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Treas. Reg. Section 1.732-2

Special partnership basis of distributed property

(a) Adjustments under section 734(b). In the case of a distribution of property to a partner, the partnership bases of the distributed properties shall reflect any increases or decreases to the basis of partnership property which have been made previously under section 734(b) (relating to the optional adjustment to basis of undistributed partnership property) in connection with previous distributions.

(b) Adjustments under section 743(b). In the case of a distribution of property to a partner who acquired any part of his interest in a transfer as to which an election under section 754 was in effect, then, for the purposes of section 732 (other than subsection (d) thereof), the adjusted partnership bases of the distributed property shall take into account, in addition to any adjustments under section 734(b), the transferee's special basis adjustment for the distributed property under section 743(b). The application of this paragraph may be illustrated by the following example:

Example. Partner D acquired his interest in partnership ABD from a previous partner. Since the partnership had made an election under section 754, a special basis adjustment with respect to D is applicable to the basis of partnership property in accordance with section 743(b). One of the assets of the partnership at the time D acquired his interest was property X, which is later distributed to D in a current distribution. Property X has an adjusted basis to the partnership of \$1,000 and with respect to D it has a special basis adjustment of \$500. Therefore, for purposes of section 732(a)(1), the adjusted basis of such property to the partnership with respect to D immediately before its distribution is \$1,500. However, if property X is distributed to partner A, a nontransferee partner, its adjusted basis to the partnership for purposes of section 732(a)(1) is only \$1,000. In such case, D's \$500 special basis adjustment may shift over to other property. See §1.743-1(g).

(c) Adjustments to basis of distributed inventory and unrealized receivables. Under section 732, the basis to be allocated to distributed properties shall be allocated first to any unrealized receivables and inventory items. If the distributee partner is a transferee of a partnership interest and has a special basis adjustment for unrealized receivables or inventory items under either section 743(b) or section 732(d), then the partnership adjusted basis immediately prior to distribution of any unrealized receivables or inventory items distributed to such partner shall be determined as follows: If the distributee partner receives his entire share of the fair market value of the inventory items or unrealized receivables of the partnership, the adjusted basis of such distributed property to the partnership, for the purposes of section 732, shall take into account the entire amount of any special basis adjustment which the distributee partner may have for such assets. If the distributee partner receives less than his entire share of the fair market value of partnership inventory items or unrealized receivables, then, for purposes of section 732, the adjusted basis of such distributed property to the partnership shall take into account the same

proportion of the distributee's special basis adjustment for unrealized receivables or inventory items as the value of such items distributed to him bears to his entire share of the total value of all such items of the partnership. The provisions of this paragraph may be illustrated by the following example:

Example. Partner C acquired his 40-percent interest in partnership AC from a previous partner. Since the partnership had made an election under section 754, C has a special basis adjustment to partnership property under section 743(b). C retires from the partnership when the adjusted basis of his partnership interest is \$3,000. He receives from the partnership in liquidation of his entire interest, \$1,000 cash, certain capital assets, depreciable property, and certain inventory items and unrealized receivables. C has a special basis adjustment of \$800 with respect to partnership inventory items and of \$200 with respect to unrealized receivables. The common partnership basis for the inventory items distributed to him is \$500 and for the unrealized receivables is zero. If the value of inventory items and the unrealized receivables distributed to C in his 40 percent share of the total value of all partnership inventory items and unrealized receivables, then, for purposes of section 732, the adjusted basis of such property in C's hands will be \$1,300 for the inventory items (\$500 plus \$800) and \$200 for the unrealized receivables (zero plus \$200). The remaining basis of \$500, which constitutes the basis of the capital assets and depreciable property distributed to C, is determined as follows: \$3,000 (total basis) less \$1,000 cash, or \$2,000 (the amount to be allocated to the basis of all distributed property), less \$1,500 (\$800 and \$200 special basis adjustments, plus \$500 common partnership basis, the amount allocated to inventory items and unrealized receivables). However, if the value of the inventory items and unrealized receivables distributed to C consisted of only 20 percent of the total fair market value of such property (i.e., only one-half of C's 40-percent share), then only one-half of C's special basis adjustment of \$800 for partnership inventory items and \$200 for unrealized receivables would be taken into account. In that case, the basis of the inventory items in C's hands would be \$650 (\$250, the common partnership basis for inventory items distributed to him, plus \$400, one-half of C's special basis adjustment for inventory items). The basis of the unrealized receivables in C's hands would be \$100 (zero plus \$100, one-half of C's special basis adjustment for unrealized receivables).