Partnership Continuations and Terminations After the TCJA

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Sarah has worked in mergers and acquisitions, internal restructurings, and various proceedings before the Internal Revenue Service (IRS). She drafts partnership agreements and recently became a co-editor of Structuring and Drafting Partnership Agreements: Including LLC Agreements (Warren, Gorham & Lamont).
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Amanda is a partner in the tax department of Proskauer and a member of the private investment funds group. Her practice concentrates on planning for and the structuring of domestic and international private investment funds, including venture capital, buyout, real estate and hedge funds, as well as advising those funds on investment activities and operational issues. She also represents many types of investors, including tax-exempt and non-U.S. investors, with their investments in private investment funds. Amanda has significant experience structuring taxable and tax-free mergers and acquisitions, real estate transactions and stock and debt offerings. She also counsels both sports teams and sports leagues with a broad range of tax issues.

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Jen is a principal in the Passthroughs Group in the National Tax Office of Deloitte Tax LLP in Washington DC. She specializes in tax issues arising in connection with the formation and ongoing operation of joint ventures, and the use of partnerships in domestic and cross border mergers and acquisitions. She has represented a wide variety of clients in multiple industries, including financial institutions, investment funds, energy, and healthcare.

Before joining Deloitte, Jen practiced law as a partner in the Washington DC office of Crowell & Moring LLP.


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Section 708

• 708(a) General Rule: For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated.

• 708(b)(1) Termination; General Rule: For purposes of subsection (a), a partnership shall be considered as terminated only if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.
Legislative History

- Section 708 was originally intended to prevent taxpayers from electively ending the partnership tax year by changing the partners’ partnership interests.
  - A partnership for tax purposes is much broader than under common law, the Uniform Partnership Act, or individual state laws.
  - Until 1953, there was a line of cases that applied state law and concluded that a partnership terminated upon the death or withdrawal of a partner.
  - Rev. Rul. 144 (the language of which became section 708) rejected those cases, and provided that even though a partnership may *dissolve* under state law, whether or not it *terminates* for tax purposes is determined based on whether, in substance, the business of the partnership is continuing.
Repeal of Technical Termination Rule

- Repealed by TCJA (Pub. L. No. 115-97, Sec. 13504(a)).
- For partnership tax years beginning before January 1, 2018, former section 708(b)(1)(B) provided that a partnership also ended upon a sale or exchange of 50% or more of the total interest in partnership capital and profits within a 12-month period (the “technical termination rule”).
- Congress believed the technical termination rule was being used “electively to change partnership-level elections and attributes in a way which otherwise would not be permitted” and expects that “its repeal will improve tax administration and increase taxpayer compliance.” H.R. Rep. No. 115-409, at 273 (2017).
- The change is estimated to raise $1.7 billion in revenue between 2018 and 2027.
Repeal of Technical Termination Rule (Cont’d)

• However, Congress kept section 708(b)(1)(A) (now section 708(b)(1)) in its entirety:
  – “The [TCJA] repeals the section 708(b)(1)(B) rule providing for technical terminations of partnerships. The [TCJA] does not change the present-law rule of section 708(b)(1)(A) that a partnership is considered terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.” JCT, Gen. Explanation of Pub. L. 115-97 (JCS-1-18), at 225 (2018).
Why Does It Matter If a Partnership Terminates or Continues?

- **Ability to make new elections**: A partnership termination may be desired if the partnership has in effect elections that can be revoked only with the consent of the IRS (e.g., section 754 election).
- **Ability to adopt new methods**: A non-continuing partnership can elect its own accounting and tax methods (e.g., section 704(c) method).
- **Depreciation**: If a partnership terminates, depreciation and amortization may restart. The anti-churning rules under section 197, amended section 168(k) (which provides for an additional first-year depreciation deduction in the placed in-service year of qualified property), and the effect, if any, of the depreciation and amortization consequences on the business interest expense deduction limitation under section 163(j) for tax years beginning on or after January 1, 2022 should be taken into consideration.
Why Does It Matter If a Partnership Terminates or Continues? (Cont’d)

- **Audit and litigation procedures**: The final regulations under the BBA provide guidance on partnerships that “cease to exist.” Under the regulations, a partnership ceases to exist if, among other things, the partnership terminates within the meaning of section 708(b)(1), but only if the IRS makes a determination that the partnership has ceased to exist. If the IRS determines that any partnership ceases to exist before any partnership adjustment takes effect, the partnership adjustment is taken into account by the former partners. A partnership that has ceased to exist is no longer liable for any unpaid amounts resulting from a partnership adjustment that is required to be taken into account by a former partner.
When Does a Partnership Terminate Under Section 708(b)(1)?

• Can there be any overlapping partners between two partnerships?
  - “... a partnership shall be considered as terminated only if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.”

• Does it matter if the buyer partnership is newly formed or old and cold?

• Does it matter if the seller partnership liquidates afterwards?
Example 1

- A and B are 50/50 partners in AB Partnership.
- A sells his 50% interest to C and B sells his 50% interest to D.
- Does AB Partnership continue for tax purposes even though it has no historic partners?
- If it is a termination, what is the construct?
Example 2

- A and B are 50/50 partners in AB Partnership.
- C and D form a new CD Partnership.
- CD Partnership purchases all of A’s and B’s interests in AB Partnership.

**Is this a merger?**

**Is CD Partnership a continuation of AB Partnership?**

- If it is a termination, CD Partnership is treated as buying AB Partnership’s assets (see Rev. Rul. 99-6, Situation 2), rather than A’s and B’s interests in AB Partnership.
Rev. Rul. 99-6, Situation 2

- Under Rev. Rul. 99-6, Situation 2, which contained similar facts to example 2, the outcome is as follows:
  - AB Partnership terminated under section 708(b)(1) when A and B each sold their partnership interests to an unrelated person, CD Partnership.
  - A and B must report gain or loss, if any, resulting from the sale of their partnership interests.
  - AB Partnership is deemed to have made a liquidating distribution of its assets to A and B.
  - CD Partnership is deemed to acquire, by purchase, all of AB Partnership’s assets.
Example 3

- A and B are 50/50 partners in AB Partnership.
- C and D form a new CD Partnership.
- CD Partnership purchases all of AB Partnership’s assets, and then AB Partnership liquidates.
- Is CD Partnership a continuation of AB Partnership?
  - If it is a continuation, C and D are treated as buying A’s and B’s interests in AB Partnership, rather than it being treated as a purchase of AB Partnership’s assets by CD Partnership.
Example 4 (Modified Example 2)

- Same facts as example 2, but ACD Partnership purchases all of A’s and B’s interests in AB Partnership.
- Now there is an overlapping partner (partner A).
- Is ACD Partnership a continuation of AB Partnership?
Example 5 (Modified Example 3)

- Same facts as example 3, but AB Partnership sells assets to newly formed ACD Partnership.
- Now there is an overlapping partner (partner A), and AB Partnership liquidates afterwards.
- Is ACD Partnership a continuation of AB Partnership?
When Does a Partnership Terminate Under Section 708(b)(1)?

• Can there be any overlapping partners between two partnerships?
  – What is the threshold? (what if A’s interest in ACD Partnership is 0.01%?)
  – Does it matter if the overlapping partner holds capital interest or profits interest?

• Does it matter is the buyer partnership is newly formed or old and cold?
  – How do you determine what is “newly formed” or “old and cold”?

• Does it matter if the seller partnership liquidates afterwards?
  – Does it matter how soon afterwards the partnership liquidates?
  – Does it matter if the partnership is just “winding up”? (see e.g., Neubecker v. Commissioner and Rev. Rul. 66-264)