

## 26 U.S. Code § 731. Extent of recognition of gain or loss on distribution

U.S. Code   Notes   Authorities (CFR)

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**(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 732 and 734 shall be applied as if no gain were recognized, and no adjustment were

Sections 753 and 754 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).

(Aug. 16, 1954, ch. 736, 68A Stat. 245; Pub. L. 102-486, title XIX, § 1937(b)(2), Oct. 24, 1992, 106 Stat. 3033; Pub. L. 103-465, title VII, § 741(a), Dec. 8, 1994, 108 Stat. 5006; Pub. L. 105-34, title X, § 1062(b)(3), Aug. 5, 1997, 111 Stat. 947.)

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