

In general, when you contribute property to a partnership in exchange for a partnership interest you do not recognize gain or loss on the contribution. The basis you had in the property you contributed becomes both the basis the partnership gets in the property and the basis you get in the partnership interest you receive. (However, as discussed below, you may recognize gain if the contributed property is subject to debt.)

Example. Jane contributes to the ABC partnership a building valued at \$100,000, with a basis to her of \$60,000 in exchange for a 10% partnership interest. Jane has no gain on the contribution. Jane's basis in the interest she received and ABC's basis in the building are both \$60,000.

Impact of liabilities. The situation grows more complex if the property is subject to a liability. In this case, you are treated as receiving a cash distribution to the extent of your net relief from liabilities.

Example. The facts are the same as in the above example, except that the building is subject to a \$20,000 debt. Jane is treated as receiving a cash distribution of \$18,000 because she is "relieved" of a \$20,000 debt when the partnership takes over the building, but she "picks up" \$2,000 of this debt again as a 10% partner. Thus, her net debt relief is \$18,000.

Jane has no gain on the deemed cash distribution because it does not exceed her basis in her interest. Her basis, however, is reduced by the \$18,000 distribution from \$60,000 to \$42,000.

Potential for gain. Under the above rules, gain will be recognized where the debt relief exceeds the contributing partner's total basis in his interest.

If, in the preceding example, Jane's basis had been \$10,000 instead of \$60,000, the \$18,000 cash distribution would have exceeded her basis by \$8,000, with the result that \$8,000 of gain would be recognized. (If Jane owned an interest before she contributed the property, the gain would be recognized only if the deemed cash distribution exceeds her total basis in her interest.)

Planning to avoid gain on the contribution. If you're in a situation where gain would be recognized on a property contribution as explained above, you may be able to take some steps to avoid the gain recognition. These include contributing different property subject to less or no debt, paying down the debt, contributing cash or other property along with the contributed property, or waiting until after the year-end to make the contribution if you're expecting an allocation of partnership income that will increase your basis in your interest. In addition, you may avoid gain recognition by increasing the portion of the liabilities allocated to you. The rules for allocating liabilities are complex and depend on whether the liabilities are recourse or nonrecourse. However, the rules have some flexibility and it may be possible for you to be allocated a greater portion of the partnership's liabilities without incurring a significant risk of loss if the partnership becomes insolvent.