CPA
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A Section 751 Transfer usually happens in a partnership, or an limited liability company (LLC), taxed as a partnership. What the Code entails is a tax-free transfer of appreciable property by a partner to the partnership in exchange for a capital contribution to the partnership. One thing to remember with partnership taxation is that you have to track two basis amounts. The inside basis of the partnership that is reported on the K-1 form, and then off to the side you have to keep track of each partner’s outside basis.

With a Section 751 Transfer, we are usually talking about a commercial building or an appreciable asset. For this article, we are going to stick with a commercial building, because it is easier to explain. Let’s say you have a partner that has a commercial building. His basis in the building is $20. He has a certified appraisal on the building, which is recommended. The building appraises at $100. He then contributes the building to the partnership at an inside basis of $100, receiving a 50% stake in the partnership. What is important to remember is that his inside basis in the partnership is $100. For the purposes of the partner’s inside basis, he receives the stepped up basis from the appraisal. However, his outside basis is still $20.

The first year the partnership makes $100. This amount is split between the partners and added to their inside basis. Outside basis is not affected. The second year the two partners contribute $200 to the partnership, both the inside basis and outside basis are increased by $200. And so on.

The problem with an IRC §751 transfer comes at the time when there is a sale of the property that was contributed. Let’s say that five years go by and the partnership needs a new building. They put the old building up for sale for $1,000. It sells for $1,000, and here is where you lose your job. Personally, my advice would have been to do an IRC §1031 Exchange, to defer the capital gains tax, but let’s say this client doesn't listen to you and they sell the building, using the money to buy a bigger

partner only. So, he has a long term capital gain of $980, taxed at 0%, 15%, or 20% depending on adjusted gross income (AGI).

Now let's say the LLC buys a building for $3,000, all of the partner's inside and outside basis are increased by the basis of the new building. So all partners are affected by the purchase. If a Like-Kind Exchange was done instead of a sale, the original partner's outside basis would increase by the $1,000 the building sold for, plus the amount of boot that partner contributed to get to the $3,000 purchase price, however, the capital; gains tax would have been averted. This is where you need a personal relationship with your clients and they take your advice. You took something that would of otherwise been taxable to the one partner, and deferred the capital gain for as long as the building is in service.

That is a Section 751 Transfer in a nutshell.