

loss associated with the environmental liability is \$1,500,000, and the gross value of UTP's assets is \$2,500,000. The environmental liabilities were not assumed by LTP as part of a contribution by X to LTP of a trade or business with which the liabilities were associated. (See paragraph (b)(8)(iii), *Example 1* of this section.)

(ii) *Analysis.* Because UTP's basis in the LTP interest is determined by reference to X's basis in the LTP interest, X's contribution of the LTP interest to UTP is exempted from the rules of paragraph (e)(1) of this section. Under paragraph (i)(1) of this section, X's contribution of the LTP interest to UTP is treated as a contribution of X's share of the assets of LTP and UTP's assumption of X's share of the LTP liabilities (including § 1.752-7 liabilities). Therefore, X's transfer of the LTP interest to UTP is a § 1.752-7 liability transfer. The § 1.752-7 liabilities deemed transferred by X to UTP are not associated with a trade or business transferred to UTP for purposes of paragraph (d)(2)(i)(A) of this section, because they were not associated with a trade or business transferred by X to LTP as part of the original § 1.752-7 liability transfer. See paragraph (i)(2) of this section. Because none of the exceptions described in paragraph (d)(2) of this section apply to X's taxable sale of the UTP interest to A in 2008, paragraph (e)(1) of this section applies to that sale.

Example 2. The facts are the same as in *Example 1*, except that, rather than transferring the LTP interest to UTP in 2005, X contributes the LTP interest to Corporation Y in an exchange to which section 351 applies. Because Corporation Y's basis in the LTP interest is determined by reference to X's basis in that interest, X's contribution of the LTP interest is exempted from the rules of paragraph (e)(1) of this section. But see section 358(h) and § 1.358-7.

(f) *Distribution in liquidation of § 1.752-7 liability partner's partnership interest*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, immediately before a distribution in liquidation 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. This rule applies before section 737. 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) *Example.* The following example illustrates the provision of this paragraph (f):

Example—(i) *Facts.* In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value and basis of \$5,000,000 subject to a § 1.752-7 liability of \$2,000,000 for a 25% interest in PRS. B contributes \$3,000,000 cash for a 25% interest in PRS, and C contributes \$6,000,000 cash for a 50% interest in PRS. In 2012, when PRS has a section 754 election in effect, PRS distributes Property 2, which has a basis and fair market value of \$3,000,000, to A in liquidation of A's PRS interest. At the time of the distribution, the fair market value of A's PRS interest is \$3,000,000, the basis of that interest is \$5,000,000, and the remaining built-in loss associated with the § 1.752-7 liability is \$2,000,000. Assume that none of the exceptions of paragraph (d)(2) of this section apply to the distribution and that the economic performance of the § 1.752-7 liability would have given rise to a deductible expense to A. In 2013, PRS pays \$1,000,000 to satisfy the entire § 1.752-7 liability.

(ii) *Redemption of A's PRS interest.* Immediately before the distribution of Property 2 to A, 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 over the adjusted value of that interest (\$2,000,000) or the remaining built-in loss associated with the § 1.752-7 liability (\$2,000,000). Therefore, A's basis in Property 2 under section 732(b) is \$3,000,000. Because this is the same as the partnership's basis in Property 2 immediately before the distribution, the partnership's basis adjustment under section 734(b) is \$0.

(iii) *Satisfaction of § 1.752-7 liability.* PRS is not 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). Because this amount exceeds the amount paid by PRS to satisfy the § 1.752-7 liability (\$1,000,000), PRS is not

entitled to any deduction for the § 1.752-7 liability in 2013. If, however, PRS notifies A of the economic performance of the § 1.752-7 liability, then A is entitled to an ordinary deduction in 2013 of \$1,000,000 (the amount paid in satisfaction of the § 1.752-7 liability) and a capital loss of \$1,000,000 (the remaining § 1.752-7 liability reduction).

(g) *Assumption of § 1.752-7 liability by a partner other than § 1.752-7 liability partner*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, section 704(c)(1)(B) does not apply to an assumption of a § 1.752-7 liability from a partnership by a partner other than the § 1.752-7 liability partner. Instead, this paragraph (g) applies. The rules of paragraph (g)(2) of this section apply only if the § 1.752-7 liability partner is a partner in the partnership at the time of the assumption of the § 1.752-7 liability. The rules of paragraphs (g)(3) and (4) of this section apply to any assumption of the § 1.752-7 liability by a partner other than the § 1.752-7 liability partner, whether or not the § 1.752-7 liability partner is a partner in the partnership at the time of the assumption.

(2) *Consequences to § 1.752-7 liability partner.* If, at the time of an assumption of a § 1.752-7 liability from a partnership by a partner other than the § 1.752-7 liability partner, the § 1.752-7 liability partner remains a partner in the partnership, then the § 1.752-7 liability partner's basis in the partnership interest is reduced by the § 1.752-7 liability reduction. If the assuming partner (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 deduction or loss. 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.

(3) *Consequences to partnership.* Immediately after the assumption of the § 1.752-7 liability from the partnership by a partner other than the § 1.752-7