

the extent the loan remains unpaid after the bank has exhausted its remedies against the partnership. A is a subsidiary, formed by a parent of a consolidated group, with capital limited to \$20,000 to allow the consolidated group to enjoy the tax losses generated by the property while at the same time limiting its monetary exposure for such losses. These facts, when considered together with B's guarantee, indicate a plan to circumvent or avoid A's obligation to contribute to the partnership. The rules of section 752 must be applied as if A's obligation to contribute did not exist. Accordingly, the \$150,000 liability is a recourse liability that is allocated entirely to B.

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§ 1.752-3 Partner's share of non-recourse liabilities.

(a) *In general.* A partner's share of the nonrecourse liabilities of a partnership equals the sum of paragraphs (a)(1) through (a)(3) of this section as follows—

(1) The partner's share of partnership minimum gain determined in accordance with the rules of section 704(b) and the regulations thereunder;

(2) The amount of any taxable gain that would be allocated to the partner under section 704(c) (or in the same manner as section 704(c) in connection with a revaluation of partnership property) if the partnership disposed of (in a taxable transaction) all partnership property subject to one or more nonrecourse liabilities of the partnership in full satisfaction of the liabilities and for no other consideration; and

(3) The partner's share of the excess nonrecourse liabilities (those not allocated under paragraphs (a)(1) and (a)(2) of this section) of the partnership as determined in accordance with the partner's share of partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners. The partnership agreement may specify the partners' interests in partnership profits for purposes of allocating excess nonrecourse liabilities provided the interests so specified are reasonably consistent with allocations (that have substantial economic effect under the section 704(b) regulations) of some other significant item of

partnership income or gain. Alternatively, excess nonrecourse liabilities may be allocated among the partners in accordance with the manner in which it is reasonably expected that the deductions attributable to those nonrecourse liabilities will be allocated. Additionally, the partnership may first allocate an excess nonrecourse liability to a partner up to the amount of built-in gain that is allocable to the partner on section 704(c) property (as defined under § 1.704-3(a)(3)(ii)) or property for which reverse section 704(c) allocations are applicable (as described in § 1.704-3(a)(6)(i)) where such property is subject to the nonrecourse liability to the extent that such built-in gain exceeds the gain described in paragraph (a)(2) of this section with respect to such property. This additional method does not apply for purposes of § 1.707-5(a)(2)(ii). To the extent that a partnership uses this additional method and the entire amount of the excess nonrecourse liability is not allocated to the contributing partner, the partnership must allocate the remaining amount of the excess nonrecourse liability under one of the other methods in this paragraph (a)(3). Excess nonrecourse liabilities are not required to be allocated under the same method each year.

(b) *Allocation of a single nonrecourse liability among multiple properties—*(1) *In general.* For purposes of determining the amount of taxable gain under paragraph (a)(2) of this section, if a partnership holds multiple properties subject to a single nonrecourse liability, the partnership may allocate the liability among the multiple properties under any reasonable method. A method is not reasonable if it allocates to any item of property an amount of the liability that, when combined with any other liabilities allocated to the property, is in excess of the fair market value of the property at the time the liability is incurred. The portion of the nonrecourse liability allocated to each item of partnership property is then treated as a separate loan under paragraph (a)(2) of this section. In general, a partnership may not change the method of allocating a single nonrecourse liability under this paragraph (b) while any portion of the liability is

outstanding. However, if one or more of the multiple properties subject to the liability is no longer subject to the liability, the portion of the liability allocated to that property must be re-allocated among the properties still subject to the liability so that the amount of the liability allocated to any property does not exceed the fair market value of such property at the time of reallocation.

(2) *Reductions in principal.* For purposes of this paragraph (b), when the outstanding principal of a partnership liability is reduced, the reduction of outstanding principal is allocated among the multiple properties in the same proportion that the partnership liability originally was allocated to the properties under paragraph (b)(1) of this section.

(c) *Examples.* The following examples illustrate the principles of this section:

Example 1. Partner's share of nonrecourse liabilities. The AB partnership purchases depreciable property for a \$1,000 purchase money note that is nonrecourse liability under the rules of this section. Assume that this is the only nonrecourse liability of the partnership, and that no principal payments are due on the purchase money note for a year. The partnership agreement provides that all items of income, gain, loss, and deduction are allocated equally. Immediately after purchasing the depreciable property, the partners share the nonrecourse liability equally because they have equal interests in partnership profits. A and B are each treated as if they contributed \$500 to the partnership to reflect each partner's increase in his or her share of partnership liabilities (from \$0 to \$500). The minimum gain with respect to an item of partnership property subject to a nonrecourse liability equals the amount of gain that would be recognized if the partnership disposed of the property in full satisfaction of the nonrecourse liability and for no other consideration. Therefore, if the partnership claims a depreciation deduction of \$200 for the depreciable property for the year it acquires that property, partnership minimum gain for the year will increase by \$200 (the excess of the \$1,000 nonrecourse liability over the \$800 adjusted tax basis of the property). See section 704(b) and the regulations thereunder. A and B each have a \$100 share of partnership minimum gain at the end of that year because the depreciation deduction is treated as a nonrecourse deduction. See section 704(b) and the regulation thereunder. Accordingly, at the end of that year, A and B are allocated \$100 each of the nonrecourse liability to match their shares of partnership

minimum gain. The remaining \$800 of the nonrecourse liability will be allocated equally between A and B (\$400 each).

Example 2. Excess nonrecourse liabilities allocated consistently with reasonably expected deductions. The facts are the same as in *Example 1* except that the partnership agreement provides that depreciation deductions will be allocated to A. The partners agree to allocate excess nonrecourse liabilities in accordance with the manner in which it is reasonably expected that the deductions attributable to those nonrecourse liabilities will be allocated. Assuming that the allocation of all of the depreciation deductions to A is valid under section 704(b), immediately after purchasing the depreciable property, A's share of the nonrecourse liability is \$1,000. Accordingly, A is treated as if A contributed \$1,000 to the partnership.

Example 3. Allocation of liability among multiple properties. (i) A and B are equal partners in a partnership (PRS). A contributes \$70 of cash in exchange for a 50-percent interest in PRS. B contributes two items of property, X and Y, in exchange for a 50-percent interest in PRS. Property X has a fair market value (and book value) of \$70 and an adjusted basis of \$40, and is subject to a nonrecourse liability of \$50. Property Y has a fair market value (and book value) of \$120, an adjusted basis of \$40, and is subject to a nonrecourse liability of \$70. Immediately after the initial contributions, PRS refinances the two separate liabilities with a single \$120 nonrecourse liability. All of the built-in gain attributable to Property X (\$30) and Property Y (\$80) is section 704(c) gain allocable to B.

(ii) The amount of the nonrecourse liability (\$120) is less than the total book value of all of the properties that are subject to such liability (\$70 + \$120 = \$190), so there is no partnership minimum gain. § 1.704-2(d). Accordingly, no portion of the liability is allocated pursuant to paragraph (a)(1) of this section.

(iii) Pursuant to paragraph (b)(1) of this section, PRS decides to allocate the nonrecourse liability evenly between the Properties X and Y. Accordingly, each of Properties X and Y are treated as being subject to a separate \$60 nonrecourse liability for purposes of applying paragraph (a)(2) of this section. Under paragraph (a)(2) of this section, B will be allocated \$20 of the liability for each of Properties X and Y (in each case, \$60 liability minus \$40 adjusted basis). As a result, a portion of the liability is allocated pursuant to paragraph (a)(2) of this section as follows:

Partner	Property	Tier 1	Tier 2
A	X	\$0	\$0
	Y	0	0
B	X	0	20
	Y	0	20

(iv) PRS has \$80 of excess nonrecourse liability that it may allocate in any manner consistent with paragraph (a)(3) of this section. PRS determines to allocate the \$80 of excess nonrecourse liabilities to the partners up to their share of the remaining section 704(c) gain on the properties, with any remaining amount of liabilities being allocated equally to A and B consistent with their equal interests in partnership profits. B has \$70 of remaining section 704(c) gain (\$10 on Property X and \$60 on Property Y), and thus will be allocated \$70 of the liability in accordance with this gain.

The remaining \$10 is divided equally between A and B. Accordingly, the overall allocation of the \$120 nonrecourse liability is as follows:

Partner	Tier 1	Tier 2	Tier 3	Total
A	\$0	\$0	\$5	\$5
B	0	40	75	115

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§ 1.752-4 Special rules.

(a) *Tiered partnerships.* An upper-tier partnership's share of the liabilities of a lower-tier partnership (other than any liability of the lower-tier partnership that is owed to the upper-tier partnership) is treated as a liability of the upper-tier partnership for purposes of applying section 752 and the regulations thereunder to the partners of the upper-tier partnership.

(b) *Related person definition*—(1) *In general.* A person is related to a partner if the person and the partner bear a relationship to each other that is specified in section 267(b) or 707(b)(1), subject to the following modifications:

(i) Substitute "80 percent or more" for "more than 50 percent" each place it appears in those sections;

(ii) A person's family is determined by excluding brothers and sisters; and

(iii) Disregard sections 267(e)(1) and 267(f)(1)(A).

(2) *Person related to more than one partner*—(i) *In general.* If, in applying the related person rules in paragraph (b)(1) of this section, a person is related to more than one partner, paragraph (b)(1) of this section is applied by treating the person as related only to the partner with whom there is the highest percentage of related ownership. If two or more partners have the same per-

centage of related ownership and no other partner has a greater percentage, the liability is allocated equally among the partners having the equal percentages of related ownership.

(ii) *Natural persons.* For purposes of determining the percentage of related ownership between a person and a partner, natural persons who are related by virtue of being members of the same family are treated as having a percentage relationship of 100 percent with respect to each other.

(iii) *Related partner exception.* Notwithstanding paragraph (b)(1) of this section (which defines related person), persons owning interests directly or indirectly in the same partnership are not treated as related persons for purposes of determining the economic risk of loss borne by each of them for the liabilities of the partnership. This paragraph (iii) does not apply when determining a partner's interest under the de minimis rules in §§ 1.752-2 (d) and (e).

(iv) *Special rule where entity structured to avoid related person status*—(A) *In general.* If—

(1) A partnership liability is owed to or guaranteed by another entity that is a partnership, an S corporation, a C corporation, or a trust;

(2) A partner or related person owns (directly or indirectly) a 20 percent or more ownership interest in the other entity; and

(3) A principal purpose of having the other entity act as a lender or guarantor of the liability was to avoid the determination that the partner that owns the interest bears the economic risk of loss for federal income tax purposes for all or part of the liability;

then the partner is treated as holding the other entity's interest as a creditor or guarantor to the extent of the partner's or related person's ownership interest in the entity.

(B) *Ownership interest.* For purposes of paragraph (b)(2)(iv)(A) of this section, a person's ownership interest in:

(1) A partnership equals the partner's highest percentage interest in any item of partnership loss or deduction for any taxable year;

(2) An S corporation equals the percentage of the outstanding stock in the S corporation owned by the shareholder;