

Subchapter K

Part I. Determination of Tax Liability

§ 701 Partners, not partnership, subject to tax.

A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

§ 702 Income and credits of partner.

(a) General rule.

In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

- (1) gains and losses from sales or exchanges of capital assets held for not more than 1 year,
- (2) gains and losses from sales or exchanges of capital assets held for more than 1 year,
- (3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),
- (4) charitable contributions (as defined in section 170(c)),
- (5) dividends with respect to which there is a deduction under part VIII of subchapter B,
- (6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,
- (7) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary, and
- (8) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

(b) Character of items constituting distributive share.

The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (7) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) Gross income of a partner.

In any case where it is necessary to determine the gross income of a partner for purposes of this title, such amount shall include his distributive share of the gross income of the partnership.

(d) Cross reference.

For rules relating to procedures for determining the tax treatment of partnership items see subchapter C of chapter 63 (section 6221 and following).

§ 703 Partnership computations.

(a) Income and deductions.

The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that—

- (1)** the items described in section 702(a) shall be separately stated, and
- (2)** the following deductions shall not be allowed to the partnership:
 - (A) the deductions for personal exemptions provided in section 151 ,
 - (B) the deduction for taxes provided in section 164(a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,
 - (C) the deduction for charitable contributions provided in section 170 ,
 - (D) the net operating loss deduction provided in section 172 ,
 - (E) the additional itemized deductions for individuals provided in part VII of subchapter B (sec. 211 and following), and
 - (F) the deduction for depletion under section 611 with respect to oil and gas wells.

(b) Elections of the partnership.

Any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that any election under—

- (1)** subsection (b)(5) or (c)(3) of section 108 (relating to income from discharge of indebtedness),
- (2)** section 617 (relating to deduction and recapture of certain mining exploration expenditures), or
- (3)** section 901 (relating to taxes of foreign countries and possessions of the United States),

shall be made by each partner separately.

§ 704 Partner's distributive share.

(a) Effect of partnership agreement.

A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by the partnership agreement.

(b) Determination of distributive share.

A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if—

(1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or

(2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

(c) Contributed property.

(1) In general.

Under regulations prescribed by the Secretary—

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

(B) if any property so contributed is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within 7 years of being contributed—

(i) the contributing partner shall be treated as recognizing gain or loss (as the case may be) from the sale of such property in an amount equal to the gain or loss which would have been allocated to such partner under subparagraph (A) by reason of the variation described in subparagraph (A) if the property had been sold at its fair market value at the time of the distribution,

(ii) the character of such gain or loss shall be determined by reference to the character of the gain or loss which would have resulted if such property had been sold by the partnership to the distributee, and

(iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under this subparagraph.

(2) Special rule for distributions where gain or loss would not be recognized outside partnerships.

Under regulations prescribed by the Secretary, if—

(A) property contributed by a partner (hereinafter referred to as the "contributing partner") is distributed by the partnership to another partner, and

(B) other property of a like kind (within the meaning of section 1031) is distributed by the partnership to the contributing partner not later than the earlier of—

(i) the 180th day after the date of the distribution described in subparagraph (A), or

(ii) the due date (determined with regard to extensions) for the contributing partner's return of the tax imposed by this chapter for the taxable year in which the distribution described in subparagraph (A) occurs,

then to the extent of the value of the property described in subparagraph (B), paragraph (1)(B) shall be applied as if the contributing partner had contributed to the partnership the property described in subparagraph (B) .

(3) Other rules.

Under regulations prescribed by the Secretary, rules similar to the rules of paragraph (1) shall apply to contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items. Any reference in paragraph (1) or (2) to the contributing partner shall be treated as including a reference to any successor of such partner.

(d) Limitation on allowance of losses.

A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

(e) Family partnerships.

(1) Recognition of interest created by purchase or gift.

A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) Distributive share of donee includible in gross income.

In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) Purchase of interest by member of family.

For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

(f) Cross reference.

For rules in the case of the sale, exchange, liquidation, or reduction of a partner's interest, see section 706(c)(2).

§ 705 Determination of basis of partner's interest.

(a) General rule.

The adjusted basis of a partner's interest in a partnership shall, except as provided in subsection (b) , be the basis of such interest determined under section 722 (relating to contributions to a partnership) or section 742 (relating to transfers of partnership interests)—

(1) increased by the sum of his distributive share for the taxable year and prior taxable years of—

(A) taxable income of the partnership as determined under section 703(a) ,

(B) income of the partnership exempt from tax under this title, and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion;

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of—

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account; and

(3) decreased (but not below zero) by the amount of the partner's deduction for depletion for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D) .

(b) Alternative rule.

The Secretary shall prescribe by regulations the circumstances under which the adjusted basis of a partner's interest in a partnership may be determined by reference to his proportionate share of the adjusted basis of partnership property upon a termination of the partnership.

§ 706 Taxable years of partner and partnership.

(a) Year in which partnership income is includible.

In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

(b) Taxable year.

(1) Partnership's taxable year.

(A) Partnership treated as taxpayer. The taxable year of a partnership shall be determined as though the partnership were a taxpayer.

(B) Taxable year determined by reference to partners. Except as provided in subparagraph (C), a partnership shall not have a taxable year other than—

(i) the majority interest taxable year (as defined in paragraph (4)),

(ii) if there is no taxable year described in clause (i) , the taxable year of all the principal partners of the partnership, or

(iii) if there is no taxable year described in clause (i) or (ii) , the calendar year unless the Secretary by regulations prescribes another period.

(C) Business purpose. A partnership may have a taxable year not described in subparagraph (B) if it establishes, to the satisfaction of the Secretary, a business purpose therefor. For purposes of this subparagraph, any deferral of income to partners shall not be treated as a business purpose.

(2) Partner's taxable year.

A partner may not change to a taxable year other than that of a partnership in which he is a principal partner unless he establishes, to the satisfaction of the Secretary, a business purpose therefor.

(3) Principal partner.

For the purpose of this subsection, a principal partner is a partner having an interest of 5 percent or more in partnership profits or capital.

(4) Majority interest taxable year; limitation on required changes.

(A) Majority interest taxable year defined. For purposes of paragraph (1)(B)(i) —

(i) In general. The term "majority interest taxable year" means the taxable year (if any) which, on each testing day, constituted the taxable year of 1 or more partners having (on such day) an aggregate interest in partnership profits and capital of more than 50 percent.

(ii) Testing days. The testing days shall be—

(I) the 1st day of the partnership taxable year (determined without regard to clause (i)), or

(II) the days during such representative period as the Secretary may prescribe.

(B) Further change not required for 3 years. Except as provided in regulations necessary to prevent the avoidance of this section, if, by reason of paragraph (1)(B)(i), the taxable year of a partnership is changed, such partnership shall not be required to change to another taxable year for either of the 2 taxable years following the year of change.

(5) Application with other sections.

Except as provided in regulations, for purposes of determining the taxable year to which a partnership is required to change by reason of this subsection, changes in taxable years of other persons required by this subsection, section 441(i), section 584(h), section 644, or section 1378(a) shall be taken into account.

(c) Closing of partnership year.

(1) General rule.

Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Treatment of dispositions.

(A) Disposition of entire interest. The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise).

(B) Disposition of less than entire interest. The taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under subsection (b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced (whether by entry of a new partner, partial liquidation of a partner's interest, gift, or otherwise).

(d) Determination of distributive share when partner's interest changes.

(1) In general.

Except as provided in paragraphs (2) and (3), if during any taxable year of the partnership there is a change in any partner's interest in the partnership, each partner's distributive share of any item of income, gain, loss, deduction, or credit of the partnership for such taxable year shall be determined by the use of any method prescribed by the Secretary by regulations which takes into account the varying interests of the partners in the partnership during such taxable year.

(2) Certain cash basis items prorated over period to which attributable.

(A) In general. If during any taxable year of the partnership there is a change in any partner's interest in the partnership, then (except to the extent provided in regulations) each partner's distributive share of any allocable cash basis item shall be determined—

(i) by assigning the appropriate portion of such item to each day in the period to which it is attributable, and

(ii) by allocating the portion assigned to any such day among the partners in proportion to their interests in the partnership at the close of such day.

(B) Allocable cash basis item. For purposes of this paragraph, the term "allocable cash basis item" means any of the following items with respect to which the partnership uses the cash receipts and disbursements method of accounting:

(i) Interest.

(ii) Taxes.

(iii) Payments for services or for the use of property.

(iv) Any other item of a kind specified in regulations prescribed by the Secretary as being an item with respect to which the application of this paragraph is appropriate to avoid significant misstatements of the income of the partners.

(C) Items attributable to periods not within taxable year. If any portion of any allocable cash basis item is attributable to—

(i) any period before the beginning of the taxable year, such portion shall be assigned under subparagraph (A)(i) to the first day of the taxable year, or

(ii) any period after the close of the taxable year, such portion shall be assigned under subparagraph (A)(i) to the last day of the taxable year.

(D) Treatment of deductible items attributable to prior periods. If any portion of a deductible cash basis item is assigned under subparagraph (C)(i) to the first day of any taxable year—

(i) such portion shall be allocated among persons who are partners in the partnership during the period to which such portion is attributable in accordance with their varying interests in the partnership during such period, and

(ii) any amount allocated under clause (i) to a person who is not a partner in the partnership on such first day shall be capitalized by the partnership and treated in the manner provided for in section 755.

(3) Items attributable to interest in lower tier partnership prorated over entire taxable year.

If—

(A) during any taxable year of the partnership there is a change in any partner's interest in the partnership (hereinafter in this paragraph referred to as the "upper tier partnership"), and

(B) such partnership is a partner in another partnership (hereinafter in this paragraph referred to as the "lower tier partnership"),

then (except to the extent provided in regulations) each partner's distributive share of any item of the upper tier partnership attributable to the lower tier partnership shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of subparagraphs (C) and (D) of paragraph (2)) of each such item to the appropriate days during

which the upper tier partnership is a partner in the lower tier partnership and by allocating the portion assigned to any such day among the partners in proportion to their interests in the upper tier partnership at the close of such day.

(4) Taxable year determined without regard to subsection (c)(2)(A) .

For purposes of this subsection, the taxable year of a partnership shall be determined without regard to subsection (c)(2)(A) .

§ 707 Transactions between partner and partnership.

(a) Partner not acting in capacity as partner.

(1) In general.

If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

(2) Treatment of payments to partners for property or services.

Under regulations prescribed by the Secretary—

(A) Treatment of certain services and transfers of property. If—

(i) a partner performs services for a partnership or transfers property to a partnership,

(ii) there is a related direct or indirect allocation and distribution to such partner, and

(iii) the performance of such services (or such transfer) and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership,

such allocation and distribution shall be treated as a transaction described in paragraph (1).

(B) Treatment of certain property transfers. If—

(i) there is a direct or indirect transfer of money or other property by a partner to a partnership,

(ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and

(iii) the transfers described in clauses (i) and (ii) , when viewed together, are properly characterized as a sale or exchange of property,

such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership.

(b) Certain sales or exchanges of property with respect to controlled partnerships.

(1) Losses disallowed.

No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between—

(A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1) . For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b) .

(2) Gains treated as ordinary income.

In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221—

(A) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits interests,

any gain recognized shall be considered as ordinary income.

(3) Ownership of a capital or profits interest.

For purposes of paragraphs (1) and (2) of this subsection , the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section .

(c) Guaranteed payments.

To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses).

§ 708 Continuation of partnership.

(a) General rule.

For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated.

(b) Termination.

(1) General rule.

For purposes of subsection (a), a partnership shall be considered as terminated only if—

(A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or

(B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

(2) Special rules.

(A) Merger or consolidation. In the case of the merger or consolidation of two or more partnerships, the resulting partnership shall, for purposes of this section, be considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership.

(B) Division of a partnership. In the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) shall, for purposes of this section, be considered a continuation of the prior partnership.

§ 709 Treatment of organization and syndication fees.

(a) General rule.

Except as provided in subsection (b), no deduction shall be allowed under this chapter to the partnership or to any partner for any amounts paid or incurred to organize a partnership or to promote the sale of (or to sell) an interest in such partnership.

(b) Amortization of organization fees.

(1) Deduction.

Amounts paid or incurred to organize a partnership may, at the election of the partnership (made in accordance with regulations prescribed by the Secretary), be treated as deferred expenses. Such deferred expenses shall be allowed as a deduction ratably over such period of not less than 60 months as may be selected by the partnership (beginning with the month in which the partnership begins business), or if the partnership is liquidated before the end of such 60-month period, such deferred expenses (to the extent not deducted under this section) may be deducted to the extent provided in section 165.

(2) Organizational expenses defined.

The organizational expenses to which paragraph (1) applies, are expenditures which—

(A) are incident to the creation of the partnership;

(B) are chargeable to capital account; and

(C) are of a character which, if expended incident to the creation of a partnership having an ascertainable life, would be amortized over such life.

Part II. Contributions, Distributions, and Transfers

Subpart A. Contributions to a partnership

§ 721 Nonrecognition of gain or loss on contribution.

(a) General rule.

No gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

(b) Special rule.

Subsection (a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated.

(c) Regulations relating to certain transfers to partnerships.

The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, will be includible in the gross income of a person other than a United States person.

(d) Transfers of intangibles.

For regulatory authority to treat intangibles transferred to a partnership as sold, see section 367(d)(3) .

§ 722 Basis of contributing partner's interest.

The basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

§ 723 Basis of property contributed to partnership.

The basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

§ 724 Character of gain or loss on contributed unrealized receivables, inventory items, and capital loss property.

(a) Contributions of unrealized receivables.

In the case of any property which—

(1) was contributed to the partnership by a partner, and

(2) was an unrealized receivable in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property shall be treated as ordinary income or ordinary loss, as the case may be.

(b) Contributions of inventory items.

In the case of any property which—

(1) was contributed to the partnership by a partner, and

(2) was an inventory item in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as ordinary income or ordinary loss, as the case may be.

(c) Contributions of capital loss property.

In the case of any property which—

(1) was contributed by a partner to the partnership, and

(2) was a capital asset in the hands of such partner immediately before such contribution,

any loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as a loss from the sale of a capital asset to the extent that, immediately before such contribution, the adjusted basis of such property in the hands of the partner exceeded the fair market value of such property.

(d) Definitions.

For purposes of this section—

(1) Unrealized receivable.

The term "unrealized receivable" has the meaning given such term by section 751(c) (determined by treating any reference to the partnership as referring to the partner).

(2) Inventory item.

The term "inventory item" has the meaning given such term by section 751(d) determined by treating any reference to the partnership as referring to the partner and by applying section 1231 without regard to any holding period therein provided).

(3) Substituted basis property.

(A) In general. If any property described in subsection (a) , (b) , or (c) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any

substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of non-recognition transactions.

(B) Exception for stock in C corporation. Subparagraph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351.

Subpart B. Distributions by a partnership

§ 731 Extent of recognition of gain or loss on distribution.

(a) Partners.

In the case of a distribution by a partnership to a partner—

(1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution, and

(2) loss shall not be recognized to such partner, except that upon a distribution in liquidation of a partner's interest in a partnership where no property other than that described in subparagraph (A) or (B) is distributed to such partner, loss shall be recognized to the extent of the excess of the adjusted basis of such partner's interest in the partnership over the sum of—

(A) any money distributed, and

(B) the basis to the distributee, as determined under section 732, of any unrealized receivables (as defined in section 751(c)) and inventory (as defined in section 751(d)).

Any gain or loss recognized under this subsection shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner.

(b) Partnerships.

No gain or loss shall be recognized to a partnership on a distribution to a partner of property, including money.

(c) Treatment of marketable securities.

(1) In general.

For purposes of subsection (a)(1) and section 737 —

(A) the term "money" includes marketable securities, and

(B) such securities shall be taken into account at their fair market value as of the date of the distribution.

(2) Marketable securities.

For purposes of this subsection:

(A) In general. The term "marketable securities" means financial instruments and foreign currencies which are, as of the date of the distribution, actively traded (within the meaning of section 1092(d)(1)).

(B) Other property. Such term includes—

(i) any interest in—

(I) a common trust fund, or

(II) a regulated investment company which is offering for sale or has outstanding any redeemable security (as defined in section 2(a)(32) of the Investment Company Act of 1940) of which it is the issuer,

(ii) any financial instrument which, pursuant to its terms or any other arrangement, is readily convertible into, or exchangeable for, money or marketable securities,

(iii) any financial instrument the value of which is determined substantially by reference to marketable securities,

(iv) except to the extent provided in regulations prescribed by the Secretary, any interest in a precious metal which, as of the date of the distribution, is actively traded (within the meaning of section 1092(d)(1)) unless such metal was produced, used, or held in the active conduct of a trade or business by the partnership,

(v) except as otherwise provided in regulations prescribed by the Secretary, interests in any entity if substantially all of the assets of such entity consist (directly or indirectly) of marketable securities, money, or both, and

(vi) to the extent provided in regulations prescribed by the Secretary, any interest in an entity not described in clause (v) but only to the extent of the value of such interest which is attributable to marketable securities, money, or both.

(C) Financial instrument. The term "financial instrument" includes stocks and other equity interests, evidences of indebtedness, options, forward or futures contracts, notional principal contracts, and derivatives.

(3) Exceptions.

(A) In general. Paragraph (1) shall not apply to the distribution from a partnership of a marketable security to a partner if—

(i) the security was contributed to the partnership by such partner, except to the extent that the value of the distributed security is attributable to marketable securities or money contributed (directly or indirectly) to the entity to which the distributed security relates,

(ii) to the extent provided in regulations prescribed by the Secretary, the property was not a marketable security when acquired by such partnership, or

(iii) such partnership is an investment partnership and such partner is an eligible partner thereof.

(B) Limitation on gain recognized. In the case of a distribution of marketable securities to a partner, the amount taken into account under paragraph (1) shall be reduced (but not below zero) by the excess (if any) of—

(i) such partner's distributive share of the net gain which would be recognized if all of the marketable securities of the same class and issuer as the distributed securities held by the partnership were sold (immediately before the transaction to which the distribution relates) by the partnership for fair market value, over

(ii) such partner's distributive share of the net gain which is attributable to the marketable securities of the same class and issuer as the distributed securities held by the partnership

immediately after the transaction, determined by using the same fair market value as used under clause (i) .

Under regulations prescribed by the Secretary, all marketable securities held by the partnership may be treated as marketable securities of the same class and issuer as the distributed securities.

(C) Definitions relating to investment partnerships. For purposes of subparagraph (A)(iii) :

(i) Investment partnership. The term "investment partnership" means any partnership which has never been engaged in a trade or business and substantially all of the assets (by value) of which have always consisted of—

(I) money,

(II) stock in a corporation,

(III) notes, bonds, debentures, or other evidences of indebtedness,

(IV) interest rate, currency, or equity notional principal contracts,

(V) foreign currencies,

(VI) interests in or derivative financial instruments (including options, forward or futures contracts, short positions, and similar financial instruments) in any asset described in any other subclause of this clause or in any commodity traded on or subject to the rules of a board of trade or commodity exchange,

(VII) other assets specified in regulations prescribed by the Secretary, or

(VIII) any combination of the foregoing.

(ii) Exception for certain activities. A partnership shall not be treated as engaged in a trade or business by reason of—

(I) any activity undertaken as an investor, trader, or dealer in any asset described in clause (i), or

(II) any other activity specified in regulations prescribed by the Secretary.

(iii) Eligible partner.

(I) In general. The term "eligible partner" means any partner who, before the date of the distribution, did not contribute to the partnership any property other than assets described in clause (i) .

(II) Exception for certain nonrecognition transactions. The term "eligible partner" shall not include the transferor or transferee in a nonrecognition transaction involving a transfer of any portion of an interest in a partnership with respect to which the transferor was not an eligible partner.

(iv) Look-thru of partnership tiers. Except as otherwise provided in regulations prescribed by the Secretary—

(I) a partnership shall be treated as engaged in any trade or business engaged in by, and as holding (instead of a partnership interest) a proportionate share of the assets of, any other partnership in which the partnership holds a partnership interest, and

(II) a partner who contributes to a partnership an interest in another partnership shall be treated as contributing a proportionate share of the assets of the other partnership.

If the preceding sentence does not apply under such regulations with respect to any interest held by a partnership in another partnership, the interest in such other partnership shall be treated as if it were specified in a subclause of clause (i) .

(4) Basis of securities distributed.

(A) In general. The basis of marketable securities with respect to which gain is recognized by reason of this subsection shall be—

(i) their basis determined under section 732, increased by

(ii) the amount of such gain.

(B) Allocation of basis increase. Any increase in basis attributable to the gain described in subparagraph (A)(ii) shall be allocated to marketable securities in proportion to their respective amounts of unrealized appreciation before such increase.

(5) Subsection disregarded in determining basis of partner's interest in partnership and of basis of partnership property.

Sections 733 and 734 shall be applied as if no gain were recognized, and no adjustment were made to the basis of property, under this subsection .

(6) Character of gain recognized.

In the case of a distribution of a marketable security which is an unrealized receivable (as defined in section 751(c)) or an inventory item (as defined in section 751(d)), any gain recognized under this subsection shall be treated as ordinary income to the extent of any increase in the basis of such security attributable to the gain described in paragraph (4)(A)(ii) .

(7) Regulations.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations to prevent the avoidance of such purposes.

(d) Exceptions.

This section shall not apply to the extent otherwise provided by section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest), section 751 (relating to unrealized receivables and inventory items), and section 737 (relating to recognition of precontribution gain in case of certain distributions).

§ 732 Basis of distributed property other than money.

(a) Distributions other than in liquidation of a partner's interest.

(1) General rule.

The basis of property (other than money) distributed by a partnership to a partner other than in liquidation of the partner's interest shall, except as provided in paragraph (2) , be its adjusted basis to the partnership immediately before such distribution.

(2) Limitation.

The basis to the distributee partner of property to which paragraph (1) is applicable shall not exceed the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(b) Distributions in liquidation.

The basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(c) Allocation of basis.

(1) In general.

The basis of distributed properties to which subsection (a)(2) or (b) is applicable shall be allocated—

(A)

(i) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)) in an amount equal to the adjusted basis of each such property to the partnership, and

(ii) if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, then, to the extent any decrease is required in order to have the adjusted bases of such properties equal the basis to be allocated, in the manner provided in paragraph (3) , and

(B) to the extent of any basis remaining after the allocation under subparagraph (A) , to other distributed properties—

(i) first by assigning to each such other property such other property's adjusted basis to the partnership, and

(ii) then, to the extent any increase or decrease in basis is required in order to have the adjusted bases of such other distributed properties equal such remaining basis, in the manner provided in paragraph (2) or (3) , whichever is appropriate.

(2) Method of allocating increase.

Any increase required under paragraph (1)(B) shall be allocated among the properties—

(A) first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation), and

(B) then, to the extent such increase is not allocated under subparagraph (A) , in proportion to their respective fair market values.

(3) Method of allocating decrease.

Any decrease required under paragraph (1)(A) or (1)(B) shall be allocated—

(A) first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation), and

(B) then, to the extent such decrease is not allocated under subparagraph (A) , in proportion to their respective adjusted bases (as adjusted under subparagraph (A)).

(d) Special partnership basis to transferee.

For purposes of subsections (a), (b) , and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743(b) were in effect with respect to the partnership property. The Secretary may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.

(e) Exception.

This section shall not apply to the extent that a distribution is treated as a sale or exchange of property under section 751(b) (relating to unrealized receivables and inventory items).

(f) Corresponding adjustment to basis of assets of a distributed corporation controlled by a corporate partner.

(1) In general.

If—

(A) a corporation (hereafter in this subsection referred to as the "corporate partner") receives a distribution from a partnership of stock in another corporation (hereafter in this subsection referred to as the "distributed corporation"),

(B) the corporate partner has control of the distributed corporation immediately after the distribution or at any time thereafter, and

(C) the partnership's adjusted basis in such stock immediately before the distribution exceeded the corporate partner's adjusted basis in such stock immediately after the distribution,

then an amount equal to such excess shall be applied to reduce (in accordance with subsection (c)) the basis of property held by the distributed corporation at such time (or, if the corporate partner does not control the distributed corporation at such time, at the time the corporate partner first has such control).

(2) Exception for certain distributions before control acquired.

Paragraph (1) shall not apply to any distribution of stock in the distributed corporation if—

(A) the corporate partner does not have control of such corporation immediately after such distribution, and

(B) the corporate partner establishes to the satisfaction of the Secretary that such distribution was not part of a plan or arrangement to acquire control of the distributed corporation.

(3) Limitations on basis reduction.

(A) In general. The amount of the reduction under paragraph (1) shall not exceed the amount by which the sum of the aggregate adjusted bases of the property and the amount of money of the distributed corporation exceeds the corporate partner's adjusted basis in the stock of the distributed corporation.

(B) Reduction not to exceed adjusted basis of property. No reduction under paragraph (1) in the basis of any property shall exceed the adjusted basis of such property (determined without regard to such reduction).

(4) Gain recognition where reduction limited.

If the amount of any reduction under paragraph (1) (determined after the application of paragraph (3)(A)) exceeds the aggregate adjusted bases of the property of the distributed corporation—

(A) such excess shall be recognized by the corporate partner as long-term capital gain, and

(B) the corporate partner's adjusted basis in the stock of the distributed corporation shall be increased by such excess.

(5) Control.

For purposes of this subsection , the term "control" means ownership of stock meeting the requirements of section 1504(a)(2) .

(6) Indirect distributions.

For purposes of paragraph (1) , if a corporation acquires (other than in a distribution from a partnership) stock the basis of which is determined (by reason of being distributed from a partnership) in whole or in part by reference to subsection (a)(2) or (b) , the corporation shall be treated as receiving a distribution of such stock from a partnership.

(7) Special rule for stock in controlled corporation.

If the property held by a distributed corporation is stock in a corporation which the distributed corporation controls, this subsection shall be applied to reduce the basis of the property of such controlled corporation. This subsection shall be reapplied to any property of any controlled corporation which is stock in a corporation which it controls.

(8) Regulations.

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection , including regulations to avoid double counting and to prevent the abuse of such purposes.

§ 733 Basis of distributee partner's interest.

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by—

- (1)** the amount of any money distributed to such partner, and
- (2)** the amount of the basis to such partner of distributed property other than money, as determined under section 732 .

§ 734 Optional adjustment to basis of undistributed partnership property.

(a) General rule.

The basis of partnership property shall not be adjusted as the result of a distribution of property to a partner unless the election, provided in section 754 (relating to optional adjustment to basis of partnership property), is in effect with respect to such partnership.

(b) Method of adjustment.

In the case of a distribution of property to a partner, a partnership, with respect to which the election provided in section 754 is in effect, shall—

(1) increase the adjusted basis of partnership property by—

(A) the amount of any gain recognized to the distributee partner with respect to such distribution under section 731(a)(1) , and

(B) in the case of distributed property to which section 732(a)(2) or (b) applies, the excess of the adjusted basis of the distributed property to the partnership immediately before the distribution (as adjusted by section 732(d)) over the basis of the distributed property to the distributee, as determined under section 732, or

(2) decrease the adjusted basis of partnership property by—

(A) the amount of any loss recognized to the distributee partner with respect to such distribution under section 731(a)(2) , and

(B) in the case of distributed property to which section 732(b) applies, the excess of the basis of the distributed property to the distributee, as determined under section 732 , over the adjusted basis of the distributed property to the partnership immediately before such distribution (as adjusted by section 732(d)).

Paragraph (1)(B) shall not apply to any distributed property which is an interest in another partnership with respect to which the election provided in section 754 is not in effect.

(c) Allocation of basis.

The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755 .

§ 735 Character of gain or loss on disposition of distributed property.

(a) Sale or exchange of certain distributed property.

(1) Unrealized receivables.

Gain or loss on the disposition by a distributee partner of unrealized receivables (as defined in section 751(c)) distributed by a partnership, shall be considered as ordinary income or as ordinary loss, as the case may be.

(2) Inventory items.

Gain or loss on the sale or exchange by a distributee partner of inventory items (as defined in section 751(d)) distributed by a partnership shall, if sold or exchanged within 5 years from the date of the distribution, be considered as ordinary income or as ordinary loss, as the case may be.

(b) Holding period for distributed property.

In determining the period for which a partner has held property received in a distribution from a partnership (other than for purposes of subsection (a)(2)), there shall be included the holding period of the partnership, as determined under section 1223, with respect to such property.

(c) Special rules.

(1) Waiver of holding periods contained in section 1231 .

For purposes of this section, section 751(d) (defining inventory item) shall be applied without regard to any holding period in section 1231(b).

(2) Substituted basis property.

(A) In general. If any property described in subsection (a) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of nonrecognition transactions.

(B) Exception for stock in C corporation. Subparagraph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351.

§ 736 Payments to a retiring partner or a deceased partner's successor in interest.

(a) Payments considered as distributive share or guaranteed payment.

Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, except as provided in subsection (b), be considered—

(1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or

(2) as a guaranteed payment described in section 707(c) if the amount thereof is determined without regard to the income of the partnership.

(b) Payments for interest in partnership.

(1) General rule.

Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments (other than payments described in paragraph (2)) are determined, under regulations prescribed by the Secretary, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a) .

(2) Special rules.

For purposes of this subsection, payments in exchange for an interest in partnership property shall not include amounts paid for—

(A) unrealized receivables of the partnership (as defined in section 751(c)), or

(B) good will of the partnership, except to the extent that the partnership agreement provides for a payment with respect to good will.

(3) Limitation on application of paragraph (2) .

Paragraph (2) shall apply only if—

(A) capital is not a material income-producing factor for the partnership, and

(B) the retiring or deceased partner was a general partner in the partnership.

§ 737 Recognition of precontribution gain in case of certain distributions to contributing partner.

(a) General rule.

In the case of any distribution by a partnership to a partner, such partner shall be treated as recognizing gain in an amount equal to the lesser of—

(1) the excess (if any) of (A) the fair market value of property (other than money) received in the distribution over (B) the adjusted basis of such partner's interest in the partnership immediately before the distribution reduced (but not below zero) by the amount of money received in the distribution, or

(2) the net precontribution gain of the partner.

Gain recognized under the preceding sentence shall be in addition to any gain recognized under section 731. The character of such gain shall be determined by reference to the proportionate character of the net precontribution gain.

(b) Net precontribution gain.

For purposes of this section, the term "net precontribution gain" means the net gain (if any) which would have been recognized by the distributee partner under section 704(c)(1)(B) if all property which—

(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.

(c) Basis rules.

(1) Partner's interest.

The adjusted basis of a partner's interest in a partnership shall be increased by the amount of any gain recognized by such partner under subsection (a). For purposes of determining the basis of the distributed property (other than money), such increase shall be treated as occurring immediately before the distribution.

(2) Partnership's basis in contributed property.

Appropriate adjustments shall be made to the adjusted basis of the partnership in the contributed property referred to in subsection (b) to reflect gain recognized under subsection (a).

(d) Exceptions.

(1) Distributions of previously contributed property.

If any portion of the property distributed consists of property which had been contributed by a distributee partner to the partnership, such property shall not be taken into account under subsection (a)(1) and shall not be taken into account in determining the amount of the net precontribution gain. If the property distributed consists of an interest in an entity, the preceding sentence shall not apply to the extent that the value of such interest is attributable to property contributed to such entity after such interest had been contributed to the partnership.

(2) Coordination with section 751.

This section shall not apply to the extent section 751(b) applies to such distribution.

(e) Marketable securities treated as money.

For treatment of marketable securities as money for purposes of this section, see section 731(c).

Subpart C. Transfers of interests in a partnership

§ 741 Recognition and character of gain or loss on sale or exchange.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

§ 742 Basis of a transferee partner's interest.

The basis of an interest in a partnership acquired other than by contribution shall be determined under part II of subchapter O (sec. 1011 and following).

§ 743 Optional adjustment to basis of partnership property.

(a) General rule.

The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership.

(b) Adjustment to basis of partnership property.

In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect shall—

(1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property, or

(2) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership.

Under regulations prescribed by the Secretary, such increase or decrease shall constitute an adjustment to the basis of partnership property with respect to the transferee partner only. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital and, in the case of property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share. In the case of an adjustment under this subsection to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for the transferee partner with respect to his interest in such property.

(c) Allocation of basis.

The allocation of basis among partnership properties where subsection (b) is applicable shall be made in accordance with the rules provided in section 755 .

Subpart D. Determination of Tax Liability

§ 751 Unrealized receivables and inventory items.

(a) Sale or exchange of interest in partnership.

The amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

- (1) unrealized receivables of the partnership, or
- (2) inventory items of the partnership,

shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

(b) Certain distributions treated as sales or exchanges.

(1) General rule.

To the extent a partner receives in a distribution—

(A) partnership property which is—

- (i) unrealized receivables, or
- (ii) inventory items which have appreciated substantially in value,

in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in subparagraph (A)(i) or (ii) in exchange for all or a part of his interest in partnership property described in subparagraph (A)(i) or (ii) ,

such transactions shall, under regulations prescribed by the Secretary, be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution).

(2) Exceptions.

Paragraph (1) shall not apply to—

- (A) a distribution of property which the distributee contributed to the partnership, or
- (B) payments, described in section 736(a), to a retiring partner or successor in interest of a deceased partner.

(3) Substantial appreciation.

For purposes of paragraph (1)—

- (A) In general. Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds 120 percent of the adjusted basis to the partnership of such property.
- (B) Certain property excluded. For purposes of subparagraph (A) , there shall be excluded any inventory property if a principal purpose for

acquiring such property was to avoid the provisions of this subsection relating to inventory items.

(c) Unrealized receivables.

For purposes of this subchapter, the term "unrealized receivables" includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

- (1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or
- (2) services rendered, or to be rendered.

For purposes of this section and, sections 731 , 732 , and 741 (but not for purposes of section 736), such term also includes mining property (as defined in section 617(f)(2)), stock in a DISC (as described in section 992(a)), section 1245 property (as defined in section 1245(a)(3)), stock in certain foreign corporations (as described in section 1248), section 1250 property (as defined in section 1250(c)), farm land (as defined in section 1252(a)), franchises, trademarks, or trade names (referred to in section 1253(a)), and an oil, gas, or geothermal property (described in section 1254) but only to the extent of the amount which would be treated as gain to which section 617(d)(1), 995(c) , 1245(a), 1248(a) , 1250(a) , 1252(a) , 1253(a) or 1254(a) would apply if (at the time of the transaction described in this section or section 731 , 732 , or 741 , as the case may be) such property had been sold by the partnership at its fair market value. For purposes of this section and, sections 731, 732 , and 741 (but not for purposes of section 736), such term also includes any market discount bond (as defined in section 1278) and any short-term obligation (as defined in section 1283) but only to the extent of the amount which would be treated as ordinary income if (at the time of the transaction described in this section or section 731, 732 , or 741 , as the case may be) such property had been sold by the partnership.

(d) Inventory items.

For purposes of this subchapter, the term "inventory items" means—

- (1) property of the partnership of the kind described in section 1221(a)(1) ,
- (2) 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 ,
- (3) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and
- (4) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in paragraph (1), (2) , or (3).

(e) Limitation on tax attributable to deemed sales of section 1248 stock.

For purposes of applying this section and sections 731 and 741 to any amount resulting from the reference to section 1248(a) in the second sentence of subsection (c) , in the case of an individual, the tax attributable to such amount shall be limited in the manner provided by subsection (b) of section 1248 (relating to gain from certain sales or exchanges of stock in certain foreign corporation).

(f) Special rules in the case of tiered partnerships, etc.

In determining whether property of a partnership is—

- (1) an unrealized receivable, or

(2) an inventory item,

such partnership shall be treated as owning its proportionate share of the property of any other partnership in which it is a partner. Under regulations, rules similar to the rules of the preceding sentence shall also apply in the case of interests in trusts.

§ 752 Treatment of certain liabilities.

(a) Increase in partner's liabilities.

Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership.

(b) Decrease in partner's liabilities.

Any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

(c) Liability to which property is subject.

For purposes of this section, a liability to which property is subject shall, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

(d) Sale or exchange of an interest.

In the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships.

§ 753 Partner receiving income in respect of decedent.

The amount includible in the gross income of a successor in interest of a deceased partner under section 736(a) shall be considered income in respect of a decedent under section 691 .

§ 754 Manner of electing optional adjustment to basis of partnership property.

If a partnership files an election, in accordance with regulations prescribed by the Secretary, the basis of partnership property shall be adjusted, in the case of a distribution of property, in the manner provided in section 734 and, in the case of a transfer of a partnership interest, in the manner provided in section 743 . Such an election shall apply with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years. Such election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary.

§ 755 Rules for allocation of basis.

(a) General rule.

Any increase or decrease in the adjusted basis of partnership property under section 734(b) (relating to the optional adjustment to the basis of undistributed partnership property) or section 743(b) (relating to the optional adjustment to the basis of

partnership property in the case of a transfer of an interest in a partnership) shall, except as provided in subsection (b), be allocated—

- (1) in a manner which has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties, or
- (2) in any other manner permitted by regulations prescribed by the Secretary.

(b) Special rule.

In applying the allocation rules provided in subsection (a) , increases or decreases in the adjusted basis of partnership property arising from a distribution of, or a transfer of an interest attributable to, property consisting of—

- (1) capital assets and property described in section 1231(b) , or
- (2) any other property of the partnership,

shall be allocated to partnership property of a like character except that the basis of any such partnership property shall not be reduced below zero. If, in the case of a distribution, the adjustment to basis of property described in paragraph (1) or (2) is prevented by the absence of such property or by insufficient adjusted basis for such property, such adjustment shall be applied to subsequently acquired property of a like character in accordance with regulations prescribed by the Secretary.

Part III. Definitions

§ 761 Terms defined.

(a) Partnership.

For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate. Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of—

(1) for investment purposes only and not for the active conduct of a business,

(2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or

(3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

(b) Partner.

For purposes of this subtitle, the term "partner" means a member of a partnership.

(c) Partnership agreement.

For purposes of this subchapter, a partnership agreement includes any modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) Liquidation of a partner's interest.

For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partner's entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership.

(e) Distributions of partnership interests treated as exchanges.

Except as otherwise provided in regulations, for purposes of—

(1) section 708 (relating to continuation of partnership),

(2) section 743 (relating to optional adjustment to basis of partnership property), and

(3) any other provision of this subchapter specified in regulations prescribed by the Secretary,

any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange.

(f) Cross reference.

For rules in the case of the sale, exchange, liquidation, or reduction of a partner's interest, see sections 704(b) and 706(c)(2) .