

basis. The \$1,000 basis increase is allocated between Properties A1 and A2 based on the unrealized appreciation in each asset before such basis adjustment. As a result, the adjusted tax basis of Property A1 is increased by \$167 ($\$1,000 \times \$500 / \$3,000$) and the adjusted tax basis of Property A2 is increased by \$833 ($\$1,000 \times \$2,500 / 3,000$).

§ 1.737-4 Anti-abuse rule.

(a) *In general.* The rules of section 737 and §§ 1.737-1, 1.737-2, and 1.737-3 must be applied in a manner consistent with the purpose of section 737.

Accordingly, if a principal purpose of a transaction is to achieve a tax result that is inconsistent with the purpose of section 737, the Commissioner can recast the transaction for federal tax purposes as appropriate to achieve tax results that are consistent with the purpose of section 737. Whether a tax result is inconsistent with the purpose of section 737 must be determined based on all the facts and circumstances. See § 1.704-4(f) for an anti-abuse rule and examples in the context of section 704(c)(1)(B). The anti-abuse rule and examples under section 704(c)(1)(B) and § 1.704-4(f) are relevant to section 737 and §§ 1.737-1, 1.737-2, and 1.737-3 to the extent that the net precontribution gain for purposes of section 737 is determined by reference to section 704(c)(1)(B).

(b) *Examples.* The following examples illustrate the rules of this section. The examples set forth below do not delineate the boundaries of either permissible or impermissible types of transactions. Further, the addition of any facts or circumstances that are not specifically set forth in an example (or the deletion of any facts or circumstances) may alter the outcome of the transaction described in the example. Unless otherwise specified, partnership income equals partnership expenses (other than depreciation deductions for contributed property) for each year of the partnership, the fair market value of partnership property does not change, all distributions by the partnership are subject to section 737, and all partners are unrelated.

Example 1. Increase in distributee partner's basis by temporary contribution; results inconsistent with the purpose of section 737. (i) On January 1, 1995, A, B, and C form partnership ABC as equal partners. A contributes Property A1, nondepreciable real property with a fair market value of \$10,000 and an adjusted tax basis of \$1,000. B contributes Property B, nondepreciable real property with a fair market value of \$10,000 and an adjusted tax basis of \$10,000. C contributes \$10,000 cash.

(ii) On January 1, 1999, pursuant to a plan a principal purpose of which is to avoid gain under section 737, A contributes to the partnership Property A2, nondepreciable real

property with a fair market value and adjusted tax basis of \$9,000. A, therefore, increased the adjusted tax basis of A's partnership interest from \$1,000 to \$10,000. The partnership agreement is amended and all other necessary steps are taken so that substantially all of the economic risks and benefits of Property A2 are retained by A. On February 1, 1999, Property B is distributed to A in partial liquidation of A's interest in the partnership. If the contribution of Property A2 is taken into account for purposes of section 737, there is no excess distribution because the fair market value of distributed Property B (\$10,000) does not exceed the adjusted tax basis of A's interest in the partnership (\$10,000), and therefore section 737 does not apply. A's adjusted tax basis in distributed Property B is \$10,000 under section 732(a)(1) and the adjusted tax basis of A's partnership interest is reduced to zero under section 733.

(iii) On March 1, 2000, A receives Property A2 from the partnership in complete liquidation of A's interest in the partnership. A recognizes no gain on the distribution of Property A2 because the property was previously contributed property. See § 1.737-2(d).

(iv) Although the contribution of Property A2 increases the adjusted tax basis of A's interest in the partnership (assuming it was a valid contribution to the partnership under section 721), it would be inconsistent with the purpose of section 737 to recognize the contribution of Property A2 to the partnership as in substance a bona fide contribution of an asset used in the conduct of joint business activity. Section 737 requires recognition of gain when the value of distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. Section 737 assumes that any contribution or other transaction that affects a partner's adjusted tax basis in the partnership interest is not a transitory contribution or transaction engaged in with a principal purpose of avoiding recognition of gain under section 737. Because the contribution of Property A2 was a transitory contribution made with a principal purpose of avoiding recognition of gain under section 737, the Commissioner can disregard the contribution of Property A2 for this purpose. As a result, A recognizes gain of \$9,000 under section 737 on the receipt of Property B, an amount equal to the lesser of the excess distribution of \$9,000 ($\$10,000$ fair market value of distributed Property B less the \$1,000 adjusted tax basis of A's partnership interest, determined without regard to the transitory contribution of Property A2) or A's net precontribution gain of \$9,000 on Property A1.

Example 2. Increase in distributee partner's basis; section 752 liability shift; results consistent with the purpose of section 737. (i) On January 1, 1995, A and B form general partnership AB as equal partners. A contributes Property A, nondepreciable real property with a fair market value of \$10,000 and an adjusted tax basis of \$1,000. B contributes Property B, nondepreciable real property with a fair market value and adjusted tax basis of \$10,000. The partnership also borrows \$10,000 on a

recourse basis and purchases Property C. The \$10,000 liability is allocated equally between A and B under section 752, thereby increasing the adjusted tax basis in A's partnership interest to \$6,000.

(ii) On December 31, 1998, the partners agree that A is to receive Property B in partial liquidation of A's interest in the partnership. If A were to receive Property B at that time, A would recognize \$4,000 of gain under section 737, an amount equal to the lesser of the excess distribution of \$4,000 ($\$10,000$ fair market value of Property B less \$6,000 adjusted tax basis in A's partnership interest) or A's net precontribution gain of \$9,000 ($\$10,000$ fair market value of Property A less \$1,000 adjusted tax basis of Property A).

(iii) With a principal purpose of avoiding such gain, A and B agree that A will be solely liable for the repayment of the \$10,000 partnership liability and take the steps necessary so that the entire amount of the liability is allocated to A under section 752. The adjusted tax basis in A's partnership interest is thereby increased from \$6,000 to \$11,000 to reflect A's share of the \$5,000 of liability previously allocated to B. As a result of this increase in A's adjusted tax basis, there is no excess distribution because the fair market value of distributed Property B (\$10,000) is less than the adjusted tax basis of A's partnership interest. Recognizing A's increased adjusted tax basis as a result of the shift in liabilities is consistent with the purpose of section 737 and this section. Section 737 requires recognition of gain only when the value of the distributed property exceeds the distributee partner's adjusted tax basis in the partnership interest. The \$10,000 recourse liability is a bona fide liability of the partnership and A's and B's agreement that A will assume responsibility for repayment of that debt has substance. Therefore, the increase in A's adjusted tax basis in A's interest in the partnership due to the shift in partnership liabilities under section 752 is respected, and A recognizes no gain under section 737.

§ 1.737-5 Effective date.

Sections 1.737-1, 1.737-2, 1.737-3, and 1.737-4 apply to distributions by a partnership to a partner on or after January 9, 1995.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

[FR Doc. 95-171 Filed 1-6-95; 8:45 am]

BILLING CODE 4830-01-U

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 110

[CGD 86-079]

RIN 2115-AC96]

Anchorage Regulations; Regulated Navigation Areas and Limited Access Areas (CGD 86-079)

AGENCY: Coast Guard, DOT.