for the transferee to amend its prior returns to properly reflect the adjustment under section 743(b).

(l) *Effective/applicability date.* The provisions in this section apply to transfers of partnership interests that occur on or after December 15, 1999. The provisions of this section relating to section 1022 are effective on and after January 19, 2017. The last three sentences of paragraph (j)(4)(i)(B)(*1*) of this section, and the last sentence of paragraph (j)(4)(i)(B)(*2*) of this section, apply to transfers of partnership interests that occur on or after September 24, 2019. However, a partnership may choose to apply the last three sentences in paragraph (j)(4)(i)(B)(1) of this section, and the last sentence of paragraph (j)(4)(i)(B)(2) of this section, for transfers of partnership interests that occur on or after September 28, 2017. A partnership may rely on the last three sentences in paragraph (j)(4)(i)(B)(1) of this section in regulation project REG–104397–18 (2018–41 I.R.B. 558) (see §601.601(d)(2)(ii)(b) of this chapter) for transfers of partnership interests that occur on or after September 28, 2017, and ending before September 24, 2019.

[T.D. 8847, 64 FR 69909, Dec. 15, 1999; 65 FR 9220, Feb. 24, 2000, as amended by T.D. 9137, 69 FR 42559, July 16, 2004; T.D. 9811, 82 FR 6239, Jan. 19, 2017; T.D. 9874, 84 FR 50150, Sept. 24, 2019]

PROVISIONS COMMON TO PART II, SUBCHAPTER K, CHAPTER 1 OF THE CODE

§ 1.751–1 Unrealized receivables and inventory items.

(a) *Sale or exchange of interest in a partnership*—(1) *Character of amount realized.* To the extent that money or property received by a partner in exchange for all or part of his partnership interest is attributable to his share of the value of partnership unrealized receivables or substantially appreciated inventory items, the money or fair market value of the property received shall be considered as an amount realized from the sale or exchange of property other than a capital asset. The remainder of the total amount realized on the sale or exchange of the partnership interest is realized from the sale or exchange of a capital asset under section 741. For definition of ''unrealized receivables'' and ''inventory items which have appreciated substantially in value'', see section 751 (c) and (d). Unrealized receivables and substantially appreciated inventory items are hereafter in this section referred to as ''section 751 property''. See paragraph (e) of this section.

(2) *Determination of gain or loss.* The income or loss realized by a partner upon the sale or exchange of its interest in section 751 property is the amount of income or loss from section 751 property (including any remedial allocations under §1.704–3(d)) that would have been allocated to the partner (to the extent attributable to the partnership interest sold or exchanged) if the partnership had sold all of its property in a fully taxable transaction for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)) immediately prior to the partner's transfer of the interest in the partnership. Any gain or loss recognized that is attributable to section 751 property will be ordinary gain or loss. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 and the amount of ordinary income or loss determined under this paragraph (a)(2) is the transferor's capital gain or loss on the sale of its partnership interest. See §1.460–4(k)(2)(iv)(E) for rules relating to the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting.

(3) *Statement required.* A partner selling or exchanging any part of an interest in a partnership that has any section 751 property at the time of sale or exchange must submit with its income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information—

(i) The date of the sale or exchange;

(ii) The amount of any gain or loss attributable to the section 751 property; and

(iii) The amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

(b) *Certain distributions treated as sales or exchanges*—(1) *In general.* (i) Certain distributions to which section 751(b) applies are treated in part as sales or exchanges of property between the partnership and the distributee partner, and not as distributions to which sections 731 through 736 apply. A distribution treated as a sale or exchange under section 751(b) is not subject to the provisions of section 707(b). Section 751(b) applies whether or not the distribution is in liquidation of the distributee partner's entire interest in the partnership. However, section 751(b) applies only to the extent that a partner either receives section 751 property in exchange for his relinquishing any part of his interest in other property, or receives other property in exchange for his relinquishing any part of his interest in section 751 property.

(ii) Section 751(b) does not apply to a distribution to a partner which is not in exchange for his interest in other partnership property. Thus, section 751(b) does not apply to the extent that a distribution consists of the distributee partner's share of section 751 property or his share of other property. Similarly, section 751(b) does not apply to current drawings or to advances against the partner's distributive share, or to a distribution which is, in fact, a gift or payment for services or for the use of capital. In determining whether a partner has received only his share of either section 751 property or of other property, his interest in such property remaining in the partnership immediately after a distribution must be taken into account. For example, the section 751 property in partnership ABC has a fair market value of $100,000 in which partner A has an interest of 30 percent, or $30,000. If A receives $20,000 of section 751 property in a distribution, and continues to have a 30-percent interest in the $80,000 of section 751 property remaining in the partnership after the distribution, only $6,000 ($30,000 minus $24,000 (30 percent of $80,000)) of the section 751 property received by him will be considered to be his share of such property. The remaining $14,000 ($20,000 minus $6,000) received is in excess of his share.

(iii) If a distribution is, in part, a distribution of the distributee partner's share of section 751 property, or of other property (including money) and, in part, a distribution in exchange of such properties, the distribution shall be divided for the purpose of applying section 751(b). The rules of section 751(b) shall first apply to the part of the distribution treated as a sale or exchange of such properties, and then the rules of sections 731 through 736 shall apply to the part of the distribution not treated as a sale or exchange. See paragraph (b)(4)(ii) of this section for treatment of payments under section 736(a).

(2) *Distribution of section 751 property (unrealized receivables or substantially appreciated inventory items).* (i) To the extent that a partner receives section 751 property in a distribution in exchange for any part of his interest in partnership property (including money) other than section 751 property, the transaction shall be treated as a sale or exchange of such properties between the distributee partner and the partnership (as constituted after the distribution).

(ii) At the time of the distribution, the partnership (as constituted after the distribution) realizes ordinary income or loss on the sale or exchange of the section 751 property. The amount of the income or loss to the partnership will be measured by the difference between the adjusted basis to the partnership of the section 751 property considered as sold to or exchanged with the partner, and the fair market value of the distributee partner's interest in other partnership property which he relinquished in the exchange. In computing the partners' distributive shares of such ordinary income or loss, the income or loss shall be allocated only to partners other than the distributee and separately taken into account under section 702(a)(8).

(iii) At the time of the distribution, the distributee partner realizes gain or loss measured by the difference between his adjusted basis for the property relinquished in the exchange (including any special basis adjustment which he may have) and the fair market value of the section 751 property received by him in exchange for his interest in other property which he has relinquished. The distributee's adjusted basis for the property relinquished is the basis such property would have had under section 732 (including subsection (d) thereof) if the distributee partner had received such property in a current distribution immediately before the actual distribution which is treated wholly or partly as a sale or exchange under section 751(b). The character of the gain or loss to the distributee partner shall be determined by the character of the property in which he relinquished his interest.

(3) *Distribution of partnership property other than section 751 property.* (i) To the extent that a partner receives a distribution of partnership property (including money) other than section 751 property in exchange for any part of his interest in section 751 property of the partnership, the distribution shall be treated as a sale or exchange of such properties between the distributee partner and the partnership (as constituted after the distribution).

(ii) At the time of the distribution, the partnership (as constituted after the distribution) realizes gain or loss on the sale or exchange of the property other than section 751 property. The amount of the gain to the partnership will be measured by the difference between the adjusted basis to the partnership of the distributed property considered as sold to or exchanged with the partner, and the fair market value of the distributee partner's interest in section 751 property which he relinquished in the exchange. The character of the gain or loss to the partnership is determined by the character of the distributed property treated as sold or exchanged by the partnership. In computing the partners' distributive shares of such gain or loss, the gain or loss shall be allocated only to partners other than the distributee and separately taken into account under section 702(a)(8).

(iii) At the time of the distribution, the distributee partner realizes ordinary income or loss on the sale or exchange of the section 751 property. The amount of the distributee partner's income or loss shall be measured by the difference between his adjusted basis for the section 751 property relinquished in the exchange (including any special basis adjustment which he may have), and the fair market value of other property (including money) received by him in exchange for his interest in the section 751 property which he has relinquished. The distributee partner's adjusted basis for the section 751 property relinquished is the basis such property would have had under section 732 (including subsection (d) thereof) if the distributee partner had received such property in a current distribution immediately before the actual distribution which is treated wholly or partly as a sale or exchange under section 751(b).

(4) *Exceptions.* (i) Section 751(b) does not apply to the distribution to a partner of property which the distributee partner contributed to the partnership. The distribution of such property is governed by the rules set forth in sections 731 through 736, relating to distributions by a partnership.

(ii) Section 751(b) does not apply to payments made to a retiring partner or to a deceased partner's successor in interest to the extent that, under section 736(a), such payments constitute a distributive share of partnership income or guaranteed payments. Payments to a retiring partner or to a deceased partner's successor in interest for his interest in unrealized receivables of the partnership in excess of their partnership basis, including any special basis adjustment for them to which such partner is entitled, constitute payments under section 736(a) and, therefore, are not subject to section 751(b). However, payments under section 736(b) which are considered as made in exchange for an interest in partnership property are subject to section 751(b) to the extent that they involve an exchange of substantially appreciated inventory items for other property. Thus, payments to a retiring partner or to a deceased partner's successor in interest under section 736 must first be divided between payments under section 736(a) and section 736(b). The section 736(b) payments must then be divided, if there is an exchange of substantially appreciated inventory items for other property, between the payments treated as a sale or exchange under section 751(b) and payments treated as a distribution under sections 731 through 736. See subparagraph (1)(iii) of this paragraph, and section 736 and § 1.736–1.

(5) *Statement required.* A partnership which distributes section 751 property to a partner in exchange for his interest in other partnership property, or which distributes other property in exchange for any part of the partner's interest in section 751 property, shall submit with its return for the year of the distribution a statement showing the computation of any income, gain, or loss to the partnership under the provisions of section 751(b) and this paragraph. The distributee partner shall submit with his return a statement showing the computation of any income, gain, or loss to him. Such statement shall contain information similar to that required under paragraph (a)(3) of this section.

(c) *Unrealized receivables.* (1) The term *unrealized receivables,* as used in subchapter K, chapter 1 of the Code, means any rights (contractual or otherwise) to payment for:

(i) Goods delivered or to be delivered (to the extent that such payment would be treated as received for property other than a capital asset), or

(ii) Services rendered or to be rendered,

to the extent that income arising from such rights to payment was not previously includible in income under the method of accounting employed by the partnership. Such rights must have arisen under contracts or agreements in existence at the time of sale or distribution, although the partnership may not be able to enforce payment until a later time. For example, the term includes trade accounts receivable of a cash method taxpayer, and rights to payment for work or goods begun but incomplete at the time of the sale or distribution.

(2) The basis for such unrealized receivables shall include all costs or expenses attributable thereto paid or accrued but not previously taken into account under the partnership method of accounting.

(3) In determining the amount of the sale price attributable to such unrealized receivables, or their value in a distribution treated as a sale or exchange, full account shall be taken not only of the estimated cost of completing performance of the contract or agreement, but also of the time between the sale or distribution and the time of payment.

(4)(i) With respect to any taxable year of a partnership ending after September 12, 1966 (but only in respect of expenditures paid or incurred after that date), the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from mining property defined in section 617(f)(2). With respect to each item of partnership mining property so defined, the potential gain is the amount that would be treated as gain to which section 617(d)(1) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the item were sold by the partnership at its fair market value.

(ii) With respect to sales, exchanges, or other dispositions after December 31, 1975, in any taxable year of a partnership ending after that date, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from stock in a DISC as described in section 992(a). With respect to stock in such a DISC, the potential gain is the amount that would be treated as gain to which section 995(c) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the stock were sold by the partnership at its fair market value.

(iii) With respect to any taxable year of a partnership beginning after December 31, 1962, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from section 1245 property. With respect to each item of partnership section 1245 property (as defined in section 1245(a)(3)), potential gain from section 1245 property is the amount that would be treated as gain to which section 1245(a)(1) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the item of section 1245 property were sold by the partnership at its fair market value. See § 1.1245–1(e)(1). For example, if a partnership would recognize under section 1245(a)(1) gain of $600 upon a sale of one item of section 1245 property and gain of $300 upon a sale of its only other item of such property, the potential section 1245 income of the partnership would be $900.

(iv) With respect to transfers after October 9, 1975, and to sales, exchanges, and distributions taking place after that date, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from stock in certain foreign corporations as described in section 1248. With respect to stock in such a foreign corporation, the potential gain is the amount that would be treated as gain to which section 1248(a) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the stock were sold by the partnership at its fair market value.

(v) With respect to any taxable year of a partnership ending after December 31, 1963, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from section 1250 property. With respect to each item of partnership section 1250 property (as defined in section 1250(c)), potential gain from section 1250 property is the amount that would be treated as gain to which section 1250(a) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the item of section 1250 property were sold by the partnership at its fair market value. See § 1.1250–1(f)(1).

(vi) With respect to any taxable year of a partnership beginning after December 31, 1969, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from farm recapture property as defined in section 1251(e)(1) (as in effect before enactment of the Tax Reform Act of 1984). With respect to each item of partnership farm recapture property so defined, the potential gain is the amount which would be treated as gain to which section 1251(c) (as in effect before enactment of the Tax Reform Act of 1984) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the item were sold by the partnership at its fair market value.

(vii) With respect to any taxable year of a partnership beginning after December 31, 1969, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from farm land as defined in section 1252(a)(2). With respect to each item of partnership farm land so defined, the potential gain is the amount that would be treated as gain to which section 1252(a)(1) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the item were sold by the partnership at its fair market value.

(viii) With respect to transactions which occur after December 31, 1976, in any taxable year of a partnership ending after that date, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain from franchises, trademarks, or trade names referred to in section 1253(a). With respect to each such item so referred to in section 1253(a), the potential gain is the amount that would be treated as gain to which section 1253(a) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the items were sold by the partnership at its fair market value.

(ix) With respect to any taxable year of a partnership ending after December 31, 1975, the term *unrealized receivables,* for purposes of this section and sections 731, 736, 741, and 751, also includes potential gain under section 1254(a) from natural resource recapture property as defined in § 1.1254–1(b)(2). With respect to each separate partnership natural resource recapture property so described, the potential gain is the amount that would be treated as gain to which section 1254(a) would apply if (at the time of the transaction described in section 731, 736, 741, or 751, as the case may be) the property were sold by the partnership at its fair market value.

(5) For purposes of subtitle A of the Internal Revenue Code, the basis of any potential gain described in paragraph (c)(4) of this section is zero.

(6)(i) If (at the time of any transaction referred to in paragraph (c)(4) of this section) a partnership holds property described in paragraph (c)(4) of this section and if—

(A) A partner had a special basis adjustment under section 743(b) in respect of the property;

(B) The basis under section 732 of the property if distributed to the partner would reflect a special basis adjustment under section 732(d); or

(C) On the date a partner acquired a partnership interest by way of a sale or exchange (or upon the death of another partner) the partnership owned the property and an election under section 754 was in effect with respect to the partnership, the partner's share of any potential gain described in paragraph (c)(4) of this section is determined under paragraph (c)(6)(ii) of this section.

(ii) The partner's share of the potential gain described in paragraph (c)(4) of this section in respect of the property to which this paragraph (c)(6)(ii) applies is that amount of gain that the partner would recognize under section 617(d)(1), 995(c), 1245(a), 1248(a), 1250(a), 1251(c) (as in effect before the Tax Reform Act of 1984), 1252(a), 1253(a), or 1254(a) (as the case may be) upon a sale of the property by the partnership, except that, for purposes of this paragraph (c)(6) the partner's share of such gain is determined in a manner that is consistent with the manner in which the partner's share of partnership property is determined; and the amount of a potential special basis adjustment under section 732(d) is treated as if it were the amount of a special basis adjustment under section 743(b). For example, in determining, for purposes of this paragraph (c)(6), the amount of gain that a partner would recognize under section 1245 upon a sale of partnership property, the items allocated under §1.1245–1(e)(3)(ii) are allocated to the partner in the same manner as the partner's share of partnership property is determined. See §1.1250–1(f) for rules similar to those contained in §1.1245–1(e)(3)(ii).

(d) *Inventory items which have substantially appreciated in value*—(1) *Substantial appreciation.* Partnership inventory items shall be considered to have appreciated substantially in value if, at the time of the sale or distribution, the total fair market value of all the inventory items of the partnership exceeds 120 percent of the aggregate adjusted basis for such property in the hands of the partnership (without regard to any special basis adjustment of any partner) and, in addition, exceeds 10 percent of the fair market value of all partnership property other than money. The terms ''inventory items which have appreciated substantially in value'' or ''substantially appreciated inventory items'' refer to the aggregate of all partnership inventory items. These terms do not refer to specific partnership inventory items or to specific groups of such items. For example, any distribution of inventory items by a partnership the inventory items of which as a whole are substantially appreciated in value shall be a distribution of substantially appreciated inventory items for the purposes of section 751(b), even though the specific inventory items distributed may not be appreciated in value. Similarly, if the aggregate of partnership inventory items are not substantially appreciated in value, a distribution of specific inventory items, the value of which is more than 120 percent of their adjusted basis, will not constitute a distribution of substantially appreciated inventory items. For the purpose of this paragraph, the ''fair market value'' of inventory items has the same meaning as ''market'' value in the regulations under section 471, relating to general rule for inventories.

(2) *Inventory items.* The term *inventory items* as used in subchapter K, chapter 1 of the Code, includes the following types of property:

(i) Stock in trade of the partnership, or other property of a kind which would properly be included in the inventory of the partnership if on hand at the close of the taxable year, or property held by the partnership primarily for sale to customers in the ordinary course of its trade or business. See section 1221(1).

(ii) Any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231. Thus, accounts receivable acquired in the ordinary course of business for services or from the sale of stock in trade constitute inventory items (see section 1221(4)), as do any unrealized receivables.

(iii) Any other property retained by the partnership which, if held by the partner selling his partnership interest or receiving a distribution described in section 751(b), would be considered property described in subdivision (i) or (ii) of this subparagraph. Property actually distributed to the partner does not come within the provisions of section 751(d)(2)(C) and this subdivision.

(e) *Section 751 property and other property.* For the purposes of this section, *section 751 property* means unrealized receivables or substantially appreciated inventory items, and *other property* means all property (including money) except section 751 property.

(f) *Effective date.* Section 751 applies to gain or loss to a seller, distributee, or partnership in the case of a sale, exchange, or distribution occurring after March 9, 1954. For the purpose of applying this paragraph in the case of a taxable year beginning before January 1, 1955, a partnership or a partner may elect to treat as applicable any other section of subchapter K, chapter 1 of the Code. Any such election shall be made by a statement submitted not later than the time prescribed by law for the filing of the return for such taxable year, or August 21, 1956, whichever date is later (but not later than 6 months after the time prescribed by law for the filing of the return for such year). See section 771(b)(3) and paragraph (b)(3) of § 1.771–1. See also section 771(c) and paragraph (c) of § 1.771–1. The rules contained in paragraphs (a)(2) and (a)(3) of this section apply to transfers of partnership interests that occur on or after December 15, 1999.

(g) *Examples.* Application of the provisions of section 751 may be illustrated by the following examples:

Example 1. (i)(A) A and B are equal partners in personal service partnership PRS. B transfers its interest in PRS to T for $15,000 when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	
	Adjusted basis	Fair market value
Cash	$3,000	$3,000
Loans Receivable	10,000	10,000
Capital Assets	7,000	5,000
Unrealized Receivables	0	14,000
Total	20,000	32,000

	Liabilities and Capital	
	Adjusted per books	Fair market value
Liabilities	$2,000	$2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
Total	20,000	32,000

(B) None of the assets owned by PRS is section 704(c) property, and the capital assets are nondepreciable. The total amount realized by B is $16,000, consisting of the cash received, $15,000, plus $1,000, B's share of the partnership liabilities assumed by T. See section 752. B's undivided half-interest in the partnership property includes a half-interest in the partnership's unrealized receivables items. B's basis for its partnership interest is $10,000 ($9,000, plus $1,000, B's share of partnership liabilities). If section 751(a) did not apply to the sale, B would recognize $6,000 of capital gain from the sale of the interest in PRS. However, section 751(a) does apply to the sale.

(ii) If PRS sold all of its section 751 property in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would have been allocated $7,000 of ordinary income from the sale of PRS's unrealized receivables. Therefore, B will recognize $7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($6,000) and the amount of ordinary income or loss determined under paragraph (a)(2) of this section ($7,000) is the transferor's capital gain or loss on the sale of its partnership interest. In this case, B will recognize a $1,000 capital loss.

Example 2. (a) *Facts.* Partnership ABC makes a distribution to partner C in liquidation of his entire one-third interest in the partnership. At the time of the distribution, the balance sheet of the partnership, which uses the accrual method of accounting, is as follows:

ASSETS

	Adjusted basis per books	Market value
Cash	$15,000	$15,000

ASSETS—Continued

	Adjusted basis per books	Market value
Accounts receivable	9,000	9,000
Inventory	21,000	30,000
Depreciable property	42,000	48,000
Land	9,000	9,000
Total	96,000	11,000

LIABILITIES AND CAPITAL

	Per books	Value
Current liabilities	$15,000	$15,000
Mortgage payable	21,000	21,000
Capital:		
A	20,000	25,000
B	20,000	25,000
C	20,000	25,000
Total	96,000	111,000

The distribution received by C consists of $10,000 cash and depreciable property with a fair market value of $15,000 and an adjusted basis to the partnership of $15,000.

(b) *Presence of section 751 property.* The partnership has no unrealized receivables, but the dual test provided in section 751(d)(1) must be applied to determine whether the inventory items of the partnership, in the aggregate, have appreciated substantially in value. The fair market value of all partnership inventory items, $39,000 (inventory $30,000, and accounts receivable $9,000), exceeds 120 percent of the $30,000 adjusted basis of such items to the partnership. The fair market value of the inventory items, $39,000, also exceeds 10 percent of the fair market value of all partnership property other than money (10 percent of $96,000 or $9,600). Therefore, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* Since C's entire partnership interest is to be liquidated, the provisions of section 736 are applicable. No part of the payment, however, is considered as a distributive share or as a guaranteed payment under section 736(a) because the entire payment is made for C's interest in partnership property. Therefore, the entire payment is for an interest in partnership property under section 736(b), and, to the extent applicable, subject to the rules of section 751. In the distribution, C received his share of cash ($5,000) and $15,000 in depreciable property ($1,000 less than his $16,000 share). In addition, he received other partnership property ($5,000 cash and $12,000 liabilities assumed, treated as money distributed under section 752(b)) in exchange for his interest in accounts receivable ($3,000), inventory ($10,000), land ($3,000), and the balance of his interest in depreciable property ($1,000). Section 751(b) applies only to the extent of the exchange of other property for section 751 property (*i.e.*, inventory items, which include trade accounts receivable). The section 751 property exchanged has a fair market value of $13,000 ($3,000 in accounts receivable and $10,000 in inventory). Thus, $13,000 of the total amount C received is considered as received for the sale of section 751 property.

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* C's share of the inventory items is treated as if he received them in a current distribution, and his basis for such items is $10,000 ($7,000 for inventory and $3,000 for accounts receivable) as determined under paragraph (b)(3)(iii) of this section. Then C is considered as having sold his share of inventory items to the partnership for $13,000. Thus, on the sale of his share of inventory items, C realizes $3,000 of ordinary income.

(2) *The part of the distribution not under section 751(b).* Section 751(b) does not apply to the balance of the distribution. Before the distribution, C's basis for his partnership interest was $32,000 ($20,000 plus $12,000, his share of partnership liabilities). See section 752(a). This basis is reduced by $10,000, the basis attributed to the section 751 property treated as distributed to C and sold by him to the partnership. Thus, C has a basis of $22,000 for the remainder of his partnership interest. The total distribution to C was $37,000 ($22,000 in cash and liabilities assumed, and $15,000 in depreciable property). Since C received no more than his share of the depreciable property, none of the depreciable property constitutes proceeds of the sale under section 751(b). C did receive more than his share of money. Therefore, the sale proceeds, treated separately in subparagraph (1) of this paragraph of this example, must consist of money and therefore must be deducted from the money distribution. Consequently, in liquidation of the balance of C's interest, he receives depreciable property and $9,000 in money ($22,000 less $13,000). Therefore, no gain or loss is recognized to C on the distribution. Under section 732(b), C's basis for the depreciable property is $13,000 (the remaining basis of his partnership interest, $22,000, reduced by $9,000, the money received in the distribution).

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* The partnership consisting of the remaining members has no ordinary income on the distribution since it did not give up any section 751 property in the exchange. Of the $22,000 money distributed (in cash and the assumption of C's share of liabilities), $13,000 was paid to acquire C's interest in inventory ($10,000 fair market value) and in accounts

receivable ($3,000). Since under section 751(b) the partnership is treated as buying these properties, it has a new cost basis for the inventory and accounts receivable acquired from C. Its basis for C's share of inventory and accounts receivable is $13,000, the amount which the partnership is considered as having paid C in the exchange. Since the partnership is treated as having distributed C's share of inventory and accounts receivable to him, the partnership must decrease its basis for inventory and accounts receivable ($30,000) by $10,000, the basis of C's share treated as distributed to him, and then increase the basis for inventory and accounts receivable by $13,000 to reflect the purchase prices of the items acquired. Thus, the basis of the partnership inventory is increased from $21,000 to $24,000 in the transaction. (Note that the basis of property acquired in a section 751(b) exchange is determined under section 1012 without regard to any elections of the partnership. See paragraph (e) of § 1.732–1.) Further, the partnership realizes no capital gain or loss on the portion of the distribution treated as a sale under section 751(b) since, to acquire C's interest in the inventory and accounts receivable, it gave up money and assumed C's share of liabilities.

(2) *The part of the distribution not under section 751(b).* In the remainder of the distribution to C which was not in exchange for C's interest in section 751 property, C received only other property as follows: $15,000 in depreciable property (with a basis to the partnership of $15,000) and $9,000 in money ($22,000 less $13,000 treated under subparagraph (1) of this paragraph of this example). Since this part of the distribution is not an exchange of section 751 property for other property, section 751(b) does not apply. Instead, the provisions which apply are sections 731 through 736, relating to distributions by a partnership. No gain or loss is recognized to the partnership on the distribution. (See section 731(b).) Further, the partnership makes no adjustment to the basis of remaining depreciable property unless an election under section 754 is in effect. (See section 734(a).) Thus, the basis of the depreciable property before the distribution, $42,000, is reduced by the basis of the depreciable property distributed, $15,000, leaving a basis for the depreciable property in the partnership of $27,000. However, if an election under section 754 is in effect, the partnership must make the adjustment required under section 734(b) as follows: Since the adjusted basis of the distributed property to the partnership had been $15,000, and is only $13,000 in C's hands (see paragraph (d)(2) of this example), the partnership will increase the basis of the depreciable property remaining in the partnership by $2,000 (the excess of the adjusted basis to the partnership of the distributed depreciable property immediately before the distribution over its basis to the distributee). Whether or not an election under section 754 is in effect, the basis for each of the remaining partner's partnership interests will be $38,000 ($20,000 original contribution, plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities each assumed).

(f) *Partnership trial balance.* A trial balance of the AB partnership after the distribution in liquidation of C's entire interest would reflect the results set forth in the schedule below. Column I shows the amounts to be reflected in the records if an election is in effect under section 754 with respect to an optional adjustment under section 734(b) to the basis of undistributed partnership property. Column II shows the amounts to be reflected in the records where an election under section 754 is not in effect. Note that in column II, the total bases for the partnership assets do not equal the total of the bases for the partnership interests.

Example 3. (a) *Facts.* Assume that the distribution to partner C in example 2 of this paragraph in liquidation of his entire interest in partnership ABC consists of $5,000 in cash and $20,000 worth of partnership inventory with a basis of $14,000.

	I		II	
	Sec.754, Election in effect		Sec.754, Election not in effect	
	Basis	Fair market value	Basis	Fair market value
Cash	$5,000	$5,000	$5,000	$5,000
Accounts receivable	9,000	9,000	9,000	9,000
Inventory	24,000	30,000	24,000	30,000
Depreciable property	29,000	33,000	27,000	33,000
Land	9,000	9,000	9,000	9,000
	76,000	86,000	74,000	86,000
Current liabilities	15,000	15,000	15,000	15,000
Mortgage	21,000	21,000	21,000	21,000
Capital:				
	20,000	25,000	20,000	25,000
	20,000	25,000	20,000	25,000
	76,000	86,000	76,000	86,000

(b) *Presence of section 751 property.* For the same reason as stated in paragraph (b) of example 2, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* In the distribution, C received his share of cash ($5,000) and his share of appreciated inventory items ($13,000). In addition, he received appreciated inventory with a fair market value of $7,000 (and with an adjusted basis to the partnership of $4,900) and $12,000 in money (liabilities assumed). C has relinquished his interest in $16,000 of depreciable property and $3,000 of land. Although C relinquished his interest in $3,000 of accounts receivable, such accounts receivable are inventory items and, therefore, that exchange was not an exchange of section 751 property for other property. Section 751(b) applies only to the extent of the exchange of other property for section 751 property (*i.e.*, depreciable property or land for inventory items). Assume that the partners agree that the $7,000 of inventory in excess of C's share was received by him in exchange for $7,000 of depreciable property.

(d) *Distributee partner's tax consequences.* C's tax consequence on the distributions are as follows:

(*1*) *The section 751(b) sale or exchange.* C is treated as if he had received his 7/16ths share of the depreciable property in a current distribution. His basis for that share is $6,125 (42,000/48,000 of $7,000), as determined under paragraph (b)(2)(iii) of this section. Then C is considered as having sold his 7/16ths share of depreciable property to the partnership for $7,000, realizing a gain of $875.

(*2*) *The part of the distribution not under section 751(b).* Section 751(b) does not apply to the balance of the distribution. Before the distribution, C's basis for his partnership interest was $32,000 ($20,000, plus $12,000, his share of partnership liabilities). See section 752(a). This basis is reduced by $6,125, the basis of property treated as distributed to C and sold by him to the partnership. Thus, C will have a basis of $25,875 for the remainder of his partnership interest. Of the $37,000 total distribution to C, $30,000 ($17,000 in money, including liabilities assumed, and $13,000 in inventory) is not within section 751(b). Under section 732(b), C's basis for the inventory with a fair market value of $13,000 (which had an adjusted basis to the partnership of $9,100) is limited to $8,875, the amount of the remaining basis for his partnership interest, $25,875, reduced by $17,000, the money received. Thus, C's total aggregate basis for the inventory received is $15,875 ($7,000 plus $8,875), and not its $14,000 basis in the hands of the partnership.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(*1*) *The section 751(b) sale or exchange.* The partnership consisting of the remaining members has $2,100 of ordinary income on the sale of the $7,000 of inventory which had a basis to the partnership of $4,900 (21,000/30,000 of $7,000). This $7,000 of inventory was paid to acquire 7/16ths of C's interest in the depreciable property. Since, under section 751(b), the partnership is treated as buying this property from C, it has a new cost basis for such property. Its basis for the depreciable property is $42,875 ($42,000 less $6,125, the basis of the 7/16ths share considered as distributed to C, plus $7,000, the partnership purchase price for this share).

(*2*) *The part of the distribution not under section 751 (b).* In the remainder of the distribution to C which was not a sale or exchange of section 751 property for other property, the partnership realizes no gain or loss. See section 731(b). Further, under section 734(a), the partnership makes no adjustment to the basis of the accounts receivable or the 9/16ths interest in depreciable property which C relinquished. However, if an election under section 754 is in effect, the partnership must make the adjustment required under section 734(b) since the adjusted basis to the partnership of the inventory distributed had been $9,100, and C's basis for such inventory after distribution is only $8,875. The basis of the inventory remaining in the partnership must be increased by $225. Whether or not an election under section 754 is in effect, the basis for each of the remaining partnership interests will be $39,050 ($20,000 original contribution, plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities now assumed, plus $1,050, each partner's share of ordinary income realized by the partnership upon that part of the distribution treated as a sale or exchange).

Example 4. (a) *Facts.* Assume the same facts as in example 3 of this paragraph, except that the partners did not identify the property which C relinquished in exchange for the $7,000 of inventory which he received in excess of his share.

(b) *Presence of section 751 property.* For the same reasons stated in paragraph (b) of example 2 of this paragraph, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* The analysis stated in paragraph (c) of example 3 of this paragraph is the same in this example, except that, in the absence of a specific agreement among the partners as to the properties exchanged, C will be presumed to have sold to the partnership a proportionate amount of each property in which he relinquished an interest. Thus, in the absence of an agreement, C has received $7,000 of inventory in exchange for his release of 7/19ths of the depreciable property and 7/19ths of the land. ($7,000, fair market value of property released, over $19,000, the sum of the fair market values of C's interest in the land and C's interest in the depreciable property.)

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(*1*) *The section 751(b) sale or exchange.* C is treated as if he had received his 7/19ths shares of the depreciable property and land in a current distribution. His basis for those shares is $6,263 (51,000/57,000 of $7,000, their fair market value), as determined under paragraph (b)(2)(iii) of this section. Then C is considered as having sold his 7/19ths shares of depreciable property and land to the partnership for $7,000, realizing a gain of $737.

(2) *The part of the distribution not under section 751(b).* Section 751(b) does not apply to the balance of the distribution. Before the distribution C's basis for his partnership interest was $32,000 ($20,000 plus $12,000, his share of partnership liabilities). See section 752(a). This basis is reduced by $6,263, the bases of C's shares of depreciable property and land treated as distributed to him and sold by him to the partnership. Thus, C will have a basis of $25,737 for the remainder of his partnership interest. Of the total $37,000 distributed to C, $30,000 ($17,000 in money, including liabilities assumed, and $13,000 in inventory) is not within section 751(b). Under section 732(b), C's basis for the inventory (with a fair market value of $13,000 and an adjusted basis to the partnership of $9,100) is limited to $8,737, the amount of the remaining basis for his partnership interest ($25,737 less $17,000, money received. Thus, C's total aggregate basis for the inventory he received is $15,737 ($7,000 plus $8,737), and not the $14,000 basis it had in the hands of the partnership.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* The partnership consisting of the remaining members has $2,100 of ordinary income on the sale of $7,000 of inventory which had a basis to the partnership of $4,900 (21,000/30,000 of $7,000). This $7,000 of inventory was paid to acquire 7/19ths of C's interest in the depreciable property and land. Since, under section 751(b), the partnership is treated as buying this property from C, it has a new cost basis for such property. The bases of the depreciable property and land would be $42,737 and $9,000, respectively. The basis for the depreciable property is computed as follows: The common partnership basis of $42,000 is reduced by the $5,158 basis (42,000/48,000 of $5,895) for C's 7/19ths interest constructively distributed and increased by $5,895 (16,000/19,000 of $7,000), the part of the purchase price allocated to the depreciable property. The basis of the land would be computed in the same way. The $9,000 original partnership basis is reduced by $1,105 basis ($9,000/9,000 of $1,105) of land constructively distributed to C, and increased by $1,105 (3,000/19,000 of $7,000), the portion of the purchase price allocated to the land.

(2) *The part of the distribution not under section 751(b).* In the remainder of the distribution to C which was not a sale or exchange of section 751 property for other property, the partnership realizes no gain or loss. See section 731(b). Further, under section 734(a), the partnership makes no adjustment to the basis of the accounts receivable or the 12/19ths interests in depreciable property and land which C relinquished. However, if an election under section 754 is in effect, the partnership must make the adjustment required under section 734(b) since the adjusted basis to the partnership of the inventory distributed had been $9,100 and C's basis for such inventory after the distribution is only $8,737. The basis of the inventory remaining in the partnership must be increased by the difference of $363. Whether or not an election under section 754 is in effect, the basis for each of the remaining partnership interests will be $39,050 ($20,000 original contribution plus $12,000, each partner's original share of the liabilities, plus $6,000, the share of C's liabilities assumed, plus $1,050, each partner's share of ordinary income realized by the partnership upon the part of the distribution treated as a sale or exchange).

Example 5. (a) *Facts.* Assume that partner C in example 2 of this paragraph agrees to reduce his interest in capital and profits from one-third to one-fifth for a current distribution consisting of $5,000 in cash, and $7,500 of accounts receivable with a basis to the partnership of $7,500. At the same time, the total liabilities of the partnership are not reduced. Therefore, after the distribution, C's share of the partnership liabilities has been reduced by $4,800 from $12,000 (1/3 of $36,000) to $7,200 (1/5 of $36,000).

(b) *Presence of section 751 property.* For the same reasons as stated in paragraph (b) of example 2 of this paragraph, the partnership inventory items have substantially appreciated in value.

(c) *The properties exchanged.* C's interest in the fair market value of the partnership properties before and after the distribution can be illustrated by the following table:

Item	C's interest Fair Market Value		C received		C relinquished
	One-third before	One-fifth after	Distribution of share	In excess of share	
Cash	$5,000	$2,000	$3,000	$2,000	
Liabilities assumed	(12,000)	(7,200)		4,800	
Inventory items:					
Accounts receivable	3,000	300	2,700	4,800	
Inventory	10,000	6,000			$4,000
Depreciable property	16,000	9,600			6,400
Land	3,000	1,800			1,200
Total	25,000	12,500	5,700	11,600	11,600

Although C relinquished his interest in $4,000 of inventory and received $4,800 of accounts receivable, both items constitute section 751 property and C has received only $800 of accounts receivable for $800 worth of depreciable property or for an $800 undivided interest in land. In the absence of an agreement identifying the properties exchanged, it is presumed C received $800 for proportionate shares of his interests in both depreciable property and land. To the extent that inventory was exchanged for accounts receivable, or to the extent cash was distributed for the release of C's interest in the balance of the depreciable property and land, the transaction does not fall within section 751(b) and is a current distribution under section 732(a). Thus, the remaining $6,700 of accounts receivable are received in a current distribution.

(d) *Distributee partner's tax consequences.* C's tax consequences on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* Assuming that the partners paid $800 worth of accounts receivable for $800 worth of depreciable property, C is treated as if he received the depreciable property in a current distribution, and his basis for the $800 worth of depreciable property is $700 (42,000/48,000 of $800, its fair market value), as determined under paragraph (b)(2)(iii) of this section. Then C is considered as having sold his $800 share of depreciable property to the partnership for $800. On the sale of the depreciable property, C realizes a gain of $100. If, on the other hand, the partners had agreed that C exchanged an $800 interest in the land for $800 worth of accounts receivable, C would realize no gain or loss, because under paragraph (b)(2)(iii) of this section his basis for the land sold would be $800. In the absence of an agreement, the basis for the depreciable property and land (which C is considered as having received in a current distribution and then sold back to the partnership) would be $716 (51,000/57,000 of $800). In that case, on the sale of the balance of the $800 share of depreciable property and land, C would realize $84 of gain ($800 less $716).

(2) *The part of the distribution not under section 751(b).* Section 751(b) does not apply to the balance of the distribution. Under section 731, C does not realize either gain or loss on the balance of the distribution. The adjustments to the basis of C's interest are illustrated in the following table:

	If accounts receivable received for depreciable property	If accounts receivable received for land	If there is no agreement
Original basis for C's interest	$32,000	$32,000	$32,000
Less basis of property distributed prior to sec. 751(b) sale or exchange	−700	−800	−716
	31,300	31,200	31,284
Less money received in distribution	−9,800	−9,800	−9,800
	21,500	21,400	21,484
Less basis of property received in a current distribution under sec. 732	−6,700	−6,700	−6,700
Resulting basis for C's interest	14,800	14,700	14,784

C's basis for the $1,500 worth of accounts receivable which he received in the distribution will be $7,500, composed of $800 for the portion purchased in the section 751(b) exchange, plus $6,700, the basis carried over under section 732(a) for the portion received in the current distribution.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* The partnership realizes no gain or loss in the section 751 sale or exchange because it had a basis of $800 for the accounts receivable for which it received $800 worth of other property. If the partnership agreed to purchase $800 worth of depreciable property, the partnership basis of depreciable property becomes $42,100 ($42,000 less $700 basis of property constructively distributed to C, plus $800, price of property purchased). If the partnership purchased land with the accounts receivable, there would be no change in the basis of the land to the partnership because the basis of land distributed was equal to its purchase price. If there were no agreement, the basis of the depreciable property and land would be $51,084 (depreciable property, $42,084 and land $9,000). The basis for the depreciable property is computed as follows: The common partnership basis of $42,000 is reduced by the $590 basis (42,000/48,000 of $674) for C's $674 interest constructively distributed, and increased by $674 (6,400/7,600 of $800), the part of the purchase price allocated to the depreciable property. The basis of the land would be computed in the same way. The $9,000 original partnership basis is reduced by $126 basis (9,000/9,000 of $126) of the land constructively distributed to C, and increased by $126 (1,200/7,600 of $800), the portion of the purchase price allocated to the land.

(2) *The part of the distribution not under section 751(b).* The partnership will realize no gain or loss in the balance of the distribution under section 731. Since the property in C's hands after the distribution will have the same basis it had in the partnership, the basis of partnership property remaining in the partnership after the distribution will not be adjusted (whether or not an election under 754 is in effect).

Example 6. (a) *Facts.* Partnership ABC distributes to partner C, in liquidation of his entire one-third interest in the partnership, a machine which is section 1245 property with a recomputed basis (as defined in section 1245(a)(2)) of $18,000. At the time of the distribution, the balance sheet of the partnership is as follows:

ASSETS

	Adjusted basis per books	Market value
Cash	$3,000	$3,000
Machine (section 1245 property)	9,000	15,000
Land	18,000	27,000
Total	30,000	45,000

LIABILITIES AND CAPITAL

	Per books	Value
Liabilities	$0	$0
Capital:		
A	10,000	15,000
B	10,000	15,000
C	10,000	15,000
Total	30,000	45,000

(b) *Presence of section 751 property.* The section 1245 property is an unrealized receivable of the partnership to the extent of the potential section 1245 income in respect of the property. Since the fair market value of the property ($15,000) is lower than its recomputed basis ($18,000), the excess of the fair market value over its adjusted basis ($9,000), or $6,000, is the potential section 1245 income of the partnership in respect of the property. The partnership has no other section 751 property.

(c) *The properties exchanged.* In the distribution C received his share of section 751 property (potential section 1245 income of $2,000, i.e., ⅓ of $6,000) and his share of section 1245 property (other than potential section 1245 income) with a fair market value of $3,000, i.e., ⅓ of ($15,000 minus $6,000), and an adjusted basis of $3,000, i.e., ⅓ of $9,000. In addition he received $4,000 of section 751 property (consisting of $4,000 ($6,000 minus $2,000) of potential section 1245 income) and section 1245 property (other than potential section 1245 income) with a fair market value of $6,000 ($9,000 minus $3,000) and an adjusted basis of $6,000 ($9,000 minus $3,000). C relinquished his interest in $1,000 of cash and $9,000 of land. Assume that the partners agree that the $4,000 of section 751 property in excess of C's share was received by him in exchange for $4,000 of land.

(d) *Distributee partner's tax consequences.* C's tax consequences on the distributions are as follows:

(1) *The section 751(b) sale or exchange.* C is treated as if he received in a current distribution 4/9ths of his share of the land with a basis of $2,667 (18,000/27,000 × $4,000). Then C is considered as having sold his 4/9ths share of the land to the partnership for $4,000, realizing a gain of $1,333. C's basis for the remainder of his partnership interest after the current distribution is $7,333, i.e., the basis of his partnership interest before the current distribution ($10,000) minus the basis of the land treated as distributed to him ($2,667).

(2) *The part of the distribution not under section 751(b).* Of the $15,000 total distribution to C, $11,000 ($2,000 of potential section 1245 income and $9,000 section 1245 property other than potential section 1245 income) is not within section 751(b). Under section 732(b) and (c), C's basis for his share of potential section 1245 income is zero (see paragraph (c)(5) of this section) and his basis for $9,000 of section 1245 property (other than potential section 1245 income) is $7,333, i.e., the amount of the remaining basis for his partnership interest ($7,333) reduced by the basis for his share of potential section 1245 income (zero). Thus C's total aggregate basis for the section 1245 property (fair market value of $15,000) distributed to him is $11,333 ($4,000 plus $7,333). For an illustration of the computation of his recomputed basis for the section 1245 property immediately after the distribution, see example 2 of paragraph (f)(3) of § 1.1245–4.

(e) *Partnership's tax consequences.* The tax consequences to the partnership on the distribution are as follows:

(1) *The section 751(b) sale or exchange.* Upon the sale of $4,000 potential section 1245 income, with a basis of zero, for 4/9ths of C's interest in the land, the partnership consisting of the remaining members has $4,000 ordinary income under sections 751(b) and 1245(a)(1). See section 1245(b)(3) and (6)(A). The partnership's new basis for the land is $19,333, i.e., $18,000, less the basis of the 4/9ths share considered as distributed to C ($2,667), plus the partnership purchase price for this share ($4,000).

(2) *The part of the distribution not under section 751(b).* The analysis under this subparagraph should be made in accordance with the

principles illustrated in paragraph (e)(2) of examples 3, 4, and 5 of this paragraph.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 6832, 30 FR 8575, July 7, 1965; T.D. 7084, 36 FR 268, Jan. 8, 1971; T.D. 8586, 60 FR 2500, Jan. 10, 1995; T.D. 8847, 64 FR 69915, Dec. 15, 1999; T.D. 9137, 69 FR 42559, July 16, 2004]

§ 1.752–0 Table of contents.

This section lists the major paragraphs that appear in §§ 1.752–1 through 1.752–7.