Reducing the partners' bases in their partnership interests by their respective shares of the partnership's $20*x* loss preserves the intended detriment of not allowing losses from sales or exchanges between partnerships and related persons to be deducted. If the partners' bases in their partnership interests were not reduced by the amount of the partnership's disallowed loss, the partners could subsequently recognize this loss (or a reduced gain), for example, upon a disposition of their partnership interests.

Under the *PRS* agreement, *A*'s distributive share of the partnership loss is $15*x* and *B*'s distributive share is $5*x*. Accordingly, the basis of *A*'s interest in *PRS* is decreased by $15*x* and the basis of *B*'s interest in *PRS* is decreased by $5*x*.

PRS2 realizes a gain of $10*x* on the subsequent sale of Property ($90*x* amount realized less $80*x* adjusted basis). Pursuant to §§ 707(b)(1) and 267(d), *PRS2* must recognize the gain only to the extent that it exceeds the amount of *PRS*'s disallowed loss. *PRS2*'s gain on the sale ($10*x*) does not exceed *PRS*'s disallowed loss ($20*x*) and, therefore, *PRS2* does not recognize any gain on the sale of Property. Consequently, the sale of Property results in a permanent increase in the aggregate basis of the assets of *PRS2* that is not taken into account by *PRS2* in determining its taxable income and will not be taken into account for federal income tax purposes in any other manner. Therefore, for purposes of § 705(a)(1)(B), the gain realized but not recognized by *PRS2* on the sale of Property, and the resulting permanent increase in basis, is income of the partnership exempt from tax.

Increasing the partner's bases in their partnership interests by their respective shares of the unrecognized gain on the sale of Property preserves the intended benefit of §§ 707(b)(1) and 267(d). If the partners' bases in their partnership interests were not increased by the amount of the partnership's unrecognized gain, the partners could subsequently recognize this gain (or a reduced loss), for example, upon a disposition of their partnership interests.

Under the *PRS2* agreement, *A*'s distributive share of the partnership gain is $6*x* and *C*'s distributive share is $4*x*. Accordingly, the basis of *A*'s interest in *PRS2* is increased by $6*x* and the basis of *C*'s interest in *PRS2* is increased by $4*x*.

HOLDINGS

(1) If a loss on the sale of partnership property is disallowed under § 707(b)(1), the basis of each partner's interest in the partnership is decreased (but not below zero) under § 705(a)(2) by the partner's share of that loss.

(2) If gain from the sale of partnership property is not recognized under §§ 707(b)(1) and 267(d), the basis of each partner's interest in the partnership is increased under § 705(a)(1) by the partner's share of that gain.

DRAFTING INFORMATION

For further information regarding this revenue ruling contact Deborah Harrington at (202) 622-3050 (not a toll-free call).

---

26 CFR 1.7-5–1: Adjustments to basis of partner's interest in partnership.
(Also §§ 170, 702, 703; 1.170A–1, 1.702–1, 1.703–1.)

Charitable contribution by partnership. A charitable contribution of property by a partnership reduces each partner's basis in the partnership by the amount of the partner's share of the partnership's basis in the property contributed.

Rev. Rul. 96–11

ISSUE

If a partnership makes a charitable contribution of property, are the partners' bases in their partnership interests decreased to reflect the contribution?

FACTS

A and *B* each contribute an equal amount of cash to form *PRS*, a general partnership. Under the *PRS* agreement, each item of income, gain, loss, and deduction of the partnership is allocated 50 percent to *A* and 50 percent to *B*. *PRS* has unencumbered property, *X*, with a basis of $60*x* and a fair market value of $100*x*. *PRS* contributes *X* in a transaction that qualifies as a charitable contribution under § 170(c) of the Internal Revenue Code. The charitable contribution is not subject to the limitations of § 170(e)(1).

LAW AND ANALYSIS

Section 170(a) allows as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year. The deduction provided by § 170(a) is subject to the limitations of § 170(b).

Section 1.170A–1(c)(1) of the Income Tax Regulations provides that, if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided by § 170(e)(1) and paragraph (a) of § 1.170A–4, or § 170(e)(3) and paragraph (c) of § 1.170A–4A.

Section 703(a)(2)(C) provides that the taxable income of a partnership is computed in the same manner as in the case of an individual except that the deduction for charitable contributions provided in § 170 is not allowed to the partnership. However, under § 702(a)(4) each partner takes into account separately the partner's distributive share of the partnership's charitable contributions (as defined in § 170(c)).

Section 1.170A–1(h)(7) provides that a partner's distributive share of charitable contributions actually paid by a partnership during its taxable year may be allowed as a deduction in the partner's separate return for the partner's taxable year with or within which the taxable year of the partnership ends, to the extent that the aggregate of the partner's share of the partnership contributions and the partner's own contributions does not exceed the limitations in § 170(b).

Section 705(a)(1) provides that the adjusted basis of a partner's interest in a partnership shall be increased by the sum of the partner's distributive share for the taxable year and prior taxable years of: (1) taxable income of the partnership as determined under § 703(a); (2) income of the partnership exempt from income tax; and (3) the excess of the deductions for depletion over the basis of the property subject to depletion.

Section 705(a)(2) provides that the adjusted basis of a partner's interest in a partnership shall be decreased (but not below zero) by distributions by the partnership and by the sum of the partner's distributive share for the taxable year and prior taxable years of: (1) losses of the partnership; and (2) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account.

The adjustments to the basis of a partner's interest in a partnership under § 705 are necessary to prevent inappropriate or unintended benefits or detriments to the partners. Generally, the basis of a partner's interest in a partnership is adjusted to reflect the tax allocations of the partnership to that partner. This ensures that the income and loss of the partnership are taken into account by its partners only once. In addition, as provided in § 705(a)(1)(B) and (a)(2)(B), adjustments must also be made to reflect certain nontaxable events in the partnership. For example, a partner's share of nontaxable income (such as exempt income) is added to the basis of the partner's interest because, without a basis adjustment, the partner could recognize gain with respect to the tax-exempt income, for example, on a sale or redemption of the partner's interest, and the benefit of the tax-exempt income would be lost to the partner. Similarly, a partner's share of nondeductible expenditures must be deducted from the partner's basis in order to prevent that amount from giving rise to a loss to the partner on a sale or a redemption of the partner's interest in the partnership. *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. A225 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 384 (1954).

In determining whether a transaction results in exempt income within the meaning of § 705(a)(1)(B), or a nondeductible, noncapital expenditure within the meaning of § 705(a)(2)(B), the proper inquiry is whether the transaction has a permanent effect on the partnership's basis in its assets, without a corresponding current or future effect on its taxable income. Pursuant to § 703(a)(2)(C), the contribution of *X* by *PRS* is not taken into account by *PRS* in computing its taxable income. Consequently, the contribution results in a permanent decrease in the aggregate basis of the assets of *PRS* that is not taken into account by *PRS* in determining its taxable income and will not be taken into account for federal income tax purposes in any other manner. Therefore, for purposes of § 705(a)(2)(B), the contribution of *X*, and the resulting permanent decrease in partnership basis, is an expenditure of the partnership not deductible in computing its taxable income and not properly chargeable to capital account. *Cf.* § 1.701–2(f), *Example 2* (requiring adjustments under § 705(a)(2)(B) for reductions in the basis of stock held by a partnership following an extraordinary dividend under § 1059).

Reducing the partners' bases in their partnership interests by their respective shares of the permanent decrease in the partnership's basis in its assets preserves the intended benefit of providing a deduction (in circumstances not under § 170(e)) for the fair market value of appreciated property without recognition of the appreciation. By contrast, reducing the partners' bases in their partnership interests by the fair market value of the contributed property would subsequently cause the partners to recognize gain (or a reduced loss), for example, upon a disposition of their partnership interests, attributable to the unrecognized appreciation in *X* at the time of this contribution.

Under the *PRS* agreement, partnership items are allocated equally between *A* and *B*. Accordingly, the basis of *A*'s and *B*'s interests in *PRS* is each decreased by $30*x*.

HOLDING

If a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership is decreased (but not below zero) by the partner's share of the partnership's basis in the property contributed.

DRAFTING INFORMATION

The principal author of this revenue ruling is Terri A. Belanger of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Ms. Belanger at (202) 622-3080 (not a toll-free call).

Section 707.—Transactions between Partner and Partnership.

26 CFR 1.707–1: Transactions between partner and partnership.

If loss on the sale of partnership property is disallowed under § 707(b)(1) of the Internal Revenue Code, are the partners' bases in their partnership interests decreased to reflect the disallowed loss? See Rev. Rul 96–10, page 00.

Section 3406.—Backup Withholding

26 CFR 31.3406–0: Outline of the backup withholding regulations.

T.D. 8637

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 31, 35a, 301, and 602

Backup Withholding, Statement Mailing Requirements, and Due Diligence

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document provides final rules on backup withholding under sections 3406(a)(1)(A), (C), and (D) of the Internal Revenue Code of 1986 (Code) when a payee fails to provide a taxpayer identification number in the required manner to a person required to make an information return, when a payee is subject to notified payee underreporting, or when a payee fails to certify, under penalties of perjury, that the payee is not subject to backup withholding due to notified payee underreporting.

This document also provides final rules on the manner for providing a statement to a payee under sections 6042(c), 6044(e), 6049(c), and 6050N(b) of the Code.

This document also contains temporary regulations on the effective date of §§35a.9999–1 through 35a.9999–5, Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in *** [IA–33–95, page 00, this Bulletin].

DATES: These regulations are effective December 21, 1995. These regulations are applicable to transactions occurring after December 31, 1996.

FOR FURTHER INFORMATION CONTACT: Renay France of the Of-