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CURRENT DEVELOPMENTS FOR REAL ESTATE PARTNERSHIPS AND INVESTORS

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SESSION H

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Prior to joining PricewaterhouseCoopers LLP, Karen was a tax associate with Covington & Burling where she focused on partnership, corporate, and general tax matters. She also served as a law clerk to United States Tax Court Chief Judge Lapsley Hamblen, Jr.

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Before joining KPMG, Stephen was a partner in the Washington, D.C. offices of Hogan Lovells US LLP, a major international law firm. In his career as an attorney, Stephen represented numerous targets and acquirers in public M&A transactions, fund sponsors, and underwriters in connection with, to date, two of the three largest initial public offerings of domestic US REITs. Prior to joining Hogan Lovells, Stephen was an associate in the New York office of Sullivan & Cromwell LLP. While in law school, Stephen was a member of *The George Washington Law Review*.

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I. Partnership Basis Adjustment Developments

A. IRS Guidance on Related-Party Basis Adjustment

1. June 2024 – IRS released guidance package on related-party basis adjustments that included Proposed Treas. Reg. § 1.6011, Notice 2024-54 and Rev. Rul. 2024-14.

2. Reporting Regulations – Proposed Treas. Reg. § 1.6011-18 defined certain transactions as "transactions of interest" requiring disclosure by material advisors and participants. The regulations were finalized on January 10, 2025. On April 17, 2025, the IRS issued Notice 2025-23, which announced Treasury and the IRS' intention to issue proposed regulations to eliminate the final regulations in accordance with a February 19, 2025 executive order. Penalties for both taxpayers and material advisors for failure to report were also waived.

3. Notice 2024-54 announced IRS was planning to release proposed regulations addressing certain covered transactions related to Section 734(b), Section 743(b) and Section 732 basis step-up transactions. Notice 2025-23 withdrew this notice and effectively ended the plan to issue regulations on the covered related-party basis transactions.

4. Rev. Rul. 2024-14 was not revoked by Notice 2025-23.

B. Where Are We Now?

1. Rev. Rul. 2024-14 is still in effect. That ruling provides that three related-party partnership transactions involving partnership basis shifting lack economic substance under COES. The IRS press release (IR-2024-166) states that the ruling was issued to provide support for the IRS' position in audits and litigation that these types of transactions violate COES doctrine.

2. Otay Project L.P. v. Commissioner (U.S. Tax Court Docket No. 6819-20)

   (a) Background: Family-held joint real estate development partnership between two brothers. Th unwinding transactions resulted in an approximate $850m Section 743(b) basis adjustment. The adjustment resulted from the non-recognition transfer of the right to deferred income

from long-term contracts held by 34 lower-tier partnerships. The taxpayer claims the restructuring was necessitated by deep family animosity.

(b) IRS Challenges to Section 743(b) Adjustments

(i) Economic Substance – Outsized tax benefits and should not respect transfer of "negative value."

(ii) Partnership Anti-Abuse Rule – Subchapter chapter K not intended to convert income properly deferred under an accounting method into income that is never recognized.

(iii) Treas. Reg. § 1.460-4(k) Anti-Abuse – Separating the right to perform under a contract from a right to income under the contract is not appropriate.

(iv) Inaccurate Liability Treatment under Section 752 – No real shift of economic risk of loss.

(c) Taxpayer´s Position

(i) The Section 743(b) statute mandates the basis adjustment as all statutory requirements were satisfied.

(ii) The transactions had economic substance.

(iii) The transactions cannot be recast under the partnership anti-abuse rule.

(d) As of September 2025, the Otay case has been fully tried and is in the pos-trial briefing stage. (Tax Court trial held in October 2024; opening briefs filed in January 2025; answering briefs filed in April 2025).

II. Self-Employment Contribution Act ("SECA") Litigation Update

A. Background to Limited Partner Exception to SECA

1. Under Section 1402(a)(13), the term "net earnings from self-employment" means the [net] income derived by an individual from any trade or business …plus his distributive share… of partnership income or loss. There shall be excluded the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services.

2. 1997 Proposed Regulations: "Limited partner" excludes any member who:

(a) Is liable for partnership debts,

(b) Can contract on partnership's behalf, or

(c) Participates greater than 500 hours in the partnerships trade or business.

3. What did Congress intend in creating the Section 1402 limited partner exception in 1977?

   (a) 1916 Uniform Limited Partnership Act: A limited partner did not become liable as a general partner unless "he takes part in the control of the business."

   (b) 1976 Revised Uniform Limited Partnership Act: Acknowledged uncertainty whether LP activities constitute "control" of the partnership's business. A "limited partner does not participate in the control of the business…solely by … being a contractor for or an agent or employee of the limited partnership or of a general partner…"

   (c) Since 1977, state law has seen significant changes are limited partnerships including limited partners' ability to participate in management and operations of the partnership while retaining their limited liability and the addition of LLCs and LLPs.

B. Posture of Litigation/Results

In 2018, the IRS began an audit campaign focused on fund managers. Recent litigation has focused on whether actively involved partners in state law limited partnerships and limited liability companies are subject to self-employment taxes. To date, the IRS has prevailed in a number of these cases. A number of these cases revolve around partnerships involving hedge and investment funds. In general, the courts have held that whether a limited partner is subject to SECA is based on a "functional analysis" of the partner's activities rather than their title under state law.

C. What is the "Functional Analysis" Test Developed by the Tax Court?

Facts and circumstances approach focused on partner's role and considers –

1. Partner's role and importance in generating the partnership's income;

2. The partner's management authority over the partnership;

3. The time and effort the partner devotes to the business;

4. The partner's capital contributions relative to the fees the business charges; and

5. How the partnership markets or represents the partner's role.

D. Section 1402(a)(13) Cases

1. Tax Court

   (a) State Law Limited Partners

   Since 2023, the Tax Court has held in three cases that state law limited partners are not "limited partners" within the meaning of Section 1402(a)(13) because they were active in the partnership's trade or business.

(i) *Soroban Capital Partners v. Commissioner* (2025)[1]: The Tax Court concluded that the taxpayers, "limited partners" under Delaware state law, were subject to SECA because the partners' were active in the partnership fund's management.

(ii) *Denham Capital Management LP v. Commissioner* (2024)[2]: The Tax Court held applied a functional analysis in concluding that "limited partners" in an investment management company were subject to SECA. The court concluded that active limited partners who participate in the activities of a fund manager are not entitled to the limited partner exception which was meant for passive investors.

(iii) *Sirius Solutions v. Commissioner*[3]: Stipulated Tax Court opinion post-*Soroban* on appeal in Fifth Circuit. The appeal was heard by the Fifth Circuit in early 2025.

(b) State Law Limited Liability Partners

(i) *Renkemeyer, Campbell & Weaver LLP v. Commissioner* (2011)[4]: The Tax Court applied a functional test to see whether limited liability partners in a law firm partnership were passive investors or were actively involved in the LLP business.

(c) State Law Limited Liability Company Members

(i) *Riether v. United States* (2012)[5]: The federal District Court concluded that LLC members were not members of a limited partnership and did not resemble limited partners.

(ii) *Castigliola v. Commissioner* (2017)[6]: The Tax Court concluded that professional limited liability company members in a law firm partnership were not members of a limited partnership in part because they had full control of the business.

2. Appealed Cases

(a) Soroban Capital Partners LP appealed to Second Circuit August 2025; Sirius Solutions LLP appealed to Fifth Circuit in 2024 and awaiting

[1] T.C. Memo. 2025-52.

[2] T.C. Memo. 2024-114.

[3] U.S. Tax Court Docket No. 11587-20.

[4] 136 T.C. 137 (2011).

[5] 919 F. Supp. 2d 1140 (D. New Mex. 2012).

[6] T.C. Memo. 2017-62.

decision; Denham Capital Management LP filed an appeal in April 2024 with First Circuit and opening brief filed August 2025.

(b) Arguments being raised include that the plain language of the limited partner exception should prevail and the Tax Court did not properly construe the meaning of "limited partner" under state law which does not impose a passive investor standard.

E. Future Outlook

The outcome of the pending appeals cases (including a potential Supreme Court appeal if the circuit courts are divided) will inform whether the functional test prevails as the standard of "limited partner" and could provide more insight into how the functional test should be applied.

III. Allocations of Partnership Liabilities under Section 752 – Related Party Rules

A. Background

1. 2013 Proposed Regulations

(a) Proposed regulations under Treas. Reg. §§ 1.752-2, 1.752-4, and 1.752-5 were published on December 16, 2013 (the "Proposed Regulations").[7]

2. 2024 Final Regulations

(a) Final regulations under Treas. Reg. §§ 1.752-2, 1.752-4, and 1.752-5 were published on December 2, 2024 (the "Final Regulations").[8]

(b) Issues addressed by the Final Regulations.

(i) The allocation of liabilities under Treas. Reg. § 1.752-2 (recourse liabilities) among partners (including unrelated partners) if there is overlap in the extent to which the partners bear the economic risk of loss with respect to a liability (or portion thereof).

(ii) The allocation of liabilities under Treas. Reg. § 1.752-2 among partners that are related to each other.

(iii) The allocation of liabilities under Treas. Reg. § 1.752-2 of a lower-tier partnership to an upper-tier partnership, including if a partner of the upper-tier partnership bears the economic risk of loss of a liability of the lower-tier partnership.

(iv) The limitation of the extent to which a partner has a share of a partnership liability for purposes of Section 752[9] because the

[7] 78 FR 76092.

[8] T.D. 10014; 89 FR 95115.

[9] All section references are to the Internal Revenue Code of 1986, as amended.

partner is otherwise treated as related to an entity in which the partnership owns a direct or indirect interest.

3. Basic Concepts

(a) The general rule under Treas. Reg. § 1.752-2 is that a partner's share of a recourse liability is equal to the portion of the liability for which the partner (or a person related to the partner) bears the economic risk of loss.[10]

(b) A recourse liability is a liability to the extent that any partner (or a related person to the partner) bears the economic risk of loss under Treas. Reg. § 1.752-2.[11]

(c) In general, an increase or decrease in a partner's share of partnership liabilities (whether recourse or nonrecourse for purposes of Section 752) is treated as a contribution or distribution of money, respectively, by (or to) the partner to (or from) the partnership.[12]

(d) A partner's share of partnership liabilities (including the partner's share of a recourse liability) is, therefore, included in the partner's basis in its interest in the partnership. Changes in the amount of the partner's share of a partnership's liabilities therefore change in the calculation of a partner's basis in its partnership interest.[13]

(e) The extent of a partner's share of a partnership's liabilities under Section 752 may have an impact on, among other things, the extent to which a partner can utilize losses under Section 704(d), the extent to which a partner may receive distributions of cash or marketable securities from a partnership without the recognition of gain under Section 731, and the amount realized by a partner in connection with a sale of all or a portion of the partner's interest in the partnership (and, consequently, the amount of gain or loss that the partner would recognize in connection with that sale) under Section 741.

(f) In general, a person is treated as bearing the economic risk of loss for a portion of a partnership liability to the extent that:

(i) the person has a payment obligation (such as, for instance, through a guaranty) described in Treas. Reg. § 1.752-2(b);

(ii) the person is a lender to the partnership as described in Treas. Reg. § 1.752-2(c);

[10] *See* Treas. Reg. § 1.752-2(a)(1).

[11] *See* Treas. Reg. § 1.752-1(a)(1).

[12] *See* Section 752(a)-(b).

[13] *See* Section 722, Section 733.

(iii) certain guarantees of interest on a partnership liability as described in Treas. Reg. § 1.752-2(e); and

(iv) the person is a lender to the partnership as described in Treas. Reg. § 1.752-2(c).

(v) The word "person" rather than "partner" is used because a partner's share of liabilities may be impacted by the extent to which the economic risk of loss for a partnership liability is borne by a person related to the partner.

(g) For purposes of Treas. Reg. § 1.752-2, a related person means a person that bears a relationship to a partner described in Section 267(b) and Section 707(b)(1), with certain modifications.[14] An important modification is that the more-than-50% threshold described in these sections is increased to an 80%-or-more threshold.[15] Moreover, a person's family is determined by excluding siblings.[16]

(h) In certain circumstances, the Final Regulations include a concept of "direct" economic risk of loss or a person directly bearing economic risk of loss of a partnership liability. In general, a person has the direct economic risk of loss for a partnership liability (or portion thereof) if it would have the economic risk of loss for the liability (or portion thereof), but looking only to the undertakings of that person, and not to other persons related to that person.[17]

4. Architecture of the Related Party- and Tiered-Partnership Rules

(a) Overlapping Risk of Loss

(i) It is possible that more than one partner may bear the economic risk of loss with respect to a single partnership liability (or portion thereof). Stated differently, partners may have overlapping economic risk of loss with respect to the liability.

(ii) Under the Final Regulations, for purposes of determining a partner's share of a partnership liability, the liability is taken into account only once.[18]

(iii) In general, if multiple partners bear the economic risk of loss for a partnership liability (or portion thereof), the partner's share of that liability (or that portion) is equal to the product of the liability multiplied by the fraction equal to the amount of the liability for

[14] *See* Treas. Res. § 1.752-4(b)(1).

[15] *See* Treas. Reg. § 1.752-4(b)(1)(i).

[16] *See* Treas. Reg. § 1.752-4(b)(1)(ii).

[17] *See* Treas. Reg. § 1.752-2(a)(3).

[18] *See* Treas. Reg. § 1.752-2(a)(2).

which the partner bears the economic risk of loss, divided by the amounts borne by all such partners.[19] The preamble to the Final Regulations refers to this concept as the "proportionality rule."

(iv) *Example 1*. Each of Partner A and Partner B, who are unrelated, guarantee the entirety of Partnership's liability of $1000. Partner A and Partner B are unrelated to each other. Each of Partner A's and Partner B's share of the liability is $500 (in the aggregate, $1000). This is determined by multiplying the amount of the liability guaranteed by both partners, $1000, by the fraction equal to the amount of the liability for which each partner bears the economic risk of loss ($1000), divided by the sum of the aggregate amounts for all partners ($2000).[20]

(v) *Example 2*. The facts are the same as set forth in Example 1, except that Partner A only guarantees the first $500 of the liability, while Partner B guarantees the entire $1000. The partners have overlapping economic risk of loss for $500 of the liability, and therefore each have a $250 share of that portion. This is determined by multiplying the relevant portion of the liability ($500), by the fraction equal to the amount of the liability for which the partner bears the economic risk of loss ($500), divided by the sum of the aggregate amounts for all partners ($1000). Partner B also has economic risk of loss for the other $500 of the liability not guaranteed by Partner A. Partner A's share of the liability is $250; Partner B's is $750.

(vi) In general, if one or more partners (or other persons who own a direct or indirect interest in a partnership through one or more other partnerships) *directly* bear the economic risk of loss for a single partnership liability (or a portion of that liability), the partner (or indirect equity owner) is not treated as related to other persons that own an interest in the partnership, directly or indirectly through one or more other partnerships, in the partnership. This rule applies only for purposes of determining the extent to which those related persons share the economic risk of loss.[21] The Final Regulations refer to this concept as the "related partner exception."

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[19] *See* Treas. Reg. § 1.752-2(a)(2).

[20] *See* Treas. Reg. § 1.752-2(f)(9) (Example 9). For purposes of all examples included in this outline, assume that (1) any guarantees are respected as being sufficient to create a "payment obligation" under Treas. Reg. § 1.752-2(a)(3) and Treas. Reg. § 1.752-2(b) and are otherwise respected under Treas. Reg. §§ 1.752-2(j) and -2(k); and that (2) insofar as multiple persons have guaranteed the same liability (or portion thereof), neither applicable law nor contract provides a clear delineation of those persons' respective responsibility or equitable sharing of the liability, including by way of a right of contribution.

[21] *See* Treas. Reg. § 1.752-4(b)(2).

(vii) Note that the related party exception does not apply for purposes of the application of the "*de minimis* exceptions" under Treas. Reg. § 1.752-2(d) (partner or related person acting as a lender or guarantor) and -2(e) (guaranteed interest).[22]

(viii) *Example 3*. Each of Partner A and Partner B own equivalent 50% interests in Partnership. Partner A and Partner B, domestic C corporations, are wholly owned by X, a domestic C corporation. Partner A guarantees the entirety of Partnership's liability of $1000. For purposes of determining the extent to which Partner A and Partner B bear the economic risk of loss for the $1000 liability, those partners are treated as unrelated notwithstanding that Partner A and Partner B otherwise are related under Treas. Reg. § 1.752-4(b)(1). Partner A *directly* bears the economic risk of loss for the $1000 liability because of its guarantee. Pursuant to the related party exception, Partner B is treated as not related to Partner A, and therefore Partner B does not bear the economic risk of loss for the portion of the liability guaranteed by Partner A. As a result, Partner A's share of the $1000 liability is $1000; Partner B's share of the liability is zero.

(b) Multiple Partners Related to Person Bearing Risk of Loss

(i) Similarly, it is possible that a non-partner (*i.e.*, a "person") that bears the economic risk of loss with respect to a partnership liability may be related to multiple partners.

(ii) Under the Final Regulations, a partnership liability for which a person *directly* bears the economic risk of loss is allocated between that person's related partners in proportion to those partners' interest of partnership profits.[23] Note that, because of the related party exception (and the ordering rule described below), this rule effectively would be "turned off" if the person that *directly* bears the economic risk of loss for a liability owns, directly or indirectly through one or more other partnerships, an interest in the borrower-partnership. The preamble to the Final Regulations refers to this concept as the "multiple partner rule."

(iii) The Final Regulations do not specifically prescribe the time or period at or during which a partner's share of profit is measured for purposes of applying the multiple partner rule.

(iv) *Example 4*. Each of Partner A and Partner B, domestic C corporations, are directly and wholly owned by X, also a domestic C corporation. Y, a domestic C corporation, also is directly and wholly owned by X. Partner A and Partner B own equivalent 50% interests in Partnership. Y makes a loan to Partnership of $1000.

[22] *See id.*

[23] *See* Treas. Reg. § 1.752-4(b)(3).

Under Treas. Reg. § 1.752-2, Partner A and Partner B have 50% shares of the $1000 partnership liability for which Y, a person related to both Partner A and Partner B, directly bears the economic risk of loss (as the lender). This is because Partner A and Partner B have equivalent 50% shares of Partnership profits.

(v) *Example 5*. The facts are the same as set forth in Example 4, except that Partner A and Partner B own equivalent 40% interests in Partnership. Partner C, an unrelated person, owns the remaining 20% interest in Partnership. Partner C then sells its 20% interest in Partnership to Y; Y remains a lender to Partnership following the sale. Y's share of the liability is equal to the entire $1000. This is because Y *directly* bears the economic risk of loss for the liability when it becomes a partner of Partnership. Therefore, the related partner exception applies and neither Partner A nor Partner B would be treated as related to Y (now Partner Y) for purposes of determining the extent to which Partner A or Partner B bears the economic risk of loss for the $1000 liability.

(c) Ordering Rules

(i) The regulations set forth an ordering rule:

- *Step 1*: determine those partners which directly bear the economic risk of loss for a partnership liability.
- *Step 2*: apply the related partner exception, if applicable.
- *Step 3*: apply the multiple partner rule, if applicable.
- *Step 4*: apply the proportionality rule (for overlapping economic risk of loss).[24]

(ii) *Example 6*. Partner A and Partner B are domestic C corporations. Partner A and Partner B are directly and wholly owned by X, which also is a domestic C corporation. Partner C is unrelated to each of Partner A and Partner B. Y, another domestic C corporation, also is directly and wholly owned by X. Partner A, Partner B, and Partner C have equivalent 33.334% interests in Partnership. Y, Partner A, and Partner C (but not Partner B) guarantee Partnership's $1000 liability. Applying the ordering rules, Y and Partner A, but not Partner B, bear *directly* the economic risk of loss for the $1000 liability. So, applying the related partner exception, Partner A and Partner B are treated as unrelated notwithstanding that Partner A and Partner B otherwise are related under Treas. Reg. § 1.752-4(b)(1). It is then necessary to apply the multiple partner rule to determine the portion of the

[24] *See* Treas. Reg. § 1.752-4(e).

economic risk of loss directly borne by Y (which is related to both Partner A and Partner B) that is borne by each of Partner A and Partner B. Because Partner A and Partner B have equivalent one-third interests in Partnership (and therefore Partnership profits), the economic risk of loss of Y's guarantee is allocated between Partner A and Partner B in equivalent amounts of $500, based on the multiple partner rule (and Partner A therefore has total economic risk of loss of $1500, equal to this $500 plus the entire $1000 for which it directly bears the economic risk of loss via its guarantee). Finally, applying the proportionality rule, Partner A's share of Partnership's liability is $500 (the $1000 liability for which there is overlapping economic risk of loss), multiplied by the quotient of $1500 divided by the aggregate amounts of the three guarantees, $3000). Partner B's share is $167. Partner C's share of the liability is $333.[25]

(iii) *Example 7*. The facts are the same as set forth in Example 6, except that X, rather than Y, guarantees the $1000 liability of Partnership. The would be the same as in Example 6. Note that, because X owns an indirect interest in Partnership only through domestic C corporations (Partner A and Partner B), the related partner exception does not apply to cause X to be treated as unrelated to Partner A and Partner B.

(iv) *Example 8*. Partner A and Partner B are domestic C corporations. Partner A and Partner B are directly and wholly owned by X, which also is a domestic C corporation. Partner C is unrelated to each of Partner A and Partner B. Partner A, Partner B, and Partner C have equivalent 33.334% interests in Partnership. Each of the partners guarantees Partnership's $1000 liability. Accordingly, each of the partners *directly* bears the economic risk of loss with respect to the $1000 liability. Applying the related party exception, Partner A and Partner B are treated as unrelated notwithstanding that Partner A and Partner B otherwise are related under Treas. Reg. § 1.752-4(b)(1). (The multiple partner rule is not relevant to this example.) Applying the proportionality rule, each of the partners has a share of the liability equal to the amount of the liability ($1000), multiplied by the quotient of that amount ($1000) divided by $3000 (the aggregate of those amounts for the three partners). Each partner has a share of the liability of $333.34.

(v) *Example 9*. Partner A and Partner B are domestic C corporations. Partner A and Partner B are directly and wholly owned by X, which also is a domestic C corporation. Partner C is unrelated to each of Partner A and Partner B. Partner A, Partner B, and Partner C have equivalent 33.334% interests in Partnership. X and Partner C guarantee Partnership's $1000 liability. Accordingly, X and Partner C (but not Partner A or Partner B) *directly* bear the

[25] *See* Treas. Reg. § 1.752-4(f).

economic risk of loss with respect to the entire $1000 liability. The multiple partner rule applies, and the $1000 for which X bears the economic risk of loss (through its guarantee) is shared between Partner A and Partner B. Partner A and Partner B therefore bear economic risk of loss for $500 of the $1000, based on their relative percentages of Partnership profits. Applying the proportionality rule, each of Partner A and Partner B have a $250 share of Partnership's liability. This is equal to the product of the $1000 liability for which there is overlapping economic risk of loss, multiplied by the quotient of the amount for which they bear economic risk of loss ($500, determined as described above), divided by the aggregate of those amounts for all partners ($2000).[26]

(vi) *Example 10*. Partner A and Partner B are domestic C corporations. Partner A and Partner B are directly and wholly owned by X, which also is a domestic C corporation. Partner A and Partner B own equivalent 50% interests in Partnership. Partner A and Partner B own 79% and 21% of the voting power and value of the stock of Y, a domestic C corporation. Each of Partner A and Y (but not Partner B) guarantee Partnership's liability of $1000. For purposes of determining the extent to which Partner A and Partner B bear the economic risk of loss for the $1000 liability, they are treated as unrelated notwithstanding that Partner A and Partner B otherwise are related under Treas. Reg. § 1.752-4(b)(1). The preamble to the Final Regulations also states that the related party exception should be interpreted broadly, and should apply also for purposes of applying the related-party attribution rules. Accordingly, because neither Partner A nor Partner B owns the 80% of Y necessary to be related in their own respective right to Y, Y is not treated as being related either to Partner A or to Partner B for purposes of determining the extent to which either bears the economic risk of loss for the $1000 liability. Accordingly, Partner A's share of the $1000 liability is $1000 (the amount it has guaranteed and for which it therefore bears the direct economic risk of loss); Partner B's share is zero.[27]

(vii) *Example 11*. The facts are the same as set forth in Example 10, except that Partner A and Partner B own 20% and 80% of Y, respectively. Partner A is not treated as being related to Y, but Partner B would be treated as being related to Y, the related partner exception notwithstanding. Accordingly, Partner A and Partner B would be treated as having overlapping economic risk of loss for $1000 liability. Applying the proportionality rule, their respective shares of the liability would be $1000 (the amount of the liability for which there is overlapping economic risk of loss), divided by the quotient of $1000 (their respective economic risk

[26] *See* Section IV.C (and the accompanying text) of T.D. 10014.

[27] *See* Treas. Reg. § 1.752-4(f).

of loss) divided by sum of those amounts, or $2000. Partner A and Partner B therefore have equivalent $500 shares.

(d) Tiered Partnerships

(i) Under the Final Regulations, in a tiered partnership structure (an upper-tier partnership, or UTP, directly or indirectly owns an interest in another partnership (a lower-tier partnership, or LTP)), liabilities of the LTP are allocated to the UTP in an amount equal to the sum of:

- the amount of liabilities of the LTP for which the UTP *directly* bears the economic risk of loss, plus
- the amount of liabilities of the LTP for which a partner of the UTP bears (not necessarily directly) the economic risk of loss, provided that the UTP's partner is not also a partner of the LTP.[28]

(ii) A LTP takes into account the proportionality rule before the tiering rule described immediately above.[29]

(iii) An UTP's share of the liabilities of a LTP (other than any liability of the LTP that is owed to the UTP) is treated as a liability of the UTP for purposes of applying Section 752 and the regulations thereunder to the partners of the UTP.[30] This rule predates the Final Regulations.

(iv) *Example 12*. Partner A and Partner B, who are unrelated to each other, each own equivalent 50% interests in UTP. UTP owns a 50% interest in LTP. LTP is the obligor on a $1000 bank borrowing. No partner of UTP owns an interest in LTP. Each of Partner A and Partner B guarantees the entire $1000 liability of LTP; no other bears direct economic risk of loss for the LTP liability. Because of their guarantees of LTP's borrowing, both Partner A and Partner B both bear the economic risk of loss for the entire $1000 liability. The proportionality rule would therefore appear to apply, and each of Partner A and Partner B would have a share of the liability under Treas. Reg. § 1.752-2(a)(2) equal to $500 (the $1000 liability for which they bear overlapping economic risk of loss, multiplied by the quotient of $1000 divided by the aggregate of the amounts of that same liability for which Partner A and Partner B bear the economic risk of loss ($2000)). UTP's share of LTP's $1000 liability is $1000.[31]

[28] *See* Treas. Reg. § 1.752-4(i)(1).

[29] *See* Treas. Reg. § 1.752-2(i)(2).

[30] *See* Treas. Reg. § 1.752-4(a).

[31] It is not entirely clear how the provision mandating that the proportionality rule in Treas. Reg. § 1.752-2(a)(2) must be applied before the tiering rule Treas. Reg. § 1.752-2(i) applies mechanically in this situation. The proportionality

Because UTP's share of LTP's liability would be treated as UTP's liability under Treas. Reg. § 1.752-4(a), and because Partner A and Partner B bear equal proportions of the economic risk of loss for UTP's liability, Partner and Partner B would have equal 50% shares of UTP's liability for purposes of Treas. Reg. § 1.752-2.

(v) *Example 13*. The facts are the same as set forth in Example 12, except that UTP also guarantees the entire $1000 debt of LTP. The result would be the same as in Example 12.

(vi) *Example 14*. The facts are the same as set forth in Example 12, except that Partner A also owns a 12% interest in LTP. Partner A directly bears the economic risk of loss for LTP's $1000 liability. As in Example 12, because of their guarantees of LTP's borrowing, both Partner A and Partner B directly bear economic risk of loss for the entire $1000 LTP liability. Because Partner A and Partner B have overlapping economic risk of loss for the $1000 liability, they each have a share of the LTP's liability (each has the economic risk of loss for $1000 multiplied by the quotient of that $1000 divided by the aggregate of the amounts of that same liability for which Partner A and Partner B bear the economic risk of loss, or $2000). Pursuant to Treas. Reg. §§ 1.752-2(i)(1)(ii) and 1.752-2(i)(2), UTP's share of the $1000 liability is equal to Partner B's share of the liability ($500). Because Partner A is a partner of LTP, Partner A's share of the $1000 liability ($500) is not taken into account in calculating UTP's share of LTP's borrowing. UTP's share of the liability ($500) is allocated entirely to Partner B under Treas. Reg. § 1.752-2.[32]

(vii) *Example 15*. The facts are the same as set forth in Example 12, except that Partner A also owns 12% interest in LTP, and unrelated person Partner D owns a 38% interest in Partnership,

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rule, on its face, applies only to "partners"; it is not entirely clear whether this is intended to apply to both direct and indirect partners, or just to direct partners It is possible that, for purposes of determining the "partners" to which Treas. Reg. § 1.752-2(a)(2) refers, partners of both the LTP and the UTP would be considered. This seems to be suggested by the example set forth in Treas. Reg. § 1.752-2(i)(3), in which a UTP-only partner's economic risk of loss is compared with that of LTP partner for purposes of applying the proportionality rule. If the proportionality rule were to apply to determine the portion of LTP's liability for which UTP is treated as having economic risk of loss under Treas. Reg. § 1.752-2(i)(1)(i) (*i.e.*, to the UTP from its partners), each of Partner A and Partner B would, after application of that rule, bear economic risk of loss of $500, the aggregate of which would be treated as a liability of UTP under Treas. Reg. § 1.752-2(i)(1) and Treas. Reg. § 1.752-4(a); the partners would effectively "keep" their shares of that UTP liability under Treas. Reg. § 1.752-2, as they would continue to bear economic risk for the liability in the same portions that caused the liability to be treated as UTP's under Treas. Reg. § 1.752-2(i)(1) and Treas. Reg. § 1.752-4(a). It may also be reasonable or appropriate, given the directive in Treas. Reg. § 1.752-2(i)(2) to apply the proportionality rule before determining the amount of liabilities allocated to a UTP by its partners, to treat the UTP (by virtue of the effect of its partners' activity under Treas. Reg. § 1.752-2(i)(1)(ii)), as the "partner" for purposes of Treas. Reg. § 1.752-2(a)(2). In any case, UTP could not be treated as bearing economic risk of loss for more than $1000 (the most any one of its partners that is not also LTP has). Otherwise, the amount of LTP's liability would be taken into account more than once; this would appear to be prohibited by the first sentence of Treas. Reg. § 1.752-2(a)(2).

[32] *See* Treas. Reg. § 1.752-2(i)(3).

with UTP owning the remaining 60% interest in Partnership. Partner D also guarantees the $1000 liability of LTP. Partner A , Partner B, and Partner D directly bear the economic risk of loss for LTP's $1000 liability. As in Example 12, because of their guarantees of LTP's borrowing, Partner A, Partner D, and Partner B directly bear economic risk of loss for the entire $1000 liability. Because Partner A, Partner D, and Partner B have overlapping economic risk of loss for LTP's $1000 liability, each have a share of UTP's $1000 liability (their economic risk of loss for $1000 multiplied by the quotient of that $1000 divided by the aggregate of the amounts of that same liability for which Partner A, Partner D, and Partner B bear the economic risk of loss, $3000). Pursuant to Treas. Reg. § 1.752-2(i)(1)(ii), UTP's share of the $1000 liability is equal to Partner B's share of the liability ($333). Because Partner A is a partner of LTP, Partner A's share of the $1000 liability ($333) is not taken into account in calculating UTP's share of LTP's borrowing. Partner D's share of LTP's liability is also $333. UTP's share of the liability ($333) is allocated entirely to Partner B under Treas. Reg. § 1.752-2. Partner D's share of LTP's liability is also $333.

(e) Liquidating Distributions

(i) It is possible that a UTP directly bears the economic risk of loss for a liability of a LTP (for instance, via a guaranty by the UTP of the LTP's borrowing). In such a case, it is possible that UTP's share of the LTP's could be determined under Treas. Reg. § 1.752-2(i)(1)(i); LTP's liability would be a recourse liability for purposes of Section 752. The UTP's partners' share of that liability may, however, be determined under Treas. Reg. § 1.752-4(a) and Treas. Reg. § 1.752-3, as a nonrecourse liability, on grounds that no UTP partner bears the economic risk of loss for the LTP's liability.

(ii) If a partner in UTP becomes a partner in the LTP by virtue of receiving a liquidating distribution from UTP of an interest in the LTP, and if the UTP continues to have the economic risk of loss for the liability (but the transferee partner of UTP (subsequently a partner in LTP) does not), there generally would be a reduction in the transferee partner's share of the LTP's liabilities for purposes of Section 752.

(iii) The preamble to the Proposed Regulations requested comments on the timing of the liability "reallocation" (in effect, the shift away of liabilities from the transferee partner) in this type of transaction. The preamble to the Final Regulations states that the Treasury Department and the IRS continue to consider whether

additional guidance is warranted to address this issue, and requested further comments.[33]

(f) Limitations on Related-Party Rules

(i) The preamble to the Final Regulations states that, following the publication of the proposed regulations, commentators identified certain situations in which the related party rules can cause a partner to be related to an entity in which the partnership owns a direct or indirect interest, merely by virtue of the partner's interest in the partnership. If the entity in which the partnership owns a direct or indirect interest *directly* bears the economic risk of loss for a liability of the partnership, the relationship between the entity and the partner (solely as a result of partner's interest in the partnership) would cause the partner to have a share of the liability under Treas. Reg. § 1.752-2. The Final Regulations include a special series of adjustments to the related party rules to prevent this result.[34]

(ii) The preamble to the Final Regulations states that the purpose of these limitations is to prevent a partner being treated as bearing the economic risk of loss for a liability insofar as its exposure is limited to its equity in the partnership.[35] Absent a special rule, this would necessarily be the case if the partner would be treated as bearing the economic risk of loss of a partnership liability only as a result of entirely indirect ownership (through the partnership) in the subsidiary of the partnership.

(iii) *Example 16*. Partner A owns an 80% interest in Partnership. Partnership wholly owns Subsidiary, a domestic C corporation. Partnership borrows $1000. Subsidiary guarantees the $1000 liability. Notwithstanding Partner A's indirect 85%-interest in Subsidiary, Partner A and Subsidiary are not treated as being related for purposes of Treas. Reg. § 1.752-2. Accordingly, the $1000 liability would be a nonrecourse liability for purposes of Section 752; partners' share of the liability generally would be determined pursuant to Treas. Reg. § 1.752-3, not Treas. Reg. § 1.752-2.

(iv) *Example 17*. The facts are the same as Example 16, except that Subsidiary is a domestic partnership rather than a domestic C corporation; Partnership owns a 99% interest in Subsidiary. The result generally is the same as in Example 16.

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[33] *See* Section VI of T.D. 10014.

[34] *See* Treas. Reg. § 1.752-4(b)(1)(iii)-(v) (disregarding certain relationships under the attribution rules for purposes of Treas. Reg. § 1.752-2).

[35] *See* Section IV.A of T.D. 10014; *cf.* Treas. Reg. § 1.752-2(k).

(g) Anti-Abuse Rule

(i) The regulations include a special rule that is intended to prevent the use of otherwise-unrelated entities to bear the economic risk of loss for partnership liabilities.[36]

(ii) Under this rule, if (1) an entity is owed (*i.e.*, is a creditor) or guarantees a liability of a partnership; (2) the partner (or a related person to the partner) directly or indirectly owns an interest of 20% or more of that entity; and (3) a principal purpose of "having" the entity act as lender or guarantor is to prevent the partner from bearing the economic risk of loss for any portion of the liability, the partner is treated as holding the entity's "interest" as a creditor (or a guarantor) to the extent of the partner's (or related person's, as applicable) ownership interest in the entity.[37]

(iii) There are specific rules for determining the partner's (or related person's, as applicable) ownership interest in the lender- or guarantor-entity.[38]

(iv) The lender- or guarantor-entity can be a partnership, C corporation, S corporation, or trust.[39]

(v) For an example of the application of this rule, *see* Treas. Reg. § 1.752-4(b)(5)(v).

(h) Effective Dates

(i) The Final Regulations *generally* apply to liabilities incurred or assumed by a partnership on or after December 2, 2024.[40]

(ii) The Final Regulations generally do not apply to liabilities incurred or assumed by a partnership on or after December 2, 2024, but pursuant to a binding written contract in effect prior to December 2, 2024.[41]

(iii) Refinancings of liabilities to which the Final Regulations do not apply (for instance, a liability incurred or assumed by a partnership on December 1, 2024) "step into the shoes" of the

[36] *See* Treas. Reg. § 1.752-4(b)(4).

[37] *See* Treas. Reg. § 1.752-4(b)(4)(i).

[38] *See* Treas. Reg. § 1.752-4(b)(4)(i).

[39] *See* Treas. Reg. § 1.752-4(b)(4)(i)(C).

[40] *See* Treas. Reg. §§ 1.752-2(l)(4) and 1.752-5(a).

[41] *See id.*

original liability for purposes of applying the Final Regulations to the refinancing (new) liability.[42]

(iv) A taxpayer is permitted to apply the rules set forth in the Final Regulations to liabilities with respect to which the regulations are not otherwise applicable (for instance, liabilities incurred or assumed by a partnership prior to December 2, 2024), for any return filed on or after December 2, 2024, provided that the taxpayer applies the rules consistently.[43]

IV. *Rawat v. Commissioner*: Pre-TJCA Sourcing of under Section 751

A. Background

1. Character of Gain in Connection with the Sale of a Partnership Interest

(a) Gain or loss recognized by a partner in connection with a sale or exchange of a partnership interest generally is "considered as gain or loss from the sale or exchange of a capital asset."[44] This treatment applies "except as otherwise provided in section 751 (relating to unrealized receivables and inventory items)."[45]

(b) Gain or loss recognized under Section 731 by a partner in connection with a distribution is "considered as gain or loss from the sale or exchange of the partnership interest of the distribute partner." *See* Section 731(a) (flush language).[46]

2. Section 751 and "Hot Assets"

(a) Sales or Exchanges of Partnership Interests.

(i) The amount of money and the fair market value received by a transferor partner in exchange for all or part of his partnership interest attributable to unrealized receivables to the partnership or inventory items of the partnership "shall be considered as an amount realized from the sale or exchange of property other than a capital asset."[47]

(b) Certain Distributions

(i) To the extent that a partner receives in a distribution partnership property which is either unrealized receivables or substantially

[42] *See id.*

[43] *See id.*

[44] *See* Section 741.

[45] *See id.*

[46] *See* Section 731(a) (flush language).

[47] *See* Section 751(a).

appreciated inventory in exchange for all or a part of his interest in other partnership property (including money), the transaction is considered, under regulations, as a sale or exchange of such property between the distributee partner and the partnership (as constituted after the distribution).[48]

(ii) Similar rules apply to the extent that a partner receives in a distribution partnership property (other than unrealized receivables or substantially appreciated inventory), including money, in exchange for all or part of his interest in unrealized receivables or substantially appreciated inventory.[49]

3. General Sourcing Rules for Sales of Personal Property

(a) In general, income or gain from the sale of personal property is sourced to the residence of the taxpayer.[50]

(b) Gain from the sale of personal property that is attributable to the taxpayer's office or fixed place of business in the United States is treated as U.S. source.[51]

(c) Gain generally is attributable to an office or fixed place of business if either (a) the gain is derived from assets held for use in the trade or business; or (b) the activities of the business are a material factor in the realization of the gain.[52]

(d) In general, all U.S. source income (other than income described in Section 865(c)(2)) is treated as effectively connected income to the conduct of a trade or business within the United States.[53]

(e) Under Section 856(b), gain from sales of inventory may be treated as U.S. source income pursuant to the rules set forth in Sections 861(a)(6), 862(a)(6), and 863(b)(3).

4. Pre-TJCA Law

(a) Foreign Investment in Real Property Act (FIRPTA) – Section 897

(i) In general, if a partnership holds one or more U.S. real property interests, consideration received by a partner in connection with a disposition of all or a portion of its partnership interest is treated

[48] *See* Section 751(b)(1)(A) and (b)(1) (flush language).

[49] *See* Section 751(b)(1)(B) and (b)(1) (flush language).

[50] *See* Section 865.

[51] *See* Section 865(e)(2).

[52] *See* Section 865(e)(3), Section 864(c)(5)(B).

[53] *See* Section 864(c)(3).

as being received in exchange for the partner's share of the U.S. real property interests "to the extent attributable to" those assets.[54]

(ii) As a result, if the partner recognizes gain in connection with a disposition of its partnership interest, all or a portion of that gain may be treated as gain subject to Section 897(a), and therefore treated as income effectively connected with a U.S. trade or business, on a "look-through" basis to the underlying assets of the partnership whose interest was disposed.[55]

(b) Revenue Ruling 91-32[56]

(i) In 1991, the IRS addressed the source of gain recognized by a foreign partner in connection with a sale or exchange of an interest in a partnership conducting a U.S. trade or business.

(ii) In the ruling, the IRS addressed three situations. The first situation involved a disposition by the partner of its entire interest in the partnership. The second situation involved a partial disposition by the partner of its partnership interest. The final situation involved a variation of the first, and focused on the application of the provision of the treaty that required the taxpayer to have a permanent establishment in the U.S. as a condition to U.S. taxation.

(iii) The IRS reasoned that, because the partner was treated as being engaged in a U.S. trade or business through a fixed place of business by virtue of its interest in the partnership, income from the sale of that partnership interest was attributable to that fixed place of business and the partner's interest was an "ECI asset."

(iv) The IRS further reasoned that it would be inappropriate to treat any gain recognized by the partner in connection with the sale of its interest (where the partnership was engaged in U.S. trade or business) necessarily as effectively connected income; for instance, the IRS noted, a portion of the value associated with the interest could be attributable to non-U.S. business assets. The IRS then stated, without significant textual analysis, "it [was] appropriate" to treat the foreign partner's disposition of its partnership interest as a "disposition of an aggregate interest in the underlying property for purposes of determining the source and [effectively connected income] character of the gain or loss realized by the foreign partner."

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[54] *See* Section 897(g); Treas. Reg. § 1.897-7T(a).

[55] *See* Section 897(a).

[56] 1991-1 C.B. 107.

(v) As a consequence of the IRS's approach, gain or loss recognized by a partner in connection with the sale or exchange of an interest in a partnership that is exchanged in a U.S. trade or business would be treated in whole or in part as effectively connected income.

(c) *Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*[57]

(i) In *Grecian Magnesite*, the taxpayer challenged the IRS's position reflected in Rev. Rul. 91-32.

(ii) The taxpayer stipulated that, insofar as the amount it received from the distributing partnership in exchange for its partnership interest was attributable to the partner's indirect share of the partnership's U.S. real property interests, any associated gain would be treated as effectively connected income under Section 897(g).

(iii) The taxpayer argued that, insofar as its gain (under Section 731(b)) was attributable to U.S. real property interests owned by the distributing partnership, on the one hand, and other property owned by the partnership, on the other hand, that remaining gain ought not be treated as effectively connected income. This was notwithstanding that the partnership itself was engaged in a U.S. trade or business (and, in general, the distribute-partner's share of income allocated to it by the partnership was treated as effectively connected income).

(iv) The Tax Court held for the taxpayer, concluding, among other things, that the transaction should be characterized, for purposes of determining the treatment of the non-FIRPTA gain recognized by the distributee partner, as the sale or exchange of a partnership interest.

(v) As a result, for purposes of determining the source of the taxpayer's gain, the transaction was properly analyzed as a sale of personal property (*i.e.*, the partner's partnership interest) and not as an indirect sale of the partner's share of the partnership's U.S. business assets. The court criticized and rejected the reasoning set forth in Rev. Rul. 91-32.

(vi) The Tax Court then concluded that, under the applicable rules for determining the source of gain from the sale of personal property, the gain should be treated as foreign source income. The D.C. Circuit later affirmed the latter ruling, the government not having reasserted the look-through approach reflected in Rev. Rul. 91-32.[58]

[57] 149 T.C. 63 (2017), *aff'd by* 926 F.3d 819 (D.C. Cir. 2019).

[58] *See* 926 F.3d 819 (D.C. Cir. 2019).

5. Changes Under the TJCA

(a) The TJCA amended Section 864 to overrule, in effect, the holding in *Grecian Magnesite* and effectively to codify the general approach set forth in Rev. Rul. 91-32.

(b) Under Section 864(c)(8), if a foreign corporation or nonresident alien individual owns an interest in a partnership that is engaged in a U.S. trade or business, gain or loss on the sale or exchange of all or a portion of the interest is treated as effectively connected with the conduct of that trade or business.[59] This regime is similar, though different in certain important ways, to that prescribed by Section 897(g).

(i) The amount treated as effectively connected income under Section 864(c)(8) generally is capped at the partner's share of income allocatable to it by the partnership in connection with a hypothetical sale by the partnership of all its assets and that would be effectively connected income to the partner.[60]

(ii) Section 864(c)(8) is effective for transfers occurring on or after November 27, 2017.[61]

(c) A corresponding withholding regime was also enacted via Section 1446(f). The IRS guidance under Section 1446(f) prior to finalizing regulations in 2020.[62]

B. ***Rawat v. Commissioner***[63]

1. Background

(a) In a transaction not unlike that under issue in *Grecian Magnesite*, the taxpayer had recognized gain under Section 731(a) in connection with a redemption of its interest in a partnership. A portion of the gain was, pursuant to Section 751(a), treated as ordinary income. The application of Section 751 itself seemingly was not at issue.

(b) As in the Tax Court's handling of *Grecian Magnesite*, the primary issue was whether the transaction should be analyzed for purposes of determining the source of the partner's income either as the sale of a partnership interest, on the one hand, or an indirect sale of the partner's

[59] *See* Section 864(c)(8)(A).

[60] *See* Section 864(c)(8)(B).

[61] *See* P.L. 115-97, Section 13501.

[62] *See* IRS Notice 2018-8, 2018-7 IRB 352; IRS Notice 2018-29, 2018-16 IRB 495; IRS Notice 2021-51, 2021-36 IRB; Treas. Reg. § 1.1446(f)-1, et al.

[63] 108 F.4th 891 (D.C. Cir. 2024), *rev'g* T.C. Memo. 2023-14.

interest in the partnership's "hot assets" (*i.e.*, the partnership's unrealized receivables and substantially appreciated inventory).

(i) If the taxpayer were treated, for purposes of determining the source of the gain recognized in connection with the distribution to her by the partnership, as having sold inventory, the gain would have been U.S. source at least in part and, as a result, treated at least in part as effectively connected income.

(ii) If, by contrast, the taxpayer was treated for purposes of the sourcing analysis as having sold a partnership interest then, regardless of the char of the gain under Section 751, the gain would have been foreign source.

(iii) Note that the distribution occurred prior to the effective time of Section 864(c)(8).

(c) The taxpayer argued that Section 751 impacted only the character of the income she recognized in connection with the distribution; Section 751 did not, she argued, impact the general treatment of the transaction.

(i) In effect, the taxpayer asserted that Section 751 merely modified the result dictated by Section 741, in that gain recognized by a partner in connection with a sale or exchange of its partnership interest is generally treated as gain from the sale or exchange of a capital asset.

(d) The Tax Court ruled for the government.[64]

2. The Circuit Court's Analysis

(a) The D.C. Circuit overruled the Tax Court and held for the taxpayer.

(b) The court's analysis focused closely on the text of the relevant statutory provisions, including Sections 741 and 751.

(c) In particular, the court highlighted that the language in Section 751(a) described the taxpayer's amount realized as being from the sale or exchange of property "other than a capital asset."

(i) This, the court reasoned, suggested that the statute was one of character-conversion, in that Section 751 merely modifies Section 741 (as is explicitly contemplated by the latter's cross reference to Section 751).

(ii) The court emphasized that Congress, in drafting the text of Section 751, could have employed language like that in Section 897(g), or ultimately in Section 864(c)(8), and treated the sale of the

[64] *See* T.C. Memo. 2023-14.

partner's interest as an indirect sale of the partner's share of the partnership's hot assets.

(d) The court noted that Section 751(b), by comparison with Section 751(a), appeared to treat the transaction as a sale or exchange of the taxpayer's share of the partnership's hot assets (or non-hot assets, as appropriate) with the partnership.

(i) The court reasoned that the language of Section 751(b) was properly viewed as a framework for measuring the amount of the gain subject to be treated as ordinary income, rather than as a substantive recharacterization of the transaction.

C. For Further Consideration

1. IRS discretion to apply aggregate treatment

(a) The Commissioner can treat a partnership as an aggregate of its partners in whole or in part as appropriate to carry the purpose of any provision under the Internal Revenue Code or the regulations promulgated thereunder.[65]

(i) Application of the IRS's discretion is limited (*i.e.*, Treas. Reg. § 1.701-2(e) "does not apply") if both (1) the relevant statutory or regulatory provision prescribes the treatment of a partnership as an entity in whole or in part, and (2) the treatment and ultimate tax results are "clearly contemplated" by the provision.[66]

2. Section 1239

(a) In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in Section 167.[67]

(b) How does Section 1239 treat a sale of a partnership interest to a related person if the partnership owns appreciated real property that is depreciable?

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[65] *See* Treas. Reg. § 1.701-2(e)(1).

[66] *See* Treas. Reg. § 1.701-2(e)(2). For a helpful summary of the authorities considering the aggregate and entity approaches to the taxation of partnerships, *see* Monte A. Jackel, "Summaries of Aggregate and Entity Authorities" ("Petitioner Summarizes Aggregate-Entity Authorities"), Tax Notes Today Doc. 2017-63474 (July 25, 2017).

[67] Section 1239(a).

(i) Query the extent to which the continued existence of the partnership following the sale by the partner of an interest is relevant to the analysis.[68]

[68] *See* Rev. Rul. 99-6, 1999-1 C.B. 432. *But see* Rev. Rul. 72-172, 1972-1 C.B. 265.