

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 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.

#### List of Subjects

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

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

## 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