(EASA); or Dassault Aviation's EASA Design Organization Approval (DOA). If approved by the DOA, the approval must include the DOA-authorized signature.

(k) Related Information

(1) Refer to Mandatory Continuing Airworthiness Information (MCAI) EASA Airworthiness Directive 2013–0053, dated March 4, 2013, for related information. This MCAI may be found in the AD docket on the Internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2015–2967.

(2) For service information identified in this AD, contact Dassault Falcon Jet, P.O. Box 2000, South Hackensack, NJ 07606; telephone 201–440–6700; Internet *http://www.dassaultfalcon.com.* You may view this service information at the FAA, Transport Airplane Directorate, 1601 Lind Avenue SW., Renton, WA. For information on the availability of this material at the FAA, call 425–227–1221.

Issued in Renton, Washington, on July 23, 2015.

Victor Wicklund,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–109370–10]

RIN 1545–BJ34

Allocable Cash Basis and Tiered Partnership Items

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking and notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the determination of a partner's distributive share of certain allocable cash basis items and items attributable to an interest in a lower-tier partnership during a partnership taxable year in which a partner's interest changes. These proposed regulations affect partnerships and their partners.

DATES: Written or electronic comments and requests for a public hearing must be received by November 2, 2015. As of August 3, 2015, the notice of proposed rulemaking that was published in the **Federal Register** on May 24, 2005 (70 FR 29675), is partially withdrawn.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–109370–10), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–109370–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov/(IRSREG-109370-10)*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Benjamin H. Weaver, (202) 317–6850; concerning submissions of comments and requests for public hearing, Regina Johnson, (202) 317–6901 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 706 of the Internal Revenue Code (the Code) generally provides rules for the taxable years of partners and partnerships. Section 72 of the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494 (1984)) added section 706(d) to the Code to prevent a partner who acquires an interest in the partnership late in the taxable year from deducting partnership expenses incurred prior to the partner's entry into the partnership (retroactive allocations). Section 706(d)(1) provides that, except as provided in section 706(d)(2) and (d)(3), if during any taxable year of the partnership there is a change in any partner's interest in the partnership, each partner's distributive share of any item of income, gain, loss, deduction, or credit of the partnership for such taxable year shall be determined by the use of any method prescribed by regulations which takes into account the varying interests of the partners in the partnership during such taxable year.

On April 14, 2009, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–144689–04) (the 2009 proposed regulations) in the **Federal Register** to provide guidance under section 706(d)(1) and to conform the Income Tax Regulations for certain provisions of section 1246 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788 (1997)) and section 72 of the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494 (1984)). The Treasury Department and the IRS are publishing final regulations under section 706(d)(1) (the final regulations) contemporaneously with these proposed regulations. However, the Treasury Department and the IRS have decided to propose an amendment to the final regulations expanding the list of extraordinary items to include two new items: (1) For publicly traded partnerships, any item of income that is an amount subject to withholding as defined in § 1.1441–2(a) (excluding amounts effectively connected with the conduct of a trade or business within the United States) or a withholdable payment under § 1.1473–1(a) occurring during a taxable year if, for that taxable year, the partners agree to treat all such items as extraordinary items, and (2) for any partnership, deductions for the transfer of partnership equity in connection with the performance of services. In addition, these proposed regulations provide guidance under sections 706(d)(2) and (3).

1. Allocable Cash Basis Items

Section 706(d)(2) provides rules for certain allocable cash basis items. Section 706(d)(2)(A) provides that if during any taxable year of the partnership there is a change in any partner's interest in the partnership, then (except to the extent provided in regulations) each partner's distributive share of any allocable cash basis item shall be determined (i) by assigning the appropriate portion of such item to each day in the period to which it is attributable, and (ii) by allocating the portion assigned to any such day among the partners in proportion to their interests in the partnership at the close of such day. Section 706(d)(2)(B) defines ''allocable cash basis item'' as any of the following items with respect to which the partnership uses the cash receipts and disbursements method of accounting (cash method): (i) Interest, (ii) taxes, (iii) payments for services or for the use of property, or (iv) any other item of a kind specified in regulations prescribed by the Secretary as being an item with respect to which the application of section 706(d)(2) is appropriate to avoid significant misstatements of the income of the partners. Section 706(d)(2)(C) further provides that if any portion of any allocable cash basis item is attributable to (i) any period before the beginning of the taxable year, such portion shall be assigned under section 706(d)(2)(A)(i) to the first day of the taxable year, or (ii) any period after the close of the taxable year, such portion shall be assigned under section 706(d)(2)(A)(i) to the last day of the taxable year. Finally, section 706(d)(2)(D) provides that if any portion of a deductible cash basis item is assigned under section 706(d)(2)(C)(i) to the first day of any taxable year, (i) such portion shall be allocated among persons who are partners in the partnership during the period to which such portion is attributable in accordance with their varying interests in the partnership during such period, and (ii) any amount allocated under section 706(d)(2)(C)(i) to a person who is not a partner in the partnership on such first day shall be capitalized by the partnership and treated in the manner provided for in section 755.

The legislative history explains that section 706(d)(2) was enacted to prevent cash method partnerships from avoiding the retroactive allocation rules:

> [P]artnerships may attempt to avoid the retroactive allocation rules by using the cash method of accounting and deferring actual payment of deductible items until near the close of the partnership's taxable year. For example, if a partnership defers the payment of an expense (*e.g.*, interest) until December 31, and the partnership uses the interim closing method of allocations, a partner admitted on December 31 may be allowed a deduction for a full portion of the expense. This may be the case although the expense has economically accrued at an equal rate throughout the taxable year . . . In adding these rules, Congress rejected the argument that the retroactive allocations were proper because the funds invested by the new partners served to reimburse the original partners for their expenditures so that, as an economic matter, the new partners had incurred the costs for which they were claiming deductions.

H.R. Rep. No. 98–432, at 1212–1213 (1984).

On November 30, 1984, the Treasury Department and the IRS issued temporary regulations under section 706(d)(2) (§ 1.706–2T (TD 7991)) to address the interaction of sections 706(d)(2) and 267(a)(2). The temporary regulations provide that a deduction for any expense that is deferred under section 267 constitutes an allocable cash basis item under section 706(d)(2)(B)(iv). Specifically, the temporary regulations provide:

> Question 1: For purposes of section 706(d), how is an otherwise deductible amount that is deferred under section 267(a)(2) treated?
>
> Answer 1: In the year the deduction is allowed, the deduction will constitute an allocable cash basis item under section 706(d)(2)(B)(iv).

Neither the 2009 proposed regulations nor the final regulations provide guidance under section 706(d)(2). However, the 2009 proposed regulations specifically requested comments on issues that arise concerning allocable cash basis items, in particular whether the list of items in section 706(d)(2)(B) should be expanded (to include, for example, items such as property insurance), as well as any other issues with regard to allocating cash basis items. The Treasury Department and the IRS received comments relating to allocable cash basis items in response to the 2009 proposed regulations. The comments are discussed in this preamble.

2. Tiered Partnerships

Section 706(a) provides that, in computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner. Prior to the issuance of Rev. Rul. 77–311, 1977–2 CB 218, in 1977 and the enactment of section 706(d)(3) in 1984, some taxpayers took the position that, in the case of tiered partnerships, the language of section 706(a) means that an upper-tier partnership's distributive share of items from a lower-tier partnership is sustained by the upper-tier partnership on the last day of the lower-tier partnership's taxable year. These taxpayers therefore allocated the upper-tier partnership's share of the lower-tier partnership's items based solely upon the upper-tier partnership's partners' interests as of the last day of the lower-tier partnerships' taxable year. Rev. Rul. 77–311 rejected that position, and explains through an example that an upper-tier partnership's distributive share of any items of income, gain, loss, deduction, or credit from a lower-tier partnership is considered to be realized or sustained by the upper-tier partnership at the same time and in the same manner as such items were realized or sustained by the lower-tier partnership. Therefore, in allocating items from a lower-tier partnership, the upper-tier partnership must take into account variations among its partners' interests throughout the year, rather than merely looking to its partners' interests as of the last day of the lower-tier partnership's taxable year.

Section 706(d)(3) was enacted in 1984 and confirms the analysis of Rev. Rul. 77–311. Section 706(d)(3) provides that if during any taxable year of the partnership there is a change in any partner's interest in the partnership (the ''upper-tier partnership''), and such partnership is a partner in another partnership (the ''lower-tier partnership''), then (except to the extent provided in regulations) each partner's distributive share of any item of the upper-tier partnership attributable to the lower-tier partnership shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of section 706(d)(2)(C) and (D)) of each such item to the appropriate days during which the upper-tier partnership is a partner in the lower-tier partnership and by allocating the portion assigned to any such day among the partners in proportion to their interests in the upper-tier partnership at the close of such day.

Neither the 2009 proposed regulations nor the final regulations provide guidance under section 706(d)(3). However, the 2009 proposed regulations specifically requested comments on issues that arise concerning tiered partnerships, and stated that the daily allocation method, used for cash basis items, applies to all items of the lower-tier partnership if there is a change in the partnership interests in the upper-tier partnership. The Treasury Department and the IRS received comments relating to tiered partnerships in response to the 2009 proposed regulations. The comments are discussed in this preamble.

Explanation of Provisions and Summary of Comments

1. Allocable Cash Basis Items

With respect to allocable cash basis items, the proposed regulations generally restate the statutory provisions. Commenters requested that regulations clarify whether section 706(d)(2) applies only to items of deduction and loss or whether it also applies to items of income and gain. Generally, under the Code, the word ''item'' includes items of income, gain, deduction, and loss. Other than the item ''taxes,'' the items listed in section 706(d)(2)(B) can be either items of income (and gain) or deduction (and loss), depending on a taxpayer's particular circumstances. Section 706(d)(2)(B)(iv) also provides broad regulatory authority for the Secretary to add ''any other item . . . with respect to which the application of this paragraph is appropriate to avoid significant misstatements of the income of the partners.'' A significant misstatement of the income of partners can occur equally through an item of deduction or loss or an item of income or gain. Partnerships using the cash method that also use the interim closing method for accounting for partners' varying interests can use this distortion to affect the allocation of income to an incoming or outgoing partner. For these reasons, the proposed regulations provide that the allocable cash basis item rules apply to items of deduction, loss, income, and gain.

The proposed regulations provide that the term ''allocable cash basis item'' generally includes items of deduction, loss, income, or gain specifically listed in the statute: (i) interest, (ii) taxes, and (iii) payments for services or for the use of property. However, as discussed in part 4 of this preamble, the proposed regulations contain an exception for deductions for the transfer of an interest in the partnership in connection with the performance of services; such deductions generally must be allocated under the rules for extraordinary items in § 1.706–4(d).

Section 706(d)(2)(B)(iv) specifically grants the Secretary regulatory authority to include additional items in the list of allocable cash basis items to avoid significant misstatements of the income of the partners. Pursuant to the regulatory authority granted in section 706(d)(2)(B)(iv), the proposed regulations provide that the term ''allocable cash basis item'' includes any allowable deduction that had been previously deferred under section 267(a)(2). This provision incorporates the concept of § 1.706–2T and includes within the meaning of ''allocable cash basis item'' amounts deferred under section 267(a)(2) in the year in which the deduction is allowed. Accordingly, § 1.706–2T is proposed to be withdrawn by final regulations issued under section 706(d)(2).

Finally, pursuant to the regulatory authority granted in section 706(d)(2)(B)(iv), the proposed regulations provide that the term ''allocable cash basis item'' also includes any item of income, gain, loss, or deduction that accrues over time and that would, if not allocated as an allocable cash basis item, result in the significant misstatement of a partner's income. To provide additional clarification on the scope of the rule in proposed § 1.706–2(a)(2)(v), the Treasury Department and the IRS believe that items such as rebate payments, refund payments, insurance premiums, prepayments, and cash advances are examples of items which, if not allocated in the manner described in section 706(d)(2), could result in the significant misstatement of a partner's income. The Treasury Department and the IRS request comments on the inclusion of these items and other items within the meaning of ''allocable cash basis items.''

One commenter noted that section 706(d)(2) imposes the same administrative burden on partnerships regardless of the percentage of the partner's total expenses that are allocable cash basis items and therefore recommended that regulations under section 706(d)(2) include a de minimis rule. The Treasury Department and the IRS agree that a de minimis rule is appropriate given the scope of the proposed regulations. Accordingly, the proposed regulations provide that an allocable cash basis item will not be subject to the rules in section 706(d)(2) if, for the partnership's taxable year: (1) The total of the particular class of allocable cash basis items (for example, all interest income) is less than five percent of the partnership's (a) gross income, including tax-exempt income described in section 705(a)(1)(B), in the case of income or gain items, or (b) gross expenses and losses, including section 705(a)(2)(B) expenditures, in the case of losses and expense items; and (2) the total amount of allocable cash basis items from all classes of allocable cash basis items amounting to less than five percent of the partnership's (a) gross income, including tax-exempt income described in section 705(a)(1)(B), in the case of income or gain items, or (b) gross expenses and losses, including section 705(a)(2)(B) expenditures, in the case of losses and expense items, does not exceed $10 million in the taxable year, determined by treating all such allocable cash basis items as positive amounts.

Additionally, the Treasury Department and the IRS request comments on whether the final regulations should provide an exception for certain items of income or deduction arising from payments for services or for the use of property. For example, comments are requested on whether payments for services or for the use of property should be excluded from the rules in section 706(d)(2) if they arise and are, as applicable, paid or received in the ordinary course of the partnership's business (such as the regular payment of wages to employees), and whether deferred compensation or contingency or success-based fees and other payments for services based on performance conditions (which are not calculated based on an hourly rate) should be subject to the rules of section 706(d)(2) (and, if so, on the proper method for assigning the appropriate portion of such item to each day in the period).

The proposed regulations contain two examples illustrating the operation of section 706(d)(2)(D)(ii), which requires certain portions of deductible cash basis items to be capitalized in the manner provided in section 755 in the event that the deduction is otherwise partially allocable to a former partner who is no longer a partner as of the first day of the partnership's taxable year. The Treasury Department and the IRS request comments on the appropriate interaction between the principles and rules of section 755 and section 706(d), including whether the final regulations should provide an exception to the capitalization rules of section 706(d)(2)(D)(ii) in cases where the former partner ceased to be a partner in the partnership as a result of the partner's contribution of its partnership interest to another entity in a non-recognition transaction.

2. Tiered Partnerships

With respect to tiered partnerships, the proposed regulations provide that the daily allocation method used for cash basis items applies to all items of the lower-tier partnership if there is a change in any partner's interest in the upper-tier partnership.

Commenters noted the administrative burden of the daily allocation method on tiered partnerships. Commenters stated that obtaining information from a lower-tier partnership to track changes in the ownership interest in an upper-tier partnership is burdensome, and often impractical, unless the upper-tier partnership owns a controlling interest in the lower-tier partnership. One commenter suggested that the Treasury Department and the IRS issue interim guidance to provide that section 706(d)(3) should not apply to a change in a partner's interest in an upper-tier partnership unless the upper-tier partnership owns an interest in more than 50 percent of the profits and capital of the lower-tier partnership. Another commenter recommended an exception when the upper-tier partnership owns a relatively small portion (such as 10 percent or less) of the lower-tier partnership. The Treasury Department and the IRS acknowledge that a lack of information sharing among tiered partnerships may make it difficult to comply with a daily allocation requirement. Thus, the proposed regulations provide an exception from section 706(d)(3) if the upper-tier partnership directly owns an interest in less than 10 percent of the profits and capital of the lower-tier partnership (''a de minimis upper-tier partnership''), all de minimis upper-tier partnerships in aggregate own an interest in less than 30 percent of the profits and capital of the lower-tier partnership, and if no partnership is created with a purpose of avoiding the application of the tiered partnership rules of section 706(d)(3). The application of this exception is determined at each tier, depending on the interests held by the direct partners at each tier. Thus, in the case of an upper-tier partnership owning an interest in a middle tier partnership, which in turn owns an interest in a lower-tier partnership, it may be the case that the exception applies to the upper-tier partnership's interest in the middle tier partnership, but not to the middle tier partnership's interest in the lower-tier partnership (or vice-versa).

If the de minimis upper-tier partnership exception applies, the upper-tier partnership may, but is not required to, apply the general rules of § 1.706–4 in allocating items attributable to the lower-tier partnership. However, as explained in Rev. Rul. 77–311, an upper-tier partnership's distributive share of any items of income, gain, loss, deduction, or credit from a lower-tier partnership is considered to be realized or sustained by the upper-tier partnership at the same time and in the same manner as such items were realized or sustained by the lower-tier partnership. Thus, if the de minimis upper-tier partnership exception applies to an upper-tier partnership using the interim closing method, the upper-tier partnership's allocations of the lower-tier partnership items under the general rules of § 1.706–4 will generally reach the same result as applying the rules of section 706(d)(3). On the other hand, if the de minimis upper-tier partnership exception applies to an upper-tier partnership using the proration method, the upper-tier partnership may prorate the items from the lower-tier partnership across the upper-tier partnership's segments (or, if the upper-tier partnership has only one segment for its entire taxable year, it may prorate the items across its entire taxable year). Even if the de minimis upper-tier partnership exception applies, the upper-tier partnership may choose to allocate the items attributable to the lower-tier partnership according the tiered partnership rules instead. However, the proposed regulations do not impose on lower-tier partnerships an obligation to disclose to upper-tier partnerships the timing of the lower-tier partnership's items. The proposed regulations contain three examples illustrating these principles.

Commenters also requested additional guidance on the application of section 706(d)(3) in certain circumstances. One commenter requested that the final regulations provide guidance on tiered partnerships that would allow an upper-tier partnership to determine the items from the lower-tier partnership that are allocable to the upper-tier partnership segments based on an interim closing method (as of any upper-tier partnership segment end) applied to the lower-tier partnership if the upper-tier partnership: (i) Has the same taxable year as its lower-tier partnership; (ii) holds a fixed percentage interest in the lower-tier partnership during a taxable year; and (iii) uses the interim closing method. This commenter also recommended that guidance provide that an upper-tier partnership that has the same taxable year as its lower-tier partnership and holds a fixed percentage interest in that lower-tier partnership during the upper-tier partnership's taxable year may prorate the non-extraordinary items of the lower-tier partnership to each day of the upper-tier partnership's taxable year, without regard to whether the upper-tier partnership uses the proration method or the interim closing method.

However, as explained in this preamble, the Treasury Department and the IRS believe that because an upper-tier partnership's distributive share of any items of income, gain, loss, deduction, or credit from a lower-tier partnership is considered to be realized or sustained by the upper-tier partnership at the same time and in the same manner as such items were realized or sustained by the lower-tier partnership, application of the interim closing method will generally reach the same result as applying the rules of section 706(d)(3). The Treasury Department and the IRS also believe that allowing an upper-tier partnership that uses the interim closing method to prorate items from a lower-tier partnership across the upper-tier partnership's entire taxable year would be inconsistent with the principles explained in Rev. Rul. 77–311. Therefore, the proposed regulations do not adopt these comments. However, the Treasury Department and the IRS request comments on safe harbors that might be appropriate in these circumstances as well as comments on the treatment of an upper-tier partnership and a lower-tier partnership that have different taxable years.

One commenter also recommended that guidance provide that the default method for tiered partnerships is the proration method unless the upper-tier partnership agrees to use the interim closing method and receives sufficient information from the lower-tier partnership to use that method. Under section 706(d)(1) as implemented by § 1.706–4, the interim closing method is the default method unless the partners agree in writing to use the proration method. Because the recommended rule would be inconsistent with section 706(d)(1) as implemented by § 1.706–4, the Treasury Department and the IRS did not adopt this rule in the proposed regulations.

A commenter further recommended that any conventions applicable to the upper-tier partnership should apply to income from the lower-tier partnership. In general, the Treasury Department and the IRS believe that any conventions applicable to the upper-tier partnership should apply to items from the lower-tier partnership, but are continuing to consider this recommendation in the context of section 706(d)(3) and request comments on safe harbors when the upper-tier partnership and the lower-tier partnership use the same method, but different conventions.

Another commenter recommended that the final regulations permit partnerships to voluntarily apply the rules of section 706(d)(3) if the upper-tier partnership and the lower-tier partnership have an advance agreement establishing the allocation method for items derived from the upper-tier partnership's interest in the lower-tier partnership. As described in this preamble, the Treasury Department and the IRS are requesting comments on appropriate safe harbors and will continue to consider this recommendation.

The Treasury Department and the IRS also request comments on appropriate rules, if any, when there is a variance at both the upper-tier partnership and lower-tier partnership.

More generally, the Treasury Department and the IRS request comments on the appropriate coordination between the rules of sections 706(d)(2) and (3) and the rules of § 1.706–4. In particular, the Treasury Department and the IRS request comments on whether certain items such as contingency or success-based fees and other payments for services based on performance conditions are more appropriately addressed under the rules of section 706(d)(2) and (3), which require allocation of items across the period to which they are attributable, or under the rules for the allocation of extraordinary items under § 1.706–4(e), which requires allocation of items according to the partners' interests at the time of day on which the extraordinary item occurs. Additionally, the Treasury Department and the IRS request comments on whether certain items subject to section 706(d)(2) and (3) may instead be simply allocated under the proration method of § 1.706–4(d) without impinging on the Congressional intent behind sections 706(d)(2) and (3) or resulting in a substantial distortion of income.

3. Additional Extraordinary Item for Publicly Traded Partnerships (PTPs)

Section 1.706–4(e) of the final regulations provides rules for the allocation of certain ''extraordinary items.'' In general, extraordinary items must be allocated among the partners in proportion to their interests in the partnership item at the time of day on which the extraordinary item occurs. Section 1.706–4(e)(2) contains a list of extraordinary items. These proposed regulations add two additional extraordinary items to that list.

The first proposed additional extraordinary item responds to comments received on the 2009 proposed regulations regarding the administrative difficulty PTPs face in satisfying withholding obligations under section 1441 if PTPs are not permitted to use a quarterly convention. As explained in Part 1.C.iii of the preamble to the final regulations, the final regulations do not permit PTPs to use a quarterly convention. One commenter on the 2009 proposed regulations suggested other options of addressing this issue if the Treasury Department and the IRS are concerned that allowing a quarterly convention would be too broad. One option suggested was to permit PTPs that have income subject to withholding under section 1441 to treat that income as an extraordinary item allocated to PTP unit holders who are the record holders on the date the distribution is declared. The Treasury Department and the IRS agree that a special rule is desirable to link each partner's distributive share to the related cash distributions, thereby enabling PTPs and their transfer agents to satisfy their withholding obligations under chapter 4 of the Code and sections 1441 through 1443 from distributions. Therefore, these proposed regulations generally adopt this suggested alternative to a quarterly convention.

Specifically, these proposed regulations provide that for PTPs, all items of income that are amounts subject to withholding as defined in § 1.1441–2(a) (excluding income effectively connected with the conduct of a trade or business within the United States) or withholdable payments under § 1.1473–1(a) occurring during a taxable year may be treated as extraordinary items if the partners agree (within the meaning of § 1.706–4(f)) to consistently treat all such items as extraordinary items for that taxable year. If the partners so agree, then for purposes of section 706 such items shall be treated as occurring at the next time as of which the recipients of a distribution by the PTP are determined, or, to the extent such income items arise between the final time during the taxable year as of which the recipients of a distribution are determined and the end of the taxable year, such items shall be treated as occurring at the final time during the taxable year as of which the recipients of a distribution by the PTP are determined. However, this rule does not apply unless the PTP has a regular practice of making at least four distributions (other than de minimis distributions) to its partners each taxable year. The proposed regulations contain an example illustrating this rule.

The final regulations generally require extraordinary items to be allocated without regard to the partnership's method or convention. However, § 1.706–4(e)(1) of the final regulations provides that PTPs may, but are not required to, respect the applicable conventions in determining who held their publicly traded units at the time of the occurrence of an extraordinary item. The Treasury Department and the IRS believe that this exception should be turned off for all items subject to the new proposed extraordinary item rule for PTPs to ensure that each partner's distributive share of such items is linked to the related cash distributions. Accordingly, the proposed regulations modify the rule in § 1.706–4(e)(1) to provide that PTPs that choose to treat items subject to withholding under section 1441 as extraordinary items must allocate those items among the partners in proportion to their interests in those items at the time as of which the recipients of the relevant distribution are determined, regardless of the method and convention otherwise used by the PTP.

Taxpayers may rely on this proposed additional extraordinary item until final regulations are published. The proposed regulations do not use the phrase ''record holders on the date the distribution is declared,'' because the Treasury Department and the IRS understand that the recipients of a distribution by a PTP may be determined as of a time other than on the date the distribution is declared. The Treasury Department and the IRS request comments on the operation of this special rule, and on the interaction between the rules under section 706 and PTP allocations generally.

4. Coordination With Proposed Partnership Equity for Services Regulations

On May 24, 2005, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–105346–03, 70 FR 29675) in the **Federal Register**, the proposed Partnership Equity for Services regulations, relating to the tax treatment of certain transfers of partnership interests in connection with the performance of services. The proposed Partnership Equity for Services regulations provide rules for coordinating section 83 with partnership taxation principles. On June 13, 2005, the Treasury Department and the IRS published Notice 2005–43, I.R.B. 2005–24, setting forth a proposed revenue procedure providing additional related guidance. The proposed Partnership Equity for Services regulations and the proposed revenue procedure are not effective until finalized. Notice 2005–43 provides that, until then, taxpayers may continue to rely on Rev. Proc. 93–27, 1993–2 C.B. 343, and Rev. Proc. 2001–43, 2001–2 C.B. 191. The Treasury Department and the IRS continue to consider the interaction of section 83 with partnership taxation principles. No inferences should be drawn from these proposed regulations as to the resolution of the issues addressed in the proposed Partnership Equity for Services regulations or any other related issues.

The proposed Partnership Equity for Services regulations contain two provisions relating to the varying interest rule under section 706. First, proposed § 1.706–3(a) of the proposed Partnership Equity for Services regulations is intended to provide an exception to the allocable cash basis item rules of section 706(d)(2) for deductions for the transfer of partnership interests and other property subject to section 83. The preamble to the proposed Partnership Equity for Services regulations indicates that the exception was intended to allow partnerships to allocate such deductions under a closing of the books method. The preamble indicates that the Treasury Department and the IRS had concluded that, absent treatment under the allocable cash basis item rules of section 706(d)(2), the application of section 706(d)(1) would adequately ensure that partnership deductions that are attributable to the portion of the partnership's taxable year prior to a new partner's entry into the partnership are allocated to the historic partners.

The Treasury Department and the IRS have concluded that, in the case of a transfer of a partnership interest in connection with the performance of services, no portion of the partnership's deduction should be allocated to the person who performs the services. However, the Treasury Department and the IRS have also concluded that the scope of the exception to allocable cash basis treatment in proposed § 1.706–3(a) may have been too broad because it applies to all transfers of property subject to section 83, for which the Treasury Department and the IRS request comments under these proposed regulations. Therefore, the Treasury Department and the IRS withdraw proposed § 1.706–3(a). Instead, these proposed regulations provide an exception to allocable cash basis treatment for deductions for transfers of partnership interests in connection with the performance of services. Additionally, to ensure that such deductions are allocated solely to partners other than the person who performed the services, the proposed regulations add to the list of extraordinary items in § 1.706–4(d)(2) any deduction for the transfer of an interest in the partnership in connection with the performance of services, and clarify that such extraordinary item is treated as occurring immediately before the transfer or vesting of the partnership interest that results in compensation income for the person who performs the services.

As explained in the final § 1.706–4 in the Rules and Regulations section of this issue of the **Federal Register**, extraordinary items generally must be allocated among the partners in proportion to their interests in the partnership item at the time of day on which the extraordinary item occurs. However, there are exceptions to the extraordinary item rules for certain small items in § 1.704–4(e)(3) and for partnerships for which capital is not a material income-producing factor in § 1.706–4(b)(2)). To ensure that partnership deductions attributable to the transfer of interests in the partnership in connection with the performance of services are always allocated solely to the historic partners, the proposed regulations turn off these exceptions to extraordinary item treatment for such deductions. Thus, treatment as an extraordinary item subject to the special timing rule will ensure that, for both accrual and cash-method partnerships, no portion of the deduction for the transfer of a partnership interest in connection with the performance of services will be allocated to the person who performs the services.

Second, proposed § 1.706–3(b) of the proposed Partnership Equity for Services regulations provides that a partnership must make certain forfeiture allocations upon forfeiture of a partnership interest for which a section 83(b) election was made. In particular, proposed § 1.706–3(b) provides that although the person forfeiting the interest may not have been a partner for the entire taxable year, forfeiture allocations may be made out of the partnership's items for the entire taxable year. The Treasury Department and the IRS anticipate that if the rules for forfeiture allocations in proposed § 1.706–3(b) are adopted when the proposed Partnership Equity for Services regulations are finalized, those rules will include in § 1.706–3(b) an additional exception to the general application of the varying interest rule. In the meantime, these proposed regulations move § 1.706–3(b) of the proposed Partnership Equity for Services regulations to new proposed § 1.706–6(a) to accommodate the new proposed regulations in § 1.706–3.

Proposed Effective Date

The regulations are proposed to apply to partnership taxable years beginning on or after the date of publication of the Treasury decision adopting these regulations as final regulations in the **Federal Register**.

Reliance on Proposed Regulations

Taxpayers may rely on §§ 1.706–4(e)(1) and 1.706–4(e)(2)(ix) of the proposed regulations (relating to a publicly traded partnership's treatment of all amounts subject to withholding as defined in § 1.1441–2(a) that are not effectively connected with the conduct of a trade or business within the United States or withholdable payments under § 1.1473–1(a) as extraordinary items) until final regulations are issued.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this proposed regulation, and because this proposed regulation does 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 Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a 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) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Benjamin H. Weaver, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805 and 706(d)(2), § 1.706–3(a) of the notice of proposed rulemaking that was published in the **Federal Register** on May 24, 2005 (70 FR 29675), is withdrawn.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 continues to read in part as follows:

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

§ 1.706–2 also issued under 26 U.S.C. 706(d)(2)

§ 1.706–3 also issued under 26 U.S.C. 706(d)(3).

§ 1.706–4 also issued under 26 U.S.C. 706(d).* * *

■ **Par. 2.** Section 1.706–0 is amended by removing the entry for § 1.706–2T and adding entries for §§ 1.706–2, 1.706–3, and 1.706–6 to read as follows:

§ 1.706–0 Table of contents.

* * * * *

§ 1.706–2 Certain cash basis items prorated over period to which attributable.

(a) Allocable cash basis items prorated over period to which attributable.

(1) In general.

(2) Allocable cash basis item.

(3) Items attributable to periods not within taxable year.

(4) Treatment of deductible items attributable to prior periods.

(b) Example.

(c) De minimis exception.

(d) Effective/applicability date.

§ 1.706–3 Items attributable to interest in lower-tier partnership prorated over entire taxable year.

(a) General rule.
(b) Safe harbor.
(c) De minimis upper-tier partner exception.
(d) Effective/applicability date.

* * * * *

§ 1.706–6 Property transferred in connection with the performance of services.
(a) Forfeiture allocations.
(b) Effective date.

■ **Par. 3.** Section 1.706–2 is added to read as follows:

§ 1.706–2 Certain cash basis items allocable.

(a) *Allocable cash basis items prorated over period to which attributable*—(1) *In general.* If during any taxable year of the partnership there is a change in any partner's interest in the partnership, then each partner's distributive share of any allocable cash basis item shall be determined—

(i) By assigning the appropriate portion of such item to each day in the period to which it is attributable; and

(ii) By allocating the portion assigned to any such day among the partners in proportion to their interests in the partnership at the close of such day.

(2) *Allocable cash basis item.* For purposes of this section, the term *allocable cash basis item* means any of the following items of deduction, loss, income, or gain with respect to which the partnership uses the cash receipts and disbursements method of accounting:

(i) Interest;

(ii) Taxes;

(iii) Payments for the use of property or for services (other than deductions for the transfer of an interest in the partnership in connection with the performance of services; such deductions generally must be allocated under the rules for extraordinary items in § 1.706–4(d));

(iv) Any allowable deduction that had been previously deferred under section 267(a)(2);

(v) Any deduction, loss, income, or gain item that accrues over time and that would, if not allocated as an allocable cash basis item, result in the significant misstatement of a partner's income.

(3) *Items attributable to periods not within taxable year.* If any portion of any allocable cash basis item is attributable to—

(i) Any period before the beginning of the taxable year, such portion shall be assigned under paragraph (a)(1)(i) of this section to the first day of the taxable year, or

(ii) Any period after the close of the taxable year, such portion shall be assigned under paragraph (a)(1)(i) of this section to the last day of the taxable year.

(4) *Treatment of deductible items attributable to prior periods.* If any portion of a deductible cash basis item is assigned under paragraph (a)(3)(i) of this section to the first day of any taxable year—

(i) Such portion shall be allocated among persons who are partners in the partnership during the period to which such portion is attributable in accordance with their varying interests in the partnership during such period; and

(ii) Any amount allocated under paragraph (a)(4)(i) of this section to a person who is not a partner in the partnership on such first day shall be capitalized by the partnership and allocated among partnership assets under the principles of section 755 (applying the principles of § 1.755–1(b) for partners who sold or exchanged their interest, and the principles of § 1.755–1(c) for partners who received a distribution from the partnership in exchange for their interest).

(b) Example 1. On January 1, 2015, A, B, and C are equal one-third partners in PRS, a calendar year partnership that uses the cash receipts and disbursements method of accounting. On July 1, 2015, A sells her entire interest in PRS to D. On December 1, 2015, PRS pays a $12,000 interest expense that is attributable to every day in PRS's taxable year. Assume the de minimis exception of paragraph (c) of this section does not apply, and that the $12,000 interest expense must be allocated under the rules of paragraph (a) of this section. A was a partner in PRS for 181 days, and D was a partner in PRS for 184 days, including on July 1 pursuant to paragraph (a)(1)(ii) of this section. Under paragraph (a) of this section, A is entitled to 181/365 of her otherwise allocable share of deductions for the $12,000 interest expense, and D is entitled to 184/365 of his otherwise allocable share of deductions for the $12,000 interest expense. Thus, PRS allocates the interest expense deductions $1,983.56 to A, $2,016.44 to D, and $4,000 to each B and C.

Example 2. In 2015, E, F, and G are equal one-third partners in PRS, a calendar year partnership that uses the cash receipts and disbursements method of accounting. On December 31, 2015, E sells her entire interest in PRS to H. In November 2016, PRS makes a $6,000 payment for the use of property that is attributable to the period from January 1, 2015 to December 31, 2016. Assume the de minimis exception of paragraph (c) of this section does not apply, and that the $6,000 payment for the use of property must be allocated under the rules of paragraph (a) of this section. Under paragraph (a)(3)(i) of this section, half of the $6,000 expense is attributable to 2015 and must be assigned to January 1, 2016. Of this $3,000 assigned to January 1, 2016, one-third is allocable to each E, F, and G under paragraph (a)(4)(i) of this section. However, because E is not a partner in 2016, PRS must capitalize E's $1,000 share of the expense under paragraph (a)(4)(ii) of this section. Because E sold her interest to H, PRS must treat the capitalized $1,000 similar to a section 743(b) adjustment for H allocated among PRS's property under the principles of § 1.755–1(b).

Example 3. Assume the same facts as Example 2, except that on December 31, 2015, PRS distributed property to E in complete redemption of E's interest, and H never becomes a partner in PRS. PRS must capitalize E's $1,000 share of the expense under paragraph (a)(4)(ii) of this section. However, because E was redeemed, PRS must instead treat the capitalized $1,000 similar to a section 734(b) common basis adjustment allocated among PRS's property under the principles of § 1.755–1(c).

(c) *De minimis exception.* An item described in paragraph (a)(2) of this section will not be subject to the rules of this section if, for the partnership's taxable year the total amount of the particular class of allocable cash basis items described in paragraph (a)(2)(i) through (v) of this section (but in no event counting an item more than once) is less than five percent of the partnership's gross income, including tax-exempt income described in section 705(a)(1)(B), in the case of income or gain items, or gross expenses and losses, including section 705(a)(2)(B) expenditures, in the case of losses and expense items; and the total amount of allocable cash basis items from all classes of allocable cash basis items amounting to less than five percent of the partnership's gross income, including tax-exempt income described in section 705(a)(1)(B), in the case of income or gain items, or gross expenses and losses, including section 705(a)(2)(B) expenditures, in the case of losses and expense items, does not exceed $10 million in the taxable year, determined by treating all such allocable cash basis items as positive amounts.

(d) *Effective/applicability date.* This section applies to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as a final regulation in the **Federal Register**.

§ 1.706–2T [Removed]

■ **Par. 4.** Section 1.706–2T is removed.

■ **Par. 5.** Section 1.706–3 is added to read as follows:

§ 1.706–3 Items attributable to interest in lower-tier partnership.

(a) *General rule.* Except as provided in paragraphs (b) and (c) of this section, if during any taxable year of the partnership—

(1) There is a change in any partner's interest in the partnership (the upper-tier partnership); and

(2) Such partnership is a partner in another partnership (the lower-tier partnership),

then each partner's distributive share of any item of the upper-tier partnership attributable to the lower-tier partnership shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of § 1.706–2(a)(3) and (4)) of each such item to the appropriate days during which the upper-tier partnership is a partner in the lower-tier partnership and by allocating the portion assigned to any such day among the partners in proportion to their interests in the upper-tier partnership at the close of such day. An upper-tier partnership's distributive share of any items of income, gain, loss, deduction, or credit from a lower-tier partnership is considered to be realized or sustained by the upper-tier partnership at the same time and in the same manner as such items were realized or sustained by the lower-tier partnership. For an additional example of the application of the principles of this paragraph (a), see Revenue Ruling 77–311, 1977–2 CB 218. *See* section 601.601(d)(2)(ii)(b).

(b) *De minimis upper-tier partnership exception.* A de minimis upper-tier partnership is not required to, but may, apply paragraph (a) of this section. For purposes of this paragraph, a de minimis upper-tier partnership is a partnership that directly owns an interest in less than 10 percent of the profits and capital of the lower-tier partnership. This paragraph (b) only applies if all de minimis upper-tier partnerships own an interest in, in the aggregate, less than 30 percent of the profits and capital of the lower-tier partnership, and if no partnership is created with a purpose of avoiding the application of this section.

(c) Example 1. On January 1, 2015, A, B, and C are equal one-third partners in UTP, a calendar year partnership that uses the proration method and calendar day convention to account for variations during its taxable year. UTP is itself a partner in a lower-tier partnership, LTP, which is also a calendar year partnership. UTP owns a 15 percent interest in the profits and capital of LTP throughout 2015. On August 1, 2015, A sells her entire interest in UTP to D. During 2015, LTP incurred $100,000 of ordinary deductions, which were attributable to the period from January 1, 2015, to July 1, 2015. None of LTP's deductions were extraordinary items within the meaning of § 1.706–4(e). UTP's distributive share of LTP's deductions is $15,000. Under paragraph (a) of this section, UTP must assign the $15,000 equally among all days from January 1, 2015 to July 1, 2015, and allocate the assigned daily portions among its partners in accordance with their interests in UTP on those days. Accordingly, A, B, and C are each allocated $5,000 of the deduction, and D is not allocated any portion of the deduction.

Example 2. Assume the same facts as Example 1, except that UTP owned a 9 percent interest in the profits and capital of LTP throughout 2015, and that LTP had only one other partner, which owned the remaining 91 percent of LTP. UTP's distributive share of LTP's $100,000 ordinary deductions is $9,000. UTP qualifies as a de minimis upper-tier partnership under paragraph (b) of this section, and therefore UTP is not required to apply the rules of paragraph (a) of this section. Instead, UTP may apply the rules of § 1.706–4 to the $9,000 ordinary deduction. If UTP decides to apply the rules of § 1.706–4, UTP prorates the $9,000 deduction equally over its entire taxable year, and allocates it according to its partners' interests on each day. Because A was a partner in UTP for 213 days, and D was a partner in UTP for 152 days, UTP allocates the $9,000 deduction $3,000 to each of B and C, $1,750.68 to A, and $1,249.32 to D.

Example 3. Assume the same facts as Example 2, except that UTP uses the interim closing method rather than the proration method. UTP qualifies as a de minimis upper-tier partnership under paragraph (b) of this section, and therefore UTP is not required to apply the rules of paragraph (a) of this section. Instead, UTP may apply the rules of § 1.706–4 to the $9,000 ordinary deduction. UTP's distributive share of LTP items is considered to have been realized or sustained by UTP at the same time and in the same manner as such items were realized or sustained by LTP. Accordingly, even if UTP decides to apply the rules of § 1.706–4, UTP's application of the interim closing method of § 1.706–4 to the $9,000 deduction results in UTP allocating to each of A, B, and C $3,000 of the deduction, and not allocating any portion of the deduction to D. UTP would reach the same result if it had instead chosen to apply the rules of paragraph (a) of this section.

(d) *Effective/applicability date.* This section applies to partnership taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as a final regulation in the **Federal Register**.

§ 1.706–3(b) and (c) [Redesignated as § 1.706–6(a) and (b)]

■ **Par. 6.** As proposed to be added May 24, 2005 (70 FR 29675), redesignate § 1.706–3(b) and (c) as § 1.706–6(a) and (b).

■ **Par. 7.** Section 1.706–4 is amended by:

■ a. Adding a new sentence to the end of paragraph (b)(2);

■ b. Revising paragraph (e)(1);

■ c. Redesignating paragraphs (e)(2)(ix), (x), and (xi) as paragraphs (e)(2)(xi), (xii), and (xiii) respectively;

■ d. Adding new paragraphs (e)(2)(ix) and (e)(2)(x);

■ e. Adding a new sentence to the end of paragraph (e)(3);

■ f. Revising paragraph (e)(4) Example 3; and

■ g. Revising the first sentence of paragraph (f).

The additions and revisions read as follows:

§ 1.706–4 Determination of distributive share when a partner's interest varies.

* * * * *

(b) * * *

(2) * * * However, this paragraph (b)(2) does not apply to any deduction for the transfer of an interest in the partnership in connection with the performance of services. Instead, such deduction must be allocated under the extraordinary item rules of paragraphs (e)(1) and (2) of this section.

* * * * *

(e) * * *(1) *General principles.* Extraordinary items may not be prorated. The partnership must allocate extraordinary items among the partners in proportion to their interests in the partnership item at the time of day on which the extraordinary item occurred, regardless of the method (interim closing or proration method) and convention (daily, semi-monthly, or monthly) otherwise used by the partnership. These rules require the allocation of extraordinary items as an exception to the proration method, which would otherwise ratably allocate the extraordinary items across the segment, and the conventions, which could otherwise inappropriately shift extraordinary items between a transferor and transferee. However, publicly traded partnerships (as defined in section 7704(b)) that are treated as partnerships may, but are not required to, apply their selected convention in determining who held publicly traded units (as described in § 1.7704–1(b) or § 1.7704–1(c)(1)) at the time of the occurrence of any extraordinary item except extraordinary items described in paragraph (e)(2)(ix) of this section. Publicly traded partnerships that choose to treat items described in paragraph (e)(2)(ix) of this section as extraordinary items must allocate those items among the partners in proportion to their interests in those items at the time of day on which the items are deemed to have occurred according to the special timing rules for those items in paragraph (e)(2)(ix) of this section, regardless of the method and convention otherwise used by the partnership. Extraordinary items continue to be subject to any special limitation or requirement relating to the timing or amount of income, gain, loss, deduction, or credit applicable to the entire partnership taxable year (for example, the limitation for section 179 expenses).

(2) * * *

(ix) For publicly traded partnerships (as defined in section 7704(b)), any item of income that is an amount subject to withholding as defined in § 1.1441–2(a) (excluding amounts effectively connected with the conduct of a trade or business within the United States) or a withholdable payment under § 1.1473–1(a) occurring during a taxable year if the partners agree (within the meaning of paragraph (e) of this section) to consistently treat all such items as extraordinary items for that taxable year. If the partners so agree, then for purposes of section 706 such items shall be treated as occurring at the next time as of which the recipients of a distribution by the partnership are determined, or, to the extent such income items arise between the final time during the taxable year as of which the recipients of a distribution by the partnership are determined and the end of the taxable year, such items shall be treated as occurring at the final time during the taxable year as of which the recipients of a distribution by the partnership are determined. This paragraph (e)(2)(ix) does not apply unless the partnership has a regular practice of making at least four distributions (other than de minimis distributions) to its partners during each taxable year.

(x) Any deduction for the transfer of an interest in the partnership in connection with the performance of services. Such an extraordinary item is treated as occurring immediately before the transfer or vesting of the partnership interest that results in compensation income for the person who performs the services, but in no case shall the item be treated as occurring prior to the beginning of the partnership's taxable year.

* * * * *

(3) * * * However, this paragraph (e)(3) does not apply to any deduction for the transfer of an interest in the partnership in connection with the performance of services. Instead, such deduction must be allocated under the extraordinary item rules of paragraphs (e)(1) and (2) of this section.

(4) * * *

Example 3. (i) Assume the same facts as in *Example 2,* except that PRS is a publicly traded partnership (within the meaning of section 7704(b)), A held a publicly traded unit (as described in § 1.7704–1(b) or § 1.7704–1(c)(1)) in PRS, and the extraordinary item recognized at 3:15 p.m. on December 7, 2015 is not described in paragraph (e)(2)(ix) of this section. Under PRS's monthly convention, the December 12 variation is deemed to have occurred for purposes of this section at the end of the day on November 30, 2015. Pursuant to paragraph (e)(1) of this section, a publicly traded partnership (as defined in section 7704(b)) may choose to respect its conventions in determining who held its publicly traded units (as described in § 1.7704–1(b) or § 1.7704–1(c)(1)) at the time of the occurrence of an extraordinary item, except for extraordinary items described in paragraph (e)(2)(ix) of this section. Therefore, PRS may choose to treat A as not having been a partner in PRS for purposes of this paragraph (e) at the time the extraordinary item arose, and thus PRS may choose not to allocate A any share of the extraordinary item.

(ii) Assume the same facts as in paragraph (i) of this *Example 3,* except that on November 5, 2015, PRS recognizes an item of income that is an amount subject to withholding as defined in § 1.1441–2(a) (and that is not effectively connected with the conduct of a trade or business within the United States). PRS has a regular practice of making quarterly distributions to its partners each taxable year. PRS determines that the recipients of its fourth-quarter distribution will be interest holders of record at the close of business on December 15, 2015. The partners of PRS agree (within the meaning of paragraph (f) of this section) to consistently treat all such items during the taxable year as extraordinary items. Pursuant to paragraph (e)(2)(ix) of this section, the item of income that arose on November 5 is treated as an extraordinary item occurring at the next time as of which the recipients of a distribution by the partnership are determined (unless that time occurs in a different taxable year). Because December 15 occurs before the end of PRS's taxable year, the item of income is treated as occurring at the close of business on December 15, and must be allocated according to PRS's partners' interests at that time, determined without regard to PRS's applicable convention. Therefore, A will not be allocated any share of the item because A disposed of its entire interest in PRS before the close of business on December 15.

(iii) Assume the same facts as in paragraph (ii) of this *Example 3,* except that PRS determines that the recipients of its fourth-quarter distribution will be interest holders of record at the close of business on January 15, 2016, and PRS determines that the recipients of its third-quarter distribution will be interest holders of record at the close of business on October 21, 2015. Therefore, the last time during 2015 as of which the recipients of a distribution by PRS are determined is at the close of business on October 21, 2015. Pursuant to paragraph (e)(2)(ix) of this section, because the item of income subject to withholding as defined in § 1.1441–2(a) which arises on November 5 arises between the final time during the taxable year as of which the recipients of a distribution are determined and the end of the taxable year, such item shall be treated as occurring at the final time during the taxable year as of which the recipients of a distribution by the partnership are determined. Therefore, the item of income subject to withholding as defined in § 1.1441–2(a) which arises on November 5, 2015 is treated as occurring at the close of business on October 21, 2015, and must be allocated according to PRS's partners' interests at that time.

(f) *Agreement of the partners.* For purposes of paragraphs (a)(3)(iii) (relating to selection of the proration method), (c)(3) (relating to selection of the semi-monthly or monthly convention), (d)(1) (relating to performance of regular semi-monthly or monthly interim closings), (e)(2)(ix) (relating to a publicly traded partnership's treatment of all amounts subject to withholding as defined in § 1.1441–2(a) that are not effectively connected with the conduct of a trade or business within the United States or withholdable payments under § 1.1473–1(a) as extraordinary items), and (e)(2)(xi) (relating to selection of additional extraordinary items) of this section, the term agreement of the partners means either an agreement of all the partners to select the method, convention, or extraordinary item in a dated, written statement maintained with the partnership's books and records, including, for example, a selection that is included in the partnership agreement, or a selection of the method, convention, or extraordinary item made by a person authorized to make that selection, including under a grant of general authority provided for by either state law or in the partnership agreement, if that person's selection is in a dated, written statement maintained with the partnership's books and records.

* * * * *

Karen L. Schiller,

Acting Deputy Commissioner for Services and Enforcement.

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