
Notice of Proposed Rulemaking and Notice of Public Hearing

Determination of Basis of Partner's Interest; Special Rules

REG-106702-00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

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

DATES: Written comments must be received by April 12, 2001. Outlines of topics to be discussed at the public hearing scheduled for May 3, 2001, also must be received by April 12, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-106702-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-106702-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.gov/tax_regs/reglist.html. The public hearing will be held in room 6718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Barbara MacMillan, (202) 622-3050; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

Background

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

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

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

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

Explanation of Provisions

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

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

of gain (or loss) that the corporate partner would have recognized (absent the application of section 1032) if, for the taxable year in which the corporation acquired the interest, a section 754 election had been in effect.

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

Proposed Effective Date

The regulations shall apply to gain or loss allocated with respect to sales or exchanges of stock occurring after December 6, 1999.

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 the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C.

chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, 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 businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are timely submitted to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 3, 2001, beginning at 10 a.m., in room 6718 of the Internal Revenue Building. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of the preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by April 12, 2001.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Matthew Lay of the Office

of the Associate Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the IRS and the Treasury Department participated in their development.

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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 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.705–2 also issued under 26 U.S.C. 705. * * *

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

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

(a) * * *

(7) For basis adjustments necessary to coordinate sections 705 and 1032 in certain situations in which a corporation directly or indirectly acquires an interest in a partnership that holds stock in that corporation, see §1.705–2.

* * * * *

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

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

(a) *Purpose.* This section is intended to prevent inappropriate increases or decreases in the adjusted basis of a corporate partner's interest in a partnership resulting from the partnership's disposition of the corporate partner's stock. The rules under section 705 generally are intended to preserve equality between the adjusted basis of a partner's interest in a partnership (outside basis) and such partner's share of the adjusted basis in partnership assets (inside basis). In the situation where a section 754 election was not in effect for the year in which the partner acquired its interest, however, a partner's inside basis and outside basis may not be equal. In this situation, gain or loss allocated to the partner upon disposition of

the partnership assets that is attributable to the difference between the adjusted basis of the partnership assets absent the section 754 election and the adjusted basis of the partnership assets had a section 754 election been in effect generally will result in an adjustment to the basis of the partner's interest in the partnership under section 705(a). Such gain (or loss) therefore generally will be offset by a corresponding decrease in the gain or increase in the loss (or increase in the gain or decrease in the loss) upon the subsequent disposition by the partner of its interest in the partnership. Where such a difference exists with respect to stock of a corporate partner that is held by the partnership, gain or loss from the disposition of corporate partner stock attributable to the difference is not recognized by the corporate partner under section 1032. To adjust the basis of the corporate partner's interest in the partnership for this unrecognized gain or loss would not be appropriate because it would create an opportunity for the recognition of taxable gain or loss on a subsequent disposition of the partnership interest where no economic gain or loss has been incurred by the corporate partner and no corresponding taxable gain or loss had previously been allocated to the corporate partner by the partnership.

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

(2) *Example.* The provisions of this paragraph (b) are illustrated by the following example:

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

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

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

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

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

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

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

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

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

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

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

(ii) With respect to the basis of UTP's interest in LTP, if all of the gain from the sale of the B stock

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

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

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

(v) With respect to B's interest in UTP, if B's share of the gain allocated to UTP and then to B were to increase the basis of B's interest in UTP, B would have a UTP partnership interest with an adjusted basis of \$190,000 (\$100,000 + \$90,000) and a value of \$100,000, so that B would recognize a loss of \$90,000 if B sold its interest in UTP immediately after LTP's disposition of the B

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

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

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

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