Partners Share of Partnership Debt

Chapter 9

K-1, Box M
Partner Debt Share

M Partner’s share of liabilities at year end:
Nonrecourse . . . . . . . $_____
Qualified nonrecourse financing . . $_____
Recourse . . . . . . . . . . . $_____
Partners’ Share of Recourse Liabilities
Reg. 1.752-1

Recourse Debt Defined

A partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss (EROL) for that liability under §1.752-2.
**Nonrecourse Debt Defined**

A partnership liability is a nonrecourse liability to the extent that no partner or related person bears the economic risk of loss for that liability under §1.752-2.

**Constructive Liquidation**

A partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to pay the debt.
Constructive Liquidation

Upon a *constructive liquidation*, all of the following five events are deemed to occur simultaneously:

1) All of the partnership's liabilities become payable in full;

2) With the exception of property contributed solely to secure a partnership liability (see §1.752-2(h)(2)), all of the partnership's assets, including cash, have a value of zero;
3) The partnership disposes of all of its property in a fully taxable transaction for no consideration;

4) All items of *book* income, gain, loss, or deduction are allocated among the partners; and

5) The partnership liquidates.
Partner Providing Property As Security

Direct pledge.

Indirect pledge.

Partner Or Related Person As Nonrecourse Lender

A partner bears the economic risk of loss for a partnership liability to the extent that the partner or a related person makes (or acquires an interest in) a nonrecourse loan to the partnership and the economic risk of loss for the liability is not borne by another partner.

De minimis Exception
Partner as Guarantor of Nonrecourse Debt

Funds borrowed on a *nonrecourse* basis but personally *guaranteed by a partner* who has no right of reimbursement from another partner, subject the guaranteeing partner to an *economic risk of loss* and are *recourse liabilities* under the regulations.

*De minimis Exception*

*Example 9-1*

*Losses Reducing Outside Basis Leading to “Phantom Gain”*
Example 9-1

How is debt share determined?

Beginning Balance Sheet:

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$300,000</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Able (20%)</td>
<td>$20,000</td>
<td>$60,000 (20k + 40k)</td>
</tr>
<tr>
<td>Baker (80%)</td>
<td>$80,000</td>
<td>$240,000 (80k+160K)</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$300,000</td>
<td></td>
</tr>
</tbody>
</table>

Hypothetical loss of <$300,000>

Able’s cap.: $20,000 - $60,000 = <$40,000>
Baker’s cap: $80,000 - $240,000 = <$160,000>

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Able (20%)</td>
<td>&lt;$40,000&gt;</td>
<td>A’s Debt Share</td>
</tr>
<tr>
<td>Baker (80%)</td>
<td>&lt;$160,000&gt;</td>
<td>B’s Debt Share</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>&lt;$0 &gt;</td>
<td></td>
</tr>
</tbody>
</table>
Year 1 loss of <$150,000>

Able’s 20% share is <$30,000>

Baker’s 80% share is <$120,000>

### Beginning of Year 2

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$150,000</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Able</td>
<td>&lt;$10,000&gt;</td>
<td>$30,000 ($60K - $30K)</td>
</tr>
<tr>
<td>Baker</td>
<td>&lt;$40,000&gt;</td>
<td>$120,000 ($240K - $120K)</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$150,000</td>
<td></td>
</tr>
</tbody>
</table>
Year 2 loss of <$150,000>

Able’s 20% share is <$30,000>

Baker’s 80% share is <$120,000>

### Beginning of Year 3

<table>
<thead>
<tr>
<th>Assets</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>$0</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan</td>
<td>$200,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Able</td>
<td>&lt;$40,000&gt;</td>
<td>$0 ($30K - $30K)</td>
</tr>
<tr>
<td>Baker</td>
<td>&lt;$160,000&gt;</td>
<td>$0 ($120K - $120K)</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td></td>
<td>$0</td>
</tr>
</tbody>
</table>
At the beginning of Year 3
Able Sells to Carol for
$40K Debt Assumption

<p>| | |</p>
<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount Realized</td>
<td>$40,000</td>
</tr>
<tr>
<td>Outside Basis</td>
<td>$0</td>
</tr>
<tr>
<td>Able’s Gain</td>
<td>$40,000</td>
</tr>
</tbody>
</table>

Compare Example 9-1
facts if the entity were an S
corporation
(granted the debt is nonrecourse)

A’s losses would be limited to
$20,000 stock basis

B’s losses would be limited to
$80,000 stock basis
## Example 9-2

**Constructive Liquidation**

<table>
<thead>
<tr>
<th>Building</th>
<th>1,000</th>
<th>Recourse Debt</th>
<th>900</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Cap. – GP</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cap. – LP</td>
<td>90</td>
</tr>
<tr>
<td>Assets</td>
<td>1,000</td>
<td>Liabilities &amp; Capital</td>
<td>1,000</td>
</tr>
</tbody>
</table>
Hypothetical Sale Loss of <$1,000>

Sec. 704(b) forces $910 of the loss to GP

<table>
<thead>
<tr>
<th></th>
<th>GP</th>
<th>LP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Cap.</td>
<td>$10</td>
<td>90</td>
</tr>
<tr>
<td>Loss</td>
<td>-910</td>
<td>-90</td>
</tr>
<tr>
<td>Ending Cap.</td>
<td>-900</td>
<td></td>
</tr>
</tbody>
</table>
GP would pay the $900 debt based upon the hypothetical liquidation

<table>
<thead>
<tr>
<th></th>
<th>GP</th>
<th>LP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Cap.</td>
<td>$10</td>
<td>90</td>
</tr>
<tr>
<td>Loss</td>
<td>-910</td>
<td>-90</td>
</tr>
<tr>
<td>Ending Cap.</td>
<td>-900</td>
<td></td>
</tr>
</tbody>
</table>
Example 9-3  Facts

C & D each contribute $2,000.

The CD Partnership borrows $9,000 and purchases real property for $13,000.

Balance Sheet

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
<td>$13,000</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
<td>$9,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>2,000</td>
<td>2,000 + Debt?</td>
</tr>
<tr>
<td>D</td>
<td>2,000</td>
<td>2,000 + Debt?</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$13,000</td>
<td></td>
</tr>
</tbody>
</table>
**Facts**

**Profits and losses:**

- 40% to C
- 60% to D

*Until losses are recovered, then 50%/50%*

<$\text{<13,000> hypothetical loss on asset sale}$

- 40% to C <$\text{<5,200>}$
- 60% to D <$\text{<7,800>}$

<table>
<thead>
<tr>
<th></th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Contribution</td>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Loss on Hypothetical Sale</td>
<td>-$5,200</td>
<td>-$7,800</td>
</tr>
<tr>
<td>Debt Sharing =</td>
<td>($3,200)</td>
<td>($5,800)</td>
</tr>
</tbody>
</table>
## Balance Sheet

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
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<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt</td>
<td>$9,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>2,000</td>
<td>$5,200</td>
</tr>
<tr>
<td>D</td>
<td>2,000</td>
<td>$7,800</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$13,000</td>
<td></td>
</tr>
</tbody>
</table>

### Presumed Satisfaction Rule

9-9
...it is assumed that all partners who have obligations to make payments actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation.

Example 9-4

Debt Guaranteed by Limited Partner
Example 9-4  Facts

E (Gen. Ptr.) contributes $2,000
F (Ltd. Ptr.) contributes $8,000.

The EF Partnership borrows $15,000 (recourse) and purchases real property for $25,000.

Limited Partner F guarantees the debt but does not waive the right to collect from the GP.
## Balance Sheet

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
<td>$25,000</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rec. Debt</td>
<td>$15,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E (GP)</td>
<td>2,000</td>
<td>2,000 + Debt?</td>
</tr>
<tr>
<td>F (Ltd. Ptr)</td>
<td>8,000</td>
<td>8,000 + Debt?</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$25,000</td>
<td></td>
</tr>
</tbody>
</table>

The debt remains recourse debt of E (the GP) based upon E’s state law GP liability which E is presumed to be able to satisfy.
<$25,000> hypothetical loss on asset sale
E <$17,000>
F <$8,000> per IRC sec. 704(b)

<table>
<thead>
<tr>
<th></th>
<th>E (GP)</th>
<th>F (Ltd. P)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Contribution</td>
<td>$2,000</td>
<td>$8,000</td>
</tr>
<tr>
<td>Loss on Hypothetical Sale</td>
<td>-$17,000</td>
<td>-$8,000</td>
</tr>
<tr>
<td>Debt Sharing =</td>
<td>($15,000)</td>
<td>$0</td>
</tr>
</tbody>
</table>

Balance Sheet

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Tax and Book Basis</th>
<th>Partner’s Outside Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property</td>
<td>$25,000</td>
<td></td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rec. Debt</td>
<td>$15,000</td>
<td></td>
</tr>
<tr>
<td>Capital:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E (GP)</td>
<td>2,000</td>
<td>$17,000</td>
</tr>
<tr>
<td>F (Ltd. P)</td>
<td>8,000</td>
<td>$8,000</td>
</tr>
<tr>
<td>Debt + Equity</td>
<td>$25,000</td>
<td></td>
</tr>
</tbody>
</table>
No change even if GP Partner E has a personal net worth of $0.

The regulations deem that GP E is able to pay the $15,000 debt (deemed satisfaction rule).

If Ltd. Ptr. F guarantees the debt and waives the right to collect from the GP, then F would be allocated the debt.
IRS Proposes New Tests For Allocating Recourse Debt
REG-119305-11 (Feb. 17, 2014)

The prop. regs. “turn off” the presumed satisfaction rule for all partners except individuals and estates and for trade payables for debt incurred after the regs. are final.
Therefore, in Example 9-4, if E (the Gen. Ptr.) were an entity with zero net value, then the debt would be allocated to the guarantor limited partner F.

See Prop. Reg. sec. 1.752-2(f) New Example 3 9-18

The prop. regs. also include new rules for guarantees by all partners (not merely entities)

Effective for obligations incurred after the prop. regs. are final 9-15
Six standards must be met for guarantees (not for state law legal obligations):

1) The guarantor partner must maintain a commercially reasonable net worth;

2) The guarantor must periodically document his or her financial condition to the lender;

3) The term of the payment obligation cannot be shorter than the term of the partnership’s liability;

4) The obligation cannot require that the primary obligor to hold liquid assets in excess of that obligor’s reasonable needs;
5) The guarantor must receive arm’s length consideration in exchange for assuming the obligation;

6) The guarantee cannot be a “bottom-dollar” guarantee. Partner must be liable for the full amount guaranteed if any amount of the debt was not satisfied (“first-dollar”).

Reg. sec. 1.752-2(f) Example 10.

• A, B, and C are equal members of LLC ABC, a tax partnership.
• ABC borrows $1,000 from Bank.
• A guarantees payment of up to $300 of the ABC liability if any amount of the full $1,000 liability is not recovered by Bank
• (a “first-dollar” guarantee”).

Conclusion #1: A’s guarantee is OK and A is allocated $300 of debt share.
• B guarantees payment of up to $200, but only if the Bank otherwise recovers less than $200 (a “bottom-dollar” guarantee).

Conclusion #2:
B’s guarantee is not recognized.
$300 of debt is recourse debt allocated to A.
$700 of debt is nonrecourse debt allocated to A, B, and C.

Prop. Reg. sec. 1.752-2 Example 11
• The facts are the same as in Example 10, except that, in addition, C agrees to indemnify A up to $50 that A pays with respect to its guarantee, and…

C’s $50 indemnity meets all six-factors and C is allocated $50 of debt.
“Because C’s indemnity of A’s guarantee also satisfies the sixth factor it is treated as modifying A’s guarantee such that A is treated as liable for $250 only to the extent any amount beyond $50 of the partnership liability is not satisfied.”

Therefore, none of A’s guarantee is recognized so A bears no EROL for the debt.

The sixth factor also prevents recognition of a guarantee of a percentage under 100% (say 25%) of the LLC debt. See prop. reg. 1.752-2(f) Example 12.
Anti-Abuse Rules

(an exception to the presumed satisfaction rule)

A recourse debt obligation of a partner may be disregarded if the facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation or to create the appearance of the economic risk of loss where the substance of the arrangement is otherwise.
Example 9-5. Intent to Avoid or Circumvent the Obligation (IRS Audit Guide Example, Modified):

- A subsidiary of Seller Corporation (subsidiary partner) and Buyer Corporation form a partnership.
- The subsidiary is thinly capitalized.
- The subsidiary contributes a low basis high value asset to the partnership.
- The partnership borrows money from a third party financial institution, and the subsidiary partner guarantees this debt.
- The partnership immediately distributes the borrowed funds to subsidiary partner.
- If the facts and circumstances indicate that subsidiary partner will circumvent or avoid the obligation, the guarantee can be disregarded.
- Note how similar this IRS audit guide fact pattern is to Canal Corp. v. Comm’r. 135 T.C. No. 9 (August 5, 2010), discussed in Chapter 6, in which the Tax Court agreed with the IRS, that a similar guarantee by a thinly capitalized subsidiary should be ignored. The outcome was an immediately taxable disguised sale on the proceeds distributed to the subsidiary.
Canal v. Comm’r
135 T.C. No. 9
(Aug 5, 2010)

Chesapeake
100%
Wisco

Georgia Pacific
Leveraged Partnership Structure

Wisco Contributed to LLC for a 5% LLC Interest:

$775,000,000   FMV
$237,000,000   Basis

Other Partner/LLC Member

Georgia Pacific (GP) transferred its tissue business assets worth $376.4 million to the LLC in exchange for a 95% interest.
Leveraged Partnership Structure

- Partnership simultaneously borrowed $755.2 million and distributed it to Wisco.

- $775 mil. – $755.2 mil. = $19.8 mil (FMV of Wisco’s 5% LLC Interest)
Indemnity Agreement

• Georgia Pacific guaranteed the $755.2 million debt.

• Wisco indemnified Georgia Pacific.
Reported as a Sale
For Financial Accounting Purposes

Wisco Tax Argument

In Millions:
$992  ($237 + $755(debt share))
- $755   Distribution
=$237   Remaining Outside Basis

Gain = 0
(until the debt is paid)
Potential Distribution Gain (§ 731) If Debt is NOT in Wisco’s Outside Basis:

$755 Mil. Distribution

- $237 Mil. Outside Basis

= $518 Mil. Gain Recognized

Disguised Sale

$755 Mil. Sales Proceeds

- $231 Mil. Adjusted Basis

  ($755 ÷ $775 = 97.4%)

  (97.4% x $237 Mi. = $231)

= $524 Mil. Gain Recognized
Pertinent Sec. 752 Reg.

IRS may disregard an obligation...if the facts and circumstances indicate that a principal purpose of the arrangement was to create the appearance of a partner ... bearing the economic risk of loss, when the substance of the arrangement is otherwise.

Holding: Disguised Sale

- No debt is allocated to Wisco.
- Gain of $524 million.
- Tax Liability: $183,458,981
- Penalty: $36,691,796
Sale by Tribune of Newsday (and Chicago Cubs)

*ILM 201324013*
(March 14, 2013)

Leveraged Partnership Like Canal

- Chief Counsel said that Tribune’s sale of Newsday to Cablevision was a disguised sale much like Canal.

- Tribune used same structure for sale of Chicago cubs
• Tribune was an S corporation (owned by an ESOP) and the deal was designed to avoid the built-in gains tax by delaying gain recognition for 10 years.

• The leveraged partnership was done with a Q-Sub.
• Tribune later (following bankruptcy) converted to a C corporation so the plan became a deferral of C corporation income rather than an avoidance of the IRC sec. 1374 built-in gains tax.

• Chief counsel found that the Tribune's indemnity had several similarities with the indemnity in Canal.

• In Tribune's case, the lenders imposed no net worth requirement on Tribune.
• Neither the lender nor the guarantor required the indemnity.

• Tribune stood to receive the remaining collateral if called on to make the indemnification payments.

Indemnity lacked important features typical of a commercial transaction:

• No net worth maintenance requirements.
• No arm's-length fee.
• No obligation to provide annual financial statements
• No evidence that the parties engaged in genuine negotiations over the indemnity.
Example 9-6
Anti-Abuse Rule Applies
A variation on 9-5

Tiered Partnerships
Reg. Sec. 1.752-4

An upper-tier partnership's share of the liabilities of a lower-tier partnership (other than any liability of the lower-tier partnership that is owed to the upper-tier partnership) is treated as a liability of the upper-tier partnership for purposes of applying section 752 and the regulations thereunder to the partners of the upper-tier partnership.
Recourse Debt Share Involving Disregarded Entities

Reg. 1.752-2(k)

General Partnership

Bob
GP

SMLLC
Disregarded Entity

50%

Jose
General Partner

50%

BJ Partnership
$1,000,000 of Recourse Debt
Without a special rule, Bob would be allocated a share of the debt by virtue of the *presumed satisfaction rule*.

For purposes of determining EROL, *payment obligations of a disregarded entity* are taken into account for purposes of section 752 only *to the extent of the net value of the disregarded entity*.
Net value of the disregarded entity excludes the interest in the partnership for which the net value is being determined.

General Partnership

Bob GP

SMLLC
Disregarded Entity

50%

50%

Jose General Partner

BJ Partnership
$1,000,000 of Recourse Debt
If the only asset of the LLC is the BJ partnership interest, then Bob’s share of the debt is $0

What if Bob’s LLC is a partnership?
Bob

Cindy

Jose
General Partner

BC
LLC/Partnership

50%
Gen. Ptr.

50%
Gen. Ptr.

BJ Partnership
$1,000,000 of Recourse Debt

- Current Regs. only “turn off” the Presumed Satisfaction Rule for a Disregarded Entity
- 50% of the debt is allocated to the LLC/Php Per the Presumed Satisfaction Rule
IRS Proposes New Tests For Allocating Recourse Debt REG-119305-11 (Feb. 17, 2014)

The prop. regs. “turn off” the presumed satisfaction rule for all partners except individuals and estates and for trade payables

For debt incurred after the regs. are final.
Net value of the entity excludes the interest in the partnership for which the net value is being determined.
If the only asset of the BC LLC is the BJ partnership interest, then BC’s share of the debt is $0 under the prop. regs.

Example 9-7

SMLLC
With $0 Net Value
Example 9-7. Disregarded Entity With Net Value Of Zero. (Reg. 1.752-2(k)(6) Example 1, Modified):
- In 2007, A forms a wholly owned domestic limited liability company, LLC (SMLLC), with a contribution of $100,000.
- A has no liability for SMLLC’s debts, and SMLLC has no enforceable right to contribution from A.
- SMLLC is a disregarded entity.
- Also in 2007, SMLLC contributes $100,000 to LP, a limited partnership with a calendar year taxable year, in exchange for a general partnership interest in LP, and B and C each contributes $100,000 to LP in exchange for a one-third limited partnership interest in LP.
- The partnership agreement provides that only the general partner is required to make up any deficit in its capital account.
- On January 1, 2008, LP borrows $300,000 from a bank and uses $600,000 to purchase nondepreciable property.
- The $300,000 debt is secured by the property and is also a general obligation of LP.
- LP makes payments of only interest on its $300,000 debt during 2008.
- LP has a net taxable loss in 2008, and LP determines its partners’ shares of the $300,000 debt at the end of its taxable year, December 31, 2008.
- As of that date, SMLLC holds no assets other than its interest in LP.
Conclusion:

The Debt Becomes Nonrecourse

Example 9-8

SMLLC
With $175,000 of Net Value
Reg. §1.752-2(k)(6)
Example 4

SMLLC Can Work Well For Partner Who Is GP In Multiple Partnerships
Owner Reporting is Mandatory

Net value “must” be reported by the owner to each partnership for which the disregarded entity may have one or more recourse debt obligations. See Reg. 1.752-2(k)(5).

Avoiding The Disregarded Entity Rule
Reg §1.752-2(k) does not apply to a payment obligation of a SMLLC to the extent that the owner of the SMLLC is otherwise required to make a payment, such as a guarantee without a right of subrogation, with respect to the obligation of the disregarded entity.

Example 5: Guarantee

Bob

Jose General Partner

SMLLC Disregarded Entity

GP

50%

50%

BJ Partnership

$1,000,000 of Recourse Debt

50% to Bob and 50% to Jose
Effective Date Relief for Pre-October 11, 2006 Debt

Partners’ Share of Nonrecourse Debt
Reg. §1.752-3
Nonrecourse Debt Definition

A partnership debt is a nonrecourse debt to the extent that no partner or related person bears the economic risk of loss for that liability.

First Tier

Partners’ Share Of Minimum (Book) Gain
Second Tier
Partners’ share of forward and reverse sec. 704(c) taxable gain if sold and sole consideration is relief of nonrecourse debt on the property

Third Tier
(1) Per Profit Share;
(2) Per Expected Allocation of Nonrecourse deductions;
(3) Per remaining Sec. 704(c) built-in gain.
ProposedRegs.
onNonrecourseDebt
REG-119305-11
(Feb. 17, 2014)

Effective for Debt Incurred
After Regs. are Final

The prop. regs. change the rules for excess nonrecourse debt allocations (tier three).

The prop. regs. eliminate the first two tests and replace them with a liquidation value % method.
The prop. regs. change the rules for excess nonrecourse debt allocations (tier three).

The prop. regs. eliminate the first two tests and replace them with a liquidation value % method.

A partner’s liquidation value percentage is the ratio of
• the liquidation value of the partner’s interest in the partnership
to
• the liquidation value of all of the partners’ interests in the partnership.
Liquidation value is determined “upon formation of the partnership and redetermined based upon the most recent occurrence of” a 704(b) revaluation event whether the partners adjusted their capital accounts.

See Prop. Reg. Example on Page 9-29
Example 9-9

Tim contributes a building with an FMV of $200,000 (basis $40,000) subject to a nonrecourse debt of $150,000.

Beverly contributes $50,000 cash.

Third Tier debt split 50-50 by agreement.
### Tim’s Outside Basis:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Property’s Adjusted Basis</td>
<td>40,000</td>
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<tr>
<td>IRC Section 752(b)</td>
<td>-150,000</td>
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<tr>
<td>Reduction of Liability</td>
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<tr>
<td>Tier One</td>
<td>0</td>
</tr>
<tr>
<td>Tier Two ($150,000 - $40,000)</td>
<td>+110,000</td>
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<tr>
<td>Tier Three</td>
<td>+20,000</td>
</tr>
<tr>
<td></td>
<td>20,000</td>
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### Beverly’s outside basis:

<p>| | |</p>
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<tr>
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<tbody>
<tr>
<td>Cash contributed</td>
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<tr>
<td>Tier One</td>
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</tr>
<tr>
<td>Tier Two</td>
<td>0</td>
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<tr>
<td>Tier Three</td>
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<tr>
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<td>70,000</td>
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