DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9814]

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 and temporary regulations.

SUMMARY: This document contains temporary regulations that address transfers of appreciated property by United States persons (U.S. persons) to partnerships with foreign partners related to the transferor. The regulations override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under section 721(a) of the Internal Revenue Code (Code) pursuant to section 721(c) unless the partnership adopts the remedial method and certain other requirements are satisfied. The document also contains regulations under sections 197, 704, and 6038B that apply to certain transfers described in section 721. The regulations affect U.S. partners in domestic or foreign partnerships. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**. The final regulations revise and add cross-references to coordinate the application of the temporary regulations.

DATES: *Effective Date:* These regulations are effective on January 18, 2017.

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

FOR FURTHER INFORMATION CONTACT: Concerning the temporary regulations, Ryan A. Bowen, (202) 317–6937; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in the regulations is listed with the Office of Management and Budget under control numbers 1545–1668 and 1545–0123 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received February 21, 2017.

The collections of information are in §§ 1.721(c)–6T and 1.6038B–2T. The collections of information are mandatory. The likely respondents are domestic corporations. Burdens associated with these requirements will be reflected in the burden for Form 1065, U.S. Return of Partnership Income, and Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. Estimates for completing these forms can be located in the form instructions.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Background

I. Statutory Background

Until they were repealed as part of the Taxpayer Relief Act of 1997 (the 1997 Act), Public Law 105–34 (111 Stat. 788), section 1131, sections 1491 through 1494 imposed an excise tax on certain transfers of appreciated property by a U.S. person to a foreign partnership, which generally was 35 percent of the amount of gain inherent in the property. Congress believed that the imposition of enhanced information reporting obligations (including sections 6038, 6038B, and 6046A) with respect to foreign partnerships would eliminate the need for sections 1491 through 1494. Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997, Part Two: Taxpayer Relief Act of 1997 (H.R. 2014) (JCS–23–97) (Dec. 17, 1997), at 314–315.

Notwithstanding these enhanced information reporting requirements, the 1997 Act granted the Secretary regulatory authority in section 721(c) 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. In the 1997 Act, Congress also enacted section 367(d)(3), which provides the Secretary regulatory authority to apply the rules of section 367(d)(2) to transfers of intangible property to partnerships in circumstances consistent with the purposes of section 367(d). Regulations have never been issued pursuant to section 721(c) or section 367(d)(3).

Congress enacted section 367 (and its predecessor) in order to prevent U.S. persons from avoiding U.S. tax by transferring appreciated property to foreign corporations using nonrecognition transactions. Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170, 98th Congress; Pub. L. 98–369) (JCS–41–84) (Dec. 31, 1984), at 427. The outbound transfer of intangible property raises additional issues that Congress also sought to address. Specifically, section 367(d) was enacted to prevent U.S. persons from transferring intangibles offshore in order to achieve deferral of U.S. tax on the profits generated by the intangibles. H.R. Rep. No. 98–432, 98th Cong., 2d Sess., at 1311–15 (1984). Under section 367(d), a U.S. person that transfers intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or section 361 is treated as having sold such property in exchange for payments that are contingent upon the productivity, use, or disposition of such property, and receiving amounts that reasonably reflect the amounts that would have been received annually in the form of such payments over the useful life of the property, or, in the case of a disposition following the transfer (whether direct or indirect), at the time of the disposition. Section 367(d)(2)(A). The amounts taken into account must be commensurate with the income attributable to the intangible property. *Id.*

Section 721(a) provides a general rule that no gain or loss is recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership. Because section 367 applies only to the transfer of property to a foreign corporation, absent regulations under section 721(c) or section 367(d)(3), a U.S. person generally does not recognize gain on the contribution of appreciated property to a partnership with foreign partners.

Section 704(c)(1)(A) requires partnerships to allocate income, gain, loss, and deduction with respect to property contributed by a partner to the partnership so as to take into account any variation between the adjusted tax

basis of the property and its fair market value at the time of contribution.

II. Regulatory Background

Section 1.704–3(a)(1) provides that the purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution gain or loss (forward section 704(c) layer). In addition, partnerships may, but are not required to, revalue partnership property pursuant to § 1.704–1(b)(2)(iv)(*f*) or (*s*) upon the occurrence of enumerated events, such as the entry of a new partner by contribution, giving rise to a reverse section 704(c) layer. Section 1.704–3(a)(6)(i) provides that the principles of § 1.704–3 apply to allocations with respect to these reverse section 704(c) layers (reverse section 704(c) allocations).

Section 704(c) allocations must be made using any reasonable method consistent with the purpose of section 704(c). Section 1.704–3(a)(1). Section 1.704–3 describes three methods of making section 704(c) allocations that are generally reasonable, including the remedial allocation method. *Id.* Under the remedial allocation method, a partnership may eliminate distortions caused by the ceiling rule (as described in § 1.704–3(b)(1)) by making remedial allocations of income, gain, loss, or deduction to the noncontributing partners equal to the full amount of the limitation caused by the ceiling rule, and offsetting those allocations with remedial allocations of income, gain, loss, or deduction to the contributing partner. See § 1.704–3(d)(1); see also T.D. 8585 (59 FR 66724). Under § 1.704–3(a)(10), an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. However, § 1.704–3(d)(5)(ii) provides that, in exercising its authority under § 1.704–3(a)(10), the IRS will not require a partnership to use the remedial allocation method.

III. Reasons for Exercising Regulatory Authority

The Treasury Department and the IRS are aware that certain taxpayers purport to be able to contribute, consistently with sections 704(b), 704(c), and 482, property to a partnership that allocates the income or gain from the contributed property to related foreign partners that are not subject to U.S. tax. Many of these taxpayers choose a section 704(c) method other than the remedial method or use valuation techniques that are inconsistent with the arm's length standard. In 1997, Congress recognized that taxpayers might use a partnership to shift gain to a foreign person and consequently enacted sections 721(c) and 367(d)(3). Based on the experience of the IRS with the taxpayer positions described above, the Treasury Department and the IRS have determined that it is appropriate to exercise the regulatory authority granted in section 721(c) to override the application of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) in certain circumstances in which the gain, when recognized, ultimately would be includible in the gross income of a foreign person. Although Congress also provided specific authority in section 367(d)(3) to address transfers of intangible property to partnerships, the Treasury Department and the IRS have concluded that acting pursuant to section 721(c) is more appropriate because the transactions at issue are not limited to transfers of intangible property.

IV. Notice 2015–54

On August 6, 2015, the Department of the Treasury (Treasury Department) and the IRS issued Notice 2015–54, 2015–34 I.R.B. 210 (the notice), which describes regulations to be issued under section 721(c) that would ensure that, when a U.S. person transfers certain property to a partnership that has foreign partners related to the U.S. person, income or gain attributable to the appreciation in the property at the time of the contribution will be taken into account by the transferor either immediately or over time. Comments were received on the notice and will be included in the administrative record for the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register** (REG–127203–15). The Treasury Department and the IRS have considered all the submitted comments. The significant comments are discussed in the Explanation of Provisions section of this preamble.

The notice states that future regulations generally will override the application of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) in certain circumstances in which the gain, when recognized, ultimately would be includable in the gross income of a related foreign person. The notice further states that future regulations will allow for the continued application of section 721(a) to transfers to partnerships with related foreign partners when certain requirements intended to protect the U.S. tax base are satisfied. The notice described these requirements, in addition to others, as the ''gain deferral method.''

The requirements of the gain deferral method described in the notice are that (i) the section 721(c) partnership adopts the remedial allocation method for built-in gain with respect to all section 721(c) property contributed to the partnership pursuant to the same plan by the U.S. transferor and all U.S. transferors that are related persons; (ii) the section 721(c) partnership makes consistent allocations of all section 704(b) items with respect to an item of section 721(c) property (the consistent allocation method); (iii) certain reporting requirements are satisfied; (iv) the U.S. transferor recognizes any remaining built-in gain with respect to section 721(c) property upon an acceleration event; and (v) the gain deferral method is adopted for all section 721(c) property subsequently contributed to the section 721(c) partnership by the U.S. transferor and all other U.S. transferors that are related persons until the earlier of two dates: the date that no built-in gain remains with respect to any section 721(c) property to which the gain deferral method first applied, or the date that is 60 months after the date of the initial contribution of section 721(c) property to which the gain deferral method first applied (unified application requirement). See Part III of the Explanations of Provisions section of this preamble for the definitions of ''section 721(c) partnership,'' ''section 721(c) property,'' ''U.S. transferor'' and other commonly used terms.

The notice generally provides that the regulations will define an acceleration event as any transaction that either (i) would reduce the amount of remaining built-in gain that a U.S. transferor would recognize under the gain deferral method if the transaction had not occurred, or (ii) could defer the recognition of the built-in gain. The notice also describes several situations that the regulations will not treat as acceleration events.

The notice states that the regulations will apply to transactions involving tiered partnerships in a manner that is consistent with the purpose of the regulations. As examples, the notice provides that the regulations will treat a contribution of section 721(c) property by a partnership (in which a U.S. transferor is a direct or indirect partner) to a lower-tier partnership, or a

contribution by a U.S. transferor of an interest in a partnership that owns section 721(c) property to an upper-tier partnership, as though the U.S. transferor contributed its share of the section 721(c) property directly.

The notice provides that the regulations described therein will apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 that is filed on or after August 6, 2015, and that is effective on or before August 6, 2015. The notice provides, however, that the reporting requirements will not apply to taxable years that end before the date of publication of regulations described in the notice.

The notice also announced the intent to issue regulations under sections 482 and 6662 to ensure the appropriate valuation of controlled transactions involving partnerships. These regulations are not contained in this Treasury decision and will appear in future regulations. Section 482 continues to apply to controlled transactions (within the meaning of § 1.482–1(i)(8)) that are also subject to these regulations. An adjustment pursuant to section 482 does not prevent the application of these regulations.

Explanation of Provisions

I. Comments Regarding Statutory Authority for Regulations

Comments questioned whether the regulations described in the notice are within the scope of the grant of authority in section 721(c). Specifically, comments asserted that pre-contribution gain could not be taxed under section 721(c) until it is recognized in a sale or exchange by the partnership. The Treasury Department and the IRS disagree with these comments for several reasons.

First, as explained in the notice, Congress added the broad grant of regulatory authority in section 721(c) in the 1997 Act to address transactions in which property is contributed to partnerships in order to inappropriately shift gain offshore as a replacement for the repealed excise tax on transfers to foreign partnerships in sections 1491 through 1494.

Second, section 721(c) provides authority to tax the gain when the property is contributed if the gain ''will be includible'' in a foreign person's income; it is not a rule (like section 704(c)(1)(B)) that requires the ''wait-and-see'' approach suggested by the comments. The comments fail to acknowledge that neither the traditional method nor the traditional method with curative allocations will necessarily ensure that a contributing partner will bear all the tax consequences of pre-contribution gain. A contributing partner exchanges a share of the property it contributes for a share of the property the other partners contribute. Economically, a contribution is a current value-for-value exchange. The purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution built-in gain or loss in contributed property. The regulations under section 704(c) provide three generally reasonable methods under which partnerships may allocate items with respect to contributed property so as to take into account the tax consequences of pre-contribution gain or loss—the traditional method, the traditional method with curative allocations, and the remedial allocation method. None of the methods are mandatory, and taxpayers may choose any of them (or another reasonable method) on a property-by-property and section 704(c) layer-by-layer basis. In the case of a contribution of depreciable or amortizable property with pre-contribution gain, under all three methods, book cost recovery deductions reduce the pre-contribution gain in the property (the gain that must be allocated back to the contributor) over the course of the recovery period for the property. Under the traditional method, tax cost recovery deductions (which are based on tax basis in the property) are, to the extent available, allocated first to the noncontributing partner up to its allocated book cost recovery deductions. If the noncontributing partner's book cost recovery deductions exceed its tax cost recovery deductions, the noncontributing partner will be overtaxed on its investment in the partnership property. The traditional method does not make up for shortfalls in available tax deductions, and if the partnership uses the traditional method with curative allocations, those shortfalls are cured only if there are other tax items available with which to cure. Because book cost recovery deductions reduce the built-in gain in the property regardless of whether the noncontributing partner has received all of the tax cost recovery deductions to which it is economically entitled or whether the contributing partner has received taxable income (or fewer tax deductions) commensurate with the pre-contribution gain in its property, neither the traditional method nor the traditional method with curative allocations prevents a shift of the tax consequences of pre-contribution gain to the noncontributing partner when tax basis or other tax items are insufficient to reflect the economics of the noncontributing partner. When this shift occurs, the contributing partner generally will not bear the tax consequences of the pre-contribution gain until, at the earliest, its partnership interest is liquidated or sold. In this way, the contribution of property to a partnership applying either of these two methods can result in a tax-advantaged exchange with respect to the contributing partner. When the noncontributing partner is foreign, this situation is the appropriate target for the temporary regulations.

Finally, the regulations under section 704(c) give wide latitude to taxpayers regarding how and when partners may choose to recognize pre-contribution gain. Subject to anti-abuse rules, taxpayers are allowed to adopt the traditional method and the traditional method with curative allocations despite those methods' inability to prevent a shift of the tax consequences of pre-contribution gain in all cases. This latitude raises more concern in the case of related partners, one or more of whom are foreign, given their likely overall alignment of tax interests, which would not necessarily exist among unrelated partners. As explained in Part II of the Background section of this preamble, the remedial allocation method is the only method that reliably and consistently ensures that the tax consequences of pre-contribution gain from contributed property are properly borne by the contributing partner. This feature of the remedial method is particularly relevant to the Congressional concerns about the erosion of the U.S. tax base that led to the enactment of section 721(c), and thus the remedial method is the method that is most appropriate for appreciated property that is contributed to a partnership controlled by the U.S. transferor and one or more related foreign partners. For these reasons, the Treasury Department and the IRS have determined that these regulations are within the scope of the grant of authority in section 721(c).

II. Overview of the Temporary Regulations

The temporary regulations adopt the rules that were described in the notice, with certain modifications, in part, in response to comments received.

Section 1.721(c)–1T provides definitions and rules of general application for purposes of all sections of the temporary regulations. Section

1.721(c)–2T provides the general operative rules that override section 721(a) nonrecognition upon a contribution of section 721(c) property to a partnership. Section 1.721(c)–3T describes the gain deferral method, which, if adopted, avoids the immediate recognition of gain upon a contribution of section 721(c) property. Section 1.721(c)–4T provides rules regarding events that accelerate the recognition of gain that previously was deferred under the gain deferral method. Section 1.721(c)–5T identifies exceptions to the acceleration events provided in § 1.721(c)–4T, the result of which, generally, is that the gain deferral method either ends (termination events) or continues to apply without immediate gain recognition (successor events) or continues to apply with partial gain recognition (partial acceleration events). Section 1.721(c)–6T provides procedural and reporting requirements. Section 1.721(c)–7T provides examples illustrating the application of the temporary regulations.

III. General Scope of the Temporary Regulations

The temporary regulations apply on a property-by-property basis. Accordingly, as discussed in Paragraph b of Part VI of the Explanations of Provisions section of this preamble, the temporary regulations do not include the unified application requirement announced in the notice.

The temporary regulations apply to all contributions, actual or deemed, of property to a partnership, including, for example, a contribution of property that occurs as a result of (i) a partnership merger, consolidation, or division in the assets-over form, (ii) a change in entity classification that occurs pursuant to § 301.7701–3, or (iii) a transaction described in Rev. Rul. 99–5, 1999–1 C.B. 434 (change from a disregarded entity to a partnership). However, in response to a comment, the temporary regulations provide that a contribution in a technical termination of a partnership described in section 708(b)(1)(B) (technical termination) will not, by itself, cause a partnership to become a section 721(c) partnership subject to the temporary regulations. For further discussion, see Part IV of the Explanation of Provisions section of this preamble. However, the temporary regulations do apply to a technical termination of a section 721(c) partnership applying the gain deferral method. In this regard, see Part V and Paragraph c of Part VIII of the Explanation of Provisions section of this preamble, concerning the general rule of gain recognition and successor events, respectively.

The temporary regulations provide that 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. See § 1.721(c)–1T(c).

Finally, as announced in the notice, the temporary regulations contain rules for transactions involving tiered partnerships, as well as a general anti-abuse rule (see § 1.721(c)–1T(d)) that applies for purposes of all sections of the temporary regulations.

IV. Definitions: Section 721(c) Partnership, Section 721(c) Property, U.S. Transferor, and Other Terms

The notice states that future regulations would provide that a partnership is a section 721(c) partnership if a U.S. transferor contributes section 721(c) property to the partnership, and, after the contribution and any transactions related to the contribution, (i) a related foreign person is a direct or indirect partner, and (ii) the U.S. transferor and related persons own (directly or indirectly) more than 50 percent of the interests in partnership capital, profits, deductions, or losses.

A comment requested that the definition of section 721(c) partnership be revised to exclude partnerships when the interests held by related foreign persons are small and an unrelated third-party with a material adverse tax position to the U.S. transferor holds a meaningful interest in the partnership. According to the comment, these two factors would sufficiently mitigate the potential for the abuse that the notice is intended to address. While these factors may reduce the ability of a U.S. transferor to shift gain or income outside the United States, the Treasury Department and the IRS have concluded that these factors alone are insufficient to prevent the erosion of the U.S. tax base that section 721(c) was enacted to address. In particular, the Treasury Department and the IRS are concerned that even a small ownership interest held by a related foreign person may be used for a meaningful shift of gain or income outside the United States. Furthermore, the Treasury Department and the IRS have determined that such a rule would necessitate additional rules to address small interests that later become large either in absolute or relative terms. In this regard, the Treasury Department and the IRS have determined that both a general anti-abuse rule and a more targeted rule that would require periodic retesting of the size of a related foreign person's interest would be difficult to administer. Accordingly, this comment has not been adopted. The Treasury Department and the IRS, however, acknowledge that the higher the overall level of related ownership in the partnership, the more likely the arrangement among the partners will reflect tax considerations. After considering this comment and other comments that requested a higher level of related-party ownership in the definition of a section 721(c) partnership, the temporary regulations increase the threshold from a ''more than 50 percent'' test to an ''80 percent or more'' test (ownership requirement). See § 1.721(c)–1T(b)(14)(i) for the general definition of a section 721(c) partnership. The temporary regulations also provide rules that deem certain controlled partnerships in a tiered-partnership structure to be section 721(c) partnerships in order to apply the gain deferral method. See § 1.721(c)–1T(b)(14)(ii).

The temporary regulations define section 721(c) property as property, other than excluded property, with built-in gain that is contributed to a partnership by a U.S. transferor. See § 1.721(c)–1T(b)(15)(i) for the general definition of section 721(c) property. The notice incorporated the requirement that a U.S. transferor make the contribution in the definition of a section 721(c) partnership rather than in the definition of section 721(c) property. This adjustment to the definitions is intended to be a non-substantive change. The temporary regulations provide that if a U.S. transferor is treated as contributing its share of an item of property, the entire item of property is section 721(c) property. In addition, the temporary regulations provide rules that deem certain property of a tiered partnership to be section 721(c) property. See § 1.721(c)–1T(b)(15)(ii). When an interest in a partnership is contributed, the partnership interest, if it is not excluded property, is the section 721(c) property.

The temporary regulations define excluded property as (i) a cash equivalent; (ii) a security within the meaning of section 475(c)(2), without regard to section 475(c)(4); (iii) an item of tangible property with built-in gain that does not exceed $20,000 or with an adjusted tax basis in excess of book value (built-in loss); and (iv) an interest in a partnership that holds (directly, or indirectly through interests in one or more partnerships that are not excluded property under this clause (iv)) property of which 90 percent or more of the value consists of property described in clauses (i) through (iii) (partnership interest

exclusion). See § 1.721(c)–1T(b)(6). The notice announced the first three categories of excluded property. However, the temporary regulations include tangible property with a built-in loss in the third exclusion so that such property is excluded property for purposes of the partnership interest exclusion. The Treasury Department and the IRS determined that it was appropriate to add the partnership interest exclusion so that the temporary regulations do not apply to transfers of partnership interests when only a small portion of the partnership's property is section 721(c) property. If a partnership interest fails the 90-percent threshold test for the partnership interest exclusion and does not qualify under the second exclusion for securities, the interest is section 721(c) property.

Comments recommended that property that gives rise to income effectively connected with a U.S. trade or business (ECI property) be excluded from the definition of section 721(c) property, because the income will be subject to U.S. tax even if it is allocated to a related foreign person. The Treasury Department and the IRS agree with the reasoning behind this comment, and have determined that the temporary regulations should also address the situation when the property ceases to be ECI property and still has built-in gain. Accordingly, the temporary regulations continue to include ECI property in the definition of section 721(c) property but modify the application of the gain deferral method to ECI property, as discussed in Paragraph c of Part VI of the Explanation of Provisions section of this preamble.

Another comment similarly suggested that the definition of section 721(c) property exclude property the gain on which would be subject to U.S. tax under subpart F of the Code. The Treasury Department and IRS have declined to adopt such a rule, which would depend on a ''wait and see'' approach and would import the recognition rules of subpart F, including an earnings and profits requirement, rather than the more direct approach of section 721(c).

The temporary regulations define built-in gain with respect to an item of property contributed to a partnership as 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 the gain recognition rule of § 1.721(c)–2T(b). See § 1.721(c)–1T(b)(2). The temporary regulations clarify the definition provided in the notice in two respects. First, the notice states that built-in gain would be determined with respect to the contributing partner's adjusted tax basis in the property at the time of the contribution, whereas the temporary regulations provide that built-in gain is determined with respect to the partnership's adjusted tax basis in the property. The revision was made in order to more precisely describe the amount of gain that may be shifted to a related foreign partner. Second, the temporary regulations clarify that built-in gain is determined without regard to the application of the gain recognition rule under § 1.721(c)–2T(b).

The temporary regulations include a new term, ''remaining built-in gain.'' Section 1.721(c)–1T(b)(13)(i) generally defines remaining built-in gain, with respect to an item of section 721(c) property that is subject to the gain deferral method, as the built-in gain, reduced by decreases in the difference between the property's book value and adjusted tax basis. However, subsequent increases or decreases to the property's book value due to a revaluation other than a revaluation required under these temporary regulations for tiered partnerships are not taken into account in determining remaining built-in gain. The temporary regulations provide rules for determining remaining built-in gain in the case of tiered partnerships. See § 1.721(c)–1T(b)(13)(ii).

Consistent with the notice, § 1.721(c)–1T(b)(18)(i) of the temporary regulations generally defines a U.S. transferor as a U.S. person (within the meaning of section 7701(a)(30)) other than a domestic partnership. The temporary regulations also provide a rule that deems certain tiered partnerships to be a U.S. transferor solely for purposes of applying the consistent allocation method. See § 1.721(c)–1T(b)(18)(ii).

Finally, the temporary regulations, consistent with the notice, define (i) a related person as a person that is related (within the meaning of section 267(b) or section 707(b)(1)) to a U.S. transferor; (ii) a related foreign person as a person that is a related person (other than a partnership) that is not a U.S. person; and (iii) a direct or indirect partner as a person (other than a partnership) that owns an interest in a partnership directly or indirectly through one or more partnerships. See § 1.721(c)–1T(b)(12), (b)(11), and (b)(5), respectively.

V. General Rule of Gain Recognition Upon a Contribution of Section 721(c) Property to a Section 721(c) Partnership

Section 1.721(c)–2T provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a partnership. Section 1.721(c)–2T(b) provides the general rule that nonrecognition under section 721(a) will not apply to gain realized upon a contribution of section 721(c) property to a section 721(c) partnership. In contrast to the regulations described in the notice, § 1.721(c)–2T(b) provides that this general rule does not apply—and therefore that nonrecognition under section 721(a) continues to apply—to a direct contribution of section 721(c) property by an ''unrelated'' U.S. transferor (in other words, a U.S. transferor that does not, together with related persons with respect to it, satisfy the ownership requirement). The carve-out is consistent with the intent of the temporary regulations to address the shifting of income among related persons. Because this carve-out for an unrelated U.S. transferor is limited to direct contributions of section 721(c) property, it does not apply to a contribution that occurs pursuant to the partnership look-through rule in § 1.721(c)–2T(d)(1) (as discussed elsewhere in this Part V).

Section 1.721(c)–2T(c) provides a de minimis exception to the general rule. The temporary regulations modify the de minimis exception described in the notice—which focused on contributions made by a U.S. transferor (and all related U.S. transferors) during the U.S. transferor's taxable year—to focus instead on contributions during the partnership's taxable year, in order to align the rule with the reporting required under § 1.721(c)–6T. Under the de minimis exception in the temporary regulations, contributions of section 721(c) property will not be subject to immediate gain recognition if the sum of all built-in gain for all section 721(c) property contributed to a section 721(c) partnership during the partnership's taxable year does not exceed $1 million.

Section 1.721(c)–2T(d)(1) provides a look-through rule for identifying a section 721(c) partnership when an upper-tier partnership in which a U.S. transferor is a direct or indirect partner contributes property to a lower-tier partnership. For purposes of determining if the lower-tier partnership is a section 721(c) partnership, the U.S. transferor will be 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. If the lower-tier partnership is a section 721(c) partnership, absent application of the gain deferral method by the lower-tier partnership to the entire property and by the upper-tier partnership to the partnership interest in the lower-tier partnership, the upper-tier partnership will recognize the entire

built-in gain in the section 721(c) property under the general gain recognition rule, because the entire property will be section 721(c) property (see the general definition of section 721(c) property in § 1.721(c)–1T(b)(15)(i)).

Section 1.721(c)–2T(d)(2) provides that the partnership look-through rule will not apply to a deemed contribution by an ''old'' partnership to a ''new'' partnership that occurs as a result of a technical termination of the old partnership. Thus, a technical termination will not cause a non-section 721(c) partnership, in which a U.S. transferor is a direct or indirect partner, to become a section 721(c) partnership subject to these temporary regulations. If, however, a partnership is a section 721(c) partnership subject to the temporary regulations immediately before its technical termination, the technical termination would be a successor event (rather than an acceleration event) only if the new partnership continues the gain deferral method with respect to the section 721(c) property that was subject to the gain deferral method in the terminated partnership. In this regard, see § 1.721(c)–5T(c)(4) (defining a successor event to include certain technical terminations).

VI. Gain Deferral Method

a. In General

Section 1.721(c)–3T describes the gain deferral method, which generally must 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)–3T(b) provides the five general requirements for applying the gain deferral method to an item of section 721(c) property: (i) The section 721(c) partnership adopts the remedial allocation method and allocates section 704(b) items of income, gain, loss, and deduction with respect to the section 721(c) property in a manner that satisfies the consistent allocation method; (ii) the U.S. transferor recognizes gain equal to the remaining built-in gain with respect to the section 721(c) property upon an acceleration event, or an amount of gain equal to a portion of the remaining built-in gain upon a partial acceleration event or certain transfers to foreign corporations described in section 367; (iii) procedural and reporting requirements are satisfied; (iv) the U.S. transferor extends the period of limitations on assessment of tax (as discussed in Part X of the Explanation of Provisions section of this preamble); and (v) the rules for tiered partnerships are satisfied if either the section 721(c) property is an interest in a partnership or the section 721(c) property is described in the partnership look-through rule in § 1.721(c)–2T(d)(1).

b. Application of the Gain Deferral Method on a Property-by-Property Basis

Comments questioned the necessity for the unified application requirement announced in the notice. The unified application requirement was intended to prevent taxpayers from disaggregating the contribution of separate but related business property and choosing to recognize gain upon contribution for some property and to apply the gain deferral method for other property, in an attempt to minimize the reported cumulative value for all contributed property or to minimize the reported value of property for which the gain deferral method was not adopted. This concern arises, in part, because the IRS may not be able to make an adjustment for the correct amount of gain with respect to property that is not subject to the gain deferral method due to the expiration of the period of limitations on the assessment of tax. While the Treasury Department and the IRS continue to be concerned that taxpayers will attempt to disaggregate related business property in order to undervalue their contributions, the temporary regulations adopt a more targeted approach to address these comments. Accordingly, the temporary regulations do not include the unified application requirement and instead apply on a property-by-property basis.

As described in the notice, in order to apply the gain deferral method with respect to a contribution of section 721(c) property to a section 721(c) partnership, the temporary regulations require the U.S. transferor to extend the period of limitations on assessment of tax on all items related to the property with respect to which the gain deferral method applies through the close of the eighth full taxable year following the contribution. To address the concerns that motivated the uniform application requirement, the temporary regulations require a U.S. transferor to extend the period of limitations on assessment of tax on the gain recognized under the general rule with respect to any section 721(c) property that is contributed to the partnership for which the gain deferral method will not be applied through the close of the fifth full taxable year following the contribution of such property, if the property is contributed within five full taxable years after a gain deferral contribution, defined in § 1.721(c)–1T(b)(7) as a contribution of section 721(c) property to a section 721(c) partnership with respect to which the gain is deferred under the gain deferral method. See §§ 1.721(c)–3T(b)(4) and 1.721(c)–6T(b)(5)(iii), discussed in Part X of the Explanation of Provisions section of this preamble. Additionally, it should be noted that § 1.482–1T(f)(2)(i)(B) provides that separate transactions must be aggregated for purposes of determining the arm's length pricing of such transactions under section 482, including for purposes of an analysis under multiple provisions of the Code or regulations, if the transactions are so interrelated that an aggregate analysis provides the most reliable measure of the arm's length result.

c. Application of the Gain Deferral Method to ECI Property

As discussed in Part IV of the Explanation of Provisions section of this preamble, the temporary regulations do not adopt the comment recommending that ECI property be excluded from the definition of section 721(c) property. Instead, the temporary regulations continue to provide that a contribution of section 721(c) property that is ECI property is subject to immediate gain recognition if the gain deferral method is not applied. However, in response to the comment, the temporary regulations modify the gain deferral method such that ECI property is not subject to the remedial allocation method or the consistent allocation method. This special exception for ECI property applies for as long as, beginning on the date of the contribution and ending when there is no remaining built-in gain with respect to the property, all distributive shares of income and gain with respect to the property for all direct and indirect partners that are related foreign persons will be subject to taxation as effectively connected with a trade or business within the United States (under section 871 or 882), and neither the section 721(c) partnership nor a direct or indirect partner that is a related foreign person claims benefits under an income tax treaty that would exempt the income or gain from tax or reduce the rate of taxation to which the income or gain is subject. See § 1.721(c)–3T(b)(1)(ii).

All the other requirements of the gain deferral method apply with respect to ECI property. Thus, a U.S. transferor must recognize gain upon an acceleration event with respect to ECI property, including when property ceases to be ECI property, and satisfy the procedural and reporting requirements with respect to ECI property. See § 1.721(c)–6T(b)(2)(iii), (b)(3)(vii), and (c)(1).

A comment also requested an exclusion for property subject to tax under section 897 (relating to U.S. real property interests) from the definition of section 721(c) property. The temporary regulations do not adopt this comment because the special rules for ECI property appropriately address the concerns expressed regarding U.S. real property interests.

d. Application of the Gain Deferral Method to Anti-Churning Property

Comments requested guidance on how the requirement to use the remedial allocation method interacts with the section 197 anti-churning rules. In general, section 197(f)(9) prohibits the amortization of goodwill and going concern value that was nonamortizable before the enactment of section 197 (section 197(f)(9) intangible property), and that prohibition continues if the property is transferred to a related person. Under § 1.197–2(h)(12)(vii)(B), when section 197(f)(9) intangible property is contributed to a partnership, a noncontributing partner generally may receive remedial allocations of amortization with respect to the property. A noncontributing partner that is related to the contributing partner, however, may not receive such remedial allocations.

One comment requested that a U.S. transferor not be required to include remedial income with respect to section 197(f)(9) intangible property when the gain deferral method is being applied. The temporary regulations do not adopt this comment. The Treasury Department and the IRS are concerned that providing favorable treatment for section 721(c) property belonging to a particular class would incentivize taxpayers to attribute excessive value to that class of property while simultaneously undervaluing related but separate section 721(c) property that remains subject to all of the requirements of the gain deferral method. This concern is especially pronounced in the case of section 197(f)(9) intangible property, which is often difficult to value separately from other identifiable intangible property. In this regard, see the preamble of the notice of proposed rulemaking (REG–139483–13) containing proposed regulations under section 367, published in the **Federal Register** on September 16, 2015 (80 FR 55568). See also the preamble to T.D. 9803, which finalized those proposed regulations, published in the **Federal Register** on December 16, 2016 (81 FR 91012).

Another comment recommended that regulations implementing the gain deferral method require the partnership to amortize the section 197(f)(9) intangible and allocate remedial items of amortization to a related foreign partner and corresponding remedial items of income to the contributing partner. The Treasury Department and the IRS have determined that changing § 1.197–2(h)(12)(vii)(B) to permit remedial allocations of amortization to related partners, or distinguishing between domestic and related foreign partners, would be contrary to section 197(f)(9) and therefore do not adopt this comment. In lieu of providing that remedial allocations may be made to a related partner, the temporary regulations provide a special non-amortizable tax basis adjustment to the property. This special adjustment is made solely with respect to the related partner. The Treasury Department and the IRS have determined that allowing this tax basis adjustment is consistent with the policy of the section 197 anti-churning rules.

More specifically, the temporary regulations revise the remedial allocation method in § 1.704–3(d) as to related partners when a section 721(c) partnership is applying the gain deferral method with respect to section 197(f)(9) intangible property. The revised rule requires the partnership to amortize the portion of the partnership's book value in the section 197(f)(9) intangible property that exceeds its adjusted tax basis in the property. Accordingly, the allocation of book amortization to a noncontributing partner will result in a ceiling rule limitation to the extent of this allocation of book amortization. If a noncontributing partner is a related person with respect to the U.S. transferor, the temporary regulations provide that, solely with respect to the related noncontributing partner, the partnership must increase the adjusted tax basis of the property by the amount of the difference between the book allocation of the item to the related person and the tax allocation of the same item to the related person and allocate remedial income in the same amount to the U.S. transferor. See § 1.704–3T(d)(5)(iii)(C).

The rules governing the tax consequences of the special tax basis adjustment are modeled on § 1.743–1 and proposed regulations under section 704(c)(1)(C) that are contained in a notice of proposed rulemaking (REG–144468–05) published in the **Federal Register** (79 FR 3042) on January 16, 2014. The adjustment to the tax basis of section 197(f)(9) intangible property will be recovered by the related partner only upon a sale or exchange of the property by the partnership. Generally, a transfer by the noncontributing related partner of all or a portion of its interest in the partnership will eliminate the tax basis adjustment attributable to the interest such that the transferee will not succeed to the tax basis adjustment. However, if the interest is transferred in a substituted basis transaction, the transferee will succeed to the transferor's tax basis adjustment and the adjustment will be taken into account in computing and allocating any adjustment to the basis of the section 197(f)(9) intangible property under sections 743(b) and 755. These rules must be applied together with the general rules under section 197 and subchapter K of the Code. In resolving any uncertainty that arises in the implementation of these rules, it would be reasonable for taxpayers to apply principles similar to those contained in § 1.743–1, the proposed regulations under section 704(c)(1)(C), and any Code sections or regulations that reference those rules.

The Treasury Department and the IRS request comments on the following issues, and on any other issues relevant to a section 721(c) partnership's application of the remedial allocation method to section 197(f)(9) intangible property: (i) The application of the method to members of a consolidated group; (ii) the treatment of a tax basis adjustment when the adjusted section 197(f)(9) intangible property is transferred (a) in a like-kind exchange described in section 1031, (b) to a lower-tier partnership, (c) in a transaction described in section 351, (d) in a technical termination, or (e) in an installment sale; (iii) the treatment of a tax basis adjustment when the section 197(f)(9) intangible property is distributed to the related person for whom the adjustment was made or to another partner in a current or liquidating distribution; and (iv) any rules that are necessary to ensure that the tax basis adjustment does not become amortizable in contravention of the anti-churning rules.

e. Consistent Allocation Method

1. In General

Section 1.721(c)–3T(c)(1) describes the consistent allocation method, which, like the gain deferral method, applies on a property-by-property basis. The consistent allocation method requires a section 721(c) partnership to allocate the same percentage of each book item of income, gain, deduction, and loss ''with respect to the section 721(c) property'' to the U.S. transferor. Comments questioned the necessity of the requirement to apply the consistent allocation method. Some comments

asserted that the requirement is unnecessary because the built-in gain in section 721(c) property will be preserved in the difference between the book and tax capital accounts of a U.S. transferor. The Treasury Department and the IRS have determined that remedial allocations alone are insufficient to ensure that built-in gain with respect to section 721(c) property will be subject to U.S. tax. The consistent allocation method is intended to prevent a U.S. transferor from rendering the remedial allocation method ineffective by, for example, having the partnership allocate a higher percentage share of book depreciation to the U.S. transferor (which would reduce the U.S. transferor's remedial income inclusion) than the U.S. transferor's percentage share of income or gain with respect to the property, which would result in shifting the gain (and taxable income) to related foreign persons that are direct or indirect partners in the partnership. Therefore the temporary regulations do not adopt this comment. The temporary regulations provide rules (discussed in Paragraph e.2 of this Part VI) to determine the amount of income, gain, deduction, and loss that is considered to be ''with respect to section 721(c) property'' under the gain deferral method.

According to another comment, the consistent allocation method is both over-inclusive, in that situations in which a U.S. transferor is allocated greater income than its share of deductions would violate the rule, and under-inclusive, because deductions allocated to a U.S. transferor that do not arise from section 721(c) property are beyond the scope of the rule. This comment proposed an alternative anti-abuse rule that would require that a minimum cumulative amount of income be allocated to a U.S. transferor. The Treasury Department and the IRS have concluded that the rule described in the comment would be difficult to administer. However, in response to comments, the temporary regulations provide exceptions (discussed in Paragraph e.3 of this Part VI) to the consistent allocation method for certain regulatory allocations and the allocations of creditable foreign tax expenditures.

2. Determining Book Items With Respect to Section 721(c) Property

The notice did not describe how partnership items are determined to be ''with respect to section 721(c) property.'' The temporary regulations provide guidance for making this determination based on principles that will be familiar to many taxpayers.

i. Book Items of Income and Gain

Section 1.721(c)–3T(c)(2) provides the rule for determining the extent to which partnership items of book income and gain are considered to be ''with respect to'' particular section 721(c) property for purposes of applying the consistent allocation method on a property-by-property basis. This rule provides that a section 721(c) partnership must attribute book income and gain to each property in a consistent manner using any reasonable method that takes into account all the facts and circumstances. The temporary regulations provide that all items of book income and gain attributable to each property will comprise a single class of gross income for purposes of determining the extent to which partnership items of deduction or loss are allocated and apportioned with respect to the section 721(c) property.

ii. Book Items of Deduction and Loss

Section 1.721(c)–3T(c)(3) provides the rules for determining the extent to which partnership items of book deduction and loss are considered to be ''with respect to'' particular section 721(c) property for purposes of applying the consistent allocation method. A section 721(c) partnership must use the principles of §§ 1.861–8 and 1.861–8T to allocate and apportion all of its items of deduction, except for interest expense and research and experimental expenditures (R&E), and loss to the class of gross income with respect to each section 721(c) property. The section 721(c) partnership may allocate and apportion its interest expense and R&E using any reasonable method, including, but not limited to, the methods described in §§ 1.861–9 and 1.861–9T (interest expense) and § 1.861–17 (R&E).

3. Exceptions to the Consistent Allocation Method

In response to comments, the temporary regulations provide exceptions from the requirement to apply the consistent allocation method with respect to certain book items of a section 721(c) partnership.

i. Regulatory Allocations

The temporary regulations provide that a regulatory allocation (as defined in § 1.721(c)–1T(b)(10)) of book income, gain, deduction, or loss with respect to section 721(c) property that otherwise would fail to satisfy the requirements of the consistent allocation method nevertheless will, in certain cases, be deemed to satisfy the requirements. Specifically, a regulatory allocation is deemed to satisfy the requirements of the consistent allocation method if the allocation is (i) an allocation of income or gain to the U.S. transferor (or a member of its consolidated group); or (ii) an allocation of deduction or loss to a partner other than the U.S. transferor (or a member of its consolidated group). In addition, if the allocation is not described in clause (i) or (ii) but the U.S. transferor receives less income or gain or more deductions or loss with respect to the section 721(c) property because of the regulatory allocation, the allocation is treated as described in § 1.721(c)–5T(d)(2) (generally requiring that a portion of remaining built-in gain be recognized, as discussed in Paragraph d.2 of Part VIII of the Explanation of Provisions section of this preamble). See § 1.721(c)–3T(c)(4)(i)(C). The Treasury Department and the IRS have determined that this special rule for regulatory allocations is appropriate because an allocation described in clause (i) or (ii) will not reduce the U.S. tax base and an allocation described in clause (iii) will result in the U.S. transferor recognizing gain that will offset the reduction in the U.S. tax base resulting from the regulatory allocation.

The temporary regulations provide that 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(a)(3). The Treasury Department and the IRS have determined that relief is appropriate for these regulatory allocations because, in general, partners do not have discretion regarding their application and, when necessary, treating them as a partial acceleration event will result in the appropriate amount of gain being recognized for purposes of the gain deferral method. The Treasury Department and the IRS have determined that relief is not appropriate for a nonrecourse deduction, as defined in § 1.704–2(b)(1), because, unlike the other types of regulatory allocations, partners have significant discretion regarding the allocation of a nonrecourse deduction.

ii. Creditable Foreign Tax Expenditures

The temporary regulations provide that allocations of creditable foreign tax expenditures (as defined in § 1.704–

1(b)(4)(viii)(*b*)) (CFTEs) are not subject to the consistent allocation method. See § 1.721(c)–3T(c)(4)(ii). The regulations governing the allocation of CFTEs take into account section 704(c) income and gain and are not based strictly on the allocation of book items. As a result, it would be difficult to apply the consistent allocation method with respect to CFTEs.

VII. Acceleration Events

a. Overview

Section 1.721(c)–4T provides rules regarding acceleration events, which, like the gain deferral method, apply on a property-by-property basis. When an acceleration event occurs with respect to section 721(c) property, remaining built-in gain in the property must be recognized and the gain deferral method no longer applies. The temporary regulations provide exceptions to acceleration events that are discussed in Part VIII of the Explanation of Provisions section of this preamble.

b. Definition of an Acceleration Event

1. General Rules

Subject to the exceptions described in Part VIII of the Explanation of Provisions section of this preamble, § 1.721(c)–4T(b)(1) defines an acceleration event as any event that would reduce the amount of remaining built-in gain that a U.S. transferor would have recognized under the gain deferral method if the event had not occurred or that could defer the recognition of the remaining built-in gain. The temporary regulations clarify that an acceleration event includes the transfer of section 721(c) property via a contribution of the property itself or through a contribution of a partnership interest.

2. Failure To Comply With a Requirement of the Gain Deferral Method

The rules described in the notice would have provided that a failure to comply with one of the requirements of the gain deferral method with respect to any section 721(c) property would cause an acceleration event for all section 721(c) property. Comments requested that the Treasury Department and the IRS eliminate this provision. Because the temporary regulations provide that the gain deferral method is applied on a property-by-property basis (in lieu of containing the unified application requirement), the temporary regulations adopt this comment.

Under the temporary regulations, an acceleration event with respect to section 721(c) property occurs when any party fails to comply with a requirement of the gain deferral method with respect to that property. See § 1.721(c)–4T(b)(2)(i). For example, if section 721(c) property is ECI property, an acceleration event occurs if a distributive share of income or gain from the property that is allocated to a direct or indirect partner that is a related foreign person is no longer subject to taxation as income effectively connected with a trade or business within the United States or if the section 721(c) partnership or a direct or indirect partner that is a related foreign person claims certain benefits under an income tax treaty with respect to the income (see § 1.721(c)–3T(b)(1)(ii)).

An acceleration event will not occur solely as a result of a failure to comply with a procedural or reporting requirement of the gain deferral method if that failure is not willful and relief is sought under the prescribed procedures. See §§ 1.721(c)–4T(b)(2)(ii) and 1.721(c)–6T(f).

3. Special Rule When Section 721(c) Property Is an Interest in a Partnership

When section 721(c) property is an interest in a partnership, the temporary regulations provide that an acceleration event will not occur because of a reduction in remaining built-in gain in the partnership interest as a result of allocations of book items of deduction and loss or tax items of income and gain by that partnership. See § 1.721(c)–4T(b)(3).

4. Deemed Acceleration Event

Under the temporary regulations, a U.S. transferor may affirmatively treat an acceleration event as having occurred with respect to section 721(c) property by recognizing the remaining built-in gain with respect to that property and satisfying the reporting required by § 1.721(c)–6T(b)(3)(iv). See § 1.721(c)–4T(b)(4).

c. Consequences of an Acceleration Event

Section 1.721(c)–4T(c) sets forth the consequences of an acceleration event. Specifically, 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. Following the acceleration event, the section 721(c) property will no longer be subject to the gain deferral method.

The U.S. transferor generally must make correlative adjustments to its basis in its partnership interest. See § 1.721(c)–4T(c)(1). In addition, the section 721(c) partnership will increase its basis in the section 721(c) property by the amount of gain recognized by the U.S. transferor. This basis increase is made immediately before the acceleration event. See § 1.721(c)–4T(c)(2). If the section 721(c) property remains in the partnership after the acceleration event, the increase in the basis of the section 721(c) property generally would be treated in the same manner as newly purchased property, including for purposes of determining the depreciation schedule if the property is depreciable property.

VIII. Acceleration Event Exceptions

a. In General

Section 1.721(c)–5T identifies the following categories of exceptions to acceleration events, which, like acceleration events, apply on a property-by-property basis: (i) Termination events, in which case, the gain deferral method ceases to apply to the section 721(c) property; (ii) successor events, in which case, the gain deferral method continues to apply to the section 721(c) property but with respect to a successor U.S. transferor or a successor section 721(c) partnership, as applicable; (iii) partial acceleration events, in which case, a U.S. transferor recognizes an amount of gain that is less than the full amount of remaining built-in gain in the section 721(c) property and the gain deferral method continues to apply; (iv) transfers described in section 367 of section 721(c) property to a foreign corporation, in which case, the gain deferral method ceases to apply and a U.S. transferor recognizes an amount of gain equal to the remaining built-in gain attributable to the portion of the section 721(c) property that is not subject to tax under section 367; and (v) fully taxable dispositions of a portion of an interest in a section 721(c) partnership, in which case, the gain deferral method continues to apply for the retained portion of the interest.

b. Termination Events

1. In General

Section 1.721(c)–5T(b) identifies the events that cause the gain deferral method to no longer apply. The Treasury Department and the IRS have determined that it is appropriate to terminate the application of the gain deferral method with respect to the affected section 721(c) property in these cases because the potential to shift gain or income to a related foreign person that is a direct or indirect partner in the section 721(c) partnership has been eliminated.

2. Transfers of Section 721(c) Property (Other Than a Partnership Interest) to a Domestic Corporation Described in Section 351

The temporary regulations provide that a termination event occurs if a section 721(c) partnership transfers section 721(c) property other than a partnership interest to a domestic corporation in a transaction to which section 351 applies. See § 1.721(c)–5T(b)(2).

3. Certain Incorporations of a Section 721(c) Partnership

A comment questioned whether the rules described in the notice would exempt from the definition of an acceleration event certain transactions after which the partnership ceases to exist, such as those described in Rev. Rul. 84–111, 1984–2 C.B. 88 (describing three methods for incorporating a partnership). See § 601.601(d)(2)(ii)(b). The temporary regulations provide that 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. See § 1.721(c)–5T(b)(3).

4. Certain Distributions of Section 721(c) Property

A comment questioned whether an acceleration event should occur as a result of a distribution of section 721(c) property to a partner other than a U.S. transferor outside of the seven-year period described in sections 704(c)(1)(B) and 737 (rules that address certain distributions of property within seven years of a contribution). While sections 704(c)(1)(B) and 737 also are intended to ensure that gain on contributed property is not inappropriately transferred to a partner other than the contributor, in the context of contributions to partnerships with related foreign partners, the Treasury Department and the IRS have determined that concerns about the erosion of the U.S. tax base remain as long as there is remaining built-in gain in the section 721(c) property. Accordingly, the Treasury Department and the IRS have determined that it is inappropriate to provide a termination event exception for all distributions of section 721(c) property after seven years.

The temporary regulations, however, provide that a termination event occurs if a section 721(c) partnership distributes section 721(c) property to the U.S. transferor. A termination event will also occur if a section 721(c) partnership distributes section 721(c) property to a member of a U.S. transferor's consolidated group and the distribution occurs more than seven years after the contribution. See § 1.721(c)–5T(b)(4).

5. Section 721(c) Partnership Ceases to Have a Related Foreign Person Partner

In response to a comment, the temporary regulations generally provide that a termination event occurs when a section 721(c) partnership ceases to have any direct or indirect partners that are related foreign persons, provided there is no plan for a related foreign person to subsequently become a direct or indirect partner in the partnership (or a successor). See § 1.721(c)–5T(b)(5). The no-plan requirement applies independently of the general anti-abuse rule under § 1.721(c)–1T(d). An acceleration event, however, occurs upon 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 or of an Entire Interest in a Section 721(c) Partnership

The notice treated a taxable disposition of section 721(c) property by a section 721(c) partnership, or an indirect disposition of section 721(c) property through a taxable disposition of an interest in a section 721(c) partnership interest, as an acceleration event. The Treasury Department and the IRS have determined that it is appropriate instead to treat a fully taxable disposition of section 721(c) property or of an entire interest in a section 721(c) partnership as a termination event because other sections of the Code require gain to be recognized.

Accordingly, the temporary regulations provide that 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. See § 1.721(c)–5T(b)(6). In addition, a termination event occurs if either a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of an entire interest in a section 721(c) partnership that owns section 721(c) property in a transaction in which all gain or loss, if any, is recognized. This rule does not apply if a U.S. transferor is a member of a consolidated group and the interest in the section 721(c) partnership is transferred to another member in an intercompany transaction (as defined in § 1.1502–13(b)(1)). See § 1.721(c)–5T(b)(7). See, however, Paragraph c.2 of this Part VIII, which describes the rule in § 1.721(c)–5T(c)(3) that provides that such a transaction may be a successor event.

c. Successor Events

1. In General

Section 1.721(c)–5T(c) identifies the successor events that allow for the continued application of the gain deferral method. In each of these cases, it is appropriate to continue application of the gain deferral method (rather than accelerate gain recognition), because its application can be preserved in the hands of a successor U.S. transferor or a successor section 721(c) partnership, as applicable. If, however, the successor does not continue the gain deferral method, the event is an acceleration event. If only a portion of an interest in a partnership is transferred in a successor event, 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 that is retained. See § 1.721(c)–5T(c)(1).

2. A Domestic Corporation Becomes a Successor U.S. Transferor

The temporary regulations provide that a successor event occurs if either 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. See § 1.721(c)–5T(c)(2).

In addition, a successor event occurs if a U.S. transferor that is a member of a consolidated group transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to another member 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. See § 1.721(c)–5T(c)(3).

3. Technical Termination of a Section 721(c) Partnership

In response to comments, the temporary regulations provide that a successor event occurs if there is a technical termination of a section 721(c) partnership, and the gain deferral method is continued by treating the new

partnership as the section 721(c) partnership. See § 1.721(c)–5T(c)(4). Although a technical termination will cause the depreciation schedule to be reset with respect to any depreciable section 721(c) property of the terminated section 721(c) partnership, and thus defer the recognition of remaining built-in gain, the Treasury Department and the IRS have concluded that this should not cause an acceleration event. In this case, however, the general anti-abuse rule under § 1.721(c)–1T(d) may apply, depending on the facts relating to the technical termination.

4. A Partnership Becomes a Successor Section 721(c) Partnership

The temporary regulations provide two other categories of successor events that involve successor section 721(c) partnerships. In each case, section 721(c) property is directly or indirectly contributed to a successor section 721(c) partnership and the gain deferral method is applied down the chain of ownership with the result that the remaining built-in gain will continue to be subject to U.S. tax.

In the first category, a successor event occurs if (i) a section 721(c) partnership contributes section 721(c) property to a lower-tier partnership that is a controlled partnership; (ii) the gain deferral method is applied both with respect to the section 721(c) partnership's interest in the lower-tier partnership and with respect to the section 721(c) property in the hands of the lower-tier partnership; and (iii) the lower-tier partnership either is a section 721(c) partnership, or is a controlled partnership that fails the ownership requirement but is treated as a section 721(c) partnership. See § 1.721(c)–5T(c)(5)(i). In the case in which the lower-tier partnership is a controlled partnership but not a section 721(c) partnership, the Treasury Department and the IRS have determined that it is appropriate to allow the parties to continue to apply the gain deferral method to the section 721(c) property, rather than triggering an acceleration event, provided the parties treat the lower-tier partnership as a section 721(c) partnership for purposes of applying the gain deferral method.

In the second category, a successor event occurs if (i) either 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 an upper-tier partnership that is a controlled partnership; (ii) the gain deferral method is continued with respect to the section 721(c) property in the hands of the section 721(c) partnership; (iii) if the upper-tier partnership directly owns its interest in the section 721(c) partnership, the gain deferral method is applied with respect to the upper-tier partnership's interest in the section 721(c) partnership and the upper-tier partnership is, or is treated as, a section 721(c) partnership; and (iv) if the upper-tier partnership indirectly owns its interest in the section 721(c) partnership through one or more partnerships, the principles described in clause (iii) are applied with respect to the upper-tier partnership and each partnership through which the upper-tier partnership indirectly owns an interest in the section 721(c) partnership. See § 1.721(c)–5T(c)(5)(ii).

Both categories of successor events involve tiered partnerships. Therefore, pursuant to § 1.721(c)–3T(b)(5), the rules for tiered partnerships (described in § 1.721(c)–3T(d)) must be applied in order to satisfy the requirements to apply the gain deferral method as required under the rules described in the two preceding paragraphs.

To illustrate, consider the following simplified example: In year 1, USP, a domestic corporation, and CFC1, a wholly owned foreign subsidiary of USP, form PS1, a partnership, as equal partners. USP contributes section 721(c) property, asset A, a depreciable asset with a $10 million built-in gain (fair market value of $10 million and tax basis of zero) (USP contribution). PS1 is a section 721(c) partnership as a result of the USP contribution, and the gain deferral method is applied with respect to asset A. In year 2, PS1 and CFC1 form PS2, a partnership, as equal partners. PS1 contributes asset A to PS2 (PS1 contribution) when asset A has remaining built-in gain of $8 million and a fair market value of $12 million (the tax basis is still zero). PS2 is a section 721(c) partnership as a result of the PS1 contribution. The PS1 contribution will be a successor event with respect to asset A if PS2 applies the gain deferral method to asset A and PS1 applies the gain deferral method to its interest in PS2 as described in § 1.721(c)–5T(c)(5)(i). The remaining built-in gain in asset A in the hands of PS2 will be $12 million (excess of book value of $12 million over PS2's adjusted tax basis of $0). If PS2 sells the property, PS2 will allocate $12 million to PS1, and PS1 will allocate $10 million of the gain to USP ($8 million of which would be allocated under § 1.704–3(a)(9)).

On the other hand, the PS1 contribution will be an acceleration event (rather than a successor event) with respect to asset A if either PS1 or PS2 does not apply the gain deferral method. In this case, USP will recognize $8 million of gain, which is the amount of the remaining built-in gain that would have been allocated to USP if PS1 had sold asset A immediately before the PS1 contribution for fair market value, and PS1 will increase its tax basis in asset A from $0 to $8 million. See § 1.721(c)–4T(c). Furthermore, the PS1 contribution will be subject to the general gain recognition rule under § 1.721(c)–2T(b) because PS2 is a section 721(c) partnership and asset A is section 721(c) property. PS1's realized gain with respect to asset A that will not qualify for nonrecognition under section 721(a) is $4 million (fair market value of $12 million less adjusted tax basis of $8 million) and PS1 will allocate half of that gain to USP.

d. Partial Acceleration Events

1. In General

Section 1.721(c)–5T(d) identifies the partial acceleration events, and, in each case, the amount of gain that a U.S. transferor must recognize. The basis adjustments in § 1.721(c)–4T(c) that must be made by a U.S. transferor and a section 721(c) partnership upon a ''full'' acceleration event also apply for a partial acceleration event, except in the case of a partial acceleration that occurs as a result of an adjustment under section 734 to section 721(c) property, as described in Paragraph d.3 of this Part VIII. If there is remaining built-in gain in the section 721(c) property immediately after the partial acceleration event, the gain deferral method must continue to apply following the partial acceleration event.

2. Regulatory Allocations

Section 1.721(c)–3T(c)(4)(i)(C) provides that a regulatory allocation that results in an over-allocation of book deduction or loss to a U.S. transferor or an under-allocation of book income or gain to a U.S. transferor will nevertheless be treated as satisfying the consistent allocation method if gain is recognized. See the discussion in Paragraph e.3.i of Part VI of the Explanation of Provisions section of this preamble. In order for such a regulatory allocation to be deemed to satisfy the consistent allocation method, the U.S. transferor must recognize an amount of gain equal to the amount of the allocation that, 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. See § 1.721(c)–5T(d)(2). However, the amount of gain recognized is limited to the amount of the remaining built-in gain that would have been allocated to the U.S. transferor upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the regulatory allocation is made for fair market value.

3. Distributions of Other Partnership Property to a Partner That Result in an Adjustment Under Section 734

The temporary regulations provide that a partial acceleration event occurs if there is a distribution of other property by a section 721(c) partnership that results in a positive basis adjustment to section 721(c) property under section 734. In these cases, the U.S. transferor must recognize an amount of gain equal to the positive basis adjustment to the section 721(c) property under section 734. However, the amount of gain recognized is limited to the amount of the remaining built-in gain that would have been allocated to the U.S. transferor upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the regulatory allocation is made for fair market value. Furthermore, if the property that triggered the section 734 adjustment was distributed to the U.S. transferor or a member of its consolidated group, the amount described in the preceding sentence is reduced (but not below zero) by the amount of gain recognized by the U.S. transferor (or the consolidated group member) under section 731(a). See § 1.721(c)–5T(d)(3). The amount of gain recognized as a result of the acceleration event is not reduced by any step-down to distributed property described by section 734(b)(1)(B). The partnership will not increase its basis under § 1.721(c)–4T(c)(2) for the gain recognized by the U.S. transferor.

e. Section 367 Transfers of Section 721(c) Property to a Foreign Corporation

Section 1.721(c)–5T(e) provides rules for certain direct and indirect transfers of section 721(c) property to a foreign corporation. These rules apply if a section 721(c) partnership transfers section 721(c) property, or 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 foreign corporation in a transaction described in section 367. In this case, the underlying section 721(c) property will no longer be subject to the gain deferral method. The Treasury Department and the IRS have determined that this result is appropriate because 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) (in general, providing an aggregate treatment of partnerships for purposes of applying the outbound transfer provisions under section 367). Furthermore, for the remaining portion of the property (which is the portion attributable to non-U.S. persons and therefore not subject to tax under section 367), 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 upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the transfer for fair market value. The basis adjustments in § 1.721(c)–4T(c) that must be made by a U.S. transferor and a section 721(c) partnership upon a ''full'' acceleration event also apply in this case. If stock in the transferee foreign corporation is received by a section 721(c) partnership, the stock will not be subject to the gain deferral method.

f. Fully Taxable Dispositions of a Portion of an Interest in a Section 721(c) Partnership

Section 1.721(c)–5T(f) provides a special rule when there is a fully taxable disposition of a portion of an interest in a section 721(c) partnership. Specifically, 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 rule does not apply to an intercompany transaction (as defined in § 1.1502–13(b)(1)). See § 1.721–5T(c)(3). See also the discussion in Paragraph c.2 of this Part VIII.

IX. Tiered Partnerships Rules

a. Overview

This Part IX discusses the application of the gain deferral method to tiered partnerships. The temporary regulations employ two general principles in applying the gain deferral method to tiered partnerships. First, if the section 721(c) property is an interest in a partnership, the contribution of that partnership interest, and not the indirect contribution of the underlying property of the lower-tier partnership, to a section 721(c) partnership is subject to section 721(c), and the gain deferral method applies to the contribution of the interest. Second, the gain deferral method must also be adopted at all levels in the ownership chain.

These principles, however, raise various issues in applying the gain deferral method to tiered partnerships: (i) Not all partnerships in the ownership chain will necessarily be section 721(c) partnerships; (ii) when the book value of an interest in a partnership reflects appreciation in the property of the lower-tier partnership that has not yet been reflected in the book value of the property, there will be a discrepancy between the built-in gain in the partnership interest and the built-in gain in the underlying property; (iii) an upper-tier partnership's allocation of its distributive share of certain lower-tier partnership items must comply with § 1.704–3(a)(9) (concerning the application of section 704(c) to tiered partnerships) and with the consistent allocation method; and (iv) a partnership whose interest is section 721(c) property that is contributed to a section 721(c) partnership may have previously adopted a method other than the remedial allocation method with respect to its underlying section 704(c) property.

To address these issues, the temporary regulations specify requirements that must be satisfied, in addition to all the other requirements to apply the gain deferral method, in order for the gain deferral method to be applied to tiered partnerships. See § 1.721(c)–3T(b)(5) (the last requirement to apply the gain deferral method).

b. Additional Requirements for Applying the Gain Deferral Method

1. In General

For purposes of applying the gain deferral method, the temporary regulations address the conditions required to be satisfied by upper-tier partnerships and lower-tier partnerships involved in tiered-partnership transactions to ensure that the gain

deferral method is applied at all levels in the ownership chain and the allocation of partnership items up the chain correctly traces the built-in gain to the U.S. transferor. See § 1.721(c)–3T(d). In the base case in which a U.S. transferor directly contributes section 721(c) property to a section 721(c) partnership, the U.S. transferor will recognize gain under the general rule in these temporary regulations unless the gain deferral method is applied to the contribution. The same principle applies when section 721(c) property is indirectly (through an upper-tier partnership) contributed by a U.S. transferor to a section 721(c) partnership and the partnership look-through rule in § 1.721(c)–2T(d)(1) applies, in which case, the tiered-partnership rules in § 1.721(c)–3T(d)(2) apply to the transferor upper-tier partnership and all controlled partnerships above it in the ownership chain. In addition, when the section 721(c) property is an interest in a partnership, the tiered-partnership rules in § 1.721(c)–3T(d)(1) apply to the partnership whose interest is transferred and all controlled partnerships below it in the ownership chain. Therefore, when a partnership interest described in the preceding sentence is indirectly contributed by a U.S. transferor and the partnership look-through rule applies, the rules of both § 1.721(c)–3T(d)(1) and (2) apply.

2. Indirect Contribution of Section 721(c) Property

Section 1.721(c)–3T(d)(2) provides the additional requirements for applying the gain deferral method if the section 721(c) property is indirectly contributed by a U.S. transferor to a section 721(c) partnership and the partnership look-through rule applies. In particular, this rule applies if an upper-tier partnership in which a U.S. transferor is a direct or indirect partner contributes section 721(c) property to a lower-tier section 721(c) partnership. The upper-tier partnership need not be a section 721(c) partnership for the partnership look-through rule to apply, but, in order for the upper-tier partnership to avoid immediate gain recognition under the general gain recognition rule, the lower-tier section 721(c) partnership must apply the gain deferral method to the contributed property. This application of the gain deferral method has several additional requirements. First, the lower-tier section 721(c) partnership must treat the upper-tier partnership (which is not necessarily a section 721(c) partnership) as the U.S. transferor solely for purposes of applying the consistent allocation method. Second, the upper-tier partnership, if it is a controlled partnership, must apply the gain deferral method to its interest in the lower-tier section 721(c) partnership. If the upper-tier partnership is not a section 721(c) partnership, it is deemed to be so, and the interest in the lower-tier section 721(c) partnership is deemed to be section 721(c) property. See § 1.721(c)–1T(b)(14)(ii) and (b)(15)(ii).

For the upper-tier partnership to apply the gain deferral method to the interest in the lower-tier partnership, § 1.704–3T(a)(13)(ii) provides that the upper-tier partnership must treat its distributive share of lower-tier partnership items of gain, loss, and amortization, depreciation, or other cost recovery deductions with respect to a lower-tier partnership's section 721(c) property as though they were items of gain, loss, and amortization, depreciation, or other cost recovery with respect to the upper-tier partnership's interest in the lower-tier partnership. Section 1.704–3T(a)(13)(ii) is intended to reach the same result as if an aggregate approach governed the application of § 1.704–3(a)(9) in the context of the gain deferral method. Section 1.704–3(a)(9) provides that if a partnership contributes section 704(c) property to a lower-tier partnership, or if a partner that receives a partnership interest in exchange for contributed property subsequently contributes the partnership interest to an upper-tier partnership, the upper-tier partnership must allocate its distributive share of lower-tier partnership items with respect to that section 704(c) property in a manner that takes into account the contributing partner's remaining built-in gain or loss. The Treasury Department and the IRS considered comments about aggregate treatment that were received on Notice 2009–70, 2009–34 I.R.B. 255, in developing the rule in § 1.704–3T(a)(13)(ii). This rule applies only to a tiered-partnership structure that has at least one section 721(c) partnership and to which the gain deferral method is applied. The Treasury Department and the IRS intend no inference regarding the application of § 1.704–3(a)(9) to partnerships not applying the gain deferral method.

If the U.S. transferor is an indirect partner in the upper-tier partnership through one or more partnerships, these requirements must be satisfied by each controlled partnership in the chain of ownership between the upper-tier partnership and the U.S. transferor.

3. Contribution of an Interest in a Partnership

Section 1.721(c)–3T(d)(1) provides the additional requirements for applying the gain deferral method if the section 721(c) property that is contributed to a section 721(c) partnership is an interest in a lower-tier partnership. The lower-tier partnership need not be a section 721(c) partnership. First, the lower-tier partnership, if it is a controlled partnership with respect to a U.S. transferor, must revalue all of its property under § 1.704–1T(b)(2)(iv)(*f*)(*6*) if the revaluation would result in a new positive reverse section 704(c) layer in at least one property that is not excluded property (revaluation requirement). If the lower-tier partnership is not a section 721(c) partnership, it will be deemed to be so upon the revaluation. See § 1.721(c)–1T(b)(14)(ii).

The revaluation requirement ensures, to the greatest extent possible, that all appreciation in the underlying property of a lower-tier partnership that is reflected in the book value of the partnership interest in the lower-tier partnership is subject to the temporary regulations to the same extent that appreciation would be subject to the temporary regulations if the property of the lower-tier partnership (rather than the interest in the lower-tier partnership) were contributed.

Second, the lower-tier partnership must apply the gain deferral method with respect to each property (other than excluded property) for which there is a new positive reverse section 704(c) layer as a result of the revaluation. A property with a new positive reverse section 704(c) layer is deemed to be section 721(c) property, and the remaining built-in gain includes the new positive reverse section 704(c) layer. See § 1.721(c)–1T(b)(15)(ii) and (b)(13)(ii), respectively. Although § 1.721(c)–3T(b)(1)(i)(A) requires the application of the remedial allocation method to the remaining built-in gain, a lower-tier partnership may apply the gain deferral method by adopting the remedial allocation method only for the positive reverse section 704(c) layer if the partnership has previously adopted a section 704(c) method other than the remedial method for the property. Accordingly, the lower-tier partnership may continue to apply a different, historical section 704(c) method to forward section 704(c) layers or to pre-existing reverse section 704(c) layers, as applicable, and still satisfy the requirements of the gain deferral method. For further discussion of the revaluation requirement and the definition of a controlled partnership, see Paragraph c of this Part IX.

Third, the lower-tier partnership must treat a partner that is a partnership in which the U.S. transferor is a direct or

indirect partner as the U.S. transferor solely for purposes of applying the consistent allocation requirement. As a result, the lower-tier partnership must allocate its book items to the deemed U.S. transferor under the consistent allocation method. Regardless of the number of tiers of partnerships in the chain, the tiered-partnership rules are intended to cause the U.S. transferor that contributed (directly or indirectly) the lower-tier partnership interest to the section 721(c) partnership to be the person to recognize gain upon an acceleration event.

If the lower-tier partnership owns (directly or indirectly through one or more partnerships) one or more partnerships that are controlled partnerships with respect to the U.S. transferor, these three requirements must be satisfied by each controlled partnership.

c. Revaluation Requirement

In recognition of the possibility that a U.S. transferor may not be able to cause a lower-tier partnership to revalue its property when a partnership interest is contributed to an upper-tier partnership, the revaluation requirement is limited to those lower-tier partnerships that are controlled partnerships with respect to the U.S. transferor. Control is a facts-and-circumstances test, except that the U.S. transferor and related persons will be deemed to control a partnership in which those persons, in the aggregate, own (directly or indirectly through one or more partnerships) more than 50 percent of the interests in partnership capital or profits. See § 1.721(c)–1T(b)(4).

The definition of built-in gain in the notice excluded revaluation gain because a reverse section 704(c) layer with respect to property does not arise on the contribution of that property. However, a partnership that does not create and apply the remedial method to a positive reverse section 704(c) layer created on the contribution of a lower-tier partnership interest to an upper-tier partnership may shift the tax consequences of a portion of the built-in gain to a partner that is a related foreign person. The Treasury Department and the IRS believe that the description of the tiered-partnership rules contained in the notice notified taxpayers of an intention to promulgate a rule with the result reached by the temporary regulations.

The revaluation requirement described in the gain deferral method requires an expansion of permissible events for partnership revaluations under section 704(b). Accordingly, § 1.704–1T(b)(2)(iv)(*f*)(*6*) allows a partnership to revalue its property if the revaluation is a condition for applying the gain deferral method. When multiple partnerships revalue their property, the revaluations occur in order from the lowest-tier partnership to the highest-tier partnership.

If a partnership revalues its property, § 1.704–3T(a)(13)(i) provides that the principles of § 1.704–3(a)(9) shall apply to any reverse section 704(c) allocations made as a result of the revaluation.

In developing the revaluation requirement and § 1.704–3T(a)(13)(i), the Treasury Department and the IRS considered comments received on revaluation rules in proposed regulations under section 751(b) that are contained in a notice of proposed rulemaking (REG–151416–06) published on November 3, 2014, in the **Federal Register** (79 FR 65151). See proposed §§ 1.704–1(b)(2)(iv)(*f*) and 1.704–3(a)(9).

X. Procedural and Reporting Requirements

To comply with the gain deferral method, the notice described regulations that would be issued requiring reporting of a gain deferral contribution and annual reporting with respect to the section 721(c) property to which the gain deferral method applies. The notice requested comments on whether the regulations should provide rules similar to those in the regulations under sections 367(a) and 6038B regarding failures to file gain recognition agreements or to satisfy other reporting obligations, including the standards for relief therein. See T.D. 9704 (79 FR 68763) (the 2014 GRA regulations). Comments were received expressing support for this approach.

a. Reporting and Procedural Requirements for the Year of the Gain Deferral Contribution

The temporary regulations implement the rules described in the notice in a manner consistent with the approach in the 2014 GRA regulations. For a U.S. transferor, the reporting requirements include, among other information, the information required to be filed under section 6038B. The temporary regulations also adopt procedural requirements in order to seek relief for a failure to meet the reporting requirements of the gain deferral method, which mirror the approach in the 2014 GRA regulations, including procedures relating to the manner by which a transferor can establish the lack of willfulness and that a failure was due to reasonable cause. See §§ 1.721(c)–6T(f) and 1.6038B–2T(h). The temporary regulations adopt these procedural requirements for all U.S. persons that have a reporting obligation under section 6038B with respect to a transfer of property to a foreign partnership and that are seeking relief under the reasonable cause exception, not only for U.S. transferors described in the section 721(c) regulations. The reasonable cause procedure in the temporary regulations applies to all requests for reasonable cause relief (regardless of the date on which the contribution or the failure to file occurred) filed on or after January 18, 2017.

In addition to adopting the current requirements of § 1.6038B–2(c), the temporary regulations require reporting necessary to demonstrate compliance with the gain deferral method. In general, the temporary regulations require a U.S. transferor to report information on a statement included on (or attached to) the Form 8865, Schedule O, Transfer of Property to a Foreign Partnership. The Treasury Department and the IRS intend that the Schedule O will be revised to include the information required by the temporary regulations.

For purposes of the U.S. transferor's reporting requirements under § 1.721(c)–6T with respect to a gain deferral contribution to a domestic section 721(c) partnership, a domestic section 721(c) partnership will generally be treated as foreign under section 7701(a)(4) for reporting purposes. See §§ 1.721(c)–6T(b)(4) and 1.6038B–2T(a)(1)(iii). As a result, a U.S. transferor that contributes section 721(c) property to a domestic section 721(c) partnership in a gain deferral contribution must file a Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships (including Form 8865, Schedule O, Transfer of Property to a Foreign Partnership), with its return for the taxable year that includes the date of the gain deferral contribution.

Also as a requirement of the gain deferral method, the temporary regulations require that the U.S. transferor agree to extend the period of limitations on the assessment of tax for eight full taxable years with respect to the gain realized but not recognized on a gain deferral contribution, and for six full taxable years with respect to the U.S. transferor's distributive share of all items with respect to the section 721(c) property for the year of contribution and two subsequent years. See § 1.721(c)–6T(b)(5)(i) and (ii). The U.S. transferor also must agree to extend the period of limitations on the assessment of tax for five full taxable years with respect to the gain recognized on the contribution of section 721(c) property for which the gain deferral method is not applied if

the contribution is made within five partnership taxable years following a gain deferral contribution. See § 1.721(c)–6T(b)(5)(iii). All agreements to extend the period of limitations on assessment of tax are deemed consented to and signed by the Secretary for purposes of section 6501(c)(4). The Treasury Department and the IRS intend to issue a designated form for use in extending the period of limitations by consent, as described above. Until the time such form is issued, the required consent must be submitted as a statement attached to the U.S. Transferor's Form 8865, Schedule O. Once such form is issued, the U.S. transferor must use the designated form to submit the required consent. These agreements must be filed only in connection with contributions occurring on or after January 18, 2017.

If section 721(c) property that is subject to the gain deferral method is ECI property, the temporary regulations require the U.S. transferor to obtain from the section 721(c) partnership and each related foreign person that is a direct or indirect partner in the section 721(c) partnership a statement 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 ECI property for the period in which there is remaining built-in gain. See § 1.721(c)–6T(c)(1).

The temporary regulations require the U.S. transferor also to provide information with respect to related foreign partners and certain section 721(c) partnerships under section 6038B and the gain deferral method. This requirement also applies in the case of a partnership in a tiered-partnership structure that applies the gain deferral method under § 1.721(c)–3T(d). See § 1.721(c)–6T(b)(2). The U.S. transferor must attach this information to its return.

If the section 721(c) partnership has a reporting obligation under section 6031, it also will be required to report certain information under the temporary regulations. See § 1.721(c)–6T(d). Although the temporary regulations require the partnership to submit certain information to the IRS and comply with other requirements relating to the application of the gain deferral method, a failure to do so will not constitute an acceleration event to the U.S. transferor. The Treasury Department and the IRS intend that the Form 1065, Schedule K–1, or their accompanying instructions will be revised to describe this required information. Failure to include this information may result in imposition of a penalty. See sections 6721 and 6722.

b. Annual Reporting Requirements

The temporary regulations require the U.S. transferor to provide certain information on an annual basis with respect to section 721(c) property subject to the gain deferral method. See §§ 1.721(c)–6T(b)(3) and 1.6038B–2T(c)(9). This includes information about income from the section 721(c) property (book and remedial income) allocated to the U.S. transferor in the partnership taxable year that ends with, or within, the U.S. transferor's taxable year, a calculation of remaining built-in gain, and information about acceleration, termination, successor, and partial acceleration events. The U.S. transferor must also attach a Schedule K–1 (Form 8865), Partner's Share of Income, Deductions, Credits, etc., for all related foreign persons that are direct or indirect partners in the section 721(c) partnership (if the partnership does not have a filing obligation under section 6031) for the partnership taxable year that ends with, or within, the U.S. transferor's taxable year.

In the case of ECI property subject to the gain deferral method, the U.S. transferor must annually declare that, after exercising reasonable diligence, to the best of the U.S. transferor's knowledge and belief all the income from the property was income effectively connected with the conduct of a trade or business within the United States, and no benefits with respect to the ECI property were claimed under any income tax convention by related foreign persons that are direct or indirect partners in the section 721(c) partnership or by the section 721(c) partnership. This requirement eliminates the potential need for related foreign persons that are direct or indirect partners in the section 721(c) partnership and the partnership to submit to the U.S. transferor an annual waiver of treaty benefits.

The U.S. transferor must describe all acceleration, termination, successor, and partial acceleration events that occur with respect to the section 721(c) property during the partnership taxable year that ends with, or within, the U.S. transferor's taxable year. When there is a successor event, the U.S. transferor must identify the new partnership, lower-tier partnership, upper-tier partnership, or U.S. corporation (as applicable). If the section 721(c) partnership is a foreign partnership, the U.S. transferor must include 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 or whether the U.S. transferor controlled the section 721(c) partnership. If the U.S. transferor is not a controlling fifty-percent partner (as defined in § 1.6038–3(a)), the U.S. transferor may comply with this requirement by providing only the information described in § 1.6038–3(g)(1). These requirements also apply to a U.S. transferor that is a successor, as described in Paragraph c.2 of Part VIII of the Explanation of Provisions section of this preamble.

If the section 721(c) partnership has a filing obligation under section 6031, the partnership must include the information required under § 1.721(c)–6T(b)(2) and (3) on the Schedule K–1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., of the U.S. transferor and all related foreign persons that are direct or indirect partners in the section 721(c) partnership. See § 1.721(c)–6T(d)(2).

XI. Effective/Applicability Dates

The applicability dates of the temporary regulations generally relate back to the issuance of the notice. Accordingly, in general, the temporary regulations apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 that is filed on or after August 6, 2015 (referred to in this preamble as the ''general applicability date''). However, new rules, including any substantive changes to the rules described in the notice, apply to contributions occurring on or after January 18, 2017, or to contributions occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 that is filed on or after January 18, 2017. Taxpayers may, however, elect to apply those new rules and substantive changes to the rules described in the notice to a contribution occurring on or after the general applicability date. The election is made by reflecting the application of the relevant rule on a timely filed or amended return.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. 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. Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that the temporary regulations include a $1,000,000 de minimis exception for certain transfers, and tangible property with built-in gain that does not exceed $20,000 is excluded from the regulations. In addition, the regulations only apply 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.

Drafting Information

The principal author of these regulations is Ryan A. Bowen of the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

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 adding entries in numerical order to read in part as follows:

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

Section 1.197–2T also issued under 26 U.S.C. 197(g).

* * * * *

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

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

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

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

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

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

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

* * * * *

Section 1.6038B–2T also issued under 26 U.S.C. 6038B.

* * * * *

■ **Par. 2.** Section 1.197–2 is amended by adding 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) [Reserved]. For further guidance, see § 1.197–2T(h)(12)(vii)(C).

* * * * *

(l) * * *

(5) [Reserved]. For further guidance, see § 1.197–2T(l)(5).

■ **Par 3.** Section 1.197–2T is added to read as follows:

§ 1.197–2T Amortization of goodwill and certain other intangibles.

(a) through (h)(12)(vii)(B) [Reserved]. For further guidance, see § 1.197–2(a) through (h)(12)(vii)(B).

(C) *Rules for section 721(c) partnerships.* See § 1.704–3T(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)–1T(b)(14)).

(viii) through (l)(4)(iii) [Reserved]. For further guidance, see § 1.197–2(h)(12)(viii) through (l)(4)(iii).

(5) *Rules for section 721(c) partnerships*—(i) *Applicability dates*—(A) *In general.* Except as provided in paragraph (l)(5)(i)(B) 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

(B) *Election to apply the provisions described in paragraph (l)(5)(i)(A) of this section retroactively.* Paragraph (h)(12)(vii)(C) of this section may, by election, be applied with respect to a contribution occurring on or after August 6, 2015, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (h)(12)(vii)(C) of this section on a timely filed original return (including extensions) or an amended return filed no later than six months after January 18, 2017.

(ii) *Expiration date.* Paragraph (h)(12)(vii)(C) of this section expires on January 17, 2020.

■ **Par. 4.** Section 1.704–1 is amended by adding paragraph (b)(2)(iv)(*f*)(*6*) following the undesignated paragraph at the end of paragraph (b)(2)(iv)(*f*)(*5*) and adding paragraph (f) to read as follows:

§ 1.704–1 Partner's distributive share.

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(*f*) * * *

(*6*) [Reserved]. For further guidance, see § 1.704–1T(b)(2)(iv)(*f*)(*6*).

* * * * *

(f) [Reserved]. For further guidance, see § 1.704–1T(f).

■ **Par. 5.** Section 1.704–1T is amended by:

■ 1. Revising paragraphs (b)(1)(iii) through (b)(2)(iv)(*f*)(*5*).

■ 2. Adding paragraph (b)(2)(iv)(*f*)(*6*).

■ 3. Revising paragraphs (b)(2)(iv)(*g*) through (b)(4)(viii)(*a*) introductory text.

■ 4. Redesignating paragraph (f) as paragraph (g).

■ 5. Adding a new paragraph (f).

■ 6. Revising newly redesignated paragraph (g).

The additions and revisions read as follows:

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

* * * * *

(b)(1)(iii) through (b)(2)(iv)(*f*)(*5*) [Reserved]. For further guidance, see § 1.704–1(b)(1)(iii) through (b)(2)(iv)(*f*)(*5*).

(*6*) Notwithstanding paragraph (b)(2)(iv)(*f*)(*5*) of this section, the revaluation is required under § 1.721(c)–3T(d)(1) as a condition of the application of the gain deferral method (as described in § 1.721(c)–3T(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)–1T(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.

(b)(2)(iv)(*g*) through (b)(4)(viii)(*a*) introductory text [Reserved]. For further guidance, see § 1.704–1(b)(2)(iv)(*g*) through (b)(4)(viii)(*a*) introductory text.

* * * * *

(f) *Dates*—(1) *Applicability dates*—(i) *In general.* Except as provided in paragraph (f)(1)(ii) 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

(ii) *Election to apply the provisions described in paragraph (f)(1)(i) of this section retroactively.* Paragraph (b)(2)(iv)(*f*)(*6*) of this section may, by election, be applied with respect to a contribution occurring on or after August 6, 2015, but before January 18, 2017, and with respect to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is 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 six months after January 18, 2017.

(2) *Expiration date.* Paragraph (b)(2)(iv)(*f*)(*6*) of this section expires on January 17, 2020.

(g) *Expiration date.* The applicability of this section (other than paragraphs (b)(2)(iv)(*f*)(*6*) and (f) of this section) expires on February 4, 2019.

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

§ 1.704–3 Contributed property.

(a) * * *

(13) [Reserved]. For further guidance, see § 1.704–3T(a)(13).

* * * * *

(d) * * *

(5) * * *

(iii) [Reserved]. For further guidance, see § 1.704–3T(d)(5)(iii).

* * * * *

(g) [Reserved]. For further guidance, see § 1.704–3T(g).

■ **Par. 7.** Section 1.704–3T is added to read as follows:

§ 1.704–3T Contributed property (temporary).

(a)(1) through (12) [Reserved]. For further guidance, see § 1.704–3(a)(1) through (12).

(13) *Rules for tiered section 721(c) partnerships*—(i) *Revaluations.* If a partnership revalues its property pursuant to § 1.704–1T(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 § 1.704–1T(b)(2)(iv)(*f*)(*6*), the principles of § 1.704–3(a)(9) 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)–1T(b)(8), section 721(c) partnership is defined in § 1.721(c)–1T(b)(14), and section 721(c) property is defined in § 1.721(c)–1T(b)(15).

(b) through (d)(5)(ii) [Reserved]. For further guidance, see § 1.704–3(b) through (d)(5)(ii).

(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)–1T(b)(7), related person is defined in § 1.721(c)–1T(b)(12), section 721(c) partnership is defined in § 1.721(c)–1T(b)(14), section 721(c) property is defined in § 1.721(c)–1T(b)(15), and U.S. transferor is defined in § 1.721(c)–1T(b)(18). For an example applying the rules of this paragraph (d)(5)(iii), see § 1.721(c)–7T, *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) and § 1.704–3(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.

(d)(6) through (f) [Reserved]. For further guidance, see § 1.704–3(d)(6) through (f).

(g) *Certain rules for section 721(c) partnerships*—(1) *Applicability dates*—(i) *In general.* Notwithstanding § 1.704–3(f), except as provided in paragraph (g)(1)(ii) 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

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

(2) *Expiration date.* The applicability of paragraphs (a)(13) and (d)(5)(iii) of this section expires on January 17, 2020.

■ **Par. 8.** Section 1.721(c)–1T is added to read as follows:

§ 1.721(c)–1T Overview, definitions, and rules of general application (temporary).

(a) *Overview*—(1) *In general.* This section and §§ 1.721(c)–2T through 1.721(c)–7T (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)–2T 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)–3T 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)–4T provides rules regarding acceleration events for purposes of applying the gain deferral method. Section 1.721(c)–5T identifies exceptions to the rules regarding acceleration events provided in § 1.721(c)–4T(b). Section 1.721(c)–6T provides procedural and reporting requirements. Section 1.721(c)–7T 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, and paragraph (f) of this section provides the date of expiration.

(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)–4T(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)–2T(b).

(3) *Consistent allocation method.* The consistent allocation method is the method described in § 1.721(c)–3T(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 this purpose, 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)–3T(b).

(9) *Partial acceleration event.* A partial acceleration event is an event described in § 1.721(c)–5T(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(a)(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.* 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.

(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 this purpose, 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)–3T(d)(1)(ii), the remaining built-in gain includes the new positive reverse section 704(c) layer described in § 1.721(c)–3T(d)(1)(ii), reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for this purpose, 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)–3T(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)–3T(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)–2T(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)–2T(d), the entire property will be section 721(c) property.

(ii) *Special rule for tiered partnerships.* Property described in § 1.721(c)–3T(d)(1)(ii) and an interest in a partnership described in § 1.721(c)–3T(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)–5T(c)(2), (3), (4), or (5).

(17) *Termination event.* A termination event is an event described in § 1.721(c)–5T(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)–3T(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 occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring on or after August 6, 2015, but before January 18, 2017, and with respect to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015, but before January 18, 2017.

(3) *Election to apply the provisions described in paragraph (e)(2) of this section retroactively.* Paragraphs (b)(6)(iv), (b)(14)(i)(B), and (c) of this section, without the modification described in paragraph (e)(2) of this section, may, by election, be applied to a contribution occurring on or after August 6, 2015, but before January 18, 2017, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (b)(6)(iv) or (c) as described in paragraph (b)(14)(i)(B) or (e)(2) 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 six months after January 18, 2017.

(f) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 9**. Section 1.721(c)–2T is added to read as follows:

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

(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, and paragraph (f) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(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)–3T (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)–5T(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 occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring on or after August 6, 2015, but before January 18, 2017, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is 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 six months after January 18, 2017.

(f) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 10**. Section 1.721(c)–3T is added to read as follows:

§ 1.721(c)–3T Gain deferral method (temporary).

(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, and paragraph (f) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(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)–2T(b) will not be subject to § 1.721(c)–2T(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)–5T(d) or (e), as applicable.

(3) The procedural and reporting requirements provided in § 1.721(c)–6T(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)–6T(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)–2T(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 exceptions to this general rule, 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 this purpose, 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)–1T(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 that paragraph 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)–5T(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)–2T(d)(1), and under § 1.721(c)–2T(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 occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

(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 occurring on or after August 6, 2015, but before January 18, 2017, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (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 six months after January 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 be made to apply paragraph (c)(3) or (2) of this section, respectively, to the contribution.

(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.

(f) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 11**. Section 1.721(c)–4T is added to read as follows:

§ 1.721(c)–4T Acceleration events (temporary).

(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, and paragraph (e) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(b).

(b) *Definition of an acceleration event*—(1) *General rules.* Except as provided in this paragraph (b) and § 1.721(c)–5T (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)–3T(b)(3) that is not willful. See §§ 1.721(c)–6T(f) and 1.6038B–2T(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)–6T(b)(3)(iv). 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)–5T(d)(1), and a transfer described in section 367 of section 721(c) property to the extent provided in § 1.721(c)–5T(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 occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015.

(e) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 12**. Section 1.721(c)–5T is added to read as follows:

§ 1.721(c)–5T Acceleration event exceptions (temporary).

(a) *Scope.* This section identifies exceptions to the acceleration events, which, like the rules regarding acceleration events provided in § 1.721(c)–4T(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, and paragraph (h) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(b).

(b) *Termination events*—(1) *In general.* Notwithstanding § 1.721(c)–4T(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)).

(c) *Successor events*—(1) *In general.* Notwithstanding § 1.721(c)–4T(b)(1), a successor event with respect to section 721(c) property will not constitute an acceleration event. If only 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), (B), and (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)–3T(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), (B), (C), and (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)–3T(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)–4T, 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)–4T(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)–3T(c)(4)(i) but not in § 1.721(c)–3T(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)–4T(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)–4T(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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

(2) *Election to apply this section retroactively.* This section may, by election, be applied to a contribution occurring on or after August 6, 2015, but before January 18, 2017, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed

on or after August 6, 2015. The election is made by applying this section to the contribution on a timely filed original return (including extensions) or an amended return filed no later than six months after January 18, 2017.

(h) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 13**. Section 1.721(c)–6T is added to read as follows:

§ 1.721(c)–6T Procedural and reporting requirements (temporary).

(a) *Scope.* This section provides procedural and reporting requirements that must be satisfied under § 1.721(c)–3T(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, and paragraph (h) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(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)–1T(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 (including Form 8865, Schedule O, Transfer of Property to a Foreign Partnership), and must be submitted in the form and manner and to the extent prescribed by the form (and its 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) A statement, titled ''Statement of Application of the Gain Deferral Method under Section 721(c),'' that contains 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)–3T(d)(1);

(ii) A statement, titled ''Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method under Section 721(c),'' completed and executed in the manner prescribed in forms and instructions, extending 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 paragraphs (c)(1) of this section (if any);

(iv) Information relating to the section 721(c) partnership described in paragraph (c)(2) of this section (if any);

(v) 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 file an annual statement, titled ''Annual Statement of Application of the Gain Deferral Method under Section 721(c),'' for each gain deferral contribution. The information in the statement 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 statement must contain the following information:

(i) 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;

(ii) 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;

(iii) 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;

(iv) 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)–5T(d) in the case of a partial acceleration event, and whether the acceleration event is described in § 1.721(c)–4T(b)(4));

(v) 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)–5T(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);

(vi) A description of all transfers of 721(c) property to a foreign corporation described in § 1.721–5T(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;

(vii) 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;

(viii) A statement, titled ''Consent to Extend the Time To Assess Tax Pursuant to the Gain Deferral Method under Section 721(c),'' completed and executed as prescribed in forms and instructions, extending 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;

(ix) 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)(ix) by providing only the information described in § 1.6038–3(g)(1);

(x) 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)–2T(d)(1)) during the taxable year to which the gain deferral method is not applied; and

(xi) 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:

(i) With respect to the gain realized but not recognized on a gain deferral contribution, through the close of the eighth full taxable year following 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 close of the sixth full taxable year following 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 close of the fifth full taxable year following 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)–3T(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)–6T,'' 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)–3T(d), the U.S. transferor must supply all 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 with the U.S. transferor's Schedule K–1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc. The partnership must also attach to its Form 1065 a Schedule K–1 (Form 1065) for each partner that is a related foreign person with respect to the U.S. transferor.

(e) *Signatory.* The 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)–3T(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)–3T(b)(3) if the U.S. transferor demonstrates that the

failure was not willful using the procedure provided in this paragraph (f). For this purpose, 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 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 Form 8865, Schedule O, and a statement (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 close of the eighth full taxable year following the taxable year during which the contribution occurred (*date one*), or the close of the third full taxable year ending 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 Form 8865, Schedule O, 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 Form 8865, Schedule O. The amended return and either a Form 8865, Schedule O, or a copy of the previously filed Form 8865, Schedule O, 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–2T(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 occurring before January 18, 2017, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after January 18, 2017.

(2) *Reporting relating to effectively connected income.* Paragraphs (b)(2)(iii), (b)(3)(vii), and (d)(1) of this section apply to a contribution occurring on or after August 6, 2015, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015, and, in either case, provided § 1.721(c)–3T(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)(vii), or (d)(1) of this section, an amended return complying with such paragraphs must be filed no later than six months after January 18, 2017.

(3) *Transition rules.* For transfers occurring on or after August 6, 2015, and for transfers occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 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 and the regulations thereunder with respect to the contribution of the section 721(c) property to the section 721(c) partnership.

(h) *Expiration date.* The applicability of this section expires on January 17, 2020.

■ **Par. 14**. Section 1.721(c)–7T is added to read as follows:

§ 1.721(c)–7T Examples (temporary).

(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)–1T(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)–1T(b)(4).

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

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)–1T(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)–1T(b)(2), the patent has built-in gain of $1.2 million. The patent is not excluded property under § 1.721(c)–1T(b)(6). Therefore, under § 1.721(c)–1T(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)–1T(b)(2), the security has built-in gain of $80,000. Under § 1.721(c)–1T(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)–1T(b)(6)(iii), the machine is excluded property and therefore is not section 721(c) property.

(D) Under § 1.721(c)–1T(b)(12), CFC1 is a related person with respect to USP, and under § 1.721(c)–1T(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)–1T(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)–2T(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)–2T(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.

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)–2T(b).

(iii) *Alternative facts and results.* (A) Assume the same facts as in paragraph (i) of this *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)–1T(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)–1T(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)–2T(b).

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)–2T(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)–2T(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)–2T(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)–3T(b), the gain deferral method must be applied with respect to the patent. In addition, under § 1.721(c)–3T(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 (i) of this *Example 3,* the gain deferral method is applied. PRS2 is a controlled partnership with respect to USP. Under § 1.721(c)–5T(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 § 1.704–3T(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).

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)–2T(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)–5T(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)–5T(b)(1), the trademark is no longer subject to the gain deferral method.

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)–2T(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)–5T(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)–5T(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 thereunder. With respect to the remaining portion of the patent, 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)–4T(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)–4T(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.

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 § 1.704–3T(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 § 1.704–3T(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 § 1.704–3T(d)(5)(iii)(C), PRS1 increases the adjusted tax basis in the IP by $12 million, and pursuant to § 1.704–3T(d)(5)(iii)(D), that basis adjustment is solely with respect to CFC1. Pursuant to § 1.704–3T(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 § 1.704–3T(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.

■ **Par. 15**. Section 1.6038B–2 is amended by:
■ 1. Revising paragraphs (a)(1)(i) and (ii), (a)(3), (c)(6) and (c)(7)(v).
■ 2. Adding paragraphs (a)(1)(iii) and (c)(8) and (9).
■ 3. Revising paragraphs (h)(1) introductory text and (h)(3).
■ 4. Adding paragraphs (j)(4) and (5).

The revisions and additions read as follows.

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

(a) * * *

(1) * * *

(i) Immediately after the transfer, the United States person owns, directly, indirectly, or by attribution, at least a 10-percent interest in the partnership, as defined in section 6038(e)(3)(C) and the regulations thereunder;

(ii) The value of the property transferred, when added to the value of any other property transferred in a section 721 contribution by such person (or any related person) to the partnership during the 12-month period ending on the date of the transfer, exceeds $100,000; or

(iii) [Reserved]. For further guidance, see § 1.6038B–2T(a)(1)(iii).

* * * * *

(3) [Reserved]. For further guidance see § 1.6038B–2T(a)(3).

* * * * *

(c) * * *

(6) A separate description of each item of contributed property that is appreciated property subject to the allocation rules of section 704(c) (except to the extent that the property is permitted to be aggregated in making allocations under section 704(c)), or is intangible property, including its estimated fair market value and adjusted basis;

(7) * * *

(v) Other property;

(8) [Reserved]. For further guidance, see § 1.6038B–2T(c)(8); and

(9) [Reserved]. For further guidance, see § 1.6038B–2T(c)(9).

* * * * *

(h) * * *

(1) *Consequences of a failure.* If a United States person is required to file a return under paragraph (a) of this section and fails to comply with the reporting requirements of section 6038B and this section, or § 1.721(c)–6T, then that person is subject to the following penalties:

* * * * *

(3) [Reserved]. For further guidance see § 1.6038B–2T(h)(3).

* * * * *

(j) * * *

(4) through (5) [Reserved]. For further guidance, see § 1.6038B–2T(j)(4) through (5).

■ **Par. 16.** Section 1.6038B–2T is added to read as follows:

§ 1.6038B–2T Reporting of certain transfers to foreign partnerships (temporary).

(a) introductory text through (a)(1)(ii) [Reserved]. For further guidance, see § 1.6038B–2(a) introductory text through (a)(1)(ii).

(iii) The United States person is a U.S. transferor (as defined in § 1.721(c)–1T(b)(18)) that makes a gain deferral contribution and is required to report under § 1.721(c)–6T(b)(2). The reporting required under this paragraph (a) includes the annual reporting required by § 1.721(c)–6T(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).

(a)(2) [Reserved]. For further guidance, see § 1.6038B–2(a)(2).

(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)–1T(b)(15)) to another foreign partnership in a transfer described in § 1.721(c)–3T(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.

(a)(4) through (c)(7) [Reserved]. For further guidance, see § 1.6038B–2(a)(4) through (c)(7).

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

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

(d) through (h)(2) [Reserved]. For further guidance, see § 1.6038B–2(d) through (h)(2).

(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.

(i) through (j)(3) [Reserved]. For further guidance, see § 1.6038B–2(i) through (j)(3).

(4) *Transfers of section 721(c) property*—(i) *Applicability dates.* Paragraph (c)(8) of this section applies to transfers occurring on or after August 6, 2015, and to transfers occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is 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 occurring before January 18, 2017, resulting from entity classification elections made under § 301.7701–3 of this chapter that are filed on or after January 18, 2017.

(ii) *Expiration date.* The applicability of paragraphs (a)(1)(iii), (a)(3), and (c)(8) and (9) of this section expires on January 17, 2020.

(5) *Reasonable cause exception*—(i) *Applicability date.* Paragraph (h)(3) of this section applies to all requests for relief for transfers of property to partnerships filed on or after February 21, 2017.

(ii) *Expiration date.* The applicability of paragraph (h)(3) of this section expires on January 17, 2020.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

Approved: January 10, 2017.

Mark J. Mazur,

Assistant Secretary of the Treasury (Tax Policy).

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