553(d) of title 5 of the United States Code.

Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these temporary regulations are Christopher M. Bass and Frances L. Kelly, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.1502–78T also issued under 26 U.S.C. 1502 and 6411(c). * * *

Par. 2. Section 1.1502–78T is added to read as follows:

§ 1.1502–78T Rules for filing applications for tentative carryback adjustments.

(a) through (f) [Reserved]. For further guidance, see § 1.1502–78(a) through (f).

(g) *Time for filing application*—(1) *General rule.* The provisions of section 6411(a) apply to the filing of an application for a tentative carryback adjustment by a consolidated group.

(2) *Special rule for new members*—(i) *New member.* A new member is a corporation that, in the preceding taxable year, did not qualify as a member, as defined in § 1.1502–1(b), of the consolidated group that it now joins.

(ii) *End of taxable year.* Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under section 6411(a), the separate return year of a qualified new member shall be treated as ending on the same date as the end of the current taxable year of the consolidated group that the qualified new member joins.

(iii) *Qualified new member.* A new member of a consolidated group qualifies for purposes of the provisions of this paragraph (g)(2), if immediately prior to becoming a new member, either—

(A) It was the common parent of a consolidated group; or

(B) It was not required to join in the filing of a consolidated return.

(iv) *Examples.* The provisions of this paragraph (g)(2) may be illustrated by the following examples:

Example 1. Individual A owns 100 percent of the stock of X, a corporation filing returns on a calendar year basis. On January 31 of year 1, X becomes a member of the Y consolidated group, which also files returns on a calendar year basis. X is a qualified new member as defined in paragraph (g)(2)(iii)(B) of this section because, immediately prior to becoming a new member of the Y consolidated group, X was not required to join in the filing of a consolidated return. As a result of its becoming a new member of Group Y, X's separate return for the short taxable year (January 1 of year 1 through January 31 of year 1) is due September 15 of year 2 (with extensions). Section 1.1502–76(c). Group Y's consolidated return is also due September 15 of year 2 (with extensions). Section 1.1502–76(c). Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under Section 6411(a), X's taxable year for the separate return year is treated as ending on December 31 of year 1. X's application for a tentative carryback adjustment is therefore due on or before December 31 of year 2.

Example 2. Assume the same facts as in *Example 1* except that immediately prior to becoming a new member of Group Y, X was a member of the Z consolidated group. Because X was required to join in the filing of the consolidated return for Group Z, X is not a qualified new member as defined in paragraph (g)(2)(iii) of this section. X's items for the one-month period will be included in the consolidated return for Group Z. Group Z's application for a tentative carryback adjustment, if any, continues to be due within 12 months of the end of its taxable year, which is not affected by X's change in status as a new member of Group Y.

(v) *Effective date.*

The provisions of this paragraph (g)(2) apply for applications by new members of consolidated groups for tentative carryback adjustments resulting from net operating losses, net capital losses, or unused business credits arising in separate return years of new members that begin on or after January 1, 2001.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: December 13, 2000.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury.

[FR Doc. 01–196 Filed 1–3–01; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8925]

RIN 1545–AX32

Partnership Mergers and Divisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the tax consequences of partnership mergers and divisions. The final regulations affect partnerships and their partners.

DATES: *Effective Date:* These regulations are effective January 4, 2001.

Applicability Date: For dates of applicability of these regulations, see §§ 1.708–1(c)(7), 1.708–1(d)(7), and 1.752–5(a).

FOR FURTHER INFORMATION CONTACT: Mary Beth Collins or Dan Carmody, (202) 622–3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends sections 708 and 752 of the Income Tax Regulations (26 CFR part 1) regarding partnership mergers and divisions.

On January 11, 2000, a notice of proposed rulemaking and a notice of public hearing (REG–111119–99, 2000–5 I.R.B. 455) were published in the **Federal Register** (65 FR 1572) regarding sections 708, 743, and 752 of the Internal Revenue Code. No one requested to speak at the public hearing. Accordingly, the public hearing scheduled for May 4, 2000, was canceled in the **Federal Register** (65 FR 24897) on April 28, 2000. Comments responding to the proposed regulations were received. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

I. Partnership Mergers

Section 708(b)(2)(A) provides that in the case of a merger or consolidation of two or more partnerships, the resulting partnership is, for purposes of section 708, considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership. Section 1.708–1(b)(2)(i) of the Income Tax Regulations provides that if the resulting partnership can be considered a continuation of more than one of the merging partnerships, the resulting partnership is the continuation of the partnership that is credited with the contribution of the greatest dollar value of assets to the resulting partnership. If the members of none of the merging partnerships own more than a 50 percent interest in the capital and profits of the resulting partnership, all of the merged partnerships are considered terminated, and a new partnership results. The taxable years of the merging partnerships that are considered terminated are closed under section 706(c).

II. Partnership Divisions

Section 708(b)(2)(B) provides that, in the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) are considered a continuation of the prior partnership. Section 1.708–1(b)(2)(ii) provides that any other resulting partnership is not considered a continuation of the prior partnership but is considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the prior partnership, the prior partnership is terminated. Where members of a partnership that has been divided do not become members of a resulting partnership that is considered a continuation of the prior partnership, such members' interests are considered liquidated as of the date of the division.

Explanation of Revisions and Summary of Comments

I. Assets-Up Form for Partnership Mergers and Divisions

The proposed regulations provide that the form of a partnership merger or division accomplished under laws of the applicable jurisdiction will be respected if the partnership undertakes the steps of one of two prescribed forms. Generally, for partnership mergers, a terminating partnership contributes its assets and liabilities to the resulting partnership in exchange for interests in the resulting partnership, and immediately thereafter, the terminated partnership distributes interests in the resulting partnership to its partners in liquidation of the terminating partnership (Assets-Over Form). Alternatively, for partnership mergers, the terminating partnership liquidates by distributing its assets and liabilities to its partners who then contribute the assets and liabilities to the resulting partnership (Assets-Up Form). The default rule for partnership mergers is the Assets-Over Form, so that if a transaction is not characterized under the Assets-Up Form, it will be characterized under the Assets-Over Form regardless of whether that form is followed.

In general, for partnership divisions, a prior partnership transfers certain assets and liabilities to a resulting partnership in exchange for interests in the resulting partnership, and immediately thereafter, the prior partnership distributes the resulting partnership interests to partners who are designated to receive interests in the resulting partnership (Assets-Over Form). Alternatively, for partnership divisions, the prior partnership distributes certain assets and liabilities to some or all of its partners who then contribute the assets and liabilities to a resulting partnership in exchange for interests in the resulting partnership (Assets-Up Form). As with partnership mergers, the default rule for partnership divisions is the Assets-Over Form, so that if a transaction is not characterized under the Assets-Up Form, it will be characterized under the Assets-Over Form regardless of whether that form is followed.

One commentator expressed concern that where the assets of an operating business are distributed to the partners as joint owners, and the partners continue to operate the business, the owners of the assets may be considered to remain partners for federal income tax purposes. Under the proposed regulations, it was intended that the Assets-Up Form would be respected where the assets are conveyed to the partners under the laws of the applicable jurisdiction and then reconveyed to the resulting partnership. An example has been added to the final regulations to confirm this result. The example also confirms that a partnership can use the Assets-Up Form for partnership mergers and divisions regardless of whether the partners could otherwise generally hold certain assets, such as undivided interests in goodwill, outside of a partnership.

The same commentator suggested that the Assets-Up Form should be respected if, rather than actually conveying ownership of the assets under applicable jurisdictional law, the partners assign their rights to receive title to the assets in liquidation of the partnership, or direct the partnership to transfer title to the assets to the resulting partnership. In providing that the Assets-Up Form would be respected in accomplishing partnership mergers and divisions, the IRS and Treasury did not intend to establish a regime whereby partners essentially could elect between the Assets-Up Form and the Assets-Over Form by creating different documents that have the same legal effect. The IRS and Treasury believe that if the Assets-Up Form is to be respected, a partnership must actually undertake the steps that are necessary, under the laws of the applicable jurisdiction, to convey ownership of the assets that are distributed to the partners. For most types of assets, this will not require the actual transfer and recording of a deed or certificate of title.

While the IRS and Treasury believe that it should be necessary for a partnership to actually convey ownership of the partnership's assets to its partners in order to follow the Assets-Up Form, it should not be necessary for the partners to actually assume the liabilities of the partnership in order to follow such form. Pursuant to section 752 and the regulations thereunder, a partner essentially is deemed to have directly incurred a share of the partnership's liabilities. Requiring the partners to actually assume debt that they already are deemed to have incurred is unnecessary. Such a requirement also could create a trap for the unwary. If a partner momentarily assumes an amount of the partnership's debt that is less than the partner's share of such debt under section 752 (and other partners momentarily assume an amount of debt in excess of their shares), the partner could inappropriately recognize gain as a result of the deemed distribution.

II. Bifurcation of Assets-Over Form and Assets-Up Form

The proposed regulations provide that the form of a partnership merger or division accomplished under laws of the applicable jurisdiction will be respected if the partnership undertakes the steps of either the Assets-Over Form or the Assets-Up Form. One commentator recommended that a single partnership merger or division be respected if the partnership undertakes the steps of the Assets-Over Form with respect to some assets and the Assets-Up Form with respect to others. For example, in a partnership merger, the terminating partnership could distribute some assets to certain partners who then contribute the assets to the resulting partnership in exchange for interests in the resulting partnership (Assets-Up Form), and simultaneously, the terminating partnership could transfer the remaining assets to the resulting partnership in exchange for interests in the resulting partnership and then distribute the interests to the remaining partners in liquidation of their interests in the terminating partnership (Assets-Over Form).

In the preamble to the proposed regulations, the IRS and Treasury recognized that there are numerous transactions that may be undertaken pursuant to local jurisdictional law to accomplish the result of a partnership merger or division. The rules set forth in the proposed regulations were not intended to provide unlimited flexibility among the various structural alternatives for accomplishing these transactions. Instead, the proposed regulations were intended to provide a set of administrable rules that taxpayers and the IRS could apply in characterizing these transactions.

In view of this purpose, the IRS and Treasury do not believe it is appropriate for a partnership merger to be accomplished using both the Assets-Over Form and the Assets-Up Form when all the assets and liabilities of the terminated partnership are transferred to a single resulting partnership. While a partnership merger may be accomplished by using any number of transactional structures, the result is a single transaction that combines two partnerships. In the two alternatives set forth in the proposed regulations, and adopted in these final regulations, each partner must participate (or will be deemed to participate) in the partnership merger in the same manner (with the exception of those partners who are subject to the buy-out rule). Therefore, if the partners wish for a partnership merger to be characterized under the Assets-Up Form, the terminated partnership must undertake the steps of the Assets-Up Form for all of its assets when it distributes the assets to its partners. Otherwise, the transaction will be characterized under the Assets-Over Form. However, where more than two partnerships are combined, each combination will be viewed as a separate merger so that the characterization of a merger of one partnership into the resulting partnership under the Assets-Over Form will not prevent a simultaneous merger of another partnership into the same resulting partnership from being characterized under the Assets-Up Form.

For the same reasons, with respect to partnership divisions, the IRS and Treasury believe that it is appropriate to require consistency in applying either the Assets-Over Form or the Assets-Up Form to characterize a transfer of assets to a resulting partnership. However, where a single partnership is divided in a transaction that involves a transfer of assets (either actual or deemed) to multiple partnerships, the transfer to each resulting partnership should be viewed separately. As with mergers involving more than two partnerships, it is consistent with the purposes of these regulations, in the context of divisions, to allow the transfer to one resulting partnership to be characterized under the Assets-Over Form while characterizing the transfer to another resulting partnership under the Assets-Up Form. The proposed regulations provided an example that illustrates when such a division accomplished under both the Assets-Over Form and the Assets-Up Form will be respected. The final regulations do not change the example. See § 1.708–1(d)(5) Example 7 of the final regulations. The final regulations also add an example to illustrate when a division accomplished under both the Assets-Over Form and the Assets-Up Form will not be respected.

III. Clarification of Partnership Merger Buy-Out Rule

The proposed regulations contain a special buy-out rule that allows a resulting partnership in a merger to fund the purchase of one or more partners' interests in a terminating partnership without triggering the disguised sale rules, which otherwise would cause all of the partners in the terminating partnership to recognize gain or loss as a result of the purchase. Specifically, the proposed regulations provide that if the merger agreement (or similar document) specifies that the resulting partnership is purchasing the exiting partner's interest in the terminating partnership and the amount paid for the interest, the transaction will be treated as a sale of the exiting partner's interest to the resulting partnership.

Because the transaction described in the proposed regulations is treated as a sale of a partnership interest, the resulting partnership inherits the exiting partner's capital account in the terminating partnership and any section 704(c) liability of the exiting partner. Additionally, if the terminating partnership has an election in effect under section 754 (or makes an election under section 754), the resulting partnership will have a special basis adjustment regarding the terminating partnership's property under section 743. The proposed regulations provide that the resulting partnership's basis adjustments under section 743 must be allocated solely to the partners who were partners in the resulting partnership immediately before the merger.

Commentators questioned whether the exiting partner must be a party to the merger agreement in order to obtain the benefit of the special buy-out rule contained in the proposed regulations. Another commentator asked whether the exiting partner must consent to the sale treatment. The commentator explained that it may be difficult to receive consent from small investors in a large partnership whose interests are being sold to the resulting partnership.

The IRS and Treasury believe that the exiting partner does not have to be a party to the merger agreement in order to obtain the benefit of the special buy-out rule. However, to ensure that all partners to the transaction treat the transaction consistently when filing their returns, the final regulations require that, prior to or contemporaneous with the transfer, the exiting partner must consent to the sale treatment provided in the special rule.

Commentators noted that the resulting partnership's basis adjustments under section 743 should not be allocated solely to the partners who were partners in the resulting partnership immediately before the merger. As indicated in § 1.708–1(c)(4) Example 4 of the proposed regulations, where the resulting partnership has acquired an interest in the terminating partnership in accordance with the special buy-out rule, the terminating partnership, as part of the merger, distributes assets to the resulting partnership in liquidation of the resulting partnership's interest in the terminating partnership. Accordingly, the resulting partnership should take an exchanged basis in the distributed assets under section 732(b), rather than a transferred basis that includes the basis adjustment under section 743(b). In response to these comments, the IRS and Treasury have removed the proposed regulations under section 743 and have clarified the example to indicate that the basis rules under section 732(b) apply.

Commentators also asked whether a partnership termination under section 708(b)(1)(B) occurs immediately before a merger if exiting partners sell 50 percent or more of the total interests in the terminating partnership under the buy-out provision. Although not discussed in the final regulations, it follows from treating the buyout as occurring immediately prior to the merger that, if exiting partners sell 50 percent or more of the total interest in the terminating partnership's capital and profits as part of a merger, then a partnership termination under section 708(b)(1)(B) will occur immediately before the merger.

IV. Partnership Division Tax Consequences

The proposed regulations provide that the resulting partnership that is regarded as continuing shall file a return for the taxable year of the partnership that has been divided. Commentators requested that the final regulations clarify the tax consequences of a partnership that is regarded as continuing. For instance, commentators asked how a partnership files a return and which partnership retains the prior partnership's employer identification number (EIN) when more than one resulting partnership is considered a continuation of the prior partnership. Additionally, commentators asked whether subsequent elections by one resulting partnership that is regarded as continuing binds all resulting partnerships that are regarded as continuing.

In response to these comments, the final regulations clarify certain tax consequences that follow from a partnership division when more than one resulting partnership is regarded as continuing. Specifically, the final regulations provide that when more than one resulting partnership is regarded as continuing, the resulting partnership that is treated as the divided partnership will file a return for the taxable year of the partnership that has been divided and retain the EIN of the prior partnership. All other resulting partnerships that are regarded as continuing and all new partnerships (*i.e.,* resulting partnerships that are not considered continuing) will file separate returns for the taxable year beginning on the day after the date of the division with new EINs for each partnership.

The final regulations also provide that all resulting partnerships that are continuing partnerships are subject to preexisting elections that were made by the prior partnership. However, a post-division election that is made by a resulting partnership will not bind any of the other resulting partnerships.

V. Definition of Partnership Mergers and Divisions

The proposed regulations do not define what constitutes a partnership merger or division. Some commentators have requested that these terms be defined in the final regulations. Other practitioners have stated that the selectivity that would be created by attempting to draw lines in such definitions could lead to planning opportunities that would be adverse to the government's interest. The IRS and Treasury have decided not to provide comprehensive definitions of what is a partnership merger or division in these final regulations.

In addition to requesting guidance as to the general definitions of a partnership merger and division, some commentators have asked more narrowly whether a partnership division can occur when only one partner from the prior partnership is a partner in a resulting partnership. Consider the following example: ABC partnership owns X business and Y business. A and B each own a 20-percent interest, and C owns a 60-percent interest in the ABC partnership. C does not want to continue in the partnership with A and B and would like to operate X business with D. Accordingly, ABC partnership distributes X business to C in liquidation of C's interest in partnership ABC. Subsequently, C forms a partnership with D and contributes X business to the CD partnership. After the distribution and contribution of X business, AB partnership owns Y business and CD partnership owns X business.

The IRS and Treasury believe that the above transaction does not constitute a division. To have a division, at least two members of the prior partnership must be members of each resulting partnership that exists after the transaction. In the above example, C is the only member of the ABC partnership in the CD partnership. Accordingly, this transaction would not be treated as a division for Federal income tax purposes. The final regulations modify the proposed regulations to clarify this result.

VI. Application of Sections 704(c) and 737 in Partnership Divisions

In the preamble to the proposed regulations, the IRS and Treasury requested comments as to whether expanded exceptions under sections 704(c)(1)(B) and 737 would be appropriate in the context of partnership divisions. Most commentators agreed that it would not be wise to expand the current exceptions. In a related point, some commentators stated that the contribution of assets in a division should not create new section 704(c) property or section 737 net precontribution gain.

To the extent that a partnership division merely affects a restructuring of the form in which the partners hold property (that is, each partner's overall interest in each partnership property does not change), the IRS and Treasury agree that a partnership division should not create new section 704(c) property or section 737 net precontribution gain. However, it is not clear that this result is necessarily appropriate where a division is non-pro rata as to the partners, where some property is extracted from or added to the partnerships in connection with the division, or where new partners are added to the ownership group in connection with the division. The IRS and Treasury intend to study this issue and request comments in this regard.

VII. Effective Date

The proposed regulations apply to mergers and divisions occurring on or after the date final regulations are published in the **Federal Register**. Commentators requested that the final regulations allow partnerships to apply the regulations to mergers and divisions occurring on or after January 11, 2000, (the date the proposed regulations were published in the **Federal Register**). The commentators explained that the regulations provide needed clarity in an area that has lacked guidance.

The IRS and Treasury believe it is appropriate to allow partnerships to apply the final regulations retroactively to the publication date of the proposed regulations. Therefore, the final regulations apply to mergers and divisions occurring on or after January 4, 2001. However, a partnership may apply the rules in the final regulations for mergers and divisions occurring on or after January 11, 2000.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Mary Beth Collins, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 * * *

§ 1.708–1 [Amended]

Par. 2. Section 1.708–1 is amended as follows:

1. Paragraph (b) is amended by removing paragraph (b)(2) and by redesignating each paragraph listed in the first column of the following table as the paragraph listed in the second column as indicated in the following table:

Old paragraph	Redesignated paragraph
(b)(1)(i)	(b)(1)
(b)(1)(i)(*a*)	(b)(1)(i)
(b)(1)(i)(*b*)	(b)(1)(ii)
(b)(1)(ii)	(b)(2)
(b)(1)(iii)	(b)(3)
(b)(1)(iii)(*a*)	(b)(3)(i)
(b)(1)(iii)(*b*)	(b)(3)(ii)
(b)(1)(iv)	(b)(4)
(b)(1)(v)	(b)(5)

2. Paragraphs (c) and (d) are added to read as follows:

§ 1.708–1 Continuation of partnership.

* * * * *

(c) *Merger or consolidation*—(1) *General rule.* If two or more partnerships merge or consolidate into one partnership, the resulting partnership shall be considered a continuation of the merging or consolidating partnership the members of which own an interest of more than 50 percent in the capital and profits of the resulting partnership. If the resulting partnership can, under the preceding sentence, be considered a continuation of more than one of the merging or consolidating partnerships, it shall, unless the Commissioner permits otherwise, be considered the continuation solely of that partnership which is credited with the contribution of assets having the greatest fair market value (net of liabilities) to the resulting partnership. Any other merging or consolidating partnerships shall be considered as terminated. If the members of none of the merging or consolidating partnerships have an interest of more than 50 percent in the capital and profits of the resulting partnership, all of the merged or consolidated partnerships are terminated, and a new partnership results.

(2) *Tax returns.* The taxable years of any merging or consolidating partnerships which are considered terminated shall be closed in accordance with the provisions of section 706(c) and the regulations thereunder, and such partnerships shall file their returns for a taxable year ending upon the date of termination, *i.e.,* the date of merger or consolidation. The resulting partnership shall file a return for the taxable year of the merging or consolidating partnership that is considered as continuing. The return shall state that the resulting partnership is a continuation of such merging or consolidating partnership, shall retain the employer identification number (EIN) of the partnership that is continuing, and shall include the names, addresses, and EINs of the other merged or consolidated partnerships. The respective distributive shares of the partners for the periods prior to and including the date of the merger or consolidation and subsequent to the date of merger or consolidation shall be shown as a part of the return.

(3) *Form of a merger or consolidation*—(i) *Assets-over form.* When two or more partnerships merge or consolidate into one partnership under the applicable jurisdictional law without undertaking a form for the merger or consolidation, or undertake a form for the merger or consolidation that is not described in paragraph (c)(3)(ii) of this section, any merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section is treated as undertaking the assets-over form for Federal income tax purposes. Under the assets-over form, the merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section contributes all of its assets and liabilities to the resulting partnership in exchange for an interest in the resulting partnership, and immediately thereafter, the terminated partnership distributes interests in the resulting partnership to its partners in liquidation of the terminated partnership.

(ii) *Assets-up form.* Despite the partners' transitory ownership of the terminated partnership's assets, the form of a partnership merger or consolidation will be respected for Federal income tax purposes if the merged or consolidated partnership that is considered terminated under paragraph (c)(1) of this section distributes all of its assets to its partners (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) in liquidation of the partners' interests in the terminated partnership, and immediately thereafter, the partners in the terminated partnership contribute the distributed assets to the resulting partnership in exchange for interests in the resulting partnership.

(4) *Sale of an interest in the merging or consolidating partnership.* In a transaction characterized under the assets-over form, a sale of all or part of a partner's interest in the terminated partnership to the resulting partnership that occurs as part of a merger or consolidation under section 708(b)(2)(A), as described in paragraph (c)(3)(i) of this section, will be respected as a sale of a partnership interest if the merger agreement (or another document) specifies that the resulting partnership is purchasing interests from a particular partner in the merging or consolidating partnership and the consideration that is transferred for each interest sold, and if the selling partner in the terminated partnership, either prior to or contemporaneous with the transaction, consents to treat the transaction as a sale of the partnership interest. See section 741 and § 1.741–1 for determining the selling partner's gain or loss on the sale or exchange of the partnership interest.

(5) *Examples.* The following examples illustrate the rules in paragraphs (c)(1) through (4) of this section:

Example 1. Partnership AB, in whose capital and profits A and B each own a 50-percent interest, and partnership CD, in whose capital and profits C and D each own a 50-percent interest, merge on September 30, 1999, and form partnership ABCD. Partners A, B, C, and D are on a calendar year, and partnership AB and partnership CD also are on a calendar year. After the merger, the partners have capital and profits interests as follows: A, 30 percent; B, 30 percent; C, 20 percent; and D, 20 percent. Since A and B together own an interest of more than 50 percent in the capital and profits of partnership ABCD, such partnership shall be considered a continuation of partnership AB and shall continue to file returns on a calendar year basis. Since C and D own an interest of less than 50 percent in the capital and profits of partnership ABCD, the taxable year of partnership CD closes as of September 30, 1999, the date of the merger, and partnership CD is terminated as of that date. Partnership ABCD is required to file a return for the taxable year January 1 to December 31, 1999, indicating thereon that, until September 30, 1999, it was partnership AB. Partnership CD is required to file a return for its final taxable year, January 1 through September 30, 1999.

Example 2. (i) Partnership X, in whose capital and profits A owns a 40-percent interest and B owns a 60-percent interest, and partnership Y, in whose capital and profits B owns a 60-percent interest and C owns a 40-percent interest, merge on September 30, 1999. The fair market value of the partnership X assets (net of liabilities) is $100X, and the fair market value of the partnership Y assets (net of liabilities) is $200X. The merger is accomplished under state law by partnership Y contributing its assets and liabilities to partnership X in exchange for interests in partnership X, with partnership Y then liquidating, distributing interests in partnership X to B and C.

(ii) B, a partner in both partnerships prior to the merger, owns a greater than 50-percent interest in the resulting partnership following the merger. Accordingly, because the fair market value of partnership Y's assets (net of liabilities) was greater than that of partnership X's, under paragraph (c)(1) of this section, partnership X will be considered to terminate in the merger. As a result, even though, for state law purposes, the transaction was undertaken with partnership Y contributing its assets and liabilities to partnership X and distributing interests in partnership X to its partners, pursuant to paragraph (c)(3)(i) of this section, for Federal income tax purposes, the transaction will be treated as if partnership X contributed its assets to partnership Y in exchange for interests in partnership Y and then liquidated, distributing interests in partnership Y to A and B.

Example 3. (i) The facts are the same as in *Example 2,* except that partnership X is engaged in a trade or business and has, as one of its assets, goodwill. In addition, the merger is accomplished under state law by having partnership X convey an undivided 40-percent interest in each of its assets to A and an undivided 60-percent interest in each of its assets to B, with A and B then contributing their interests in such assets to partnership Y. Partnership Y also assumes all of the liabilities of partnership X.

(ii) Under paragraph (c)(3)(ii) of this section, the form of the partnership merger will be respected so that partnership X will be treated as following the assets-up form for Federal income tax purposes.

Example 4. (i) Partnership X and partnership Y merge when the partners of partnership X transfer their partnership X interests to partnership Y in exchange for partnership Y interests. Immediately thereafter, partnership X liquidates into partnership Y. The resulting partnership is considered a continuation of partnership Y, and partnership X is considered terminated.

(ii) The partnerships are treated as undertaking the assets-over form described in paragraph (c)(3)(i) of this section because the partnerships undertook a form that is not the assets-up form described in paragraph (c)(3)(ii) of this section. Accordingly, for Federal income tax purposes, partnership X is deemed to contribute its assets and liabilities to partnership Y in exchange for interests in partnership Y, and, immediately thereafter, partnership X is deemed to have distributed the interests in partnership Y to its partners in liquidation of their interests in partnership X.

Example 5. (i) A, B, and C are partners in partnership X. D, E, and F are partners in Partnership Y. Partnership X and partnership Y merge, and the resulting partnership is considered a continuation of partnership Y. Partnership X is considered terminated. Under state law, partnerships X and Y undertake the assets-over form of paragraph (c)(3)(i) of this section to accomplish the partnership merger. C does not want to become a partner in partnership Y, and partnership X does not have the resources to buy C's interest before the merger. C, partnership X, and partnership Y enter into an agreement specifying that partnership Y will purchase C's interest in partnership X for $150 before the merger, and as part of the agreement, C consents to treat the transaction in a manner that is consistent with the agreement. As part of the merger, partnership X receives from partnership Y $150 that will be distributed to C immediately before the merger, and interests in partnership Y in exchange for partnership X's assets and liabilities.

(ii) Because the merger agreement satisfies the requirements of paragraph (c)(4) of this section and C provides the necessary consent, C will be treated as selling its interest in partnership X to partnership Y for $150 before the merger. See section 741 and § 1.741–1 to determine the amount and character of C's gain or loss on the sale or exchange of its interest in partnership X.

(iii) Because the merger agreement satisfies the requirements of paragraph (c)(4) of this section, partnership Y is considered to have purchased C's interest in partnership X for $150 immediately before the merger. See § 1.704–1(b)(2)(iv)(*l*) for determining partnership Y's capital account in partnership X. Partnership Y's adjusted basis of its interest in partnership X is determined under section 742 and § 1.742–1. To the extent any built-in gain or loss on section 704(c) property in partnership X would have been allocated to C (including any allocations with respect to property revaluations under section 704(b) (reverse section 704(c) allocations)), see section 704 and § 1.704–3(a)(7) for determining the built-in gain or loss or reverse section 704(c) allocations apportionable to partnership Y. Similarly, after the merger is completed, the built-in gain or loss and reverse section 704(c) allocations attributable to C's interest are apportioned to D, E, and F under section 704(c) and § 1.704–3(a)(7).

(iv) Under paragraph (c)(3)(i) of this section, partnership X contributes its assets and liabilities attributable to the interests of A and B to partnership Y in exchange for interests in partnership Y; and, immediately thereafter, partnership X distributes the interests in partnership Y to A and B in liquidation of their interests in partnership X. At the same time, partnership X distributes assets to partnership Y in liquidation of partnership Y's interest in partnership X. Partnership Y's bases in the distributed assets are determined under section 732(b).

(6) *Prescribed form not followed in certain circumstances.* (i) If any transactions described in paragraph (c)(3) or (4) of this section are part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed in such paragraph, the Commissioner may disregard such form, and may recast the larger series of transactions in accordance with their substance.

(ii) *Example.* The following example illustrates the rules in paragraph (c)(6) of this section:

Example. A, B, and C are equal partners in partnership ABC. ABC holds no section 704(c) property. D and E are equal partners in partnership DE. B and C want to exchange their interests in ABC for all of the interests in DE. However, rather than exchanging partnership interests, DE merges with ABC by undertaking the assets-up form described in paragraph (c)(3)(ii) of this section, with D and E receiving title to the DE assets and then contributing the assets to ABC in exchange for interests in ABC. As part of a prearranged transaction, the assets acquired from DE are contributed to a new partnership, and the interests in the new partnership are distributed to B and C in complete liquidation of their interests in ABC. The merger and division in this example represent a series of transactions that in substance are an exchange of interests in ABC for interests in DE. Even though paragraph (c)(3)(ii) of this section provides that the form of a merger will be respected for Federal income tax purposes if the steps prescribed under the assets-up form are followed, and paragraph (d)(3)(i) of this section provides a form that will be followed for Federal income tax purposes in the case of partnership divisions, these forms will not be respected for Federal income tax purposes under these facts, and the transactions will be recast in accordance with their substance as a taxable exchange of interests in ABC for interests in DE.

(7) *Effective date.* This paragraph (c) is applicable to partnership mergers occurring on or after January 4, 2001. However, a partnership may apply paragraph (c) of this section to partnership mergers occurring on or after January 11, 2000.

(d) *Division of a partnership*—(1) *General rule.* Upon the division of a partnership into two or more partnerships, any resulting partnership (as defined in paragraph (d)(4)(iv) of this section) or resulting partnerships shall be considered a continuation of the prior partnership (as defined in paragraph (d)(4)(ii) of this section) if the members of the resulting partnership or partnerships had an interest of more than 50 percent in the capital and profits of the prior partnership. Any other resulting partnership will not be considered a continuation of the prior partnership but will be considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the prior partnership, none of the resulting partnerships will be considered a continuation of the prior partnership, and the prior partnership will be considered to have terminated. Where members of a partnership which has been divided into two or more partnerships do not become members of a resulting partnership which is considered a continuation of the prior partnership, such members' interests shall be considered liquidated as of the date of the division.

(2) *Tax consequences*—(i) *Tax returns.* The resulting partnership that is treated as the divided partnership (as defined in paragraph (d)(4)(i) of this section) shall file a return for the taxable year of the partnership that has been divided and retain the employer identification number (EIN) of the prior partnership. The return shall include the names, addresses, and EINs of all resulting partnerships that are regarded as continuing. The return shall also state that the partnership is a continuation of the prior partnership and shall set forth separately the respective distributive shares of the partners for the periods prior to and including the date of the division and subsequent to the date of division. All other resulting partnerships that are regarded as continuing and new partnerships shall file separate returns for the taxable year beginning on the day after the date of the division with new EINs for each partnership. The return for a resulting partnership that is regarded as continuing and that is not the divided partnership shall include the name, address, and EIN of the prior partnership.

(ii) *Elections.* All resulting partnerships that are regarded as continuing are subject to preexisting elections that were made by the prior partnership. A subsequent election that is made by a resulting partnership does not affect the other resulting partnerships.

(3) *Form of a division*—(i) *Assets-over form.* When a partnership divides into two or more partnerships under applicable jurisdictional law without undertaking a form for the division, or undertakes a form that is not described in paragraph (d)(3)(ii) of this section, the transaction will be characterized under the assets-over form for Federal income tax purposes.

(A) *Assets-over form where at least one resulting partnership is a continuation of the prior partnership.* In a division under the assets-over form where at least one resulting partnership is a continuation of the prior partnership, the divided partnership (as defined in paragraph (d)(4)(i) of this section) contributes certain assets and liabilities to a recipient partnership (as defined in paragraph (d)(4)(iii) of this section) or recipient partnerships in exchange for interests in such recipient partnership or partnerships; and, immediately thereafter, the divided partnership distributes the interests in such recipient partnership or partnerships to some or all of its partners in partial or complete liquidation of the partners' interests in the divided partnership.

(B) *Assets-over form where none of the resulting partnerships is a continuation of the prior partnership.* In a division under the assets-over form where none of the resulting partnerships is a continuation of the prior partnership, the prior partnership will be treated as contributing all of its assets and liabilities to new resulting partnerships in exchange for interests in the resulting partnerships; and, immediately thereafter, the prior partnership will be treated as liquidating by distributing the interests in the new resulting partnerships to the prior partnership's partners.

(ii) *Assets-up form*—(A) *Assets-up form where the partnership distributing assets is a continuation of the prior partnership.* Despite the partners' transitory ownership of some of the prior partnership's assets, the form of a partnership division will be respected for Federal income tax purposes if the divided partnership (which, pursuant to § 1.708–1(d)(4)(i), must be a continuing partnership) distributes certain assets (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) to some or all of its partners in partial or complete liquidation of the partners' interests in the divided partnership, and immediately thereafter, such partners contribute the distributed assets to a recipient partnership or partnerships in exchange for interests in such recipient partnership or partnerships. In order for such form to be respected for transfers to a particular recipient partnership, all assets held by the prior partnership that are transferred to the recipient partnership must be distributed to, and then contributed by, the partners of the recipient partnership.

(B) *Assets-up form where none of the resulting partnerships are a continuation of the prior partnership.* If none of the resulting partnerships are a continuation of the prior partnership, then despite the partners' transitory ownership of some or all of the prior partnership's assets, the form of a partnership division will be respected for Federal income tax purposes if the prior partnership distributes certain assets (in a manner that causes the partners to be treated, under the laws of the applicable jurisdiction, as the owners of such assets) to some or all of its partners in partial or complete liquidation of the partners' interests in the prior partnership, and immediately thereafter, such partners contribute the distributed assets to a resulting partnership or partnerships in exchange for interests in such resulting partnership or partnerships. In order for such form to be respected for transfers to a particular resulting partnership, all assets held by the prior partnership that are transferred to the resulting partnership must be distributed to, and then contributed by, the partners of the resulting partnership. If the prior partnership does not liquidate under the applicable jurisdictional law, then with respect to the assets and liabilities that, in form, are not transferred to a new resulting partnership, the prior partnership will be treated as transferring these assets and liabilities to a new resulting partnership under the assets-over form described in paragraph (d)(3)(i)(B) of this section.

(4) *Definitions*—(i) *Divided partnership.* For purposes of paragraph (d) of this section, the divided partnership is the continuing partnership which is treated, for Federal income tax purposes, as transferring the assets and liabilities to the recipient partnership or partnerships, either directly (under the assets-over form) or indirectly (under the assets-up form). If the resulting partnership that, in form, transferred the assets and liabilities in connection with the division is a continuation of the prior partnership, then such resulting partnership will be treated as the divided partnership. If a partnership divides into two or more partnerships and only one of the resulting partnerships is a continuation of the prior partnership, then the resulting partnership that is a continuation of the prior partnership will be treated as the divided partnership. If a partnership divides into two or more partnerships without undertaking a form for the division that is recognized under paragraph (d)(3) of this section, or if the resulting partnership that had, in form, transferred assets and liabilities is not considered a continuation of the prior partnership, and more than one resulting partnership is considered a continuation of the prior partnership, the continuing resulting partnership with the assets having the greatest fair

market value (net of liabilities) will be treated as the divided partnership.

(ii) *Prior partnership.* For purposes of paragraph (d) of this section, the prior partnership is the partnership subject to division that exists under applicable jurisdictional law before the division.

(iii) *Recipient partnership.* For purposes of paragraph (d) of this section, a recipient partnership is a partnership that is treated as receiving, for Federal income tax purposes, assets and liabilities from a divided partnership, either directly (under the assets-over form) or indirectly (under the assets-up form).

(iv) *Resulting partnership.* For purposes of paragraph (d) of this section, a resulting partnership is a partnership resulting from the division that exists under applicable jurisdictional law after the division and that has at least two partners who were partners in the prior partnership. For example, where a prior partnership divides into two partnerships, both partnerships existing after the division are resulting partnerships.

(5) *Examples.* The following examples illustrate the rules in paragraphs (d)(1), (2), (3), and (4) of this section:

Example 1. Partnership ABCD is in the real estate and insurance businesses. A owns a 40-percent interest, and B, C, and D each owns a 20-percent interest, in the capital and profits of the partnership. The partnership and the partners report their income on a calendar year. On November 1, 1999, they separate the real estate and insurance businesses and form two partnerships. Partnership AB takes over the real estate business, and partnership CD takes over the insurance business. Because members of resulting partnership AB owned more than a 50-percent interest in the capital and profits of partnership ABCD (A, 40 percent, and B, 20 percent), partnership AB shall be considered a continuation of partnership ABCD. Partnership AB is required to file a return for the taxable year January 1 to December 31, 1999, indicating thereon that until November 1, 1999, it was partnership ABCD. Partnership CD is considered a new partnership formed at the beginning of the day on November 2, 1999, and is required to file a return for the taxable year it adopts pursuant to section 706(b) and the applicable regulations.

Example 2. (i) Partnership ABCD owns properties W, X, Y, and Z, and divides into partnership AB and partnership CD. Under paragraph (d)(1) of this section, partnership AB is considered a continuation of partnership ABCD and partnership CD is considered a new partnership. Partnership ABCD distributes property Y to C and titles property Y in C's name. Partnership ABCD distributes property Z to D and titles property Z in D's name. C and D then contribute properties Y and Z, respectively, to partnership CD in exchange for interests in partnership CD. Properties W and X remain in partnership AB.

(ii) Under paragraph (d)(3)(ii) of this section, partnership ABCD will be treated as following the assets-up form for Federal income tax purposes.

Example 3. (i) The facts are the same as in *Example 2*, except partnership ABCD distributes property Y to C and titles property Y in C's name. C then contributes property Y to partnership CD. Simultaneously, partnership ABCD contributes property Z to partnership CD in exchange for an interest in partnership CD. Immediately thereafter, partnership ABCD distributes the interest in partnership CD to D in liquidation of D's interest in partnership ABCD.

(ii) Under paragraph (d)(3)(i) of this section, because partnership ABCD did not undertake the assets-up form with respect to all of the assets transferred to partnership CD, partnership ABCD will be treated as undertaking the assets-over form in transferring the assets to partnership CD. Accordingly, for Federal income tax purposes, partnership ABCD is deemed to contribute property Y and property Z to partnership CD in exchange for interests in partnership CD, and immediately thereafter, partnership ABCD is deemed to distribute the interests in partnership CD to partner C and partner D in liquidation of their interests in partnership ABCD.

Example 4. (i) Partnership ABCD owns three parcels of property: property X, with a value of $500; property Y, with a value of $300; and property Z, with a value of $200. A and B each own a 40-percent interest in the capital and profits of partnership ABCD, and C and D each own a 10 percent interest in the capital and profits of partnership ABCD. On November 1, 1999, partnership ABCD divides into three partnerships (AB1, AB2, and CD) by contributing property X to a newly formed partnership (AB1) and distributing all interests in such partnership to A and B as equal partners, and by contributing property Z to a newly formed partnership (CD) and distributing all interests in such partnership to C and D as equal partners in exchange for all of their interests in partnership ABCD. While partnership ABCD does not transfer property Y, C and D cease to be partners in the partnership. Accordingly, after the division, the partnership holding property Y is referred to as partnership AB2.

(ii) Partnerships AB1 and AB2 both are considered a continuation of partnership ABCD, while partnership CD is considered a new partnership formed at the beginning of the day on November 2, 1999. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property X to partnership AB1 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

Example 5. (i) The facts are the same as in *Example 4*, except that partnership ABCD divides into three partnerships by operation of state law, without undertaking a form.

(ii) Under the last sentence of paragraph (d)(4)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property Y to partnership AB2 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

Example 6. (i) The facts are the same as in *Example 4*, except that partnership ABCD divides into three partnerships by contributing property X to newly-formed partnership AB1 and property Y to newly-formed partnership AB2 and distributing all interests in each partnership to A and B in exchange for all of their interests in partnership ABCD.

(ii) Because resulting partnership CD is not a continuation of the prior partnership (partnership ABCD), partnership CD cannot be treated, for Federal income tax purposes, as the partnership that transferred assets (*i.e.,* the divided partnership), but instead must be treated as a recipient partnership. Under the last sentence of paragraph (d)(4)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over form, with partnership ABCD contributing property Y to partnership AB2 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

Example 7. (i) Partnership ABCDE owns Blackacre, Whiteacre, and Redacre, and divides into partnership AB, partnership CD, and partnership DE. Under paragraph (d)(1) of this section, partnership ABCDE is considered terminated (and, hence, none of the resulting partnerships are a continuation of the prior partnership) because none of the members of the new partnerships (partnership AB, partnership CD, and partnership DE) owned an interest of more than 50 percent in the capital and profits of partnership ABCDE.

(ii) Partnership ABCDE distributes Blackacre to A and B and titles Blackacre in the names of A and B. A and B then contribute Blackacre to partnership AB in exchange for interests in partnership AB. Partnership ABCDE will be treated as following the assets-up form described in paragraph (d)(3)(ii)(B) of this section for Federal income tax purposes.

(iii) Partnership ABCDE distributes Whiteacre to C and D and titles Whiteacre in the names of C and D. C and D then contribute Whiteacre to partnership CD in exchange for interests in partnership CD. Partnership ABCDE will be treated as following the assets-up form described in paragraph (d)(3)(ii)(B) of this section for Federal income tax purposes.

(iv) Partnership ABCDE does not liquidate under state law so that, in form, the assets in new partnership DE are not considered to have been transferred under state law. Partnership ABCDE will be treated as undertaking the assets-over form described in paragraph (d)(3)(i)(B) of this section for Federal income tax purposes with respect to the assets of partnership DE. Thus, partnership ABCDE will be treated as contributing Redacre to partnership DE in exchange for interests in partnership DE; and, immediately thereafter, partnership ABCDE will be treated as distributing interests in partnership DE to D and E in liquidation of their interests in partnership ABCDE. Partnership ABCDE then terminates.

(6) *Prescribed form not followed in certain circumstances.* If any transactions described in paragraph (d)(3) of this section are part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed in such paragraph, the Commissioner may disregard such form, and may recast the larger series of transactions in accordance with their substance.

(7) *Effective date.* This paragraph (d) is applicable to partnership divisions occurring on or after January 4, 2001. However, a partnership may apply paragraph (d) of this section to partnership divisions occurring on or after January 11, 2000.

Par. 3. Section 1.752–1 is amended as follows:

1. A sentence is added to the end of paragraph (f).
2. The current *Example* in paragraph (g) is redesignated as *Example 1.*
3. *Example 2* is added in paragraph (g).

The additions read as follows:

§ 1.752–1 Treatment of partnership liabilities.

* * * * *

(f) * * * When two or more partnerships merge or consolidate under section 708(b)(2)(A), as described in § 1.708–1(c)(3)(i), increases and decreases in partnership liabilities associated with the merger or consolidation are netted by the partners in the terminating partnership and the resulting partnership to determine the effect of the merger under section 752.

(g) * * *

Example 1. * * *

Example 2. Merger or consolidation of partnerships holding property encumbered by liabilities. (i) B owns a 70 percent interest in partnership T. Partnership T's sole asset is property X, which is encumbered by a $900 liability. Partnership T's adjusted basis in property X is $600, and the value of property X is $1,000. B's adjusted basis in its partnership T interest is $420. B also owns a 20 percent interest in partnership S. Partnership S's sole asset is property Y, which is encumbered by a $100 liability. Partnership S's adjusted basis in property Y is $200, the value of property Y is $1,000, and B's adjusted basis in its partnership S interest is $40.

(ii) Partnership T and partnership S merge under section 708(b)(2)(A). Under section 708(b)(2)(A) and § 1.708–1(c)(1), partnership T is considered terminated and the resulting partnership is considered a continuation of partnership S. Partnerships T and S undertake the form described in § 1.708–1(c)(3)(i) for the partnership merger. Under § 1.708–1(c)(3)(i), partnership T contributes property X and its $900 liability to partnership S in exchange for an interest in partnership S. Immediately thereafter, partnership T distributes the interests in partnership S to its partners in liquidation of their interests in partnership T. B owns a 25 percent interest in partnership S after partnership T distributes the interests in partnership S to B.

(iii) Under paragraph (f) of this section, B nets the increases and decreases in its share of partnership liabilities associated with the merger of partnership T and partnership S. Before the merger, B's share of partnership liabilities was $650 (B had a $630 share of partnership liabilities in partnership T and a $20 share of partnership liabilities in partnership S immediately before the merger). B's share of S's partnership liabilities after the merger is $250 (25 percent of S's total partnership liabilities of $1,000). Accordingly, B has a $400 net decrease in its share of S's partnership liabilities. Thus, B is treated as receiving a $400 distribution from partnership S under section 752(b). Because B's adjusted basis in its partnership S interest before the deemed distribution under section 752(b) is $460 ($420 + $40), B will not recognize gain under section 731. After the merger, B's adjusted basis in its partnership S interest is $60.

* * * * *

Par. 4. In § 1.752–5, paragraph (a) is amended by adding two sentences after the third sentence.

§ 1.752–5 Effective dates and transition rules.

(a) *In general.* * * * In addition, § 1.752–1(f) last sentence and (g) *Example 2*, do not apply to any liability incurred or assumed by a partnership prior to January 4, 2001. Nevertheless, § 1.752–1(f) last sentence and (g) *Example 2*, may be relied on for any liability incurred or assumed by a partnership prior to January 4, 2001 and, unless the partnership makes an election under paragraph (b)(1) of this section, on or after December 28, 1991, other than a liability incurred or assumed by the partnership pursuant to a written binding contract in effect prior to December 28, 1991 and at all times thereafter. * * *

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David A. Mader,

Acting Deputy Commissioner of Internal Revenue.

Approved: December 20, 2000.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8924]

RIN 1545–AY63

Liabilities Assumed in Certain Corporate Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary and final regulations.

SUMMARY: These temporary and final regulations relate to the assumption of liabilities in certain corporate transactions under section 301 of the Internal Revenue Code. The temporary and final regulations affect corporations and their shareholders. Changes to the applicable law were made by the Miscellaneous Trade and Technical Corrections Act of 1999, Public Law 106–36 (113 Stat. 127). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective January 4, 2001.

Applicability Date: For dates of applicability, see the Effective Dates portion of the preamble under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: Mary Dean, (202) 622–7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

A. State of the Law Before the Miscellaneous Trade and Technical Corrections Act of 1999

Section 301(b)(2) of the Internal Revenue Code (Code) provides that in a distribution of property made by a corporation to a shareholder with respect to its stock, the amount of the distribution shall be reduced (but now below zero) by (A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution and (B) the amount of any liability to which the property was subject immediately before, and after, the distribution. See also § 1.301–1(g) of the regulations.

Section 357 of the Code generally provides rules for the treatment of the assumption of liabilities in connection with transfers of property to which section 351 or 361 of the Code applies.