

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 continues to read in part as follows:

PART 1—INCOME TAXES

1. The authority citation for part 1 continues to read in part as follows:

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

Section 1.752-1(a) also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-6 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-7 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

2. Section 1.358-7 is added to read as follows:

§ 1.358-7 Transfers by partners and partnerships to corporations.

(a) *Contributions of partnership interests.* For purposes of section 358(h), a transfer of a partnership interest to a corporation is treated as a transfer of the partner's share of each of the partnership's assets and an assumption by the corporation of the partner's share of partnership liabilities (including section 358(h) liabilities, as defined in paragraph (d) of this section). See paragraph (e), *Example 1* of this section.

(b) *Contributions by partnerships.* If a corporation assumes a section 358(h) liability from a partnership in an exchange to which section 358(a) applies, then, for purposes of applying section 705 (determination of basis of partner's interest) and § 1.704-1(b), any reduction, under section 358(h)(1), in the partnership's basis in corporate stock received in the transaction is treated as an expenditure of the partnership described in section 705(a)(2)(B). See paragraph (e), *Example 2* of this section. This expenditure must be allocated among the partners in accordance with section 704(b) and (c) and § 1.752-7(c). If a partner's share of the reduction, under section 358(h)(1), in the partnership's basis in corporate stock exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess,

which is treated as gain from the sale or exchange of a partnership interest. This paragraph does not apply to the extent that § 1.752-7(i)(4) applies to the assumption of the § 1.752-7 liability by the corporation.

(c) *Assumption of section 358(h) liability by partnership followed by transfer of partnership interest or partnership property to a corporation—trade or business exception.* Where a partnership assumes a section 358(h) liability from a partner and, subsequently, the partner transfers all or part of the partner's partnership interest to a corporation in an exchange to which section 358(a) applies, the section 358(h) liability is treated as associated only with the contribution made to the partnership by that partner. Similar rules apply where a partnership assumes a section 358(h) liability of a partner and a corporation subsequently assumes that section 358(h) liability from the partnership in an exchange to which section 358(a) applies. See paragraph (e), *Example 1* of this section.

(d) *Section 358(h) liabilities defined.* For purposes of this section, section 358(h) liabilities are liabilities described in section 358(h)(3).

(e) *Examples.* The following examples illustrate the provisions of this section. Assume, for purposes of these examples, that the obligation assumed by the corporation does not reduce the shareholder's basis in the corporate stock under section 358(d). The examples are as follows:

Example 1. Contribution of partnership interest to corporation. In 2004, A contributes undeveloped land with a value and basis of \$4,000,000 in exchange for a 50% interest in PRS and an assumption by PRS of \$2,000,000 of pension liabilities from a separate business that A conducts. A's basis in the PRS interest immediately after the contribution is A's basis in the land, \$4,000,000, unreduced by the amount of the pension liabilities. PRS develops the land as a landfill. Before PRS has economically performed with respect to the pension liabilities, A contributes A's interest in PRS to Corporation X, in an exchange to which section 351 applies. At the time of the exchange, the value of A's PRS interest is \$2,000,000, A's basis in PRS is \$4,000,000, and A has no share of partnership liabilities other than the pension liabilities. For purposes of applying section 358(h), the contribution of the PRS interest to Corporation X is treated as a contribution to Corporation X of A's share of PRS assets and of A's share of the pension liabilities of PRS (\$2,000,000). Because the pension liabilities were not assumed by PRS from A in an exchange in which either the trade or business associated with the liability or substantially all of the assets associated with the liability were transferred to PRS, the contribution of the PRS interest to Corporation X is not excepted from section

358(h) under section 358(h)(2). Under section 358(h), A's basis in the Corporation X stock is reduced by the \$2,000,000 of pension liabilities.

Example 2. Contribution of partnership property to corporation. In 2004, in an exchange to which section 351(a) applies, PRS, a cash basis taxpayer, contributes \$2,000,000 cash to Corporation X, also a cash basis taxpayer, in exchange for Corporation X shares and the assumption by Corporation X of \$1,000,000 of accounts payable incurred by PRS. At the time of the exchange, PRS has two partners, A, a 90% partner, who has a \$2,000,000 basis in the PRS interest, and B, a 10% partner, who has a \$50,000 basis in the PRS interest. Assume that, under section 358(h)(1), PRS's basis in the Corporation X stock is reduced by the accounts payable assumed by Corporation X (\$1,000,000). Under paragraph (b) of this section, A's and B's bases in PRS must be reduced, but not below zero, by their respective shares of the section 358(h)(1) basis reduction. If either partner's share of the section 358(h)(1) basis reduction exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess. A's share of the section 358(h) basis reduction is \$900,000 (90% of \$1,000,000). Therefore, A's basis in the PRS interest is reduced to \$1,100,000 (\$2,000,000—\$900,000). B's share of the section 358(h) basis reduction is \$100,000 (10% of \$1,000,000). Because B's share of the section 358(h) basis reduction (\$100,000) exceeds B's basis in the PRS interest (\$50,000), B's basis in the PRS interest is reduced to \$0 and B recognizes \$50,000 of gain. This gain is treated as gain from the sale of the PRS interest.

(f) *Effective date.* This section applies to assumptions of liabilities by a corporation occurring on or after June 24, 2003.

§ 1.704-1 [Amended]

3. Section 1.704-1 is amended as follows:

1. Paragraph (b)(1)(ii) is amended by removing the language "The" at the beginning of the first sentence and adding "Except as otherwise provided in this section, the" in its place.

2. Paragraph (b)(2)(iv)(b)(2) is amended by removing the language "secured by such contributed property" in the parenthetical.

3. Paragraph (b)(2)(iv)(b)(2) is further amended by removing the language "under section 752" in the parenthetical.

4. Paragraph (b)(2)(iv)(b)(5) is amended by removing the language "secured by such distributed property" in the parenthetical.

5. Paragraph (b)(2)(iv)(b)(5) is further amended by removing the language "under section 752" in the parenthetical.

6. Paragraph (b)(2)(iv)(b) is further amended by adding a sentence at the end of the paragraph.