

§ 1.722-1

26 CFR Ch. I (4-1-04 Edition)

at the time of the contribution) whether made at the formation of the partnership or subsequent thereto. To the extent that any of the partners gives up any part of his right to be repaid his contributions (as distinguished from a share in partnership profits) in favor of another partner as compensation for services (or in satisfaction of an obligation), section 721 does not apply. The value of an interest in such partnership capital so transferred to a partner as compensation for services constitutes income to the partner under section 61. The amount of such income is the fair market value of the interest in capital so transferred, either at the time the transfer is made for past services, or at the time the services have been rendered where the transfer is conditioned on the completion of the transferee's future services. The time when such income is realized depends on all the facts and circumstances, including any substantial restrictions or conditions on the compensated partner's right to withdraw or otherwise dispose of such interest. To the extent that an interest in capital representing compensation for services rendered by the decedent prior to his death is transferred after his death to the decedent's successor in interest, the fair market value of such interest is income in respect of a decedent under section 691.

(2) To the extent that the value of such interest is: (i) Compensation for services rendered to the partnership, it is a guaranteed payment for services under section 707(c); (ii) compensation for services rendered to a partner, it is not deductible by the partnership, but is deductible only by such partner to the extent allowable under this chapter.

(c) *Underwritings of partnership interests*—(1) *In general.* For the purpose of section 721, if a person acquires a partnership interest from an underwriter in exchange for cash in a qualified underwriting transaction, the person who acquires the partnership interest is treated as transferring cash directly to the partnership in exchange for the partnership interest and the underwriter is disregarded. A qualified underwriting transaction is a transaction in which a partnership issues partnership interests for cash in an underwriting in

which either the underwriter is an agent of the partnership or the underwriter's ownership of the partnership interests is transitory.

(2) *Effective date.* This paragraph (c) is effective for qualified underwriting transactions occurring on or after May 1, 1996.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8665, 61 FR 19189, May 1, 1996]

**§ 1.722-1 Basis of contributing partner's interest.**

The basis to a partner of a partnership interest acquired by a contribution of property, including money, to the partnership shall be the amount of money contributed plus the adjusted basis at the time of contribution of any property contributed. If the acquisition of an interest in partnership capital results in taxable income to a partner, such income shall constitute an addition to the basis of the partner's interest. See paragraph (b) of § 1.721-1. If the contributed property is subject to indebtedness or if liabilities of the partner are assumed by the partnership, the basis of the contributing partner's interest shall be reduced by the portion of the indebtedness assumed by the other partners, since the partnership's assumption of his indebtedness is treated as a distribution of money to the partner. Conversely, the assumption by the other partners of a portion of the contributor's indebtedness is treated as a contribution of money by them. See section 752 and § 1.752-1. The provisions of this section may be illustrated by the following examples:

*Example 1.* A acquired a 20-percent interest in a partnership by contributing property. At the time of A's contribution, the property had a fair market value of \$10,000, an adjusted basis to A of \$4,000, and was subject to a mortgage of \$2,000. Payment of the mortgage was assumed by the partnership. The basis of A's interest in the partnership is \$2,400, computed as follows:

Adjusted basis to A of property contributed .....	\$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80 percent of \$2,000) .....	1,600
Basis of A's interest .....	2,400

*Example 2.* If, in example 1 of this section, the property contributed by A was subject to a mortgage of \$6,000, the basis of A's interest would be zero, computed as follows:

**Internal Revenue Service, Treasury**

**§ 1.731-1**

Adjusted basis to A of property contributed .....	\$4,000
Less portion of mortgage assumed by other partners which must be treated as a distribution (80 percent of \$6,000) .....	4,800
	(800)

Since A's basis cannot be less than zero, the \$800 in excess of basis, which is considered as a distribution of money under section 752(b), is treated as capital gain from the sale or exchange or a partnership interest. See section 731(a).

**§ 1.723-1 Basis of property contributed to partnership.**

The basis to the partnership of property contributed to it by a partner is the adjusted basis of such property to the contributing partner at the time of the contribution. Since such property has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. See section 1223(2). For elective adjustments to the basis of partnership property arising from distributions or transfers of partnership interests, see sections 732(d), 734(b), and 743(b).

**DISTRIBUTIONS BY A PARTNERSHIP**

**§ 1.731-1 Extent of recognition of gain or loss on distribution.**

(a) *Recognition of gain or loss to partner*—(1) *Recognition of gain.* (i) Where money is distributed by a partnership to a partner, no gain shall be recognized to the partner except to the extent that the amount of money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. This rule is applicable both to current distributions (i.e., distributions other than in liquidation of an entire interest) and to distributions in liquidation of a partner's entire interest in a partnership. Thus, if a partner with a basis for his interest of \$10,000 receives a distribution of cash of \$8,000 and property with a fair market value of \$3,000, no gain is recognized to him. If \$11,000 cash were distributed, gain would be recognized to the extent of \$1,000. No gain shall be recognized to a distributee partner with respect to a distribution of property (other than money) until he sells or otherwise dis-

poses of such property, except to the extent otherwise provided by section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest) and section 751 (relating to unrealized receivables and inventory items). See section 731(c) and paragraph (c) of this section.

(ii) For the purposes of sections 731 and 705, advances or drawings of money or property against a partner's distributive share of income shall be treated as current distributions made on the last day of the partnership taxable year with respect to such partner.

(2) *Recognition of loss.* Loss is recognized to a partner only upon liquidation of his entire interest in the partnership, and only if the property distributed to him consists solely of money, unrealized receivables (as defined in section 751(c)), and inventory items (as defined in section 751(d)(2)). The term *liquidation of a partner's interest*, as defined in section 761(d), is the termination of the partner's entire interest in the partnership by means of a distribution or a series of distributions. Loss is recognized to the distributee partner in such cases to the extent of the excess of the adjusted basis of such partner's interest in the partnership at the time of the distribution over the sum of:

- (i) Any money distributed to him, and
- (ii) The basis to the distributee, as determined under section 732, of any unrealized receivables and inventory items that are distributed to him.

If the partner whose interest is liquidated receives any property other than money, unrealized receivables, or inventory items, then no loss will be recognized. Application of the provisions of this subparagraph may be illustrated by the following examples:

*Example 1.* Partner A has a partnership interest in partnership ABC with an adjusted basis to him of \$10,000. He retires from the partnership and receives, as a distribution in liquidation of his entire interest, his share of partnership property. This share is \$5,000 cash and inventory with a basis to him (under section 732) of \$3,000. Partner A realizes a capital loss of \$2,000, which is recognized under section 731(a)(2).

*Example 2.* Partner B has a partnership interest in partnership BCD with an adjusted basis to him of \$10,000. He retires from the