

Presented:
62nd Annual Taxation Conference

December 3-4, 2014
Austin, Texas

**PLANNING FOR PARTNERSHIP LIABILITY
ALLOCATIONS, INCLUDING THE NEW
PROPOSED REGULATIONS**

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By

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September 2014

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January 2, 2014

I. INTRODUCTION

- A. The allocation of partnership liabilities can be critical to effectuating the tax planning goals of a partner.
- B. A partner's basis in a partnership interest generally includes the partner's allocable share of partnership liabilities. A partner's basis in the partnership interest is of great importance for two principal reasons.
- C. First, a partner recognizes gain upon a distribution of cash from a partnership only to the extent the distribution exceeds the partner's basis in the partnership interest. Section 731(a)(1).² On the other side of the coin, a partner may receive distributions of cash up to the amount of the partner's basis in the partnership interest without recognizing taxable gain.
- D. Second, a partner may deduct losses of the partnership only to the extent of the partner's basis in the partnership interest. Section 704(d).
- E. Accordingly, a partner's allocation of partnership liabilities is important in determining the extent to which the partner can receive tax-free distributions of cash and deduct losses of the partnership.
- F. In addition, a decrease in a partner's share of liabilities causes the partner to recognize taxable gain to the extent such decrease exceeds the partner's basis in the partnership. Section 752(b); Section 731(a). Such a deemed cash distribution could occur, for example, if a partnership reduces a liability, or if another partner guarantees a partnership liability. Thus, it is important for a partner to know how partnership liabilities are allocated for Federal income tax purposes and how to achieve an allocation that is beneficial to that partner.
- G. Part II of this outline summarizes the rules for allocating partnership liabilities for Federal income tax purposes under the existing section 752 regulations and contains a series of examples that illustrate techniques for managing the allocation

² Unless otherwise noted or clear from context, section references are to the Internal Revenue Code of 1986, as amended.

of partnership liabilities under these rules. In addition, this section explains how these rules and techniques apply to limited liability companies (“LLC”) that are treated as partnerships for Federal income tax purposes.³

- H. Part III of this outline summarizes and analyzes the proposed partnership liability regulations under section 752 that were issued on January 29, 2014. As noted below, the proposed regulations would significantly change the way partnership liabilities are allocated to partners and would, in many cases, trigger gain to partners that have negative tax basis capital accounts or limit the ability of partners to take losses into account.

II. **PLANNING UNDER THE EXISTING PARTNERSHIP LIABILITY ALLOCATION RULES**

A. **ALLOCATION OF PARTNERSHIP LIABILITIES: GENERAL RULES**

1. **Increase in Share of Liabilities**

- a. Under section 752(a), any increase in a partner’s share of liabilities of a partnership, or any increase in a partner’s individual liabilities by reason of the assumption by such partner of partnership liabilities, is treated as a contribution of money by such partner to the partnership.
- b. Under section 722, this deemed contribution of money by the partner to the partnership increases the partner’s basis in the partnership interest.

2. **Decrease in Share of Liabilities**

- a. Under section 752(b), any decrease in a partner’s share of the liabilities of a partnership, or any decrease in a partner’s individual liabilities by reason of the assumption by the partnership of such individual liabilities, is treated as a distribution of money to the partner by the partnership. Under sections 733(1) and 705(a)(2), this deemed distribution of money by the partnership to the partner reduces the partner’s basis in the partnership interest, but not below zero.
- b. Under section 731(a), upon a distribution of money to a partner by a partnership (including a deemed distribution of money pursuant to Section 752(b)), gain is recognized by the distributee partner to

³ An LLC is taxable as a partnership for Federal income tax purposes unless it elects to be taxed as a corporation under the “check-the-box” regulations. Treas. Reg. § 301.7701-3(b)(1).

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First appeared as part of the conference materials for the
62nd Annual Taxation Conference session

"New Proposed Regulations on Partnership Liability Allocations"