Puerto Rico, Reporting and recordkeeping requirements, Student aid, Virgin Islands.

24 CFR Part 954

Administrative practice and procedure, Grant programs-housing and community development, Grant programs-Indians, Indians, Low and moderate income housing, Manufactured homes, Rent subsidies, Reporting and recordkeeping requirements.

24 CFR Part 1003

Alaska, Community development block grants, Grant programs-housing and community development, Grant programs-Indians, Indians, Reporting and recordkeeping requirements.

Accordingly, for the reasons described in the preamble, HUD amends 24 CFR parts 20, 570, 954, and 1003 as follows:

PART 20—BOARD OF CONTRACT APPEALS

1. The authority citation for 24 CFR part 20 continues to read as follows:

Authority: 41 U.S.C. 601–613; 42 U.S.C. 3535(d).

2. Section 20. 3 is amended by revising paragraph (a) to read as follows:

§ 20.3 Organization and location of the Board.

(a) *Location.* The Board is located at 1707 H Street, NW., Eleventh Floor, Washington, DC 20006. Mail and non-postal delivery may be sent to the Board at this address. Mail also may be addressed to: Board of Contract Appeals, U.S. Department of Housing and Urban Development, Room 2131, 451 Seventh Street, SW., Washington, DC 20410–0001. The telephone number of the Board is (202) 254–0000. (This is not a toll-free number.) For learning or speech-impaired persons, this number may be accessed via TTY by contacting the Federal Information Relay Service at 1–800–877–8339. The facsimile number is (202) 254–0011.

* * * * *

PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS

3. The authority citation for 24 CFR part 570 continues to read as follows:

Authority: 42 U.S.C. 3535(d) and 5301–5320.

4. Section 570.489 is amended by revising paragraph (l) to read as follows:

§ 570.489 Program administrative requirements.

* * * * *

(l) *Debarment and suspension.* As required by 24 CFR part 24, each CDBG participant shall require participants in lower tier covered transactions to include a certification that neither it nor its principals are currently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in the covered transaction, in any proposal submitted in connection with the lower tier covered transactions. A participant may rely on the certification, unless it knows the certification is erroneous.

* * * * *

PART 954—INDIAN HOME PROGRAM

5. The authority citation for 24 CFR part 954 continues to read as follows:

Authority: 42 U.S.C. 3535(d) and 12701–12839.

6. Section 954.4 is amended by revising paragraph (i) to read as follows:

§ 954.4 Other Federal requirements.

* * * * *

(i) *Debarment and suspension.* As required by 24 CFR part 24, each grantee must require participants in lower tier covered transactions (e.g., sub-contractors) to include a certification that neither it nor its principals are currently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in the covered transaction, in any proposal submitted in connection with the lower tier covered transactions. A participant may rely on the certification unless it knows the certification is erroneous.

PART 1003—COMMUNITY DEVELOPMENT BLOCK GRANTS FOR INDIAN TRIBES AND ALASKA NATIVE VILLAGES

7. The authority citation for 24 CFR part 1003 continues to read as follows:

Authority: 42 U.S.C. 3535(d) and 5301 *et seq.*

8. Section 1003.608 is revised to read as follows:

§ 1003.608 Debarment and suspension.

As required by 24 CFR part 24, each grantee must require participants in lower tier covered transactions (e.g., contractors and sub-contractors) to include a certification that neither it nor its principals are currently debarred, suspended, proposed for debarment, declared ineligible, or voluntarily excluded from participation in the covered transaction, in any proposal submitted in connection with the lower tier covered transactions. A participant may rely on the certification, unless it knows the certification is erroneous.

Dated: March 22, 2002.

Aaron Santa Anna,

Assistant General Counsel for Regulations.

[FR Doc. 02–7544 Filed 3–28–02; 8:45 am]

BILLING CODE 4210–32–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8986]

RIN 1545–AX94

Determination of Basis of Partner's Interest; Special Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to special rules on determination of basis of a partner's interest under section 705 of the Internal Revenue Code. The final regulations are necessary to coordinate sections 705 and 1032.

DATES: *Effective Date:* These regulations are effective on March 29, 2002.

Applicability Date: These regulations are applicable with respect to sales or exchanges of stock occurring after December 6, 1999.

FOR FURTHER INFORMATION CONTACT: Barbara MacMillan or Rebekah A. Myers (202) 622–3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

In Rev. Rul. 99–57 (1999–2 C.B. 678), the IRS issued guidance with respect to the tax consequences for a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction. Under that ruling, section 1032 will protect a corporate partner from recognizing gain or loss (to the extent allocated to such partner) when the partnership exchanges stock of the corporate partner in a taxable transaction. The ruling also concludes that, under section 705, the corporate partner increases its basis in its partnership interest by an amount equal to its share of the gain resulting from the partnership's sale or exchange of the stock.

In situations where a corporation acquires an interest in a partnership that holds that corporation's stock, a section

754 election is not in effect with respect to the partnership for the taxable year in which the corporation acquires the partnership interest, and the partnership later sells or exchanges the stock, it may be inconsistent with the intent of sections 705 and 1032 to increase the basis of the corporation's partnership interest by the full amount of the gain that is not recognized.

For instance, assume that a corporation (A) purchases a 50 percent interest in a partnership for $100,000. The partnership's only asset is A stock with a basis of $100,000 and a value of $200,000. If the partnership had not made a section 754 election, then when the partnership disposes of the property for $200,000, A would be allocated $50,000 of gain. Under section 1032, the gain allocated to A would not be subject to tax. If A's basis in the partnership interest were increased to $150,000 under section 705(a)(1), A would recognize a corresponding $50,000 loss (or reduced gain) upon a subsequent sale of the partnership interest. In this situation, it would be inconsistent with the intent of sections 705 and 1032 to increase the basis of A's partnership interest for the gain that is not recognized. To do so would create a recognizable loss (or reduced gain) in a situation where no economic loss was incurred and no offsetting gain had previously been recognized.

Accordingly, in Notice 99–57 (1999–2 C.B. 692), the IRS announced that it intended to promulgate regulations under section 705 to address certain situations where a corporation acquires an interest in a partnership that holds stock in that corporation, and a section 754 election is not in effect with respect to the partnership for the taxable year in which the corporation acquired the interest. The IRS announced that rules regarding tiered-entity structures also would be included in the regulations. The IRS requested comments as to the appropriate scope of the regulations regarding other situations where the price paid for a partnership interest reflects built-in gain or accrued income items that will not be subject to tax, or built-in loss or accrued deductions that will be permanently denied, when allocated to the transferee partner, and the partnership has not made an election under section 754. No formal comments were received.

On January 3, 2001, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–106702–00, 2001–4 I.R.B. 424) under section 705 of the Internal Revenue Code (Code) in the **Federal Register** (66 FR 315). Only one commentator submitted written comments in response to the notice of proposed rulemaking, and no public hearing was requested or held. After consideration of the comment, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Revisions and Summary of Contents

1. Overview of Provisions

As discussed in Notice 99–57, these final regulations are being issued in order to prevent inappropriate increases or decreases in the adjusted basis of a corporate partner's interest in a partnership resulting from the partnership's disposition of the corporate partner's stock.

The final regulations set forth a detailed statement of the purpose for these regulations which is consistent with the discussion in Notice 99–57. The final regulations then provide a specific rule implementing this purpose in situations where a corporate partner holds a direct interest in a partnership that owns stock of the corporate partner. This rule applies where a corporation acquires an interest in a partnership that holds stock in that corporation (or the partnership subsequently acquires stock in that corporation in an exchanged basis transaction), the partnership does not have an election under section 754 in effect for the year in which the corporation acquires the interest, and the partnership later sells or exchanges the stock. In these situations, the increase (or decrease) in the corporation's adjusted basis in its partnership interest resulting from the sale or exchange of the stock equals the amount of gain (or loss) that the corporate partner would have recognized (absent the application of section 1032) if, for the taxable year in which the corporation acquired the interest, a section 754 election had been in effect.

The purpose of these final regulations cannot be avoided through the use of tiered partnerships or other arrangements. For example, the final regulations provide that if a corporation acquires an indirect interest in its own stock through a chain of two or more partnerships (either where the corporation acquires a direct interest in a partnership or where one of the partnerships in the chain acquires an interest in another partnership), and gain or loss from the sale or exchange of the stock is subsequently allocated to the corporation, then the bases of the interests in the partnerships included in the chain shall be adjusted in a manner that is consistent with the purpose of the final regulations. As stated above, the final regulations include a statement describing the purpose of these regulations which is intended to guide taxpayers in making basis adjustments in the tiered partnership context. In addition, the final regulations include two examples illustrating the basis adjustments that are required by the final regulations where a corporation acquires an indirect interest in its own stock through a chain of two or more partnerships.

2. The Secretary's Authority

The only comment received in response to the notice of proposed rulemaking discussed the Secretary's authority under section 705 to issue the regulations as proposed. Specifically, the comment suggested that the regulations could be challenged as inconsistent with the plain language of section 705. The comment acknowledged that the proposed regulations are a reasonable interpretation of section 705, but argued that the aggregate treatment of partnerships in the context of section 1032 provides a stronger basis for the Secretary's authority.

Accordingly, the final regulations clarify that the authority for the regulations includes both sections 705 and 1032. As explained in Rev. Rul. 99–57, the use of the aggregate theory of partnerships in the context of section 1032 is necessary to carry out the intent of that section. To reflect this application of the aggregate theory of partnerships and prevent any unintended benefit or detriment to the partners, appropriate adjustments under section 705 must be made to a corporate partner's outside basis. See H.R. Rep. No. 1337, 83d Cong., 2d Sess. 225 (1954); S. Rep. No. 1337, 83d Cong. 2d Sess. 384 (1954). Thus, the regulations provide the mechanical rules necessary to implement Congressional intent under both sections 705 and 1032.

3. Technical Correction Relating to Tiered Partnerships

The comment suggested technical changes to the proposed regulations to prevent taxpayers in tiered partnership situations from inappropriately allocating to the corporate partner a loss resulting from a sale of a lower-tier partnership (LTP) interest that is attributable to gain allocated to and recognized by the noncorporate partners upon the LTP's sale of the corporate partner's stock. The final regulations include modifications to prevent such inappropriate allocations.

4. De Minimis Rule

The comment suggested that an elective *de minimis* rule would be appropriate as a matter of administrative convenience. However, after considering the purpose of these regulations and issues of administrative burden and technical complexity, Treasury and the IRS have determined that a *de minimis* rule is unnecessary.

5. Scope of the Regulations

The comment suggested that the regulations provide guidance with respect to the issues addressed in Rev. Rul. 96–10 (1996–1 C.B. 138) (partners' bases in their partnership interests are increased to reflect gain from the sale of partnership property that is not recognized under sections 267(d) and 707(b)(1)) and Rev. Rul. 96–11 (1996–1 C.B. 140) (a charitable contribution of property by a partnership reduces each partner's basis in the partnership by the partner's share of the partnership's basis in the property contributed). Treasury and the IRS believe that these issues are beyond the scope of these regulations. Accordingly, this comment is not addressed in these regulations.

6. Other Developments

The notice of proposed rulemaking issued elsewhere in this issue of the **Federal Register** addresses remaining issues that Treasury and the IRS considered during the development of the final regulations. Specifically, the proposed regulations apply principles similar to those applied in the final regulations where a corporation's indirect interest in its own stock held through one or more partnerships increases as the result of a distribution of partnership property to another partner and the partnership does not have a section 754 election in effect at the time of the distribution. In addition, the proposed regulations clarify that references in the regulations to stock of a corporate partner include any position in stock of a corporate partner to which section 1032 applies. Certain minor, nonsubstantive changes were made to the final regulations to accommodate the eventual incorporation of the proposed regulations.

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 Barbara MacMillan 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 in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

1. The authority citation for part 1 is amended by adding a citation to read in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.705–2 also issued under 26 U.S.C. 705 and 1032. * * *

2. Section 1.705–1 is amended by adding paragraph (a)(7) to read as follows:

§ 1.705–1 Determination of basis of partner's interest.

(a) * * *

(7) For basis adjustments necessary to coordinate sections 705 and 1032 in certain situations in which a partnership disposes of stock of a corporation that holds a direct or indirect interest in the partnership, see § 1.705–2.

* * * * *

3. Section 1.705–2 is added to read as follows:

§ 1.705–2 Basis adjustments coordinating sections 705 and 1032.

(a) *Purpose.* This section coordinates the application of sections 705 and 1032 and is intended to prevent inappropriate increases or decreases in the adjusted basis of a corporate partner's interest in a partnership resulting from the partnership's disposition of the corporate partner's stock. The rules under section 705 generally are intended to preserve equality between the adjusted basis of a partner's interest in a partnership (outside basis) and such partner's share of the adjusted basis in partnership assets (inside basis). However, in situations where a section 754 election was not in effect for the year in which a partner acquired its interest, the partner's inside basis and outside basis may not be equal. In these situations, gain or loss allocated to the partner upon disposition of the partnership assets that is attributable to the difference between the adjusted basis of the partnership assets absent the section 754 election and the adjusted basis of the partnership assets had a section 754 election been in effect generally will result in an adjustment to the basis of the partner's interest in the partnership under section 705(a). Such gain (or loss) therefore generally will be offset by a corresponding decrease in the gain or increase in the loss (or increase in the gain or decrease in the loss) upon the subsequent disposition by the partner of its interest in the partnership. Where such a difference exists with respect to stock of a corporate partner that is held by the partnership, gain or loss from the disposition of corporate partner stock attributable to the difference is not recognized by the corporate partner under section 1032. To adjust the basis of the corporate partner's interest in the partnership for this unrecognized gain or loss would not be appropriate because it would create an opportunity for the recognition of taxable gain or loss on a subsequent disposition of the partnership interest where no economic gain or loss has been incurred by the corporate partner and no corresponding taxable gain or loss had previously been allocated to the corporate partner by the partnership.

(b) *Single partnership*—(1) *Required adjustments relating to acquisitions of partnership interest.* (i) This paragraph (b)(1) applies in situations where a corporation acquires an interest in a partnership that holds stock in that corporation (or the partnership subsequently acquires stock in that corporation in an exchanged basis transaction), the partnership does not have an election under section 754 in effect for the year in which the corporation acquires the interest, and the partnership later sells or exchanges the stock. In these situations, the increase (or decrease) in the corporation's adjusted basis in its partnership interest resulting from the sale or exchange of the stock equals the amount of gain (or loss) that the corporate partner would have recognized (absent the application of section 1032) if, for the year in which the corporation acquired the interest, a section 754 election had been in effect.

(ii) The provisions of this paragraph (b)(1) are illustrated by the following example:

Example. (i) A, B, and C form equal partnership PRS. Each partner contributes $30,000 in exchange for its partnership interest. PRS has no liabilities. PRS purchases stock in corporation X for $30,000, which appreciates in value to $120,000. PRS also purchases inventory for $60,000, which appreciates in value to $150,000. A sells its interest in PRS to corporation X for $90,000 in a year for which an election under section 754 is not in effect. PRS later sells the X stock for $150,000. PRS realizes a gain of $120,000 on the sale of the X stock. X's share of the gain is $40,000. Under section 1032, X does not recognize its share of the gain.

(ii) Normally, X would be entitled to a $40,000 increase in the basis of its PRS interest for its allocable share of PRS's gain from the sale of the X stock, but a special rule applies in this situation. If a section 754 election had been in effect for the year in which X acquired its interest in PRS, X would have been entitled to a basis adjustment under section 743(b) of $60,000 (the excess of X's basis for the transferred partnership interest over X's share of the adjusted basis to PRS of PRS's property). See § 1.743–1(b). Under § 1.755–1(b), the basis adjustment under section 743(b) would have been allocated $30,000 to the X stock (the amount of the gain that would have been allocated to X from the hypothetical sale of the stock), and $30,000 to the inventory (the amount of the gain that would have been allocated to X from the hypothetical sale of the inventory).

(iii) If a section 754 election had been in effect for the year in which X acquired its interest in PRS, the amount of gain that X would have recognized upon PRS's disposition of X stock (absent the application of section 1032) would be $10,000 (X's share of PRS's gain from the stock sale, $40,000, minus the amount of X's basis adjustment under section 743(b), $30,000). See § 1.743–1(j). Accordingly, the increase in the basis of X's interest in PRS is $10,000.

(2) [Reserved]

(c) *Tiered partnerships and other arrangements*—(1) *Required adjustments.* The purpose of these regulations as set forth in paragraph (a) of this section cannot be avoided through the use of tiered partnerships or other arrangements. For example, if a corporation acquires an indirect interest in its own stock through a chain of two or more partnerships (either where the corporation acquires a direct interest in a partnership or where one of the partnerships in the chain acquires an interest in another partnership), and gain or loss from the sale or exchange of the stock is subsequently allocated to the corporation, then the bases of the interests in the partnerships included in the chain shall be adjusted in a manner that is consistent with the purpose of this section.

(2) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. Acquisition of upper-tier partnership interest by corporation. (i) A, B, and C form a partnership (UTP), with each partner contributing $25,000. UTP and D form a partnership (LTP). UTP contributes $75,000 in exchange for its interest in LTP, and D contributes $25,000 in exchange for D's interest in LTP. Neither UTP nor LTP has any liabilities. LTP purchases stock in corporation E for $100,000, which appreciates in value to $1,000,000. C sells its interest in UTP to corporation E for $250,000 in a year for which an election under section 754 is not in effect for UTP or LTP. LTP later sells the E stock for $2,000,000. LTP realizes a $1,900,000 gain on the sale of the E stock. UTP's share of the gain is $1,425,000, and E's share of the gain is $475,000. Under section 1032, E does not recognize its share of the gain.

(ii) With respect to the basis of UTP's interest in LTP, if all of the gain from the sale of the E stock (including E's share) were to increase the basis of UTP's interest in LTP, UTP's basis in such interest would be $1,500,000 ($75,000 + $1,425,000). The fair market value of UTP's interest in LTP is $1,500,000. Because UTP did not have a section 754 election in effect for the taxable year in which E acquired its interest in UTP, UTP's basis in the LTP interest does not reflect the purchase price paid by E for its interest. Increasing the basis of UTP's interest in LTP by the full amount of the gain that would be recognized (in the absence of section 1032) on the sale of the E stock preserves the conformity between UTP's inside basis and outside basis with respect to LTP (i.e., UTP's share of LTP's cash is equal to $1,500,000, and UTP's basis in the LTP interest is $1,500,000) and appropriately would cause UTP to recognize no gain or loss on the sale of UTP's interest in LTP immediately after the sale of the E stock. Accordingly, increasing the basis of UTP's interest in LTP by the entire amount of gain allocated to UTP (including E's share) from LTP's sale of the E stock is consistent with the purpose of this section. The $1,425,000 of gain allocated by LTP to UTP will increase the adjusted basis of UTP's interest in LTP under section 705(a)(1). The basis of UTP's interest in LTP immediately after the sale of the E stock is $1,500,000.

(iii) With respect to the basis of E's interest in UTP, if E's share of the gain allocated to UTP and then to E were to increase the basis of E's interest in UTP, E's basis in such interest would be $725,000 ($250,000 + $475,000) and the fair market value of such interest would be $500,000, so that E would recognize a loss of $225,000 if E sold its interest in UTP immediately after LTP's disposition of the E stock. It would be inappropriate for E to recognize a taxable loss of $225,000 upon a disposition of its interest in UTP because E would not incur an economic loss in the transaction, and E did not recognize a taxable gain upon LTP's disposition of the E stock that appropriately would be offset by a taxable loss on the disposition of its interest in UTP. Accordingly, increasing E's basis in its UTP interest by the entire amount of gain allocated to E from the sale of the E stock is not consistent with the purpose of this section. (Conversely, because A and B were allocated taxable gain on the disposition of the E stock, it would be appropriate to increase A's and B's bases in their respective interests in UTP by the full amount of the gain allocated to them.)

(iv) The appropriate basis adjustment for E's interest in UTP upon the disposition of the E stock by LTP can be determined as the amount of gain that E would have recognized (in the absence of section 1032) upon the sale by LTP of the E stock if both UTP and LTP had made section 754 elections for the taxable year in which E acquired the interest in UTP. If section 754 elections had been in effect for UTP and LTP for the year in which E acquired E's interest in UTP, the following would occur. E would be entitled to a $225,000 positive basis adjustment under section 743(b) with respect to the property of UTP. The entire basis adjustment would be allocated to UTP's only asset, its interest in LTP. In addition, the sale of C's interest in UTP would be treated as a deemed sale of E's share of UTP's interest in LTP for purposes of sections 754 and 743. The deemed selling price of E's share of UTP's interest in LTP would be $250,000 (E's share of UTP's adjusted basis in LTP, $25,000, plus E's basis adjustment under section 743(b) with respect to the assets of UTP, $225,000). The deemed sale of E's share of UTP's interest in LTP would trigger a basis adjustment under section 743(b) of $225,000 with respect to the assets of LTP (the excess of E's share of UTP's adjusted basis in LTP, including E's basis adjustment ($225,000), $250,000, over E's share of the adjusted basis of LTP's property, $25,000). This $225,000 adjustment by LTP would be allocated to LTP's only asset, the E stock, and would be segregated and allocated solely to E. The amount of LTP's gain from the sale of the E stock (before considering section 743(b)) would be $1,900,000. E's share of this gain, $475,000, would be offset in part by the $225,000 basis adjustment under section 743(b), so that E would recognize gain equal to $250,000 in the absence of section 1032.

(v) If the basis of E's interest in UTP were increased by $250,000, the total basis of E's interest would equal $500,000. This would conform to E's share of UTP's basis in the LTP interest ($1,500,000 × 1/3 = $500,000) as well as E's indirect share of the cash held by LTP ((1/3 × 3/4) × $2,000,000 = $500,000). Such a basis adjustment does not create the opportunity for the recognition of an inappropriate loss by E on a subsequent disposition of E's interest in UTP and is consistent with the purpose of this section. Accordingly, under this paragraph (c), of the $475,000 gain allocated to E, only $250,000 will apply to increase the adjusted basis of E in UTP under section 705(a)(1). E's adjusted basis in its UTP interest following the sale of the E stock is $500,000.

Example 2. Acquisition of lower-tier partnership interest by upper-tier partnership. (i) A, corporation B, and C form an equal partnership (UTP), with each partner contributing $100,000. D, E, and F also form an equal partnership (LTP), with each partner contributing $30,000. LTP purchases stock in corporation B for $90,000, which appreciates in value to $900,000. LTP has no liabilities. UTP purchases D's interest in LTP for $300,000. LTP does not have an election under section 754 in effect for the taxable year of UTP's purchase. LTP later sells the B stock for $900,000. UTP's share of the gain is $270,000, and B's share of that gain is $90,000. Under section 1032, B does not recognize its share of the gain.

(ii) With respect to the basis of UTP's interest in LTP, if all of the gain from the sale of the B stock (including B's share) were to increase the basis of UTP's interest in LTP, UTP's basis in the LTP interest would be $570,000 ($300,000 + $270,000), and the fair market value of such interest would be $300,000, so that B would be allocated a loss of $90,000 (($570,000—$300,000) × 1/3) if UTP sold its interest in LTP immediately after LTP's disposition of the B stock. It would be inappropriate for B to recognize a taxable loss of $90,000 upon a disposition of UTP's interest in LTP. B would not incur an economic loss in the transaction, and B was not allocated a taxable gain upon LTP's disposition of the B stock that appropriately would be offset by a taxable loss on the disposition of UTP's interest in LTP. Accordingly, increasing UTP's basis in its LTP interest by the gain allocated to B from the sale of the B stock is not consistent with the purpose of this section. (Conversely, because E and F were allocated taxable gain on the disposition of the B stock, it would be appropriate to increase E's and F's bases in their respective interests in LTP by the full amount of such gain.)

(iii) The appropriate basis adjustment for UTP's interest in LTP upon the disposition of the B stock by LTP can be determined as the amount of gain that UTP would have recognized (in the absence of section 1032) upon the sale by LTP of the B stock if the portion of the gain allocated to UTP that subsequently is allocated to B were determined as if LTP had made an election under section 754 for the taxable year in which UTP acquired its interest in LTP. If a section 754 election had been in effect for LTP for the year in which UTP acquired its interest in LTP, then with respect to B, the following would occur. UTP would be entitled to a $90,000 positive basis adjustment under section 743(b), allocable to B, in the property of LTP. The entire basis adjustment would be allocated to LTP's only asset, its B stock. The amount of LTP's gain from the sale of the B stock (before considering section 743(b)) would be $810,000. UTP's share of this gain, $270,000, would be offset, in part, by the basis adjustment under section 743(b), so that UTP would recognize gain equal to $180,000.

(iv) If the basis of UTP's interest in LTP were increased by $180,000, the total basis of UTP's partnership interest would equal $480,000. This would conform to the sum of UTP's share of the cash held by LTP ((1/3 × $900,000 = $300,000) and the taxable gain recognized by A and C on the disposition of the B stock that appropriately may be offset on the disposition of their interests in UTP ($90,000 + $90,000 = $180,000). Such a basis adjustment does not inappropriately create the opportunity for the allocation of a loss to B on a subsequent disposition of UTP's interest in LTP and is consistent with the purpose of this section. Accordingly, of the $270,000 gain allocated to UTP, only $180,000 will apply to increase the adjusted basis of UTP in LTP under section 705(a)(1). Such $180,000 basis increase must be segregated and allocated $90,000 each to solely A and C. UTP's adjusted basis in its LTP interest following the sale of the B stock is $480,000.

(v) With respect to B's interest in UTP, if B's share of the gain allocated to UTP and then to B were to increase the basis of B's interest in UTP, B would have a UTP partnership interest with an adjusted basis of $190,000 ($100,000 + $90,000) and a value of $100,000, so that B would recognize a loss of $90,000 if B sold its interest in UTP immediately after LTP's disposition of the B stock. It would be inappropriate for B to recognize a taxable loss of $90,000 upon a disposition of its interest in UTP because B would not incur an economic loss in the transaction, and B did not recognize a taxable gain upon LTP's disposition of the B stock that appropriately would be offset by a taxable loss on the disposition of its interest in UTP. Accordingly, increasing B's basis in its UTP interest by the gain allocated to B from the sale of the B stock is not consistent with the purpose of this section. (Conversely, because A and C were allocated taxable gain on the disposition of the B stock that is a result of LTP not having a section 754 election in effect, it would be appropriate for A and C to recognize an offsetting taxable loss on the disposition of A's and C's interests in UTP. Accordingly, it would be appropriate to increase A's and C's bases in their respective interests in UTP by the amount of gain recognized by A and C.)

(vi) The appropriate basis adjustment for B's interest in UTP upon the disposition of the B stock by LTP can be determined as the amount of gain that B would have recognized (in the absence of section 1032) upon the sale by LTP of the B stock if the portion of the gain allocated to UTP that is subsequently allocated to B were determined as if LTP had made an election under section 754 for the taxable year in which UTP acquired its interest in LTP. If a section 754 election had been in effect for LTP for the year in which UTP acquired its interest in LTP, then with respect to B, the following would occur. UTP would be entitled to a basis adjustment under section 743(b) in the property of LTP of $90,000 with respect to B. The entire basis adjustment would be allocated to LTP's only asset, its B stock. The amount of LTP's gain from the sale of the B stock (before considering section 743(b)) would be $810,000. UTP's share of this gain, $270,000, would be offset, in part, by the $90,000 basis adjustment under section 743(b), so that UTP would recognize gain equal to $180,000. The $90,000 basis adjustment would completely offset the gain that otherwise would be allocated to B.

(vii) If no gain were allocated to B so that the basis of B's interest in UTP was not increased, the total basis of B's interest would equal $100,000. This would conform to B's share of UTP's basis in the LTP interest (($480,000—$180,000 (i.e., A's and C's share of the basis that should offset taxable gain recognized as a result of LTP's failure to have a section 754 election)) × 1/3 = $100,000) as well as B's indirect share of the cash held by LTP ((1/3 × 1/3) × $900,000 = $100,000). Such a basis adjustment does not create the opportunity for the recognition of an inappropriate loss by B on a subsequent disposition of B's interest in UTP and is consistent with the purpose of this section. Accordingly, under this paragraph (c), of the $90,000 gain allocated to B, none will apply to increase the adjusted basis of B in UTP under section 705(a)(1). B's adjusted basis in its UTP interest following the sale of the B stock is $100,000.

(viii) Immediately after LTP's disposition of the B stock, UTP sells its interest in LTP for $300,000. UTP's adjusted basis in its LTP interest is $480,000, $180,000 of which must be allocated $90,000 each to A and C. Accordingly, upon UTP's sale of its interest in LTP, UTP realizes $180,000 of loss, and A and C in turn each realize $90,000 of loss.

(d) [Reserved]

(e) *Effective date.* This section applies to gain or loss allocated with respect to sales or exchanges of stock occurring after December 6, 1999.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: March 14, 2002.

Mark Weinberger,

Assistant Secretary of the Treasury.

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DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 100

[CGD11–02–001]

RIN 2115–AE46

Special Local Regulations; San Diego Crew Classic

AGENCY: Coast Guard, DOT.

ACTION: Notice of implementation.

SUMMARY: This Notice announces the implementation of the regulations located at 33 CFR 100.1101 for the San Diego Crew Classic on April 6–7, 2002. These regulations will be effective on Mission Bay and are necessary to control vessel traffic in the regulated areas during the event to ensure the safety of participants and spectators.

EFFECTIVE DATES: This section is effective from 6:00 a.m. on April 6, 2002 until 6:00 p.m. on April 7, 2002.

FOR FURTHER INFORMATION CONTACT: Petty Officer Austin Murai, U. S. Coast