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IRS Finalizes Partnership Allocation Antiabuse Rules for Contributed Property

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Summary by taxanalysts

The IRS strengthened antiabuse rules on partnership allocations of contributed property in final regulations issued June 8 by taking into account the tax effect on both direct and indirect partners in a consolidated group.

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The IRS strengthened antiabuse rules on partnership allocations of contributed property in final regulations issued June 8 by taking into account the tax effect on both direct and indirect partners in a consolidated group. The final rules adopt without substantive change the IRS's 2008 proposed rules. (For the final regs (T.D. 9485), see *Doc 2010-12556*. For the proposed regs (REG-100798-06), see *Doc 2008-10901* or *2008 TNT 97-7*.)

The purpose of the final rules under reg. section 1.704-3 is to permit the IRS to recast transactions involving property contributed to a partnership when the transaction is "inconsistent with the intent of subchapter K," according to the regulation's preamble.

Although several written comments asked the IRS to provide examples of abusive transactions that would be covered under section 704(c) -- or transactions that fall outside the ambit of that provision but are subject to the general partnership antiabuse rule of reg. section 1.701-2 -- the Service declined to do so, citing the factual nature of such transactions. The IRS also refused to implement a requested de minimis related-party rule.

A 2003 Joint Committee on Taxation report prompted by the Enron Corp. fallout suggested that Congress should address partnership allocation rules that were being used to generate unwarranted benefits, resulting in the enactment of section 755(c). One of the Enron transactions used partnerships to shift basis among assets so that basis was shifted from Enron shares to depreciable assets contributed to the partnership. (For the JCT report, see *Doc 2003-4185* or *2003 TNT 34-35*.)

Steven R. Schneider, a director at Goulston & Storrs, told Tax Analysts that "the key to the regulations is that they strengthen the section 704(c) antiabuse rules, particularly in the related-party context; remind people that the transaction may also be recast under the reg. section 1.701-2 partnership antiabuse rules; and reject taxpayer suggestions for a de minimis partner exception for determining whether there is an abusive tax benefit to a direct or indirect partner."

Monte Jackel, managing director in the partnership group at PricewaterhouseCoopers LLP, told Tax Analysts that he "wish[es] the government had added examples as requested," but doesn't blame it for not doing so. He called the reg provisions applying the section 704(c) antiabuse rule to indirect partners "a perfectly logical result" given that the substantiality rules under section 704(b) regs provide the same treatment.

However, when discussing the rule in the final regulations applying the principles of reg. section 1.701-2 to section 704(c) allocations, Jackel said that considering that the government doesn't use reg. section 1.701-2 in cases in which the economic substance common-law doctrine would otherwise apply, "I fail to see that these final regulations will have any real significance given new section 755(c) and the codification of the economic substance doctrine under section 7701(o)."

Aaron P. Nocjar of Steptoe & Johnson LLP echoed Jackel, telling Tax Analysts, "With respect to the finalization of these regulations, I think what practitioners should be thinking about is, 'What does this regulation add to the conceptual analysis of transactions involving section 704(c) property?'" The regulations generally "do not add much in light of the ever-growing array of antiabuse rules, including the general partnership antiabuse rule, the economic substance doctrine (codified and common-law versions), and general substance over form principles," he said.

1. Tax Analysts Information

Code Sections: Section 704 -- Partner's Distributive Share
Section 7701(o) -- Economic Substance Codification
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