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TaxNewsFlash

United States

No. 2024-225
June 17, 2024

Treasury and IRS release guidance on partnership “basis shifting” transactions

The U.S. Treasury Department and IRS today released three guidance documents related to certain “basis-shifting” transactions involving partnerships and related parties.

As explained in the related IRS release—FS-2024-21 (June 17, 2024)—the basis shifting transactions targeted in the new guidance generally fall into three groups:

- **Transfer of partnership interest to related party:** In this transaction, a partner with a low share of the partnership’s “inside” tax basis and a high “outside” tax basis transfers the interest in a tax-free transaction to a related person or to a person who is related to other partners in the partnership. This related-party transfer generates a tax-free basis increase to the transferee partner’s share of “inside” basis.

- **Distribution of property to a related party:** In this transaction, a partnership with related partners distributes a high-basis asset to one of the related partners that has a low outside basis. After this, the distributee partner reduces the basis of the distributed asset and the partnership increases the basis of its remaining assets. The related partners can arrange this transaction so that the reduced tax basis of the distributed asset will not adversely impact the related partners, while the basis increase to the partnership’s retained assets can produce tax savings for the related parties.

- **Liquidation of related partnership or partner:** In this transaction, a partnership with related partners liquidates and distributes (1) a low-basis asset that is subject to accelerated cost recovery or for which the parties intend to sell to a partner with a high outside basis. and (2) a high-basis property that is subject to longer cost recovery (or no cost recovery at all) or for which the parties intend to hold to a partner with a low outside basis. Under the partnership liquidation rules, the first related partner increases the basis of the property with a shorter life or which is held for sale while the second related partner decreases the basis of the long-lived or non-depreciable property, with the result that the related parties generate or accelerate tax benefits.

The guidance generally only impacts partnerships when partners are related parties. For purposes of the guidance, partners and other persons would be considered as related if they have a relationship described in section 267(b) (without regard to section 267(c)(3)) or section 707(b)(1) immediately before or immediately after a transaction. However, the guidance would impact certain transactions not involving related parties – including where a party is tax-exempt, foreign (in certain cases) or has a tax-attribute precluding the recognition of gain (in certain cases).

Notice 2024-54 announces forthcoming regulations

To address these transactions, the Treasury Department and IRS today released Notice 2024-54 announcing two sets of upcoming regulations:

- The first set would require partnerships to treat basis adjustments arising from covered transactions in a way that would restrict them from deriving inappropriate tax benefits from the basis adjustments. The notice further announces that the covered transactions governed by these regulations would involve basis adjustments under sections 732, 734(b) and/or 743(b).

- The second set would provide rules to ensure clear reflection of the taxable income and tax liability of a consolidated group of corporations when members of the group own interests in partnerships. According to the guidance, regulations would apply a single-entity approach to partnership interests held by various members of a consolidated group.

The notice states that the Treasury Department and IRS intend to propose that the first set of regulations apply to tax years ending on or after June 17, 2024. That is, once finalized, the regulations would govern the availability and amount of cost recovery deductions and gain or loss calculations for tax years ending on or after June 17, 2024, even if the relevant covered transaction was completed in a prior taxable year. The effective date for the second set of regulations will be proposed in the upcoming proposed regulations.

Proposed regulations identifying certain partnership basis shifting transactions as transactions of interest

In addition, the Treasury Department and IRS today released proposed regulations (REG-124593-23) that would identify certain partnership related-party basis adjustment transactions and substantially similar transactions as transactions of interest (TOI), a type of reportable transaction.

The TOIs generally involve positive basis adjustments of $5 million or more under section 732(b) or (d), 734(b), or 743(b), for which no corresponding tax is paid. The transactions would include either a distribution of partnership property to a partner that is related to one or more other partners in the partnership, or the transfer of a partnership interest in which the transferor is related to the transferee, or the transferee is related to one or more of the partners. In these transactions, the basis increase allows related parties an opportunity for decreasing their taxable income through increased cost recovery deductions or through decreasing their taxable gain (or increasing their taxable loss) on the subsequent transfer of the property in a transaction in which gain or loss is recognized in whole or in part.

The proposed regulations are proposed to apply as of the date of publication of final regulations in the Federal Register. However, taxpayers and their advisors should note that they may be required to report transactions that occurred prior to the date of publication of the final regulations.

Comments on the proposed regulations, as well as requests to speak and outlines for topics to be discussed at a public hearing (scheduled for September 17, 2024, at 10:00 AM ET), are due by August 19, 2024. If no outlines are received by that date, the public hearing will be cancelled.

Revenue Ruling 2024-14 clarifies application of economic substance doctrine to partnership basis-shifting transactions

Finally, the Treasury Department and IRS today released [Rev. Rul. 2024-14](#) clarifying when the economic substance doctrine may apply to disallow tax benefits associated with basis-shifting transactions involving partnerships and related parties.

In particular, Rev. Rul. 2024-14 announces that the economic substance doctrine will be raised in cases when related parties:

- Create inside/outside basis disparities through various methods, including the use of certain partnership allocations and distributions

- Capitalize on the disparity by either transferring a partnership interest in a nonrecognition transaction or making a current or liquidating distribution of partnership property to a partner

- Claim a basis adjustment under sections 732(b), 734(b), or 743(b) resulting from the nonrecognition transaction or distribution

Read another related IRS release—IR-2024-166 (June 17, 2024)

The purpose of this *TaxNewsFlash* is to provide a high-level summary of these guidance documents. Another *TaxNewsFlash* will be released shortly providing initial analysis and observations on the guidance.

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