

Tax Advice and Controversy Client Service Group

To: Our Clients and Friends

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IRS Publishes Proposed Regulations Determining Partner's Share of Recourse Liabilities

The Internal Revenue Service recently published proposed regulations under section 752 of the Internal Revenue Code of 1986, as amended. These proposed regulations provide guidance on how to determine a partner's share of recourse liabilities in the following situations.

- *Overlapping Economic Risk of Loss.* It is unclear under current regulations how partners allocate a recourse liability if multiple partners share the economic risk of loss related to the same liability. The proposed regulations specify that in such a situation, the economic risk of loss borne by each partner should be equal to the amount of such liability multiplied by a fraction the numerator of which is the economic risk of loss borne by such partner and the denominator of which is the sum of such amounts for all partners.
- *Tiered Partnerships.* The current regulations allocate a recourse liability of a lower-tier partnership to an upper-tier partnership if either the upper-tier partnership or one or more of its partners bears the economic risk of loss for such recourse liability. The current regulations do not, however, provide guidance on a situation where a partner of the upper-tier partnership is also a partner in the lower-tier partnership. In such a situation, the proposed regulations provide that such recourse liability should be allocated to the partner who bears the economic risk of loss and not to the upper-tier partnership, which will generally apply when the upper tier partnership does not have a payment obligation or is not the lender.
- *Constructive Ownership of Stock.* Under the current regulations, a partner may be treated as related to a corporation through a partnership's ownership interest in such corporation. If the corporation has a payment obligation with respect to a liability of its partnership owner or the corporation lends money to the partnership, a partner may be treated as bearing the economic risk of loss for such obligation as a result of its constructive ownership interest in the corporation. The proposed regulations eliminate this constructive ownership interest in situations where the corporation is a lender to the partnership or has a payment obligation with respect to a liability of its partnership owner.

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- *Person Related to Multiple Partners.* Under current regulations, if a person is related to more than one partner in a partnership, then the related party rules for purposes of determining the economic risk of loss are applied by treating that person as related only to the partner with whom there is the highest percentage of related ownership (the greatest percentage rule). If two or more partners have the same percentage ownership (and no one has a greater percentage), then the liability is allocated equally among the partners having the same percentage ownership. The proposed regulations eliminate the greatest percentage rule; instead, if a person is a lender or has a payment obligation for a partnership liability and is related to more than one partner, those related partners share the liability equally.
- *Related Partner Exception to Related Party Rules.* Under current regulations, persons owning interests directly or indirectly in the same partnership are not treated as related persons for purposes of determining the economic risk of loss borne by each of them (the related partner exception). The proposed regulations limit this related party exception to the extent a partner has a payment obligation or is the lender with respect to a partnership obligation.
- *Liquidating Distributions of Tiered Partnership Interests.* The IRS and the Department of the Treasury are requesting comments regarding the proper treatment of liabilities when an upper-tier partnership bears the economic risk of loss for a lower-tier partnership liability and distributes, in a liquidating distribution, its interest in the lower-tier partnership but, following such distribution, the recipient partner does not bear the economic risk of loss for the lower-tier partnership's liability.

These regulations are proposed to apply to liabilities incurred or assumed by a partnership on or after the date these regulations are published as final regulations.

To discuss this issue further, please speak to your Bryan Cave contact, or to:

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