(c) to override the application of IRC 721(a) for gain realized on the transfer of appreciated property to a partnership (domestic or foreign) in circumstances where there may be a shift of the tax consequences associated with pre-contribution gain (and attendant income) outside the United States.

Therefore, when a U.S. Transferor contributes appreciated property to partnerships with foreign partners who are related to the transferor, the normal non-recognition provisions of IRC 721(a) are disregarded unless the gain deferral method applies.

 **CAUTION:** Please be aware that Form 1065 may need to be opened for examination to work this issue. There may be different statute dates for Form 1120 and Form 1065. Please consider the need for statute extensions under the Tax Equity and Fiscal Responsibility Act (TEFRA)/Bipartisan Budget Act (BBA).

 **CONSULTATION:** Please consult with the Partnership Practice Network for TEFRA/BBA provisions. Please consult with the Transfer Pricing Practice Network for assistance on whether to perform a transfer pricing analysis of a controlled transaction involving the contribution of property to a partnership (e.g., if the value of the contributing partner's interest in the partnership following a contribution does not appear to be consistent with the value of the partner's contribution).

# Summary of Process Steps

## Transfers of Property to Partnerships with a Related Foreign Partner

### Process Steps

When a U.S. Transferor contributes appreciated property to a partnership with a related foreign partner, the following steps should be taken to determine the correct tax treatment.

<a href="#">Step 1</a>	Determine if there is a contribution of IRC 721(c) property.
<a href="#">Step 2</a>	Determine if the contribution is to an IRC 721(c) partnership.
<a href="#">Step 3</a>	Determine if the five requirements of the Gain Deferral Method (GDM) are met.
<a href="#">Step 3a</a>	Determine if the IRC 721(c) partnership adopted both the remedial allocation method of making IRC 704(c) allocations and the consistent allocation method.

# Summary of Process Steps (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Process Steps

When a U.S. Transferor contributes appreciated property to a partnership with a related foreign partner, the following steps should be taken to determine the correct tax treatment.


<a href="#">Step 3b</a>	Determine if the U.S. Transferor recognizes gain equal to the remaining built-in gain with respect to IRC 721(c) property upon an acceleration event.
<a href="#">Step 3c</a>	Determine if procedural and reporting requirements are satisfied.
<a href="#">Step 3d</a>	Determine if the U.S. Transferor extended the statute of limitations on assessment of tax.
<a href="#">Step 3e</a>	Determine if U.S. Transferor complied with the rules for tiered IRC 721(c) partnerships.
<a href="#">Step 4</a>	Determine if compliance with the reporting requirements referenced above is satisfied.

# Step 1: IRC 721(c) Property

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 1

Determine if there is a contribution of IRC 721(c) property.


Considerations	Resources
<p>IRC 721(c) property is built-in gain property contributed by a U.S. Transferor to a partnership. Certain property is excluded from the definition of IRC 721(c) property, including:</p> <ul style="list-style-type: none"> <li>▪ Cash equivalents;</li> <li>▪ Securities (as defined in IRC 475(c)(2) without regard to (c)(4)), or</li> <li>▪ Tangible property with built-in gain of \$20,000 or less.</li> </ul> <p>A de minimis exception applies where the sum of all the built-in gain with respect to IRC 721(c) property contributed to an IRC 721(c) partnership during a taxable year of the IRC 721(c) partnership is less than \$1 million. In this instance, the IRC 721(c) rules will not apply, and IRC 721(a) non-recognition will apply.</p> <p>An interest in a partnership may also constitute IRC 721(c) property in certain tiered structures.</p> <p> <b>CONSULTATION:</b> Consult with an economist or the Transfer Pricing Practice Network for valuation issues.</p>	<ul style="list-style-type: none"> <li>▪ IRC 721(c) - <i>Regulations Relating to Certain Transfers to Partnerships</i></li> <li>▪ Treas. Regs. 1.721(c)-1(b)(14) - <i>Section 721(c) Partnership</i></li> <li>▪ yK1</li> <li>▪ Employee User Portal (EUP)</li> <li>▪ Form 1065, Schedule L - <i>Balance Sheet per Books</i></li> <li>▪ Form 8865, Schedule L - <i>Balance Sheet per Books</i></li> </ul>



# Step 1: IRC 721(c) Property (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 1

Considerations	Resources
<p>In determining whether IRC 721(c) property has been contributed to the partnership, review the following:</p> <ul style="list-style-type: none"> <li>▪ Form 1120 Balance Sheet</li> <li>▪ Schedule M-2 and K-1s for significant increases in asset and/or partner capital accounts</li> <li>▪ Partnership's IRC 704(b) Basis Workpapers</li> <li>▪ Form 1065, Schedule L</li> <li>▪ Form 8865, Schedule L, Schedule O and Schedule P</li> <li>▪ K-1s</li> <li>▪ Transfer Pricing Documentation</li> <li>▪ Valuation Studies</li> <li>▪ Partnership/Member Agreement</li> </ul> <p> <b>CAUTION:</b> Be aware that not all intangibles may be reflected on the balance sheet of the U.S. Transferor. Many self-developed intangibles have value and will not be on the balance sheet.</p>	<ul style="list-style-type: none"> <li>▪ IRC 721(c) - <i>Regulations Relating to Certain Transfers to Partnerships</i></li> <li>▪ Treas. Regs. 1.721(c)-1(b)(14) - <i>Section 721(c) Partnership</i></li> <li>▪ Form 8865 - <i>Return of U.S. Persons With Respect to Certain Foreign Partnerships</i></li> <li>▪ Form 8865, Schedule G - <i>Statement of Application of the Gain Deferral Method Under Section 721(c)</i></li> <li>▪ Financial Statements</li> <li>▪ Partnership's IRC 704(b) Basis Workpapers,</li> <li>▪ K-1s</li> <li>▪ Partnership /Member Agreement</li> </ul>

# Step 2: IRC 721(c) Partnership

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 2

Determine if the contribution is to an IRC 721(c) partnership.

Considerations	Resources
<p>As noted in the preceding slides, if appreciated property is contributed to a partnership, the tax consequences of the pre-contribution gain attributable to the appreciated property may escape U.S. taxation absent the IRC 721(c) rules. Please note that the partnership can be domestic or foreign, but commonly the partnership is foreign. Additionally, an entity that checks-the-box to be treated as a partnership for U.S. federal tax purposes is also subject to these rules.</p> <p>An IRC 721(c) partnership is any partnership to which a U.S. Transferor contributes IRC 721(c) property if after the contribution and related transactions:</p> <ol style="list-style-type: none"><li>1. A related foreign person is a direct or indirect partner, AND</li><li>2. The U.S. Transferor and one or more related foreign persons owns 80 percent or more of the interests in the partnership capital, profits, deductions or losses</li></ol>	<ul style="list-style-type: none"><li>▪ <i>Treas. Reg. 1.721(c)-1(b)(14) - Section 721(c) Partnership</i></li><li>▪ <i>Treas. Reg. 1.721(c)-2(d) - Rules for Identifying a 721(c) Partnership When a Partnership Contributes Property to Another Partnership</i></li></ul>

# Step 2: IRC 721(c) Partnership (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 2

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ After the contribution and all transactions related to the contribution,               <ul style="list-style-type: none"> <li>– Is a foreign related person a direct or indirect partner in the partnership?</li> <li>– Do the U.S. Transferor and related persons own 80 percent or more of the interests in partnership capital, profits, deductions, or losses?</li> </ul> </li> <li>▪ In determining whether the foreign related person is a direct or indirect partner, and whether the U.S. Transferor and foreign related persons own 80 percent or more of the interests in the partnership, review the following:               <ul style="list-style-type: none"> <li>– Tax organizational chart</li> <li>– Financial statements</li> <li>– Form 1065, Schedule L and Schedule K</li> <li>– Form 8865, line 6</li> <li>– Form 8865, Schedule L and Schedule K</li> <li>– yK1, EUP</li> <li>– K-1s</li> <li>– Partnership/Member Agreement</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-1(b)(14) - Section 721(c) Partnership</i></li> <li>▪ <i>Form 8865, Schedule A - Constructive Ownership of Partnership Interest</i></li> <li>▪ <i>Form 8865, Schedule A-1 - Certain Partners of Foreign Partnership</i></li> <li>▪ <i>Form 8865, Schedule A-2 - Foreign Partners of Section 721(c) Partnership</i></li> </ul>

## Step 2: IRC 721(c) Partnership (cont'd)

### Transfers of Property to Partnerships with a Related Foreign Partner

#### Step 2

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ Is there a tiered partnership structure?</li> </ul> <p>If the U.S. Transferor is a direct or indirect partner in a partnership that contributes property to another partnership (lower-tier partnership), the U.S. Transferor is treated as contributing to the lower-tier partnership its share of the property actually contributed by the upper-tier partnership for purposes of determining if the lower-tiered partnership is an IRC 721(c) partnership.</p> <ul style="list-style-type: none"> <li>▪ In determining whether there is a tiered partnership structure, review the following:               <ul style="list-style-type: none"> <li>- Tax Organizational Chart</li> <li>- Financial Statements</li> <li>- Form 1065</li> <li>- Form 8865</li> <li>- yK1, EUP</li> <li>- K-1s</li> <li>- Partner/Member Agreement</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-2(d) - Rules for Identifying a 721(c) Partnership When a Partnership Contributes Property to Another Partnership</i></li> </ul>

# Step 3: Five Requirements for the Gain Deferral Method (GDM)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3

Determine if the five requirements of the Gain Deferral Method (“GDM”) are met.

Considerations	Resources
<p>The general rule is that the non-recognition of gain under IRC 721(a) does not apply to a contribution of IRC 721(c) property to an IRC 721(c) partnership unless certain requirements are met. Specifically, the full amount of gain with respect to IRC 721(c) property is recognized at the time of the contribution of that property by the U.S. Transferor to the IRC 721(c) partnership unless the GDM is applied.</p> <p>There are five general requirements for applying the GDM:</p> <ol style="list-style-type: none"><li>The IRC 721(c) partnership must adopt both the remedial allocation method of making IRC 704(c) allocations and the consistent allocation method (please note that separate requirements apply with respect to IRC 721(c) property that generates income or gain effectively connected (collectively, ECI) with the conduct of a trade or business within the U.S.);</li><li>U.S. Transferor recognizes gain equal to the remaining built-in gain with respect to the IRC 721(c) property upon an acceleration event;</li><li>Procedural and reporting requirements are satisfied;</li><li>U.S. Transferor extends the period of limitations on assessment of tax; and</li><li>Specific rules for tiered IRC 721(c) partnerships are applied (if applicable).</li></ol>	<ul style="list-style-type: none"><li>▪ <i>Treas. Reg. 1.721(c)-2 - Recognition of Gain on Certain Contributions to Partnerships With Related Foreign Partners</i></li><li>▪ <i>Treas. Reg. 1.721(c)-3 - Gain Deferral Method</i></li><li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li></ul>

# Step 3a: GDM Requirements - Allocation Methods

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3a

Determine if the IRC 721(c) partnership adopted both the remedial allocation method of making IRC 704(c) allocations and the consistent allocation method.

Considerations	Resources
<p>a) The IRC 721(c) partnership must adopt both the remedial allocation method of making IRC 704(c) allocations and the consistent allocation method.</p> <p>The first requirement is for the IRC 721(c) partnership to adopt the remedial allocation method. In general, taxpayers are granted flexibility in choosing IRC 704(c) allocation methods to address IRC 704(c) contributions including the traditional method, the traditional method with curative allocations, and the remedial allocation method. The remedial allocation method eliminates distortions caused by the traditional allocation method (ceiling rule distortions, see slide 4 for an additional description of the ceiling rule) by allowing a partnership to create offsetting allocations of tax items. Specifically, under the remedial allocation method, the partnership creates notional or “remedial” allocations of income, gain, loss, or deduction to the noncontributing partner equal to the full amount of the ceiling-rule limited item and offsets those allocations with remedial allocations to the contributing partner. In other words, notional allocations of tax items precisely offset the impact of ceiling rule distortions.</p> <p>The remedial allocation method, therefore, is the only IRC 704(c) allocation method that reliably and consistently ensures that the tax consequences of pre-contribution gain are properly borne by the contributing partner. Thus, the IRC 721(c) regulations mandate the remedial allocation method.</p> <p>Please see <a href="#">Slide 41</a> for an example of the remedial allocation method and ceiling rule.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3 - Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-2 - Recognition of Gain in Certain Contributions of Property to Partnerships with Related Foreign Partners</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.704-3(a) - General Principles</i></li> <li>▪ <i>Treas. Reg. 1.704-3(b) - Traditional method</i></li> <li>▪ <i>Treas. Reg. 1.704-3(d) - Remedial Allocation Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-3(c) - Consistent Allocation Method</i></li> </ul>

# Step 3a: GDM Requirements - Allocation Method (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner


### Step 3a

Considerations	Resources
<p>The second part of the first requirement is that the IRC 721(c) partnership applies the consistent allocation method. The consistent allocation method requires an IRC 721(c) partnership to allocate IRC 704(b) book items with respect to the IRC 721(c) property to the U.S. Transferor in a consistent manner; specifically, the book items must be allocated to the US Transferor in the same percentage. Although the consistent allocation method requires each book item of income, gain, deduction, and loss with respect to IRC 721(c) property to be allocated to a U.S. Transferor in the same percentage for a single taxable year, the consistent allocation method does not require the allocations to be in the same percentage among all taxable years in which the gain deferral method is applied.</p> <p>The consistent allocation method prevents the U.S. Transferor from rendering the remedial allocation (and the gain deferral method) ineffective by, for example, allocating a higher percentage of book depreciation to the U.S. Transferor than its percentage share of book income or gain with respect to the IRC 721(c) property.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3 - Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-2 - Recognition of Gain in Certain Contributions of Property to Partnerships With Related Foreign Partners</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.704-3(d) - Remedial Allocation Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-3(c) - Consistent Allocation Method</i></li> </ul>

# Step 3a: GDM Requirements - Allocation Method (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3a


Considerations	Resources
<p>The IRC 721(c) regulations includes ECI property in the definition of IRC 721(c) property. The first prong of the gain deferral method (remedial allocation method and consistent allocation method), however, provides a special rule for ECI property. Specifically, an IRC 721(c) partnership can apply the gain deferral method to ECI property without making remedial allocations or consistent allocations if all distributive shares of income and gain with respect to the ECI property for all direct and indirect partners that are related foreign persons will be subject to taxation as ECI and not otherwise exempted or reduced under a treaty.</p> <p> <b>CONSULTATION:</b> Please reach out to the Jurisdiction to Tax Practice Network and Counsel if you have an ECI issue.</p> <p>For a contribution of IRC 721(c) property that is an intangible asset described in IRC 197(f)(9), the IRC 721(c) regulations alter the application of the remedial method. Specifically, a noncontributing partner that is related to the U.S. Transferor is entitled to a nonamortizable tax basis adjustment with respect to the property, corresponding to the amount of a ceiling-rule limited item, in lieu of remedial allocations; that adjustment will be recovered by the related partner only upon a sale or exchange of the property by the partnership.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.721(c)-3(b) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-3(b)(1)(B)(ii) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.704-3(d)(5)(iii)(C) - <i>Special Rules for a IRC 721(c) Partnership and Anti-churning Property</i></li> <li>▪ Treas. Reg. 1.197-2 - <i>Amortization of Goodwill and Certain Other Intangibles</i></li> <li>▪ IRC 197(f)(9) - <i>Anti-churning Rules</i></li> </ul>



# Step 3a: GDM Requirements - Allocation Method (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3a

Considerations	Resources
<p>Follow the five-step approach for reviewing the taxpayer's remedial allocation on a property-by-property basis.</p> <ol style="list-style-type: none"> <li>1) Compute book items related to IRC 721(c) property.</li> <li>2) Allocate book item between partners.</li> <li>3) Compute tax items related to IRC 721(c) property.</li> <li>4) Determine the applicability of the ceiling rule by allocating tax items between the partners.</li> <li>5) Allocate remedial tax items, if any, to eliminate distortions caused by the ceiling rule.</li> </ol> <p>The partnership must use the consistent allocation method (i.e., allocating IRC 704(b) book items to the U.S. Transferor in the same percentage). Non-consistent allocations are not allowed. But see preceding slides for an exception that applies with respect to ECI property.</p> <p> <b>CONSULTATION:</b> Consult with the Partnership Practice Network.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.721(c)-3(b) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-3(b)(1)(B)(ii) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.704-3(d)(5)(iii)(C) - <i>Special Rules for a IRC 721(c) Partnership and Anti-churning Property</i></li> <li>▪ Treas. Reg. 1.197-2 - <i>Amortization of Goodwill and Certain Other Intangibles</i></li> </ul>

# Step 3a: GDM Requirements - Allocation Method (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3a


Considerations	Resources
<p>For purposes of applying the GDM, application of the remedial method is generally required to avoid immediate gain recognition. Therefore, in reviewing whether the U.S. Transferor applied the remedial method, review the following:</p> <ul style="list-style-type: none"> <li>▪ Form 1065</li> <li>▪ Form 1065, Schedule K</li> <li>▪ Form 8865, Schedule G</li> <li>▪ Form 8865, Schedule H</li> <li>▪ Form 8865, Schedule K-1</li> <li>▪ White Paper “Annual Statement of Application of Gain Deferral Method under Section 721(c)” attached to Tax Return</li> <li>▪ Partnership/Member Agreement</li> <li>▪ Partnership’s IRC 704(b) Basis Workpapers</li> <li>▪ Partnership’s Tax Basis Workpapers</li> <li>▪ Taxpayer’s Workpapers for calculating tax item related to IRC 721(c) or 704(c) property</li> <li>▪ Taxpayer’s Workpapers allocating the book item related to IRC 721(c) or 704(c) property between the partners</li> <li>▪ Taxpayer’s Workpapers allocating the tax item related to IRC 721(c) or 704(c) property between the partners</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>IRC 704(c)(1)(A) - Contributed Property</i></li> <li>▪ <i>Treas. Reg. 1.704-3(a)(1) - General Principles</i></li> </ul>

# Step 3b: GDM Requirements - Acceleration Event

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3b


Determine if the U.S. Transferor recognizes gain equal to the remaining built-in gain with respect to IRC 721(c) property upon an acceleration event.

Considerations	Resources
<p>b) Upon an acceleration event, the U.S. Transferor must recognize gain in an amount equal to the remaining built-in gain in the IRC 721(c) property.</p> <p>Generally, an acceleration event with respect to IRC 721(c) property is any event 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 event had not occurred, or that could defer the recognition of the remaining built-in gain (applied on a property-by-property basis).</p> <p>In general, an acceleration event with respect to IRC 721(c) property occurs when any party fails to comply with a condition of the gain deferral method with respect to the IRC 721(c) property. However, an acceleration event will not occur solely as a result of a failure to comply with procedural and reporting requirements that are not willful.</p> <p> <b>CONSULTATION:</b> Consult with the Organization/Restructuring Practice Network and Partnership Practice Network if you think there is an acceleration event.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.721(c)-2 - <i>Recognition of Gain in Certain Contributions of Property to Partnerships With Related Foreign Partners</i></li> <li>▪ Treas. Reg. 1.721(c)-3 - <i>Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-3(b) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Form 8865, Schedule H - <i>Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)</i></li> </ul>

# Step 3b: GDM Requirements - Acceleration Event (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3b

Considerations	Resources
<p>There are several exceptions to accelerations events with respect to IRC 721(c) property:</p> <ul style="list-style-type: none"> <li>▪ Termination events</li> <li>▪ Successor events</li> <li>▪ Partial acceleration events</li> <li>▪ Transfers of IRC 721(c) property to a foreign corporation that are described in IRC 367</li> <li>▪ Fully taxable dispositions of a portion of an interest in an IRC 721(c) partnership</li> </ul> <p> <b>CAUTION:</b> Please refer to the Regulations if your examination reveals any of these acceleration-event exceptions.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5 - Acceleration Event Exceptions</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5(b) - Termination Events</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5(c) - Successor Events</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5(d) - Partial Acceleration Events</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5(e) - Transfers Described in Section 367 of Section 721(c) Property to a Foreign Corporation</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-5(f) - Fully Taxable Dispositions of a Portion of an Interest in a Partnership</i></li> <li>▪ <i>Form 8865, Schedule H - Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)</i></li> </ul>

# Step 3c: GDM Requirements – Procedural and Reporting Req.

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3c

Determine if procedural and reporting requirements are satisfied.

Considerations	Resources
<p>c) Certain procedural and reporting requirements must be satisfied.</p> <p>A U.S. Transferor must include with its timely filed return all appropriate forms or schedules including, as applicable, Form 8865 Schedule A-1, Schedule A-2, Schedule G, Schedule H, Schedule O, Form 8838-P, etc.). Additionally, with respect to IRC 721(c) property, the U.S. Transferor must include the following information as applicable:</p> <ul style="list-style-type: none"> <li>▪ A description of the property (including whether the property is intangible under IRC 367(d)((4)) and recovery period (or periods) for the property;</li> <li>▪ Whether the property is an intangible described in IRC 197(f)(9);</li> <li>▪ A calculation of the built-in gain, the basis, and fair market value on the date of the contribution, including the amount of gain recognized by the U.S. Transferor, if any, on the gain deferral contribution;</li> <li>▪ The name, U.S. taxpayer identification number (if any), address, and country of organization (if any) of each direct or indirect partner in the IRC 721(c) partnership that is a related person with respect to the U.S. Transferor, and a description of each partner's interest in capital and profits immediately after the gain deferral contribution.</li> </ul> <p>For a comprehensive description of all procedural and reporting requirements see <a href="#">Step 4</a>.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-6(b) - Procedural and Reporting Requirements of a U.S. Transferor</i></li> </ul>

# Step 3d: GDM Requirements – Extend Statute of Limitations

## Transfers of Property to Partnerships with a Related Foreign Partner

### [Step 3d](#)

Determine if the U.S. Transferor extended the statute of limitations on assessment of tax.


Considerations	Resources
<p>d) For purposes of filing Form 8838-P, a U.S. Transferor must extend the period of limitations on assessments of tax.</p> <p>In order to comply with the GDM, the U.S. Transferor must extend the period of limitations on assessment of tax utilizing Form 8838-P - <i>Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method</i>.</p> <p>For more information on the requirement to extend the statute of limitations on assessment of tax, see <a href="#">Step 4</a>.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-3(b) - Requirements of the Gain Deferral Method</i></li> <li>▪ <i>Treas. Reg. 1.721(c)-6(b)(5) - Extension of Period of Limitations on Assessment of Tax</i></li> <li>▪ <i>Form 8838-P - Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method</i></li> <li>▪ <i>Form 8838-P Instructions</i></li> </ul>

# Step 3e: GDM Requirements – Tiered Partnerships

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 3e

Determine if U.S. Transferor complied with the rules for tiered IRC 721(c) partnerships.

Considerations	Resources
<p>e) For applicable tiered partnership structures, additional requirements must be satisfied.</p> <p>If the IRC 721(c) property is a partnership interest, or IRC 721(c) property is contributed by an upper-tier partnership to a lower-tier partnership, consider the requirements in Treas. Reg. 1.721(c)-3(d).</p> <p> <b>CONSULTATION:</b> When these provisions are applicable, request assistance from the Organization/Restructuring Practice Network, Transfer Pricing Practice Network, Partnership Practice Network and Counsel.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.721(c)-3(b) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-3(d); <i>Tiered Partnership Rules</i></li> </ul>

# Step 4: Evaluate Reporting Requirements

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Determine if compliance with the reporting requirements is satisfied.


Considerations	Resources
<p><u>Overview</u></p> <p>Separate reporting requirements exist for the U.S. Transferor's activities with respect to foreign partnerships under each of the following code sections:</p> <ul style="list-style-type: none"> <li>▪ IRC 6038 - Information reporting with respect to certain foreign partnerships</li> <li>▪ IRC 6038B - Notice of certain transfers to foreign partnerships</li> <li>▪ IRC 6046A - Reporting of acquisition, disposal and substantial change in partnership interests</li> <li>▪ IRC 721(c)- Reporting of a gain deferral contribution and annual reporting with respect to the IRC 721(c) property to which the gain deferral method applies</li> </ul>	<ul style="list-style-type: none"> <li>▪ IRC 6038 - <i>Information Reporting With Respect to Certain Foreign Corporations and Partnerships</i></li> <li>▪ Treas. Reg. 1.6038-3 - <i>Information Returns Required of Certain United States persons With Respect to Controlled Foreign Corporations</i></li> <li>▪ IRC 6038B - <i>Notice of Certain Transfers to Foreign Persons</i></li> <li>▪ Treas. Reg. 1.6038B-2 - <i>Reporting of Certain Transfers to Foreign Partnerships</i></li> <li>▪ IRC 6046A - <i>Returns as to Interests in Foreign Partnerships</i></li> <li>▪ Treas. Reg. 1.6046A-1 - <i>Return Requirement for United States Persons Who Acquire or Dispose of an Interest in a Foreign Partnership, or Whose Proportional Interest in a Foreign Partnership Changes Substantially</i></li> <li>▪ IRC 721(c) - <i>Regulations Relating to Certain Transfers to Partnerships</i></li> <li>▪ Treas. Reg. 1.721(c)-6 - <i>Procedural and Reporting Requirements</i></li> </ul>



# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Category of Filer</u></p> <p>A U.S. Transferor qualifying under one or more of the categories of filers must complete and file Form 8865 and all schedules required for their respective territory. Determine what category of filer is applicable considering:</p> <ul style="list-style-type: none"> <li>▪ Discussion of foreign partnership activities with taxpayer</li> <li>▪ Review of historical Form 8865 filings</li> <li>▪ Instructions for Form 8865</li> </ul> <p> <b>CONSULTATION:</b> Consider consultation with the Organization/Restructuring Practice Network or Partnership &amp; TEFRA Practice Network.</p>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Practice Unit - <i>Foreign Partnership-Taxation</i></li> <li>▪ Practice Unit - <i>Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 &amp; 2 Filers</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Reporting of a Gain Deferral Contribution</u></p> <p>In the year of contribution of IRC 721(c) property the U.S. Transferor must file Form 8865, Schedule G - <i>Statement of Application of the Gain Deferral Method Under Section 721(c)</i>. Form 8865, Schedule G contains six sections as shown below:</p> <ul style="list-style-type: none"> <li>▪ Part I – Section 721(c) Property</li> <li>▪ Part II – Remaining Built-in Gain, Remedial Income, and Gain Recognition</li> <li>▪ Part III – Allocation % of Partnership Items with Respect to Section 721(c) Property</li> <li>▪ Part IV – Allocation of Items to US Transferor with Respect to Section 721(c) Property</li> <li>▪ Part V – Additional Information Questions</li> <li>▪ Part VI – Supplemental Information</li> </ul>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Form 8865, Schedule G - <i>Statement of Application of the Gain Deferral Method Under Section 721(c)</i></li> <li>▪ Treas. Reg. 1.721(c)-6(b) - <i>Procedural and Reporting Requirements of a U.S. Transferor</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Reporting of a Gain Deferral Contribution (cont'd)</u></p> <p>Note that if any of questions 1 through 6b in Part V of Form 8865, Schedule G are marked yes, then Form 8865, Schedule H - <i>Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)</i> must also be completed/filed. Form 8865, Schedule H also contains six sections as shown below:</p> <ul style="list-style-type: none"> <li>▪ Part I – Acceleration Event</li> <li>▪ Part II – Termination Event</li> <li>▪ Part III – Successor Event</li> <li>▪ Part IV – Taxable Disposition of a Portion of an Interest in Partnership Event</li> <li>▪ Part V – Section 367 Transfer Event</li> <li>▪ Part VI – Supplemental Information</li> </ul>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Form 8865, Schedule H – <i>Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Reporting of a Gain Deferral Contribution (cont'd)</u></p> <p>In addition to Form 8865, Schedule G, the U.S. Transferor must file Form 8865, Schedule O - <i>Transfer of Property to a Foreign Partnership</i>. Schedule O consists of the information required to comply with IRC 6038B and contains three sections as shown below:</p> <ul style="list-style-type: none"> <li>▪ Part I – Transfers Reportable Under Section 6038B</li> <li>▪ Part II – Dispositions Reportable Under Section 6038B</li> <li>▪ Part III – Gain Recognition Under Section 904(f)(3) or (f)(5)(F)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Form 8865, Schedule O - <i>Transfer of Property to a Foreign Partnership (Under Section 6038B)</i></li> <li>▪ IRC 6038B - <i>Notice of Certain Transfers to Foreign Persons</i></li> <li>▪ Treas. Reg. 1.6038B - <i>Reporting of Certain Transfers to Foreign Corporations</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Statute Extensions</u></p> <p>In order to comply with the gain deferral method, the U.S. Transferor must extend the period of limitations on assessment of tax utilizing Form 8838-P- <i>Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method</i>.</p> <p>For purposes of the period of limitations on the assessment of tax discussed on the next slide, any reference to a "full taxable year" means 12 months. So, for example, five full taxable years equals 60 months.</p>	<ul style="list-style-type: none"><li>▪ Form 8838-P Instructions</li><li>▪ Form 8838-P- <i>Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method</i></li><li>▪ Treas. Reg. 1.721(c)-6(b)(5) - <i>Extension of Period of Limitations on Assessment of Tax</i></li></ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Statute Extensions (cont'd)</u></p> <p>For purposes of filing Form 8838-P, a U.S. Transferor must extend the following period of limitations on assessment of tax as applicable.</p> <p><u>Gain Realized but not Recognized on a Gain Deferral Contribution</u></p> <p>Form 8838-P which relates to a gain deferral contribution, extends the period of limitations to the close of the 8<sup>th</sup> full taxable year following the initial transfer year for gain realized but not recognized.</p> <p><u>Gain Recognized</u></p> <p>Where IRC 721(c) property is contributed to an IRC 721(c) partnership within five full taxable years following a gain deferral contribution, and gain is recognized on the subsequent contribution (i.e., the gain deferral method is not applied), the U.S. Transferor must extend the statute to the close of the 6<sup>th</sup> full year following the year of contribution with respect to which the gain is recognized.</p>	<ul style="list-style-type: none"> <li>▪ Form 8838-P Instructions</li> <li>▪ Form 8838-P - <i>Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-3(b) - <i>Requirements of the Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-6(b)(5) - <i>Extension of Period of Limitations on Assessment of Tax</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Statute Extensions (cont'd)</u></p> <p><u>Book and Tax Items</u></p> <p>U.S. Transferor must extend the statute with respect to book and tax items regarding IRC 721(c) property. Recall that IRC 704(b) book items with respect to IRC 721(c) property must generally be allocated in a consistent manner (see Slide 21). This requirement helps ensure, in relevant part, that the IRC 704(b) book items are allocated consistently; additionally, this requirement helps measure the remaining built-in gain in IRC 721(c) property.</p>	

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4


Considerations	Resources
<p><u>Annual Reporting Relating to Gain Deferral Method</u></p> <p>As discussed previously, in the year of contribution of 721(c) property the U.S. Transferor must file Form 8865, Schedule G - <i>Statement of Application of the Gain Deferral Method Under Section 721(c)</i>. This form must also be filed on an annual basis for each gain deferral contribution until the gain deferral method no longer applies (i.e., there is no remaining built-in-gain with respect to IRC 721(c) property).</p> <p>Some of the key information disclosed annually would include:</p> <ul style="list-style-type: none"> <li>▪ Identification of significant event affecting the IRC 721(c) property</li> <li>▪ Built-in-Gain amounts at beginning and end of year</li> <li>▪ Book and tax items allocated to the U.S. Transferor</li> <li>▪ Adjustments to property basis</li> <li>▪ Amounts of gain recognized</li> </ul>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Form 8865, Schedule G - <i>Statement of Application of the Gain Deferral Method Under Section 721(c)</i></li> <li>▪ Treas. Reg. 1.721(c)-6(b)(3) - <i>Annual Reporting Relating to Gain Deferral Method</i></li> </ul>



# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Annual Reporting Relating to Gain Deferral Method (cont'd)</u></p> <ul style="list-style-type: none"> <li>▪ If any of the questions in Part V of Form 8865, Schedule G are marked yes, then Form 8865, Schedule H - <i>Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)</i>, must also be completed/filed.</li> </ul> <p> <b>CAUTION:</b> If a waiver of treaty benefits was filed upon contribution of IRC 721(c) property to the IRC 721(c) partnership, then an annual declaration must be made by the U.S. Transferor acknowledging that income from the IRC 721(c) property remains subject to US taxation.</p>	<ul style="list-style-type: none"> <li>▪ Form 8865 Instructions</li> <li>▪ Form 8865 - <i>Schedule G, Part V, Questions 7a and 7b</i></li> <li>▪ Treas. Reg. 1.721(c)-6(b)(2)(iii) - <i>Reporting of a Gain Deferral Contribution</i></li> <li>▪ Treas. Reg. 1.721(c)-6(b)(3) - <i>Annual Reporting Relating to Gain Deferral Method</i></li> <li>▪ Treas. Reg. 1.721(c)-6(c)(1) - <i>Information With Respect to Section 721(c) Partnerships and Related Foreign Persons</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Failure to File</u></p> <p>U.S. Transferor reporting requirements for outbound transfers of property are found in IRC 6038B and 721(c) and the regulations thereunder.</p> <p>If any U.S. Transferor fails to furnish the information required at the time and manner required by the regulations, such person shall pay a penalty equal to 10 percent of the fair market value of the property at the time of the exchange. The penalty shall not exceed \$100,000 unless the failure was due to intentional disregard. The penalty will not apply if the U.S. Transferor shows that the failure was due to reasonable cause and not to willful neglect.</p>	<ul style="list-style-type: none"> <li>▪ IRC 6038B - <i>Notice of Certain Transfers to Foreign Persons</i></li> <li>▪ Treas. Reg. 1.6038B-2 - <i>Reporting of Certain Transfers to Foreign Partnerships</i></li> <li>▪ IRC 721(c) - <i>Regulations Relating to Certain Transfers to Partnerships</i></li> <li>▪ Treas. Reg. 1.721(c)-6(f) - <i>Relief for Certain Failures to File or Failures to Comply That Are Not Willful</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

## Transfers of Property to Partnerships with a Related Foreign Partner


### Step 4

Considerations	Resources
<p><u>Failure to File (cont'd)</u></p> <p>Treas. Regs. 1.721(c)-6(f) provide relief from certain failures to file or failures to comply that are not willful. For purposes of this analysis, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to comply was willful will be determined by the Issue Manager's Director Field Operations (DFO) based on all of the facts and circumstances.</p> <p>The U.S. Transferor must submit a request for relief, and the request for relief will only be considered if, promptly after the U.S. Transferor becomes aware of the failure, an amended return is filed that includes the information that should have been included with the original return. The U.S. Transferor must provide a written statement explaining the reasons for its failure to comply. And, in certain cases, the U.S. Transferor must also file, with the amended return, Form 8865, Schedule O.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.721(c)-6(f) - Relief for Certain Failures to File or Failures to Comply That Are Not Willful</i></li> </ul>

# Step 4: Evaluate Reporting Requirements (cont'd)

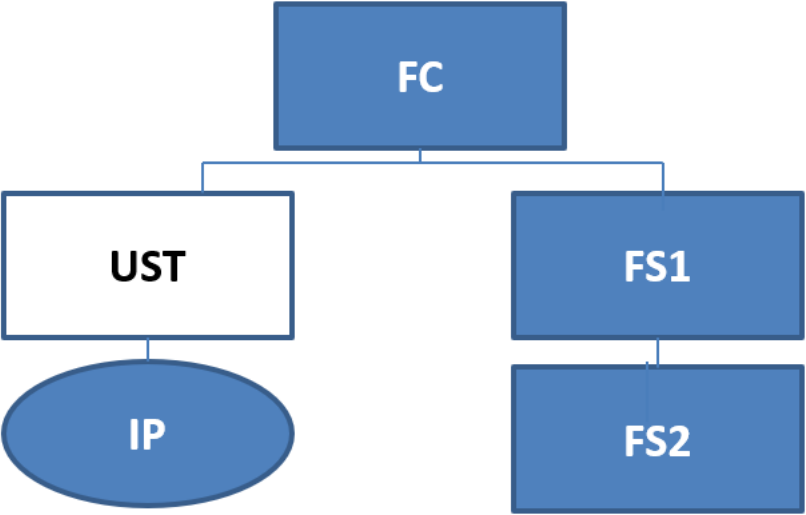
## Transfers of Property to Partnerships with a Related Foreign Partner

### Step 4

Considerations	Resources
<p><u>Failure to File (cont'd)</u></p> <p>Any U.S. Transferor whose failure to comply is determined not to be willful under the IRC 721(c) regulations may still be subject to a penalty under IRC 6038B if it fails to satisfy the applicable reporting requirements under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect.</p> <p>The U.S. Transferor may submit a request for relief from the penalty under IRC 6038B as part of the same submission for IRC 721(c) relief. For IRC 6038B relief purposes, the U.S. Transferor's request for relief will only be considered if, promptly after the U.S. Transferor becomes aware of the failure, an amended return is filed that includes the information that should have been included with the original return. The U.S. Transferor must provide a written statement explaining the reasons for failure to comply.</p> <p>Whether a failure to comply was due to reasonable cause will be determined by the Issue Manager's DFO based on all of the facts and circumstances.</p> <p> <b>CONSULTATION:</b> Consult with the Organization/Restructuring Practice Network to assist with reasonable cause analysis.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.6038B-2(h) - Failure to Comply With Reporting Requirements</i></li> <li>▪ <i>Treas. Reg. 1.6038B-2 - Reporting of Certain Transfers to Foreign Partnerships</i></li> <li>▪ <i>IRM 20.1.9.7, IRC 6038B(c) - Failure to Provide Notice of Transfers to Foreign Person</i></li> </ul>

# Example of Process: Gain Deferral Method

## Transfers of Property to Partnerships with a Foreign Related Partner

Diagram of Transaction	Facts
 <pre>graph TD; FC[FC] --- UST[UST]; FC --- FS1[FS1]; UST --- IP([IP]); FS1 --- FS2[FS2];</pre> <p>The diagram illustrates the ownership structure. At the top is a blue box labeled 'FC'. Two lines descend from 'FC' to two blue boxes: 'UST' on the left and 'FS1' on the right. From 'UST', a line descends to a blue oval labeled 'IP'. From 'FS1', a line descends to another blue box labeled 'FS2'.</p>	<ul style="list-style-type: none"><li>▪ Foreign Parent (Foreign Corporation (FC)) owns Foreign Subsidiary 1 (FS1) and United States Transferor (UST).</li><li>▪ UST owns intangible property (IP) that is not an IRC 197(f)(9) intangible.</li><li>▪ FS1 owns Foreign Subsidiary 2 (FS2).</li><li>▪ Note that the existence of Foreign Parent versus the Domestic Parent is not critical to the fact pattern. However, a foreign-parented structure is more likely for newly-created IRC 721(c) partnerships after the enactment of the Tax Cuts and Jobs Act of 2017.</li></ul>

# Example of Process: Gain Deferral Method (cont'd)

## Transfers of Property to Partnerships with a Foreign Related Partner

Diagram of Transaction	Facts
<p>The diagram illustrates the following structure:</p> <ul style="list-style-type: none"> <li><b>FC</b> (Foreign Country) is at the top, connected to <b>UST</b> (United States Trustee) and <b>FS1</b> (Foreign Related Person).</li> <li><b>UST</b> and <b>FS1</b> are connected to <b>FP</b> (Foreign Partnership), which is represented by a dashed triangle. Dashed arrows indicate that UST and FS1 each own 50% of FP.</li> <li><b>FP</b> is connected to <b>IP</b> (Inventory Property) and <b>FS2</b> (Foreign Related Person).</li> <li><b>IP</b> is shown as a blue oval with the text: <b>FMV: \$150</b> and <b>Basis: \$0</b>.</li> <li><b>FS2</b> is shown as a blue rectangle with the text: <b>FMV: \$150</b> and <b>Basis: \$150</b>.</li> </ul>	<ul style="list-style-type: none"> <li>On day 1 of tax year 1, UST and FS1 create a 50/50 foreign or domestic partnership (here, foreign partnership, FP).             <ul style="list-style-type: none"> <li>UST contributes IP with FMV of \$150 and Adjusted Basis of \$0.</li> <li>FS1, a foreign related person with respect to UST, contributes stock of FS2 with FMV and Adjusted Basis of \$150.</li> </ul> </li> <li>UST's contributed property has a built-in gain of \$150 and is, therefore, IRC 721(c) property.</li> <li>FP is an IRC 721(c) partnership because there is a contribution of IRC 721(c) property by UST and after the contributions, UST and FS1, a foreign related person with respect to UST, wholly-own FP.</li> </ul>

# Transaction and Fact Pattern: Gain Deferral Method

## Transfers of Property to Partnerships with a Foreign Related Partner

Foreign Partnership Assets and Partners' Capital Accounts Beginning of Year 1				Facts																
<table border="1"> <thead> <tr> <th>Partnership Assets</th> <th>IRC 704(b)</th> <th>Tax Basis</th> <th>Built-in Gain</th> </tr> </thead> <tbody> <tr> <td>FS2 Stock</td> <td>\$150</td> <td>\$150</td> <td>\$0</td> </tr> <tr> <td>IP</td> <td>\$150</td> <td>\$0</td> <td>\$150</td> </tr> <tr> <td>Total FP Assets</td> <td>\$300</td> <td>\$150</td> <td>\$150</td> </tr> </tbody> </table>				Partnership Assets	IRC 704(b)	Tax Basis	Built-in Gain	FS2 Stock	\$150	\$150	\$0	IP	\$150	\$0	\$150	Total FP Assets	\$300	\$150	\$150	<ul style="list-style-type: none"> <li>▪ The tables to the left show the Foreign Partnership's Assets and the Partners' Capital Accounts just after the contribution of property discussed on the previous slide.</li> <li>▪ UST's contributed property has a built-in gain of \$150 subject to IRC 721(c). The built-in gain is determined by the difference between the book value of the property upon contribution (the IRC 704(b) value) and the Foreign Partnership's adjusted tax basis in the property upon contribution.</li> <li>▪ UST's capital account has a book-to-tax disparity of \$150 (i.e., IRC 704(b) value-to-basis, or \$150 to \$0).</li> <li>▪ FS1's contributed property has a built-in gain of \$0 and its book and tax capital accounts are equal.</li> </ul>
Partnership Assets	IRC 704(b)	Tax Basis	Built-in Gain																	
FS2 Stock	\$150	\$150	\$0																	
IP	\$150	\$0	\$150																	
Total FP Assets	\$300	\$150	\$150																	
<table border="1"> <thead> <tr> <th>Capital Accounts</th> <th>IRC 704(b)</th> <th>Tax Basis</th> <th>Built-in Gain</th> </tr> </thead> <tbody> <tr> <td>UST</td> <td>\$150</td> <td>\$0</td> <td>\$150</td> </tr> <tr> <td>FS1</td> <td>\$150</td> <td>\$150</td> <td>\$0</td> </tr> <tr> <td>Total Capital</td> <td>\$300</td> <td>\$150</td> <td>\$150</td> </tr> </tbody> </table>				Capital Accounts	IRC 704(b)	Tax Basis	Built-in Gain	UST	\$150	\$0	\$150	FS1	\$150	\$150	\$0	Total Capital	\$300	\$150	\$150	
Capital Accounts	IRC 704(b)	Tax Basis	Built-in Gain																	
UST	\$150	\$0	\$150																	
FS1	\$150	\$150	\$0																	
Total Capital	\$300	\$150	\$150																	

# Transaction and Fact Pattern: Gain Deferral Method (cont'd)

## Transfers of Property to Partnerships with a Foreign Related Partner

Partners' Capital Accounts End of Year 1			Illustration of Ceiling Rule
Capital Accounts	IRC 704(b)	Tax Basis	
UST Beginning	\$150	\$0	<ul style="list-style-type: none"> <li>For book/IRC 704(b) purposes, assume the IP has a 15-year recovery period and generates \$10 of income each year - \$5 allocated to each partner. Amortization is \$10 a year - \$5 allocated to each partner – as determined by dividing the excess of the book value of the IP over tax basis (\$150) over the IP's recovery period (15).</li> <li>Recall that UST's contributed property had a built-in gain of \$150 upon contribution. Because the property had \$0 tax basis upon contribution, there is a \$5 dollar ceiling-rule limited item that creates a book-to-tax disparity in FS1's capital account.</li> <li>Resolution of this disparity is deferred until liquidation of the partnership or sale of one or both of the partner's interests (which may result in indefinite deferral).</li> <li>The table to the left shows the partners' capital accounts at the end of year 1.</li> <li>Over 15 years this disparity will be \$75 (that is, \$5 per year multiplied by 15 years). Therefore, at the end of the 15-year period, FS1 is overtaxed by \$75, thereby shifting a portion of the tax consequences of the pre-contribution gain in the IP from UST to FS1.</li> </ul>
IP Income	\$5	\$5	
Amortization	(\$5)	\$0	
UST Ending	\$150	\$5	
FS1 Beginning	\$150	\$150	
IP Income	\$5	\$5	
Amortization	(\$5)	\$0	
FS1 Ending	\$150	\$155	
Total Capital	\$300	\$160	



# Transaction and Fact Pattern: Gain Deferral Method (cont'd)

## Transfers of Property to Partnerships with a Foreign Related Partner

### Partners' Capital Accounts

	UST		FS1	
	IRC 704(b)	Tax Basis	IRC 704(b)	Tax Basis
Initial Contribution	\$150	\$0	\$150	\$150
Income (50/50)	\$5	\$5	\$5	\$5
Amortization (50/50)	(\$5)	\$0	(\$5)	\$0
Remedial Method Allocation	\$0	\$5	\$0	(\$5)
Ending Basis	\$150	\$10	\$150	\$150

### Illustration of the Remedial Allocation Method

- Remedial Allocations are notional tax items that FP will allocate among UST and FS1 to address ceiling rule distortions (i.e., FS1 will be allocated the tax amortization to which FS1 is economically entitled and UST will be allocated an offsetting tax item of income).
- Because remedial allocations are notional and offsetting, they do not impact the partnership's taxable income or adjusted basis.
- By allocating the remedial items, no book- to-tax disparity is created in FS1's capital accounts. Therefore, the tax consequences of UST's pre-contribution gain in the IP have not been shifted from UST to FS1.
- After the 15-year recovery period, UST's book-to-tax disparity disappears. Ultimately UST will take into account the full amount of pre-contribution gain in the IP.



**CONSULTATION:** Consider consultation with the Partnership & TEFRA Practice Network.

# Index of Referenced Resources

## Transfers of Property to Partnerships with a Foreign Related Partner

Form 1065

Form 1065, Schedule L

Form 8838-P

Form 8865

Form 8865, Schedule A-1

Form 8865, Schedule A-2

Form 8865, Schedule G

Form 8865, Schedule H

Form 8865, Schedule O

Form 1065 Instructions

Form 8838-P Instructions

Form 8865 Instructions

IRC 197

IRC 704

IRC 721(c)

IRC 6038

IRC 6038A

# Index of Referenced Resources (cont'd)

## Transfers of Property to Partnerships with a Foreign Related Partner

IRC 6038B

IRC 6046

Treas. Reg. 1.197-2

Treas. Reg. 1.704-3

Treas. Reg. 1.721(c)-1

Treas. Reg. 1.721(c)-2

Treas. Reg. 1.721(c)-3

Treas. Reg. 1.721(c)-4

Treas. Reg. 1.721(c)-5

Treas. Reg. 1.721(c)-6

Treas. Reg. 1.6038-3

Treas. Reg. 1.6038B-2

Treas. Reg. 1.6046A-1

# Training and Additional Resources

Transfers of Property to Partnerships with a Foreign Related Partner	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none"><li>▪ <i>Gain Deferral Method - Transfer of Section 721(c) Property to Section 721(c) Partnerships – Saba Meeting</i></li></ul>
Additional Guidance	<ul style="list-style-type: none"><li>▪ Notice 2015-54 - Notice announcing an intent to issue regulations under IRC 721(c), which provided the foundation for the regulations under IRC 721(c).</li><li>▪ FAA 20204201F - Field advice in which the Service used the anti-abuse rule provided in Treas. Reg. 1.704-3(a)(10) to address a pre-Notice 2015-54 transaction.</li><li>▪ PLR 202047006 - Private letter ruling regarding the rule provided in Treas. Reg. 1.721(c)-5(e) regarding transfers described in IRC 367 of IRC 721(c) property to a foreign corporation.</li></ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
BBA	Bipartisan Budget Act
DFO	Director of Field Operations
ECI	Effectively Connected Income
EUP	Employee User Portal
FC	Foreign Corporation
FMV	Fair Market Value
FP	Foreign Partnership
FS	Foreign Subsidiary
GDM	Gain Deferral Method
IP	Intangible Property
IRC	Internal Revenue Code
TEFRA	Tax Equity and Fiscal Responsibility Act
Treas. Reg.	Treasury Regulation
U.S.	United States
UST	United States Transferor
yK1	yK1 Link Analysis Tool

# Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
9434	<i>Foreign Partnership-Taxation</i>
9560	<i>Monetary Penalties for Failure to Timely File a Complete and Accurate Form 8865 – Category 1 &amp; 2 Filers</i>