



# ***The Comm'r v. Basis Shifting***

July 10, 2024

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# Agenda

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Background

Rev. Rul. 2024-14

NPRM Part 1: Related Parties

NPRM Part 2: Consolidated Returns

Prop. Treas. Reg. § 1.6011-18

# Background

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- On June 17, 2024: IRS announces guidance to combat “abusive” basis shifting transactions between related parties
  - Transfer of partnership interest to related person (high outside/low inside basis)
  - Distribution of property (low outside/high inside basis)
  - Liquidation of related partner (low-basis asset to high basis partner/high-basis asset to low-basis partner)
- Three pieces of guidance
  - Notice of Proposed Rulemaking (related parties and consolidated returns)
  - Prop. Treas. Reg. § 1.6011-18
  - Rev. Rul. 2024-14

# Background (Cont'd)

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## ■ Basis Rules

- Carryover basis for property transferred to or from partnership. §§ 723, 732(a)
- In liquidation, distributed property takes outside basis. § 732(b)
- Taxable transfers of interest provide cost basis in partnership interest. § 742
- Basis of partnership assets are not adjusted on transfer of interest. §§ 732(a), 743(a)

## ■ Section 754 Election

- Section 754 election permits partnership to adjust its basis in partnership assets on distribution of an asset or transfer of a partnership interest. §§ 754, 755
- Transfer of interest: increased by the difference in outside and inside basis with respect to transferee partner. § 743(b)
- Distribution of asset: increase partnership basis by difference in outside basis and basis of asset distributed. § 734(b)

# Rev. Rul. 2024-14

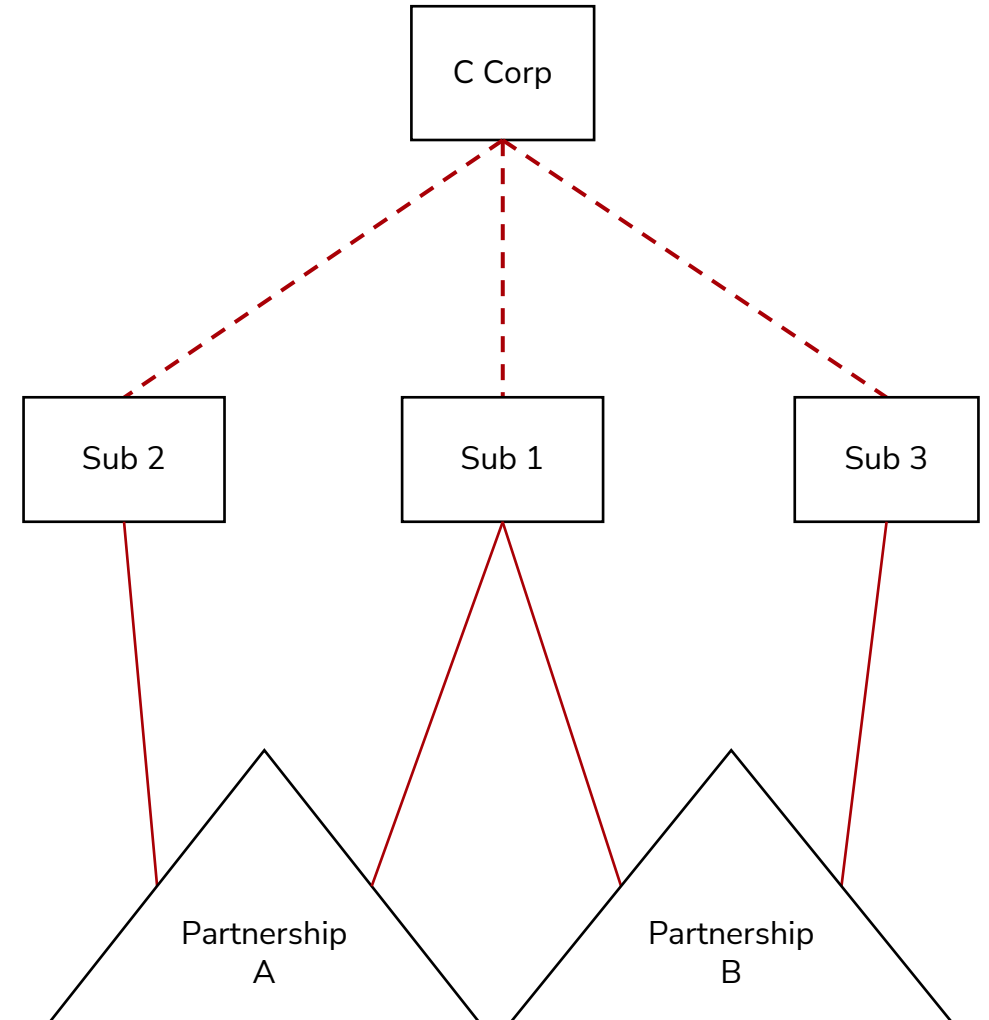
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- IRS ruled certain related-party transfers, distributions, and liquidations lacked economic substance under § 7701(o)(1)
  - Economic substance only if, **apart from Federal income tax effects**:
    - (1) taxpayer's economic position meaningfully changes and
    - (2) taxpayer has a substantial purpose for entering into transaction
- “The stated business purpose of achieving cost savings from cleaning up intercompany accounts between the C Subsidiaries, reducing administrative complexity, and achieving administrative efficiencies may be a legitimate nontax economic purpose. However, any such business purpose is not substantial compared to the Federal income tax purposes the transactions were designed to carry out.”

# Situation 1

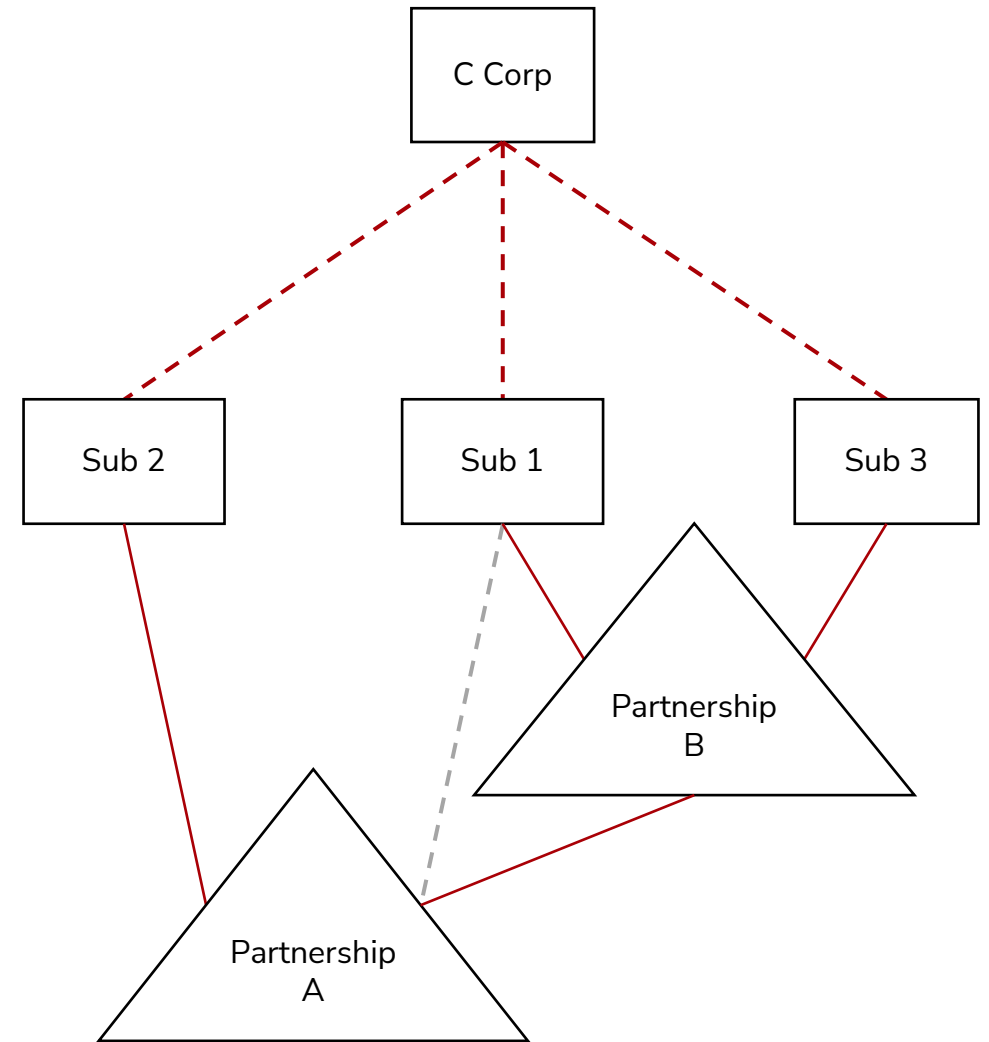
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- Partnership A has a valid § 754 election in place
- All parties are related under §§ 267 or 707(b)
- **Sub 1's Basis in A**
  - Outside: \$100
  - Inside: \$20



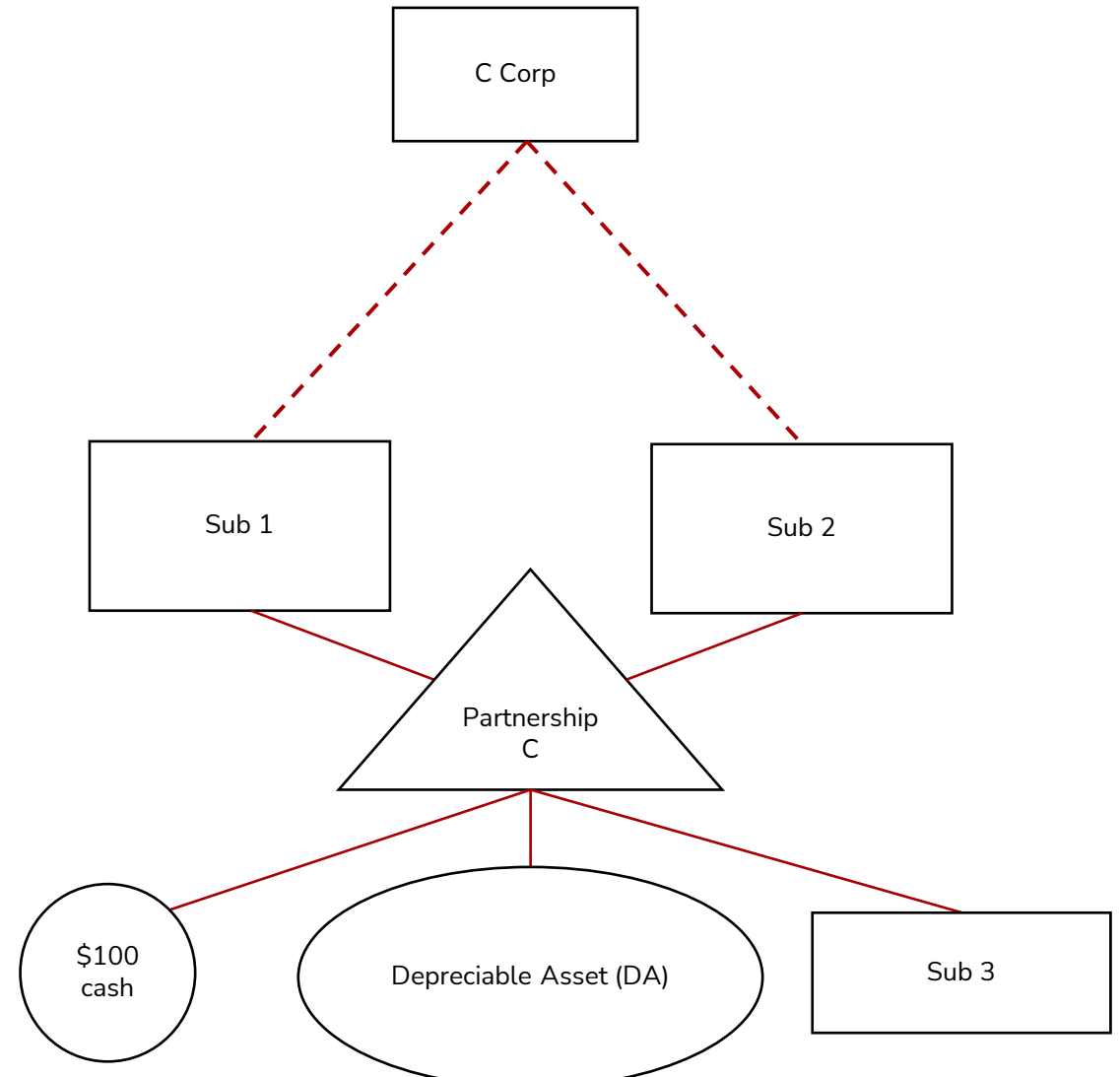
# Situation 1

- Sub 1 transfers its interest in Partnership A to Partnership B in a contribution that qualifies for nonrecognition of gain or loss under § 721(a)
- **Sub 1's Basis in A (Before Contribution)**
  - Outside: \$100
  - Inside: \$20
- **B's Basis in A (After Contribution, No § 754 Election)**
  - Outside: \$100 (§ 723)
  - Inside: \$20
- **B's Basis in A (After Contribution, § 754 Election)**
  - Outside: \$100
  - Inside: \$100 (§ 743(b))
- \$80 increase in inside basis is with respect to Partnership B only
- Basis allocated to depreciable and amortizable property under § 755



# Situation 2

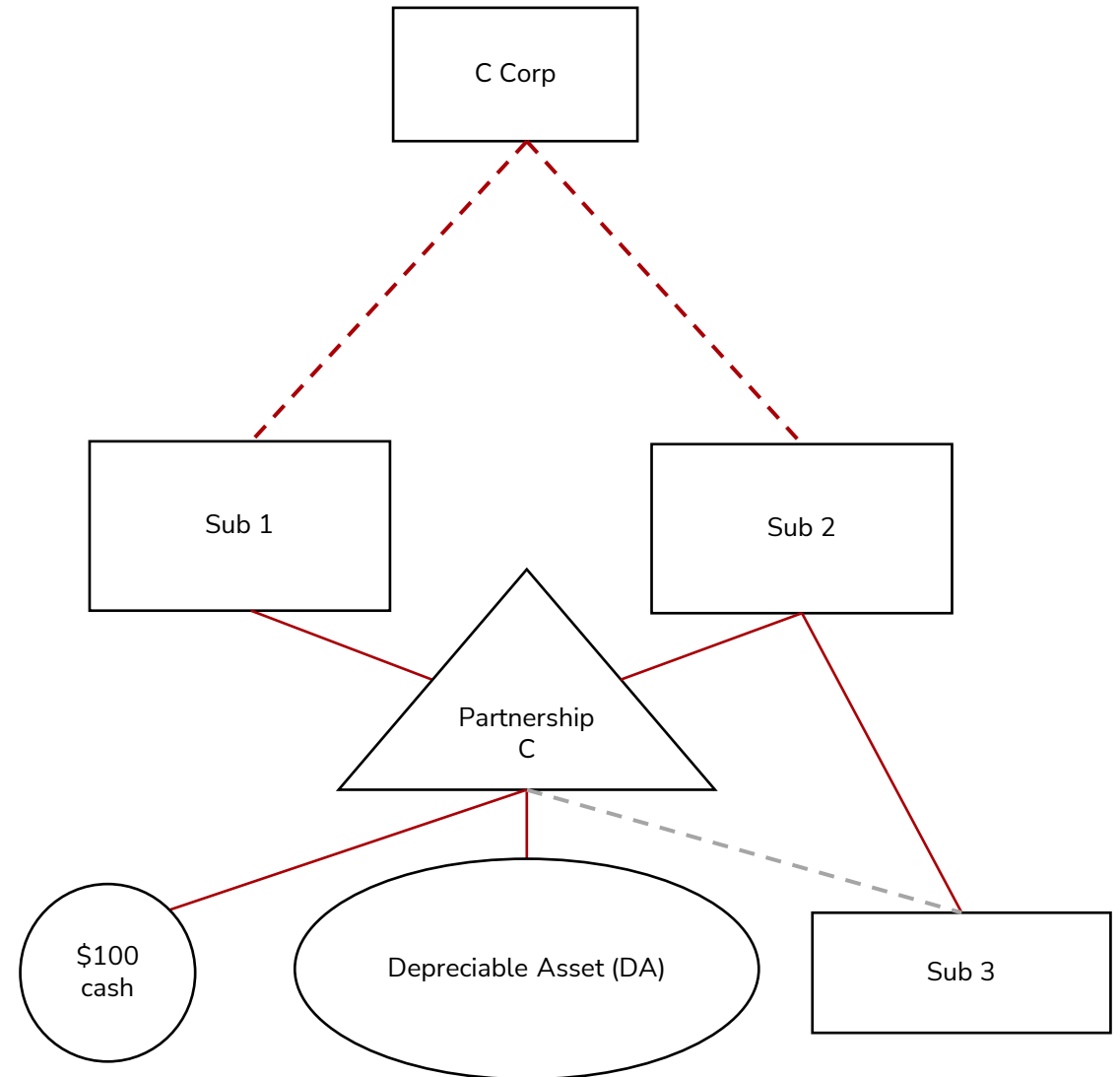
- Partnership C has a valid § 754 election in place
- All parties are related under §§ 267 or 707(b)
- **Sub 1**
  - Outside Basis in C: \$100
- **Sub 2**
  - Outside Basis in C: \$10
- **Partnership C**
  - Depreciable Asset (DA)
    - Basis: \$10
    - FMV: \$100
  - Sub 3 stock
    - Basis: \$90
    - FMV: \$100





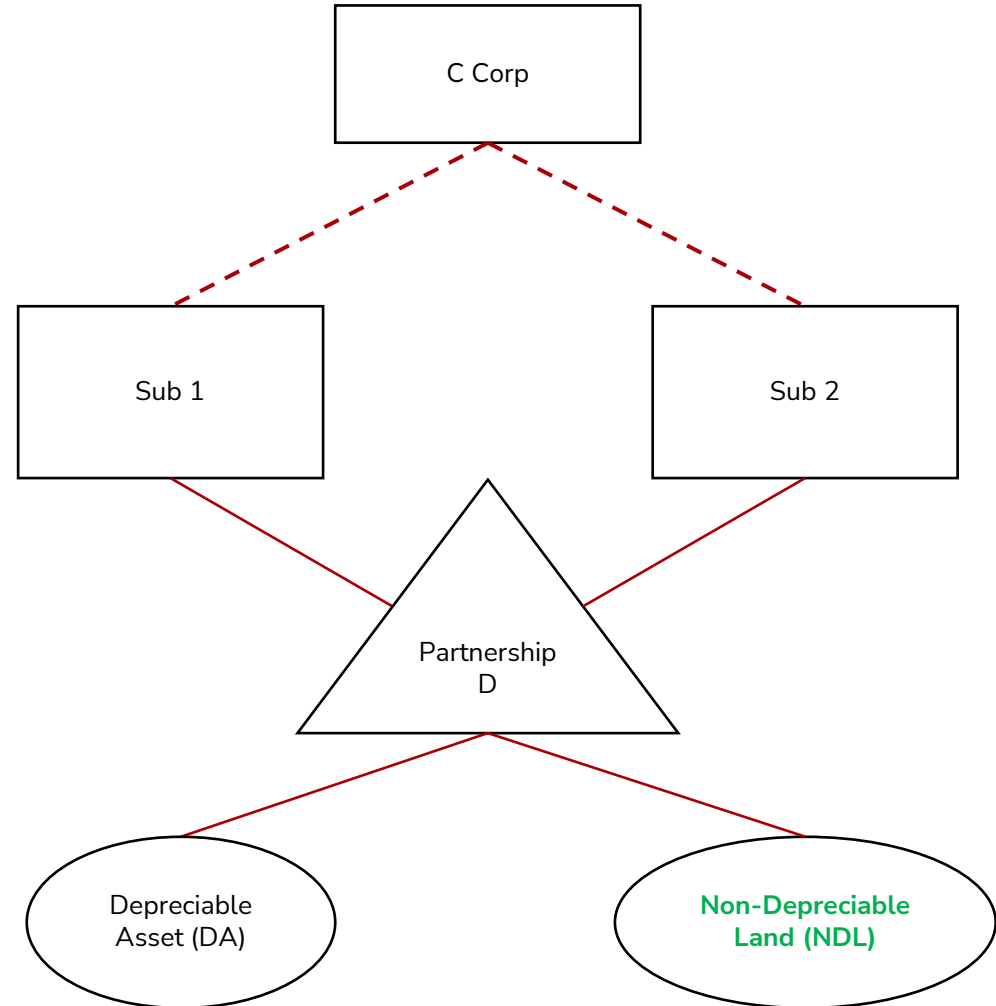
# Situation 2

- Partnership C distributes Sub 3 stock to Sub 2
- **Sub 1**
  - Outside Basis in C: \$100
- **Sub 2**
  - Adjusted Basis in Sub 3 stock: \$10 (§ 732(a)(2))
  - Outside Basis in C: \$0 (§ 733(2))
- **Partnership C (No § 754 Election)**
  - Depreciable Asset (DA)
    - Basis: \$10
    - FMV: \$100
- **Partnership C (§ 754 Election)**
  - Depreciable Asset (DA)
    - Basis: \$90 (§ 734(b)(1)(B))
    - FMV: \$100
- Excess basis from distribution of Sub 3 stock is allocated to Depreciable Asset under § 755



# Situation 3

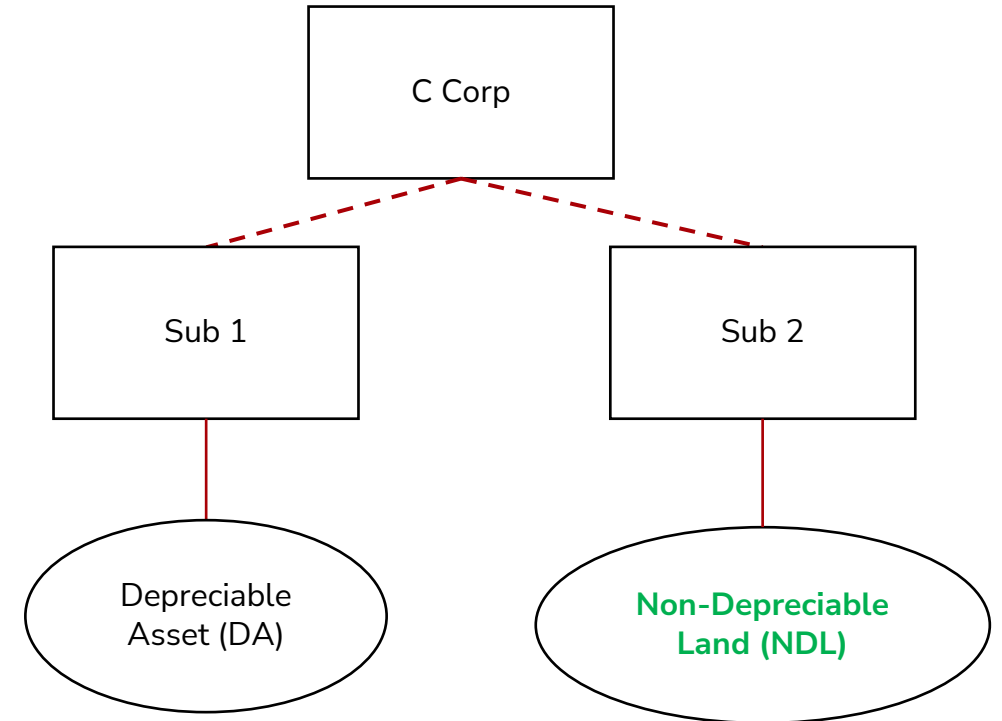
- All parties are related under §§ 267 or 707(b)
- **Sub 1**
  - Outside Basis in D: \$100
- **Sub 2**
  - Outside Basis in D: \$20
- **Partnership D**
  - Depreciable Asset (DA)
    - Basis: \$20
    - FMV: \$100
  - Non-Depreciable Land
    - Basis: \$90
    - FMV: \$100



# Situation 3

- Partnership D liquidates by distributing the Depreciable Asset to Sub 1 and the Non-Depreciable Land to Sub 2

Asset	Basis (before liquidation)	Distributee Partner's Basis in Partnership Interest	Basis (after liquidation)
Depreciable Asset	20	100	100
Non-Depreciable Land	90	20	20



# NPRM Part 1: Related Parties

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- “Mechanical rules” apply if (1) covered transaction and (2) property allocated a basis increase
- Covered transaction:
  - § 743(b): Transfer of a partnership interest to a related party in a nonrecognition transaction and gain recognized is less than basis adjustment
  - § 734(b): Distribution in which partnership’s basis in distributed property is higher than the distributee partner’s outside basis
  - § 732: Liquidating distribution resulting in basis increase to liquidating partner and basis decrease to related partners or partnership with related partners
- Related: §§ 267(b) or 707(b)(1) (before and after transaction)
- Treatment of “related-party basis adjustment” (RBPA)

# NPRM Part 1: Related Parties (Cont'd)

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- § 743(b) (Transfer)
  - RPBA ineligible for cost recovery, sale, or disposition until transferee becomes unrelated to transferor and all existing partners
  - RPBA taken into account for purposes of § 732 distributions but remains RPBA
  - On disposition, amount of RPBA is reallocated to like property possessed (or, if no like property, when such property is acquired)
- § 734(b) (Distribution)
  - RPBA is recovered using the cost recovery method and remaining recovery period of the corresponding distributed property (continuing on distribution to partner)
  - Cannot take RPBA into account on sale or disposition of partnership property
  - RPBA is treated as normal basis after “qualifying disposition” of corresponding property to third party
  - On disposition, RPBA is reallocated to like property (or, if no like property, when such property is acquired)
- § 732 (Liquidation)
  - RPBA is recovered using the cost recovery method and remaining recovery period of the corresponding property
  - Cannot take RPBA into account on sale or other disposition
  - RPBA is treated as normal basis after “qualifying disposition” of corresponding property to third party
- Applicable to tax-indifferent parties (e.g., tax-exempt orgs)

# NPRM Part 2: Consolidated Returns

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- Concern that transfers of partnership interests or distributions “do not clearly reflect income”
- Apply a “single entity approach” to partnership interests
- Intended to prevent direct or indirect basis shifts and avoid “anomalous results” from intergroup or intercompany transfers
- Applicability date
  - Related-Party Regulations: ending on or after June 17, 2024, even if transaction occurred earlier
  - Consolidated Return Regulations: to be proposed in forthcoming regulations

# Prop. Treas. Reg. § 1.6011-18

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- Certain related-party basis adjustment transactions identified as “transactions of interest” under IRC § 6011
  - Only a transaction of interest if the sum of all basis increases exceeds the gain recognized from the transactions by \$5 million
  - “Transactions of interest” are a type of reportable transaction that must be disclosed by filing a disclosure statement
  - Effective when regulations are finalized
- Same as, or substantially similar to, transactions listed in Prop. Treas. Reg. § 1.6011-18(c)
  - Generally, related-party liquidations, distributions, and transfers with basis increase

# Prop. Treas. Reg. § 1.6011-18(c)

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- Prop. Treas. Reg. § 1.6011-18(c)(1)(i)
  - The partnership distributes property to a person who is a related partner in a current or liquidating distribution
  - The partnership increases the basis of one or more of its remaining properties under § 734(b), (c)
- Prop. Treas. Reg. § 1.6011-18(c)(1)(ii)
  - The partnership distributes property to a person who is a related partner in liquidation of the partner's partnership interest or in a complete liquidation
  - The basis of the distributed property is increased under § 732(b), (c)



# Prop. Treas. Reg. § 1.6011-18(c) (Cont'd)

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- Prop. Treas. Reg. § 1.6011-18(c)(2)
  - The partnership transfers an interest in a partnership to a related partner in a non-recognition transaction
  - The basis of one or more of the properties is increased under § 743(b)(1)
- Prop. Treas. Reg. § 1.6011-18(c)(1)(iii)
  - The partnership distributes property to a person who is a related partner
  - The basis of the distributed property is increased under § 732(d)
  - The related partner acquired all or part of its interest in the partnership in a transaction that would have been described in (c)(2) above, had the partnership had a § 754 election in place