

of the lease, ownership, or use of an interest in real property, and what characteristics should be taken into account in making that determination.

2. Whether this regulatory project should address the allocation of the consideration paid for the lease or purchase of a specified infrastructure and the license, permit, franchise, or other similar right to operate that specified infrastructure for purposes of determining the fair market value of such property.

In regard to the allocation of purchase price, comments are also sought as to whether, for purposes of allocating the consideration paid for a lease of the specified infrastructure and the license, permit, franchise, or other similar right to operate that specified infrastructure, the length of the lease (including whether the lease is for the useful life of the property) should be taken into account.

**L.E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-164370-05]

RIN 1545-BF27

#### Section 108(e)(8) Application to Partnerships

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations relating to the application of section 108(e)(8) of the Internal Revenue Code (Code) to partnerships and their partners. These regulations provide guidance regarding the determination of discharge of indebtedness income of a partnership that transfers a partnership interest to a creditor in satisfaction of the partnership's indebtedness (debt-for-equity exchange). The proposed regulations also provide that section 721 applies to a contribution of a partnership's recourse or nonrecourse indebtedness by a creditor to the partnership in exchange for a capital or profits interest in the partnership. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by January 29, 2009. Outlines of topics to be discussed at the public hearing scheduled for February 19, 2009, must be received by January 27, 2009.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-164370-05), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-164370-05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-164370-05). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:**

Concerning the proposed regulations, Megan A. Stoner, Office of Associate Chief Counsel (Passthroughs and Special Industries), (202) 622-3070; concerning submission of comments, the hearing, and/or placed on the building access list to attend the hearing, Richard Hurst, (202) 622-2949 (TDD Telephone) (not toll-free numbers) and his e-mail address is [Richard.A.Hurst@irsounsel.treas.gov](mailto:Richard.A.Hurst@irsounsel.treas.gov).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document contains proposed amendments to 26 CFR Part 1 under sections 108 and 721 of the Code relating to the application of section 108(e)(8) to partnerships.

Section 108(e)(8) was amended by section 896 of the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1648), to include discharges of partnership indebtedness occurring on or after October 22, 2004. Prior to the amendment, section 108(e)(8) only applied to discharges of corporate indebtedness. Section 108(e)(8), as amended, provides that for purposes of determining income of a debtor from discharge of indebtedness (COD income), if a debtor corporation transfers stock or a debtor partnership transfers a capital or profits interest in such partnership to a creditor in satisfaction of its recourse or nonrecourse indebtedness, such corporation or partnership shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock or interest. In the case of a partnership, any COD income

recognized under section 108(e)(8) shall be included in the distributive shares of the partners in the partnership immediately before such discharge.

**Explanation of Provisions**

*1. Valuation of Partnership Interest Transferred in Satisfaction of Partnership Debt*

Section 108(e)(8) provides that for purposes of determining COD income of a debtor partnership, the partnership shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the interest transferred to the creditor. The amount by which the indebtedness exceeds the fair market value of the partnership interest transferred is the amount of COD income required to be included in the distributive shares of the partners in the debtor partnership immediately before the discharge.

The IRS and the Treasury Department believe that provided certain requirements are satisfied, it is appropriate to allow the partnership and the creditor to value the partnership interest transferred to the creditor in a debt-for-equity exchange (debt-for-equity interest) based on liquidation value. For this purpose, liquidation value equals the amount of cash that the creditor would receive with respect to the debt-for-equity interest if, immediately after the transfer, the partnership sold all of its assets (including goodwill, going concern value, and any other intangibles associated with the partnership's operations) for cash equal to the fair market value of those assets, and then liquidated. If a partnership maintains capital accounts in accordance with the capital accounting rules of § 1.704-1(b)(2)(iv), the amount by which the creditor's capital account is increased as a result of the debt-for-equity exchange will equal the fair market value of the indebtedness exchanged. See § 1.704-1(b)(2)(iv)(b) and (d).

Accordingly, the proposed regulations provide that for purposes of applying section 108(e)(8), the fair market value of a debt-for-equity interest is the liquidation value of that debt-for-equity interest, if (i) the debtor partnership determines and maintains capital accounts of its partners in accordance with the capital accounting rules of § 1.704-1(b)(2)(iv), (ii) the creditor, debtor partnership, and its partners treat the fair market value of the indebtedness as being equal to the liquidation value of the debt-for-equity interest for purposes of determining the tax consequences of the debt-for-equity exchange, (iii) the debt-for-equity

exchange is an arm's-length transaction, and (iv) subsequent to the debt-for-equity exchange, neither the partnership redeems nor any person related to the partnership purchases the debt-for-equity interest as part of a plan at the time of the debt-for-equity exchange which has as a principal purpose the avoidance of COD income by the partnership. If these conditions are not satisfied, all of the facts and circumstances are considered in determining the fair market value of the debt-for-equity interest for purposes of applying section 108(e)(8).

## 2. Application of Section 721 to Debt-for-Equity Exchanges

Generally, when property is transferred as payment on indebtedness (or in satisfaction thereof), gain or loss on the property is recognized. The IRS and the Treasury Department, however, believe that in the case of a debt-for-equity exchange, the nonrecognition rule of section 721 generally should apply to the creditor's contribution of partnership indebtedness (other than unpaid interest or accrued original issue discount) to the partnership in exchange for the partnership interest. Such a rule is consistent with the policies underlying section 721 to defer the recognition of gain or loss where persons join together to conduct joint business (including investment). Accordingly, the proposed regulations provide that with certain exceptions, section 721 applies to debt-for-equity exchanges.

The proposed regulations provide that section 721 does not apply to the transfer of a partnership interest to a creditor in satisfaction of a partnership's indebtedness for unpaid rent, royalties, or interest on indebtedness (including accrued original issue discount). Moreover, these proposed regulations do not supersede the rules under section 453B relating to dispositions of installment obligations. A separate guidance project addresses the application of section 721 to a partnership interest transferred in connection with the performance of services. See proposed regulations regarding partnership equity for services (70 FR 29675) (May 24, 2005).

## 3. Creditor's Basis in Partnership Interest

Because the proposed regulations provide that section 721 applies to a debt-for-equity exchange, the basis of the creditor's interest in the partnership is determined under section 722. Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including

money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution, increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

The IRS and the Treasury Department believe that a creditor should not recognize a loss in a debt-for-equity exchange subject to section 721 in which the liquidation value of the debt-for-equity interest is less than the outstanding principal balance of the indebtedness. Rather, the creditor's basis in the debt-for-equity interest received in the debt-for-equity exchange that is subject to section 721 will be increased by the adjusted basis of the indebtedness. The IRS and the Treasury Department request comments on alternative approaches.

## 4. Creditor's Holding Period in Partnership Interest

Section 1223(1) provides, in general, that in determining the period for which the taxpayer has held property received in an exchange, there shall be included the period for which the taxpayer held the property exchanged, if the property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as the property exchanged. Because the basis in the debt-for-equity interest received in a debt-for-equity exchange that is subject to section 721 is the same as the creditor's basis in the debt under section 722, the debt-for-equity interest includes the creditor's holding period in the indebtedness under section 1223(1).

## 5. Request for Comments

The IRS and the Treasury Department realize that there are other issues relating to debt-for-equity exchanges that are not addressed in these proposed regulations. One issue not addressed is whether any special allocation rules of COD income should apply where partnership indebtedness owed to a preexisting partner is satisfied with the transfer of a partnership interest. Another issue is whether COD income arising from a debt-for-equity exchange should be treated as a first-tier item under § 1.704-2(f)(6) for purposes of the minimum gain chargeback rules. A third issue is how the rules in the noncompensatory partnership options regulations relating to convertible debt interact with the rules in these proposed regulations under section 108(e)(8). The IRS and the Treasury Department request comments on these issues as

well as other issues not addressed in these proposed regulations.

## Proposed Effective Date

These regulations are proposed to apply to debt-for-equity exchanges occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

## Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. 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 its impact on small business.

## Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 19, 2009, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, all visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments by January 27, 2009. Outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January

27, 2009. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal author of these regulations is Megan A. Stoner of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

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

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendment to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

**Par. 2.** Section 1.108–8 is added to read as follows:

#### § 1.108–8 Indebtedness satisfied by partnership interest.

(a) *In general.* For purposes of determining income of a debtor from discharge of indebtedness (COD income), if a debtor partnership transfers a capital or profits interest in the partnership to a creditor in satisfaction of its recourse or nonrecourse indebtedness (a debt-for-equity exchange), the partnership is treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the partnership interest.

(b) *Determination of fair market value—(1) In general.* For purposes of paragraph (a) of this section, the fair market value of a partnership interest transferred by a debtor partnership to a creditor in satisfaction of the debtor partnership's indebtedness (debt-for-equity interest) is the liquidation value of the debt-for-equity interest, where liquidation value equals the amount of cash that the creditor would receive with respect to the debt-for-equity interest if, immediately after the transfer, the partnership sold all of its assets (including goodwill, going concern value, and any other intangibles associated with the partnership's operations) for cash equal to the fair

market value of those assets and then liquidated, if—

(i) The debtor partnership determines and maintains the capital accounts of its partners in accordance with the capital accounting rules of § 1.704–1(b)(2)(iv);

(ii) The creditor, debtor partnership, and its partners treat the fair market value of the indebtedness as being equal to the liquidation value of the debt-for-equity interest for purposes of determining the tax consequences of the debt-for-equity exchange;

(iii) The debt-for-equity exchange is an arm's-length transaction; and

(iv) Subsequent to the debt-for-equity exchange, neither the partnership redeems nor any person related to the partnership purchases the debt-for-equity interest as part of a plan at the time of the debt-for-equity exchange which has as a principal purpose the avoidance of COD income by the partnership.

(2) *Exception.* If the requirements in paragraph (b)(1) of this section are not satisfied, all the facts and circumstances will be considered in determining the fair market value of a debt-for-equity interest for purposes of paragraph (a) of this section.

(c) *Example.* The following example illustrates the provisions of this section:

*Example.* (i) AB partnership has \$1,000 of outstanding indebtedness owed to C. In an arm's-length transaction, C agrees to cancel the \$1,000 indebtedness in exchange (debt-for-equity exchange) for an interest (debt-for-equity interest) in AB. AB's partnership agreement provides that its partners' capital accounts will be determined and maintained in accordance with the capital accounting rules in § 1.704–1(b)(2)(iv). The fair market value of the \$1,000 indebtedness is \$700 at the time of the debt-for-equity exchange. Under § 1.704–1(b)(2)(iv)(b), C's capital account is increased by \$700 as a result of the debt-for-equity exchange. This amount equals the liquidation value of C's debt-for-equity interest, which is the amount of cash that C would receive with respect to that interest if AB partnership sold all of its assets for cash equal to the fair market value of those assets and then liquidated. C, AB partnership, and its partners treat the fair market value of the indebtedness as being equal to the liquidation value of C's debt-for-equity interest (\$700) for purposes of determining the tax consequences of the debt-for-equity exchange. Subsequent to the debt-for-equity exchange, neither AB partnership redeems nor any person related to AB partnership purchases C's debt-for-equity interest as part of a plan at the time of the debt-for-equity exchange which has as a principal purpose the avoidance of COD income by AB partnership.

(ii) Because the requirements in paragraph (b)(1) of this section are satisfied, the fair market value of C's debt-for-equity interest in AB partnership for purposes of determining AB partnership's COD income is the

liquidation value of C's debt-for-equity interest, or \$700. Accordingly, AB partnership is treated as satisfying the \$1,000 indebtedness with \$700 under section 108(e)(8).

(d) *Effective/applicability date.* This section applies to debt-for-equity exchanges occurring on or after the date that these regulations are published as final regulations in the **Federal Register**.

**Par. 3.** Section 1.721–1 is amended by adding paragraph (d) to read as follows:

#### § 1.721–1 Nonrecognition of gain or loss on contribution.

\* \* \* \* \*

(d) *Debt-for-equity exchange—(1) In general.* Except as otherwise provided in section 721 and the regulations under section 721, and notwithstanding § 1.108–8(a), section 721 applies to a contribution of a partnership's recourse or nonrecourse indebtedness by a creditor to the debtor partnership in exchange for a capital or profits interest in the partnership.

(2) *Exception.* Section 721 does not apply to the transfer of a partnership interest to a creditor in satisfaction of a partnership's recourse or nonrecourse indebtedness for unpaid rent, royalties, or interest on indebtedness (including accrued original issue discount). For rules applicable to a determination of whether a partnership interest transferred to a creditor is treated as payment of interest or accrued original issue discount, see §§ 1.446–2(e) and 1.1275–2(a), respectively.

(3) *Effective/applicability date.* This paragraph (d) applies to debt-for-equity exchanges occurring on or after the date that these regulations are published as final regulations in the **Federal Register**.

**Linda E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

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#### LIBRARY OF CONGRESS

#### Copyright Office

#### 37 CFR Part 201

[Docket No. RM 2008–9]

#### Fees

**AGENCY:** Copyright Office, Library of Congress.

**ACTION:** Extension of time to file comments.

**SUMMARY:** The Copyright Office is extending the time in which comments may be filed in response to its notice of