



[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9891]

RIN 1545-BM95

### Transfers of Certain Property by U.S. Persons to Partnerships with Related Foreign Partners

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance applicable to transfers of appreciated property by U.S. persons to partnerships with foreign partners related to the transferor. Specifically, when a U.S. person transfers appreciated property to a partnership with a foreign partner related to the transferor, the regulations override the general nonrecognition rule unless the partnership adopts the remedial allocation method and certain other requirements are satisfied. The regulations affect U.S. partners in domestic or foreign partnerships.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF FILING WITH THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §§1.197-2(l)(5)(i), 1.704-1(f), 1.704-3(g)(1), 1.721(c)-1(e), 1.721(c)-2(e), 1.721(c)-3(e), 1.721(c)-4(d), 1.721(c)-5(g), 1.721(c)-6(g), and 1.6038B-2(j)(4).

FOR FURTHER INFORMATION CONTACT: Chadwick Rowland, (202) 317-6937 (not a toll-free number).

## SUPPLEMENTARY INFORMATION:

### **Background**

Section 721(c) was added to the Internal Revenue Code (the “Code”) by the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788). In section 721(c), Congress granted the Secretary regulatory authority to override the application of the nonrecognition provision of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) if the gain, when recognized, would be includible in the gross income of a person other than a U.S. person.

On August 6, 2015, the Department of the Treasury (the “Treasury Department”) and the IRS issued Notice 2015-54, 2015-34 I.R.B. 210, which announces an intent to issue regulations under section 721(c).

On January 19, 2017, the Treasury Department and the IRS published temporary and final regulations (T.D. 9814) under sections 721(c), 197, 704, and 6038B in the **Federal Register** (82 FR 7582) (the “temporary regulations”). A notice of proposed rulemaking (REG-127203-15) cross-referencing the temporary regulations was published in the same issue of the **Federal Register** (82 FR 6368) (the “proposed regulations” and together with the temporary regulations the “2017 regulations”).

No public hearing on the 2017 regulations was requested or held; however, the Treasury Department and the IRS received one written comment with respect to the 2017 regulations. The Comment Summary and Explanation of Revisions section summarizes the comment and discusses relevant provisions of the 2017 regulations.

### **Comment Summary and Explanation of Revisions**

#### **I. Overview**

The Treasury Department and the IRS received one comment regarding the 2017 regulations. After full consideration of the comment, this Treasury Decision adopts the rules contained in the proposed regulations with certain modifications. This Comment Summary and Explanation of Provisions section summarizes the comment received, explains the Treasury Department and the IRS's response to that comment, and discusses the modifications to the proposed regulations adopted in this Treasury Decision.

## II. Comment

The comment expressed concern that an intercompany transaction between a U.S. person and a foreign person may result in a deemed or "accidental partnership," despite no intention by the partners to create one and no realization one was created. As a consequence, the requirements under the regulations would not be met to avoid gain recognition under section 721(c). The comment recommended an additional exception to gain recognition under section 721(c) in these circumstances if the taxpayer has reasonably determined that the property in question was not contributed to a partnership, the taxpayer is not amortizing or depreciating the property for section 704(b) purposes with respect to the arrangement for which the property owner has entered into a transaction with a related party, and all parties involved consistently treat the arrangement, with respect to the subject property, as one to which subchapter K of the Code does not apply.

The final regulations do not adopt this recommendation. The issue of what constitutes deemed or accidental partnerships and any relief that should be provided for them is not unique to the application of these regulations and, thus, goes beyond the

scope of this Treasury Decision. Nevertheless, when an accidental partnership exists as the comment describes, the filing obligations under §1.6038B-2(a)(1)(iii) (which cross references the reporting requirements under §1.721(c)-6(b)) will have not been fulfilled and, therefore, the limitations period on assessment under section 6501(c)(8) will remain open until three years after the IRS is provided the information required to be reported under section 6038B. Accordingly, a taxpayer that makes a contribution to an accidental partnership could file amended returns applying the gain deferral method, including fulfilling its reporting requirements (see §1.721(c)-6(f)).

### III. Modifications and Clarifications

#### A. Related party definition

Section 1.721(c)-1T(b) provides definitions that apply for purposes of the 2017 regulations. Section 1.721(c)-1T(b)(12) provides that a related person is, with respect to a U.S. transferor, a person that is related (within the meaning of section 267(b) or 707(b)(1)) to the U.S. transferor. A related foreign person is, with respect to a U.S. transferor, a related person (other than a partnership) that is not a U.S. person. See §1.721(c)-1T(b)(11).

The Treasury Department and the IRS have determined that a modification to the definition of related person is appropriate to limit the application of these rules in certain situations. Specifically, a new paragraph is added in §1.721(c)-1(b)(12) that provides that for purposes of determining if a person is a related person with respect to a U.S. transferor, section 267(b) is applied without regard to section 267(c)(3). This modification to the definition of related person provides relief when certain foreign individual partners of a partnership would be treated as a related person with respect to a domestic corporation by reason of section 267(c)(3). This change is consistent with

section 707(b)(3) and is intended to address the following specific fact pattern, or a variation thereof:

A partnership (PRS1) has two partners: a foreign individual that holds 4 percent of the interests in PRS1's capital and profits and a U.S. individual (unrelated to the foreign individual) that holds 96 percent of the interests in PRS1's capital and profits. PRS1 wholly owns a domestic corporation (UST). In Year 1, UST forms a new partnership (PRS2); as part of the formation, UST contributes section 721(c) property (as defined in §1.721(c)-1(b)(15)) in return for a 90 percent interest in PRS2's capital and profits, and a U.S. individual (unrelated to UST) contributes cash in return for the remaining interest in PRS2's capital and profits.

For purposes of determining whether PRS2 is a section 721(c) partnership (as defined in §1.721(c)-1(b)(14)), the rules of section 267(b) must be applied to determine whether the foreign individual is a related foreign person with respect to UST. Section 267(b)(2) provides that an individual is related to a corporation if the individual holds, directly or indirectly, more than 50 percent in value of the corporation's outstanding stock. In applying section 267(b)(2), however, the constructive stock ownership rules of section 267(c) must be taken into account. Section 267(c)(1) provides that stock owned, directly or indirectly, by a partnership will be treated as owned proportionally by its partners. Section 267(c)(5) provides that stock owned constructively by reason of section 267(c)(1) will be treated as actually owned for purposes of applying section 267(c)(3). Section 267(c)(3) provides that an individual owning any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner. But section 267(c)(3) will not apply, and will therefore not attribute stock

ownership to an individual partner, if the individual does not actually own, or constructively own under section 267(c)(1), stock in the corporation that is owned directly or indirectly by or for another partner of the partnership. See §1.267(c)-1(a)(2).

In the facts provided, section 267(c)(1) treats the foreign individual as constructively owning a proportionate share of the UST stock that is owned by PRS1; accordingly, the foreign individual is treated as constructively owning 4 percent of the UST stock. And because the foreign individual constructively owns stock in UST under section 267(c)(1), section 267(c)(3) attributes the stock owned by the U.S individual (the other partner in PRS1) to the foreign individual. As a result, the foreign individual is treated as owning all of the value of UST's outstanding stock for purposes of determining relatedness under section 267(b)(2); therefore, the foreign individual is a related person with respect to the U.S. transferor under the rule provided in §1.721(c)-1T(b)(12) of the 2017 regulations. However, because the modified definition of related person provided in this Treasury Decision applies section 267(b) without regard to section 267(c)(3), the foreign individual will not be treated as a related person under §1.721(c)-1(b)(12)(ii). As a consequence, PRS2 is not a section 721(c) partnership.

#### B. Consistent allocation method

Section 1.721(c)-3T(b) of the 2017 regulations provides the requirements of the gain deferral method. Among the requirements, a section 721(c) partnership is required to adopt the remedial allocation method and apply the consistent allocation method with respect to section 721(c) property. The consistent allocation method, as described in §1.721(c)-3T(c)(1), provides that for each taxable year of a section 721(c) partnership in which there is remaining built-in gain in section 721(c) property, the section 721(c) partnership must allocate each book item of income, gain, deduction, and loss with

respect to the section 721(c) property to the U.S. transferor in the same percentage for the taxable year. Although the consistent allocation method requires each book item of income, gain, deduction, and loss with respect to section 721(c) property to be allocated to a U.S. transferor in the same percentage for a single taxable year, the consistent allocation method does not require the allocations to be in the same percentage among all taxable years in which the gain deferral method is applied. The consistent allocation method, therefore, prevents a U.S. transferor from rendering the remedial allocation method ineffective by, for example, having the partnership allocate a higher percentage of book depreciation to the U.S. transferor than the U.S. transferor's percentage share of income or gain with respect to the section 721(c) property. See preamble to the temporary regulations (82 FR at 7589). The consistent allocation method, therefore, ensures that the built-in gain in section 721(c) property will be subject to U.S. tax.

The Treasury Department and the IRS have determined that a modification to §1.721(c)-3T(c)(1) of the 2017 regulations is appropriate to clarify the application of the consistent allocation method. Specifically, a new sentence is added in §1.721(c)-3(c)(1); the new sentence provides that upon a variation (as described in §1.706-4(a)(1)) of a U.S. transferor's interest in a section 721(c) partnership, book items with respect to section 721(c) property that are allocated under the interim closing method (as described in §1.706-4) will be treated as allocated in the same percentage for purposes of applying the consistent allocation method in a single taxable year unless the variation results from a transaction undertaken with a principal purpose of avoiding the tax consequences of the gain deferral method.

If any partner's interest in a partnership changes during a taxable year of the partnership, section 706(d) grants the Secretary regulatory authority to prescribe rules for determining each partner's distributive share of any partnership item for the taxable year that takes into account the partner's varying interests in the partnership. The variations described in section 706(d) include, among other things, a reduction in a partner's interest in a partnership, including a reduction that occurs due to the entry of a new partner. See §1.706-4(a). If a partner's interest in a partnership is reduced during a taxable year, but not completely disposed of, the taxable year of the partnership will not close as a result of the variation. See section 706(c)(2)(B). Instead, if a variation occurs during the taxable year of a partnership, §1.706-4(a)(3) generally allows the partnership to choose how to determine each partner's share of the partnership items for the taxable year under either the proration method or the interim closing method. See §1.706-4(a)(3)(iii). The interim closing method divides the taxable year of the partnership into segments based on the interim closings of the partnership's books; the segments are then used to apportion the partnership items for the year among its segments, and to determine, taking into account the partners' interests during each segment, the partners' distributive shares of the partnership items. See generally §1.706-4(a)(3).

The modification to the consistent allocation method when the interim closing method is applied is intended to clarify that a U.S. transferor continues to comply with the consistent allocation method following certain economic events that do not close the taxable year of the section 721(c) partnership. Given the high thresholds required to be subject to these rules, the Treasury Department and the IRS have determined that



allowing the partnership to choose the proration method is not appropriate for the consistent allocation method: a section 721(c) partnership will have the resources and capabilities necessary to comply with the more precise interim closing method without imposing an undue burden on the partnership.

### C. Reporting

The final regulations include the reporting requirements provided in the 2017 regulations regarding both gain deferral contributions and the annual reporting requirements with respect to section 721(c) property to which the gain deferral method applies. The 2017 regulations require much of the reporting to be on statements attached to returns. See §§1.721(c)-6T and 1.6038B-2T. Since the issuance of the 2017 regulations, however, the IRS has updated and added new schedules to Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, to facilitate compliance with these reporting requirements. The IRS has also issued new Form 8838-P, *Consent To Extend the Time To Assess Tax Pursuant to the Gain Deferral Method (Section 721(c))*. The purpose of these changes was to include the information that previously was reported on the statements. The final regulations reference and require the use of these forms and schedules to fulfill the reporting requirements. For tax returns filed before [INSERT DATE 60 DAYS AFTER DATE OF FILING WITH THE **FEDERAL REGISTER**], however, §1.721(c)-6(g)(3)(ii) provides relief for reporting that met the requirements of §1.721(c)-6T (as in effect before January 1, 2020).

The final regulations also clarify the duration for which the U.S. transferor must extend the period of limitations on the assessment of tax under §1.721(c)-6(b). Section 1.721(c)-6(b)(5) clarifies the relevant periods to which Form 8838-P applies by measuring each period by the number of months occurring after the relevant date;

accordingly, the final regulations measure each period by a fixed term that is determinable on the date of contribution. The final regulations also provide a similar clarification in §1.721(c)-6(f)(2).

#### D. Technical terminations

Section 708(b) generally provides that a partnership will terminate if the partnership ceases to do business. Before the enactment of the Tax Cuts and Jobs Act, Public Law 115-97 (2017) (the “TCJA”), section 708(b)(1)(B) provided another way for a partnership to terminate: a partnership terminated if within any 12-month period, 50 percent or more of the total interest in partnership capital and profits was sold or exchanged. The termination described in section 708(b)(1)(B) is commonly referred to as a “technical termination.” The regulations in §1.708-1(b)(4) provide that a technical termination results in a deemed contribution of all the terminated partnership’s assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to both the purchasing partners and the remaining partners.

The TCJA repealed section 708(b)(1)(B) for all partnership taxable years beginning after December 31, 2017; therefore, technical terminations no longer apply. See Conference Report on H.R. 1, Tax Cuts and Jobs Act, H. Rept. 115-446, at 416.

The 2017 regulations provide rules regarding technical terminations in two contexts: they provide that a partnership will not be treated as a section 721(c) partnership (as defined in §1.721(c)-1T(b)(14)) following a deemed contribution that occurs as a result of a technical termination, and they treat certain technical terminations as successor events for purposes of the acceleration event exceptions provided in §1.721(c)-5T. See §§1.721(c)-2T(d)(2) and 1.721(c)-5T(c)(4).

The rules in the 2017 regulations regarding technical terminations are retained in this Treasury Decision. Although the TCJA repealed section 708(b)(1)(B), the applicability date for these final regulations relates back to the applicability date provided in the 2017 regulations, which is before the effective date provided in the TCJA. Accordingly, the rules provided in this Treasury Decision regarding technical terminations will have limited applicability; the rules will only apply to technical terminations occurring on or after the applicability date provided in the 2017 regulations but before the effective date for the repeal of section 708(b)(1)(B) provided in the TCJA.

E. Request for comments

Under the final regulations, as well as the 2017 regulations, stock is excluded from the definition of section 721(c) property and, therefore, a contribution of stock of a controlled foreign corporation (within the meaning of section 957) (“CFC”) to a section 721(c) partnership is not subject to the final regulations. However, the Treasury Department and the IRS are concerned that taxpayers may avail themselves of partnerships to shift the tax liability, in whole or in part, with respect to earnings of a CFC attributable to subpart F income (within the meaning of section 952) or tested income (within the meaning of section 951A(c)(2)(A) and §1.951A-2(b)(1)) to a related foreign partner that is not owned (within the meaning of section 958(a)) by a United States shareholder (within the meaning of section 951(b)). The Treasury Department and the IRS are studying the use of partnerships in this context, including under what circumstances it may be appropriate to apply section 721(c) to a contribution of stock of a CFC to a partnership. The Treasury Department and the IRS request comments on this matter.

**Special Analyses**

## I. Regulatory Planning and Review

The Administrator of the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget, has determined that this rule is not a significant regulatory action, as that term is defined in section 3(f) of Executive Order 12866. Therefore, OIRA has not reviewed this rule pursuant to section 6(a)(3)(A) of Executive Order 12866 and the April 11, 2018, Memorandum of Agreement between the Department of Treasury and the Office of Management and Budget (OMB).

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the collection of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations include a \$1,000,000 de minimis exception for certain transfers and exclude contributions of tangible property with built-in gain that does not exceed \$20,000. In addition, the regulations apply only when a U.S. transferor contributes property to a partnership with a partner that is a related foreign person and persons related to the U.S. transferor own more than 80 percent of the interests in the partnership. Accordingly, the Treasury Department and the IRS expect that these regulations primarily will affect large domestic corporations. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

## II. Paperwork Reduction Act

The collection of information imposed by these regulations is contained in §§1.721(c)-6 and 1.6038B-2. The collection of information provided by these regulations has been reviewed and approved by the Office of Management and Budget

under control numbers 1545-1668 and 1545-0123. The information is required to comply with the gain deferral method, which generally allows a U.S. transferor to avoid immediate gain recognition upon a contribution of section 721(c) property to a section 721(c) partnership. The likely respondents are domestic corporations. Estimates for completing these forms can be located in the instructions to Forms 8865, 8838-P, and 1065.

Upon a contribution of section 721(c) property to a section 721(c) partnership, a U.S. transferor must comply with the gain deferral method described in §1.721(c)-3 to avoid immediate gain recognition. To comply with the gain deferral method, §1.721(c)-3(b)(3) provides that the procedural and reporting requirements of §1.721(c)-6 must be met; additionally, §1.721(c)-3(b)(4) provides that a U.S. transferor must consent to an extension of the period of limitations on assessment of tax as required by §1.721(c)-6(b)(5).

Section 1.721(c)-6(b) describes the procedural and reporting requirements of a U.S. transferor. The collection of information described in §§1.721(c)-6(b)(2) and (c)(2) and 1.6038B-2(a)(1)(iii) regarding a gain deferral contribution is provided by the U.S. transferor to the IRS on any applicable Schedules to Form 8865, *Return of U.S.*

*Persons With Respect to Certain Foreign Partnerships*, and is mandatory; the relevant Schedules include, as applicable, Schedule A-1, *Certain Foreign Partners*; Schedule A-2, *Foreign Partners of Section 721(c) Partnership*; Schedule G, *Statement of Application of the Gain Deferral Method Under Section 721(c)*; Schedule H, *Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c)*; and

Schedule O, *Transfer of Property to a Foreign Partnership*. The information will be used by the U.S. transferor to comply with the gain deferral method.

The collection of information described in §§1.721(c)-6(b)(3) and 1.6038B-2(a)(1)(iii) is provided on Schedules G, H, and O of Form 8865 and is mandatory. The information will be used by the U.S. transferor to annually report information for each gain deferral contribution.

The collection of information described in §1.721(c)-6(b)(3)(iii), if not already provided elsewhere, is provided on Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, and is mandatory. The information will be used by the U.S. transferor to comply with the gain deferral method.

The collection of information described in §1.721(c)-6(b)(5) is provided by the U.S. transferor to the IRS on Form 8838-P, *Consent To Extend the Time To Assess Tax Pursuant to the Gain Deferral Method (Section 721(c))*, and is mandatory. The information will be used by the U.S. transferor to extend the period of limitations on the assessment of tax to ensure that the gain deferral method is properly applied.

If a section 721(c) partnership does not have a filing obligation under section 6031, the collection of information described in §1.721(c)-6(c)(3) is provided by a section 721(c) partnership to a U.S. transferor on Schedule K-1 (Form 8865), *Partner's Share of Income, Deduction, Credits, etc.*, for all related foreign persons that are direct or indirect partners in the section 721(c) partnership. The information will be used by the U.S. transferor to annually report information for each gain deferral contribution.

If a section 721(c) partnership has a filing obligation under section 6031, the collection of information described in §1.721(c)-6(d)(2) is provided by the section 721(c)

partnership to the U.S. transferor on Schedule K-1 (Form 1065). The information will be used by the U.S. transferor to comply with the requirements of the gain deferral method provided in §1.721(c)-6(b)(2) and (3).

### **Revision of Existing Forms**

	<b>New</b>	<b>Revision of existing form</b>	<b>Number of additional respondents (estimated, rounded to nearest 100)</b>
Form 8865		Y	<200
Form 8838-P		Y	<200
Form 1065		Y	<200

Source: RAAS:CDW and SOI

The numbers of respondents in the Revision of Existing Forms table were estimated by the Research, Applied Analytics and Statistics Division of the IRS from the Compliance Data Warehouse and Statistics of Income, using tax year 2017. Data for each of the Forms 8865, 8838-P, and 1065 represent preliminary estimates of the total number of additional taxpayers that are expected to file these forms. The tax data for 2018 is not yet available.

### **III. Unfunded Mandates Reform Act**

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately \$154 million. These regulations do not include any Federal

mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### IV. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

#### **Drafting Information**

The principal authors of these regulations are Chadwick Rowland and Ronald M. Gootzeit, Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

#### **Statement of Availability**

Notice 2015-54 (cited in this preamble) is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <https://www.irs.gov>.

#### **Effect on Other Documents**

The following section of the following publication is obsolete as of [INSERT DATE OF FILING WITH THE **FEDERAL REGISTER**]:



Section 4 of Notice 2015-54 (2015-34 I.R.B. 210).

## **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

## **Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by removing the sectional authority citations for §§1.197-2T, 1.704-3T, 1.721(c)-1T through 1.721(c)-7T, and 1.6038B-2T and adding entries in numerical order for §§1.721(c)-1 through 1.721(c)-7 to read in part as follows:

Authority: 26 U.S.C. 7805, unless otherwise noted.

\* \* \* \* \*

Section 1.721(c)-1 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-2 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-3 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-4 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-5 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-6 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-7 also issued under 26 U.S.C. 721(c).

\* \* \* \* \*

Par. 2. Section 1.197-2 is amended by revising paragraphs (h)(12)(vii)(C) and (l)(5) to read as follows:

§1.197-2 Amortization of goodwill and certain other intangibles.

\* \* \* \* \*

(h) \* \* \*

(12) \* \* \*

(vii) \* \* \*

(C) Rules for section 721(c) partnerships. See §1.704-3(d)(5)(iii) if there is a contribution of a section 197(f)(9) intangible to a section 721(c) partnership (as defined in §1.721(c)-1(b)(14)).

\* \* \* \* \*

(l) \* \* \*

(5) Applicability dates for section 721(c) partnerships--(i) In general. Except as provided in paragraph (l)(5)(ii) of this section, paragraph (h)(12)(vii)(C) of this section applies with respect to contributions occurring on or after January 18, 2017, and with respect to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(ii) Application of the provisions described in paragraph (l)(5)(i)(A) of this section retroactively. Paragraph (h)(12)(vii)(C) of this section may be applied with respect to a contribution occurring on or after August 6, 2015, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. A taxpayer applying paragraph (h)(12)(vii)(C) of this section retroactively must apply paragraph (h)(12)(vii)(C) of this section on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017.

§1.197-2T [Removed]

Par. 3. Section 1.197-2T is removed.

Par. 4. Section 1.704-1 is amended by revising paragraphs (b)(2)(iv)(f)(6) and (f) to read as follows:

§1.704-1 Partner's distributive share.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iv) \* \* \*

(f) \* \* \*

(6) Notwithstanding paragraph (b)(2)(iv)(f)(5) of this section, the revaluation is required under §1.721(c)-3(d)(1) as a condition of the application of the gain deferral method (as described in §1.721(c)-3(b)) and is pursuant to an event described in this paragraph (b)(2)(iv)(f)(6). If an interest in a partnership is contributed to a section 721(c) partnership (as defined in §1.721(c)-1(b)(14)), the partnership whose interest is contributed may revalue its property in accordance with this section. In this case, the revaluation by the partnership whose interest was contributed must occur immediately before the contribution. If a partnership that revalues its property pursuant to this paragraph owns an interest in another partnership, the partnership in which it owns an interest may also revalue its property in accordance with this section. When multiple partnerships revalue under this paragraph (b)(2)(iv)(f)(6), the revaluations occur in order from the lowest-tier partnership to the highest-tier partnership.

\* \* \* \* \*

(f) Applicability dates--(1) In general. Except as provided in paragraph (f)(2) of this section, paragraph (b)(2)(iv)(f)(6) of this section applies with respect to contributions occurring on or after January 18, 2017, and with respect to contributions that occurred before January 18, 2017 resulting from an entity classification election made under

§301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(2) Election to apply the provisions described in paragraph (f)(1) of this section retroactively. Paragraph (b)(2)(iv)(f)(6) of this section may, by election, be applied with respect to a contribution that occurred on or after August 6, 2015 but before January 18, 2017, and with respect to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election must have been made by applying paragraph (b)(2)(iv)(f)(6) of this section on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017.

§1.704-1T [Amended]

Par. 5. Paragraphs (b)(2)(iv)(f)(6) and (f) of §1.704-1T are removed.

Par. 6. Section 1.704-3 is amended by revising paragraphs (a)(13), (d)(5)(iii), and (g) to read as follows:

§1.704-3 Contributed property.

(a) \* \* \*

(13) Rules for tiered section 721(c) partnerships--(i) Revaluations. If a partnership revalues its property pursuant to §1.704-1(b)(2)(iv)(f)(6) immediately before an interest in the partnership is contributed to another partnership, or if an upper-tier partnership owns an interest in a lower-tier partnership, and both the upper-tier partnership and the lower-tier partnership revalue partnership property pursuant to

§1.704-1(b)(2)(iv)(f)(6), the principles of paragraph (a)(9) of this section will apply to any reverse section 704(c) allocations made as a result of the revaluation.

(ii) Basis-derivative items. If a lower-tier partnership that is a section 721(c) partnership applies the gain deferral method, then, for purposes of applying this section, the upper-tier partnership must treat its distributive share of lower-tier partnership items of gain, loss, amortization, depreciation, or other cost recovery with respect to the lower-tier partnership's section 721(c) property as though they were items of gain, loss, amortization, depreciation, or other cost recovery with respect to the upper-tier partnership's interest in the lower-tier partnership. For purposes of this paragraph (a)(13)(ii), gain deferral method is defined in §1.721(c)-1(b)(8), section 721(c) partnership is defined in §1.721(c)-1(b)(14), and section 721(c) property is defined in §1.721(c)-1(b)(15).

\* \* \* \* \*

(d) \* \* \*

(5) \* \* \*

(iii) Special rules for a section 721(c) partnership and anti-churning property--  
(A) In general. Solely in the case of a gain deferral contribution of section 721(c) property that is a section 197(f)(9) intangible that was not an amortizable section 197 intangible in the hands of the contributor, the remedial allocation method is modified with respect to allocations to a related person to the U.S. transferor pursuant to paragraphs (d)(5)(iii)(B) through (F) of this section. For purposes of this paragraph (d)(5)(iii), gain deferral contribution is defined in §1.721(c)-1(b)(7), related person is defined in §1.721(c)-1(b)(12), section 721(c) partnership is defined in §1.721(c)-

1(b)(14), section 721(c) property is defined in §1.721(c)-1(b)(15), and U.S. transferor is defined in §1.721(c)-1(b)(18). For an example applying the rules of this paragraph (d)(5)(iii), see §1.721(c)-7(b)(6) (Example 6).

(B) Book basis recovery. The section 721(c) partnership must amortize the portion of the partnership's book value in the section 197(f)(9) intangible that exceeds the adjusted basis in the property upon contribution using any recovery period and amortization method available to the partnership as if the property had been newly purchased by the partnership from an unrelated party.

(C) Effect of ceiling rule limitations. If the ceiling rule causes the book allocation of the item of amortization of a section 197(f)(9) intangible under paragraph (d)(5)(iii)(B) of this section by a section 721(c) partnership to a related person with respect to the U.S. transferor to differ from the tax allocation of the same item to the related person (a ceiling rule limited related person), the partnership must not create a remedial item of deduction to allocate to the related person but instead must increase the adjusted basis of the section 197(f)(9) intangible by an amount equal to the difference solely with respect to that related person. The partnership simultaneously must create an offsetting remedial item in an amount identical to the increase in adjusted tax basis of the section 197(f)(9) intangible and allocate it to the contributing partner.

(D) Effect of basis adjustment--(1) In general. The basis adjustment described in paragraph (d)(5)(iii)(C) of this section constitutes an adjustment to the adjusted basis of a section 197(f)(9) intangible with respect to the ceiling rule limited related person only. No adjustment is made to the common basis of partnership property. Thus, for purposes of calculating gain and loss, the ceiling rule limited related person will have a

special basis for that section 197(f)(9) intangible. The adjustment to the basis of partnership property under this section has no effect on the partnership's computation of any item under section 703.

(2) Computation of a partner's distributive share of partnership items. The partnership first computes its items of gain or loss at the partnership level under section 703. The partnership then allocates the partnership items among the partners, including the ceiling rule limited related person, in accordance with section 704, and adjusts the partners' capital accounts accordingly. The partnership then adjusts the ceiling rule limited related person's distributive share of the items of partnership gain or loss, in accordance with paragraph (d)(5)(iii)(D)(3) of this section, to reflect the effects of that person's basis adjustment under this section. These adjustments to that person's distributive shares must be reflected on Schedules K and K-1 of the partnership's return (Form 1065) (when otherwise required to be completed) and do not affect that person's capital account.

(3) Effect of basis adjustment in determining items of income, gain, or loss. The amount of a ceiling rule limited related person's gain or loss from the sale or exchange of a section 197(f)(9) intangible in which that person has a tax basis adjustment is equal to that person's share of the partnership's gain or loss from the sale of the asset (including any remedial allocations under this paragraph (d)), minus the amount of that person's tax basis adjustment for the section 197(f)(9) intangible.

(E) Subsequent transfers--(1) In general. Except as provided in paragraph (d)(5)(iii)(E)(2) of this section, if a ceiling rule limited related person transfers all or part of its partnership interest, the portion of the basis adjustment for a section 197(f)(9)

intangible attributable to the interest transferred is eliminated. The transferor of the partnership interest remains the ceiling rule limited related person with respect to any remaining basis adjustment for the section 197(f)(9) intangible.

(2) Special rules for substituted basis transactions. Paragraph (d)(5)(iii)(E)(1) of this section does not apply to the extent a ceiling rule limited related person transfers its partnership interest in a transaction in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the ceiling rule limited related person's basis in that interest. Instead, in such a case, the transferee succeeds to that portion of the transferor's basis adjustment for a section 197(f)(9) intangible attributable to the interest transferred. In such a case, the basis adjustment in a section 197(f)(9) intangible to which the transferee succeeds is taken into account for purposes of determining the transferee's share of the adjusted basis to the partnership of the partnership's property for purposes of §§1.743-1(b) and 1.755-1(b)(5). To the extent a transferee would be required to decrease the adjusted basis of a section 197(f)(9) intangible pursuant to §§1.743-1(b)(2) and 1.755-1(b)(5), the decrease first reduces the special basis adjustment described in paragraph (d)(5)(iii)(C) of this section, if any, to which the transferee succeeds.

(F) Non-amortization of basis adjustment. Neither the increase to the adjusted basis of a section 197(f)(9) intangible with respect to a ceiling rule limited related person nor the portion of the basis of any property that was determined by reference to such increase is subject to amortization, depreciation, or other cost recovery.

\* \* \* \* \*



(g) Applicability dates for rules for section 721(c) partnerships--(1) In general.

Notwithstanding paragraph (f) of this section, except as provided in paragraph (g)(2) of this section, paragraphs (a)(13) and (d)(5)(iii) of this section apply with respect to contributions occurring on or after January 18, 2017, and with respect to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(2) Election to apply the provisions described in paragraph (g)(1) of this section retroactively. Paragraphs (a)(13) and (d)(5)(iii) of this section may, by election, be applied with respect to a contribution that occurred on or after August 6, 2015 but before January 18, 2017, and with respect to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election must have been made by applying paragraph (a)(13) or (d)(5)(iii) of this section, as applicable, on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017.

§1.704-3T [Removed]

Par. 7. Section 1.704-3T is removed.

Par. 8. Section 1.721(c)-1 is added to read as follows:

§1.721(c)-1 Overview, definitions, and rules of general application.

(a) Overview--(1) In general. This section and §§1.721(c)-2 through 1.721(c)-7 (collectively, the section 721(c) regulations) provide rules under section 721(c). This section provides definitions and rules of general application for purposes of the section

721(c) regulations. Section 1.721(c)-2 provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Section 1.721(c)-3 describes the gain deferral method, which may be applied in order to avoid the immediate recognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Section 1.721(c)-4 provides rules regarding acceleration events for purposes of applying the gain deferral method. Section 1.721(c)-5 identifies exceptions to the rules regarding acceleration events provided in §1.721(c)-4(b). Section 1.721(c)-6 provides procedural and reporting requirements. Section 1.721(c)-7 provides examples illustrating the application of the section 721(c) regulations.

(2) Scope. Paragraph (b) of this section provides definitions. Paragraph (c) of this section describes the treatment of a change in form of a partnership. Paragraph (d) of this section provides an anti-abuse rule. Paragraph (e) of this section provides the dates of applicability.

(b) Definitions. The following definitions apply for purposes of the section 721(c) regulations. Unless otherwise indicated, the definitions apply on a property-by-property basis, as applicable.

(1) Acceleration event. An acceleration event has the meaning provided in §1.721(c)-4(b).

(2) Built-in gain. Built-in gain is, with respect to property contributed to a partnership, the excess of the book value of the property over the partnership's adjusted tax basis in the property upon the contribution, determined without regard to the application of §1.721(c)-2(b).

(3) Consistent allocation method. The consistent allocation method is the method described in §1.721(c)-3(c).

(4) Controlled partnership. A partnership is a controlled partnership with respect to a U.S. transferor if the U.S. transferor and related persons control the partnership. For purposes of this paragraph (b)(4), control is determined based on all the facts and circumstances, except that a partnership will be deemed to be controlled by a U.S. transferor and related persons if those persons, in the aggregate, own (directly or indirectly through one or more partnerships) more than 50 percent of the interests in the partnership capital or profits.

(5) Direct or indirect partner. A direct or indirect partner is a person (other than a partnership) that owns an interest in a partnership directly or indirectly through one or more partnerships.

(6) Excluded property. Excluded property is--

(i) A cash equivalent;

(ii) A security within the meaning of section 475(c)(2), without regard to section 475(c)(4);

(iii) Tangible property with a book value exceeding adjusted tax basis by no more than \$20,000 or with an adjusted tax basis in excess of book value; and

(iv) An interest in a partnership in which 90 percent or more of the property (as measured by value) held by the partnership (directly or indirectly through interests in one or more partnerships that are not excluded property) consists of property described in paragraphs (b)(6)(i) through (iii) of this section.

(7) Gain deferral contribution. A gain deferral contribution is a contribution of section 721(c) property to a section 721(c) partnership with respect to which the recognition of gain is deferred under the gain deferral method.

(8) Gain deferral method. The gain deferral method is the method described in §1.721(c)-3(b).

(9) Partial acceleration event. A partial acceleration event is an event described in §1.721(c)-5(d)(2) or (3).

(10) Regulatory allocation. A regulatory allocation is--

(i) An allocation pursuant to a minimum gain chargeback, as defined in §1.704-2(b)(2);

(ii) A partner nonrecourse deduction, as determined in §1.704-2(i)(2);

(iii) An allocation pursuant to a partner minimum gain chargeback, as described in §1.704-2(i)(4);

(iv) An allocation pursuant to a qualified income offset, as defined in §1.704-1(b)(2)(ii)(d);

(v) An allocation with respect to the exercise of a noncompensatory option described in §1.704-1(b)(2)(iv)(s); and

(vi) An allocation of partnership level ordinary income or loss described in §1.751-1(b)(3).

(11) Related foreign person. A related foreign person is, with respect to a U.S. transferor, a related person (other than a partnership) that is not a U.S. person.

(12) Related person—(i) In general. A related person is, with respect to a U.S. transferor, a person that is related (within the meaning of section 267(b) or 707(b)(1)) to the U.S. transferor.

(ii) Modification to the application of section 267(b). For purposes of determining if a person is a related person with respect to a U.S. transferor, section 267(b) is applied without regard to section 267(c)(3).

(13) Remaining built-in gain--(i) In general. Remaining built-in gain is, with respect to section 721(c) property subject to the gain deferral method, the built-in gain reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for purposes of this paragraph (b)(13)(i), without taking into account increases or decreases to the property's book value pursuant to §1.704-1(b)(2)(iv)(f) or (s).

(ii) Special rule for tiered partnerships. If section 721(c) property is described in §1.721(c)-3(d)(1)(ii), the remaining built-in gain includes the new positive reverse section 704(c) layer described in §1.721(c)-3(d)(1)(ii), reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for purposes of this paragraph (b)(13)(ii), without taking into account increases or decreases to the property's book value pursuant to §1.704-1(b)(2)(iv)(f) or (s) that are unrelated to the revaluation described in §1.721(c)-3(d)(1)(i).

(14) Section 721(c) partnership--(i) In general. A partnership (domestic or foreign) is a section 721(c) partnership if there is a contribution of section 721(c) property to the partnership and, after the contribution and all transactions related to the contribution--

(A) A related foreign person with respect to the U.S. transferor is a direct or indirect partner in the partnership; and

(B) The U.S. transferor and related persons own 80 percent or more of the interests in partnership capital, profits, deductions, or losses.

(ii) Special rule for tiered partnerships. A partnership described in §1.721(c)-3(d)(1) or (2) is deemed to be a section 721(c) partnership for purposes of the gain deferral method.

(15) Section 721(c) property--(i) In general. Section 721(c) property is property, other than excluded property, with built-in gain that is contributed to a partnership by a U.S. transferor, including pursuant to a contribution described in §1.721(c)-2(d) (partnership look-through rule). If the U.S. transferor is treated as contributing its share of property to a partnership pursuant to §1.721(c)-2(d), the entire property will be section 721(c) property.

(ii) Special rule for tiered partnerships. Property described in §1.721(c)-3(d)(1)(ii) and an interest in a partnership described in §1.721(c)-3(d)(2)(ii) is deemed to be section 721(c) property.

(16) Successor event. A successor event is an event described in §1.721(c)-5(c)(2), (3), (4), or (5).

(17) Termination event. A termination event is an event described in §1.721(c)-5(b)(2), (3), (4), (5), (6), or (7).

(18) U.S. transferor--(i) In general. A U.S. transferor is a United States person within the meaning of section 7701(a)(30) (a U.S. person), other than a domestic partnership.

(ii) Special rule for tiered partnerships. Solely for purposes of applying the consistent allocation method, a U.S. transferor includes a partnership that is treated as a U.S. transferor under §1.721(c)-3(d)(1)(iii) or (d)(2)(i).

(c) Change in form of a partnership. A mere change in identity, form, or place of organization of a partnership or a recapitalization of a partnership will not cause the partnership to become a section 721(c) partnership.

(d) Anti-abuse rule. If a U.S. transferor engages in a transaction (or series of transactions) or an arrangement with a principal purpose of avoiding the application of the section 721(c) regulations, the transaction (or series of transactions) or the arrangement may be recharacterized (including by aggregating or disregarding steps or disregarding an intermediate entity) in accordance with its substance.

(e) Applicability dates--(1) In general. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015.

(2) Certain provisions. Except as provided in paragraph (e)(3) of this section, paragraphs (b)(6)(iv) and (c) of this section apply to contributions occurring on or after January 18, 2017, and to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017. Except as provided in paragraph (e)(3) of this section, paragraph (b)(14)(i)(B) of this section applies by replacing “80 percent or more” with “greater than 50 percent” with

respect to contributions that occurred on or after August 6, 2015 but before January 18, 2017, and with respect to contributions that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015, but was filed on or after August 6, 2015 but before January 18, 2017. Except as provided in paragraph (e)(3) of this section, paragraph (b)(12)(ii) of this section applies to contributions occurring on or after **[INSERT DATE OF FILING WITH THE FEDERAL REGISTER]**.

(3) Election to apply the provisions described in paragraph (e)(2) of this section retroactively. Paragraphs (b)(6)(iv) and (c) of this section and paragraph (b)(14)(i)(B) of this section, without the modification described in paragraph (e)(2) of this section, may, by election, be applied to a contribution that occurred on or after August 6, 2015 but before January 18, 2017, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election described in the preceding sentence must have been made by applying paragraph (b)(6)(iv) or (c) as described in paragraph (e)(2) of this section or paragraph (b)(14)(i)(B) of this section, without the modification described in paragraph (e)(2) of this section, as applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017. Paragraph (b)(12)(ii) of this section, may, by election, be applied to a contribution that occurred on or after August 6, 2015 but before **[INSERT DATE OF FILING WITH THE FEDERAL REGISTER]**, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was



effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election described in the preceding sentence must be made by applying paragraph (b)(12)(ii) of this section to the contribution on a timely filed original return (including extensions) or an amended return filed no later July 17, 2020.

§1.721(c)-1T [Removed]

Par. 9. Section 1.721(c)-1T is removed.

Par. 10. Section 1.721(c)-2 is added to read as follows:

§1.721(c)-2 Recognition of gain on certain contributions of property to partnerships with related foreign partners.

(a) Scope. This section provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Paragraph (b) of this section provides the general rule that nonrecognition of gain under section 721(a) does not apply to a contribution of section 721(c) property to a section 721(c) partnership. Paragraph (c) of this section provides a de minimis exception to the application of the general rule in paragraph (b) of this section. Paragraph (d) of this section provides rules for identifying a section 721(c) partnership when a partnership in which a U.S. transferor is a direct or indirect partner contributes property to another partnership. Paragraph (e) of this section provides the dates of applicability. For definitions that apply for purposes of this section, see §1.721(c)-1(b).

(b) General rule for contributions of section 721(c) property. Except as provided in this paragraph (b), paragraph (c) of this section, and §1.721(c)-3 (describing the gain deferral method), nonrecognition under section 721(a) will not apply to gain realized by the contributing partner upon a contribution of section 721(c) property to a section

721(c) partnership. This paragraph (b) does not apply to a direct contribution by a U.S. transferor if the U.S. transferor and related persons with respect to the U.S. transferor do not own 80 percent or more of the interests in partnership capital, profits, deductions, or losses.

(c) De minimis exception. Paragraph (b) of this section will not apply with respect to contributions to a section 721(c) partnership during a taxable year of the section 721(c) partnership for which the sum of the built-in gain with respect to all section 721(c) property contributed in that taxable year does not exceed \$1 million. If, pursuant to the last sentence of paragraph (b) of this section, a direct contribution of property to the section 721(c) partnership by a U.S. transferor is not subject to paragraph (b) of this section, then such contribution is not taken into account for purposes of this paragraph (c).

(d) Rules for identifying a section 721(c) partnership when a partnership contributes property to another partnership--(1) Partnership look-through rule. If a U.S. transferor is a direct or indirect partner in a partnership (upper-tier partnership) and the upper-tier partnership contributes all or a portion of its property to another partnership (lower-tier partnership), then, for purposes of determining if the lower-tier partnership is a section 721(c) partnership, the U.S. transferor is treated as contributing to the lower-tier partnership its share of the property actually contributed by the upper-tier partnership to the lower-tier partnership.

(2) Exception for a technical termination of a partnership. Paragraph (d)(1) of this section will not apply to a deemed contribution that occurs as a result of a termination of a partnership described in section 708(b)(1)(B) (technical termination). If

a partnership is a section 721(c) partnership immediately before a technical termination, see §1.721(c)-5(c)(4) (which treats technical terminations as successor events in certain circumstances).

(e) Applicability dates--(1) In general. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015.

(2) Certain provisions. Except as provided in paragraph (e)(3) of this section, the final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, and paragraph (d)(2) of this section apply to contributions occurring on or after January 18, 2017, and to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(3) Election to apply the provisions described in paragraph (e)(2) of this section retroactively. The final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, and paragraph (d)(2) of this section may, by election, be applied to a contribution that occurred on or after August 6, 2015 but before January 18, 2017, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election must have been made by applying the final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, or paragraph (d)(2) of this section, as

applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017.

§1.721(c)-2T [Removed]

Par. 11. Section 1.721(c)-2T is removed.

Par. 12. Section 1.721(c)-3 is added to read as follows:

§1.721(c)-3 Gain deferral method.

(a) Scope. This section describes the gain deferral method to avoid the immediate recognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Paragraph (b) of this section provides the requirements of the gain deferral method, including the requirement to apply the consistent allocation method. Paragraph (c) of this section describes the consistent allocation method. Paragraph (d) of this section provides rules for tiered partnerships. Paragraph (e) of this section provides the dates of applicability. For definitions that apply for purposes of this section, see §1.721(c)-1(b).

(b) Requirements of the gain deferral method. A contribution of section 721(c) property to a section 721(c) partnership that would be subject to §1.721(c)-2(b) will not be subject to §1.721(c)-2(b) if the conditions in paragraphs (b)(1) through (5) of this section are satisfied with respect to that property.

(1) Either--

(i) Both--

(A) The section 721(c) partnership adopts the remedial allocation method described in §1.704-3(d) with respect to the section 721(c) property; and

(B) The section 721(c) partnership applies the consistent allocation method provided in paragraph (c) of this section; or

(ii) For the period beginning on the date of the contribution of the section 721(c) property and ending on the date on which there is no remaining built-in gain with respect to that property, all distributive shares of income and gain with respect to the section 721(c) property for all direct and indirect partners that are related foreign persons with respect to the U.S. transferor will be subject to taxation as income effectively connected with a trade or business within the United States (under either section 871 or 882), and neither the section 721(c) partnership nor a related foreign person that is a direct or indirect partner in the section 721(c) partnership claims benefits under an income tax convention that would exempt the income or gain from tax or reduce the rate of taxation to which the income or gain is subject.

(2) Upon an acceleration event, the U.S. transferor recognizes an amount of gain equal to the remaining built-in gain with respect to the section 721(c) property or an amount of gain required to be recognized under §1.721(c)-5(d) or (e), as applicable.

(3) The procedural and reporting requirements provided in §1.721(c)-6(b) are satisfied.

(4) The U.S. transferor consents to extend the period of limitations on assessment of tax as required by §1.721(c)-6(b)(5).

(5) If the section 721(c) property is a partnership interest or property described in the partnership look-through rule provided in §1.721(c)-2(d), the applicable tiered-partnership rules provided in paragraph (d) of this section are applied.

(c) Consistent allocation method--(1) In general. For each taxable year of a section 721(c) partnership in which there is remaining built-in gain in the section 721(c) property, the section 721(c) partnership must allocate each book item of income, gain, deduction, and loss with respect to the section 721(c) property to the U.S. transferor in the same percentage. For purposes of this paragraph (c)(1), upon a variation (as defined in §1.706-4(a)(1)) of a U.S. transferor's interest in a section 721(c) partnership, a book item of income, gain, deduction, and loss with respect to a section 721(c) property is treated as allocated in the same percentage if the item is allocated under the interim closing method (as described in §1.706-4), unless the variation results from a transaction undertaken with a principal purpose of avoiding the tax consequences of the gain deferral method. For exceptions to the first sentence in this paragraph (c)(1), see paragraph (c)(4) of this section.

(2) Determining income or gain with respect to section 721(c) property. For purposes of applying paragraph (c)(1) of this section, a section 721(c) partnership must attribute book income and gain to each item of section 721(c) property in a consistent manner using any reasonable method taking into account all the facts and circumstances. All items of book income and gain attributable to an item of section 721(c) property will comprise a single class of gross income for purposes of applying paragraph (c)(3) of this section.

(3) Determining deduction or loss with respect to section 721(c) property. For purposes of applying paragraph (c)(1) of this section, a section 721(c) partnership must use the principles of §§1.861-8 and 1.861-8T to allocate and apportion its items of deduction, except for interest expense and research and experimental expenditures,

and loss to the class of gross income with respect to each item of section 721(c) property as determined in paragraph (c)(2) of this section. Accordingly, a deduction or loss will be considered to be definitely related and therefore allocable to a class of gross income with respect to particular section 721(c) property whether or not there is any item of gross income in that class that is received or accrued during the taxable year and whether or not the amount of deduction or loss exceeds the amount of gross income in that class during the taxable year. If a deduction or loss is definitely related and therefore allocable to gross income attributable to more than one class of gross income of the section 721(c) partnership or if a deduction or loss is not definitely related to any class of gross income of the section 721(c) partnership, the section 721(c) partnership must apportion that deduction or loss among its classes of gross income using a reasonable method that reflects to a reasonably close extent the factual relationship between the deduction or loss and the classes of gross income. The section 721(c) partnership may allocate and apportion its interest expense and research and experimental expenditures under any reasonable method, including, but not limited to, the methods prescribed in §§1.861-9 and 1.861-9T (interest expense) and §1.861-17 (research and experimental expenditures). For purposes of this paragraph (c)(3), the section 721(c) partnership must allocate and apportion its deductions and losses without regard to the partners' percentage interests in the partnership.

(4) Exceptions to the consistent allocation method--(i) Regulatory allocations. A regulatory allocation (as defined in §1.721(c)-1(b)(10)) of book income, gain, deduction, or loss with respect to section 721(c) property that otherwise would fail to satisfy

paragraph (c)(1) of this section is nevertheless deemed to satisfy paragraph (c)(1) of this section if the allocation is--

(A) An allocation of income or gain to the U.S. transferor (or a member of its consolidated group as defined in §1.1502-1(h));

(B) An allocation of deduction or loss to a partner other than the U.S. transferor (or a member of its consolidated group); or

(C) Treated as a partial acceleration event pursuant to §1.721(c)-5(d)(2).

(ii) Allocation of creditable foreign tax expenditures. An allocation of a creditable foreign tax expenditure (as defined in §1.704-1(b)(4)(viii)(b)) is not subject to the consistent allocation method.

(d) Tiered partnership rules. This paragraph (d) provides the tiered partnership rules referred to in paragraph (b)(5) of this section.

(1) Section 721(c) property is a partnership interest. If the section 721(c) property that is contributed to a section 721(c) partnership is an interest in a partnership (lower-tier partnership), then the lower-tier partnership, if it is a controlled partnership with respect to the U.S. transferor, and each partnership in which an interest is owned (directly or indirectly through one or more partnerships) by the lower-tier partnership and that is a controlled partnership with respect to the U.S. transferor, must satisfy the requirements of paragraphs (d)(1)(i), (ii), and (iii) of this section.

(i) The partnership must revalue all its property under §1.704-1(b)(2)(iv)(f)(6) if the revaluation would result in a separate positive difference between book value and adjusted tax basis in at least one property that is not excluded property.



(ii) The partnership must apply the gain deferral method for each property (other than excluded property) for which there is a separate positive difference between book value and adjusted tax basis resulting from the revaluation described in paragraph (d)(1) of this section (new positive reverse section 704(c) layer). If the partnership has previously adopted a section 704(c) method other than the remedial allocation method for the property, the partnership satisfies the requirement of paragraph (b)(1)(i)(A) of this section by adopting the remedial allocation method for the new positive reverse section 704(c) layer.

(iii) The partnership must treat a partner that is a partnership in which the U.S. transferor is a direct or indirect partner as if it were the U.S. transferor with respect to the section 721(c) property solely for purposes of applying the consistent allocation method.

(2) Section 721(c) property is indirectly contributed by a U.S. transferor under the partnership look-through rule. If the U.S. transferor is a direct or indirect partner in the upper-tier partnership described in §1.721(c)-2(d)(1), and under §1.721(c)-2(d)(1), the U.S. transferor is treated as contributing the section 721(c) property (including an interest in a partnership described in paragraph (d)(1) of this section) to a section 721(c) partnership, then the requirements of paragraphs (d)(2)(i), (ii), and (iii) of this section must be satisfied.

(i) The section 721(c) partnership must treat the upper-tier partnership as the U.S. transferor of the section 721(c) property solely for purposes of applying the consistent allocation method;

(ii) The upper-tier partnership, if it is a controlled partnership with respect to the U.S. transferor, must apply the gain deferral method to its interest in the section 721(c) partnership; and

(iii) If the U.S. transferor is an indirect partner in the upper-tier partnership through one or more partnerships, the principles of paragraphs (d)(2)(i) and (ii) of this section must be applied with respect to those partnerships that are controlled partnerships with respect to the U.S. transferor.

(e) Applicability dates--(1) In general. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015.

(2) Certain provisions. Except as provided in paragraph (e)(3) of this section, paragraphs (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (d)(1) and (2) of this section apply to contributions occurring on or after January 18, 2017, and to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017. Except as provided in paragraph (e)(3) of this section, the second sentence of paragraph (c)(1) of this section applies to contributions occurring on or after **[INSERT DATE OF FILING WITH THE FEDERAL REGISTER]**.

(3) Election to apply the provisions described in paragraph (e)(2) of this section retroactively. Paragraphs (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (d)(1) and (2) of this section may, by election, be applied to a contribution that occurred on or after

August 6, 2015 but before January 18, 2017, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election described in the preceding sentence must have been made by applying paragraph (b)(1)(ii), (c)(2) or (3), (c)(4)(i) or (ii), or (d)(1) or (2) of this section, as applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017. In order to elect to apply paragraph (c)(2) or (3) of this section to a contribution described in this paragraph (e)(3), an election must also have been made to apply paragraph (c)(3) or (2) of this section, respectively, to the contribution. The second sentence of paragraph (c)(1) of this section, may, by election, be applied to a contribution that occurred on or after August 6, 2015 but before **[INSERT DATE OF FILING WITH THE FEDERAL REGISTER]**, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election described in the preceding sentence must be made by applying the second sentence of paragraph (c)(1) of this section to the contribution on a timely filed original return (including extensions) or an amended return filed no later than July 17, 2020.

(4) Transitional rules. If a contribution is described in paragraph (e)(2) of this section and no election described in paragraph (e)(3) of this section is made to apply one or more of paragraphs (c)(2) and (3) and (c)(4)(i) and (ii) of this section, as applicable, to the contribution, then, for purposes of paragraph (c)(1) of this section, the section 721(c) partnership must attribute book income, gain, loss, and deduction to the

section 721(c) property in a consistent manner under any reasonable method taking into account all the facts and circumstances. If a contribution is described in paragraph (e)(2) of this section and no election described in paragraph (e)(3) of this section is made to apply paragraph (d)(1) or (2) of this section, as applicable, to the contribution, then, this section must be applied in a manner consistent with the purpose of the section 721(c) regulations. Thus, for example, if a U.S. transferor is a direct or indirect partner in a partnership and that partnership contributes section 721(c) property to a lower-tier partnership, or, if a U.S. transferor contributes an interest in a partnership that owns section 721(c) property to a lower-tier partnership, then paragraph (b) of this section applies as though the U.S. transferor contributed its share of the section 721(c) property directly.

§1.721(c)-3T [Removed]

Par. 13. Section 1.721(c)-3T is removed.

Par. 14. Section 1.721(c)-4 is added to read as follows:

§1.721(c)-4 Acceleration events.

(a) Scope. This section provides rules regarding acceleration events for purposes of applying the gain deferral method. Paragraph (b) of this section defines an acceleration event. Paragraph (c) of this section provides the consequences of an acceleration event. Paragraph (d) of this section provides the dates of applicability. For definitions that apply for purposes of this section, see §1.721(c)-1(b).

(b) Definition of an acceleration event--(1) General rules. Except as provided in this paragraph (b) and §1.721(c)-5 (acceleration event exceptions), an acceleration event with respect to section 721(c) property is any event that either would reduce the

amount of remaining built-in gain that a U.S. transferor would recognize under the gain deferral method if the event had not occurred or could defer the recognition of the remaining built-in gain. An acceleration event includes a contribution of section 721(c) property to another partnership by a section 721(c) partnership and a contribution of an interest in a section 721(c) partnership to another partnership. This paragraph (b) applies on a property-by-property basis.

(2) Failure to comply with a requirement of the gain deferral method--(i) General rule. An acceleration event with respect to section 721(c) property occurs when any party fails to comply with a condition of the gain deferral method with respect to the section 721(c) property.

(ii) Certain failures to comply with procedural and reporting requirements. Notwithstanding paragraph (b)(2)(i) of this section, an acceleration event will not occur solely as a result of a failure to comply with a requirement of §1.721(c)-3(b)(3) that is not willful. See §§1.721(c)-6(f) and 1.6038B-2(h)(3).

(3) Lower-tier partnership allocations. Notwithstanding paragraph (b)(1) of this section, an acceleration event will not occur because of a reduction in remaining built-in gain in an interest in a partnership that is section 721(c) property that occurs as a result of allocations of book items of deduction and loss, or tax items of income and gain.

(4) Deemed acceleration event. A U.S. transferor may treat an acceleration event as having occurred with respect to section 721(c) property by both recognizing gain in an amount equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold the section 721(c) property immediately before the deemed acceleration event for fair market value and satisfying

the reporting required by §1.721(c)-6(b)(3)(i)(D). In this case, see paragraph (c) of this section regarding basis adjustments.

(c) Consequences of an acceleration event. Paragraphs (c)(1) and (2) of this section provide the consequences of an acceleration event with respect to section 721(c) property, a partial acceleration event with respect to section 721(c) property to the extent provided in §1.721(c)-5(d)(1), and a transfer described in section 367 of section 721(c) property to the extent provided in §1.721(c)-5(e).

(1) U.S. transferor. The U.S. transferor must recognize gain in an amount equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold the section 721(c) property immediately before the acceleration event for fair market value. The U.S. transferor will increase its basis in its partnership interest by the amount of gain recognized. If the U.S. transferor is an indirect partner in the section 721(c) partnership through one or more tiered partnerships, appropriate basis adjustments will be made to the interests in the tiered partnerships.

(2) Section 721(c) partnership. The section 721(c) partnership will increase its basis in the section 721(c) property by the amount of built-in gain recognized by the U.S. transferor under paragraph (c)(1) of this section. Any tax consequences of the acceleration event will be determined taking into account the increase in the partnership's adjusted tax basis in the section 721(c) property. If the section 721(c) property remains in the partnership after the acceleration event, the increase in basis of the section 721(c) property may be recovered using any applicable recovery period and depreciation (or other cost recovery) method (including first-year conventions) available

to the partnership for newly purchased property of the same type placed in service on the date of the acceleration event. The section 721(c) property will no longer be subject to the gain deferral method.

(d) Applicability dates. This section applies to contributions occurring on or after August 6, 2015, and to contributions that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015.

§1.721(c)-4T [Removed]

Par. 15. Section 1.721(c)-4T is removed.

Par. 16. Section 1.721(c)-5 is added to read as follows:

§1.721(c)-5 Acceleration event exceptions.

(a) Scope. This section identifies exceptions to the acceleration events, which, like the rules regarding acceleration events provided in §1.721(c)-4(b), apply on a property-by-property basis. Paragraph (b) of this section identifies the events that terminate the requirement to apply the gain deferral method. Paragraph (c) of this section identifies the successor events that allow for the continued application of the gain deferral method. Paragraph (d) of this section identifies the partial acceleration events. Paragraph (e) of this section provides special rules for transfers of section 721(c) property to a foreign corporation described in section 367. Paragraph (f) of this section allows for the continued application of the gain deferral method if there is a fully taxable disposition of a portion of an interest in a partnership. Paragraph (g) of this section provides the dates of applicability. For definitions that apply for purposes of this section, see §1.721(c)-1(b).

(b) Termination events--(1) In general. Notwithstanding §1.721(c)-4(b)(1), a termination event with respect to section 721(c) property will not constitute an acceleration event. In these cases, the section 721(c) property will no longer be subject to the gain deferral method.

(2) Transfers of section 721(c) property (other than a partnership interest) to a domestic corporation described in section 351. A termination event occurs if a section 721(c) partnership transfers section 721(c) property (other than an interest in a partnership) to a domestic corporation in a transaction to which section 351 applies.

(3) Certain incorporations of a section 721(c) partnership. A termination event occurs upon an incorporation of a section 721(c) partnership into a domestic corporation by any method of incorporation (other than a method involving an actual distribution of partnership property to the partners, followed by a contribution of that property to a corporation), provided that the section 721(c) partnership is liquidated as part of the incorporation transaction.

(4) Certain distributions of section 721(c) property. A termination event occurs if a section 721(c) partnership distributes section 721(c) property either to the U.S. transferor or, if the U.S. transferor is a member of a consolidated group (as defined in §1.1502-1(h)) at the time of the distribution and the distribution occurs outside the seven-year period described in section 704(c)(1)(B), to a member of the consolidated group.

(5) Partnership ceases to have a partner that is a related foreign person. A termination event occurs when a section 721(c) partnership ceases to have any direct or indirect partners that are related foreign persons with respect to the U.S. transferor,



provided there is no plan for a related foreign person to subsequently become a direct or indirect partner in the partnership (or a successor). This paragraph (b)(5) does not apply to a distribution of section 721(c) property in redemption of a related foreign person's interest in a section 721(c) partnership.

(6) Fully taxable dispositions of section 721(c) property. A termination event occurs if a section 721(c) partnership disposes of section 721(c) property in a transaction in which all gain or loss, if any, is recognized.

(7) Fully taxable dispositions of an entire interest in a section 721(c) partnership. A termination event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of its entire interest in a section 721(c) partnership that owns the section 721(c) property in a transaction in which all gain or loss, if any, is recognized. This paragraph (b)(7) does not apply if a U.S. transferor is a member of a consolidated group (as defined in §1.1502-1(h)) and the interest in the section 721(c) partnership is transferred in an intercompany transaction (as defined in §1.1502-13(b)(1)); see paragraph (c)(3) of this section for a successor event rule applicable to these intercompany transactions.

(c) Successor events--(1) In general. Notwithstanding §1.721(c)-4(b)(1), a successor event with respect to section 721(c) property will not constitute an acceleration event. If a portion of an interest in a partnership is transferred in a successor event described in this paragraph (c), the principles of §1.704-3(a)(7) apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest that is transferred and the portion of the interest that is retained.

(2) Transfers of an interest in a section 721(c) partnership by a U.S. transferor or upper-tier partnership to a domestic corporation in certain nonrecognition transactions.

A successor event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to a domestic corporation in a transaction to which section 351 or 381 applies, and the gain deferral method is continued by treating the transferee domestic corporation as the U.S. transferor for purposes of the section 721(c) regulations. If the transfer described in this paragraph (c)(2) also results in a termination under section 708(b)(1)(B) of the section 721(c) partnership, see paragraph (c)(4) of this section.

(3) Transfers of an interest in a section 721(c) partnership in an intercompany transaction. A successor event occurs if a U.S. transferor that is a member of a consolidated group (as defined in §1.1502-1(h)) transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership in an intercompany transaction (as defined in §1.1502-13(b)(1)), and the gain deferral method is continued by treating the transferee member as the U.S. transferor for purposes of the section 721(c) regulations. If the transfer described in this paragraph (c)(3) also results in a termination under section 708(b)(1)(B) of the section 721(c) partnership, see paragraph (c)(4) of this section.

(4) Termination under section 708(b)(1)(B) of a section 721(c) partnership. A successor event occurs if there is a termination under section 708(b)(1)(B) of a section 721(c) partnership, and the gain deferral method is continued by treating the new

partnership as the section 721(c) partnership for purposes of the section 721(c) regulations.

(5) Transactions involving tiered partnerships--(i) Contributions of section 721(c) property to a lower-tier partnership. A successor event occurs if a section 721(c) partnership contributes the section 721(c) property to a partnership that is a controlled partnership with respect to the U.S. transferor (lower-tier section 721(c) partnership) and the requirements of paragraphs (c)(5)(i)(A) through (C) of this section are satisfied.

(A) The lower-tier section 721(c) partnership is a section 721(c) partnership or is treated as a section 721(c) partnership.

(B) The gain deferral method is applied with respect to the section 721(c) property in the hands of the lower-tier section 721(c) partnership.

(C) The gain deferral method is applied with respect to the section 721(c) partnership's interest in the lower-tier section 721(c) partnership. See §1.721(c)-3(b)(5) and (d)(2).

(ii) Contributions of an interest in a section 721(c) partnership to an upper-tier partnership. A successor event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner contributes (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to a partnership that is a controlled partnership with respect to the U.S. transferor (upper-tier section 721(c) partnership) and the requirements of paragraphs (c)(5)(ii)(A) through (D) of this section are satisfied.

(A) The gain deferral method is continued with respect to the section 721(c) property in the hands of the section 721(c) partnership.

(B) The upper-tier section 721(c) partnership is, or is treated as, a section 721(c) partnership.

(C) If the upper-tier section 721(c) partnership directly owns its interest in the section 721(c) partnership, the gain deferral method is applied with respect to the upper-tier section 721(c) partnership's interest in the section 721(c) partnership. See §1.721(c)-3(b)(5) and (d)(1).

(D) If the upper-tier section 721(c) partnership indirectly owns its interest in the section 721(c) partnership through one or more partnerships, the principles of paragraphs (c)(5)(ii)(B) and (C) of this section are applied with respect to each partnership through which the upper-tier section 721(c) partnership indirectly owns an interest in the section 721(c) partnership.

(d) Partial acceleration events--(1) In general. Notwithstanding §1.721(c)-4, a partial acceleration event with respect to section 721(c) property does not constitute an acceleration event. In these cases, except as provided in paragraph (d)(3) of this section, the rules in §1.721(c)-4(c) (concerning the consequences of an acceleration event) for making basis adjustments apply to the extent that the U.S. transferor is required to recognize gain under paragraph (d)(2) or (3) of this section. Furthermore, if there is remaining built-in gain with respect to the section 721(c) property after the application of this paragraph (d), the application of the gain deferral method with respect to the section 721(c) property must be continued in the same manner.

(2) Regulatory allocations. If a regulatory allocation is described in §1.721(c)-3(c)(4)(i) but not in §1.721(c)-3(c)(4)(i)(A) or (B), a partial acceleration event occurs with respect to section 721(c) property if the U.S. transferor recognizes an

amount of gain (but not in excess of remaining built-in gain) equal to the amount of the allocation that, under the consistent allocation method, had the regulatory allocation not occurred, would have been allocated to the U.S. transferor in the case of income or gain, or would not have been allocated to the U.S. transferor in the case of deduction or loss.

(3) Certain distributions of other partnership property to a partner that result in an adjustment under section 734. A partial acceleration event occurs with respect to section 721(c) property if there is a distribution of other property by the section 721(c) partnership that results in a positive basis adjustment to the section 721(c) property under section 734. In these cases, the U.S. transferor must recognize an amount of gain (but not in excess of the remaining built-in gain) equal to the positive basis adjustment to the section 721(c) property under section 734, reduced (but not below zero) by the amount of gain recognized by the U.S. transferor (or a member of its consolidated group (as defined in §1.1502-1(h))) under section 731(a). In these cases, the partnership will not increase its basis under §1.721(c)-4(c)(2) by the amount of gain recognized by the U.S. transferor.

(e) Transfers described in section 367 of section 721(c) property to a foreign corporation. If a section 721(c) partnership transfers section 721(c) property, or a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) all or a portion of an interest in a section 721(c) partnership that owns section 721(c) property, to a foreign corporation in a transaction described in section 367, then the property will no longer be subject to the gain deferral method. To the extent any U.S. transferor is treated as

transferring the section 721(c) property to the foreign corporation for purposes of section 367, the tax consequences will be determined under section 367. In this regard, see §§1.367(a)-1T(c)(3)(i) and (ii), 1.367(d)-1T(d)(1), and 1.367(e)-2(b)(1)(iii) (providing for the aggregate treatment of partnerships). However, for the remaining portion of the property (if any), the U.S. transferor must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold that portion of the section 721(c) property immediately before the transfer for fair market value. The stock in the transferee foreign corporation received will not be subject to the gain deferral method. The rules in §1.721(c)-4(c) (concerning the consequences of an acceleration event) for making basis adjustments will apply to the extent that the U.S. transferor recognizes gain under this paragraph (e).

(f) Fully taxable dispositions of a portion of an interest in a partnership. If a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of (directly or indirectly through one or more partnerships) a portion of an interest in a section 721(c) partnership in a transaction in which all gain or loss, if any, is recognized, an acceleration event will not occur with respect to the portion of the interest transferred. The gain deferral method will continue to apply with respect to the section 721(c) property of the section 721(c) partnership. The principles of §1.704-3(a)(7) will apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest in a section 721(c) partnership that is retained. This paragraph (f) will not apply to an intercompany transaction (as defined in §1.1502-13(b)(1)).

(g) Applicability dates--(1) In general. Except as provided in paragraph (g)(2) of this section, this section applies to contributions occurring on or after January 18, 2017, and to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(2) Election to apply this section retroactively. This section may, by election, be applied to a contribution that occurred on or after August 6, 2015 but before January 18, 2017, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. The election must have been made by applying this section to the contribution on a timely filed original return (including extensions) or an amended return filed no later than July 18, 2017.

§1.721(c)-5T [Removed]

Par. 17. Section 1.721(c)-5T is removed.

Par. 18. Section 1.721(c)-6 is added to read as follows

§1.721(c)-6 Procedural and reporting requirements.

(a) Scope. This section provides procedural and reporting requirements that must be satisfied under §1.721(c)-3(b)(3) of the gain deferral method. Paragraph (b) of this section describes the procedural and reporting requirements of a U.S. transferor. Paragraph (c) of this section describes information required to be reported with respect to related foreign persons and partnerships. Paragraph (d) of this section describes the procedural and reporting requirements of a section 721(c) partnership with a section 6031 filing obligation. Paragraph (e) of this section provides the proper signatory for the

information provided under this section. Paragraph (f) of this section provides relief for certain failures to comply that are not willful. Paragraph (g) of this section provides the dates of applicability. For definitions that apply for purposes of this section, see §1.721(c)-1(b).

(b) Procedural and reporting requirements of a U.S. transferor--(1) In general.

This paragraph (b) describes the procedural and reporting requirements that a U.S. transferor (as defined §1.721(c)-1(b)(18)(i)) must satisfy in applying the gain deferral method. The information required under this paragraph (b) must be included with the U.S. transferor's timely filed return on (or attached to) the appropriate forms or schedules (or their successors) and must be submitted in the form and manner and to the extent prescribed by the forms and schedules (and their accompanying instructions).

(2) Reporting of a gain deferral contribution. A U.S. transferor must report the following information with respect to a gain deferral contribution:

(i) On Schedule A-1, Certain Foreign Partners, Schedule A-2, Foreign Partners of Section 721(c) Partnership, Schedule G, Statement of Application of the Gain Deferral Method Under Section 721(c), and Schedule H, Acceleration Events and Exceptions Reporting Relating to Gain Deferral Method Under Section 721(c) (for each such Schedule, with respect to Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships), as applicable, the following information with respect to the section 721(c) property--

- (A) A description of the property and recovery period (or periods) for the property;
- (B) Whether the property is an intangible described in section 197(f)(9);



(C) A calculation of the built-in gain, the basis, and fair market value on the date of the contribution, including the amount of gain recognized by the U.S. transferor, if any, on the gain deferral contribution;

(D) The name, U.S. taxpayer identification number (if any), address, and country of organization (if any) of each direct or indirect partner in the section 721(c) partnership that is a related person with respect to the U.S. transferor, and a description of each partner's interest in capital and profits immediately after the gain deferral contribution; and

(E) When the section 721(c) property is a partnership interest, the information described in paragraphs (b)(2)(i)(A) through (D) of this section with respect to each property of a lower-tier partnership to which the gain deferral method is applied under §1.721(c)-3(d)(1);

(ii) On Form 8838-P, Consent To Extend the Time To Assess Tax Pursuant to the Gain Deferral Method (Section 721(c)), an extension of the period of limitations on the assessment of tax as described in paragraph (b)(5) of this section;

(iii) A copy of the waiver of treaty benefits described in paragraph (c)(1) of this section (if any);

(iv) On Schedule A-1, Schedule A-2, and Schedule G (for each such Schedule, with respect to Form 8865), as applicable, information relating to the section 721(c) partnership described in paragraph (c)(2) of this section (if any);

(v) On, Schedule O, Transfer of Property to a Foreign Partnership (Form 8865) with respect to any foreign partnership, (or partnership treated as foreign under

paragraph (b)(4) of this section), the information required under §1.6038B-2(c)(1) through (7); and

(vi) The information required under paragraph (b)(3) of this section.

(3) Annual reporting relating to gain deferral method. A U.S. transferor must annually report information for each gain deferral contribution. The information reported must be with respect to the partnership taxable year that ends with, or within, the taxable year of the U.S. transferor, beginning with the partnership's taxable year that includes the date of the gain deferral contribution and ending with the last taxable year in which the gain deferral method is applied to the section 721(c) property. The information reported must include:

(i) For each deferral contribution, the U.S. transferor must report the following information on Schedule G and Schedule H (for each Schedule, with respect to Form 8865), as applicable:

(A) The amount of book income, gain, deduction, and loss and tax items allocated to the U.S. transferor with respect to the section 721(c) property, including a description of any regulatory allocations;

(B) The proportion (expressed as a percentage) in which the book income, gain, deduction, and loss with respect to the section 721(c) property was allocated among the U.S. transferor and related persons that are partners in the section 721(c) partnership under the consistent allocation method;

(C) The amount of remaining built-in gain at the beginning of the taxable year, the remedial income allocated to the U.S. transferor under the remedial allocation method, the amount of built-in gain taken into account by reason of an acceleration

event or partial acceleration event (if any), the partnership's adjustment to its tax basis in the section 721(c) property, and the remaining built-in gain at the end of the taxable year;

(D) A declaration stating whether an acceleration event or partial acceleration event occurred during the taxable year, the date of the event, and a description of the event (including a citation to the relevant paragraph of §1.721(c)-5(d) in the case of a partial acceleration event, and whether the acceleration event is described in §1.721(c)-4(b)(4));

(E) A description of a termination event or any successor event that occurred during the taxable year with a citation to the relevant paragraph of §1.721(c)-5(b) or (c), the date of the event, and, in the case of a successor event, the name, address, and U.S. taxpayer identification number (if any) of any successor partnership, lower-tier partnership, upper-tier partnership, or U.S. corporation (as applicable);

(F) A description of all transfers of section 721(c) property to a foreign corporation described in §1.721(c)-5(e) that occurred during the taxable year, and for each transfer, the date of the transfer, the section 721(c) property transferred, and the name, address, and U.S. taxpayer identification number (if any) of the foreign transferee corporation; and

(G) With respect to section 721(c) property for which a waiver of treaty benefits was filed under paragraph (b)(2)(iii) of this section, a declaration that, after exercising reasonable diligence, to the best of the U.S. transferor's knowledge and belief, all income from the section 721(c) property allocated to the partners during the taxable year remained subject to taxation as income effectively connected with the conduct of a

trade or business within the United States (under either section 871 or 882) for all direct or indirect partners that are related foreign persons with respect to the U.S. transferor (regardless of whether any such partner was a partner at the time of the gain deferral contribution), and, that neither the partnership nor any such partner has made any claim under any income tax convention to an exemption from U.S. income tax or a reduced rate of U.S. income taxation on income derived from the use of the section 721(c) property;

(ii) On Form 8838-P, an extension of the period of limitations on the assessment of tax, in the case of a gain deferral contribution, as described in paragraph (b)(5)(ii) of this section, and, in the case of certain contributions on which gain is recognized, as described in paragraph (b)(5)(iii) of this section;

(iii) If the section 721(c) partnership is a partnership that does not have a filing obligation under section 6031, the information described in §1.6038-3(g) (contents of information returns required of certain United States persons with respect to controlled foreign partnerships), if not already reported elsewhere, without regard to whether the section 721(c) partnership is a controlled foreign partnership within the meaning of section 6038. If the U.S. transferor is not a controlling fifty-percent partner (as defined in §1.6038-3(a)), the U.S. transferor complies with the requirement of this paragraph (b)(3)(iii) by providing the information described in §1.6038-3(g)(1);

(iv) On Schedule O (Form 8865), a description of all section 721(c) property contributed by the U.S. transferor to the section 721(c) partnership (including pursuant to a contribution described in §1.721(c)-2(d)(1)) during the taxable year to which the gain deferral method is not applied; and

(v) The information required in paragraphs (c)(2) and (3) of this section for related foreign persons that are direct or indirect partners in the section 721(c) partnership and the section 721(c) partnership itself (if any).

(4) Domestic partnerships treated as foreign. Solely for purposes of this section, a U.S. transferor must treat a domestic section 721(c) partnership as a foreign partnership if the partnership was formed on or after January 18, 2017. If the section 721(c) partnership has an information return filing obligation under section 6031, that requirement is not affected by the requirement of this paragraph (b)(4) that the U.S. transferor treat the partnership as a foreign partnership.

(5) Extension of period of limitations on assessment of tax. In order to comply with the gain deferral method, a U.S. transferor must extend the period of limitations on the assessment of tax using Form 8838-P:

(i) With respect to the gain realized but not recognized on a gain deferral contribution, through the date that is 96 months after the close of the U.S. transferor's taxable year that includes the date of the gain deferral contribution;

(ii) With respect to all book and tax items with respect to the section 721(c) property allocated to the U.S. transferor in the partnership's taxable year that includes the date of the gain deferral contribution and the subsequent two years, through the date that is 72 months after the close of such taxable year with which, or within which, the partnership's taxable year ends; and

(iii) With respect to the gain recognized on a contribution of section 721(c) property to a section 721(c) partnership for which the gain deferral method is not applied, if the contribution occurs within five partnership taxable years following a

partnership taxable year that includes the date of a gain deferral contribution, through the date that is 60 months after the close of the U.S. transferor's taxable year that includes the date of the contribution on which gain is recognized.

(c) Information with respect to section 721(c) partnerships and related foreign persons--(1) Effectively connected income. If the gain deferral method is applied with respect to a contribution of section 721(c) property that satisfies the condition in §1.721(c)-3(b)(1)(ii), the U.S. transferor must obtain a statement from the section 721(c) partnership and from each related foreign person that is a direct or indirect partner in the section 721(c) partnership, titled "Statement of Waiver of Treaty Benefits under §1.721(c)-6," pursuant to which the partner and the partnership waive any claim under any income tax convention (whether or not currently in force at the time of the contribution) to an exemption from U.S. income tax or a reduced rate of U.S. income taxation on income derived from the use of the section 721(c) property for the period during which the section 721(c) property is subject to the gain deferral method.

(2) Partnerships in tiered-partnership structures applying the gain deferral method. If the gain deferral method is applied as a result of a transaction described in §1.721(c)-3(d), the U.S. transferor must supply all the information that a section 721(c) partnership would be required to report under paragraph (b) of this section if the section 721(c) partnership were a U.S. transferor.

(3) Schedules K-1 for related foreign partners. If a section 721(c) partnership does not have a filing obligation under section 6031, the U.S. transferor must obtain a Schedule K-1 (Form 8865), Partner's Share of Income, Deduction, Credits, etc., for all

related foreign persons that are direct or indirect partners in the section 721(c) partnership.

(d) Reporting and procedural requirements of a section 721(c) partnership with a section 6031 filing obligation--(1) Waiver of treaty benefits. A section 721(c) partnership with a return filing obligation under section 6031 must include its waiver of treaty benefits described in paragraph (c)(1) of this section with its tax return for the taxable year that includes the date of the gain deferral contribution.

(2) Information on Schedule K-1. A section 721(c) partnership with a return filing obligation under section 6031 must provide the relevant information necessary for the U.S. transferor to comply with the requirements in paragraphs (b)(2) and (3) of this section (using the Forms and Schedules specified in paragraphs (b)(2) and (3) of this section) with the U.S. transferor's Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc. The partnership must also attach a Schedule K-1 (Form 1065) to its Form 1065 for each direct or indirect partner that is a related foreign person with respect to the U.S. transferor.

(e) Signatory. Any statements required in this section must be signed under penalties of perjury by an agent of the U.S. transferor, the related foreign person that is a direct or indirect partner in the section 721(c) partnership, or the section 721(c) partnership, as applicable, that is authorized to sign under a general or specific power of attorney, or by an appropriate party. For the U.S. transferor, an appropriate party is a person described in §1.367(a)-8(e)(1). For a partnership with a section 6031 filing obligation, an appropriate party is any party authorized to sign Form 1065.

(f) Relief for certain failures to file or failures to comply that are not willful--(1) In general. This paragraph (f)(1) provides relief from the failure to comply with the procedural and reporting requirements of the gain deferral method prescribed by §1.721(c)-3(b)(3) and provided in paragraph (b) of this section if there is a failure to file or to include information required by this section (failure to comply). A failure to comply will be deemed not to have occurred for purposes of §1.721(c)-3(b)(3) if the U.S. transferor demonstrates that the failure was not willful using the procedure provided in this paragraph (f). For purposes of this paragraph (f), willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to comply was willful will be determined by the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director) based on all the facts and circumstances. The U.S. transferor must submit a request for relief and an explanation as provided in paragraph (f)(2) of this section. A U.S. transferor whose failure to comply is determined not to be willful under this paragraph (f) will be subject to a penalty under section 6038B if it fails to satisfy the applicable reporting requirements under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect. See §1.6038B-2(h). The determination of whether the failure to comply was willful under this section has no effect on any request for relief made under §1.6038B-2(h).

(2) Procedures for establishing that a failure to comply was not willful--(i) Time and manner of submission. A U.S. transferor's statement that a failure to comply was



not willful will be considered only if, promptly after the U.S. transferor becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section as well as a written statement explaining the reasons for the failure to comply. The U.S. transferor also must file, with the amended return, a Schedule O (Form 8865) and Form 8838-P (as described in paragraph (b)(5) of this section), completed and executed as prescribed in forms and instructions, consenting to extend the period of limitations on assessment of tax with respect to the gain realized but not recognized on the gain deferral contribution to the later of the date that is 96 months after the close of the U.S. transferor's taxable year that includes the date of the gain deferral contribution (date one), or the date that is 36 months after the date on which the required information is provided to the Director (date two). However, the U.S. transferor is not required to file a Schedule O (Form 8865), with the amended return if both date one is later than date two and a consent to extend the period of limitations on assessment of tax with respect to the gain realized but not recognized on the gain deferral contribution for the U.S. transferor's taxable year that includes the date of the contribution was previously submitted with a Schedule O (Form 8865). The amended return and either a Schedule O (Form 8865) or a copy of the previously filed Schedule O (Form 8865), as the case may be, must be filed with the Internal Revenue Service at the location where the U.S. transferor filed its original return. The U.S. transferor may submit a request for relief from the penalty under section 6038B as part of the same submission. See §1.6038B-2(h)(3).

(ii) Notice requirement. In addition to the requirements of paragraph (f)(2)(i) of this section, the U.S. transferor must comply with the notice requirements of this paragraph (f)(2)(ii). If any taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return must be delivered to the Director.

(g) Applicability dates--(1) In general. Except as provided in paragraphs (g)(2) and (3) of this section, this section applies with respect to contributions occurring on or after January 18, 2017, and with respect to contributions that occurred before January 18, 2017 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before January 18, 2017 but was filed on or after January 18, 2017.

(2) Reporting relating to effectively connected income. Paragraphs (b)(2)(iii), (b)(3)(i)(G), and (d)(1) of this section apply to a contribution occurring on or after August 6, 2015, and to a contribution that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015, and, in either case, provided §1.721(c)-3(b)(1)(ii) applies to the contribution. To the extent that a previously filed return did not comply with paragraph (b)(2)(iii), (b)(3)(i)(G), or (d)(1) of this section, an amended return complying with such paragraphs must have been filed no later than July 18, 2017.

(3) Transition rules--(i) Reporting under sections 6038, 6038B, and 6046A. For transfers occurring on or after August 6, 2015, and for transfers that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015, a U.S. transferor (or a domestic partnership in which a U.S. transferor is a direct or indirect partner) must fulfill any reporting requirements imposed under sections 6038, 6038B, and 6046A with respect to the contribution of the section 721(c) property to the section 721(c) partnership.

(ii) Reporting using statements instead of prescribed forms and schedules. For tax returns filed before [INSERT DATE 60 DAYS AFTER DATE FILING WITH IN THE **FEDERAL REGISTER**], reporting that met the requirements of §1.721(c)-6T (see 26 CFR part 1, revised as of April 1, 2019) as in effect before January 1, 2020, will be deemed to satisfy the corresponding requirements of this section.

§1.721(c)-6T [Removed]

Par. 19. Section 1.721(c)-6T is removed.

Par. 20. Section 1.721(c)-7 is added to read as follows:

§1.721(c)-7 Examples.

(a) Presumed facts. For purposes of the examples in paragraph (b) of this section, assume that there are no other transactions that are related to the transactions described in the examples and that all partnership allocations have substantial economic effect under section 704(b). For definitions that apply for purposes of this section, see §1.721(c)-1(b). Except where otherwise indicated, the following facts are presumed--

(1) USP and USX are domestic corporations that each use a calendar taxable year. USX is not a related person with respect to USP.

(2) CFC1, CFC2, FX, and FY are foreign corporations.

(3) USP wholly owns CFC1 and CFC2. Neither FX nor FY is a related person with respect to USP or with respect to each other.

(4) PRS1, PRS2, and PRS3 are foreign entities classified as partnerships for U.S. tax purposes. A partnership interest in PRS1, PRS2, and PRS3 is not described in section 475(c)(2).

(5) A taxable year is referred to, for example, as year 1.

(6) A partner in a partnership has the same percentage interest in income, gain, loss, deduction, and capital of the partnership.

(7) No property is described in section 197(f)(9) in the hands of a contributing partner.

(8) No partnership is a controlled partnership solely under the facts and circumstances test in §1.721(c)-1(b)(4).

(b) Examples. The application of the rules stated in §§1.721(c)-1 through 1.721(c)-6 may be illustrated by the following examples:

(1) Example 1: Determining if a partnership is a section 721(c) partnership--  
(i) Facts. In year 1, USP and CFC1 form PRS1 as equal partners. CFC1 contributes cash of \$1.5 million to PRS1, and USP contributes three properties to PRS1: a patent with a book value of \$1.2 million and an adjusted tax basis of zero, a security (within the meaning of section 475(c)(2)) with a book value of \$100,000 and an adjusted tax basis of \$20,000, and a machine with a book value of \$200,000 and an adjusted tax basis of \$600,000.

(ii) Results. (A) Under §1.721(c)-1(b)(18)(i), USP is a U.S. transferor because USP is a U.S. person and not a domestic partnership. Under §1.721(c)-1(b)(2), the patent has built-in gain of \$1.2 million. The patent is not excluded property under §1.721(c)-1(b)(6). Therefore, under §1.721(c)-1(b)(15)(i), the patent is section 721(c)

property because it is property, other than excluded property, with built-in gain that is contributed by a U.S. transferor, USP.

(B) Under §1.721(c)-1(b)(2), the security has built-in gain of \$80,000. Under §1.721(c)-1(b)(6)(ii), the security is excluded property because it is described in section 475(c)(2). Therefore, the security is not section 721(c) property.

(C) The tax basis of the machine exceeds its book value. Under §1.721(c)-1(b)(6)(iii), the machine is excluded property and therefore is not section 721(c) property.

(D) Under §1.721(c)-1(b)(12), CFC1 is a related person with respect to USP, and under §1.721(c)-1(b)(11), CFC1 is a related foreign person. Because USP and CFC1 collectively own at least 80 percent of the interests in the capital, profits, deductions, or losses of PRS1, under §1.721(c)-1(b)(14)(i), PRS1 is a section 721(c) partnership upon the contribution by USP of the patent.

(E) The de minimis exception described in §1.721(c)-2(c) does not apply to the contribution because during PRS1's year 1 the sum of the built-in gain with respect to all section 721(c) property contributed in year 1 to PRS1 is \$1.2 million, which exceeds the de minimis threshold of \$1 million. As a result, under §1.721(c)-2(b), section 721(a) does not apply to USP's contribution of the patent to PRS1, unless the requirements of the gain deferral method are satisfied.

(2) Example 2: Determining if partnership interest is section 721(c) property--

(i) Facts. In year 1, USP and FX form PRS2. USP contributes a security (within the meaning of section 475(c)(2)) with a book value of \$100,000 and an adjusted tax basis of \$20,000 and a building located in country X with a book value of \$30,000 and an adjusted tax basis of \$8,000 in exchange for a 40-percent interest. FX contributes a machine with a book value of \$195,000 and an adjusted tax basis of \$250,000 in exchange for a 60-percent interest.

(ii) Results. PRS2 is not a section 721(c) partnership because FX is not a related person with respect to USP. USP's contributions to PRS2 are not subject to §1.721(c)-2(b).

(iii) Alternative facts and results. (A) The facts are the same as in paragraph (b)(2)(i) of this section (the facts in Example 2). In addition, USP and CFC1 form PRS1 as equal partners. CFC1 contributes cash of \$130,000 to PRS1, and USP contributes its 40-percent interest in PRS2.

(B) PRS2's property consists of a security and a machine that are excluded property, and a building with built-in gain in excess of \$20,000. Under §1.721(c)-1(b)(6)(iv), because more than 90 percent of the value of the property of PRS2 consists of excluded property described in §1.721(c)-1(b)(6)(i) through (iii) (the security and the machine), any interest in PRS2 is excluded property. Therefore, the 40-percent interest in PRS2 contributed by USP to PRS1 is not section 721(c) property. Accordingly, USP's contribution of its interest in PRS2 to PRS1 is not subject to §1.721(c)-2(b).

(3) Example 3: Assets-over tiered partnerships--(i) Facts. In year 1, USP and CFC1 form PRS1 as equal partners. USP contributes a patent with a book value of \$300 million and an adjusted tax basis of \$30 million (USP contribution). CFC1 contributes cash of \$300 million. Immediately thereafter, PRS1 contributes the patent to PRS2 in exchange for a two-thirds interest (PRS1 contribution), and CFC2 contributes cash of \$150 million in exchange for a one-third interest. The patent has a remaining recovery period of 5 years out of a total of 15 years. With respect to all contributions described in §1.721(c)-2(b), the de minimis exception does not apply, and the gain deferral method is applied. Thus, the partnership agreements of PRS1 and PRS2 provide that the partnership will make allocations under section 704(c) using the remedial allocation method under §1.704-3(d).

(ii) Results: USP contribution. PRS1 is a section 721(c) partnership as a result of the USP contribution.

(iii) Results: PRS1 contribution. (A) For purposes of determining whether PRS2 is a section 721(c) partnership as a result of the PRS1 contribution, under §1.721(c)-2(d)(1), USP is treated as contributing to PRS2 its share of the patent that PRS1 actually contributes to PRS2. USP and CFC1 are each one-third indirect partners in PRS2. Taking into account the one-third interest in PRS2 directly owned by CFC2, USP, CFC1, and CFC2 collectively own at least 80 percent of the interests in PRS2. Thus, PRS2 is a section 721(c) partnership as a result of the PRS1 contribution.

(B) Under §1.721(c)-2(b), section 721(a) does not apply to PRS1's contribution of the patent to PRS2, unless the requirements of the gain deferral method are satisfied. Under §1.721(c)-3(b), the gain deferral method must be applied with respect to the patent. In addition, under §1.721(c)-3(d)(2), because PRS1 is a controlled partnership with respect to USP, the gain deferral method must be applied with respect to PRS1's interest in PRS2, and, solely for purposes of applying the consistent allocation method, PRS2 must treat PRS1 as the U.S. transferor. As stated in paragraph (b)(3)(i) of this section (the facts in Example 3), the gain deferral method is applied. PRS2 is a controlled partnership with respect to USP. Under §1.721(c)-5(c)(5)(i), the PRS1 contribution is a successor event with respect to the USP contribution.

(iv) Results: application of remedial allocation method. (A) Under §1.704-3(d)(2), in year 1, PRS2 has \$24 million of book amortization with respect to the patent (\$6 million (\$30 million of book value equal to adjusted tax basis divided by the 5-year remaining recovery period) plus \$18 million (\$270 million excess of book value over tax basis divided by the new 15-year recovery period)). PRS2 has \$6 million of tax amortization. Under the PRS2 partnership agreement, PRS2 allocates \$8 million of book amortization to CFC2 and \$16 million of book amortization to PRS1. Because of the application of the ceiling rule, PRS2 allocates \$6 million of tax amortization to CFC2 and \$0 of tax amortization to PRS1. Because the ceiling rule would cause a disparity of \$2 million between CFC2's book and tax amortization, PRS2 must make a remedial allocation of \$2 million of tax amortization to CFC2 and an offsetting remedial allocation of \$2 million of taxable income to PRS1.

(B) PRS1's distributive share of each of PRS2's items with respect to the patent is \$16 million of book amortization, \$0 of tax amortization, and \$2 million of taxable income from the remedial allocation from PRS1. Under §1.704-3(a)(9), PRS1 must allocate its distributive share of each of PRS2's items with respect to the patent in a manner that takes into account USP's remaining built-in gain in the patent. Therefore, PRS1 allocates \$2 million of taxable income to USP. Under §1.704-3(a)(13)(ii), PRS1 treats its distributive share of each of PRS2's items of amortization with respect to PRS2's patent as items of amortization with respect to PRS1's interest in PRS2. Under the PRS1 partnership agreement, PRS1 allocates \$8 million of book amortization and \$0 of tax amortization to CFC1, and \$8 million of book amortization and \$0 of tax amortization to USP. Because the ceiling rule would cause a disparity of \$8 million between CFC1's book and tax amortization, PRS1 must make a remedial allocation of \$8 million of tax amortization to CFC1. PRS1 must also make an offsetting remedial allocation of \$8 million of taxable income to USP. USP reports \$10 million of taxable income (\$2 million of remedial income from PRS2 and \$8 million of remedial income from PRS1).

(4) Example 4: Section 721(c) partnership ceases to have a related foreign person as a partner--(i) Facts. In year 1, USP and CFC1 form PRS1. USP contributes a trademark with a built-in gain of \$5 million in exchange for a 60-percent interest, and CFC1 contributes other property in exchange for the remaining 40-percent interest. With respect to all contributions described in §1.721(c)-2(b), the de minimis exception does not apply, and the gain deferral method is applied. On day 1 of year 4, CFC1 sells its entire interest in PRS1 to FX. There is no plan for a related foreign person with respect to USP to subsequently become a partner in PRS1 (or a successor).

(ii) Results. (A) PRS1 is a section 721(c) partnership.

(B) With respect to year 4, under §1.721(c)-5(b)(5), the sale is a termination event because, as a result of CFC1's sale of its interest, PRS1 will no longer have a partner that is a related foreign person, and there is no plan for a related foreign person to subsequently become a partner in PRS1 (or a successor). Thus, under §1.721(c)-5(b)(1), the trademark is no longer subject to the gain deferral method.

(5) Example 5: Transfer described in section 367 of section 721(c) property to a foreign corporation--(i) Facts. In year 1, USP, CFC1, and USX form PRS1. USP contributes a patent with a built-in gain of \$5 million in exchange for a 60-percent interest, CFC1 contributes other property in exchange for a 30-percent interest, and USX contributes cash in exchange for a 10-percent interest. With respect to all contributions described in §1.721(c)-2(b), the de minimis exception does not apply, and the gain deferral method is applied. In year 3, when the patent has remaining built-in gain, PRS1 transfers the patent to FX in a transaction described in section 351.

(ii) Results. (A) PRS1 is a section 721(c) partnership.

(B) With respect to year 3, the transfer of the patent to FX is a transaction described in section 367(d). Therefore, under §1.721(c)-5(e), the patent is no longer

subject to the gain deferral method. Under §§1.367(d)-1T(d)(1) and 1.367(a)-1T(c)(3)(i), for purposes of section 367(d), USP and USX are treated as transferring their proportionate share of the patent actually transferred by PRS1 to FX. Under §1.721(c)-5(e), to the extent USP and USX are treated as transferring the patent to FX, the tax consequences are determined under section 367(d) and the regulations under section 367(d). With respect to the remaining portion of the patent, if any, which is attributable to CFC1, USP must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to USP if PRS1 had sold that portion of the patent immediately before the transfer for fair market value. Under §1.721(c)-4(c)(1), USP must increase the basis in its partnership interest in PRS1 by the amount of gain recognized by USP and under §1.721(c)-4(c)(2), immediately before the transfer, PRS1 must increase its basis in the patent by the same amount. The stock in FX received by PRS1 is not subject to the gain deferral method.

(6) Example 6: Limited remedial allocation method for anti-churning property with respect to related partners--(i) Facts. USP, CFC1, and FX form PRS1. On January 1 of year 1, USP contributes intellectual property (IP) with a book value of \$600 million and an adjusted tax basis of \$0 in exchange for a 60-percent interest. The IP is a section 197(f)(9) intangible (within the meaning of §1.197-2(h)(1)(i)) that was not an amortizable section 197 intangible in USP's hands. CFC1 contributes cash of \$300 million in exchange for a 30-percent interest, and FX contributes cash of \$100 million in exchange for a 10-percent interest. The IP is section 721(c) property, and PRS1 is a section 721(c) partnership. The gain deferral method is applied. The partnership agreement provides that PRS1 will make allocations under section 704(c) with respect to the IP using the remedial allocation method under §1.704-3(d)(5)(iii). All of PRS1's allocations with respect to the IP satisfy the requirements of the gain deferral method. On January 1 of year 16, PRS1 sells the IP for cash of \$900 million to a person that is not a related person. During years 1 through 16, PRS1 earns no income other than gain from the sale of the IP in year 16, has no expenses or deductions other than from amortization of the IP, and makes no distributions.

(ii) Results: year 1. Under §1.704-3(d)(5)(iii)(B), PRS1 must recover the excess of the book value of the IP over its adjusted tax basis at the time of the contribution (\$600 million) using any recovery period and amortization method that would have been available to PRS1 if the property had been newly purchased property from an unrelated party. Thus, under section 197(a), PRS1 must amortize \$600 million of the IP's book value ratably over 15 years for book purposes, and PRS1 will have \$40 million of book amortization per year without any tax amortization. Under the partnership agreement, in year 1, PRS1 allocates book amortization of \$24 million to USP, \$12 million to CFC1, and \$4 million to FX. Because in year 1 the ceiling rule would cause a disparity between FX's allocations of book and tax amortization, PRS1 makes a remedial allocation of tax amortization of \$4 million to FX and an offsetting remedial allocation of \$4 million of taxable income to USP. In year 1, the ceiling rule would also cause a disparity between CFC1's allocations of book and tax amortization. However, §1.197-2(h)(12)(vii)(B) precludes PRS1 from making a remedial allocation of tax amortization to CFC1. Instead, pursuant to §1.704-3(d)(5)(iii)(C), PRS1 increases the adjusted tax basis in the IP by \$12 million, and pursuant to §1.704-3(d)(5)(iii)(D), that basis



adjustment is solely with respect to CFC1. Pursuant to §1.704-3(d)(5)(iii)(C), PRS1 also makes an offsetting remedial allocation of \$12 million of taxable income to USP.

(iii) Results: years 2-15. At the end of year 15, PRS1 has book basis and adjusted tax basis of \$0 in the IP. PRS1 has amortized \$600 million for book purposes by allocating total book amortization deductions of \$360 million to USP, \$180 million to CFC1, and \$60 million to FX. For U.S. tax purposes, by the end of year 15, PRS1 has made remedial allocations of \$60 million of tax amortization to FX and increased the adjusted tax basis in the IP by \$180 million solely with respect to CFC1. PRS1 has also made total remedial allocations of \$240 million of taxable income to USP (attributable to \$60 million of remedial tax amortization to FX and \$180 million of tax basis adjustments with respect to CFC1). With respect to their partnership interests in PRS1, USP has a capital account and an adjusted tax basis of \$240 million, CFC1 has a capital account of \$120 million and an adjusted tax basis of \$300 million, and FX has a capital account and an adjusted tax basis of \$40 million.

(iv) Results: sale of property in year 16. PRS1's sale of the IP for cash of \$900 million on January 1 of year 16 results in \$900 million of book and tax gain (\$900 million - \$0). PRS1 allocates the book and tax gain 60 percent to USP (\$540 million), 10 percent to FX (\$90 million), and 30 percent to CFC1 (\$270 million). However, under §1.704-3(d)(5)(iii)(D)(3), CFC1's tax gain is \$90 million, equal to its share of PRS1's gain (\$270 million), minus the amount of the tax basis adjustment (\$180 million). After the sale, PRS1's only property is cash of \$1.3 billion. With respect to their partnership interests in PRS1, USP has a capital account and an adjusted tax basis of \$780 million, CFC1 has a capital account and an adjusted tax basis of \$390 million, and FX has a capital account and an adjusted tax basis of \$130 million.

§ 1.721(c)-7T [Removed]

Par. 21. Section 1.721(c)-7T is removed.

Par. 22. Section 1.6038B-2 is amended by:

1. Revising paragraphs (a)(1)(iii), (a)(3), and (c)(8) and (9).
2. In paragraph (h)(1) introductory text, removing “§1.721(c)-6T” and adding “§1.721(c)-6” in its place.
3. Revising paragraphs (h)(3) and (j)(4) and (5).

The revisions read as follows:

§1.6038B-2 Reporting of certain transfers to foreign partnerships.

(a) \* \* \*

(1) \* \* \*

(iii) The United States person is a U.S. transferor (as defined in §1.721(c)-1(b)(18)) that makes a gain deferral contribution and is required to report under §1.721(c)-6(b)(2). The reporting required under this paragraph (a) includes the annual reporting required by §1.721(c)-6(b)(3). For purposes of applying this paragraph (a)(1)(iii) to partnerships formed on or after January 18, 2017, a domestic partnership is treated as a foreign partnership pursuant to section 7701(a)(4).

\* \* \* \* \*

(3) Indirect transfer through a foreign partnership. Solely for purposes of this section, if a foreign partnership transfers section 721(c) property (as defined in §1.721(c)-1(b)(15)) to another foreign partnership in a transfer described in §1.721(c)-3(d) (tiered-partnership rules), then the transferor foreign partnership's partners will be considered to have transferred a proportionate share of the property to the foreign partnership.

\* \* \* \* \*

(c) \* \* \*

(8) With respect to reporting required under §1.721(c)-6(b)(2) and paragraph (a)(1)(iii) of this section with regard to a gain deferral contribution, the information required by §1.721(c)-6(b)(2); and

(9) With respect to section 721(c) property for which reporting is required under §1.721(c)-6(b)(3) and paragraph (a)(1)(iii) of this section, the information required by §1.721(c)-6(b)(3).

\* \* \* \* \*

(h) \* \* \*

(3) Reasonable cause exception. Under section 6038B(c)(2) and this section, the provisions of paragraph (h)(1) of this section will not apply if the United States person shows, in a timely manner, that a failure to comply was due to reasonable cause and not willful neglect. A United States person's statement that the failure to comply was due to reasonable cause and not willful neglect will be considered timely only if, promptly after the United States person becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to comply. If any taxable year of the United States person is under examination when the amended return is filed, a copy of the amended return must be delivered to the Internal Revenue Service personnel conducting the examination when the amended return is filed. If no taxable year of the United States person is under examination when the amended return is filed, a copy of the amended return must be delivered to the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director). Whether a failure to comply was due to reasonable cause and not willful neglect will be determined by the Director under all the facts and circumstances.

\* \* \* \* \*

(j) \* \* \*

(4) Transfers of section 721(c) property. Paragraph (c)(8) of this section applies to transfers occurring on or after August 6, 2015, and to transfers that occurred before August 6, 2015 resulting from an entity classification election made under §301.7701-3 of this chapter that was effective on or before August 6, 2015 but was filed on or after August 6, 2015. Paragraphs (a)(1)(iii), (a)(3), and (c)(9) of this section apply to transfers occurring on or after January 18, 2017, and to transfers that occurred before January 18, 2017 resulting from entity classification elections made under §301.7701-3 of this chapter that were effective on or before January 18, 2017 but were filed on or after January 18, 2017.

(5) Reasonable cause exception. Paragraph (h)(3) of this section applies to all requests for relief for transfers of property to partnerships filed on or after January 18, 2017.

§1.6038-2T [Removed]

Par. 23. Section 1.6038B-2T is removed.

Sunita Lough  
Deputy Commissioner for Services and Enforcement.

Approved: December 11, 2019

David J. Kautter

Assistant Secretary of the Treasury (Tax Policy).

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