

Internal Revenue Service, Treasury

§ 1.734-2

Example 1. Partner G has a basis of \$11,000 for his one-third interest in partnership GHI. Partnership assets consist of cash of \$10,000 and property with a basis of \$23,000 and a value of \$20,000. There are no partnership liabilities. In liquidation of his entire interest in the partnership, G receives \$10,000 in cash. He has a loss of \$1,000 under section 731(a)(2). If the election under section 754 is in effect, the partnership basis for the property becomes \$22,000 (\$23,000 less \$1,000).

Example 2. Partner J has a basis of \$11,000 for his one-third interest in partnership JKL. The partnership balance sheet before the distribution shows the following:

ASSETS		
	Adjusted basis	Value
Cash	\$5,000	\$5,000
Property X	10,000	10,000
Property Y	18,000	15,000
Total	33,000	30,000
LIABILITIES AND CAPITAL		
	Adjusted basis	Value
Liabilities	\$0	\$0
Capital:		
J	11,000	10,000
K	11,000	10,000
L	11,000	10,000
Total	33,000	30,000

In liquidation of his entire interest in the partnership, J receives property X with a partnership basis of \$10,000. J's basis for property X under section 732(b) is \$11,000. Where the election under section 754 is in effect, the excess of \$1,000 (\$11,000 basis of property X to J, the distributee, less its \$10,000 adjusted basis to the partnership immediately before the distribution) decreases the basis of property Y in the partnership. Thus, the basis of property Y becomes \$17,000 (\$18,000 less \$1,000). If the distribution is made to a transferee partner who elects under section 732(d), see § 1.734-2.

(c) *Allocation of basis.* For allocation among the partnership properties of basis adjustments under section 734(b) and paragraph (b) of this section, see section 755 and § 1.755-1.

(d) *Returns.* A partnership which must adjust the bases of partnership properties under section 734 shall attach a statement to the partnership return for the year of the distribution setting forth the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(e) *Recovery of adjustments to basis of partnership property*—(1) *Increases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the distribution of property to a partner, then the increased portion of the basis must be taken into account as if it were newly-purchased recovery property placed in service when the distribution occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Decreases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is decreased as a result of the distribution of property to a partner, then the decrease in basis must be accounted for over the remaining recovery period of the property beginning with the recovery period in which the basis is decreased.

(3) *Effective date.* This paragraph (e) applies to distributions of property from a partnership that occur on or after December 15, 1999.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8847, 64 FR 69908, Dec. 15, 1999]

§ 1.734-2 Adjustment after distribution to transferee partner.

(a) In the case of a distribution of property by the partnership to a partner who has obtained all or part of his partnership interest by transfer, the adjustments to basis provided in section 743(b) and section 732(d) shall be taken into account in applying the rules under section 734(b). For determining the adjusted basis of distributed property to the partnership immediately before the distribution where there has been a prior transfer of a partnership interest with respect to which the election provided in section 754 or section 732(d) is in effect, see §§ 1.732-1 and 1.732-2.

(b)(1) If a transferee partner, in liquidation of his entire partnership interest, receives a distribution of property (including money) with respect to

which he has no special basis adjustment, in exchange for his interest in property with respect to which he has a special basis adjustment, and does not utilize his entire special basis adjustment in determining the basis of the distributed property to him under section 732, the unused special basis adjustment of the distributee shall be applied as an adjustment to the partnership basis of the property retained by the partnership and as to which the distributee did not use his special basis adjustment. The provisions of this subparagraph may be illustrated by the following example:

Example. Upon the death of his father, partner S acquires by inheritance a half-interest in partnership ACS. Partners A and C each have a one-quarter interest. The assets of the partnership consist of \$10,000 cash and land used in farming worth \$10,000 with a basis of \$1,000 to the partnership. Since the partnership had made the election under section 754 at the time of transfer, partner S had a special basis adjustment of \$4,500 under section 743(b) with respect to his undivided half-interest in the real estate. The basis of S's partnership interest, in accordance with section 742, is \$10,000. S retires from the partnership and receives \$10,000 in cash in exchange for his entire interest. Since S has received no part of the real estate, his special basis adjustment of \$4,500 will be allocated to the real estate, the remaining partnership property, and will increase its basis to the partnership to \$5,500.

(2) The provisions of this paragraph do not apply to the extent that certain distributions are treated as sales or exchanges under section 751(b) (relating to unrealized receivables and substantially appreciated inventory items). See section 751(b) and paragraph (b) of § 1.751-1.

§ 1.735-1 Character of gain or loss on disposition of distributed property.

(a) *Sale or exchange of distributed property*—(1) *Unrealized receivables.* Any gain realized or loss sustained by a partner on a sale or exchange or other disposition of unrealized receivables (as defined in paragraph (c)(1) of § 1.751-1) received by him in a distribution from a partnership shall be considered gain or loss from the sale or exchange of property other than a capital asset.

(2) *Inventory items.* Any gain realized or loss sustained by a partner on a sale or exchange of inventory items (as de-

defined in section 751(d)(2)) received in a distribution from a partnership shall be considered gain or loss from the sale or exchange of property other than a capital asset if such inventory items are sold or exchanged within 5 years from the date of the distribution by the partnership. The character of any gain or loss from a sale or exchange by the distributee partner of such inventory items after 5 years from the date of distribution shall be determined as of the date of such sale or exchange by reference to the character of the assets in his hands at that date (inventory items, capital assets, property used in a trade or business, etc.).

(b) *Holding period for distributed property.* A partner's holding period for property distributed to him by a partnership shall include the period such property was held by the partnership. The provisions of this paragraph do not apply for the purpose of determining the 5-year period described in section 735(a)(2) and paragraph (a)(2) of this section. If the property has been contributed to the partnership by a partner, then the period that the property was held by such partner shall also be included. See section 1223(2). For a partnership's holding period for contributed property, see § 1.723-1.

(c) *Effective date.* Section 735(a) applies to any property distributed by a partnership to a partner after March 9, 1954. See section 771(b)(2) and paragraph (b)(2) of § 1.771-1. However, see section 771(c).

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6832, 30 FR 8574, July 7, 1965]

§ 1.736-1 Payments to a retiring partner or a deceased partner's successor in interest.

(a) *Payments considered as distributive share or guaranteed payment.* (1)(i) Section 736 and this section apply only to payments made to a retiring partner or to a deceased partner's successor in interest in liquidation of such partner's entire interest in the partnership. See section 761(d). Section 736 and this section do not apply if the estate or other successor in interest of a deceased partner continues as a partner in its own right under local law. Section 736