

# US Government finalizes rules on transfers to partnerships with related foreign partners

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In an effort to close the door to a potentially abusive tax scheme involving partnerships with related foreign partners, the US government issued final regulations on 17 January 2020. The regulations, which generally apply to transfers occurring on or after August 6, 2015 (when the substance of the rules was first announced) largely follow proposed and temporary regulations issued in 2017.

Generally, US taxpayers can transfer appreciated property to a partnership without triggering tax. US taxpayers forming partnerships with related foreign entities (i.e., their own foreign subsidiaries) would sometimes transfer appreciated property to the partnership and then use rules governing allocations of partnership income and deductions to shift income to the foreign partners. This shifting can have the effect of moving the economic appreciation on the property out of the US tax base, reducing the related group's overall tax liability.

The new rules seek to stop these potentially abusive transactions by simply making transfers of appreciated property to such partnerships taxable to the US taxpayers in the first place. The new rules apply to transfers to partnerships where there is a related direct or indirect foreign partner and where 80% or more of the partnership is owned by related parties. The new rules do not apply if the built-in gain in the appreciated property does not exceed \$1 million; the rules also provide relief if the income attributable to the appreciated property is subject to US taxation because it is effectively connected with a US business.

Taxpayers that would otherwise be caught by the new rules can avoid them by electing to apply a special method for allocating income and deductions. This special method—called the “remedial” method—reduces the potential for abuse by forcing US partners who contributed appreciated property to the partnership to recognize their economic gain over time. This method ensures that the economic gain will be included fully in the US tax base rather than shifted abroad.

{While the new rules should stop the most abusive structures among related entities, they will not affect the availability of tax-free status of transfers to true joint ventures between unrelated third parties...