Notice of Proposed Rulemaking and Notice of Public Hearing

Section 707 Regarding Disguised Sales, Generally

REG–149519–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the treatment of transactions between a partnership and its partners as disguised sales of partnership interests between the partners under section 707(a)(2)(B) of the Internal Revenue Code (Code). The proposed regulations affect partnerships and their partners, and are necessary to provide guidance needed to comply with the applicable tax law. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by February 24, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for March 8, 2005, at 10:00 a.m. must be received by February 15, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–149519–03), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149519–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS internet site *http://www.irs.gov/regs* or via the Federal eRulemaking Portal site at *http://www.regulations.gov* (indicate IRS and REG–149519–03). The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deane M. Burke or Christopher L. Trump, (202) 622–3070; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Treena V. Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 25, 2005. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in the proposed regulations is in §§1.707–3(c)(2), 1.707–5(a)(8), 1.707–6(c), and 1.707–7(k). This information is required by the IRS to ensure that section 707(a)(2)(B) of the Code and the regulations thereunder are properly applied to transfers between partners in a partnership. The information collected will be used to determine whether partners are complying with section 707(a)(2)(B) and the regulations thereunder. The respondents will be partners and partnerships.

Estimated total annual reporting burden: 7,500 hours.

Estimated average burden per respondent varies from 15 minutes to 25 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

Estimated number of respondents: 22,500.

Estimated annual frequency of responses: annually.

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 26 U.S.C. 6103.

Background

This document proposes to amend section 707 of the Income Tax Regulations (26 CFR part 1) regarding disguised sales of partnership property, including partnership interests.

Section 707(a)(2)(B) of the Code provides that, under regulations prescribed

by the Secretary, transfers to and by a partnership that are more properly characterized as transactions between the partnership and one who is not a partner or between two or more partners acting other than in their capacity as partners shall be treated as such transactions. The legislative history of section 707(a)(2)(B) indicates the provision was adopted as a result of Congressional concern that taxpayers were deferring or avoiding tax on sales of partnership property, including sales of partnership interests, by characterizing sales as contributions of property, including money, followed or preceded by related partnership distributions. See H.R. Rep. No. 861, 98th Cong. 2nd Sess. 861 (1984), 1984–3 (Vol. 2) C.B. 115. Specifically, Congress was concerned about court decisions that allowed tax-free treatment in cases that were economically indistinguishable from sales of property to a partnership or another partner, and believed that these transactions should be treated for tax purposes in a manner consistent with their underlying economic substance. See H.R. Rep. No. 432, 98th Cong. 2nd Sess. 1218 (1984) (H.R. Rep.), and S. Prt. No. 169 (Vol. I), 98th Cong. 2nd Sess. 225 (1984) (S. Prt.) (discussing *Communications Satellite Corp. v. United States*, 625 F.2d 997 (Ct. Cl. 1980), and *Jupiter Corp. v. United States*, 2 Cl. Ct. 58 (1983), both of which involved disguised sales of a partnership interest).

On September 30, 1992, final regulations under section 707(a)(2) (T.D. 8439, 1992–2 C.B. 126) relating to disguised sales of property to and by partnerships were published in the **Federal Register** (57 FR 44974 as corrected on November 30, 1992, by 57 FR 56443) (existing regulations). Section 1.707–7 of the existing regulations was reserved for rules on disguised sales of partnership interests. On October 9, 2001, the IRS and the Treasury Department issued Notice 2001–64, 2001–2 C.B. 316, announcing that the IRS and the Treasury Department were considering issuing proposed regulations under section 707(a)(2)(B), relating to disguised sales of partnership interests. The IRS and the Treasury Department requested comments on the scope and substance of guidance concerning disguised sales of partnership interests, including any applicable safe harbors or exceptions. Written comments in response to Notice 2001–64 were received and considered in drafting these proposed regulations.

In February 2003, the Joint Committee on Taxation released its Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues and Policy Recommendations (Enron Report), and the Written Testimony of the Staff of the Joint Committee on the Enron Report (Written Testimony). In the Enron Report and the Written Testimony, the Joint Committee recommended changes to rules in the existing regulations that require disclosure of certain transactions. These proposed regulations include those changes and provide disclosure rules for disguised sales of partnership interests consistent with the disclosure rules in the existing regulations, as amended.

Explanation of Provisions

1. *Framework of Rules*

Commentators responding to Notice 2001–64 generally recommended that the proposed regulations relating to disguised sales of partnership interests include a framework similar to that in the existing regulations, with a general rule that applies based on all of the facts and circumstances, and a variety of safe harbors and presumptions. In addition, the commentators specifically recommended that certain of the presumptions and safe harbors in the existing regulations be incorporated into the proposed regulations and that the treatment of liabilities under the proposed regulations largely follow the treatment of liabilities under the existing regulations. The IRS and the Treasury Department agree with those recommendations and, accordingly, the proposed regulations follow the form of the existing regulations and include rules similar to many of the rules in the existing regulations, with appropriate modifications.

2. *General Rule*

The commentators also recommended that the proposed regulations provide a narrower rule than the existing regulations for determining that a purported contribution and distribution are related, and therefore, are treated as a disguised sale of a partnership interest. One commentator noted that, unlike the existing regulations, the proposed regulations would potentially apply whenever there are cash contributions and distributions, which are common events for most partnerships. In addition, unlike in a disguised sale of partnership property, no person, other than the partnership, participates in both of the transactions that constitute the disguised sale (transfers to and by a partnership) and a party engaged in one of those transactions may not even be aware of the other transaction. Another commentator expressed concern that without a narrower rule, the proposed regulations could apply to many common, legitimate partnership transactions, such as the routine admission to and redemption from professional and securities partnerships.

Under the existing regulations, a transfer of property by a partner to a partnership and a simultaneous transfer of money or other consideration by the partnership to the partner are treated as a disguised sale of property only if, based on all the facts and circumstances, the transfer by the partnership would not have been made but for the transfer to the partnership, and, in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations. Section 1.707–3(b)(1). One of the commentators suggested that in addition to the "but for" test in the existing regulations, the proposed regulations provide that transfers to and by a partnership will constitute a disguised sale of a partnership interest only if the two transfers are "directly related." Another commentator suggested that the proposed regulations find a disguised sale of a partnership interest only where both the transfer to and the transfer by the partnership would not have been made but for the other transfer, a so-called "double but for test." The commentators also recommended narrowing the scope of the proposed regulations by providing additional favorable presumptions or safe harbors for certain transactions, such as transfers to and from professional partnerships.

The IRS and the Treasury Department agree that because many more transactions may potentially be subject to the proposed regulations, it is appropriate that the proposed regulations be narrower than the existing regulations. However, the IRS and the Treasury Department have

concerns about the alternate tests of relatedness suggested by the commentators. Specifically, the IRS and the Treasury Department are not certain how a "directly related" test would be interpreted or applied, or whether it would be effective in narrowing the scope of the proposed rules. In addition, the IRS and the Treasury Department are concerned that certain transactions that should be treated as a disguised sale of a partnership interest would not be covered under a "double but for test." For example, assume that a prospective investor in a partnership and an existing partner who wishes to sell its partnership interest agree that upon the prospective investor's transfer to the partnership, the partnership will make a corresponding transfer to the existing partner. If the prospective investor is indifferent as to whether the existing partner retains its partnership interest, the transaction would not satisfy a "double but for test" since the transfer to the partnership was not made but for the transfer from the partnership. Nonetheless, the IRS and the Treasury Department believe that the transaction is economically indistinguishable from a sale of a partnership interest and should be treated as such. In contrast, the IRS and the Treasury Department believe that the "but for" test of the existing regulations provides a relatively bright line rule that is easier to interpret and administer and that, in most cases, covers those transactions that should be treated as disguised sales of partnership interests. The IRS and the Treasury Department thus believe that the appropriate way to narrow the scope of those rules is to provide additional safe harbors but adopt the same "but for" test included in the existing regulations.

Accordingly, the proposed regulations provide that a transfer of money, property or other consideration (including the assumption of a liability) (consideration) by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner only if, based on all the facts and circumstances, the transfer by the partnership would not have been made but for the transfer to the partnership, and, in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

3. *Facts and Circumstances*

As under the existing regulations, the proposed regulations provide that whether two transfers constitute a disguised sale is determined based on all the facts and circumstances. The proposed regulations list a series of factors that, among others, tend to indicate the existence of a disguised sale of a partnership interest. The weight given each of the factors will depend on the circumstances of each case. Generally, the facts and circumstances existing on the date of the earliest of the transfers are the ones considered in determining if a sale exists.

Many of the factors listed in the proposed regulations are similar to those under the existing regulations. However, the proposed regulations include additional facts and circumstances that are relevant in the context of a disguised sale of a partnership interest. For example, included in the facts and circumstances in the proposed regulations are (1) that the same property (other than money, including marketable securities that are treated as money under section 731(c)(1)) (non-cash property) that is transferred to the partnership by the purchasing partner is transferred to the selling partner, and (2) that the partnership holds transferred non-cash property for a limited period of time, or during the period of time the partnership holds transferred non-cash property, the risk of gain or loss associated with the property is not significant.

4. *Presumptions and Safe Harbors*

a. *In General*

The commentators generally suggested that the proposed regulations provide presumptions and safe harbors that model those contained in the existing regulations. Those rules generally focus on the timing, risk, and source of partnership distributions. The IRS and the Treasury Department believe that rules similar to those rules in the existing regulations should apply in the context of disguised sales of partnership interests. Therefore, the proposed regulations include presumptions and safe harbors similar to those in the existing regulations, along with an additional favorable presumption and an additional exception that address concerns specifically relevant in the context of disguised sales of partnership interests. As under the existing regulations, each of the presumptions in the proposed regulations may be rebutted only by facts and circumstances that clearly establish the contrary.

b. *Timing of Transfers, Liquidations, and Service Partnerships*

The proposed regulations adopt an approach similar to that in the existing regulations regarding transfers made within two years and transfers made more than two years apart. Thus, the proposed regulations provide that a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner that are made within two years of each other are presumed to be a sale, and that such transfers made more than two years apart are presumed not to be a sale. One commentator suggested that the timing presumptions in the proposed regulations should only apply to "extraordinary" contributions and distributions because the proposed regulations, unlike the existing regulations, may apply whenever there is a cash contribution to and cash distribution from a partnership, which are routine transactions for many partnerships. The IRS and the Treasury Department believe that this concern is adequately addressed by the inclusion in the proposed regulations of (1) presumptions, discussed below, against sale treatment for transfers of money (including marketable securities) to a selling partner in liquidation of the selling partner's interest in the partnership as well as for guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures, and (2) an exception for contributions and distributions of money (including marketable securities) to and from service partnerships (defined as described below).

Another commentator argued that the proposed regulations should not include presumptions based upon the amount of time that elapses between transfers. The commentator submitted that the timing presumptions in the existing regulations have done little to promote certainty for taxpayers. The IRS and the Treasury

Department did not follow the commentator's recommendation. Even though timing presumptions do not eliminate the need to analyze the relevant facts and circumstances, the IRS and the Treasury Department believe that timing presumptions help the IRS and taxpayers identify transactions where closer scrutiny is required. See S. Prt. No. 169 (Vol. I), 98th Cong. 2nd Sess. 231 (1984) (suggesting that regulations provide a presumption of "relatedness" for transfers within three years).

The IRS and the Treasury Department believe that the abuse that section 707(a)(2)(B) was intended to address typically is not present in situations involving complete liquidations of partners' partnership interests for money. Accordingly, the proposed regulations provide that, notwithstanding the presumption relating to transfers within two years, a transfer of money, including marketable securities that are treated as money under section 731(c)(1), to a selling partner in liquidation of that partner's entire interest in the partnership is presumed not to be part of a disguised sale of that interest. However, the IRS and the Treasury Department recognize that there are instances in which a liquidating distribution may properly be characterized as part of a disguised sale of a partnership interest, particularly when the tax consequences of a liquidating distribution are significantly different from those of a sale of a partnership interest. Accordingly, the presumption against sale treatment may be rebutted in those cases.

As recommended by the commentators, the proposed regulations provide that transfers of money, including marketable securities that are treated as money under section 731(c)(1), to and by a partnership that would be described in section 448(d)(2) if the partnership were a corporation (service partnership) are not a sale and need not be disclosed. This exception takes into account that partners frequently enter and exit service partnerships and, in most cases, those transactions are factually unrelated to each other and should not be treated as a disguised sale of a partnership interest. One commentator also suggested that the proposed regulations provide favorable presumptions or safe harbors for other types of partnerships, including securities partnerships and partnerships involved in staged closings. The IRS and the Treasury Department specifically request additional comments on whether the proposed regulations should include safe harbors for partnerships other than service partnerships, and if so, how to appropriately define those categories of partnerships.

c. *Guaranteed Payments, Preferred Returns, Operating Cash Flow Distributions, and Qualified Reimbursements*

As recommended by the commentators, the proposed regulations provide that rules similar to those provided in §1.707–4 of the existing regulations concerning guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures apply (notwithstanding the presumption relating to transfers made within two years of each other) to determine the extent to which a transfer to a selling partner is treated as part of a sale of the selling partner's interest in the partnership to the purchasing partner. The IRS and the Treasury Department agree that inclusion of those rules in the proposed regulations is appropriate in order to distinguish between transfers to partners that occur in the ordinary course of business and transfers to partners that are part of a disguised sale.

d. *Certain Presumptions Not Included*

Commentators expressed concern that a transfer of property by one partner to a partnership and a transfer of different property by the partnership to another partner should not form the basis of a disguised sale of a partnership interest. One commentator argued that to recharacterize those transfers as a sale of a partnership interest would require the reordering of steps or the creation of additional steps, which is impermissible under the step transaction and related doctrines. Nonetheless, the commentator acknowledged that there are situations in which the recharacterization more properly reflects the substance of the transaction.

The proposed regulations do not adopt a specific favorable presumption or safe harbor for transactions involving transfers of different property. The IRS and the Treasury Department are concerned that if such a favorable presumption or safe harbor were available, a purchasing partner and selling partner could easily structure a transaction to fit within the favorable presumption or safe harbor, for example, by the purchasing partner transferring an asset that it wishes to sell to the partnership and the partnership selling the asset and transferring the sales proceeds to the selling partner. The IRS and the Treasury Department specifically request additional comments on whether a favorable presumption or safe harbor for transactions involving transfers of different property is appropriate and, if so, how any favorable presumption or safe harbor could be narrowly tailored to cover only those transactions that clearly should not be characterized as a sale of a partnership interest.

The commentators also suggested that the proposed regulations provide a safe harbor for situations in which one partner funds a defaulting partner's obligation to make a capital contribution. According to one commentator, the subsequent transfer by the defaulting partner to the partnership and the related transfer by the partnership to the non-defaulting partner merely restore the original economic deal intended, and should not be characterized as a sale. The IRS and the Treasury Department believe, however, that this type of transaction can be difficult to distinguish from an actual sale of a partnership interest. Therefore, the proposed regulations do not include a safe harbor for these transactions.

5. *Liabilities*

The proposed regulations generally follow the approach of the existing regulations with respect to the treatment of liabilities. Thus, if a partnership assumes a liability of a partner, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability immediately after the partnership assumes the liability. Similarly, if a partner assumes a liability of a partnership, the partner is treated as transferring consideration to the partnership to the extent that the amount of the liability assumed exceeds the partner's share of that liability immediately before the assumption. However, the proposed regulations specifically provide, as suggested by the commentators, that deemed contributions to and distributions from a partnership under section 752

resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration. The rules in the proposed regulations relating to a partner's share of a partnership liability, including the effect of a subsequent reduction in a partner's share of a partnership liability, follow those rules in the existing regulations. The proposed regulations also include rules with respect to debt-financed transfers of consideration by partnerships that follow the rules in the existing regulations.

Unlike the existing regulations, the proposed regulations do not include any special rules for qualified liabilities. The IRS and the Treasury Department believe that the inclusion of those special rules in the existing regulations is appropriate because, otherwise, any transfer of property to a partnership subject to a liability could be recharacterized as a disguised sale of property. In contrast, under the proposed regulations, a transfer to a partnership of encumbered property alone would not be subject to recharacterization as a disguised sale of a partnership interest. Rather, a transfer to a partnership of encumbered property would have to be related to a transfer of consideration by another partner in order for disguised sale treatment to apply. Nonetheless, the IRS and the Treasury Department specifically request comments on whether the proposed regulations should include rules similar to those in the existing regulations for qualified liabilities, and if so, whether and how those rules should be modified to address issues particular to disguised sales of partnership interests.

The proposed regulations also include an anti-abuse rule to address cases in which the rules of the proposed regulations do not adequately capture the substance of an integrated set of transactions. The anti-abuse rule in the proposed regulations provides that an increase in a partner's share of a partnership liability may be treated as a transfer of consideration in a sale of a partnership interest if, within a short period of time after the partnership incurs or assumes the liability or another liability, one or more partners (or related parties) in substance bear an economic risk for the liability that is disproportionate to the partners' interests in partnership profits or capital, and the transactions are undertaken pursuant to a plan that has as one of its principal purposes minimizing the extent to which the partners are treated as making a transfer of consideration to a partnership that may be treated as part of a sale. Comments are requested on this proposed anti-abuse rule, including examples of particular situations where application of this rule would be appropriate.

6. *Treatment of Transfers as a Sale*

If a transfer of consideration by a purchasing partner to the partnership and a transfer of consideration by the partnership to a selling partner are treated as part of a sale of a partnership interest, the proposed regulations provide several rules relating to the tax consequences of sale treatment. First, the proposed regulations provide that transfers that are treated as a sale of a partnership interest are treated as a sale for all purposes of the Code. In addition, the proposed regulations include rules relating to the timing of the sale that are similar to those in the existing regulations. Specifically, the proposed regulations provide that the sale is considered to take place on the date of the earliest of the transfers. If the transfer by the partnership occurs before the transfer to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred to the partnership an obligation to deliver that partner's consideration in exchange for the consideration transferred by the partnership to the selling partner (selling partner's consideration), and the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for the selling partner's partnership interest. If the transfer by the partnership occurs after the transfer to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration to the partnership (purchasing partner's consideration) in exchange for an obligation of the partnership to deliver the selling partner's consideration, and the purchasing partner transferred that obligation to the selling partner in exchange for the selling partner's partnership interest.

The IRS and the Treasury Department intend that the deemed transactions that are treated as occurring as described in the immediately preceding paragraph result in actual tax consequences to the partnership, the purchasing partner(s), and the selling partner(s) for all purposes of the Code. Thus, for instance, where the consideration actually transferred by the purchasing partner to a partnership is different than the actual consideration later transferred from the partnership to the purchasing partner, there may be tax consequences for the partnership and the partners resulting from deemed exchanges of consideration, *e.g.*, gain or loss recognition to the partnership or partners (including the potential application of section 267 or 707).

The proposed regulations also provide rules relating to the amount of the sale and the inclusion of liability relief in the amount realized on the sale. Specifically, with respect to the amount of the sale, the proposed regulations provide that the selling partner is treated as selling to the purchasing partner a partnership interest with a value equal to the lesser of the selling partner's consideration or the purchasing partner's consideration. For this purpose, simultaneous transfers of consideration by more than one purchasing partner to a partnership, or by a partnership to more than one selling partner, are aggregated. In those cases, each purchasing partner is presumed to have purchased a fractional share of the partnership interest(s) sold, and each selling partner is presumed to have sold its fractional share of the total partnership interest(s) sold. In addition, although the proposed regulations provide that deemed contributions to and distributions from a partnership under section 752 resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration, the proposed regulations clarify that the amount realized by a selling partner on the sale of the partner's interest in the partnership includes any reduction in the selling partner's share of partnership liabilities that is treated as occurring as a result of the sale, if the reduction in liability has not otherwise been treated as a transfer of consideration to the selling partner.

The proposed regulations also address issues relating to the application of certain rules that may overlap. First, the proposed regulations provide that if a portion of a transfer of consideration by a partnership to a selling partner is not treated as part of a sale of the partner's interest in the partnership, but as a distribution to the selling partner under section 731, and the sale

is treated as occurring on the same date as the distribution, then the distribution is treated as occurring immediately following the sale. Thus, the portion of the transfer that is treated as a distribution is not taken into account for purposes of computing the selling partner's basis in its partnership interest prior to the disguised sale of the interest. In addition, the proposed regulations provide that the rules for disguised sales of property apply before the rules of the proposed regulations, and to the extent a transfer of consideration is treated as part of a sale of property under the rules for disguised sales of property, the transfer is not taken into account for purposes of the rules in the proposed regulations. This ordering rule is appropriate because, in some cases, the tax consequences of a disguised sale of property may be simpler than a disguised sale of a partnership interest because, for example, a disguised sale of property will not result in a technical termination of the partnership under section 708(b)(1)(B) or basis adjustments under section 743(b).

Finally, the proposed regulations clarify whether the rules apply to certain transfers that occur upon the formation or termination of a partnership. The proposed regulations do not apply to transfers incident to the formation of a partnership, although these transfers may be subject to recharacterization as a disguised sale of property under the existing regulations. The proposed regulations also do not apply to deemed transfers resulting from a termination of a partnership under section 708(b)(1)(B). The IRS and the Treasury Department specifically request comments on whether the proposed regulations should include special rules or exceptions for some or all of the transfers occurring in a partnership merger or division under §1.708–1(c) or (d).

7. *Disclosure*

In the Enron Report and the Written Testimony, the Joint Committee recommended that the period for which disclosure of a transaction is required under the disguised sale rules should be extended beyond two years. The Committee further suggested that expanding the disclosure period to seven years might make it more likely that taxpayers would undertake the facts and circumstances determination for transfers occurring more than two years apart and would make that facts and circumstances determination easier for the IRS to administer. To effect this recommendation, the proposed regulations would amend §§1.707–3(c)(2) and 1.707–6(c) of the existing regulations to extend the disclosure requirement to the specified events occurring within seven years instead of two years. The IRS and the Treasury Department request comments regarding whether the disclosure requirement should be extended to a period that is more than two years, but less than seven years.

The proposed regulations also would add a new requirement to both §§1.707–5 and –6 of the existing regulations, relating to the disclosure of the assumption of or taking subject to liabilities. Specifically, §1.707–5(a)(8) of the proposed regulations would require disclosure if a partner transfers property to a partnership, and the partnership assumes or takes subject to a liability of the partner (whether or not the liability is qualified) within a seven-year period (without regard to the order of the transactions), and the partner treats the transactions as other than as a sale for tax purposes. Similarly, §1.707–6(c)(3) of the proposed regulations would require disclosure if a partnership transfers property to a partner, and the partner assumes or takes subject to a liability of the partnership (whether or not the liability is qualified) within a seven-year period (without regard to the order of the transactions), and the partnership treats the transactions as other than as a sale for tax purposes. These disclosure requirements were added because of a concern that taxpayers are taking unwarranted positions regarding a partner's share of partnership liabilities before or after an assumption of or taking subject to a liability.

Finally, the proposed regulations would amend the provision in §1.707–8(c) to clarify who is required to disclose under the disguised sale rules. The amended paragraph provides that the required disclosure must be made by any person who makes a transfer that is required to be disclosed, and that the persons who are required to disclose may designate by written agreement a single person to make the disclosure. However, the designation of one person to make the disclosure does not relieve the other persons required to disclose from their obligation to make the disclosure, if the designated person fails to make the appropriate disclosure.

The proposed regulations provide disclosure rules for transactions that may be treated as disguised sales of partnership interests consistent with the disclosure rules in the existing regulations, as amended. Disclosure to the IRS is required when a partner transfers consideration to a partnership and the partnership transfers consideration to another partner within a seven-year period (without regard to the order of the transfers), the partners treat the transfers other than as a sale for tax purposes, and the transfer of consideration by the partnership is not presumed to be a guaranteed payment for capital, is not a reasonable preferred return, and is not an operating cash flow distribution. However, disclosure is not required if the exception described earlier for service partnerships applies.

8. *Review of Existing Regulations*

The IRS and the Treasury Department have become aware of certain deficiencies and technical ambiguities in the existing regulations under §§1.707–3, 1.707–4 and 1.707–5. Among the deficiencies and technical ambiguities identified are the rules for capital expenditure reimbursements, the liability sharing rules, and the interaction of the capital expenditure reimbursement rules with the qualified liability rules. In order to address these deficiencies and technical ambiguities, the IRS and the Treasury Department intend to issue proposed regulations amending the existing regulations. In addition, the IRS and the Treasury Department intend to revise these proposed regulations to reflect those proposed amendments to the existing regulations. The IRS and Treasury Department request comments on the scope and content of the revisions to the existing regulations (and these proposed regulations).

Proposed Effective Date

The regulations are proposed to apply to transactions with respect to which all transfers considered part of a sale occur on and after the date these regulations are published as final regulations in the **Federal Register**. A determination of disguised sale treatment for a partnership interest for the period between the effective

date of section 707(a)(2)(B) and the effective date of these regulations is to be made based on the statutory language and the guidance provided in the legislative history of section 707(a)(2)(B).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these 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 prepare the required disclosure is not lengthy and few small businesses are likely to be partners or parties required to make the disclosures required by the rule, and particularly, because the disclosure requirement does not apply to certain service partnerships. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on all aspects of the proposed regulations. Comments are also requested on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 8, 2005, at 10:00 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by February 24, 2005, and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by February 15, 2005. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs & Special Industries), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAX

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.707–2 through 1.707–9 also issued under 26 U.S.C. 707(a)(2)(B).

Par. 2. Section 1.707–0 is amended as follows:

1. Adding an entry for §1.707–5(a)(8).
2. Revising the entry for §1.707–7.
3. Adding entries for §§1.707–7(a) through 1.707–7(l).
4. Revising the entry for §1.707–8(c).
5. Revising the entries for §§1.707–9(a) and (a)(2).

The revisions and additions read as follows:

* * * * *

§1.707–0 Table of contents.

* * * * *

§1.707–5 Disguised sales of property to partnerships; special rules relating to liabilities.

* * * * *

(a) * * *

(8) Disclosure of liabilities assumed or taken subject to within seven years of transfer.

* * * * *

§1.707–7 Disguised sales of partnership interests.

(a) Treatment of transfers as a sale.

(1) In general.

(2) Definition, timing and consequences of sale.

(i) Definition of sale.

(ii) Timing and consequences of sale.

(A) In general.

(B) Simultaneous transfers.

(C) Transfer to selling partner first.

(D) Transfer by purchasing partner first.

(E) Consequences of deemed transactions.

(3) Amount of sale.

(i) In general.

(ii) Aggregation of consideration.

(4) Liability relief included in amount realized on sale.

(5) Sale precedes excess distribution to selling partner.

(6) Transfers first treated as a sale of property.

(7) Application of disguised sale rules.

(8) Certain transfers disregarded.

(b) Transfers treated as sale.

(1) In general.

(2) Facts and circumstances.

(c) Transfers made within two years presumed to be a sale.

(d) Transfers made more than two years apart presumed not to be a sale.

(e) Transfers of money in liquidation of a partner's interest presumed not to be a sale.

(f) Application of §1.707–4 (special rules applicable to guaranteed payments, preferred returns, operating cash flow

distributions, and reimbursements of preformation expenditures).

(g) Exception for certain transfers to and by service partnerships.

(h) Other exceptions.

(i) [Reserved.]

(j) Special rules relating to liabilities.

(1) In general.

(2) Partner liability assumed by partnership.

(3) Partnership liability assumed by partner.

(4) Partner's share of liability.

(i) Recourse liability.

(ii) Nonrecourse liability.

(5) Reduction of partner's share of liability.

(6) Treatment of debt-financed transfers of consideration by partnerships.

(i) In general.

(ii) Partner's allocable share of liability.

(A) In general.

(B) Debt-financed transfers made pursuant to a plan.

(*1*) In general.

(*2*) Special rule.

(C) Reduction of partner's share of liability.

(7) Share of liability where assumption accompanied by transfer of money.

(8) Anti-abuse rule.

(k) Disclosure rules.

(l) Examples.

* * * * *

§1.707–8 Disclosure of certain information.

* * * * *

(c) Parties required to disclose.

* * * * *

§1.707–9 Effective dates and transitional rules.

(a) Sections 1.707–3 through 1.707–7.

(1) * * *

(2) Transfers occurring before effective dates.

* * * * *

Par. 3. In §1.707–3, the heading for paragraph (c)(2) and the text in paragraph (c)(2)(i) are amended by removing the language "two" and adding "seven" in its place.

Par. 4. In §1.707–5, new paragraph (a)(8) is added.

The addition reads as follows:

§1.707–5 Disguised sales of property to partnership; special rules relating to liabilities.

(a) * * *

(8) *Disclosure of liabilities assumed or taken subject to within seven years of transfer*. Disclosure to the Internal Revenue Service in accordance with §1.707–8 is required if—

(i) A partner transfers property to a partnership and the partnership assumes or takes subject to a liability of the partner (whether or not the liability is qualified, as described in §1.707–5(a)(6)) within a seven-year period (without regard to the order of the transactions);

(ii) The partner treats the transactions as other than as a sale for tax purposes; and

(iii) The transactions are not disclosed under paragraph (a)(7)(ii) of this section.

* * * * *

Par. 5. In §1.707–6 is amended as follows:

1. Revising paragraph (c) introductory text.

2. Amending paragraph (c)(1) by removing the language "two" and adding "seven" in its place.

3. Adding new paragraph (c)(3).

The revisions and addition read as follows:

§1.707–6 Disguised sales of property by partnership to partners; general rule.

* * * * *

(c) * * * Similar to the rules provided in §§1.707–3(c)(2), 1.707–5(a)(7)(ii), and 1.707–5(a)(8), a partnership is to disclose to the Internal Revenue Service, in accordance with §1.707–8, the facts in the following circumstances:

* * * * *

(3) When a partnership transfers property to a partner and the partner assumes or takes subject to a liability of the partnership (whether or not the liability is qualified, as described in §1.707–5(a)(6)) within a seven-year period (without regard to the order of the transactions), the partnership treats the transactions as other than as a sale for tax purposes, and the transactions are not disclosed under paragraph (c)(2) of this section.

* * * * *

Par. 6. Section 1.707–7 is revised to read as follows:

§1.707–7 Disguised sales of partnership interests.

(a) *Treatment of transfers as a sale*—(1) *In general*. Except as otherwise provided in this section, if a transfer of money, property or other consideration (including the assumption of a liability) (consideration) by a partner (purchasing partner) to a partnership and a transfer of consideration by the partnership to another partner (selling partner) are described in paragraph (b)(1) of this section, the transfers are treated as a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner. For purposes of this section, the term *transfer* refers to a portion of a single transfer or to one or more transfers.

(2) *Definition, timing and consequences of sale*—(i) *Definition of sale*. For purposes of this section, the use of the term *sale* (or any variation of that word) to refer to a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner means a sale or exchange, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner, rather than a contribution and distribution to which sections 721 and 731, respectively, apply. Transfers that are treated as a sale under paragraph (a)(1) of this section are treated as a sale for all purposes of the Internal Revenue Code (*e.g.*, sections 453, 483, 704, 708, 743, 751, 1001, 1012 and 1274).

(ii) *Timing and consequences of sale*—(A) *In general*. For purposes of this section, a transfer is treated as occurring on the date of the actual transfer, or if earlier, on the date that the transferor agrees in writing to make the transfer. The sale of the selling partner's partnership interest is considered to take place on the date of the earliest of the transfers described in paragraph (a)(1) of this section. On this date, the purchasing partner is treated as acquiring the partnership interest sold for all purposes of the Internal Revenue Code.

(B) *Simultaneous transfers*. If the transfer of consideration by the purchasing partner and the transfer of consideration to the selling partner are simultaneous and the

consideration transferred is the same, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration (purchasing partner's consideration) directly to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. If the transfer of consideration by the purchasing partner to the partnership and the transfer of consideration by the partnership to the selling partner are simultaneous and the consideration transferred is not the same, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration to the partnership in exchange for the consideration to be transferred to the selling partner (selling partner's consideration) and then the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership.

(C) *Transfer to selling partner first*. If the transfer of consideration by the partnership to the selling partner occurs before the transfer of consideration by the purchasing partner to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred an obligation to deliver the purchasing partner's consideration to the partnership in exchange for the selling partner's consideration and then the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. On the date of the actual transfer of the purchasing partner's consideration, the purchasing partner and the partnership are treated as if the purchasing partner satisfied its obligation to deliver the purchasing partner's consideration to the partnership.

(D) *Transfer by purchasing partner first*. If the transfer of consideration by the partnership to the selling partner occurs after the transfer of consideration by the purchasing partner to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred the purchasing partner's consideration to the partnership in exchange for an obligation of the partnership to deliver the selling partner's consideration and then the purchasing partner transferred that obligation to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. On the date of the actual transfer of the selling partner's consideration, the selling partner and the partnership are treated as if the partnership satisfied its obligation to deliver the selling partner's consideration to the selling partner.

(E) *Consequences of deemed transactions*. Transfers and exchanges that are deemed to occur under paragraphs (a)(2)(ii)(B), (a)(2)(ii)(C), and (a)(2)(ii)(D) of this section are treated as actual transfers or exchanges for all purposes of the Internal Revenue Code (*e.g.*, sections 453, 483, 704, 708, 743, 751, 1001, 1012 and 1274).

(3) *Amount of sale*—(i) *In general*. If a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner are treated as a sale under paragraph (b)(1) of this section, the selling partner is treated as selling to the purchasing partner a partnership interest with a value equal to the lesser of the selling partner's consideration or the purchasing partner's consideration.

(ii) *Aggregation of consideration*. For purposes of paragraph (a)(3)(i) of this section, simultaneous transfers of consideration by more than one purchasing partner to a partnership or by a partnership to more than one selling partner are aggregated. In those cases—

(A) Each purchasing partner is presumed to have purchased that fraction of each partnership interest(s) sold equal to—

(*1*) The amount of consideration transferred by that partner to the partnership, divided; by

(*2*) The aggregate consideration transferred by all purchasing partners to the partnership; and

(B) Each selling partner is presumed to have sold that fraction of the total partnership interest(s) sold equal to—

(*1*) The amount of consideration transferred by the partnership to that partner, divided; by

(*2*) The aggregate consideration transferred by the partnership to all selling partners.

(4) *Liability relief included in amount realized on sale*. The amount realized by a selling partner on the sale of the selling partner's interest in the partnership includes any reduction in the selling partner's share of partnership liabilities that is treated as occurring as a result of the sale. If a sale of a partnership interest and either a distribution by the partnership to the selling partner under section 731 or a contribution by the purchasing partner to the partnership under section 721 occur on the same date, the reduction in the selling partner's share of partnership liabilities is computed immediately after the sale and before the distribution or the contribution, as the case may be. To the extent a reduction in a selling partner's share of partnership liabilities is included in the amount realized by the selling partner on the sale of an interest in a partnership because the amount is treated as consideration received by the selling partner in exchange for the selling partner's interest under paragraph (j)(2) of this section, the amount of the reduction shall not also be included in the amount realized by operation of this paragraph.

(5) *Sale precedes excess distribution to selling partner*. If a portion of a transfer of consideration by a partnership to a selling partner is not treated as part of a sale of the selling partner's interest in the partnership, but as a distribution to the selling partner under section 731, and the sale is treated as occurring on the same date as the distribution, then the distribution is treated as occurring immediately following the sale.

(6) *Transfers first treated as a sale of property*. To the extent that a transfer of consideration by a purchasing partner to a partnership or a transfer of consideration by a partnership to a selling partner may be treated as part of a sale of property under §1.707–3(a), §1.707–3(a) applies before this section, and to the extent the transfer is treated as part of a sale of property under §1.707–3(a), such transfer is not taken into account in applying the rules of this section.

(7) *Application of disguised sale rules*. Except as otherwise provided in paragraph (a)(8) of this section, the rules of this section apply to transfers to and from a partnership even if, after the application of the rules of this section, it is determined that the partnership has terminated under section 708(b)(1)(A).

(8) *Certain transfers disregarded*. Section 707(a)(2)(B) and the rules of this section do not apply to deemed transfers resulting from a termination of a partnership under section 708(b)(1)(B) and transfers

incident to the formation of a partnership. However, transfers incident to the formation of a partnership may be transfers to which §1.707–3(a) applies.

(b) *Transfers treated as sale*—(1) *In general.* A transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner only if, based on all the facts and circumstances—

(i) The transfer of consideration by the partnership to the selling partner would not have been made but for the transfer of consideration to the partnership by the purchasing partner; and

(ii) In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

(2) *Facts and circumstances.* The determination of whether a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale under paragraph (b)(1) of this section is made based on all the facts and circumstances in each case. The weight to be given each of the facts and circumstances will depend on the particular case. Generally, the facts and circumstances existing on the date of the earliest of the transfers are the ones considered in determining if a sale exists under paragraph (b)(1) of this section. Among the facts and circumstances that may tend to prove the existence of a sale under paragraph (b)(1) of this section are the following:

(i) That the timing and amount of all or any portion of a subsequent transfer are determinable with reasonable certainty at the time of an earlier transfer;

(ii) That the person receiving the subsequent transfer has a legally enforceable right to the transfer or that the right to receive the transfer is secured in any manner, taking into account the period for which it is secured;

(iii) That the same property (other than money, including marketable securities that are treated as money under section 731(c)(1)) that is transferred to the partnership by the purchasing partner is transferred to the selling partner;

(iv) That partnership distributions, allocations or control of operations are designed to effect an exchange of the benefits and burdens of ownership of transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)), including a partnership interest;

(v) That the partnership holds transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)) for a limited period of time, or during the period of time the partnership holds transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)), the risk of gain or loss associated with the property is not significant;

(vi) That the transfer of consideration by the partnership to the selling partner is disproportionately large in relationship to the selling partner's general and continuing interest in partnership profits;

(vii) That the selling partner has no obligation to return or repay the consideration to the partnership, or has an obligation to return or repay the consideration due at such a distant point in the future that the present value of that obligation is small in relation to the amount of consideration transferred by the partnership to the selling partner;

(viii) That the transfer of consideration by the purchasing partner or the transfer of consideration to the selling partner is not made *pro rata*;

(ix) That there were negotiations between the purchasing partner and the selling partner (or between the partnership and each of the purchasing and selling partners with each partner being aware of the negotiations with the other partner) concerning any transfer of consideration; and

(x) That the selling partner and purchasing partner enter into one or more agreements, including an amendment to the partnership agreement (other than for admitting the purchasing partner) relating to the transfers.

(c) *Transfers made within two years presumed to be a sale.* For purposes of this section, if within a two-year period a purchasing partner transfers consideration to a partnership and the partnership transfers consideration to a selling partner (without regard to the order of the transfers), the transfers are presumed to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

(d) *Transfers made more than two years apart presumed not to be a sale.* For purposes of this section, if a transfer of consideration by a purchasing partner to a partnership and the transfer of consideration by the partnership to a selling partner (without regard to the order of the transfers) occur more than two years apart, the transfers are presumed not to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfers constitute a sale.

(e) *Transfers of money in liquidation of a partner's interest presumed not to be a sale.* Notwithstanding the presumption set forth in paragraph (c) of this section, for purposes of this section, if a partnership transfers money, including marketable securities that are treated as money under section 731(c)(1), to a selling partner, or is treated as transferring consideration to the selling partner under paragraph (j)(2) of this section, in liquidation of the selling partner's interest in the partnership, the transfer is presumed not to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfer is part of a sale. See §1.761–1(d) for the definition of the term *liquidation of a partner's interest*.

(f) *Application of §1.707–4 (special rules applicable to guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures).* Notwithstanding the presumption set forth in paragraph (c) of this section, rules similar to those provided in §1.707–4 apply to determine the extent to which a transfer to a selling partner is treated as part of a sale of the selling partner's interest in the partnership to the purchasing partner.

(g) *Exception for certain transfers to and by service partnerships.* Section 707(a)(2)(B) and the rules of this section do not apply to transfers of money, including marketable securities that are treated as money under section 731(c)(1), to and by a partnership that would be described in section 448(d)(2) if the partnership were a corporation. Solely for purposes of apply-

ing section 448(d)(2) to partnerships under this paragraph (g), partners are treated as employees of the partnership and "partnership interest" is substituted for "stock" in testing for ownership by the employees performing services.

(h) *Other exceptions*. The Commissioner may provide by guidance published in the Internal Revenue Bulletin that section 707(a)(2)(B) and the rules of this section do not apply to other transfers to and by a partnership.

(i) [Reserved.]

(j) *Special rules relating to liabilities*—(1) *In general*. For purposes of this section, deemed contributions to and distributions from a partnership under section 752 resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration. Under paragraph (a)(4) of this section, the preceding sentence does not apply if the transaction is otherwise treated as a sale of a partnership interest under the rules of this section.

(2) *Partner liability assumed by partnership*. For purposes of this section, if a partnership assumes a liability of a partner, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability (determined under the rules of paragraphs (j)(4) and (5) of this section) immediately after the partnership assumes the liability. For purposes of this section, a partnership is treated as assuming a liability of a partner to the extent provided in §§1.752–1(d) and (e). For purposes of this paragraph (j)(2), if the partnership assumes the liabilities of more than one partner pursuant to a plan, a partner's share of the liabilities assumed by the partnership pursuant to that plan immediately after the assumptions equals the sum of that partner's shares of the liabilities assumed by the partnership pursuant to the plan. The preceding sentence does not apply to any liability assumed by the partnership with a principal purpose of reducing the extent to which any other liability assumed by the partnership is treated as a transfer of consideration to a partner under this paragraph (j)(2).

(3) *Partnership liability assumed by partner*. For purposes of this section, if a partner assumes a liability of a partnership, the partner is treated as transferring consideration to the partnership to the extent that the amount of the liability exceeds the partner's share of that liability (determined under the rules of paragraph (j)(4) of this section) immediately before the partner assumes the liability. For purposes of this section, a partner assumes a partnership liability to the extent provided in §§1.752–1(e) and 1.704–1(b)(2)(iv)(c). For purposes of this paragraph (j)(3), if more than one partner assumes a liability of the partnership pursuant to a plan, the amount that is treated as a transfer of consideration by each partner is the amount by which all of the liabilities assumed by the partner pursuant to the plan exceed the partner's share of all of those liabilities immediately before the assumption. The preceding sentence does not apply to any liability assumed by a partner with a principal purpose of reducing the extent to which any other liability assumed by a partner is treated as a transfer of consideration to a partnership under this paragraph (j)(3).

(4) *Partner's share of liability*. A partner's share of any liability of the partnership is determined under the following rules:

(i) *Recourse liability*. A partner's share of a recourse liability of the partnership equals the partner's share of the liability under the rules of section 752 and the regulations thereunder. A partnership liability is a recourse liability to the extent that the obligation is a recourse liability under §1.752–1(a)(1) or would be treated as a recourse liability under that section if it were treated as a partnership liability for purposes of that section.

(ii) *Nonrecourse liability*. A partner's share of a nonrecourse liability of the partnership is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under §1.752–3(a)(3). A partnership liability is a nonrecourse liability of the partnership to the extent that the obligation is a nonrecourse liability under §1.752–1(a)(2) or would be treated as a nonrecourse liability under that section if it were treated as a partnership liability for purposes of that section.

(5) *Reduction of partner's share of liability*. For purposes of this section, a partner's share of a liability, immediately after a partnership assumes the liability, is determined by taking into account a subsequent reduction in the partner's share if—

(i) At the time that the partnership assumes a liability, it is anticipated that the transferring partner's share of the liability will be subsequently reduced; and

(ii) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the assumption of the liability is treated as part of a sale under this section.

(6) *Treatment of debt-financed transfers of consideration by partnerships*—(i) *In general*. For purposes of this section, if a partnership incurs a liability and all or a portion of the proceeds of that liability are allocable under §1.163–8T to a transfer of consideration to a partner made within 90 days of incurring the liability, the transfer of consideration to the partner is taken into account only to the extent that the amount of consideration transferred exceeds that partner's allocable share of the partnership liability.

(ii) *Partner's allocable share of liability*—(A) *In general*. A partner's allocable share of a partnership liability for purposes of paragraph (j)(6)(i) of this section equals the amount obtained by multiplying the partner's share of the liability (as defined in paragraph (j)(4) of this section) by a fraction determined by dividing—

(*1*) The portion of the liability that is allocable under §1.163–8T to the consideration transferred to the partner; by

(*2*) The total amount of the liability.

(B) *Debt-financed transfers made pursuant to a plan*—(*1*) *In general*. Except as provided in paragraph (j)(6)(ii)(C) of this section, if a partnership transfers to more than one partner pursuant to a plan all or a portion of the proceeds of one or more partnership liabilities, paragraph (j)(6)(i) of this section is applied by treating all of the liabilities incurred pursuant to the plan as one liability, and each partner's allocable share of those liabilities equals the amount obtained by multiplying the sum of the partner's shares of each of the respective liabilities (as defined in paragraph (j)(4) of this section) by the fraction obtained by dividing—

(*i*) The portion of those liabilities that is allocable under §1.163–8T to the consideration transferred to the partners pursuant to the plan; by

(*ii*) The total amount of those liabilities.

(*2*) *Special rule*. Paragraph (j)(6)(ii)(B)(1) of this section does not apply to any

transfer of consideration to a partner that is made with a principal purpose of reducing the extent to which any transfer is taken into account under paragraph (j)(6)(i) of this section.

(C) *Reduction of partner's share of liability*. For purposes of paragraph (j)(6)(ii) of this section, a partner's share of a liability is determined by taking into account a subsequent reduction in the partner's share if—

(*1*) It is anticipated that the partner's share of the liability that is allocable to a transfer of consideration to the partner will be reduced subsequent to the transfer; and

(*2*) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the partnership's distribution of the proceeds of the borrowing is treated as part of a sale.

(7) *Share of liability where assumption accompanied by transfer of money*. For purposes of paragraph (j)(2) of this section, if pursuant to a plan a partner pays or contributes money to the partnership and the partnership assumes one or more liabilities of the partner, the amount of those liabilities that the partnership is treated as assuming is reduced (but not below zero) by the money transferred. Similarly, for purposes of paragraph (j)(3) of this section, if pursuant to a plan a partnership pays or distributes money to a partner and the partner assumes one or more liabilities of the partnership, the amount of those liabilities that the partner is treated as assuming is reduced (but not below zero) by the money transferred.

(8) *Anti-abuse rule*. For purposes of this section, an increase in a partner's share of a partnership liability may be treated as a transfer of consideration by the partner to the partnership, notwithstanding any other rule in this section, if—

(i) Within a short period of time after the partnership incurs or assumes the liability or another liability, one or more partners of the partnership, or related parties to a partner (within the meaning of section 267(b) or 707(b)), in substance bears an economic risk for the liability that is disproportionate to the partner's interest in partnership profits or capital; and

(ii) The transactions are undertaken pursuant to a plan that has as one of its principal purposes minimizing the extent to which the partner is treated as making a transfer of consideration to the partnership that may be treated as part of a sale under this section.

(k) *Disclosure rules*. Disclosure to the Internal Revenue Service in accordance with §1.707–8 is required when a partner transfers consideration to a partnership and the partnership transfers consideration to another partner within a seven-year period (without regard to the order of the transfers), the partners treat the transfers other than as a sale for tax purposes, and the transfer of consideration by the partnership is not presumed to be a guaranteed payment for capital under §1.707–4(a)(1)(ii), is not a reasonable preferred return within the meaning of §1.707–4(a)(3), and is not an operating cash flow distribution within the meaning of §1.707–4(b)(2). However, disclosure is not required under this paragraph if an exception provided in either paragraph (a)(8) (relating to transfers resulting from a termination of a partnership under section 708(b)(1)(B) and transfers incident to the formation of a partnership) or paragraph (g) (relating to transfers to and by service partnerships) applies to either of the transfers.

(l) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, assume that the transfers would otherwise be respected as contributions and distributions and that, except as otherwise provided, sections 721(b), 751(b), 704(c)(1)(B), 737, and §1.707–3 do not apply. All amounts and percentages in these examples are rounded to the nearest whole number.

Example 1. Treatment of simultaneous transfers as a sale by a selling partner to a purchasing partner. (i) A and B each owns a 50% interest in partnership AB. AB holds Blackacre, real property with a fair market value of $400x. AB has no liabilities. On May 25, 2008, C transfers $100x in cash to AB in exchange for an interest in AB. Simultaneously, AB transfers $100x in cash to A.

(ii) Because C's transfer of $100x to AB and AB's transfer of $100x to A occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A or the consideration transferred by C to AB. C transferred $100x to AB, and A received $100x from AB. Thus, A is treated as having sold an interest in AB with a value of $100x to C.

Example 2. Treatment of non-simultaneous transfers as a sale by a selling partner to a purchasing partner. (i) The facts are the same as in *Example 1*, except that AB transfers $100x in cash to A on March 25, 2008, and C transfers $50x in cash to AB on May 25, 2008, in exchange for an interest in AB.

(ii) Because AB's transfer of $100x to A and C's transfer of $50x to AB occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's interest in AB to C. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, March 25, 2008, upon AB's transfer of $100x to A. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A or the consideration transferred by C to AB. C transferred $50x to AB, and A received $100x from AB. Thus, A is treated as having sold an interest in AB with a value of $50x to C. Under paragraph (a)(2)(ii)(C), because the transfer to A precedes the transfer by C, each of A, C, and AB is treated as if, on March 25, 2008, C transferred an obligation to deliver $50x to AB in exchange for $50x, and then C transferred $50x to A in exchange for a portion of A's interest in AB with a value of $50x. On May 25, 2008, when C actually transfers $50x to AB, C is treated as satisfying the obligation to deliver $50x to AB. A also is treated as receiving, in its capacity as a partner, a distribution from AB to which section 731 applies of $50x ($100x transfer - $50x amount of sale). Under paragraph (a)(5) of this section, the distribution is treated as occurring immediately following the sale.

Example 3. Treatment of deemed transfers and exchanges. (i) A and B each owns a 50% interest in partnership AB. AB holds Whiteacre, real property with a fair market value of $1,000x and a tax basis of $700x, along with other assets. AB has no liabilities. On January 1, 2008, C transfers Investment Property, with a fair market value of $1,500x and a tax basis of $300x, to AB. Simultaneously with that transfer, AB transfers Whiteacre to B.

(ii) Because C's transfer of Investment Property to AB and AB's transfer of Whiteacre to B occurred within two years, the transfers are presumed to be a sale of a portion of B's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of B's interest in AB to C. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, January 1, 2008. Under paragraph (a)(3)(i) of this section, the value of

the partnership interest that B is treated as selling to C equals the lesser of the consideration transferred by C to AB or the consideration transferred by AB to B. C transferred the Investment Property with a fair market value of $1,500x to AB, and B received Whiteacre with a fair market value of $1,000x from AB. Thus, B is treated as having sold an interest in AB with a value of $1,000x to C.

(iii) Under paragraph (a)(2)(ii)(B), because the transfers are simultaneous and the consideration transferred is not the same, each of B, C, and AB is treated as if, on January 1, 2008, C transferred $1,000x of the Investment Property to AB in exchange for Whiteacre and then C transferred Whiteacre to B in exchange for a portion of B's interest in AB with a value of $1,000x. In the deemed exchange of $1,000x worth of the Investment Property for Whiteacre, AB realizes and recognizes gain of $300x ($1,000x - $700x basis), and C realizes and recognizes gain of $800x ($1,000x - $200x allocable basis). In the deemed exchange of Whiteacre for B's interest in AB, B realizes and recognizes gain or loss under section 741 (and section 751(a), if applicable) based on an amount realized of $1,000x. C also is considered to have contributed to AB, in C's capacity as a partner, $500x of the Investment Property ($1,500x total value of transferred Investment Property - $1,000x amount treated as C's consideration) with an allocable basis of $100x in a transaction to which section 721 applies. Thus, the basis of the Investment Property in the hands of AB is $1,100x, C's basis in the partnership interest is $1,100x, and the basis of Whiteacre in the hands of B is $1,000x.

Example 4. Treatment of simultaneous transfers as a sale by a selling partner to more than one purchasing partner. (i) E and F each owns a 50% interest in partnership EF. EF holds a building with a fair market value of $500x. EF has no liabilities. On May 25, 2008, G and H each transfer $50x in cash to EF in exchange for an interest in EF. Simultaneously, EF distributes $100x in cash to E.

(ii) Because each of G's and H's transfers of $50x to EF and EF's transfer of $100x to E occurred within two years, G's transfer to EF and EF's transfer to E, and H's transfer to EF and EF's transfer to E, are presumed to be a sale of a portion of E's interest in EF to G and H, respectively, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of E's partnership interest to G and H, respectively. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that E is treated as selling to each of G and H equals the lesser of the consideration transferred by EF to E or the consideration transferred by G and H to EF. Because G and H made simultaneous transfers of consideration to EF, the transfers are aggregated under paragraph (a)(3)(ii) of this section. G and H together transferred $100x to EF, and E received $100x from EF. Thus, E is treated as having sold a partnership interest with a value of $100x to G and H. Under paragraph (a)(3)(ii) of this section, when transfers of multiple purchasing partners are aggregated, each purchasing partner is presumed to have purchased a *pro rata* portion of the selling partner's partnership interest. That is, G is presumed to have purchased the fraction of E's partnership interest sold that is equal to G's amount transferred ($50x) divided by the aggregate amount transferred by G and H ($100x), or one-half of the partnership interest that was sold. H also is presumed to have purchased the fraction of E's partnership interest equal to H's amount transferred ($50x) divided by the aggregate amount transferred by both of G and H ($100x), or one-half of the partnership interest that was sold. Thus, each of G and H is treated as having purchased a fraction of E's partnership interest that is equal to $50x.

Example 5. Treatment of non-simultaneous transfers as a sale by a selling partner to more than one purchasing partner. (i) The facts are the same as in *Example 4*, except that partnership EF distributes $75x in cash to E on May 1, 2007. In addition, G transfers $50x in cash to EF on March 25, 2008, and H transfers $50x in cash to EF on May 25, 2008, each in exchange for a partnership interest in EF.

(ii) Because each of G's and H's transfers of $50x to EF and EF's transfer of $75x to E occurred within two years, G's transfer to EF and EF's transfer to E, and H's transfer to EF and EF's transfer to E, are presumed to be a sale of a portion of E's partnership interest to G and H, respectively, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of E's interest in EF to each of G and H, respectively. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, May 1, 2007, the date that EF transferred $75x to E. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that E is treated as selling to each of G and H equals the lesser of the consideration transferred by G and H to EF, or the consideration transferred by EF to E. Because the transfers made by G and H were not simultaneous, the transfers are not aggregated. Rather, in accordance with paragraph (a)(2)(ii)(A) of this section, the transfers are considered in the order in which they were made. The value of the partnership interest that E is treated as selling to G equals $50x, the lesser of G's $50x transfer to EF and the $75x that E received from EF. The value of the partnership interest that E is treated as selling to H equals $25x, the lesser of the remaining amount of the transfer to E, $25x ($75x - $50x = $25x), and H's $50x transfer to EF. H also is considered to have contributed to EF, in H's capacity as a partner, $25x ($50x transfer - $25x amount of sale), to which section 721 applies.

(iii) Under paragraph (a)(2)(ii)(C), each of E, G, and EF are treated as if, on May 1, 2007, G transferred an obligation to deliver $50x to EF in exchange for $50x, and, on that same date, G transferred $50x to E in exchange for a portion of E's interest in EF with a value of $50x. On March 25, 2008, when G actually transfers $50x to EF, G is treated as satisfying its obligation to deliver $50x to EF. Also, under paragraph (a)(2)(ii)(C), each of E, H, and EF are treated as if, on May 1, 2007, H transferred an obligation to deliver $25x to EF in exchange for $25x, and, on that same date, H transferred $25x to E in exchange for a portion of E's interest in EF with a value of $25x. On May 25, 2008, when H actually transfers $25x to EF, H is treated as satisfying its obligation to deliver $25x to EF.

Example 6. Operation of presumption for liquidation of a partner for money. (i) A and B each owns a 50% interest in partnership AB. AB holds marketable securities with a fair market value of $200x. AB has no liabilities. On April 1, 2008, C transfers $100x in cash to AB in exchange for an interest in AB. Simultaneously, AB distributes $100x of the marketable securities to A in liquidation of A's partnership interest in AB. Assume that the marketable securities transferred to A are treated, under section 731(c)(1), as money for purposes of section 731(a)(1).

(ii) Because C's transfer of $100x to AB and AB's transfer of $100x of marketable securities to A occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section. However, under paragraph (e) of this section, notwithstanding the presumption set forth in paragraph (c) of this section, AB's transfer of marketable securities to A in liquidation of A's interest in AB is presumed not to be a sale of A's partnership interest to C, unless the facts and circumstances clearly establish otherwise. If, however, one of the exceptions under section 731(c)(3) applies to the $100x of marketable securities distributed to A, the securities would not be treated as money for purposes of section 731(a)(1), and the presumption against sale treatment under paragraph (e) of this section would not apply.

Example 7. Transfers that would otherwise be treated as both a sale of property and a sale of a partnership interest. (i) C and D each owns a 50% interest in partnership CD. CD holds Greenacre, real property with a fair market value of $2,000x. CD has no liabilities. On June 1, 2008, E transfers $500x in cash to CD in exchange for a partnership interest in CD. Immediately after E's transfer, C transfers Redacre to CD, and CD distributes $500x in cash to C. At the time of the transfers, Redacre has a fair market value of $250x.

(ii) Because E's transfer of $500x to CD and CD's transfer of $500x to C occurred within two years, the transfers are presumed to be a sale of a portion of C's partnership interest in CD to E under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of C's partnership interest in CD to E. However, because C's transfer of Redacre to CD and CD's transfer of $500x to C occurred within two years, under §1.707–3(c), the transfers are presumed to be a sale of Redacre by C to CD. There are no facts that rebut the presumption that the transfers are a sale of Redacre by C to CD. Under paragraph (a)(6) of this section, transfers that are in part a sale of a partnership interest and in part a sale of property are treated, first, as part of a sale of property. Thus, C's transfer of Redacre to CD and $250x of CD's $500x transfer to C are treated, first, as a sale of Redacre by C to CD for $250x. Although the $250x distributed to C that is treated as part of a sale of Redacre is not treated as part of a sale of C's partnership interest in CD to E, the remaining

$250x that is distributed to C is treated as part of a sale of C's partnership interest in CD to E. The value of the partnership interest that C is treated as selling to E equals $250x, the lesser of E's $500x transfer to CD, and the remaining $250x that C received from CD. E also is considered to have contributed to CD, in E's capacity as a partner, $250x ($500x contribution - $250x amount of sale), to which section 721 applies.

Example 8. Treatment of simultaneous transfers as a sale where partnership has nonrecourse liabilities. (i) A and B each owns a 50% interest in partnership AB. The partnership agreement states that the partners agree to share profits in proportion to the partners' booked-up capital accounts. AB holds $100x cash and Orangeacre, a parcel of raw land with a fair market value of $860x. Orangeacre is encumbered by a $360x nonrecourse liability incurred by AB in 1998 in connection with the purchase of Orangeacre. The liability, which has an issue price of $360x, has a term of 10 years and all principal is payable at maturity. The liability provides for adequate stated interest, all of which is qualified stated interest. On January 1, 2007, C contributes $100x to AB in exchange for an interest in AB. On the same date, A receives a transfer of $200x from AB.

(ii) For purposes of determining whether the transfers constitute a disguised sale of A's or B's interest in AB, the $360x liability is ignored because no partner assumes the liability. Because C's transfer of $100x to AB and AB's transfer of $200x to A occurred within two years, the transfers are presumed to be a sale of a portion of A's partnership interest in AB to C, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's partnership interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A, or the consideration transferred by C to AB. C transferred $100x to AB, and A received $200x from AB. Thus, A is treated as having sold an interest in AB with a value of $100x to C. Under paragraph (a)(4) of this section, the amount realized by A on the sale of its partnership interest includes any reduction in A's share of the $360x partnership liability that is treated as occurring as a result of the sale. Before the sale, A's share of the nonrecourse liability under §1.752–3(a)(3) was $180x (50% of the $360x liability). As a result of A's sale of its $100x partnership interest in AB to C, A's share of the nonrecourse liability under §1.752–3(a)(3) was reduced to $120x (because A's partnership interest was 33% after the sale but immediately before the $100x distribution from AB that reduced A's interest in AB to 20%). Thus, A's amount realized on the sale of its partnership interest equals $100x plus the reduction in A's share of the $360x partnership liability of $60x ($180x - $120x), or $160x. A also is treated as receiving, in its capacity as a partner, and without regard to any deemed distributions under section 752(b), a distribution from AB to which section 731 applies of $100x ($200x transfer - $100x amount of sale). Under paragraph (a)(5) of this section, the distribution is treated as occurring immediately following the sale.

Example 9. Treatment of simultaneous transfers as a sale where selling partner has recourse liabilities that are assumed by the partnership. (i) The facts are the same as those in *Example 8*, except that AB does not make a transfer to A but AB does assume a personal $80x recourse liability of A's, on January 1, 2007. Immediately after AB's assumption of A's personal $80x recourse liability, A is completely released from liability, and only B and C are ultimately liable on the $80x recourse debt.

(ii) As in *Example 8*, the $360x liability is ignored for purposes of determining whether the transfers constitute a sale of A's or B's interest in AB because no partner assumes the $360x liability. However, AB's assumption of A's $80x recourse liability is treated as a transfer of consideration to A to the extent that the amount of the liability exceeds A's share of that liability immediately after AB assumes the liability, determined as provided in paragraph (j)(4)(i) of this section. Under paragraph (j)(4)(i) of this section, A's share of the recourse liability immediately following the assumption is zero. Thus, the assumption is treated as a transfer of $80x to A by AB on January 1, 2007. Because C's transfer of $100x to AB, and AB's transfer of $80x to A, occurred within two years, the transfers are presumed to be a sale of a portion of A's partnership interest in AB to C, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's partnership interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A, or the consideration transferred by C to AB. C transferred $100x to AB, and A received $80x from AB. Thus, A is treated as having sold a partnership interest in AB with a value of $80x to C. Under paragraph (a)(4) of this section, the amount realized by A on the sale of its partnership interest includes any reduction in A's share of the $360x partnership liability that is treated as occurring as a result of the sale. Before the sale, A's share of the nonrecourse liability under §1.752–3(a)(3) was $180x (50% of the $360x liability). As a result of A's sale of its $80x partnership interest in AB to C, A's share of the nonrecourse liability under §1.752–3(a)(3) was reduced to $133x (because A's partnership interest was 37% after the sale). Thus, A's amount realized on the sale of its partnership interest equals $80x plus the reduction in A's share of the $360x partnership liability of $47x ($180x - $133x), or $127x. C also is treated as making, in its capacity as a partner, and without regard to any deemed contributions under section 752(a), a contribution to AB to which section 721 applies of $20x ($100x contribution - $80x amount of sale).

Par. 7. Section 1.707–8 is amended as follows:

1. Revising paragraph (a).
2. Revising paragraph (c).

The revisions read as follows:

§1.707–8 Disclosure of certain information.

(a) *In general*. The disclosure referred to in §1.707–3(c)(2) (regarding certain transfers made within seven years of each other), §1.707–5(a)(7)(ii) (regarding a liability incurred within two years prior to a transfer of property), §1.707–5(a)(8) (relating to liabilities assumed within seven years of the transfer), §1.707–6(c) (relating to transfers of property from a partnership to a partner in situations analogous to those listed above), and §1.707–7(k) (relating to certain transfers made within seven years of each other) is to be made in accordance with paragraphs (b) and (c) of this section.

* * * * *

(c) *Parties required to disclose*. The disclosure required by this section must be made by any person who makes a transfer that is required to be disclosed. The persons who are required to disclose may designate by written agreement a single person to make the disclosure. The designation of one person to make the disclosure does not relieve the other persons required to disclose from their obligation to make the disclosure if the designated person fails to make the disclosure in accordance with paragraph (b) of this section.

Par. 8. Section 1.707–9 is amended as follows:

1. Revising the heading for paragraph (a).
2. Revising paragraph (a)(1).
3. Revising the heading for paragraph (a)(2), and adding a sentence at the end of the paragraph.
4. Amending paragraph (a)(3) by removing the language "1.707–6" and adding "1.707–7" in its place.
5. Revising paragraph (b).

The revisions and addition read as follows:

§1.707–9 Effective dates and transitional rules.

(a) *Sections 1.707–3 through 1.707–7*—(1) *In general*. Except as provided in paragraph (a)(3) of this section, §§1.707–3 through 1.707–7 apply to any transaction with respect to which all transfers that are part of a sale of an item of property or of a partnership interest occur on or after the date these regulations are

published as final regulations in the **Federal Register**. For any transaction with respect to which all transfers that are part of a sale of an item of property occur after April 24, 1991, but before the date these regulations are published as final regulations in the **Federal Register**, §§1.707–3 through 1.707–6 as contained in 26 CFR edition revised April 1, 2004, (T.D. 8439) apply, except as provided in paragraph (a)(3) of this section.

(2) *Transfers occurring before effective dates*. * * * In addition, except as provided in paragraph (a)(3) of this section, in the case of any transaction with respect to which one or more of the transfers occurs after April 24, 1991, but before the date these regulations are published as final regulations in the **Federal Register**, the determination of whether the transaction is a disguised sale of a partnership interest under section 707(a)(2)(B) is to be made on the same basis.

* * * * *

(b)* * * The disclosure provisions described in §1.707–8 apply to transactions with respect to which all transfers that are part of a sale of property occur on and after the date these regulations are published as final regulations in the **Federal Register**. For transactions with respect to which all transfers that are part of a sale of property occur after September 30, 1992, but before the date these regulations are published as final regulations in the **Federal Register**, the disclosure provisions as described in §1.707–8 as contained in the 26 CFR edition revised April 1, 2004, (T.D. 8439) apply.

* * * * *

Par. 9. Section 1.752–3 is amended in the sixth sentence of paragraph (a)(3) by revising the sentence "This additional method does not apply for purposes of §1.707–5(a)(2)(ii)" to read "This additional method does not apply for purposes of §§1.707–5(a)(2)(ii) and 1.707–7(j)(4)(ii)."

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 24, 2004, 8:45 a.m., and published in the issue of the Federal Register for November 26, 2004, 69 F.R. 68838)