



# TaxNewsFlash

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## Corrections to final regulations under section 1061 include change to capital interest allocations exception

The U.S. Treasury Department and IRS today released corrections to [final regulations](#) (T.D. 9945) under section 1061 previously issued in January 2021.

While the [corrections](#) largely relate to typographical or grammatical errors, there is one substantive change. The final section 1061 regulations contain rules relating to “Capital Interest Allocations” that exempt gain allocated with respect to a capital interest from potential recharacterization to short-term capital gain so long as certain requirements are met. The original regulations contain a rule providing that capital funded by a partner, the partnership, or a person related to such partner or partnership would not qualify as contributed capital in applying the exception for Capital Interest Allocations. Under the original rule, a partner who borrowed from a person related to such partner (like a partner borrowing from his or her spouse) would not be allowed to include the contribution of the borrowed proceeds. This result was irrational because the contributing partner’s related-party group was still providing the funding and was at risk for the investment.

Under the correction, borrowed proceeds will be excluded only if they are borrowed from the partnership or *another* partner (or a person related to such persons). Thus, a loan borrowed from a person related to the partner making the contribution now can qualify as contributed capital for purposes of the exception for Capital Interest Allocations so long as that related person (1) is not also related to the partnership, and (2) did not borrow the money from another partner or the partnership (or a person related to such persons).

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