

and the adjusted tax basis of A's partnership interest is reduced to zero under section 733.

(iii) On March 1, 2000, A receives Property A2 from the partnership in complete liquidation of A's interest in the partnership. A recognizes no gain on the distribution of Property A2 because the property was previously contributed property. See §1.737-2(d).

(iv) Although A has treated the transfer of Property A2 as a contribution to the partnership that increased the adjusted tax basis of A's interest in the partnership, it would be inconsistent with the purpose of section 737 to recognize the transfer as a contribution to the partnership. Section 737 requires recognition of gain when the value of distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. Section 737 assumes that any contribution or other transaction that affects a partner's adjusted tax basis in the partnership interest is a contribution or transaction in substance and is not engaged in with a principal purpose of avoiding recognition of gain under section 737. Because the transfer of Property A2 to the partnership was not a contribution in substance and was made with a principal purpose of avoiding recognition of gain under section 737, the Commissioner can disregard the contribution of Property A2 for this purpose. As a result, A recognizes gain of \$9,000 under section 737 on the receipt of Property B, an amount equal to the lesser of the excess distribution of \$9,000 (\$10,000 fair market value of distributed Property B less the \$1,000 adjusted tax basis of A's partnership interest, determined without regard to the transitory contribution of Property A2) or A's net precontribution gain of \$9,000 on Property A1.

*Example 2. Increase in distributee partner's basis; section 752 liability shift; results consistent with the purpose of section 737.* (i) On January 1, 1995, A and B form general partnership AB as equal partners. A contributes Property A, nondepreciable real property with a fair market value of \$10,000 and an adjusted tax basis of \$1,000. B contributes Property B, nondepreciable real property with a fair market value and adjusted tax basis of \$10,000. The partnership also borrows \$10,000 on a recourse basis and purchases Property C. The \$10,000 liability is allocated equally between A and B under section 752, thereby increasing the adjusted tax basis in A's partnership interest to \$6,000.

(ii) On December 31, 1998, the partners agree that A is to receive Property B in a current distribution. If A were to receive Property B at that time, A would recognize \$4,000 of gain under section 737, an amount equal to the lesser of the excess distribution of \$4,000 (\$10,000 fair market value of Property B less \$6,000 adjusted tax basis in A's partnership interest) or A's net precontribution gain of \$9,000 (\$10,000 fair

market value of Property A less \$1,000 adjusted tax basis of Property A).

(iii) With a principal purpose of avoiding such gain, A and B agree that A will be solely liable for the repayment of the \$10,000 partnership liability and take the steps necessary so that the entire amount of the liability is allocated to A under section 752. The adjusted tax basis in A's partnership interest is thereby increased from \$6,000 to \$11,000 to reflect A's share of the \$5,000 of liability previously allocated to B. As a result of this increase in A's adjusted tax basis, there is no excess distribution because the fair market value of distributed Property B (\$10,000) is less than the adjusted tax basis of A's partnership interest. Recognizing A's increased adjusted tax basis as a result of the shift in liabilities is consistent with the purpose of section 737 and this section. Section 737 requires recognition of gain only when the value of the distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. The \$10,000 recourse liability is a bona fide liability of the partnership that was undertaken for a substantial business purpose and A's and B's agreement that A will assume responsibility for repayment of that debt has substance. Therefore, the increase in A's adjusted tax basis in A's interest in the partnership due to the shift in partnership liabilities under section 752 is respected, and A recognizes no gain under section 737.

[T.D. 8642, 60 FR 66738, Dec. 26, 1995]

#### § 1.737-5 Effective date.

Sections 1.737-1, 1.737-2, 1.737-3, and 1.737-4 apply to distributions by a partnership to a partner on or after January 9, 1995.

[T.D. 8642, 60 FR 66739, Dec. 26, 1995]

### TRANSFERS OF INTERESTS IN A PARTNERSHIP

#### § 1.741-1 Recognition and character of gain or loss on sale or exchange.

(a) The sale or exchange of an interest in a partnership shall, except to the extent section 751(a) applies, be treated as the sale or exchange of a capital asset, resulting in capital gain or loss measured by the difference between the amount realized and the adjusted basis of the partnership interest, as determined under section 705. For treatment of selling partner's distributive share up to date of sale, see section 706(c)(2). Where the provisions of section 751 require the recognition of ordinary income or loss with respect to a portion