

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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## INTERNATIONAL TAXATION



### SUBJECT

## NEW NOTICE 2015-54 ADDRESSES CERTAIN CONTRIBUTIONS MADE TO PARTNERSHIPS

### SUMMARY

Notice 2015-54 (the “Notice”) provides that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) plan to issue Treasury Regulations that will require, in certain situations, partners to recognize gain either immediately or periodically, when a partner contributes appreciated property to a partnership.

### BACKGROUND

When a partner contributes appreciated property to a partnership, the general rule under Internal Revenue Code (“IRC”) Section 721(a) is that no gain is recognized by the partner. Prior to the issuance of the Notice, United States taxpayers treated a contribution of appreciated property to a partnership as a nonrecognition event under the general principles of IRC Section 721(a) even in situations where a portion of the income or gain attributable to the contributed property was allocated, through the partnership, to a foreign partner not subject to United States income tax. Often times, the foreign partner would be a wholly-owned subsidiary or other related party of the United States partner. The position taken by United States taxpayers, prior to the issuance of the Notice, created an opportunity to shift income from the United States partner to the related foreign partner, who is not subject to United States income tax, through partnership allocations without triggering an “exit tax” on the outbound transfer.

### DETAILS

#### A. General Rules

The Notice provides that when a United States transferor (as defined in the Notice) contributes most types of appreciated property to a partnership, the United States transferor is required to recognize gain immediately if: (1) a

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related foreign person is a direct or indirect partner in the partnership, and (2) the United States transferor and related persons own more than 50% of the partnership interests in capital, profits, deductions or losses. This type of partnership structure is referred to as a “Section 721(c) partnership” in the Notice. Certain types of property (e.g., cash equivalents, any asset that is a security within the meaning of IRC Section 475(c)(2), without regard to IRC Section 475(c)(4) and any item of tangible property with built-in gain that does not exceed \$20,000) will not be subject to these new rules.

The Notice further provides an exception where the United States transferor is not required to immediately recognize gain on the contribution of appreciated property to a Section 721(c) partnership, provided the partnership adopts the “Gain Deferral Method.” The Gain Deferral Method has several requirements (e.g., use of the remedial allocation method described in §1.704-3(d)) that essentially requires the partnership to allocate income or gain attributable to the contributed appreciated property to the United States transferor-partner over time so that income and gain attributable to the appreciated property cannot be shifted through the partnership structure to the foreign partner not subject to United States income tax. The regulations to be issued will also apply to transactions involving tiered partnerships in a manner consistent with the rules provided in the Notice.

### **B. Cost-Sharing Arrangements**

In the Notice, the Service and Treasury stated their intention to issue guidance under IRC Section 482 applying Cost-Sharing Arrangement principles to contributions of appreciated property to Section 721(c) partnerships (as defined in the Notice) adjusted as needed to take into account the differences between a Section 721(c) partnership and Cost-Sharing Arrangements. In particular, the Notice states that the Service and the Treasury will issue guidance on the application of the “periodic adjustment provisions” in the Cost-Sharing Arrangement Regulations to Section 721(c) partnerships.

### **C. Reporting Requirements**

The Notice also provides that the Service plans to modify Schedule O of Form 8865 (Return of U.S. Persons With Respect to Certain Foreign Partnerships) to require supplemental information for contributions of appreciated property to Section 721(c) partnerships. The Treasury Regulations to be issued will also describe additional reporting requirements for United States transferors for each taxable year in which the Gain Deferral Method applies.

### **D. Statute of Limitations**

The Treasury Regulations to be issued will require the United States transferor to extend the statute of limitations period for all items related to the appreciated property contributed to the Section 721(c) partnership for eight full taxable years following the taxable year of the contribution.

### **E. Effective Date**

The new rules requiring immediate gain recognition or the adoption of the Gain Deferral Method on transfers of appreciated property to a Section 721(c) partnership will apply to transfers occurring on or after August 6, 2015, and to transfers occurring before August 6, 2015, resulting from a check-the-box election to recognize an entity as a partnership filed on or after August 6, 2015, with an effective date on or before August 6, 2015.

The new reporting requirements, statute of limitations, and periodic adjustment provisions will be effective for transfers occurring on or after the date of publication of the Treasury Regulations.

## **HOW BDO CAN HELP**

BDO can assist you with determining the Federal tax implications on contributions to a Section 721(c) partnership, analyzing the tax implications under the Gain Deferral Method, and complying with the new reporting requirements that will be issued.

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