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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-160330-02]

RIN 1545-BB65

#### Section 704(c), Installment Obligations and Contributed Contracts

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations relating to the tax treatment of installment obligations and property acquired pursuant to a contract under sections 704(c) and 737. The proposed regulations affect partners and partnerships and provide guidance necessary to comply with the law.

**DATES:** Written and electronic comments and requests for a public hearing must be received no later than February 23, 2004.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-160330-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-160330-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at: [www.irs.gov/regs](http://www.irs.gov/regs).

**FOR FURTHER INFORMATION CONTACT:** Concerning the regulations, Christopher L. Trump, 202-622-3070; concerning submissions and the hearing, Robin Jones, 202-622-3521 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 704(c)(1)(A) provides that income, gain, loss or deduction with respect to property contributed to a partnership by a partner shall be shared among the partners so as to take into account the variation between the basis of the property to the partnership and its fair market value at the time of the contribution.

Under section 704(c)(1)(B) and the regulations thereunder, any partner that contributes section 704(c) property to a partnership must recognize gain or loss

on the distribution of such property to another partner within 7 years of its contribution. The amount of gain or loss recognized is the amount of gain or loss that would have been allocated to such partner under section 704(c)(1)(A) if the property had been sold by the partnership to the distributee partner for its fair market value at the time of the distribution.

Under section 737(a) and the regulations thereunder, any partner that contributes section 704(c) property to a partnership may recognize gain on a distribution of property (other than money) by the partnership to that partner. The amount of gain recognized is the lesser of: (1) The amount by which the fair market value of the distributed property exceeds the distributee partner's adjusted tax basis in the partner's partnership interest, or (2) the net precontribution gain of the partner. Section 737(b) defines the net precontribution gain of the partner as the net gain (if any) that would have been recognized by the distributee partner under section 704(c)(1)(B) if all property that (1) had been contributed to the partnership by the distributee partner within 7 years of the distribution and (2) is held by such partnership immediately before the distribution, had been distributed by such partnership to another partner.

For purposes of section 704(c)(1)(A) and (B) and section 737, if a partnership disposes of section 704(c) property in a nonrecognition transaction in which no gain or loss is recognized, the substituted basis property (within the meaning of section 7701(a)(42)) is treated as section 704(c) property with the same amount of built-in gain or loss as the section 704(c) property disposed of by the partnership. See §§ 1.704-3(a)(8), 1.704-4(d)(1), and 1.737-2(d)(3).

If a partnership disposes of property in an installment sale, income is taken into account under the installment method unless the partnership elects otherwise. See section 453. Upon the satisfaction of an installment obligation at other than its face value or the distribution, transmission, sale, or other disposition of an installment obligation, a taxpayer is generally required, under section 453B, to recognize gain or loss. Section 453B does not apply, however, on the disposition of an installment obligation in certain situations where the Internal Revenue Code (Code) otherwise provides for nonrecognition of gain or loss. For example, § 1.453-9(c)(2) provides that no gain or loss results under section 453(d) (now section 453B) in the case of a contribution to or distribution from a partnership under sections 721 or 731.

In addition, if a partnership acquires property pursuant to a contract such as an option, a forward contract, or a futures contract, the partnership may recognize no gain or loss on the acquisition of the property.

#### Explanation of Provisions

The proposed regulations amend § 1.704-3(a)(8) to clarify that, if a partnership disposes of section 704(c) property in exchange for an installment obligation, the installment obligation is treated as the section 704(c) property. The proposed regulations also clarify that, if a partner contributes a contract that is section 704(c) property to a partnership, and the partnership subsequently acquires property pursuant to that contract in a transaction in which less than all of the gain or loss is recognized, the acquired property is treated as the section 704(c) property for purposes of sections 704(c) and 737. For this purpose the term contract includes, but is not limited to, options, forward contracts, and futures contracts.

The proposed regulations amend § 1.704-4(d)(1) to provide that an installment obligation received by a partnership and property acquired pursuant to a contributed contract are treated as section 704(c) property for purposes of section 704(c)(1)(B) to the extent that the installment obligation or the acquired property is section 704(c) property under § 1.704-3(a)(8). As a result, if the installment obligation or property acquired pursuant to a contributed contract is distributed by a partnership to a partner other than the contributing partner within 7 years of the contribution, the contributing partner may recognize gain or loss under section 704(c)(1)(B). The proposed regulations include a similar rule under § 1.737-2(d)(3).

No inference is intended as to the treatment of these transactions under prior law.

#### Proposed Effective Date

These regulations are proposed to apply to installment obligations received by a partnership on or after November 24, 2003 in exchange for section 704(c) property and to property acquired on or after November 24, 2003 by a partnership pursuant to a contract that is section 704(c) property.

#### Special Analyses

It has been determined that this notice of proposed rulemaking 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 these 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 Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules, how they can be made easier to understand and the administrability of the rules in the proposed regulations. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the public hearing will be published in the **Federal Register**.

### Drafting Information

The principal author of these proposed regulations is Christopher L. Trump of the Office of Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from Treasury and the IRS participated in their development.

### List of Subjects in 26 CFR Part 1

Income taxes, reporting and recordkeeping requirements.

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

## PART 1—INCOME TAXES

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

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

**Par. 2.** Section 1.704–3 is amended as follows:

1. The paragraph heading for (a)(8) is revised.
2. The text of paragraph (a)(8) is redesignated as paragraph (a)(8)(i).
3. A paragraph heading for newly designated paragraph (a)(8)(i) is added.

4. The first sentence of newly designated paragraph (a)(8)(i) is amended by removing the language “in which no gain or loss is recognized”.

5. Paragraphs (a)(8)(ii) and (a)(8)(iii) are added.

6. Paragraph (f) is amended by:

- a. Amending the first sentence of paragraph (f) by removing the language “of paragraph (a)(11)” and adding “of paragraphs (a)(8)(ii), (a)(8)(ii) and (a)(11)” in its place.
- b. Adding two sentences at the end of paragraph (f).

The revisions and additions read as follows:

### § 1.704–3 Contributed property.

(a) \* \* \*

(8) *Special rules*—(i) *Disposition in a nonrecognition transaction.* \* \* \*

(ii) *Disposition in an installment sale.* If a partnership disposes of section 704(c) property in an installment sale as defined in section 453(b), the installment obligation received by the partnership is treated as the section 704(c) property with the same amount of built-in gain as the section 704(c) property disposed of by the partnership (with appropriate adjustments for any gain recognized on the installment sale). The allocation method for the installment obligation must be consistent with the allocation method chosen for the original property.

(iii) *Contributed contracts.* If a partner contributes to a partnership a contract that is section 704(c) property, and the partnership subsequently acquires property pursuant to that contract in a transaction in which less than all of the gain or loss is recognized, then the acquired property is treated as the section 704(c) property with the same amount of built-in gain or loss as the contract (with appropriate adjustments for any gain or loss recognized on the acquisition). For this purpose, the term contract includes, but is not limited to, options, forward contracts, and futures contracts. The allocation method for the acquired property must be consistent with the allocation method chosen for the contributed contract.

\* \* \* \* \*

(f) *Effective date.* \* \* \* Paragraph (a)(8)(ii) applies to installment obligations received by a partnership in exchange for section 704(c) property on or after November 24, 2003. Paragraph (a)(8)(iii) is effective for property acquired on or after November 24, 2003 by a partnership pursuant to a contract that is section 704(c) property.

**Par. 3.** Section 1.704–4 is amended as follows:

1. The paragraph heading for (d)(1) is revised.

2. The text of paragraph (d)(1) is redesignated as paragraph (d)(1)(i).

3. A paragraph heading for newly designated paragraph (d)(1)(i) is added.

4. Paragraphs (d)(1)(ii) and (d)(1)(iii) are added.

5. Revising paragraph (g).

The revisions and additions read as follows:

### § 1.704–4 Distribution of contributed property.

\* \* \* \* \*

(d) *Special rules*—(1) *Nonrecognition transactions, installment obligations and contributed contracts*— (i) *Nonrecognition transactions.* \* \* \*

(ii) *Installment obligations.* An installment obligation received by the partnership in an installment sale (as defined in section 453(b)) of section 704(c) property is treated as the section 704(c) property for purposes of section 704(c)(1)(B) and this section to the extent that the installment obligation received is treated as section 704(c) property under § 1.704–3(a)(8). See § 1.737–2(d)(3) for a similar rule in the context of section 737.

(iii) *Contributed contracts.* Property acquired by the partnership pursuant to a contract that is section 704(c) property is treated as the section 704(c) property for purposes of section 704(c)(1)(B) and this section, to the extent that the acquired property is treated as section 704(c) property under § 1.704–3(a)(8). See § 1.737–2(d)(3) for a similar rule in the context of section 737.

\* \* \* \* \*

(g) *Effective date.* This section applies to distributions by a partnership to a partner on or after January 9, 1995, except that paragraphs (d)(1)(i) and (ii) apply to distributions by a partnership to a partner on or after November 24, 2003.

**Par. 4.** Section 1.737–2 is amended as follows:

1. The paragraph heading for (d)(3) is revised.
2. The text of paragraph (d)(3) is redesignated (d)(3)(i).
3. A paragraph heading for newly designated (d)(3)(i) is added.
4. Paragraphs (d)(3)(ii) and (d)(3)(iii) are added.

### § 1.737–2 Exceptions and special rules.

\* \* \* \* \*

(d) \* \* \*

(3) *Nonrecognition transactions, installment sales and contributed contracts*—(i) *Nonrecognition transactions.* \* \* \*

(ii) *Installment sales.* An installment obligation received by the partnership in an installment sale (as defined in section 453(b)) of section 704(c)

property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the installment obligation received is treated as section 704(c) property under § 1.704-3(a)(8). See § 1.704-4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

(iii) *Contributed contracts.* Property acquired by a partnership pursuant to a contract that is section 704(c) property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the acquired property is treated as section 704(c) property under § 1.704-3(a)(8). See § 1.704-4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

\* \* \* \* \*

**Par. 5.** Section 1.737-5 is revised to read as follows:

**§ 1.737-5 Effective dates.**

Sections 1.737-1, 1.737-2, 1.737-3, and 1.737-4 apply to distributions by a partnership to a partner on or after January 9, 1995, except that § 1.737-2(d)(3)(ii) and (ii) apply to distributions by a partnership to a partner on or after November 24, 2003.

**Mark E. Matthews,**

*Deputy Commissioner of Services and Enforcement.*

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**ENVIRONMENTAL PROTECTION AGENCY**

**40 CFR Part 52**

[PA203-4217b; FRL-7588-2]

**Approval and Promulgation of Air Quality Implementation Plans; Pennsylvania; NO<sub>x</sub> RACT Determinations for Hercules Cement Company**

**AGENCY:** Environmental Protection Agency (EPA).

**ACTION:** Proposed rule.

**SUMMARY:** EPA proposes to approve the State Implementation Plan (SIP) revision submitted by the Commonwealth of Pennsylvania to establish and require reasonably available control technology (RACT) for Hercules Cement Company, a major source of nitrogen oxides (NO<sub>x</sub>) located in Northampton County, Pennsylvania. In the Final Rules section of this **Federal Register**, EPA is approving the Pennsylvania's SIP submittal as a direct final rule without prior proposal because the Agency views this as a

noncontroversial submittal and anticipates no adverse comments. A detailed rationale for the approval is set forth in the direct final rule. If no adverse comments are received in response to this action, no further activity is contemplated. If EPA receives adverse comments, the direct final rule will be withdrawn and all public comments received will be addressed in a subsequent final rule based on this proposed rule. EPA will not institute a second comment period. Any parties interested in commenting on this action should do so at this time.

**DATES:** Comments must be received in writing by December 24, 2003.

**ADDRESSES:** Comments may be submitted either by mail or electronically. Written comments should be mailed to Makeba Morris, Chief, Air Quality Planning Branch, Mailcode 3AP21, U.S. Environmental Protection Agency, Region III, 1650 Arch Street, Philadelphia, Pennsylvania 19103. Electronic comments should be sent either to [morris.makeba@epa.gov](mailto:morris.makeba@epa.gov) or to <http://www.regulations.gov>, which is an alternative method for submitting electronic comments to EPA. To submit comments, please follow the detailed instructions described in the **SUPPLEMENTARY INFORMATION** section.

Copies of the documents relevant to this action are available for public inspection during normal business hours at the Air Protection Division, U.S. Environmental Protection Agency, Region III, 1650 Arch Street, Philadelphia, Pennsylvania 19103; and Pennsylvania Department of Environmental Resources Bureau of Air Quality Control, P.O. Box 8468, 400 Market Street, Harrisburg, Pennsylvania 17105.

**FOR FURTHER INFORMATION CONTACT:** Rose Quinto at (215) 814-2182, or by e-mail at [quinto.rose@epa.gov](mailto:quinto.rose@epa.gov).

**SUPPLEMENTARY INFORMATION:** For further information, please see the information provided in the direct final action, Pennsylvania's Approval of NO<sub>x</sub> RACT Determinations for Hercules Cement Company, that is located in the "Rules and Regulations" section of this **Federal Register** publication.

You may submit comments either electronically or by mail. To ensure proper receipt by EPA, identify the appropriate rulemaking identification number PA203-4217 in the subject line on the first page of your comment. Please ensure that your comments are submitted within the specified comment period. Comments received after the close of the comment period will be marked "late." EPA is not required to consider these late comments.

1. *Electronically.* If you submit an electronic comment as prescribed below, EPA recommends that you include your name, mailing address, and an e-mail address or other contact information in the body of your comment. Also include this contact information on the outside of any disk or CD ROM you submit, and in any cover letter accompanying the disk or CD ROM. This ensures that you can be identified as the submitter of the comment and allows EPA to contact you in case EPA cannot read your comment due to technical difficulties or needs further information on the substance of your comment. EPA's policy is that EPA will not edit your comment, and any identifying or contact information provided in the body of a comment will be included as part of the comment that is placed in the official public docket. If EPA cannot read your comment due to technical difficulties and cannot contact you for clarification, EPA may not be able to consider your comment.

i. *E-mail.* Comments may be sent by electronic mail (e-mail) to [morris.makeba@epa.gov](mailto:morris.makeba@epa.gov), attention: PA203-4217. EPA's e-mail system is not an "anonymous access" system. If you send an e-mail comment directly without going through [Regulations.gov](http://www.regulations.gov), EPA's e-mail system automatically captures your e-mail address. E-mail addresses that are automatically captured by EPA's e-mail system are included as part of the comment that is placed in the official public docket.

ii. *Regulations.gov.* Your use of [Regulation.gov](http://www.regulations.gov) is an alternative method of submitting electronic comments to EPA. Go directly to <http://www.regulations.gov>, then select "Environmental Protection Agency" at the top of the page and use the "go" button. The list of current EPA actions available for comment will be listed. Please follow the online instructions for submitting comments. The system is an "anonymous access" system, which means EPA will not know your identity, e-mail address, or other contact information unless you provide it in the body of your comment.

iii. *Disk or CD ROM.* You may submit comments on a disk or CD ROM that you mail to the mailing address identified in the **ADDRESSES** section of this document. These electronic submissions will be accepted in WordPerfect, Word or ASCII file format. Avoid the use of special characters and any form of encryption.

2. *By Mail.* Written comments should be addressed to the EPA Regional office listed in the **ADDRESSES** section of this document.