

## Section 755.—Rules for Allocation of Basis

26 CFR 1.755-1: Rules for allocation of basis.

### T.D. 9059

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service 26 CFR Parts 1 and 602

## Coordination of Sections 755 and 1060; Allocation of Basis Adjustments Among Partnership Assets and Application of the Residual Method to Certain Partnership Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document finalizes regulations relating to the allocation of basis adjustments among partnership assets under section 755. The regulations are necessary to implement section 1060, which applies the residual method to certain partnership transactions.

DATES: These regulations are effective June 9, 2003.

FOR FURTHER INFORMATION CONTACT: Craig Gerson, (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

This document contains amendments to 26 CFR part 1 under section 755 of the In-

ternal Revenue Code (Code). On April 5, 2000, a notice of proposed rulemaking (REG-107872-99, 2000-1 C.B. 911 [65 FR 17829]) under section 755 was published in the **Federal Register**. Only one commentator submitted written comments in response to the notice of proposed rulemaking, and no public hearing was requested or held. After consideration of the comment, the proposed regulations are adopted as revised by this Treasury decision.

### Explanation of Revisions and Summary of Contents

#### 1. Summary

Section 743(b) provides for an optional adjustment to the basis of partnership property following certain transfers of partnership interests. The amount of the basis adjustment is the difference between the transferee's basis in the partnership interest and the transferee's share of the partnership's basis in the partnership's assets. Once the amount of the basis adjustment is determined, it is allocated among the partnership's individual assets pursuant to section 755.

On December 14, 1999, final regulations (T.D. 8847, 1999-2 C.B. 701 [64 FR 69903]) were published in the **Federal Register** under section 755. Under these regulations, basis adjustments under section 743(b) are allocated among a partnership's assets as follows. First, the adjustment is allocated between the two classes of property described in section 755(b). These classes of property consist of capital assets and section 1231(b) property (capital gain property), and any other property of the partnership (ordinary income property). The amount of a basis adjustment under section 743(b) that is allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss that would be allocated to the transferee from the sale of all ordinary income property. The amount of the basis adjustment under section 743(b) that is allocated to capital gain property is the total amount of the basis adjustment under section 743(b) less the amount of the basis adjustment allo-

ated to ordinary income property. The basis adjustment is then allocated to individual assets within each class.

The final regulations issued on December 14, 1999, worked in conjunction with §1.755-2T. In the case of a basis adjustment under section 743(b) or section 732(d), the fair market values of all assets other than goodwill or going concern value were determined on the basis of all the facts and circumstances, and the fair market value of goodwill and going concern value was determined using the residual method. As described more fully in the notice of proposed rulemaking, §1.755-2T was published prior to the enactment of section 1060(d), which (as amended in 1993) requires the residual method to be applied for purposes of determining the values of section 197 intangibles for purposes of applying section 755. These final regulations implement section 1060(d) and replace §1.755-2T.

These final regulations differ from §1.755-2T by using the residual method to value all section 197 intangibles (not just goodwill and going concern value). In addition, these final regulations also apply to basis adjustments under section 734(b) and contain special rules for certain substituted basis transactions. Finally, for convenience, the provisions of the regulations have been relocated to the beginning of §1.755-1.

Under these final regulations, a partnership is required to assign values to its assets as follows. First, the partnership must determine the values of each of its assets other than section 197 intangibles under all the facts and circumstances, taking into account section 7701(g) (treating the fair market value of a property as not less than the amount of any nonrecourse indebtedness to which the property is subject). The partnership then must determine the gross value of all partnership assets (partnership gross value). Last, the partnership is required to use the residual method to assign values to the partnership's section 197 intangibles. For purposes of these regulations, the term *section 197 intangibles* includes all section 197 intangibles (as defined in section 197), as

well as any goodwill or going concern value that would not qualify as a section 197 intangible under section 197.

If the aggregate value of partnership property other than section 197 intangibles is equal to or greater than partnership gross value, then all section 197 intangibles are deemed to have a value of zero. In all other cases, the aggregate value of the partnership's section 197 intangibles (the residual section 197 intangibles value) is deemed to equal the excess of partnership gross value over the aggregate value of partnership property other than section 197 intangibles. The residual section 197 intangibles value must be allocated, first, among section 197 intangibles other than goodwill and going concern value. Any remaining value is assigned to goodwill and going concern value.

The proposed regulations used the residual method to assign values to all partnership assets, rather than limiting the scope of the residual method to section 197 intangibles. Treasury and the IRS have concluded that these rules were unduly complex, especially when they applied to partnerships whose partnership agreements contained special allocations of partnership income or loss. Accordingly, the final regulations utilize the residual method only to value section 197 intangibles.

## 2. Transactions Subject to the Regulations

Because the proposed regulations used the residual method to value all partnership assets (and not just section 197 intangibles), it was desirable for all partnerships to value their assets using the same method. Accordingly, under the authority of sections 1060(d) and 755, the proposed regulations applied to all partnerships, whether or not their assets constituted a trade or business. In contrast, the final regulations apply the residual method only for the purpose of valuing section 197 intangibles, which are usually held by partnerships whose assets constitute a trade or business. Thus, the final regulations apply the residual method only to partnerships whose assets constitute a trade or business (as described in §1.1060-1(b)(2)).

The proposed regulations specifically applied to basis adjustments under section 732(d). Some references to section 732(d) have been removed in the final regulations to enhance readability. Neverthe-

less, the final regulations continue to apply to basis adjustments under section 732(d).

## 3. Methods for Determining Partnership Gross Value

If a partnership interest is transferred in a taxable transaction, the transferee's basis in its partnership interest provides a frame of reference for determining partnership gross value. In these transactions, both the proposed and the final regulations generally provide that partnership gross value is the amount that, if assigned to all partnership property, would result in a liquidating distribution to the transferee partner equal to that partner's basis (reduced by the amount, if any, of such basis that is attributable to partnership liabilities) in the transferred partnership interest immediately following the relevant transfer.

In certain circumstances involving basis adjustments under section 743(b), such as where income or loss with respect to particular section 197 intangibles is allocated differently among partners, partnership gross value may vary depending on the fair market values of particular section 197 intangibles held by the partnership. In these situations, the final regulations require the partnership to use a reasonable method, consistent with the purposes of the final regulations, to determine partnership gross value.

In the preamble to the proposed regulations, the IRS and the Treasury Department requested comments regarding how the residual method applies in the context of a basis adjustment that results from an exchange of a partnership interest in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest (a transferred basis exchange). Determining partnership gross value in such an exchange is problematic, because the transferee's basis in the partnership interest does not necessarily have any connection to the fair market values of partnership assets. No comments were received regarding the specific method to be adopted by the final regulations.

The IRS and the Treasury Department also requested comments regarding how the residual method applies in the context of basis adjustments under section 734(b). One commentator suggested that the final regulations should require one method for valuing partnership assets in the case of a "*pro*

*rata*" distribution, and another method for valuing partnership assets in the case of a "*non-pro rata*" distribution. The IRS and the Treasury Department believe that this approach would be unnecessarily complex.

The final regulations adopt a single method for determining partnership gross value that applies to all section 734(b) basis adjustments and to section 743(b) basis adjustments resulting from transferred basis exchanges. In these circumstances, partnership gross value is the value of the entire partnership as a going concern, increased by the amount of partnership liabilities. In the case of a basis adjustment under section 734(b), the value of the entire partnership as a going concern is determined immediately after the distribution causing the adjustment.

A commentator has suggested that the same method for determining partnership gross value should apply to exchanged basis transactions, such as the distribution of a partnership interest by a partnership. The final regulations adopt this comment by replacing all references to transferred basis exchanges with references to substituted basis transactions. Conforming adjustments are also made to the special rules contained in §1.755-1(b)(5) for allocating basis adjustments under section 743(b) among a partnership's assets in these exchanges.

## 4. Transferors of Partnership Interests

In the preamble to the proposed regulations, comments were requested as to whether the residual method should be used to determine the fair market values of partnership assets for purposes of applying section 1(h)(6)(B) (collectibles gain or loss), section 1(h)(7) (section 1250 capital gain), and section 751(a) (ordinary income) to the sale or other disposition of a partnership interest. No comments were received on this issue. Treasury and the IRS have determined that the potential benefits of a rule allowing transferors to use the residual method do not justify the increased complexity that the rule would have created.

## 5. Other Changes

The final regulations add two clarifying rules for allocating basis adjustments under section 743(b) among a partnership's assets in the case of a transaction that is not a substituted basis transaction. The first rule provides that assets with respect to which

## PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry to read in part as follows:

Authority: 26 U.S.C. 7805. \* \* \*

Section 1.755–2 also issued under 26 U.S.C. 755 and 26 U.S.C. 1060. \* \* \*

Par. 2. Section 1.755–1 is amended as follows:

1. Paragraph (a) is revised.
- 2–3. A paragraph heading is added for paragraph (b)(1)(i).
4. The first two sentences of paragraph (b)(1)(i) are revised.
5. Paragraph (b)(3)(iii) is redesignated as paragraph (b)(3)(iv).
6. New paragraph (b)(3)(iii) is added.
7. In paragraph (b)(4)(ii), the *Example* is revised.
8. The paragraph heading for paragraph (b)(5) is revised.
9. Paragraph (b)(5)(i) is revised.
10. In paragraph (b)(5)(iv) *Example 1*, the last sentence is amended by removing the language “transferred basis exchange” and adding “substituted basis transaction” in its place.
11. In paragraph (b)(5)(iv) *Example 2*, paragraph (iii), the third sentence is amended by adding the language “this” before the language “paragraph (b)(5)”.
12. In paragraph (c)(5) *Example (i)* introductory text is revised.
13. Paragraph (d) is revised.
14. Paragraph (e) is added.

The revisions and additions read as follows:

### *§1.755–1 Rules for allocation of basis.*

(a) *In general*—(1) *Scope*. This section provides rules for allocating basis adjustments under sections 743(b) and 734(b) among partnership property. If there is a basis adjustment to which this section applies, the basis adjustment is allocated among the partnership’s assets as follows. First, the partnership must determine the value of each of its assets under paragraphs (a)(2) through (5) of this section. Second, the basis adjustment is allocated between the two classes of property described in section 755(b). These classes of property consist of capital assets and section 1231(b) property (capital gain property), and any other property of the partnership (ordinary income property). For purposes of this section, properties and potential gain treated

as unrealized receivables under section 751(c) and the regulations thereunder shall be treated as separate assets that are ordinary income property. Third, the portion of the basis adjustment allocated to each class is allocated among the items within the class. Basis adjustments under section 743(b) are allocated among partnership assets under paragraph (b) of this section. Basis adjustments under section 734(b) are allocated among partnership assets under paragraph (c) of this section.

(2) *Coordination of sections 755 and 1060*. If there is a basis adjustment to which this section applies, and the assets of the partnership constitute a trade or business (as described in §1.1060–1(b)(2)), then the partnership is required to use the residual method to assign values to the partnership’s section 197 intangibles. To do so, the partnership must, first, determine the value of partnership assets other than section 197 intangibles under paragraph (a)(3) of this section. The partnership then must determine partnership gross value under paragraph (a)(4) of this section. Last, the partnership must assign values to the partnership’s section 197 intangibles under paragraph (a)(5) of this section. For purposes of this section, the term *section 197 intangibles* includes all section 197 intangibles (as defined in section 197), as well as any goodwill or going concern value that would not qualify as a section 197 intangible under section 197.

(3) *Values of properties other than section 197 intangibles*. For purposes of this section, the fair market value of each item of partnership property other than section 197 intangibles shall be determined on the basis of all the facts and circumstances, taking into account section 7701(g).

(4) *Partnership gross value*—(i) *Basis adjustments under section 743(b)*—(A) *In general*. Except as provided in paragraph (a)(4)(ii) of this section, in the case of a basis adjustment under section 743(b), partnership gross value generally is equal to the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner equal to the transferee’s basis in the transferred partnership interest immediately following the relevant transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities).

(B) *Special situations*. In certain circumstances, such as where income or loss

the transferee partner has no interest in income, gain, losses, or deductions are not taken into account in allocating basis adjustments to capital assets. The second rule provides that in no event may the amount of any decrease in basis allocated to an item of capital gain property exceed the partnership’s adjusted basis in that item. If the amount of a decrease in basis otherwise allocable to a particular capital asset exceeds the partnership’s adjusted basis in that asset, the transferee’s negative basis adjustment in that asset is limited to the partnership’s adjusted basis in that asset, and the excess must be applied to reduce the remaining basis, if any, of other capital gain assets *pro rata* in proportion to the partnership’s adjusted bases in such assets.

### **Effective Date**

These regulations apply to transfers of partnership interests and distributions of property from partnerships that occur on or after June 9, 2003.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

### **Drafting Information**

The principal author of these regulations is Craig Gerson of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the IRS and the Treasury Department participated in their development.

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### **Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

with respect to particular section 197 intangibles are allocated differently among partners, partnership gross value may vary depending on the values of particular section 197 intangibles held by the partnership. In these special situations, the partnership must assign value, first, among section 197 intangibles (other than goodwill and going concern value) in a reasonable manner that is consistent with the ordering rule in paragraph (a)(5) of this section and would cause the appropriate liquidating distribution under paragraph (a)(4)(i)(A) of this section. If the actual fair market values, determined on the basis of all the facts and circumstances, of all section 197 intangibles (other than goodwill and going concern value) is not sufficient to cause the appropriate liquidating distribution, then the fair market value of goodwill and going concern value shall be presumed to equal an amount that if assigned to goodwill and going concern value would cause the appropriate liquidating distribution.

(C) *Income in respect of a decedent.* Solely for the purpose of determining partnership gross value under this paragraph (a)(4)(i), where a partnership interest is transferred as a result of the death of a partner, the transferee's basis in its partnership interest is determined without regard to section 1014(c), and is deemed to be adjusted for that portion of the interest, if any, that is attributable to items representing income in respect of a decedent under section 691.

(ii) *Basis adjustments under section 743(b) resulting from substituted basis transactions.* This paragraph (a)(4)(ii) applies to basis adjustments under section 743(b) that result from exchanges in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the transferor's basis in the interest or to the basis of other property held at any time by the transferee (substituted basis transactions). In the case of a substituted basis transaction, partnership gross value equals the value of the entire partnership as a going concern, increased by the amount of partnership liabilities at the time of the exchange giving rise to the basis adjustment.

(iii) *Basis adjustments under section 734(b).* In the case of a basis adjustment under section 734(b), partnership gross value equals the value of the entire partnership

as a going concern immediately following the distribution causing the adjustment, increased by the amount of partnership liabilities immediately following the distribution.

(5) *Determining the values of section 197 intangibles*—(i) *Two classes.* If the aggregate value of partnership property other than section 197 intangibles (as determined in paragraph (a)(3) of this section) is equal to or greater than partnership gross value (as determined in paragraph (a)(4) of this section), then all section 197 intangibles are deemed to have a value of zero for purposes of this section. In all other cases, the aggregate value of the partnership's section 197 intangibles (the residual section 197 intangibles value) is deemed to equal the excess of partnership gross value over the aggregate value of partnership property other than section 197 intangibles. The residual section 197 intangibles value must be allocated between two asset classes in the following order —

(A) Among section 197 intangibles other than goodwill and going concern value; and

(B) To goodwill and going concern value.

(ii) *Values assigned to section 197 intangibles other than goodwill and going concern value.* The fair market value assigned to a section 197 intangible (other than goodwill and going concern value) shall not exceed the actual fair market value (determined on the basis of all the facts and circumstances) of that asset on the date of the relevant transfer. If the residual section 197 intangibles value is less than the sum of the actual fair market values (determined on the basis of all the facts and circumstances) of all section 197 intangibles (other than goodwill and going concern value) held by the partnership, then the residual section 197 intangibles value must be allocated among the individual section 197 intangibles (other than goodwill and going concern value) as follows. The residual section 197 intangibles value is assigned first to any section 197 intangibles (other than goodwill and going concern value) having potential gain that would be treated as unrealized receivables under the flush language of section 751(c) (flush language receivables) to the extent of the basis of those section 197 intangibles and the amount of income arising from the flush language receivables that the partnership would recognize if the section 197 intan-

gibles were sold for their actual fair market values (determined based on all the facts and circumstances) (collectively, the flush language receivables value). If the value assigned to section 197 intangibles (other than goodwill and going concern value) is less than the flush language receivables value, then the assigned value is allocated among the properties giving rise to the flush language receivables value in proportion to the flush language receivables value in those properties. Any remaining residual section 197 intangibles value is allocated among the remaining portions of the section 197 intangibles (other than goodwill and going concern value) in proportion to the actual fair market values of such portions (determined based on all the facts and circumstances).

(iii) *Value assigned to goodwill and going concern value.* The fair market value of goodwill and going concern value is the amount, if any, by which the residual section 197 intangibles value exceeds the aggregate value of the partnership's section 197 intangibles (other than goodwill and going concern value).

(6) *Examples.* The provisions of paragraphs (a)(2) through (5) are illustrated by the following examples, which assume that the partnerships have an election in effect under section 754 at the time of the transfer and that the assets of each partnership constitute a trade or business (as described in §1.1060-1(b)(2)). Except as provided, no partnership asset (other than inventory) is property described in section 751(a), and partnership liabilities are secured by all partnership assets. The examples are as follows:

*Example 1.* (i) A is the sole general partner in PRS, a limited partnership having three equal partners. PRS has goodwill and going concern value, two section 197 intangibles other than goodwill and going concern value (Intangible 1 and Intangible 2), and two other assets with fair market values (determined using all the facts and circumstances) as follows: inventory worth \$1,000,000 and a building (a capital asset) worth \$2,000,000. The fair market value of each of Intangible 1 and Intangible 2 is \$50,000. PRS has one liability of \$1,000,000, for which A bears the entire risk of loss under section 752 and the regulations thereunder. D purchases A's partnership interest for \$650,000, resulting in a basis adjustment under section 743(b). After the purchase, D bears the entire risk of loss for PRS's liability under section 752 and the regulations thereunder. Therefore, D's basis in its interest in PRS is \$1,650,000.

(ii) D's basis in the transferred partnership interest (reduced by the amount of such basis that is attributable to partnership liabilities) is \$650,000 (\$1,650,000 - \$1,000,000). Under paragraph (a)(4)(i) of this section, partnership gross value is \$2,950,000

(the amount that, if assigned to all partnership property, would result in a liquidating distribution to D equal to \$650,000).

(iii) Under paragraph (a)(3) of this section, the inventory has a fair market value of \$1,000,000, and the building has a fair market value of \$2,000,000. Thus, the aggregate value of partnership property other than section 197 intangibles, \$3,000,000, is equal to or greater than partnership gross value, \$2,950,000. Accordingly, under paragraphs (a)(3) and (5) of this section, the value assigned to each of the partnership's assets is as follows: inventory, \$1,000,000; building, \$2,000,000; Intangibles 1 and 2, \$0; and goodwill and going concern value, \$0. D's section 743(b) adjustment must be allocated under paragraph (b) of this section using these assigned fair market values.

*Example 2.* (i) Assume the same facts as in *Example 1*, except that the fair market values of Intangible 1 and Intangible 2 are each \$300,000, and that D purchases A's interest in PRS for \$1,000,000. After the purchase, D's basis in its interest in PRS is \$2,000,000.

(ii) D's basis in the transferred partnership interest (reduced by the amount of such basis that is attributable to partnership liabilities) is \$1,000,000 (\$2,000,000 - \$1,000,000). Under paragraph (a)(4)(i) of this section, partnership gross value is \$4,000,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to D equal to \$1,000,000).

(iii) Under paragraph (a)(5) of this section, the residual section 197 intangibles value is \$1,000,000 (the excess of partnership gross value, \$4,000,000, over the aggregate value of assets other than section 197 intangibles, \$3,000,000 (the sum of the value of the inventory, \$1,000,000, and the value of the building, \$2,000,000)). The partnership must determine the values of section 197 assets by allocating the residual section 197 intangibles value among the partnership's assets. The residual section 197 intangibles value is assigned first to section 197 intangibles other than goodwill and going concern value, and then to goodwill and going concern value. Thus, \$300,000 is assigned to each of Intangible 1 and Intangible 2, and \$400,000 is assigned to goodwill and going concern value (the amount by which the residual section 197 intangibles value, \$1,000,000, exceeds the fair market value of section 197 intangibles other than goodwill and going concern value, \$600,000). D's section 743(b) adjustment must be allocated under paragraph (b) of this section using these assigned fair market values.

*Example 3.* (i) Assume the same facts as in *Example 1*, except that the fair market values of Intangible 1 and Intangible 2 are each \$300,000, and that D purchases A's interest in PRS for \$750,000. After the purchase, D's basis in its interest in PRS is \$1,750,000. Also assume that Intangible 1 was originally purchased for \$300,000, and that its adjusted basis has been decreased to \$50,000 as a result of amortization. Assume that, if PRS were to sell Intangible 1 for \$300,000, it would recognize \$250,000 of gain that would be treated as an unrealized receivable under the flush language in section 751(c).

(ii) D's basis in the transferred partnership interest (reduced by the amount of such basis that is attributable to partnership liabilities) is \$750,000 (\$1,750,000 - \$1,000,000). Under paragraph (a)(4)(i) of this section, partnership gross value is \$3,250,000

(the amount that, if assigned to all partnership property, would result in a liquidating distribution to D equal to \$750,000).

(iii) Under paragraph (a)(5) of this section, the residual section 197 intangibles value is \$250,000 (the amount by which partnership gross value, \$3,250,000, exceeds the aggregate value of partnership property other than section 197 intangibles, \$3,000,000). Intangible 1 has potential gain that would be treated as unrealized receivables under the flush language of section 751(c). The flush language receivables value in Intangible 1 is \$300,000 (the sum of PRS's basis in Intangible 1, \$50,000, and the amount of ordinary income, \$250,000, that the partnership would recognize if Intangible 1 were sold for its actual fair market value). Because the residual section 197 intangibles value, \$250,000, is less than the flush language receivables value of Intangible 1, Intangible 1 is assigned a value of \$250,000, and Intangible 2 and goodwill and going concern value are assigned a value of zero. D's section 743(b) adjustment must be allocated under paragraph (b) of this section using these assigned fair market values.

*Example 4.* Assume the same facts as in *Example 1*, except that the fair market values of Intangible 1 and Intangible 2 are each \$300,000, and that A does not sell its interest in PRS. Instead, A contributes its interest in PRS to E, a newly formed corporation wholly-owned by A, in a transaction described in section 351. Assume that the contribution results in a basis adjustment under section 743(b) (other than zero). PRS determines that its value as a going concern immediately following the contribution is \$3,000,000. Under paragraph (a)(4)(ii) of this section, partnership gross value is \$4,000,000 (the value of PRS as a going concern, \$3,000,000, increased by the partnership's liability, \$1,000,000, immediately after the contribution). Under paragraph (a)(5) of this section, the residual section 197 intangibles value is \$1,000,000 (the amount by which partnership gross value, \$4,000,000, exceeds the aggregate value of partnership property other than section 197 intangibles, \$3,000,000). Of the residual section 197 intangibles value, \$300,000 is assigned to each of Intangible 1 and Intangible 2, and \$400,000 is assigned to goodwill and going concern value (the amount by which the residual section 197 intangibles value, \$1,000,000, exceeds the fair market value of section 197 intangibles other than goodwill and going concern value, \$600,000). E's section 743(b) adjustment must be allocated under paragraph (b)(5) of this section using these assigned fair market values.

*Example 5.* G is the sole general partner in PRS, a limited partnership having three equal partners (G, H, and I). PRS has goodwill and going concern value, two section 197 intangibles other than goodwill and going concern value (Intangible 1 and Intangible 2), and two capital assets with fair market values (determined using all the facts and circumstances) as follows: vacant land worth \$1,000,000, and a building worth \$2,000,000. The fair market value of each of Intangible 1 and Intangible 2 is \$300,000. PRS has one liability of \$1,000,000, for which G bears the entire risk of loss under section 752 and the regulations thereunder. PRS distributes the land to H in liquidation of H's interest in PRS. Immediately prior to the distribution, PRS's basis in the land is \$800,000, and H's basis in its interest in PRS is \$750,000. The distribution causes the partnership to increase the basis of its remaining property by \$50,000 under sec-

tion 734(b)(1)(B). PRS determines that its value as a going concern immediately following the distribution is \$2,000,000. Under paragraph (a)(4)(iii) of this section, partnership gross value is \$3,000,000 (the value of PRS as a going concern, \$2,000,000, increased by the partnership's liability, \$1,000,000, immediately after the distribution). Under paragraph (a)(5) of this section, the residual section 197 intangibles value of PRS's section 197 intangibles is \$1,000,000 (the amount by which partnership gross value, \$3,000,000, exceeds the aggregate value of partnership property other than section 197 intangibles, \$2,000,000). Of the residual section 197 intangibles value, \$300,000 is assigned to each of Intangible 1 and Intangible 2, and \$400,000 is assigned to goodwill and going concern value (the amount by which the residual section 197 intangibles value, \$1,000,000, exceeds the fair market value of section 197 intangibles other than goodwill and going concern value, \$600,000). PRS's section 734(b) adjustment must be allocated under paragraph (c) of this section using these assigned fair market values.

(b) *Adjustments under section 743(b)*—(1) *Generally*—(i) *Application*. For basis adjustments under section 743(b) resulting from substituted basis transactions, paragraph (b)(5) of this section shall apply. For basis adjustments under section 743(b) resulting from all other transfers, paragraphs (b)(2) through (4) of this section shall apply. \* \* \*

\* \* \* \* \*

(3) \* \* \*

(ii) *Special rules*—(A) *Assets in which partner has no interest*. An asset with respect to which the transferee partner has no interest in income, gain, losses, or deductions shall not be taken into account in applying paragraph (b)(3)(ii)(B) of this section.

(B) *Limitation in decrease of basis*. In no event may the amount of any decrease in basis allocated to an item of capital gain property under paragraph (b)(3)(ii)(B) of this section exceed the partnership's adjusted basis in that item (or in the case of property subject to the remedial allocation method, the transferee's share of any remedial loss under §1.704-3(d) from the hypothetical transaction). In the event that a decrease in basis allocated under paragraph (b)(3)(ii)(B) of this section to an item of capital gain property would otherwise exceed the partnership's adjusted basis in that item, the excess must be applied to reduce the remaining basis, if any, of other capital gain assets *pro rata* in proportion to the bases of such assets (as adjusted under this paragraph (b)(3)).

\* \* \* \* \*

(4) \* \* \*

(ii) \* \* \*

*Example.* (i) A and B are equal partners in personal service partnership PRS.

In 2004, as a result of B's death, B's partnership interest is transferred to T when PRS's balance sheet (reflecting a cash receipts and disbursements method

of accounting) is as follows (based on all the facts and circumstances):

Assets		
	Adjusted Basis	Fair Market Value
Section 197 Intangible .....	\$2,000	\$ 5,000
Unrealized Receivables .....	<u>0</u>	<u>15,000</u>
<b>Total .....</b>	<b>\$2,000</b>	<b>\$20,000</b>
Liabilities and Capital		
	Adjusted Per Books	Fair Market Value
<b>Capital:</b>		
A .....	1,000	10,000
B .....	<u>1,000</u>	<u>10,000</u>
<b>Total .....</b>	<b>\$2,000</b>	<b>\$20,000</b>

(ii) None of the assets owned by PRS is section 704(c) property, and the section 197 intangible is not amortizable. The fair market value of T's partnership interest on the applicable date of valuation set forth in section 1014 is \$10,000. Of this amount, \$2,500 is attributable to T's 50% share of the partnership's section 197 intangible, and \$7,500 is attributable to T's 50% share of the partnership's unrealized receivables. The partnership's unrealized receivables represent income in respect of a decedent. Accordingly, under section 1014(c), T's basis in its partnership interest is not adjusted for that portion of the interest which is attributable to the unrealized receivables. Therefore, T's basis in its partnership interest is \$2,500.

(iii) Under paragraph (a)(4)(i)(C) of this section, solely for purposes of determining partnership gross value, T's basis in its partnership interest is deemed to be \$10,000. Under paragraph (a)(4)(i) of this section, partnership gross value is \$20,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to T equal to \$10,000).

(iv) Under paragraph (a)(5) of this section, the residual section 197 intangibles value is \$5,000 (the excess of partnership gross value, \$20,000, over the aggregate value of assets other than section 197 intangibles, \$15,000). The residual section 197 intangibles value is assigned first to section 197 intangibles other than goodwill and going concern value, and then to goodwill and going concern value. Thus, \$5,000 is assigned to the section 197 intangible, and \$0 is assigned to goodwill and going concern value. T's section 743(b) adjustment must be allocated using these assigned fair market values.

(v) At the time of the transfer, B's share of the partnership's basis in partnership assets is \$1,000. Accordingly, T receives a \$1,500 basis adjustment under section 743(b). Under this paragraph (b)(4), the entire basis adjustment is allocated to the partnership's section 197 intangible.

(5) *Substituted basis transactions*—(i) *In general.* This paragraph (b)(5) applies to ba-

sis adjustments under section 743(b) that result from exchanges in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the transferor's basis in that interest. For exchanges on or after June 9, 2003, this paragraph (b)(5) also applies to basis adjustments under section 743(b) that result from exchanges in which the transferee's basis in the partnership interest is determined by reference to other property held at any time by the transferee. For example, this paragraph (b)(5) applies if a partnership interest is contributed to a corporation in a transaction to which section 351 applies, if a partnership interest is contributed to a partnership in a transaction to which section 721(a) applies, or if a partnership interest is distributed by a partnership in a transaction to which section 731(a) applies.

\* \* \* \* \*

(c) \* \* \*

(5) \* \* \*

*Example.* (i) A, B, and C form equal partnership PRS. A contributes \$50,000 and Asset 1, nondepreciable capital gain property with a fair market value of \$50,000 and an adjusted tax basis of \$25,000. B and C each contributes \$100,000. PRS uses the cash to purchase Assets 2, 3, 4, 5, and 6. Assets 2 and 3 are nondepreciable capital assets, and Assets 4, 5, and 6 are inventory that has not appreciated substantially in value within the meaning of section 751(b)(3). Assets 4, 5, and 6 are the only assets held by the partnership that are subject to section 751. The partnership has an election in effect under section 754. Af-

ter seven years, the adjusted basis and fair market value of PRS's assets are as follows:

\* \* \* \* \*

(d) *Required statements.* See §1.743-1(k)(2) for provisions requiring the transferee of a partnership interest to provide information to the partnership relating to the transfer of an interest in the partnership. See §1.743-1(k)(1) for a provision requiring the partnership to attach a statement to the partnership return showing the computation of a basis adjustment under section 743(b) and the partnership properties to which the adjustment is allocated under section 755. See §1.732-1(d)(3) for a provision requiring a transferee partner to attach a statement to its return showing the computation of a basis adjustment under section 732(d) and the partnership properties to which the adjustment is allocated under section 755. See §1.732-1(d)(5) for a provision requiring the partnership to provide information to a transferee partner reporting a basis adjustment under section 732(d).

(e) *Effective Date*—(1) *Generally.* Except as provided in paragraphs (b)(5) and (e)(2) of this section, this section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after December 15, 1999.

(2) *Special rules.* Paragraphs (a) and (b)(3)(iii) of this section apply to transfers of partnership interests and distributions of property from a partnership that occur on or after June 9, 2003.

## **§1.755–2T [Removed]**

Par. 3. Section 1.755–2T is removed.

Par. 4. In §1.1060–1, paragraph (e)(2) is revised to read as follows:

*§1.1060–1 Special allocation rules for certain asset acquisitions.*

\* \* \* \* \*

(e) \* \* \*

(2) *Transfers of interests in partnerships.* For reporting requirements relating to the transfer of a partnership interest, see §1.755–1(d).

## **PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

## **602.101 [Amended]**

Par. 6. In §602.101, paragraph (b), the entry for “1.755–2T” is removed.

David A. Mader,  
*Assistant Deputy Commissioner of  
Internal Revenue.*

Approved May 22, 2003.

Pamela F. Olson,  
*Assistant Secretary of the Treasury.*