# Treasury Issues Reporting Rules for Partnership Tax Basis Shifting Transactions

**January 15, 2025**

## INTRODUCTION

As part of a flurry of tax guidance provided by the outgoing administration, the IRS and Treasury issued final regulations (the "Final Regulations") that classify as transactions of interest certain related-party basis adjustment ("RPBA") transactions involving partnerships. The Final Regulations require partnerships that engage in RPBAs, affected partners and material advisors to report such transactions, as well as substantially similar transactions, to the IRS.[1]

An RPBA transaction arises primarily when

- a partner receives a distribution of property and has a tax basis in the distributed asset that is higher than the partnership had, with a corresponding decrease to the tax basis in the partnership's other assets that burdens related partners,
- a partner receives a distribution in kind and has a tax basis in the distributed asset that is lower than the partnership had, with a corresponding increase to the tax basis in the partnership's other assets that benefits related partners or
- a partner transfers a partnership interest to a related person in a non-recognition transaction and the related transferee's share of the partnership's tax basis in its assets is increased as a result of the transfer.

The IRS and Treasury received significant pushback over the extensive reach of the Proposed Regulations and narrowed their scope in the Final Regulations in response to many of these comments. Still, significant reporting obligations remain, including with respect to transactions that have already occurred. While it remains to be seen whether

[1] The IRS and Treasury previously issued proposed regulations (the "Proposed Regulations") as part of a broader set of guidance addressing related-party basis shifting transactions discussed in our prior Debevoise In Depth. The Final Regulations address only the reporting obligations and do no touch upon the other parts of the prior guidance package.

the incoming Trump administration takes action to limit the effect of the Final Regulations, any such action will likely not come before taxpayers and their material advisors begin preparations for reporting under the Final Regulations.

## SCOPE REDUCTIONS

### Applicable Threshold

The Final Regulations exclude any RPBA where the tax basis increase is $10 million or less (the Proposed Regulations had a $5 million threshold). Additionally, with respect to RPBAs that result from a distribution, the $10 million threshold only includes tax basis increases to the extent the offsetting tax basis decrease affects related partners (and in certain circumstances tax-indifferent partners).

**Comment**: This rule may have a material impact in limiting the scope of the Final Regulations. For example, upon a distribution of property to a partner giving rise to an increase in the tax basis of undistributed partnership property, the partnership may have a $50 million tax basis increase to its undistributed property. However, if the partners related to the partner receiving the distribution own less than 20% of the partnership after the distribution, their share of the increase would be less than $10 million, and the transaction would not be subject to disclosure.

### Transfer of Interest Acquired by Purchase

The Final Regulations fix a significant drafting issue with the Proposed Regulations that would have swept many innocuous transfers of partnership interests into the scope of these rules. Under the Proposed Regulations, if a partner acquired for cash an interest in a partnership that had a 754 election in effect, and the partner received a significant upward 743 adjustment, a later non-recognition transfer involving such partnership interest would have tended to be an RPBA. This is because the non-recognition transfer would have triggered a re-computation of the 743 adjustment, although without an increase to the magnitude of the adjustment. The Final Regulations fix this glitch by providing that only the increase in the 743 adjustment is counted against the appliable threshold.

**Comment**: The change in the Final Regulations is a welcome development, as non-recognition transactions that don't increase the 743 adjustment in the hands of the transferee are both common and not necessarily evidence of abuse by the parties.

### Definition of Related Partners

The Final Regulations limit the definition of a "related partner" to a direct partner of the partnership. When assessing whether partners are related, only direct partners are tested, excluding any indirect partners.

**Comment**: The Proposed Regulations would have required looking through upper-tier partnerships for any related partners. Transferors and transferees may not be aware that there are related indirect partners. This would be similarly implicated in the context of a continuation fund, where a significant portion of partners roll their interests into a new partnership vehicle.

### Purchases from Unrelated Partners

Unlike the Proposed Regulations, the Final Regulations acknowledge that transfers of partnership interests between unrelated parties have less potential for tax avoidance and thus exclude from reporting transfers of partnership interests between unrelated parties, even if the transferee is related to one or more existing partners. Accordingly, only 743(b) transfers between a transferor and transferee that are related to each other immediately before or immediately after the transfer fall under the scope of the Final Regulations.

### Tax-indifferent Parties

In response to numerous comments requesting modifications to the tax-indifferent party rule, the IRS has amended the definition of tax-indifferent party so that it now applies to parties whose tax status is known or should have been known to the other person participating in the transaction or the other partners in the partnership. Partnerships and S corps are not treated as tax-indifferent parties given that these entities are not generally liable to tax, and the tax status of their partners or shareholders could be diverse; however, the Final Regulations include an anti-avoidance rule where a principal purpose of the use of such entities is to avoid tax-indifferent party status.

## RETROACTIVITY ISSUES

While the Proposed Regulations applied to prior RPBA transactions as long as tax benefits from the transaction remained (*i.e.*, tax basis step-up was still relevant for depreciation or gain determinations), the Final Regulations include a six-year look back period – for calendar-year taxpayers, transactions that occurred on or after January 1, 2019 – in an effort to narrow the breadth of past transaction that can be subject to these rules. In addition, the threshold for prior transaction is increased to $25 million.

In response to comments on the compliance burdens and costs, the IRS gave taxpayers and material advisors an additional 90 calendar days (by July 13, 2025 for taxpayers and July 29, 2025 for material advisors) to meet their disclosure obligations with respect to prior transactions, acknowledging the additional time taxpayers and material advisors may need to identify and prepare disclosures for already-completed transactions.

**Comment**: Taxpayers and their advisors will need procedures intended to identify both new transactions and transactions during the six year look back period that require disclosure under the Final Regulations. Certain commercial and non-tax motivated transactions might still need to be disclosed. Potentially problematic but common transactions can include transactions in which one private equity fund sells an interest in a partnership to a related fund (such as seen in continuation vehicle transactions), transactions involving sales of "blocker" corporations, which often are distributed interests in underlying partnership vehicles prior to sale, and acquisitions of partnership interests from related parties in which the seller has a meaningfully larger "outside" tax basis than its share of partnership "inside" tax basis.

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Please do not hesitate to contact us with any questions.

Michael Bolotin
Partner, New York
+1 212 909 6013
mbolotin@debevoise.com

Rafael Kariyev
Partner, New York
+1 212 909 6383
rkariyev@debevoise.com

Peter F. G. Schuur
Partner, New York
+1 212 909 6353
pfgschuur@debevoise.com

Lena E. Smith
Partner, New York
+1 212 909 6398
lesmith@debevoise.com

Samuel D. Krawiecz
Counsel, New York
+1 212 909 6626
sdkrawiecz@debevoise.com

Jose Faina
Associate, Hong Kong
+852 2160 9828
jfainaro@debevoise.com

**Sophia Huang**
Associate, Hong Kong
+852 2160 9810
shuang@debevoise.com

**Harshil Mehta**
Associate, New York
+1 212 909 6430
hdmehta@debevoise.com

**David N. Simpser**
Associate, New York
+1 212 909 6450
dsimpser@debevoise.com

**Charlie Daley**
Law Clerk, New York
+1 212 909 6196
bcdaley@debevoise.com