made between members of a family (including collaterals) under a purported purchase agreement, if the characteristics of a gift are ascertained from the terms of the purchase agreement, the terms of any loan or credit arrangements made to finance the purchase, or from other relevant data.

(*c*) In the case of a limited partnership, for the purpose of the allocation provisions of subdivision (i) of this subparagraph, consideration shall be given to the fact that a general partner, unlike a limited partner, risks his credit in the partnership business.

(4) *Purchased interest*—(i) *In general.* If a purported purchase of a capital interest in a partnership does not meet the requirements of subdivision (ii) of this subparagraph, the ownership by the transferee of such capital interest will be recognized only if it qualifies under the requirements applicable to a transfer of a partnership interest by gifts. In a case not qualifying under subdivision (ii) of this subparagraph, if payment of any part of the purchase price is made out of partnership earnings, the transaction may be regarded in the same light as a purported gift subject to deferred enjoyment of income. Such a transaction may be lacking in reality either as a gift or as a bona fide purchase.

(ii) *Tests as to reality of purchased interests.* A purchase of a capital interest in a partnership, either directly or by means of a loan or credit extended by a member of the family, will be recognized as bona fide if:

(*a*) It can be shown that the purchase has the usual characteristics of an arm's-length transaction, considering all relevant factors, including the terms of the purchase agreement (as to price, due date of payment, rate of interest, and security, if any) and the terms of any loan or credit arrangement collateral to the purchase agreement; the credit standing of the purchaser (apart from relationship to the seller) and the capacity of the purchaser to incur a legally binding obligation; or

(*b*) It can be shown, in the absence of characteristics of an arm's-length transaction, that the purchase was genuinely intended to promote the success of the business by securing participation of the purchaser in the business or by adding his credit to that of the other participants.

However, if the alleged purchase price or loan has not been paid or the obligation otherwise discharged, the factors indicated in (*a*) and (*b*) of this subdivision shall be taken into account only as an aid in determining whether a bona fide purchase or loan obligation existed.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.704–1, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov*.

§1.704–1T Partner's distributive share (temporary).

(a) Through (b)(1)(ii)(*b*)(*2*) [Reserved] For further guidance, see §1.704–1(a) through (b)(1)(ii)(*b*)(*2*).

(*3*) *Special rules for certain inter-branch payments*—(A) *In general.* The provisions of §1.704–1(b)(4)(viii)(*c*)(*3*)(*ii*) and §1.704–1(b)(4)(viii)(*d*)(*3*) apply for partnership taxable years beginning on or after January 1, 2012.

(B) *Transition rule.* Transition relief is provided herein to partnerships whose agreements were entered into prior to February 14, 2012. In such case, if there has been no material modification to the partnership agreement on or after February 14, 2012, then the partnership may apply the provisions of §1.704–1(b)(4)(viii)(*c*)(*3*)(*ii*) and §1.704–1(b)(4)(viii)(*d*)(*3*) (revised as of April 1, 2011). For purposes of this paragraph (b)(1)(ii)(*b*)(*3*), any change in ownership constitutes a material modification to the partnership agreement. This transition rule does not apply to any taxable year in which persons bearing a relationship to each other that is specified in section 267(b) or section 707(b) collectively have the power to amend the partnership agreement without the consent of any unrelated party (and all subsequent taxable years).

(b)(1)(iii) through (b)(4)(viii)(*d*)(*2*) [Reserved] For further guidance, see §1.704–1(b)(1)(iii) through (b)(4)(viii)(*d*)(*2*).

(*3*) *Special rules for inter-branch payments.* For rules relating to foreign tax paid or accrued in partnership taxable years beginning before January 1, 2012

in respect of certain inter-branch payments, see 26 CFR 1.704–1(b)(4)(viii)(*d*)(*3*) (revised as of April 1, 2011).

(b)(4)(ix) through (b)(5) *Example 23* [Reserved] For further guidance, see §1.704–1(b)(4)(ix) through (b)(5) *Example 23*.

Example 24. (i) The facts are the same as in *Example 21*, except that businesses M and N are conducted by entities (DE1 and DE2, respectively) that are corporations for country X and Y tax purposes and disregarded entities for U.S. tax purposes. Also, assume that DE1 makes payments of $75,000 during 2012 to DE2 that are deductible by DE1 for country X tax purposes and includible in income of DE2 for country Y tax purposes. As a result of such payments, DE1 has taxable income of $25,000 for country X purposes on which $10,000 of taxes are imposed and DE2 has taxable income of $125,000 for country Y purposes on which $25,000 of taxes are imposed. For U.S. tax purposes, $100,000 of AB's income is attributable to the activities of DE1 and $50,000 of AB's income is attributable to the activities of DE2. Pursuant to the partnership agreement, all partnership items from business M, excluding CFTEs paid or accrued by business M, are allocated 75 percent to A and 25 percent to B, and all partnership items from business N, excluding CFTEs paid or accrued by business N, are split evenly between A and B (50 percent each). Accordingly, A is allocated 75 percent of the income from business M ($75,000), and 50 percent of the income from business N ($25,000). B is allocated 25 percent of the income from business M ($25,000), and 50 percent of the income from business N ($25,000).

(ii) Because the partnership agreement provides for different allocations of the net income attributable to businesses M and N, the net income attributable to each of business M and business N is income in separate CFTE categories. See paragraph (b)(4)(viii)(*c*)(*2*) of this section. Under paragraph (b)(4)(viii)(*c*)(*3*) of this section, the $100,000 of net income attributable to business M is in the business M CFTE category and the $50,000 of net income attributable to business N is in the business N CFTE category. Under paragraph (b)(4)(viii)(*d*)(*1*) of this section, the $10,000 of country X taxes is allocated to the business M CFTE category and $10,000 of the country Y taxes is allocated to the business N CFTE category. The additional $15,000 of country Y tax imposed with respect to the inter-branch payment is assigned to the business M CFTE category because for U.S. tax purposes, the related $75,000 of income that country Y is taxing is in the business M CFTE category. Therefore, $25,000 of taxes ($10,000 of country X taxes and $15,000 of the country Y taxes) is related to the $100,000 of net income in the business M CFTE category and the other $10,000 of country Y taxes is related to the $50,000 of net income in the business N CFTE category. See paragraph (b)(4)(viii)(*c*)(*1*) of this section. The allocations of country X taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners' interests in the partnership if such taxes are allocated 75 percent to A and 25 percent to B. The allocations of country Y taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners' interests in the partnership if $15,000 of such taxes is allocated 75 percent to A and 25 percent to B and the other $10,000 of such taxes is allocated 50 percent to A and 50 percent to B. No inference is intended with respect to the application of other provisions to arrangements that involve disregarded payments.

(iii) Assume that the facts are the same as in paragraph (i) of this *Example 24*, except that in order to reflect the $75,000 payment from DE1 to DE2, the partnership agreement allocates $75,000 of the income attributable to business M equally between A and B (50 percent each). In order to prevent separating the CFTEs from the related foreign income, the $75,000 payment is treated as a divisible part of the business M activity and, therefore, a separate activity. See paragraph (b)(4)(viii)(*c*)(*2*)(*iii*) of this section. Because items from the disregarded payment and business N are both shared equally between A and B, the disregarded payment activity and the business N activity are treated as a single CFTE category. See paragraph (b)(4)(viii)(*c*)(*2*)(*i*) of this section. Accordingly, $25,000 of net income attributable to business M is in the business M CFTE category and $75,000 of income of business M attributable to the disregarded payment and the $50,000 of net income attributable to business N are in the business N CFTE category. Under paragraph (b)(4)(viii)(*d*)(*1*) of this section, the $10,000 of country X taxes is allocated to the business M CFTE category and all $25,000 of the country Y taxes is allocated to the business N CFTE category. The allocations of country X taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners' interests in the partnership if such taxes are allocated 75 percent to A and 25 percent to B. The allocations of country Y taxes will be in proportion to the distributive shares of income to which they relate and will be deemed to be in accordance with the partners' interests in the partnership if such taxes are allocated 50 percent to A and 50 percent to B.

Example 25 through (e) [Reserved] For further guidance, see §1.704–1(b)(5) *Example 25* through (e).

(f) *Expiration date.* The applicability of this section expires on February 9, 2015.

[T.D. 9577, 77 FR 8134, Feb. 14, 2012]

§ 1.704–2 Allocations attributable to nonrecourse liabilities.

(a) *Table of contents.* This paragraph contains a listing of the major headings of this §1.704–2.

§ 1.704–2 Allocations attributable to nonrecourse liabilities.

(b) *General principles and definitions—*(1) *Definition of and allocations of nonrecourse deductions.* Allocations of losses, deductions, or section 705(a)(2)(B) expenditures attributable to partnership nonrecourse liabilities (''nonrecourse deductions'') cannot have economic effect because the creditor alone bears any economic burden that corresponds to those allocations.