

Related Party Basis Shifting Transactions

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I am primarily known for my work on complex deals involving advanced tax considerations, such as Section 1031 Exchanges, the Qualified Opportunity Zone Program, Freeze Partnerships, Private Equity Mergers & Acquisitions, and Qualified Small Business Stock.

I also have served as a trusted advisor for prominent funds, executives of multinational corporations, venture capitalists, successful startup businesses, ultra-high net worth families, and clients seeking creative solutions to seemingly intractable problems requiring tax-focused analysis.

Areas of Concentration

- Asset Protection
- Estate & Trust Administration
- Estate Planning & Structuring
- Family Business Planning & Succession
- International Taxation
- Tax Controversy & Litigation
- Tax Planning, Structuring & Compliance
- Cryptocurrency and Emerging Tech

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What are Related Party Basis Shifting Transactions?

- Basis shifting transactions are **sophisticated tax maneuvers** executed over multiple years by **related-party partnerships** that exploit the mechanical partnership rules in the Internal Revenue Code of 1986, as amended, to **generate tax benefits** (i.e., increased cost recovery deductions and lower taxable gain when an asset is sold) **without any true economic consequence** to the filing taxpayer.
- Generally, these transactions involve shuffling assets among related partners to either:
 - shift basis from one asset to another; or
 - shift basis between partners to manufacture a step up in basis.



The Treasury and IRS have recently issued guidance on Related Party Basis Shifting Transactions

- On June 17, 2024, the IRS and Treasury issued multiprong guidance to prevent the inappropriate use of partnership rules to inflate or “bump” the basis of partnership assets with little or no substantive economic consequence.
- Multipart Approach to Combat Partnership Basis-Shifting Transactions:
 - New Partnership Group in Office of Chief Counsel
 - Notice of Proposed Rulemaking (NPRM) 2024-54
 - NPRM 2024-13282 (89 FR 51476)
 - Revenue Ruling 2024-14
- The Treasury estimates that the shut down of related party basis shifting transactions will raise more than \$50 billion over the next decade.



The Passthroughs, Trust and Estates Office

- The Passthroughs, Trust and Estates Office will focus exclusively on partnerships, S corporations, and trusts and estates.
- The IRS hired Jeffrey Erickson as the new Associate Chief Counsel who shall oversee the newly formed Passthroughs, Trust and Estates Office.
- Most recently, Mr. Erickson served as a principal in Ernst & Young's National Tax Passthroughs Transaction Group



NPRM 2024-54

- The IRS announced two sets of proposed regulations under Sections 732, 734, 743, and 755 to address certain basis-shifting transactions involving related party partnerships (“Covered Transactions”). Covered Transactions are similar to the transactions of interests identified in Proposed Rule 89 FR 51476.
- **First set of proposed regulations:** Require partnerships to treat basis adjustments (under Sections 732, 734, 743, and 755) arising from covered transactions in a way that would eliminate inappropriate tax benefits created from covered transactions. Upon finalization, this set of proposed regulations would apply to taxable years ending on or after June 17, 2024.
- **Second set of proposed regulations:** Apply a single-entity approach with respect to interests in a partnership held by members of a consolidated group and prevents partnership basis shifting among members of a consolidated group.



NPRM 2024-13282 (89 FR 51476)

- **Identifies transactions of interest.** The proposed regulations would add Section 1.6011-18 to identify certain partnership basis adjustment transactions as “transactions of interest” (a reportable transaction).
- **Disclosure Requirements.** Taxpayers and material advisers would be required to disclose the transactions of interest and information identifying and describing the transaction and parties involved; all basis adjustments resulting from the transaction and basis information; and any potential tax consequences expected to result from the transaction.
- **\$5 million threshold.** Transactions of interests must be reported if the sum of all basis increases (without netting for any basis adjustment in the same transaction or other transaction that reduces basis) resulting from all such transactions of interest exceeds the gain recognized from the transactions by more than \$5 million.



Transactions of Interest

1. **Transfer of partnership interest to related party.** A partner with a low share of the partnership's "inside" tax basis and a high "outside" tax basis transfers the interest in a tax-free transaction to a related person or to a person who is related to other partners in the partnership. This related-party transfer generates a tax-free basis increase to the transferee partner's share of "inside" basis.
2. **Distribution of property to a related party.** A partnership with related partners distributes a high-basis asset to one of the related partners that has a low outside basis. After this, the distributee partner reduces the basis of the distributed asset and the partnership increases the basis of its remaining assets. The related partners can arrange this transaction so that the reduced tax basis of the distributed asset will not adversely impact the related partners, while the basis increase to the partnership's retained assets can produce tax savings for the related parties.



Transactions of Interest

- 3. Liquidation of related partnership or partner.** A partnership with related partners liquidates and distributes (1) a low-basis asset that is subject to accelerated cost recovery or for which the parties intend to sell to a partner with a high outside basis and (2) a high-basis property that is subject to longer cost recovery (or no cost recovery at all) or for which the parties intend to hold to a partner with a low outside basis.

Under the partnership liquidation rules, the first related partner increases the basis of the property with a shorter life or which is held for sale while the second related partner decreases the basis of the long-lived or non-depreciable property, with the result that the related parties generate or accelerate tax benefit.

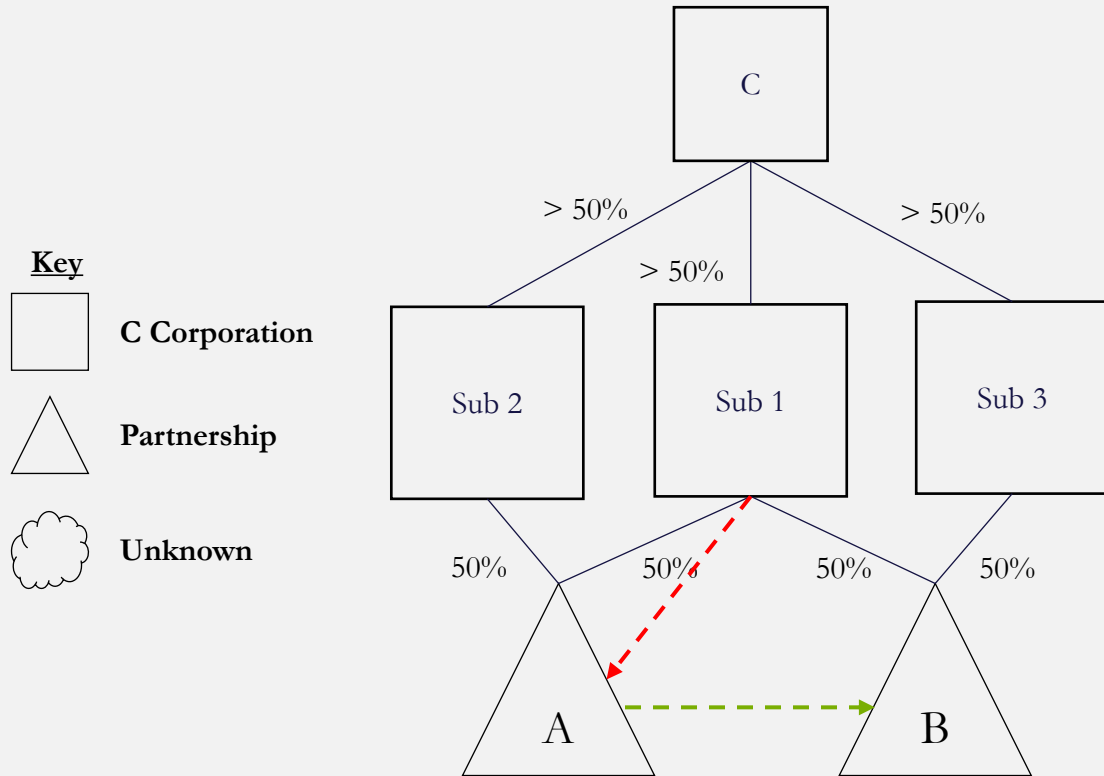


Revenue Ruling 2024-14

- The IRS will apply the **economic substance doctrine** to challenge related party basis-shifting transactions that intend to:
 - **Create disparities** between inside/outside basis through contribution or distribution of property, transfer of a partnership interest, or allocation of federal income tax items under Sections 704(b) and (c),
 - **Capitalize on the created disparity** by transferring a partnership interest in a nonrecognition transaction or making a current or liquidating distribution of partnership property to a partner, and
 - **Claim a basis adjustment** under Section 732(b), 734(b), or 743(b), resulting from the nonrecognition transaction or distribution.
- Undisclosed noneconomic substance transactions will be subject to heightened penalties. Under Section 7701(o), there is a **20% penalty** for any underpayment attributable to a transaction that lacks economic substance, and under Section 6662(i), the **penalty is increased to 40%** on any portion of the underpayment attributable to one or more undisclosed noneconomic substance transactions.



Revenue Ruling 2024-14: Situation 1

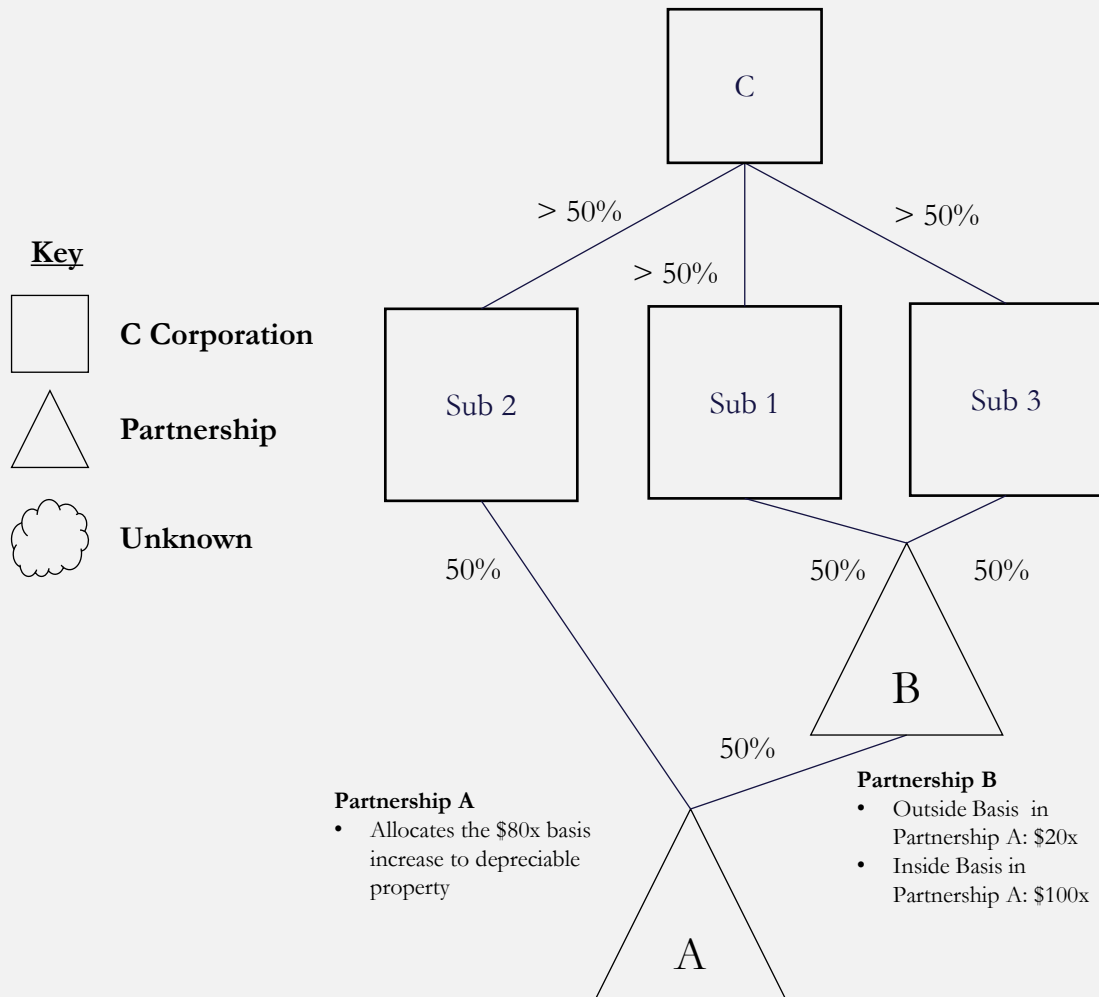


Sub 1

- Outside Basis in Partnership A: \$20x
- Inside Basis in Partnership A: \$100x

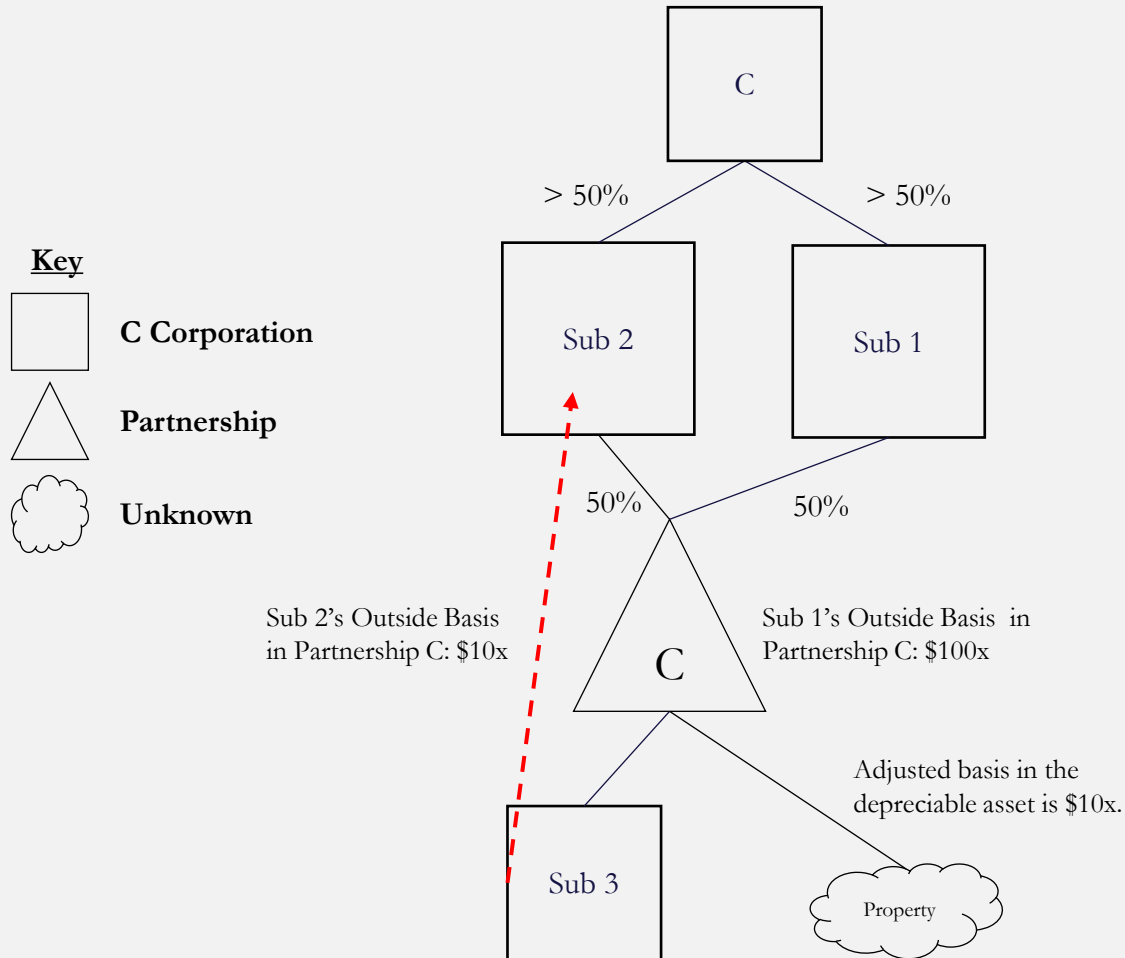
- On Date 1, Sub 1 transfers its interest in Partnership A to Partnership B in a contribution that qualifies for nonrecognition of gain or loss under Section 721(a). The business purpose for this contribution is to reduce administrative complexity and for cost savings.
- Prior to Date 1, Partnership A had a valid Section 754 election and Sub 1's share of the inside and outside basis was as follows:
 - Inside basis (i.e., adjusted tax basis in Partnership A's property): **\$20x**
 - Outside basis (i.e., adjusted tax basis in Partnership A): **\$100x**.
- The \$80x disparity in Sub 1's inside and outside basis resulted from Sub 1 and Sub 2 making contributions to Partnership A, and Partnership A making distributions to Sub 1 and Sub 2, of property with specific federal income tax attributes and allocations (taken with the intention of creating a disparity).

Revenue Ruling 2024-14: Situation 1



- Immediately after the contribution, Partnership B's inside and outside basis in its interest in Partnership A is \$20x and \$100x, respectively.
- Partnership A increases the adjusted basis of its property by \$80x** (the excess of Partnership B's \$100x outside basis over its \$20x proportionate share of inside basis) with respect to Partnership B only.
- Partnership A allocates substantially all of this \$80x basis increase to its depreciable or amortizable property.
- The IRS takes the position that the contribution was undertaken to exploit the disparity between Sub 1's inside and outside basis in Partnership A and to increase Partnership B's share of Partnership A's inside basis in the depreciable or amortizable property. The cost savings were insubstantial in relation to tax savings from the \$80x increase in Partnership A's basis in the depreciable or amortizable property.

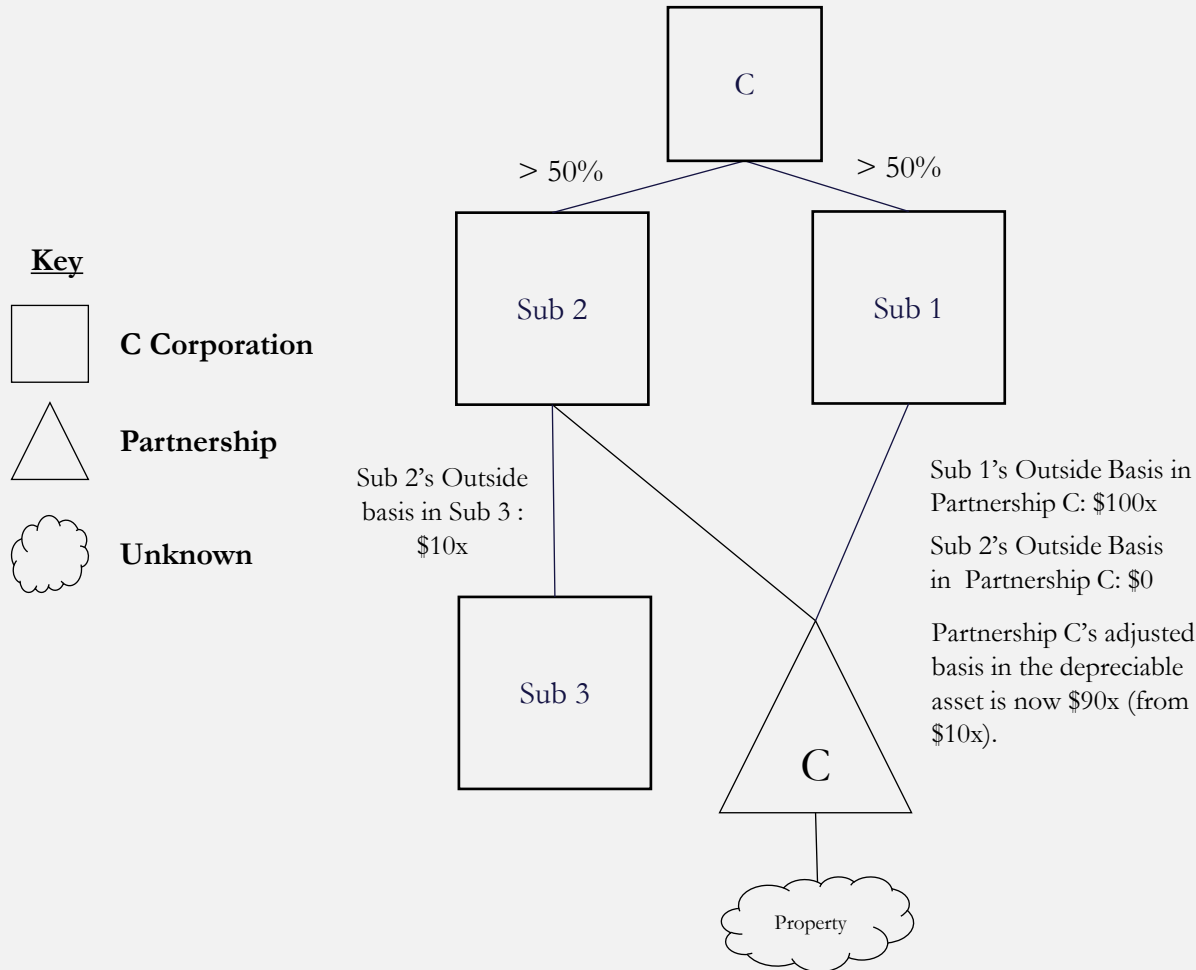
Revenue Ruling 2024-14: Situation 2



- On Date 2, Partnership C distributes all of the Sub 3 stock to Sub 2 other than in liquidation of Sub's 2 interest in Partnership C. The business purpose for this contribution is to reduce administrative complexity and for cost savings.
- Prior to Date 2, Partnership A had a valid Section 754 election and Partnership C held shares in Sub 3 with an outside basis of \$10x, an inside basis of \$90x, and fair market value of \$100x. Sub 3 has a depreciable asset with a fair market value of \$100 and an adjusted basis of \$10x.
- Sub1's outside basis in Partnership C was \$100x and Sub 2's outside basis in Partnership C was \$10x.
- This is the result of each Sub making contributions to Partnership C and Partnership C making distributions with specific tax items intended to create a disparity between Sub 2's outside basis and Partnership C's inside basis in Sub 3 stock.



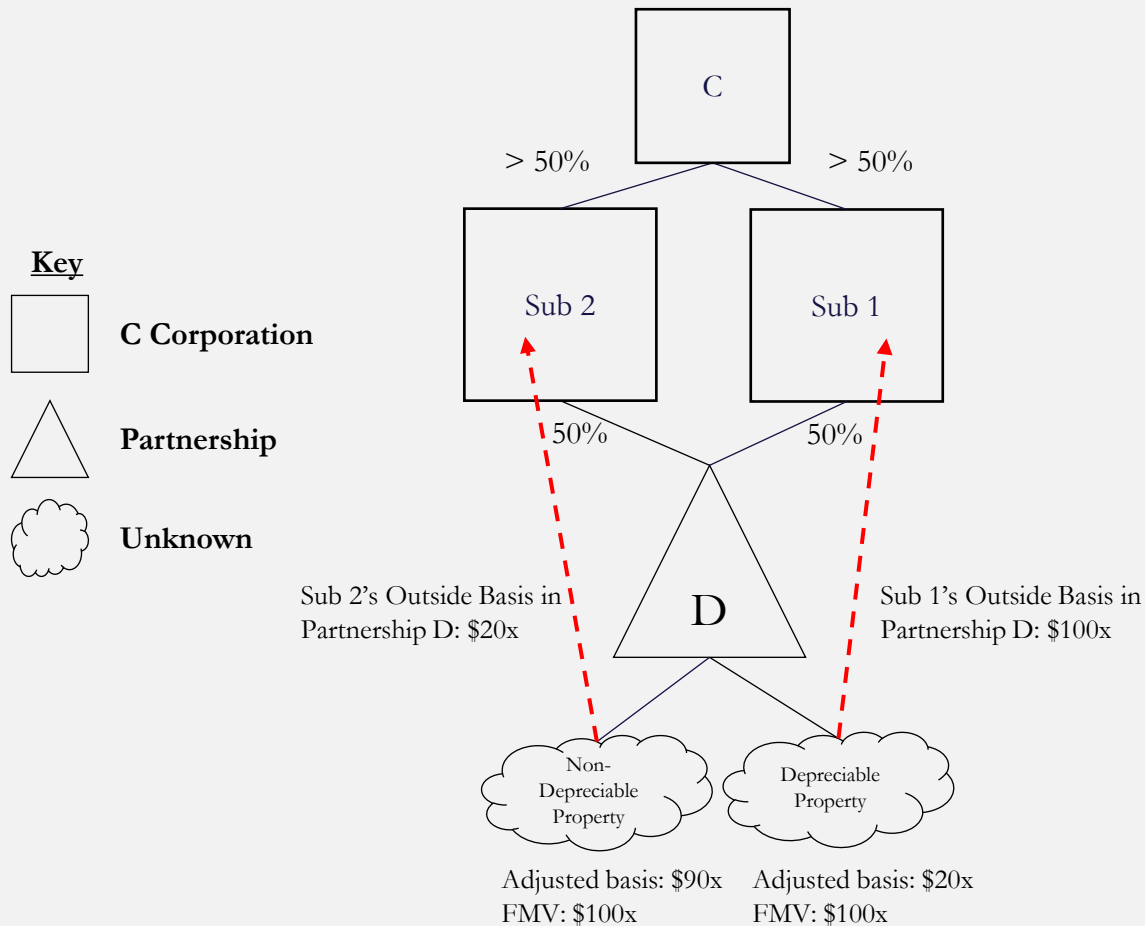
Revenue Ruling 2024-14: Situation 2



- Immediately after the distribution, Sub 2's adjusted basis in the Sub 3 stock is \$10x (the same as its outside basis in Partnership C prior to distribution). Sub 2's outside basis in Partnership C is reduced to zero.
- Partnership C increases the inside basis of its assets by \$80x and increases the basis of its depreciable asset from \$10x to \$90x.
- The IRS takes the position that the cost savings resulting from the distribution was insubstantial in comparison of the \$80x increase in Partnership C's inside basis in the remaining depreciable asset, which results in Sub 1 and Sub 2 being allocated increase amount of deductions for depreciation or reduced amount of gain (or increased amounts of loss) upon the sale of the depreciate asset held by Partnership C.



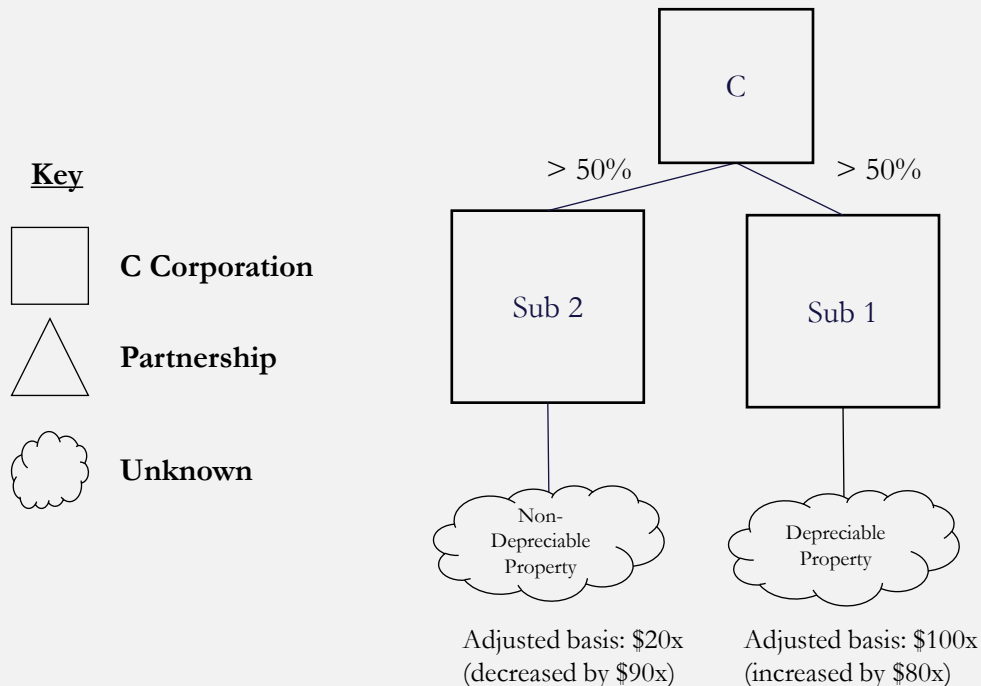
Revenue Ruling 2024-14: Situation 3



- On Date 3, Partnership D liquidated by distributing the depreciable asset to Sub 1 and the nondepreciable property to Sub 2. The business purpose for this contribution was to reduce administrative complexity and for cost savings.
- Prior to Date 3, Partnership owned a depreciable and a nondepreciable asset. Sub1's outside basis in Partnership D was \$100x and Sub 2's outside basis in Partnership D was \$20x.
- This is the result of each Sub making contributions to Partnership C and Partnership C making distributions with specific tax items intended to create a disparity between Sub 2's outside basis and Partnership C's inside basis in Sub 3 stock.



Revenue Ruling 2024-14: Situation 3



- Immediately after the liquidation of Partnership D, Sub 1's adjusted basis in the depreciable asset is \$100x, which equals Sub 1's outside basis in Partnership D prior to liquidation and reflects an increase of \$80x.
- Immediately after the liquidation of Partnership D, Sub 2's adjusted basis in the depreciable asset is \$20x, which equals Sub 2's outside basis in Partnership D prior to liquidation and reflects a decrease of \$70x.
- The IRS takes the position that the cost savings resulting from the liquidation of Partnership D are insubstantial in relation to the tax savings resulting from the \$80x increase in the adjusted basis of the depreciable asset.



Thank you!

Contact me anytime with questions!



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