

Form 15254: Request for Section 754 Revocation

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Form 15254: Request for Section 754 Revocation

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Why Make a Section 754 Election

- Equalizes Inside and Outside Basis to Transferee under Section 743
- Example

	Basis	Value
Assets		
Cash	3,000	3,000
Land	6,000	24,000
Total Assets	9,000	27,000
Capital		
A	3,000	9,000
B	3,000	9,000
C	3,000	9,000
Total Capital	9,000	27,000

A Sells 1/3 interest to D for \$9,000

1. A recognizes a gain of \$6,000
2. D takes a \$9,000 outside basis in partnership interest
3. Partnership sells Land for \$24,000 and recognizes \$18,000 of gain
4. Without Sec. 754 election, D will recognize \$6,000 of partnership gain and the outside basis will increase to \$15,000 vs inside basis of \$9,000. D will have to wait until sale or liquidation to recognize loss

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Why Make a Section 754 Election

- Section 754 election allows D's share of the land basis to step up from \$2,000 to \$8,000
- Sale of Land by Partnership for \$24,000 generates a gain allocated to D of \$6,000 ($1/3$ of SP = \$8,000 less $1/3$ of the inside basis of \$2,000)
- Section 754, allows D's basis in the land to step up to \$8,000 resulting in no gain or loss recognized to D on the Partnership's sale of land

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Elements of Section 754 Election

- Once an election is made, it applies automatically to all subsequent transfers of partnership interests
- Election may result in a
 - Positive adjustment – increases the transferee's basis in partnership assets, therefore reducing or eliminating the partner's share of the partnership's gain on a subsequent sale of assets
 - Negative adjustment – reduces the transferee's basis in partnership assets, thereby reducing or eliminating the partner's share of the partnership's loss on a subsequent sale of assets

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Substantial Built-in Loss Rule

- Substantial Built-in Loss Rule
 - Purpose is to prevent a double benefit of built-in losses that may result from the transfer of a partnership interest
 - If the partnership does not make a downward adjustment to the partnership's built-in loss property, the transferee will benefit from the built-in loss through depreciation or loss on disposition
 - Prior law – through December 31, 2017
 - Used the aggregate method
 - The partnership compared the FMV of all assets to its total adjusted basis. A substantial built-in loss existed if the adjusted basis of partnership assets exceed the FMV of partnership assets by more than \$250,000

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Substantial Built-in Loss Rule

- New law for transfers after December 31, 2017
 - Substantial built-in loss exists when
 - The partnership's adjusted basis in partnership property exceeds the FMV of the property by more than \$250,000
- Or
 - The transferee would be allocated a loss of more than \$250,000 if the partnership sold assets for cash equal to their FMV immediately after such transfer

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Substantial Built-in Loss Rule

- New Law (Continued)
 - The partnership computes gain or loss on an asset-by-asset basis
 - Even with no overall loss, it is possible that on an individual basis, some assets, if sold, would result in a loss
 - If the transferee partner would be allocated a loss of more than \$250,000 from the sale of such asset, the partnership must adjust the basis of its assets to the transferee partner

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Section 754 and Distributions of Property (Section 734(b))

- A section 754 election provides for an increase in the basis of partnership property by the amount of gain and decreased by the amount of loss recognized by the distributing partner as a result of a current or liquidating distribution

Termination of Partnerships – Pre-2018

- Pre 2018, A partnership would terminate if:
 - No part of the partnership's activities was carried on by any of its partners (e.g., the partnership ceases its activities and liquidates), or
 - There was a sale or exchange of 50% or more of the interests in the partnership's capital and profits within a 12-month period (IRC §708(b)(1)(B)). This was referred to as a "technical termination"

Termination of Partnerships - Post 2018

- The Tax Cuts and Jobs Act of 2017 (TCJA) eliminated technical terminations for tax years beginning after 12/31/2017
- A partnership will 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

Pre-TCJA – Technical Termination

- Partners sold greater than 50% of their capital and profits interests in XY, causing a technical termination under IRC § 708(b). XY Partnership filed a final return for the short period ending on the partnership termination date
- New partnership XY retained the same name and taxpayer ID. New partnership XY filed a short period return beginning on the day after the termination date
 - New elections had to be made
 - Basis of assets carried over, but depreciation period reset

Pre-TCJA – Technical Termination (continued)

- Departing partners and new partners received short-year K-1s
- Remaining partners got two sets of short period K-1s, one of which showed “final” K-1 for the first short period
- Tax advantages of Technical Terminations
 - Ability to make new elections including accounting methods
 - Ability to change depreciation methods

Tax disadvantages

Depreciable property deemed transferred from the old partnership to the new partnership is considered newly acquired, and depreciation is restarted on the remaining basis

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Post TCJA – Technical Terminations

- Partners sold greater than 50% of their capital and profits interests in AB
 - There is no technical termination under IRC § 708(b)(1)(B) since that section has been repealed
 - There is no short-period return filed since there is no technical termination
 - There is no ability to reset elections, and no change to depreciation
- Departing partners and new partners get short period K-1s
- Remaining Partners get full year K-1

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Steps of a Technical Termination

- In a technical termination, the following is deemed to occur:
 - The terminating partnership contributed all assets & liabilities to a new partnership in exchange for an interest in the new partnership
 - The terminated partnership is liquidated by distributing interests in the new partnership to the purchaser and the other remaining partners
 - The new partnership continues doing business

Challenges of Technical Terminations

- Careful tracking of sales or exchanges of partnership interests
- Requirement to file two short-year returns
- Required closing of the books to determine taxable income for each short period
- Issues with tiered partnerships, in that, lower tier partnerships may also have a technical termination
- Must restart depreciation including a new recovery period, placed in service date, and applicable convention was used to depreciate the remaining adjusted basis

Opportunities Provided by Technical Terminations

- The new partnership had the ability to make new decisions about accounting methods, tax year, inventory methods, and various elections
- Section 754 elections can only be revoked with the consent of the District Director, however, a technical termination can terminate the Section 754 election but allow any basis adjustments under Sec. 734(b) or Sec. 743(b) made by the terminating partnership to continue in the new partnership

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Revoking the Election

- Revoking a 754 election can only be done if such revocation is approved by the district director for the Internal Revenue district in which the partnership return is required to be filed
- Although the number of requests granted is not public knowledge, it is believed that historically, many of these requests have not been granted

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Revoking the Election

- Many additional revocation requests were submitted to the IRS due to the removal of the technical termination rule
 - Previously a technical termination occurred if 50 percent or more of a partnership was sold within a 12-month period
 - Loss of this technical termination removed opportunities to change the election
 - Less opportunity to naturally change elections resulted in significant additional formal requests

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Revoking the Election

- Additional requests led to a standardization of the process
 - IRS creation of new form to submit requests
 - Listing of examples where revocation will be granted
 - Listing of specific reasons which will not result in revocation being granted

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Revoking the Election

- Form 15254 is the new method for requesting revocation
- Form was released in September 2020
- Form 15254 must be filed no later than 30 days after the Close of the Year for which the revocation is intended to take place
- Form must be signed by one of the partners and indicate the reason for the revocation

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Revoking the Election

- Treasury Regulation Section 1.754-1(c) provides examples of reasons which could result in approval of the revocation, including situations where the election provides an administrative burden for the partnership due to a change in the nature of the partnership's business, substantial increase in the partnership's assets, change in the character of the partnership's assets, or more frequent shifts of partnership interests
- An application for revocation of an election will not be approved when the purpose of the revocation is primarily to avoid a reduction in the basis of partnership assets upon a transfer or distribution

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Submission of Form

- Form 15254 is a short form with only a limited amount of information required
- General information:
 - Name, address, EIN, principal business activity, tax year, contact information

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Submission of Form

- Specific questions and information requested:
 - Has the partnership previously revoked a section 754 election?
 - Does the section 754 election result in or is it expected to result in a substantial administrative burden to the partnership?
 - Has the nature of the partnership's business changed, or is it expected to change?
 - Will the revocation of the section 754 election result in an avoidance of a reduction in the basis of partnership assets under section 734(b) or section 743(b)?
 - Has there been a substantial increase in the assets of the partnership or a change in the character of partnership assets?
 - Has there been, or is there expected to be, an increased frequency of retirements or shifts of partnership interests
 - Reason for the Request

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Planning for Acceptance

- The key to acceptance of this form is the reason listed for requesting the revocation
- Examples listed in the regulations are very broad and cover numerous situations that the partnership will face

Planning for Acceptance

- Change in the nature of the partnership's business:
 - Different lines of business and mix of assets
- Substantial increase in the partnership's assets:
 - As a business grows the volume and impact of the previous 754 adjustment changes

Planning for Acceptance

- Change in the character of the partnership's assets:
 - Depreciable assets vs. other types of assets
- More frequent shifts of partnership interests:
 - Timing of adjustments to assets and multiple layers of calculations
 - Analysis of whether the benefits of Section 754 election outweigh the administrative burden

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Additional Documentation

- Background, nature, and structure of the business entity
- Documentation of previous revocations, if any

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Other Considerations

- New form and process do not change the qualification for revoking an election, but they do provide a framework for including information that will satisfy the IRS
 - Therefore, the process could lead to more readily accepted revocation requests
- Documentation is key
- Potential acceleration of timing of when acceptance or rejection of the request occurs
- Follow-up process will likely be easier
- Continue to maintain caution when making this election, as the revocation is still contingent on approval



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