

# IRS Provides Needed Relief on When a Guarantee Satisfies the Section 465 At-Risk Rules

Over the past few years, the Section 465 At Risk-Rules (Section 465), along with basis and loss issues, have been the frequent focus of IRS examinations. Let's face it, nobody plans to lose money. Thus, harvesting losses is usually not part of anyone's initial business plan. We have seen a number of instances where the IRS has argued that LLC members are not "at risk" when those members have guaranteed the LLC's debt. The IRS has recently provided some welcome relief on when guarantors of an LLC's debt are "at risk."

## Background

Under Section 465, a loss from an activity (to which Section 465 applies) will be allowed only to the extent the taxpayer is "at risk" with respect to that activity. Generally, a taxpayer's amount at-risk includes: (1) money contributed by the taxpayer; (2) the adjusted basis of property contributed by the taxpayer; and (3) amounts borrowed with respect to the activity, to the extent the taxpayer is personally liable for repayment of such amounts or has pledged property as security for such amounts. I.R.C. § 465(b)(1).

A taxpayer is not considered at risk, however, with respect to amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements or similar arrangements. I.R.C. § 465(b)(4).

## The Guarantee Issue

When a taxpayer guarantees the debt of an LLC (whether taxed as a partnership or a disregarded entity), the Code is silent as to whether the guarantee increases the amount at risk. We have seen a number of cases where the Service has argued a guarantee does not create an amount at risk until the guarantor actually makes payment on a guarantee.

## A Welcome IRS Clarification

In CCA 201308028, the IRS ruled that a guarantor of a debt of an LLC, which is taxed either as a partnership or a disregarded entity, is at risk for purposes of Section 465 with respect to the guaranteed debt, even if the guarantor does not

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completely waive his or her rights of subrogation and reimbursement from the LLC. This welcome clarification, however, it is not without limit.

The guarantee must be bona fide and enforceable by the creditor against the guarantor under local law. Further, the guarantor must not otherwise be protected against loss.

Additionally, when other persons co-guarantee the debt of the LLC, a guarantor will not be at risk with respect to the guarantee if the guarantor has a right of contribution and reimbursement against the other guarantors under local law.

From a planning perspective, the authors note that in the past it was common to waive subrogation against the entity and argue before the IRS that the at-risk rules should not apply. This added step now seems unnecessary. Rather, going forward, it appears that the economics of a deal and lender requirements will likely drive how guarantees are structured, not IRS concerns.

If you have any questions about the at-risk rules, or any tax controversy or tax planning topic, feel free to contact the authors, your Reinhart attorney or any member of Reinhart's Tax Practice.

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