

Section 704.—Partner's Distributive Share

26 CFR 1.704-3: *Contributed property.*

T.D. 9193

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Section 704(c), Installment Obligations and Contributed Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 704(c) and 737 relating to the tax treatment of installment obligations and property acquired pursuant to a contract. The regulations affect partners and partnerships and provide guidance necessary to comply with the law.

DATES: *Effective Date:* These regulations are effective November 23, 2003.

Applicability Date: For dates of applicability, see §§1.704-3(f), 1.704-4(g) and 1.737-5.

FOR FURTHER INFORMATION CONTACT: Christopher L. Trump, (202) 622-3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under sections 704 and 737. On November 24, 2003, a notice of proposed rulemaking (REG-160330-02, 2003-2 C.B. 1230) relating to the tax treatment of installment obligations and property acquired pursuant to a contract under sections 704(c) and 737 was published in the **Federal Register** (68 FR 65864). A notice of correction was published in the **Federal Register** (69 FR 5797) on February 6, 2004. No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested, and accordingly, no hearing was held. This Treasury decision adopts the language of the proposed regulations without change.

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 proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

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Adoption of Amendments to Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:
Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.704-3 is amended as follows:

- 1. The paragraph heading for (a)(8) is revised.
- 2. The text of paragraph (a)(8) is redesignated as paragraph (a)(8)(i).
- 3. A paragraph heading for newly designated paragraph (a)(8)(i) is added.
- 4. The first sentence of newly designated paragraph (a)(8)(i) is amended by removing the language “in which no gain or loss is recognized”.
- 5. Paragraphs (a)(8)(ii) and (a)(8)(iii) are added.

- 6. Paragraph (f) is amended by:
 - a. Revising the paragraph heading.
 - b. Amending the first sentence of paragraph (f) by removing the language “of paragraph (a)(11)” and adding “of paragraphs (a)(8)(ii), (a)(8)(iii) and (a)(11)” in its place.

c. Adding two sentences at the end of paragraph (f).

The revisions and additions read as follows:

§1.704-3 Contributed property.

- (a) * * *
- (8) *Special rules*—(i) *Disposition in a nonrecognition transaction.* * * *
- (ii) *Disposition in an installment sale.* If a partnership disposes of section 704(c) property in an installment sale as defined in section 453(b), the installment obligation received by the partnership is treated as the section 704(c) property with the same amount of built-in gain as the section 704(c) property disposed of by the partnership (with appropriate adjustments for any gain recognized on the installment sale). The allocation method for the installment obligation must be consistent with the allocation method chosen for the original property.

(iii) *Contributed contracts.* If a partner contributes to a partnership a contract that is section 704(c) property, and the partnership subsequently acquires property pursuant to that contract in a transaction in which less than all of the gain or loss is recognized, then the acquired property is treated as the section 704(c) property with the same amount of built-in gain or loss as the contract (with appropriate adjustments for any gain or loss recognized on the acquisition). For this purpose, the term contract includes, but is not limited to, options, forward contracts, and futures contracts. The allocation method for the acquired property must be consistent with the allocation method chosen for the contributed contract.

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(f) *Effective dates.* * * * Paragraph (a)(8)(ii) applies to installment obligations received by a partnership in exchange for section 704(c) property on or after November 24, 2003. Paragraph (a)(8)(iii) applies to property acquired on or after November 24, 2003, by a partnership pursuant to a contract that is section 704(c) property.

Par. 3. Section 1.704-4 is amended as follows:

- 1. The paragraph heading for (d)(1) is revised.
- 2. The text of paragraph (d)(1) is redesignated as paragraph (d)(1)(i).

3. A paragraph heading for newly designated paragraph (d)(1)(i) is added.

4. Paragraphs (d)(1)(ii) and (d)(1)(iii) are added.

5. Revising paragraph (g).

The revisions and additions read as follows:

§1.704-4 Distribution of contributed property.

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(d) *Special rules*—(1) *Nonrecognition transactions, installment obligations and contributed contracts*— (i) *Nonrecognition transactions.* * * *

(ii) *Installment obligations.* An installment obligation received by the partnership in an installment sale (as defined in section 453(b)) of section 704(c) property is treated as the section 704(c) property for purposes of section 704(c)(1)(B) and this section to the extent that the installment obligation received is treated as section 704(c) property under §1.704-3(a)(8). See §1.737-2(d)(3) for a similar rule in the context of section 737.

(iii) *Contributed contracts.* Property acquired by the partnership pursuant to a contract that is section 704(c) property is treated as the section 704(c) property for purposes of section 704(c)(1)(B) and this section, to the extent that the acquired property is treated as section 704(c) property under §1.704-3(a)(8). See §1.737-2(d)(3) for a similar rule in the context of section 737.

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(g) *Effective dates.* This section applies to distributions by a partnership to a partner on or after January 9, 1995, except that paragraphs (d)(1)(ii) and (iii) apply to distributions by a partnership to a partner on or after November 24, 2003.

Par. 4. Section 1.737-2 is amended as follows:

- 1. The paragraph heading for (d)(3) is revised.
- 2. The text of paragraph (d)(3) is redesignated (d)(3)(i).
- 3. A paragraph heading for newly designated (d)(3)(i) is added.
- 4. Paragraphs (d)(3)(ii) and (d)(3)(iii) are added.

§1.737-2 Exceptions and special rules.

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(d) * * *

(3) *Nonrecognition transactions, installment sales and contributed contracts*—(i) *Nonrecognition transactions*.
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(ii) *Installment sales*. An installment obligation received by the partnership in an installment sale (as defined in section 453(b)) of section 704(c) property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the installment obligation received is treated as section 704(c) property under §1.704-3(a)(8). See §1.704-4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

(iii) *Contributed contracts*. Property acquired by a partnership pursuant to a contract that is section 704(c) property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the acquired property is treated as section 704(c) property under §1.704-3(a)(8). See §1.704-4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

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Par. 5. Section 1.737-5 is revised to read as follows:

§1.737-5 Effective dates.

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, except that §1.737-2(d)(3)(ii) and (iii) apply to distributions by a partnership to a partner on or after November 24, 2003.

Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

Approved March 15, 2005.

Eric Solomon,
*Acting Deputy Assistant Secretary
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on March 21, 2005, 8:45 a.m., and published in the issue of the Federal Register for March 22, 2005, 70 F.R. 14394)