



# What's News in Tax

Analysis that matters from Washington National Tax

February 26, 2025



## Partnership Related Party Basis Adjustment Transactions of Interest—The Rules

by Bryan Rimmke, Anna Holtsman, and Matt Sorensen Washington National Tax

New final regulations require significant and burdensome reporting of partnership transactions that have the effect of shifting basis in a manner perceived by the government as abusive. The regulations are extremely broad, requiring both taxpayers and material advisors to report certain transactions of interest going forward and looking back to the prior six years. Importantly, the transactions of interest generally represent common business transactions forcing taxpayers and advisors to find, evaluate, and report many transactions without regard to the taxpayer's intent or business purpose.

Generally, the new rules target both an exchange of a partnership interest between related parties and any distribution of property from a partnership with related partners if either results in a shifting of tax basis under the provisions of subchapter K. Taxpayers are also required to report basis recovery in all affected years resulting from such transactions. Taxpayers must act quickly to identify and report transactions of interest occurring in the prior six years by the July 14, 2025 deadline for tax years in which returns have already been filed. Additionally, taxpayers will have reporting obligations on their tax year 2024 filings for transactions occurring in 2024 and any basis recovery impacting their 2024 returns from transactions occurring in the past six years.

On January 14, 2025, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") issued final regulations under section 1.6011-18 (the "Final Regulations"),<sup>1</sup> identifying certain partnership related-party basis adjustment transactions and substantially similar transactions as transactions of interest ("TOIs"). The release of the Final Regulations follows the proposed regulations (REG-124593-23) (the "Proposed Regulations") released on June 17, 2024.

---

<sup>1</sup> Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

The Final Regulations include significant and burdensome retroactive reporting requirements, which will generally require both taxpayers and material advisors to report transactions from the prior six years as TOIs. Taxpayers and material advisors should act quickly to begin to identify historical transactions occurring in the past six years that may be subject to reporting given the fast-approaching deadlines to report historical transactions (generally July 14, 2025, for participants and July 29, 2025, for material advisors) and the need to disclose any tax benefit related to the historical transactions on 2024 tax returns. The applicability dates and reporting thresholds are described in more detail below.

## Targeted Transactions

Similar to the earlier issued guidance package, the Final Regulations generally target three types of transactions that have the effect of shifting basis and that Treasury and the IRS perceive to be abusive. The transactions generally involve partners capitalizing on the disparity of the “outside” basis in their partnership interests as compared to their share of the partnership’s “inside” tax basis of its assets. The transactions take the form of transfers of partnership interests between related parties, resulting in a section 743(b) basis adjustment. Or the transactions are current or liquidating distributions of particular assets to a partner with a related person that is a member in the partnership, resulting in section 732 basis adjustments on distributed property and section 734(b) basis adjustments of the remaining partnership property. The transactions of concern are generally nonrecognition transactions and thus can result in a taxable benefit between the related parties without any economic outlay by them.

The Final Regulations generally affect partnerships that have direct partners that are related parties. Partners and other persons would be considered as related if they have a relationship described in section 267(b) (without regard to section 267(c)(3)) or section 707(b)(1) immediately before or immediately after a transaction. However, the guidance would also affect similar transactions involving “tax-indifferent” parties—potentially including where a partner is tax-exempt, foreign, or has a tax-attribute (e.g., net operating loss (“NOL”) carryforwards), if the gain from the transaction would not result in federal income tax liability or would be mitigated by the use of a tax-indifferent partner.

## Final Regulations—Reportable Transactions

### Transactions of Interest

The Final Regulations outline four TOIs. The first three are related to distributions by partnerships, and the last is related to transfers of partnership interests.

**Section 734(b) TOI.** The partnership distributes property to a person who is a related partner (meaning the partnership has two or more direct partners that are related immediately before or immediately after the transaction) in a current or liquidating distribution, the partnership has a positive section 734(b) basis increase to one or more of its remaining properties as a result of the transaction, and the applicable threshold (as discussed below) is met.

In determining whether the applicable threshold is met, only gross section 734(b) basis increases attributable to the related partners (including the distributee partner if they remain in the partnership) are counted. Any gross section 734(b) basis increase allocated to unrelated partners is not included in the threshold determination. The Final Regulations provide that for purposes of determining a specific partner’s share of a section 734(b) basis adjustment, rules similar to section 1.197-2(h)(12)(iv)(D) apply.

**Section 732(b) TOI.** The partnership distributes property to a partner who is a related partner (meaning the partnership has two or more direct partners that are related immediately before or immediately after the transaction) in liquidation of the partner’s partnership interest (or in complete liquidation of the partnership), the basis of one or more distributed properties is increased under section 732(b) and (c), and the applicable threshold (discussed below) is met.

In determining whether the applicable threshold has been met, the gross section 732(b) basis increases are reduced for any basis decreases attributable to unrelated partners (other than a tax-indifferent party). This could be either under section 734(b) if the partnership continues or under section 732(b) if the partnership liquidates.

**Section 732(d) TOI.** The partnership distributes property to a person who is a related partner (meaning the partnership has two or more direct partners that are related immediately before or immediately after the transaction), the basis of one or more distributed properties is increased under section 732(d), the related partner acquired all or a part of its interest in a nonrecognition transaction when the partnership did not have a section 754 election in effect, and the applicable threshold is met.

**Section 743(b) TOI.** A partner transfers an interest in a partnership to a related partner in a nonrecognition transaction, the basis of one or more partnership properties is increased under section 743(b), and the applicable threshold (discussed below) is met.

The Final Regulations include two exceptions to the section 743(b) TOI. First, if a partner acquires a partnership interest in a recognition transaction (first transfer) and receives a basis adjustment under section 743(b), and the partner (transferor) later transfers the partnership interest to a related partner in a nonrecognition transfer (subsequent transfer) any section 743(b) basis adjustment computed by the related transferee partner in the subsequent transfer will not be counted toward the applicable threshold to the extent the subsequent section 743(b) basis adjustment is equal to the transferor's remaining adjusted section 743(b) basis adjustment from the first transfer. In other words, a section 743(b) basis adjustment that is merely "replacing" a prior existing section 743(b) adjustment that arose in a recognition transaction does not give rise to a TOI, except to the extent the subsequent nonrecognition section 743(b) adjustment exceeds the prior existing section 743(b) adjustment by the applicable threshold amount. Note that this subsequent transfer exception is only applicable to the first subsequent non-recognition transfer.

The second exception to a section 743(b) TOI is a section 743(b) basis adjustment resulting from a transfer of a partnership interest upon the death of a partner. The Final Regulations provide that a TOI does not include a transfer of a partnership interest from a partner to such partner's estate, or a deemed transfer from a grantor trust owned by the partner to a trust that becomes a separate entity for federal income tax purposes by reason of the partner's death. Note that this exception is limited to only certain transfers upon death and consultation with a trust and estate expert may be needed to determine if it applies.

**Substantially Similar Transactions.** The Final Regulations also apply to transactions that are substantially similar to the four specified above, as a TOI by definition includes transactions that are the same or substantially similar to a type of transaction that the IRS has identified by notice, regulation, or other form of published guidance as a TOI. The guidance provides two examples of substantially similar transactions but notes that this is not an exhaustive list.

First, the distribution TOIs (section 734(b) TOIs and section 732 TOIs) would extend to transactions between unrelated parties if one or more of the partners is tax indifferent. For a transaction substantially similar to a 732(b) TOI, for purposes of determining the applicable threshold, a basis increase is an increase to the basis distributed to one of the partners only to the extent of a corresponding basis decrease to a tax-indifferent partner.

Generally, a tax-indifferent party is a person that is either not liable for federal income tax because it is tax exempt, foreign, or where gain would not result in a federal income tax liability due to the partner's tax attributes (e.g., the partner has a capital loss carryforward), and whose status as a tax-indifferent party is known or should be known to any other person that participates in the transaction. The Final Regulations added the knowledge requirement in the case of a substantially similar transaction with tax-indifferent parties in response to comments concerned with the possibility that participants in these types of transactions would have no way of knowing whether another participant had certain tax attributes that would make them a tax-indifferent party. The Final Regulations also clarified that a partnership or an S corporation is not considered a tax-indifferent party unless a principal purpose of the use of the partnership or S corporation is to avoid tax-indifferent party status.

Second, a substantially similar transaction to a section 743(b) TOI includes a transaction in which a partner transfers an interest in a partnership to a related partner in a recognition transaction and the applicable threshold is met.

**Six-Year Lookback Period.** As discussed above, the Final Regulations require the reporting of a TOI that occurred prior to the publication of the Final Regulations in the *Federal Register*. Specifically, the Final Regulations provide that any transaction that occurred within the 72-month period immediately preceding the first month of the taxpayer's most recent tax year that began before January 14, 2025 (the "Six-Year Lookback Period") is subject to reporting. For calendar year taxpayers, this means that any transaction that is a TOI under the Final Regulations occurring on or after January 1, 2019, is required to be reported to the Office of Tax Shelter Analysis ("OTSA").

**Applicable Threshold.** For transactions occurring during the Six-Year Lookback Period, the applicable threshold is met for a tax year if the sum of all gross basis increases (i.e., without netting for any basis decreases from the same transaction) resulting from all such transactions of a partnership or partner during the tax year exceeds by at least \$25 million the gain recognized from such transactions, if any, on which tax is imposed and is required to be paid by any of the related partners (or tax-indifferent parties) to these transactions.

For transactions occurring after January 14, 2025, the applicable threshold is met for a tax year if the sum of all gross basis increases (i.e., without netting for any basis decreases resulting from the same transaction) resulting from all such transactions of a partnership or partner during the tax year exceeds by at least \$10 million the gain recognized from such transactions, if any, on which tax is imposed and is required to be paid by any of the related partners (or tax-indifferent parties) to these transactions.

## Disclosure Requirements—Participants

Form 8886, *Reportable Transaction Disclosure Statement*, is required for each tax year in which a participant participated in a TOI. Additionally, the participating partnership, participating partners, and related subsequent transferees will have disclosure requirements in subsequent years in the event there is any cost recovery related to a basis adjustment resulting from a TOI or if the property subject to an increase in basis resulting from a TOI is disposed of in a subsequent year in which gain or loss is recognized in whole or in part. Failure to disclose could result in significant penalties.

For purposes of the reporting requirements, a participating partner is any partner in a TOI that directly receives a distribution of property or an interest in a participating partnership, or directly transfers an interest in a participating partnership, including a person that becomes or ceases to be a partner as a result of such transaction. A participating partnership is any partnership that distributes property to a participating partner in a TOI, or has a partnership interest transferred in a transaction described in a TOI. A related subsequent transferee is any person who is related to a participating partner and directly received in a nonrecognition transaction, a transfer (including a distribution) of property that was subject to an increase in basis as a result of a TOI.

The disclosure must describe the transaction in sufficient detail and includes:

- Names and identifying numbers of all participants: the participating partnership, participating partners, related subsequent transferees, or tax-indifferent parties
- All basis adjustments resulting from a TOI
- Basis information, including the participating partnership's adjusted basis in the distributed property immediately before the distribution; any adjustments to basis under section 732 or 734(b); any adjustments to basis under section 743(b) with respect to a participating partner that is transferred an interest in a participating partnership; and, with respect to a participating partner that transfers an interest in a participating partnership, that participating partner's adjusted basis in the participating partnership interest and share of the participating partnership's adjusted basis in its property immediately before the transfer

- Federal income tax consequences realized during the year attributable to the increase in basis adjustment (cost recovery, taxable gain or loss)

### Disclosure Requirements—Material Advisors

Material advisors are required to report TOIs by filing Form 8918, *Material Advisor Disclosure Statement*, with the OTSA. Generally, a material advisor is any person with respect to a transaction that provides material aid, assistance, or advice with respect to the organizing, managing, promoting, selling, implementing, insuring, or carrying out a reportable transaction, and that directly or indirectly receives gross income generally in excess of \$50,000 (for natural persons) or \$250,000 (for all others) for the material aid or assistance.

The disclosure must describe the transaction in sufficient detail and includes:

- The nature of the expected tax treatment and expected tax benefits generated by the transaction for all affected years
- The years the tax benefits are expected to be claimed
- The role of each related, foreign, tax-exempt, or tax-indifferent entity or individual to the TOI
- Explanation of how the Code will be used to obtain the tax benefit and how the Code will allow the taxpayer to obtain the desired tax treatment
- Description of any tax result protection with respect to the transaction
- Description of the material aid, assistance, or advice provided
- Role of any other entity(ies) or individual(s) who you know or have reason to know provided material aid, assistance, or advice to the transaction, including names, identifying numbers, and addresses

Material advisors also must maintain a list of persons and relevant documents with respect to each reportable transaction for which they served as a material advisor.

### Applicability Date

The Final Regulations are effective as of January 14, 2025. Generally, with respect to a TOI occurring within the Six-Year Lookback Period during a tax year for which returns have already been filed, participating partnerships, participating partners, and related subsequent transferees with reporting requirements must file Form 8886 with OTSA by July 14, 2025. For calendar year taxpayers, this would generally include any TOIs from calendar year 2019-2023. With respect to a TOI that occurred during a tax year for which returns have not yet been filed and going forward, participating partnerships, participating partners, and related subsequent transferees are required to attach Form 8886 disclosing the TOI with their tax returns.

Material advisors have until July 29, 2025, to file Form 8918 with OTSA to report any transactions occurring on or after January 14, 2019, and before January 14, 2025 for which they acted as a material advisor. For any transactions occurring on or after January 14, 2025, material advisors must file with OTSA on the last day of the month following the calendar quarter in which they became a material advisor with respect to the transaction. The first round of prospective reporting for material advisors will be due on April 30, 2025, to disclose any TOIs occurring between January 14, 2025, and March 31, 2025.

### Impact

As highlighted above, taxpayers and material advisors may have reporting obligations with respect to transactions that have occurred since 2019 for calendar year taxpayers, and 2018 for non-calendar year taxpayers. Additionally, taxpayers will have ongoing reporting obligations with respect to prior year transactions in the event there is any recovery of the basis adjustment subject to the TOI rules. KPMG is available to help assist in the review of transactions to determine any potential reporting obligations as well as assist with the actual filing of the Form 8918.

[kpmg.com/socialmedia](https://kpmg.com/socialmedia)



The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.