

assumes from Corporation X certain pension liabilities with respect to the employees of Business B. At the time of the assumption, the amount of the pension liabilities with respect to the employees of Business A is \$3,000,000 (the A liabilities) and the amount of the pension liabilities associated with the employees of Business B (the B liabilities) is \$2,000,000. Two years later, Corporation X sells its interest in PRS to Y for \$9,000,000. At the time of the sale, the remaining built-in loss associated with the A liabilities is \$2,100,000, the remaining built-in loss associated with the B liabilities is \$900,000, and the gross value of PRS's assets (excluding § 1.752-7 liabilities) is \$20,000,000. Assume that PRS has no § 1.752-7 liabilities other than those assumed from Corporation X.

(ii) *Analysis.* The only liabilities assumed by PRS from Corporation X that were not assumed as part of Corporation X's contribution of Business A were the B liabilities. Immediately before the testing date, the remaining built-in loss associated with the B liabilities (\$900,000) was less than the lesser of 10% of the gross value of PRS's assets (\$2,000,000) or \$1,000,000. Therefore, paragraph (d)(2)(i)(B) of this section applies to exclude Corporation X's sale of the PRS interest to Y from the application of paragraph (e) of this section.

(e) *Transfer of § 1.752-7 liability partner's partnership interest—(1) In general.* Except as provided in paragraphs (d)(2) and (e)(3) of this section, immediately before the sale, exchange, or other disposition of all or a part of a § 1.752-7 liability partner's partnership interest, the § 1.752-7 liability partner's basis in the partnership interest is reduced by the § 1.752-7 liability reduction. No deduction or capital expense is allowed to the partnership on the economic performance of the § 1.752-7 liability to the extent of the remaining built-in loss associated with the § 1.752-7 liability. For purposes of section 705(a)(2)(B) and § 1.704-1(b)(2)(ii)(b) only, the remaining built-in loss associated with the § 1.752-7 liability is not treated as a nondeductible, noncapital expenditure of the partnership. Therefore, the remaining partners' capital accounts and bases in their partnership interests are not reduced by the remaining built-in loss associated with the § 1.752-7 liability. If the partnership (or any successor) notifies the § 1.752-7 liability partner of the economic performance of the § 1.752-7 liability (as described in paragraph (h) of this section), then the § 1.752-7 liability partner is entitled to a loss or deduction. The amount of that deduction or loss is, in the case of a partial satisfaction of the § 1.752-7 liability, the amount paid by the partnership in satisfaction of the § 1.752-7 liability (but not more than the § 1.752-7 liability reduction) or, in the case of a complete satisfaction of the

§ 1.752-7 liability, the remaining § 1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the § 1.752-7 liability, the character of that deduction or loss is determined as if the § 1.752-7 liability partner had satisfied the liability. To the extent that the § 1.752-7 liability reduction exceeds the amount paid in satisfaction of the § 1.752-7 liability, the character of the § 1.752-7 liability partner's loss is capital.

(2) *Examples.* The following examples illustrate the principles of paragraph (e)(1) of this section:

Example 1—(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value of \$5,000,000 and basis of \$4,000,000 subject to a § 1.752-7 liability of \$2,000,000 in exchange for a 25% interest in PRS. B contributes \$3,000,000 cash in exchange for a 25% interest in PRS, and C contributes \$6,000,000 cash in exchange for a 50% interest in PRS. In 2006, when PRS has a section 754 election in effect, A sells A's interest in PRS to D for \$3,000,000. At the time of the sale, the basis of A's PRS interest is \$4,000,000, the remaining built-in loss associated with the § 1.752-7 liability is \$2,000,000, and PRS has no liabilities (as defined in § 1.752-1(a)(1)). Assume that none of the exceptions of paragraph (d)(2) of this section apply and that economic performance of the § 1.752-7 liability would have given rise to a deductible expense to A. In 2007, PRS pays \$3,000,000 to satisfy the liability.

(ii) *Sale of A's PRS interest.* Immediately before the sale of the PRS interest to D, A's basis in the PRS interest is reduced (to \$3,000,000) by the § 1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the PRS interest (\$4,000,000) over the adjusted value of that interest (\$3,000,000), \$1,000,000, or the remaining built-in loss associated with the § 1.752-7 liability, \$2,000,000. Therefore, A recognizes no gain or loss on the sale of the PRS interest to D. D's basis in the PRS interest is \$3,000,000. D's share of the adjusted basis of partnership property equals D's interest in the partnership's previously taxed capital of \$2,000,000 (the amount of cash that D would receive on a liquidation of the partnership, \$3,000,000, increased by the amount of tax loss that would be allocated to D in the hypothetical transaction, \$0, and reduced by the amount of tax gain that would be allocated to D in the hypothetical transaction, \$1,000,000). Therefore, the basis adjustment under section 743(b) is \$1,000,000.

(iii) *Satisfaction of § 1.752-7 liability.* Neither PRS nor any of its partners is entitled to a deduction for the economic performance of the § 1.752-7 liability to the extent of the remaining built-in loss associated with the § 1.752-7 liability (\$2,000,000). PRS is entitled to a deduction, however, for the amount by which the cost of satisfying the § 1.752-7 liability exceeds the remaining built-in loss associated with the § 1.752-7 liability. Therefore, in 2007, PRS may deduct \$1,000,000 (cost to satisfy the § 1.752-7 liability, \$3,000,000, less the remaining built-

in loss associated with the § 1.752-7 liability, \$2,000,000). If PRS notifies A of the economic performance of the § 1.752-7 liability, then A is entitled to an ordinary deduction in 2007 of \$1,000,000 (the § 1.752-7 liability reduction).

*Example 2—*The facts are the same as in *Example 1* except that, at the time of A's sale of the PRS interest to D, PRS has a nonrecourse liability of \$4,000,000, of which A's share is \$1,000,000. A's basis in PRS is \$5,000,000. At the time of the sale of the PRS interest to D, the adjusted value of A's interest is \$4,000,000 (the fair market value of the interest (\$3,000,000), increased by A's share of partnership liabilities (\$1,000,000)). The difference between the basis of A's interest (\$5,000,000) and the adjusted value of that interest (\$4,000,000) is \$1,000,000. Therefore, the § 1.752-7 liability reduction is \$1,000,000 (the lesser of this difference or the remaining built-in loss associated with the § 1.752-7 liability, \$2,000,000). Immediately before the sale of the PRS interest to D, A's basis is reduced from \$5,000,000 to \$4,000,000. A's amount realized on the sale of the PRS interest to D is \$4,000,000 (\$3,000,000 paid by D, increased under section 752(d) by A's share of partnership liabilities, or \$1,000,000). Therefore, A recognizes no gain or loss on the sale. D's basis in the PRS interest is \$4,000,000. Because D's share of the adjusted basis of partnership property is \$3,000,000 (D's share of the partnership's previously taxed capital, \$2,000,000, plus D's share of partnership liabilities, \$1,000,000), the basis adjustment under section 743(b) is \$1,000,000.

(3) *Exception for nonrecognition transactions—(i) In general.* Paragraph (e)(1) of this section does not apply where a § 1.752-7 liability partner transfers all or part of the partner's partnership interest in a transaction 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 partnership interest. In addition, paragraph (e)(1) of this section does not apply to a distribution of an interest in the partnership that has assumed the § 1.752-7 liability by a partnership that is the § 1.752-7 liability partner.

(ii) *Examples.* The following examples illustrate the provisions of this paragraph (e)(3):

Example 1—(i) Facts. In 2004, X contributes undeveloped land with a value and basis of \$2,000,000 and subject to environmental liabilities of \$1,500,000 to partnership LTP in exchange for a 50% interest in LTP. LTP develops the land as a landfill. In 2005, in a transaction governed by section 721(a), X contributes the LTP interest to UTP in exchange for a 50% interest in UTP. In 2008, X sells the UTP interest to A for \$500,000. At the time of the sale, X's basis in UTP is \$2,000,000, the remaining built-in