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# **THE CONCEPT OF NONRECOURSE UNDER SECTIONS 704, 752, AND 1001**

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# THE CONCEPT OF NONRECOURSE UNDER SECTIONS 704, 752, AND 1001

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## Table of Contents

1.	Summary Inquiries Regarding Nonrecourse Rules.	8
2.	Examples.	17
3.	Section 752 Regulations.	41
[a]	Basic Definitions under Section 752.	42
[1]	“Recourse Liability” and “Nonrecourse Liability”.	42
[2]	Related person	42

**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

[b]	Liability.	46
[c]	Obligation.	47
[d]	Assumption of Liability.	48
[e]	Property subject to a liability.	48
[f]	Bearing the Economic Risk of Loss.	49
	[1] In general.	49
	[2] Obligation to Make a Payment.	49
	[i] In general.	49
	[ii] Treatment upon Deemed Disposition.	52
	[iii] Obligations Recognized.	54
	[iv] Contingent Payment Obligations.	55
	[v] Reimbursement Rights.	57
	[vi] Deemed Satisfaction of Obligation.	57
[g]	Partner or Related Person as Lender.	58
	[1] In General.	58
	[2] Wrapped Debt.	59
[h]	<i>De minimis</i> Exceptions.	60
	[1] Partner as Lender.	60
	[2] Partner as Guarantor.	65
[i]	Special Rule for Nonrecourse Liability with Interest Guaranteed by a Partner.	66
	[1] In General.	66
	[2] Computation of Present Value.	68
	[3] Safe Harbor.	68
	[4] <i>De minimis</i> Exception.	69
[j]	Time-value-of-money Considerations.	69
	[1] In General.	69
	[2] Valuation of an Obligation.	70
	[3] Satisfaction of Obligation with Partner's Promissory Note.	70
[k]	Partner Providing Property as Security for Partnership Liability.	71
	[1] Direct Pledge.	71
	[2] Indirect Pledge.	71
	[3] Valuation.	72
	[4] Partner's promissory note.	72
[l]	Treatment of recourse liabilities in tiered partnerships.	72

**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

[m]	Anti-abuse rules.	73
[1]	In general.	73
[2]	Arrangements tantamount to a guarantee.	74
[3]	Plan to circumvent or avoid the obligation.	74
[n]	Disregarded Entities.	76
[1]	In general.	76
[2]	Net value of a disregarded entity.	77
[i]	Definition.	77
[ii]	Timing of the net value determination	77
	(a) Initial determination.	77
	(b) Other events.	77
[iii]	Valuation events.	78
[iv]	Allocation date	80
[3]	Multiple liabilities.	80
[4]	Reduction in net value of a disregarded entity.	80
[5]	Information to be provided by the owner of a disregarded entity.	81
[o]	<i>Raphan v. United States.</i>	81
[p]	Proposed Regulations under Section 752 on Partner Payment Obligations.	91
[1]	Discussion of Proposed Regulations.	91
[i]	Seven recognition requirements.	93
[ii]	Commercially reasonable net worth.	97
[iii]	Commercially reasonable contractual restrictions on transfers of assets.	101
[iv]	Commercially reasonable documentation regarding the partner's financial condition.	104
[v]	The term does not end prior to the term of the partnership liability.	106
[vi]	Hold money or other liquid assets in an amount that exceeds reasonable needs.	107
[vii]	Arm's length consideration for assuming the payment obligation.	110
[viii]	Liable up to the full amount of the partner's payment obligation.	113
[ix]	For an indemnity or reimbursement agreement, the partner or related person is liable up to the full amount of the partner's payment obligation.	116

**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

[x]	State Law Exception.	117
[xi]	Satisfaction of Obligation.	118
[xii]	Net Value Requirement.	122
[xiii]	Contingent Liabilities.	125
[xiv]	Fair Market Value.	125
[xv]	Diligence in Establishing Net Value.	125
[xvi]	Uncertainty of Value.	126
[xvii]	Goodwill.	126
[xviii]	Trade Payables.	126
[xix]	Net Value Exemption for Individuals and Decedents' Estates.	128
[xx]	Valuation Events.	128
[xxi]	Allocation Dates.	131
[xxii]	Reporting Net Value to Partnership.	133
[xxiii]	Disputing Valuation.	135
[xxiv]	Return Preparation.	136
[xxv]	Allocation of Nonrecourse Liabilities.	136
[xxvi]	Antiabuse.	139
[xxvii]	Treatment of Debt on a Foreclosure.	139
[xxviii]	Payment Obligations.	145
[xxix]	Where Proposed Regulations Apply.	146
[xxx]	Effects of Proposed Regulations.	151
[xxxi]	Effect on Loss Allocations.	152
[xxxii]	"Commercially reasonable" guarantees.	154
[xxxiii]	Theoretical issues with Proposed Regulations' approach to "bottom dollar" guarantees.	155
[xxxiv]	Consistency and Tax Policy.	159
[xxxv]	Effective Dates.	161
[xxxvi]	Conclusion.	162
[2]	American Bar Association Report.	164
[i]	The current section 752 regulations are administrable.	168
[ii]	A fundamental change in the Section 752 regulations should coordinate changes to the Section 704 regulations and address the results in the cases that incorporate the "worst case scenario."	179
[iii]	The nonrecourse debt regulations should take current business arrangements into account.	186
[iv]	A more tailored or nuanced change to address abusive disguised sale	

**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

	transactions could achieve objectives in a way that would be less disruptive to business transactions and involve considerably less cost.	191
[v]	Continue the “economic risk of loss” standard for allocating partnership recourse liabilities.	192
[vi]	The “commercially reasonable” standard provides inadequate guidance.	200
[vii]	The requirement that the payment obligation last through the full term of the partnership liability is not consistent with commercial arrangements..	201
[viii]	The requirement relating to maintenance of assets should explain the meaning of the “reasonable needs” of the obligor.	203
[ix]	The requirement relating to an arm’s length fee is not consistent with commercial practice.	204
[x]	The requirement relating to no “bottom-dollar” guarantees and the requirement relating to reimbursements should be eliminated or applied solely with respect to Section 707.	205
[xi]	The “net value” requirement should not be expanded to apply to entities other than disregarded entities.	205
[xii]	Anti-Abuse Regulation.	206
[xiii]	Deficit Restoration Obligations.	207
[3]	New York Bar Association Report.	210
[i]	Repudiation of Raphan.	220
[ii]	Payment Obligation Requirements.	226
[iii]	Indemnities, Reimbursement Agreements, or Similar Arrangement.	237
[iv]	Interaction with Section 704	238
[v]	Net Value Rules.	244
[vi]	Rights to Reimbursement	246
[vii]	Allocating Nonrecourse Liabilities.	248
<b>4.</b>	<b>Nonrecourse and Section 704.</b>	<b>263</b>
[a]	Nonrecourse Liability.	263
[b]	Nonrecourse Deductions.	264

**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

	[c] Partnership Minimum Gain.	264
	[d] Partner Nonrecourse Liability.	266
	[e] Exculpatory Liability.	268
	[f] Liability That Is Secured By Specific Property, That Is Recourse To The Partnership As An Entity, But Explicitly Not Recourse To Any Partner.	269
	[g] Contribution Obligations under Section 704 Regulations.	270
<b>5.</b>	Section 1001 and “Nonrecourse.”	272
	[a] A Few Inquiries Concerning Nonrecourse Debt under Section 1001?	273
	[b] <i>Lutz &amp; Schramm Co. v. Commissioner.</i>	277
	[c] <i>Crane v. Commissioner.</i>	278
	[d] <i>Parker v. Delaney.</i>	282
	[e] <i>Woodsam Associates v. Commissioner.</i>	284
	[f] Revenue Ruling 76-111.	286
	[g] Letter Ruling 8041019.	288
	[h] Letter Ruling 8041017.	291
	[i] <i>Mayerson v. Commissioner.</i>	292
	[j] <i>Estate of Delman v. Commissioner.</i>	294
	[k] Revenue Ruling 90-16.	297
	[l] <i>2925 Briarpark, Ltd. v. Commissioner.</i>	298
	[m] <i>Gershkowitz v. Commissioner.</i>	301
	[n] <i>Danenberg v. Commissioner.</i>	315
	[o] <i>Estate of Levine v. Commissioner.</i>	321
	[p] <i>Millar v. Commissioner.</i>	323
	[q] <i>Tufts v. Commissioner.</i>	326
	[r] Section 1001 Regulations.	335
	[s] <i>Great Plains Gasification Associates v. Commissioner.</i>	343
<b>6.</b>	Section 108.	356
	[a] <i>United States v. Kirby Lumber Co.</i>	357
	[b] <i>Dallas Transfer &amp; Terminal Warehouse Co. v. Commissioner.</i>	358
	[c] <i>Fulton Gold Corporation v. Commissioner.</i>	360

THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001

[d]	<i>Lakeland Grocery Co. v. Commissioner.</i>	362
[e]	<i>Hotel Astoria, Inc. v. Commissioner.</i>	364
[f]	Revenue Ruling 82-202.	367
[g]	Revenue Ruling 91-31.	368
[h]	Revenue Ruling 92-99.	368
[i]	<i>Mylander v. Commissioner.</i>	371
[j]	<i>Landreth v. Commissioner.</i>	375

“Once upon a midnight dreary, while I pondered, weak and weary, Over many a quaint and curious volume of forgotten lore—While I nodded, nearly napping, suddenly there came a tapping, As of some one gently rapping, rapping at my chamber door— ‘Tis some visitor,” I muttered, “tapping at my chamber door—Only this and nothing more.”<sup>1</sup>

The visitor, in this story at least, is nonrecourse debt.

I recall an evening late at night (or perhaps very early in the morning) in the USC law library in 1975. The world outside was black. The law school building was closed to all but janitors and a few dedicated law students. Several of my colleagues were running about the otherwise empty law library undertaking “source and cite” for a law review article.

One student editor was troubled by a reference in an article to “nonrecourse debt.” That did not any sense. What sort of a debt could it be if there were no recourse. Did the lender not expect to be repaid? What would happen if the borrower defaulted? Did the debt simply go away if the lender truly had no recourse? That seemed reckless. Who would be willing to lend on a truly nonrecourse basis? That was my introduction to nonrecourse debt.

A student editor finally suggested that he thought that the debt could not be completely nonrecourse. The debt was probably secured. The lender could foreclose on the collateral security on a default. The debt did not permit recourse against the borrower beyond the collateral security if the borrower defaulted and the lender foreclosed.

I accepted this simple definition of “nonrecourse” debt for a time: nonrecourse debt was debt with respect to which the creditor’s recourse on a default was limited to the collateral security. This definition worked for me for a while. With the passage of time, I increasingly suspected that the simple definition might not work in all situations, particularly for tax purposes. How should I characterize debt if the borrower was a partnership and the lender a partner of that partnership?

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<sup>1</sup> Edgar Allan Poe, *The Raven*.



**THE CONCEPT OF NONRECOURSE UNDER  
SECTIONS 704, 752, AND 1001**

What was the character of debt if a partner guaranteed partnership nonrecourse debt? How should I characterize debt that was full recourse to the assets of a limited liability company, but nonrecourse to the members?

This article is about “nonrecourse” debt as “nonrecourse” is used under four Code provisions: Section 108, Section 704, Section 752, and Section 1001.<sup>2</sup> This article particularly examines the potential influence of proposed Treasury Regulations on payment obligations<sup>3</sup> in characterizing debt as recourse or nonrecourse under Section 752.

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**1. Summary Inquiries Regarding Nonrecourse Rules.**

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Before engaging in a review of nonrecourse versus recourse under Section 108, Section 704, Section 752, and Section 1001, we can review a series of basic principles:

- The stakes include these stakes:
  - Foreclosure of nonrecourse debt produces gain from sale – not cancellation of indebtedness income.
  - Foreclosure of recourse debt with a deficiency produces gain from sale to extent of fair market value of collateral and then cancellation of indebtedness income to the extent of the deficiency.
  - Cancellation of indebtedness income can qualify for insolvency and other exceptions.
  - Nonrecourse debt can produce deductions subject to special rules.
  - Recourse debt under Section 752 depends on one or more partners bearing the economic risk of loss of partnership liabilities. Bearing the economic risk of loss can be subject to complex tests.
  - Partner nonrecourse debt (which is actually a special class of recourse debt) creates deductions that are allocated to the partner bearing the economic risk of loss of the debt. Considerable doubt exists when debt will be partner nonrecourse debt.
  - The tax law should provide a consistent definition of “recourse debt” and “nonrecourse debt” across Sections 108,

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<sup>2</sup> Other provisions, such as Section 465, also refer to “nonrecourse debt.”

<sup>3</sup> REG-119305-11 (January 29, 2014).

Also available as part of the eCourse

[New Proposed Regulations on Partnership Liability Allocations](#)

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