Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG–209682–94, page 20.
Proposed regulations under sections 743, 755, and 1017 of the Code provide guidance to partnerships and their partners concerning the optional adjustments to the basis of partnership property, the allocation of basis adjustments among partnership assets, and the computation of a partner's share of the adjusted basis of depreciable partnership property.

Rev. Proc. 98–30, page 6.
Automobile owners and lessees. This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 1998 and the amounts to be included in income for automobiles first leased during calendar year 1998. In addition, this revenue procedure provides the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 1998 for which the vehicle cents-per-mile valuation rule provided under section 1.61–21(e) of the Income Tax Regulations may be applicable.

EMPLOYEE PLANS

Notice 98–24, page 5.
Qualified plans; net unrealized appreciation; capital gains. This notice describes the holding period to be used for determining the capital gains tax treatment of net unrealized appreciation in the distribution of employer securities from a qualified plan as a result of section 311 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34.

EXEMPT ORGANIZATIONS

Announcement 98–33, page 39.
A list is provided of organizations that no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

Announcement 98–34, page 39.
A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Rev. Proc. 98–32, page 11.
Information is provided about the Electronic Federal Tax Payment System (EFTPS) programs for Batch Filers and Bulk Filers (Filers). EFTPS is an electronic remittance processing system for making federal tax deposits (FTDs) and federal tax payments (FTPs). The Batch Filer and Bulk Filer programs are used by Filers for electronically submitting enrollments, FTDs, and FTPs on behalf of multiple taxpayers.

Notice 98–22, page 5.
This notice announces that shareholders of passive foreign investment companies may apply the rules of section 1.1295–1T(b)(4), (f), and (g) of the Income Tax Regulations to taxable years beginning before January 1, 1998.

Announcement 98–30, page 38.
The penalty under section 6677 of the Code will not be imposed on a U.S. owner of a foreign trust for failure to timely file if the foreign trust files Form 3520–A and furnishes the required statements to the U.S. owners and U.S. beneficiaries in accordance with this announcement.

Announcement 98–32, page 39.
This announcement withdraws the notice issued under section 7428(c) of the Code in Internal Revenue Bulletin 1997–52, dated December 29, 1997, with respect to the organization At Cost Services, Inc.

Announcement 98–35, page 40.
An updated edition of Publication 954, Tax Incentives for Empowerment Zones and Other Distressed Communities (revised March 1998), is now available.

Finding Lists begin on page 43.
Announcement of Declaratory Judgment Proceedings Under Section 7428 begins on page 41.

Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis and are published in the first Bulletin of the succeeding semiannual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 61–21: Taxation of fringe benefits.

This procedure provides the maximum value of employer-provided automobiles first made available to employees for personal use in calendar year 1998 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. See Rev. Proc. 98–30, page 6.

Section 280F.—Limitation on Depreciation for Luxury Automobiles; Limitation Where Certain Property Used for Personal Purposes

26 CFR 280F–7: Property leased after December 31, 1986.

This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 1998 and the amounts to be included in income for automobiles first leased during calendar year 1998. See Rev. Proc. 98–30, page 6.

Section 1295.—Qualified Electing Funds

Notice 98–22 announces that final regulations under section 1295 will permit shareholders of passive foreign investment companies treated as qualified electing funds to apply the rules of § 1.1295–1T(b)(4) (joint return elections), the rules of § 1.1295–1T(f) and (g) (simplified filing and reporting procedures), or both sets of rules to a taxable year beginning before January 1, 1998. See Notice 98–22, page 5.

Section 6302.—Mode or Time of Collection

26 CFR 31.6302–1: Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

Information is provided about the Electronic Federal Tax Payment System (EFTPS) programs for Batch Filers and Bulk Filers (Filers). EFTPS is an electronic remittance processing system for making federal tax deposits (FTDs) and federal tax payments (FTPs). The Batch Filer and Bulk Filer programs are used by Filers for electronically submitting enrollments, FTDs, and FTPs on behalf of multiple taxpayers. See Rev. Proc. 98–32, page 11.

Application of Section 1.1295–1T(b)(4), (f), and (g) to Taxable Years Beginning Before January 1, 1998

Notice 98–22

This notice provides guidance to direct or indirect shareholders of passive foreign investment companies (PFICs), as defined in section 1297 of the Internal Revenue Code, concerning the effective date of § 1.1295–1T(b)(4), (f), and (g) of the temporary regulations published in the **Federal Register** on January 2, 1998, as T.D. 8750. As described below, final regulations under section 1295 will permit shareholders of PFICs to apply the rules of § 1.1295–1T(b)(4), the rules of § 1.1295–1T(f) and (g), or both sets of rules to a taxable year beginning before January 1, 1998, for which the period of limitations has not run as of the date of publication of this notice, provided that, in the case of § 1.1295–1T(b)(4), the shareholders consistently apply the rules to all subsequent taxable years.

BACKGROUND

Section 1.1295–1T(b)(4) of the temporary regulations provides rules concerning a section 1295 election made by a taxpayer in a joint return under section 6013. Section 1.1295–1T(f) and (g) provide simplified rules concerning the manner of making and maintaining a section 1295 election to treat a PFIC as a qualified electing fund (QEF). Prior to the publication of § 1.1295–1T(f) and (g), Notice 88–125, 1988–2 C.B. 535, provided such guidance. Under § 1.1295–1T(k), § 1.1295–1T(b)(4), (f), and (g) is effective for taxable years of shareholders beginning after December 31, 1997.

APPLICATION TO EARLIER TAXABLE YEARS

Commenters have requested that § 1.1295–1T(b)(4) apply on an elective basis to taxable years beginning before January 1, 1998, to provide taxpayers certainty with respect to elections made on joint returns for such years. Commenters also requested that § 1.1295–1T(f) and (g) apply on an elective basis to taxable years beginning before January 1, 1998, to enable taxpayers to use the simplified reporting procedures for 1997. In response to these comments, the final regulations will permit taxpayers to apply the rules of temporary regulations § 1.1295–1T(b)(4), the rules of § 1.1295–1T(f) and (g), or both sets of rules, to a taxable year beginning before January 1, 1998, for which the statute of limitations on the assessment of tax has not expired as of the date of publication of this notice. Taxpayers that filed a joint return in which the section 1295 election was made may only apply the rules of §1.1295–1T(b)(4) if they have consistently applied the rules of that section to all taxable years following the year in which the election was made and for which the statute of limitations for the assessment of tax is open. Subject to this consistency requirement, the rule of §1.1295–1T(b)(4) may be applied to any open year even if the section 1295 election was made in a year for which the statute of limitations has expired. No action other than treatment consistent with an effective section 1295 election is necessary for the section 1295 election to be treated as made by both spouses.

PAPERWORK REDUCTION ACT

The collections of information requirements contained in the temporary regulations to which this notice applies were reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1555.

FOR FURTHER INFORMATION CONTACT Teresa Hughes at (202) 622-3840 (not a toll-free call).

Net Unrealized Appreciation in Employer Securities

Notice 98–24

PURPOSE

This notice provides guidance concerning the tax treatment of net unrealized appreciation in employer securities distributed from a qualified retirement plan, to the extent such appreciation is realized in a subsequent taxable transaction. Specifically, this notice provides guidance regarding the holding period to be used for determining the capital gains tax rate that applies with regard to net unrealized appreciation under § 1(h) of the Internal Revenue Code ("Code") as amended by § 311 of the Taxpayer Relief Act of 1997 ("TRA '97"), Pub. L. 105–34. This guidance applies to sales or other dispositions of employer securities that occur before the later of January 1, 2001, or the date further guidance is issued.

BACKGROUND

Section 402(e)(4)(A) of the Code provides that in the case of a distribution other than a lump sum distribution, the amount actually distributed to a distributee from a trust described in § 401(a) which is exempt from tax under § 501(a) shall not include any net unrealized appreciation in employer securities attributable to amounts contributed by the employee.

Section 402(e)(4)(B) provides that in the case of a lump sum distribution which includes employer securities, there shall be excluded from gross income the net unrealized appreciation attributable to the employer securities.

Section 402(e)(4)(C) provides that, for purposes of § 402(e)(4)(A) and (B), net unrealized appreciation and the resulting adjustments to basis are determined in accordance with regulations.

Section 1.402(a)–1(b)(1)(i) of the Income Tax Regulations provides that the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than six months to the extent such appreciation is realized in a subsequent taxable transaction. Net gain realized by the distributee in a subsequent taxable transaction that exceeds the amount of the net unrealized appreciation at the time of distribution shall constitute a long-term or short-term capital gain, depending on the holding period of the securities in the hands of the distributee. In

1956, when this regulation was issued, the long-term capital gains tax rate applied to the sale or exchange of a capital asset held for more than six months.

Rev. Rul. 81–122, 1981–1 C.B. 202, states that the amount of net unrealized appreciation that is not included in the basis of the securities in the hands of a distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than one year to the extent it is realized in a subsequent transaction. When this revenue ruling was published, the long-term capital gains tax rate applied to the sale or exchange of a capital asset held for more than one year.

Section 311 of TRA '97 reduces the capital gains tax rate on the sale or exchange of certain assets held for more than 18 months from 28 percent to 20 percent (10 percent in the case of gain that would otherwise be taxed at 15 percent), effective generally for amounts properly taken into account after May 6, 1997. *See* Notice 97–59, 1997–45 I.R.B. 7. The 28-percent maximum capital gains tax rate continues to apply to the sale or exchange of assets held for 18 months or less but more than one year.

CAPITAL GAINS RATE APPLICABLE TO NET UNREALIZED APPRECIATION

Under this notice, the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent that such appreciation is realized in a subsequent taxable transaction. Accordingly, for a sale or other disposition of employer securities that occurs after May 6, 1997, the actual period that an employer security was held by a qualified plan need not be calculated in order to determine whether, with respect to the net unrealized appreciation, the disposition qualifies for the rate for capital assets held for more than 18 months. However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capital gains rate that applies.

The guidance provided in this notice applies to sales or other dispositions of employer securities that occur before the later of January 1, 2001, or the date further guidance is issued. This guidance is for purposes of the Code and regulation sections cited above. No inference is intended with regard to any other section of the Code or regulations that deals with capital gains treatment.

COMMENTS

Beginning in 2001, § 311 of TRA '97 reduces the capital gains tax rates for gain from certain assets that are held for more than 5 years ("qualified 5-year gain"). The 10-percent rate is reduced to 8 percent for taxable years beginning after December 31, 2000. The 20-percent rate is reduced to 18 percent for property the holding period for which begins after December 31, 2000.

The Service invites comments with respect to the computation of the holding period for purposes of the reduced capital gains tax rates for qualified 5-year gain as these rates apply to net unrealized appreciation (for example, whether to use an actual holding period, a deemed holding period, or a combination). Comments should be submitted by October 24, 1998.

Comments can be addressed to CC:DOM:CORP:R (Notice 98–24), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98–24), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

DRAFTING INFORMATION

The principal author of this notice is Steven Linder of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074 or (202) 622-6075, between the hours of 1:30 p.m. and 3:30 p.m. Eastern time, Monday through Thursday, or Mr. Linder at (202) 622-6214. These are not toll-free numbers.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, § 280F; 1.280F–7, 1.61–21.)

Rev. Proc. 98–30

SECTION 1. PURPOSE

This revenue procedure provides: (1) limitations on depreciation deductions for owners of passenger automobiles first placed in service during calendar year 1998, including separate limitations on passenger automobiles designed to be propelled primarily by electricity and built by an original equipment manufacturer (electric automobiles); (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 1998, including separate inclusion amounts for electric automobiles; and (3) the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 1998 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. The tables detailing these depreciation limitations and lessee inclusion amounts reflect the automobile price inflation adjustments required by § 280F(d)(7) of the Internal Revenue Code. The maximum allowable automobile value for applying the vehicle cents-per-mile valuation rule reflects the automobile price inflation adjustment of § 280F(d)(7) as required by § 1.61–21(e)-(1)(iii)(A).

SECTION 2. BACKGROUND

For owners of automobiles, § 280F(a) imposes dollar limitations on the depreciation deduction for the year that the automobile is placed in service and each succeeding year. In the case of electric automobiles placed in service after August 5, 1997, and before January 1, 2005, § 280F(a)(1)(C) requires tripling of these limitation amounts. Section 280F(d)(7) requires the amounts allowable as depreciation deductions to be increased by a price inflation adjustment amount for passenger automobiles placed in service after calendar year 1988.

For leased automobiles, § 280F(c) requires a reduction in the deduction allowed to the lessee of the automobile.

The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. Under § 1.280F–7(a), this reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. There is a table for lessees of electric automobiles and a table for all other passenger automobiles. Each table shows inclusion amounts for a range of fair market values for each tax year after the automobile is first leased.

For automobiles first provided by employers to employees that meet the requirements of § 1.61–21(e)(1), the value to the employee of the use of the automobile may be determined under the vehicle cents-per-mile valuation rule of § 1.61–21(e). Section 1.61-21(e)(1)(iii)(A) provides that for an automobile first made available after 1988 to any employee of the employer for personal use, the value of the use of the automobile may not be determined under the vehicle cents-per-mile valuation rule for a calendar year if the fair market value of the automobile (determined pursuant to § 1.61–21(d)-(5)(i) through (iv)) on the first date the automobile is made available to the employee exceeds $12,800 as adjusted by § 280F(d)(7).

SECTION 3. SCOPE AND OBJECTIVE

01. The limitations on depreciation deductions in section 4.02 of this revenue procedure apply to automobiles (other than leased automobiles) that are placed in service in calendar year 1998 and continue to apply for each tax year that the automobile remains in service.

02. The tables in section 4.03 of this revenue procedure apply to leased automobiles for which the lease term begins in calendar year 1998. Lessees of such automobiles must use these tables to determine the inclusion amount for each tax year during which the automobile is leased.

03. *See* Rev. Proc. 96–25, 1996–1 C.B. 681, for information on determining inclusion amounts for automobiles first leased before January 1, 1997; Rev. Proc. 97–20, 1997–11 I.R.B. 10, for automobiles first leased during calendar year 1997, including electric automobiles first leased on or after January 1, 1997, and before August 6, 1997; and Rev. Proc. 98–24, 1998-10 I.R.B. 31, for electric automobiles first leased after August 5, 1997, and before January 1, 1998.

04. The maximum fair market value figure in section 4.04(2) of this revenue procedure applies to employer-provided automobiles first made available to any employee for personal use in calendar year 1998. *See* Rev. Proc. 97–20, for the maximum fair market value figure for automobiles first made available in calendar year 1997.

SECTION 4. APPLICATION

01. A taxpayer placing an automobile in service for the first time during calendar year 1998 is limited to the depreciation deduction shown in Table 1 of section 4.02(2) or, in the case of an electric automobile, Table 2. A taxpayer first leasing an automobile in calendar year 1998 must determine the inclusion amount that is added to gross income using Table 3 of section 4.03 or, in the case of an electric automobile, Table 4. Otherwise, the procedures of § 1.280F–7(a) must be followed. An employer providing an automobile for the first time in calendar year 1998 for the personal use of any employee may determine the value of the use of the automobile by using the cents-per-mile valuation rule in § 1.61–21(e) if the fair market value of the automobile does not exceed the amount specified in section 4.04(2). If the fair market value of the automobile exceeds the amount specified in section 4.04(2), the employer may determine the value of the use of the automobile under the general valuation rules of § 1.61–21(b) or under the special valuation rules of § 1.61–21(d) (Automobile lease valuation) or § 1.61–21(f) (Commuting valuation) if the applicable requirements are met.

02. *Limitations on Depreciation Deductions for Certain Automobiles.*

(1) *Amount of the Inflation Adjustment.* Under § 280F(d)(7)(B)(i), the automobile price inflation adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. The term "CPI automobile component" is defined in § 280F(d)(7)(B)(ii) as the "automobile component" of the Consumer Price Index for all Urban Consumers published by the Department of Labor (the CPI). The new car component of the CPI was 115.2 for October 1987 and 140.6 for October 1997. The October 1997 index exceeded the October 1987 index by 25.4. The Internal Revenue Service has, therefore, determined that the automobile price inflation adjustment for 1998 is 22.05 percent (25.4/115.2 $\times$ 100%). This adjustment is applicable to all automobiles that are first placed in service in calendar year 1998. The dollar limitations in § 280F(a) must therefore be multiplied by a factor of 0.2205, and the resulting increases, after rounding to the nearest $100, are added to the 1988 limitations to give the depreciation limitations applicable to passenger automobiles (other than electric automobiles) for 1998. To determine the dollar limitations applicable to an electric automobile first placed in service during calendar year 1998, the dollar limitations in § 280F(a) are tripled in accordance with § 280F(a)(1)(C) and are then multiplied by a factor of 0.2205; the resulting increases, after rounding to the nearest $100, are added to the tripled 1988 limitations to give the depreciation limitations for 1998.

(2) *Amount of the Limitation.* For automobiles (other than electric automobiles) placed in service in calendar year 1998, Table 1 contains the dollar amount of the depreciation limitations for each tax year. For electric automobiles placed in service in calendar year 1998, Table 2 contains these amounts.

REV. PROC. 98–30 TABLE 1

DEPRECIATION LIMITATIONS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) FIRST PLACED IN SERVICE IN CALENDAR YEAR 1998

Tax Year	*Amount*
1st Tax Year	$3,160
2nd Tax Year	$5,000
3rd Tax Year	$2,950
Each Succeeding Year	$1,775

REV. PROC. 98–30 TABLE 2

DEPRECIATION LIMITATIONS FOR ELECTRIC AUTOMOBILES
FIRST PLACED IN SERVICE IN CALENDAR YEAR 1998

Tax Year	*Amount*
1st Tax Year	$9,380
2nd Tax Year	$15,000
3rd Tax Year	$8,950
Each Succeeding Year	$5,425

03. *Inclusions in Income of Lessees of Automobiles.*

The inclusion amounts for automobiles first leased in calendar year 1998 are calculated under the procedures described in § 1.280F-7(a). Lessees of automobiles other than electric automobiles should use Table 3 in applying these procedures, while lessees of electric automobiles should use Table 4.

REV. PROC. 98–30 TABLE 3

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES)
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1998

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
$ 15,800	16,100	1	5	8	12	14
16,100	16,400	4	10	16	22	25
16,400	16,700	6	15	25	31	36
16,700	17,000	9	20	33	41	47
17,000	17,500	12	28	43	53	62
17,500	18,000	16	37	56	70	80
18,000	18,500	20	46	70	85	99
18,500	19,000	24	55	83	101	117
19,000	19,500	28	64	96	117	136
19,500	20,000	32	73	110	133	154
20,000	20,500	36	82	123	149	173
20,500	21,000	40	91	36	165	191
21,000	21,500	45	99	150	181	209
21,500	22,000	49	108	163	197	228
22,000	23,000	55	122	183	221	255
23,000	24,000	63	140	210	252	292
24,000	25,000	71	158	236	285	329
25,000	26,000	79	176	263	316	366
26,000	27,000	88	193	290	348	403
27,000	28,000	96	211	317	380	439
28,000	29,000	104	229	343	412	477
29,000	30,000	112	247	370	444	513
30,000	31,000	120	265	396	476	550
31,000	32,000	128	283	423	508	587
32,000	33,000	137	301	449	540	624
33,000	34,000	145	319	476	571	661
34,000	35,000	153	337	502	604	697
35,000	36,000	161	355	529	635	735
36,000	37,000	169	373	556	667	771
37,000	38,000	178	391	582	699	808
38,000	39,000	186	409	608	731	845
39,000	40,000	194	427	635	763	882

REV. PROC. 98–30 TABLE 3—Continued

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1998

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
40,000	41,000	202	445	662	794	919
41,000	42,000	210	463	688	827	955
42,000	43,000	218	481	715	859	992
43,000	44,000	227	498	742	891	1,028
44,000	45,000	235	516	769	922	1,066
45,000	46,000	243	534	795	955	1,102
46,000	47,000	251	552	822	986	1,140
47,000	48,000	259	570	849	1,018	1,176
48,000	49,000	268	588	875	1,050	1,213
49,000	50,000	276	606	901	1,082	1,250
50,000	51,000	284	624	928	1,114	1,286
51,000	52,000	292	642	955	1,145	1,324
52,000	53,000	300	660	981	1,178	1,360
53,000	54,000	308	678	1,008	1,209	1,398
54,000	55,000	317	695	1,035	1,241	1,434
55,000	56,000	325	713	1,062	1,273	1,471
56,000	57,000	333	732	1,087	1,305	1,508
57,000	58,000	341	750	1,114	1,337	1,544
58,000	59,000	349	768	1,140	1,369	1,582
59,000	60,000	358	785	1,168	1,400	1,619
60,000	62,000	370	812	1,207	1,449	1,674
62,000	64,000	386	848	1,261	1,512	1,747
64,000	66,000	403	884	1,313	1,577	1,821
66,000	68,000	419	920	1,367	1,640	1,894
68,000	70,000	435	956	1,420	1,704	1,968
70,000	72,000	452	991	1,474	1,767	2,042
72,000	74,000	468	1,027	1,527	1,832	2,115
74,000	76,000	484	1,063	1,580	1,896	2,189
76,000	78,000	501	1,099	1,633	1,959	2,263
78,000	80,000	517	1,135	1,686	2,023	2,337
80,000	85,000	546	1,198	1,779	2,134	2,466
85,000	90,000	587	1,287	1,913	2,294	2,649
90,000	95,000	627	1,377	2,046	2,453	2,834
95,000	100,000	668	1,467	2,178	2,613	3,018
100,000	110,000	730	1,601	2,378	2,852	3,294
110,000	120,000	812	1,780	2,644	3,172	3,662
120,000	130,000	893	1,960	2,910	3,490	4,031
130,000	140,000	975	2,139	3,176	3,810	4,398
140,000	150,000	1,057	2,318	3,443	4,128	4,767
150,000	160,000	1,139	2,498	3,708	4,447	5,135
160,000	170,000	1,221	2,677	3,974	4,766	5,504
170,000	180,000	1,302	2,857	4,240	5,085	5,872
180,000	190,000	1,384	3,036	4,506	5,404	6,241
190,000	200,000	1,466	3,215	4,772	5,724	6,608
200,000	210,000	1,548	3,394	5,039	6,042	6,977
210,000	220,000	1,630	3,574	5,304	6,361	7,345
220,000	230,000	1,712	3,753	5,570	6,680	7,714
230,000	240,000	1,793	3,932	5,837	6,999	8,082
240,000	250,000	1,875	4,112	6,102	7,318	8,450

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DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1998

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
$ 47,000	48,000	5	11	18	21	23
48,000	49,000	13	29	45	52	60
49,000	50,000	21	47	71	85	96
50,000	51,000	29	65	98	116	134
51,000	52,000	38	83	124	148	171
52,000	53,000	46	101	151	180	207
53,000	54,000	54	119	177	212	244
54,000	55,000	62	137	204	244	281
55,000	56,000	70	155	231	275	318
56,000	57,000	79	172	258	307	355
57,000	58,000	87	190	284	340	391
58,000	59,000	95	208	311	372	428
59,000	60,000	103	226	338	403	465
60,000	62,000	115	253	378	451	520
62,000	64,000	132	289	430	515	594
64,000	66,000	148	325	484	578	668
66,000	68,000	164	361	537	643	741
68,000	70,000	181	396	591	706	815
70,000	72,000	197	432	644	770	888
72,000	74,000	214	468	697	834	962
74,000	76,000	230	504	750	898	1,035
76,000	78,000	246	540	803	962	1,109
78,000	80,000	263	576	856	1,025	1,183
80,000	85,000	291	639	949	1,137	1,312
85,000	90,000	332	728	1,083	1,296	1,496
90,000	95,000	373	818	1,215	1,456	1,681
95,000	100,000	414	908	1,348	1,615	1,865
100,000	110,000	475	1,042	1,548	1,855	2,141
110,000	120,000	557	1,221	1,814	2,174	2,509
120,000	130,000	639	1,401	2,080	2,492	2,878
130,000	140,000	721	1,580	2,346	2,812	3,245
140,000	150,000	803	1,759	2,612	3,131	3,614
150,000	160,000	884	1,939	2,878	3,450	3,982
160,000	170,000	966	2,118	3,144	3,769	4,350
170,000	180,000	1,048	2,297	3,410	4,088	4,719
180,000	190,000	1,130	2,477	3,676	4,406	5,087
190,000	200,000	1,212	2,656	3,942	4,726	5,455
200,000	210,000	1,293	2,835	4,209	5,044	5,824
210,000	220,000	1,375	3,015	4,474	5,364	6,191
220,000	230,000	1,457	3,194	4,740	5,683	6,560
230,000	240,000	1,539	3,373	5,006	6,002	6,928
240,000	250,000	1,621	3,552	5,273	6,320	7,297

04. *Maximum Automobile Value for Using the Cents-per-mile Valuation Rule.*

(1) *Amount of Adjustment.* Under § 1.61–21(e)(1)(iii)(A), the limitation on the fair market value of an employer-provided automobile first made available to any employee for personal use after 1988 is to be adjusted in accordance with § 280F(d)(7). Accordingly, the adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987 (*See*, section 4.02(1).) The new car component of the CPI was 115.2 for October 1987 and 140.6 for October 1997. The October 1997 index exceeded the October 1987 index by 25.4. The Internal Revenue Service has, therefore, determined that the adjustment for 1998 is 22.05 percent (25.4/115.2 × 100%). This adjustment is applicable to all employer-provided automobiles first made available to any employee for personal use in calendar year 1998. The maximum fair market value specified in § 1.61–21(e)(1)(iii)(A) must therefore be multiplied by a factor of 0.2205, and the resulting increase, after rounding to the nearest $100, is added to $12,800 to give the maximum value for 1998.

(2) *The Maximum Automobile Value.* For automobiles first made available in calendar year 1998 to any employee of the employer for personal use, the vehicle cents-per-mile valuation rule may be applicable if the fair market value of the automobile on the date it is first made available does not exceed $15,600.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for automobiles (other than leased automobiles) that are first placed in service during calendar year 1998, to leased automobiles that are first leased during calendar year 1998, and to employer-provided automobiles first made available to employees for personal use in calendar year 1998.

DRAFTING INFORMATION

The principal author of this revenue procedure is Bernard P. Harvey of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding the depreciation limitations and lessee inclusion amounts in this revenue procedure, contact Mr. Harvey at (202) 622-3110; for further information regarding the maximum automobile value for applying the vehicle cents-per-mile valuation rule, contact Ms. Janine Cook of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-6040 (not toll-free calls).

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26 CFR 601.602: Tax forms and instructions. (Also Part I, §§ 6302; 31.6302–1)

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Table of Contents

SECTION 1. PURPOSE

This revenue procedure provides information about the Electronic Federal Tax Payment System (EFTPS) programs for Batch Filers and Bulk Filers (Filers). EFTPS is an electronic remittance processing system for making federal tax deposits (FTDs) and federal tax payments (FTPs). The Batch Filer and Bulk Filer programs are used by Filers for electronically submitting enrollments, FTDs, and FTPs on behalf of multiple taxpayers.

SECTION 2. BACKGROUND

.01 Section 6302(c) of the Internal Revenue Code provides that the Secretary of the Treasury (Secretary) may authorize Federal Reserve banks, and incorporated banks and other financial institutions that are depositories or financial agents of the United States, to receive any tax imposed under the internal revenue laws, in such manner, at such times, and under such conditions as the Secretary may prescribe. Section 6302(c) also provides that the Secretary shall prescribe the manner, times, and conditions under which the receipt of such tax by such banks and other financial institutions is to be treated as a payment of such tax to the Secretary.

.02 Section 6302(h) requires the Secretary to establish an electronic funds transfer (EFT) system to collect depositary taxes (FTDs). EFTPS is the EFT system developed by the Secretary to collect federal taxes (FTDs and FTPs). *See* § 31.6302–1(h)(4)(i) of the Employment Tax and Collection of Income Tax at Source Regulations, and Rev. Proc. 97–33, 1997–30 I.R.B. 10.

.03 Some taxpayers are required by the regulations issued under § 6302(h) to make FTDs using EFTPS. *See* § 31.6302–1(h)(2)(i)(A). Taxpayers not required to make FTDs using EFTPS may choose to do so voluntarily. Taxpayers also may choose to make FTPs using EFTPS.

.04 All Filers using the Batch Filer or Bulk Filer programs must comply with this revenue procedure, and with the Implementation Guide for EFTPS Batch Filers, or the Implementation Guide for

EFTPS Bulk Filers, whichever is applicable.

.05 The two primary remittance methods in EFTPS are an Automated Clearing House (ACH) debit entry and an ACH credit entry. Filers may also use an Electronic Tax Application (ETA) transaction. These remittance methods are defined in section 3 and described in sections 9, 10, and 11 of this revenue procedure.

.06 Filers participating in EFTPS must ensure that taxpayers' funds are remitted on a timely basis. *See* § 31.6302–1(h)(8) for rules regarding when an FTD remitted by EFTPS is deemed made. For FTDs and FTPs remitted by EFTPS, *see* § 31.6302–1(h)(9) for rules regarding when the tax is deemed paid.

.07 If a taxpayer is required by regulations to make an FTD by EFTPS, a Filer may not use a paper FTD coupon (Form 8109, Federal Tax Deposit Coupon) or the magnetic tape FTD program (described in Rev. Proc. 89–48, 1989–2 C.B. 599) to make an FTD for the taxpayer. If a taxpayer is a voluntary participant in EFTPS (that is, a participant not required by regulations to make an FTD by EFTPS) and the Filer is unable, for any reason, to make an FTD using EFTPS or chooses not to use EFTPS to make an FTD, the Filer may make a timely FTD for the taxpayer by using a paper FTD coupon, or the magnetic tape FTD program if authorized by the taxpayer.

.08 EFTPS does not change the computation of tax liability, interest or penalties, or FTD or FTP due dates.

SECTION 3. DEFINITIONS

.01 The definitions provided in this section will be used for the Batch Filer and Bulk Filer programs.

.02 *Administrative FRB Head Office Local Zone Time.* "Administrative FRB Head Office Local Zone Time" is the local zone time of the Administrative Federal Reserve Bank head office through which a financial institution, or its authorized correspondent bank, sends a Same-Day Payment.

.03 *Authorization.* An "Authorization" is an instrument used by a taxpayer to designate a Filer as the taxpayer's agent for submitting enrollments and for making FTDs or FTPs.

.04 *Automated Clearing House* (ACH). "Automated Clearing House" is a funds transfer system, governed by the ACH Rules (the Operating Rules and the Operating Guidelines published by National Automated Clearing House Association (NACHA)) that provides for the interbank clearing of electronic entries for participating financial institutions.

.05 *ACH credit entry.* An "ACH credit entry" is a transaction in which a financial institution, upon instructions from a Filer, originates an FTD or FTP to the appropriate Treasury Department account through the ACH system. An ACH credit entry is a transfer of funds representing one FTD or FTP. There are no "bulk" ACH credit entries. See section 10 of this revenue procedure for information on an ACH credit entry.

.06 *ACH debit entry.* An "ACH debit entry" is a transaction in which one of the Financial Agents, upon instructions from a Filer, instructs the Filer's or the taxpayer's financial institution to withdraw funds from a designated account for an FTD or FTP and to route the FTD or FTP to the appropriate Treasury Department account through the ACH system. A single ACH debit entry is a transfer of funds representing one FTD or FTP. A bulk ACH debit entry (a remittance method available only in the Bulk Filer program) is a transfer of funds representing multiple FTDs or FTPs. See section 9 of this revenue procedure for information on an ACH debit entry.

.07 *Batch Filer.* A Batch Filer is a Filer that is registered under the Batch Filer program. A Batch Filer submits multiple electronic enrollment files at one time and uses a personal computer or telephone for making FTDs or FTPs.

.08 *Bulk Filer.* A Bulk Filer is a Filer that is registered under the Bulk Filer program. A Bulk Filer uses Electronic Data Interchange (EDI) files to transmit and receive enrollment or payment information. A Bulk Filer also has additional remittance methods (bulk ACH debit entries and bulk ETA entries).

.09 *Electronic tax application (ETA) transaction.* An "ETA transaction" (also referred to as "Same-Day Payment") is a transfer of funds through the ETA subsystem of EFTPS that receives, processes, and transmits an FTD or FTP and the related tax payment information for Same-Day Payments through Fedwire value transfers, Fedwire non-value transactions, and Direct Access transactions. A single ETA transaction is a transfer of funds representing one FTD or FTP. A bulk ETA transaction (a remittance method available only in the Bulk Filer program) is a transfer of funds representing multiple FTDs or FTPs. See section 11 of this revenue procedure for information on an ETA transaction.

.10 *Employer identification number* (EIN). An "EIN" is a unique nine digit taxpayer identifying number issued by the Internal Revenue Service to business taxpayers for the purpose of reporting tax related information.

.11 *Federal Reserve Bank* (FRB). The "FRB" is the U.S. Government's fiscal agent. The FRB also processes ACH transactions to a commercial financial institution account or to a Treasury Department account.

.12 *Filer.* A "Filer" is a person making FTDs or FTPs on behalf of multiple taxpayers in the Batch Filer or Bulk Filer program. Each Filer must be either the taxpayer or a person authorized to act on behalf of the taxpayer.

.13 *Financial Agent.* For purposes of EFTPS, a "Financial Agent" (also referred to as a "Treasury Financial Agent") is a financial institution that is designated as an agent of the Treasury Department. The Secretary has designated NationsBank and First National Bank of Chicago (First Chicago) to be the Financial Agents for EFTPS. A Financial Agent processes Batch Filer and Bulk Filer registrations, processes taxpayer enrollments, receives payment information, originates ACH debit entries upon instructions from taxpayers or Filers, and provides customer service assistance for EFTPS enrollment and payment information.

.14 *IRS individual taxpayer identification number* (ITIN). An "ITIN" is a taxpayer identifying number issued by the Service to an alien individual who is ineligible to receive a social security number (SSN) for the purpose of reporting tax related information.

.15 *Prenotification ACH credit.* "Prenotification ACH credit" is a process whereby a financial institution verifies the appropriate Treasury Routing Transit Number (RTN), the Treasury Department's account number, and the taxpayer's taxpayer identification number (TIN).

.16 *Prenotification ACH debit.* "Prenotification ACH debit" is a process whereby the appropriate Financial Agent verifies the RTN of the financial institution, the account number, and the account type.

.17 *Social security number* (SSN). An "SSN" is a taxpayer identifying number assigned to an individual or estate by the Social Security Administration.

.18 *Taxpayer identification number* (TIN). A "TIN" is a taxpayer identifying number assigned to a taxpayer for the purpose of reporting tax related information. A TIN includes an EIN, ITIN, or SSN.

SECTION 4. OVERVIEW

Filers must follow the following procedures to participate in the Batch Filer or Bulk Filer programs:

(1) register as a Filer with the appropriate Financial Agent (see sections 5 and 6 of this revenue procedure);

(2) obtain an Authorization from each taxpayer for which the Filer will be submitting enrollments and making FTDs or FTPs, and submit these Authorizations to the Service (see section 7 of this revenue procedure); and

(3) enroll each of those taxpayers with the appropriate Financial Agent (see section 8 of this revenue procedure).

SECTION 5. REGISTRATION

.01 A Filer may register for the Batch Filer or Bulk Filer program if the Filer anticipates making FTDs or FTPs for multiple taxpayers.

.02 The Batch Filer program is recommended for Filers who anticipate submitting 50 or more enrollments. Additional information for Batch Filers is furnished in the Implementation Guide for EFTPS Batch Filers. A copy of this implementation guide may be obtained from EFTPS Customer Service (see section 22 of this revenue procedure).

.03 The Bulk Filer program is recommended for Filers who anticipate making 750 or more FTDs or FTPs on a peak day. Additional information for Bulk Filers is furnished in the Implementation Guide for EFTPS Bulk Filers. A copy of this implementation guide may be obtained from EFTPS Customer Service (see section 22 of this revenue procedure).

.04 A Filer wanting to participate in either the Batch Filer or Bulk Filer program must submit the appropriate registration letter (also referred to as an "Agreement"). Some Bulk Filers may wish to use the Batch Filer program as a backup. To participate in both programs, a Filer must submit a Batch Filer registration letter and a Bulk Filer registration letter. Blank registration letter(s) may be obtained by contacting the appropriate Financial Agent (listed in section 6 of this revenue procedure).

.05 A Filer must submit the registration letter to the address designated in the instructions accompanying the registration letter.

.06 If an unregistered entity acquires a registered Filer, a new registration letter must be submitted by the unregistered entity if it wants to participate in either the Batch Filer or Bulk Filer program.

.07 A Filer should notify the appropriate Financial Agent if the Filer chooses to withdraw from either the Batch Filer or Bulk Filer program. A Filer that is inactive in the Batch Filer or Bulk Filer program (that is, the Filer has submitted no enrollments, FTDs, or FTPs in that program) for 6 months or more is treated as having withdrawn from that program. If a Bulk Filer uses the Batch Filer program as a backup, the Filer must submit an FTD or FTP through the Batch Filer program at least once every six months to prevent the Filer from being treated as having withdrawn from the Batch Filer program. If a Filer withdraws (or is treated as having withdrawn) from a program, the Filer must reregister to participate in that program.

SECTION 6. ASSIGNMENT TO A FINANCIAL AGENT

.01 A Filer's assignment to a Financial Agent is based on the location of the Filer's principal place of business. Each Financial Agent has responsibility for certain geographic locations as listed below:

NationsBank (800) 555-4477
Alabama
American Samoa
Arizona
Arkansas
California (Los Angeles,
Orange, San Bernardino, Riverside, San Diego, and
Imperial counties only)
Commonwealth of the Northern Mariana Islands
Commonwealth of Puerto Rico
Delaware
District of Columbia
Florida
Georgia
Guam
Kentucky
Louisiana
Maryland
Mississippi
Nevada
New Mexico

First Chicago (800) 945-0966
Alaska
California (except Los Angeles, Orange, San Bernardino,
Riverside, San Diego, and Imperial counties)
Colorado
Connecticut
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Maine
Massachusetts
Michigan
Minnesota
Missouri
Montana
Nebraska
New Hampshire
New Jersey

NationsBank (800) 555-4477
North Carolina
Ohio
Oklahoma
Pennsylvania
South Carolina
Tennessee
Texas
U.S. Virgin Islands
Virginia
West Virginia

First Chicago (800) 945-0966
New York
North Dakota
Oregon
Rhode Island
South Dakota
Utah
Vermont
Washington
Wisconsin
Wyoming
Foreign countries

.02 If a Filer wants to use the other Financial Agent, the Filer must submit a written request detailing the reasons for the request and providing the name and telephone number of a contact person. This request may be submitted to:

FTD & Electronic Payments Section, T:S:C:F
Internal Revenue Service
5000 Ellin Rd
Lanham, MD 20706

or faxed to FTD & Electronic Payments Section at (202) 283-7434 (not a toll-free number).

.03 A Filer, registered with a Financial Agent on April 27, 1998, may continue using the services of that Financial Agent, regardless of the geographic assignments in section 6.01 of this revenue procedure.

SECTION 7. AUTHORIZATIONS

.01 If a Filer is not the taxpayer, the Filer must submit a taxpayer's Authorization to the Service before submitting the taxpayer's enrollment to the Financial Agent.

.02 Except as provided under the grandfather rule in section 24.02 of this revenue procedure, an Authorization must be submitted on Form 8655, Reporting Agent Authorization for Magnetic Tape/Electronic Filers, or any other instrument that complies with Rev. Proc. 96–17, 1996–1 C.B. 633, as modified by Rev. Proc. 97–47, 1997–42 I.R.B. 19.

.03 A Filer that acquires all or some of the clients of another Filer must obtain new Authorizations from those clients and submit the new Authorizations to the Service before making FTDs and FTPs on behalf of those clients.

.04 An Authorization permits a Filer to submit enrollments and to make FTDs or FTPs on behalf of a taxpayer. An Authorization may also permit the Filer to receive certain tax information on behalf of the taxpayer. Although EFTPS is designed for the payment of various types of tax, the Authorization may limit the types of tax information the Filer is permitted to receive. For example, a Filer may make FTDs and FTPs on behalf of the taxpayer, but may be authorized to receive only notices regarding FTDs for Form 941, Employer's Quarterly Federal Tax Return, and Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return.

.05 Except as provided in section 7.07 of this revenue procedure, a Filer submitting Authorizations to the Service for the Batch Filer and Bulk Filer programs on or after April 27, 1998, must include a list of all taxpayers for whom the Filer is submitting Authorizations. The list must include each taxpayer's complete name (for example, business name on file with Service), address (including zip code), and TIN. EINs, SSNs, and ITINs should each be grouped separately. Within each group, the taxpayers must be listed in TIN number sequence.

.06 Except as provided in section 7.07 of this revenue procedure, the Authorizations and the accompanying list must be submitted to:

EFTPS Coordinator—Authorizations
5333 Getwell Road
Stop 532
Memphis, TN 38118

or faxed to the EFTPS Coordinator at (901) 546-4112 (not a toll-free number).

.07 If a Filer has submitted Authorizations to the Service for the Form 941 ELF program, as described in Rev. Proc. 97–47, or the Form 941 or Form 940 Mag Tape Programs, as described in Rev. Proc. 96–18, 1996–1 C.B. 637, and these Authorizations allow the Filer to make payments on behalf of the taxpayer, the Filer is not required to resubmit the Authorizations or to submit a list containing those Authorizations to the Service. Similarly, if a Filer has submitted Authorizations to the Service for the magnetic tape FTD program, as described in Rev. Proc. 89–48, the Filer is not required to resubmit the Authorizations or to submit a list containing those Authorizations to the Service.

.08 To delete Authorizations that a Filer previously submitted to the Service, the Filer must submit a list of the taxpayers to be deleted to the EFTPS Coordinator. The list must be submitted in the format prescribed in section 7.05 of this revenue procedure and to the address (or fax number) provided in section 7.06 of this revenue procedure.

SECTION 8. ENROLLMENT

.01 A Filer must submit electronic taxpayer enrollments to the appropriate Financial Agent in accordance with the applicable implementation guide. As part of completing each taxpayer enrollment, the Filer may choose to use the ACH debit entry or ACH credit entry remittance method on a taxpayer-by-taxpayer basis. In both the Batch Filer and the Bulk Filer programs, enrollment of a taxpayer in the ACH Debit remittance method will automatically enroll the taxpayer in the ACH Credit remittance method. In the Bulk Filer program, enrollment of a taxpayer in the ACH Credit remittance method will automatically enroll the taxpayer in the ACH Debit remittance method. However, in the Batch Filer program, enrollment of a taxpayer in the ACH Credit remittance method will *not* automatically enroll the taxpayer in the ACH Debit remittance method.

.02 The Financial Agent will verify the accuracy of the enrollment information for each taxpayer and enter the verified

enrollment information in its enrollment record database. As part of the verification process for an ACH debit entry in the Batch Filer program, the Financial Agent will originate a prenotification ACH debit, if requested by the Batch Filer. In the Bulk Filer program, prenotification ACH debits are not available. When a prenotification ACH debit is not made, the Filer assumes responsibility for the accuracy of the information, including the RTN of the financial institution.

.03 When the enrollment process for a taxpayer is completed, the Financial Agent will provide the Filer with an enrollment response record that either accepts or rejects the taxpayer's enrollment. A rejected enrollment will identify necessary corrections. Any necessary corrections must be submitted by the Filer as a new enrollment of that taxpayer.

.04 If a Filer attempts to make an FTD or FTP through EFTPS before a taxpayer is enrolled, the FTD or FTP generally will be rejected and the taxpayer may be subject to a penalty for a late FTD or FTP.

SECTION 9. ACH DEBIT ENTRY

.01 For an FTD or FTP to be timely, a Filer must complete the initiation of an ACH debit entry with a Financial Agent at least one business day prior to the FTD or FTP due date.

.02 A Filer may "warehouse" an ACH debit entry for a business taxpayer by arranging for the entry up to 30 days in advance of the due date. A Filer may warehouse an ACH debit entry for an individual taxpayer by arranging for the entry up to 105 days in advance of the due date.

.03 After a Batch Filer or a Bulk Filer initiates a single ACH debit entry, the Financial Agent will validate the taxpayer's payment information and issue an acknowledgment number to the Filer. The acknowledgment number verifies when the necessary payment information was received by a Financial Agent but does not constitute proof of payment. See section 12 of this revenue procedure regarding proof of payment.

.04 After a Bulk Filer initiates a bulk ACH debit entry, the Financial Agent will validate the taxpayers' payment information and issue acknowledgment numbers to the Filer for accepted payments. The Bulk Filer will receive an acknowledgment number for the bulk ACH debit entry and separate acknowledgement numbers for each accepted FTD or FTP included in the bulk ACH debit entry. The acknowledgment numbers verify when the necessary payment information was received by a Financial Agent but do not constitute proof of payment. See section 12 of this revenue procedure regarding proof of payment.

.05 In a bulk ETA debit entry, any rejected payment will be returned to the Bulk Filer without an acknowledgement number and subtracted from the bulk ACH debit entry, as specified in the Implementation Guide for EFTPS Bulk Filers. The Bulk Filer assumes responsibility for reinitiating any rejected payments.

.06 Pursuant to the Filer's instructions, the Financial Agent, on the date designated by the Filer, will originate the transfer of funds from the taxpayer's or Filer's account to the appropriate Treasury Department account. The Financial Agent also will transmit the related payment information, supplied by the Filer, to the Service for posting to the tax account(s) of the taxpayer(s).

.07 The Service will deem an FTD or FTP made by an ACH debit entry to have been made at the time of the debit (that is, when the amount is withdrawn from the taxpayer's or Filer's account and not returned or reversed).

.08 When a timely ACH debit entry cannot be made, a Filer may instruct the Financial Agent to complete the transaction at the next opportunity to submit an ACH debit entry. The Filer may also use an ACH credit entry or an ETA transaction. If a taxpayer is not required to use EFTPS for FTDs, the Filer may use a paper FTD coupon or, if authorized by the taxpayer, the magnetic tape FTD program. To avoid penalties, the FTD or FTP must be received by an appropriate means on or before the FTD or FTP due date.

.09 The ACH Rules will govern ACH debit entry returns and reversals.

SECTION 10. ACH CREDIT ENTRY

.01 If a Filer chooses the ACH credit entry remittance method to make an FTD or FTP, the Filer may use any financial institution capable of originating an ACH credit entry.

.02 For each TIN used in making ACH credit entries through a financial institution, the Filer may request that the financial institution originate a prenotification ACH credit.

.03 To initiate a timely ACH credit entry, a Filer must take into account the financial institution's deadline for originating an ACH credit entry.

.04 When a timely ACH credit entry cannot be made, a Filer may instruct the financial institution to complete the transaction at the next opportunity to submit an ACH credit entry. The Filer may also use an ETA transaction. A Bulk Filer may initiate an ACH debit entry. However, a Batch Filer may initiate an ACH debit entry only if the taxpayer is enrolled for the ACH debit remittance method. If a taxpayer is not required to use EFTPS for FTDs, the Filer may use a paper FTD coupon or, if authorized by the taxpayer, the magnetic tape FTD program. To avoid penalties, the FTD or FTP must be received by an appropriate means on or before the FTD or FTP due date.

.05 The Financial Agent will receive and process the ACH credit entry payment information. The Financial Agent will compare the transaction's payment information with the taxpayer's enrollment record. If they match, the Financial Agent will send the payment information to the Service for posting to the taxpayer's tax account.

.06 If the Financial Agent cannot identify the taxpayer, the ACH credit entry will be returned to the originating financial institution.

.07 Failure to provide correct, complete, and properly formatted payment information may cause an ACH credit entry to be returned. In the event of a return, a Filer may instruct the financial institution to submit a corrected ACH credit entry at the next opportunity to submit an ACH credit entry. The Filer may also use an ETA transaction. A Bulk Filer may initiate an ACH debit entry. However, a Batch Filer may initiate an ACH debit entry only if the taxpayer is enrolled for the ACH debit remittance method. If a taxpayer is not required to use EFTPS for FTDs, the Filer may use a paper FTD coupon or, if authorized by the taxpayer, the magnetic tape FTD program. To avoid penalties, the FTD or FTP must be received by an appropriate means on or before the FTD or FTP due date.

.08 An ACH Credit entry that is not returned or reversed will be deemed made

at the time that the funds are paid into the appropriate Treasury Department account.

.09 The ACH Rules will govern ACH credit entry returns and reversals.

SECTION 11. ELECTRONIC TAX APPLICATION TRANSACTION

.01 A Filer may use an ETA transaction to make an FTD or FTP. The Filer should contact the financial institution through which the ETA payment will be made to determine if the financial institution is capable of making an ETA payment.

.02 A Bulk Filer may use a bulk ETA transaction to make FTDs or FTPs. The Bulk Filer should contact the financial institution through which the bulk ETA payment will be made to determine if the financial institution is capable of making a bulk ETA payment.

.03 If a Filer uses a single ETA transaction, the transfer of funds and the transmission of the related payment information occur together. If a Bulk Filer uses a bulk ETA transaction, the transmission of the payment information precedes the related transfer of funds, both of which occur on the same day.

.04 The Service generally will deem an ETA payment to have been made on the date the payment is received by the FRB. A Filer should contact the financial institution through which the ETA payment will be made to determine the deadline for initiating ETA payments for a particular day. ETA payments received by the FRB after the deadline set forth in the Treasury Financial Manual, Volume IV (IV TFM), will not be accepted. Currently, the deadline in IV TFM is 2:00 p.m. Administrative FRB Head Office Local Zone Time. If a payment is not accepted, the Filer must reoriginate the payment using an ETA transaction or any other permissible remittance method.

.05 Additional ETA information may be found in the sections on Same-Day Payments in the Implementation Guide for EFTPS Bulk Filers and the EFTPS Payment Instruction Booklets for businesses.

SECTION 12. PROOF OF PAYMENT

.01 For an ACH debit or credit entry posted to the taxpayer's account in a financial institution, a statement prepared by that financial institution showing a transfer (that is, a decrease to the taxpayer's account balance) will be accepted as proof of payment if the statement:

(1) shows the amount and the date of the transfer; and

(2) identifies the U.S. Government as the payee (for example, "USA tax").

.02 For an ETA payment posted to the taxpayer's account in a financial institution, a taxpayer may request that its financial institution obtain a statement from the FRB that executed the transfer. This statement will be accepted as proof of payment if the statement:

(1) shows the amount and the date of the transfer; and

(2) identifies the U.S. Government as the payee (for example, "USA tax").

.03 For purposes of this section, statements prepared by a financial institution include statements prepared by a third party that is contractually obligated to prepare statements for the financial institution.

.04 A taxpayer's payment to a Filer (including a subsidiary's payment to its parent) is not a payment of tax by the taxpayer. Therefore, a statement prepared by the taxpayer's financial institution showing a transfer from the taxpayer's account to the Filer as payee is not proof of payment. Further, a statement prepared by the Filer's financial institution showing a transfer of funds from the Filer's account to the U.S. Government is not proof of payment because the payment may not have been made on behalf of the taxpayer. The taxpayer will need the acknowledgement number for an FTD or FTP made from the Filer's account to establish that the FTD or FTP was made on behalf of the taxpayer. The acknowledgement number allows the Service to trace the payment. The Filer has the acknowledgement number or may obtain it from the Financial Agent.

SECTION 13. REFUNDS

No refunds of FTDs or FTPs will be made through EFTPS. However, a refund request may be made using existing tax refund procedures. If a taxpayer's error results in a significant hardship, the taxpayer may contact the Service at (800) 829-1040 for assistance.

SECTION 14. DISASTER PROCEDURES

.01 A taxpayer's ability to make FTDs and FTPs timely may be affected by the time, severity, and extent of a major disaster. In such circumstances, the Service provides relief through the nonassertion or abatement of certain penalties. The Service publicizes the relief for a particular disaster area through the publication of a News Release, Notice, or Announcement. Generally, the Service identifies the taxpayers who qualify for this disaster relief.

.02 If a disaster affects a Filer, the Filer should provide the Service with the information necessary to identify those FTDs and FTPs of taxpayers outside the disaster area which were or will be late due to the disaster. The Service will then determine if the nonassertion or abatement of certain penalties is appropriate.

.03 In addition, if a Bulk Filer's primary processing system is affected by a disaster and the Bulk Filer's backup processing system fails, the Bulk Filer may use an emergency bulk ETA transaction under which the transfer of funds occurs before the transmission of the related payment information.

SECTION 15. RESPONSIBILITIES OF A FILER

.01 Each Filer must:

(1) comply with this revenue procedure and the applicable implementation guide (Implementation Guide for EFTPS Batch Filers or Implementation Guide for EFTPS Bulk Filers);

(2) maintain a high degree of integrity, compliance, and accuracy;

(3) ensure that FTDs and FTPs are accurately and timely made;

(4) ensure the security of all transmitted information; and

(5) ensure that after a disabling event the Filer is able to operate its Batch Filer or Bulk Filer programs with minimal interruption (generally, less than 24 hours).

.02 A Filer that is not the taxpayer must:

(1) retain copies of each Authorization and each enrollment at its principal place of business for 4 years after the prescribed due date of the last return to which the any FTD or FTP relates, unless

the Filer is otherwise notified by the Service;

(2) retain any payment information (including acknowledgement numbers) at its principal place of business for 4 years after the prescribed due date of the return to which the FTD or FTP relates, unless the Filer is otherwise notified by the Service. A shorter retention period for payment information may be substituted for this "4-year" retention period, provided the Filer notifies the taxpayer in writing that the Filer will not be retaining the payment information after the shorter retention period and the Filer gives such information to the taxpayer. The shorter retention period must be at least 90 days; and

(3) advise the taxpayer to enroll itself separately in EFTPS. If the Filer is not authorized to make all the taxpayer's required FTDs and FTPs, the taxpayer's separate enrollment will allow the taxpayer to make its own FTDs and FTPs through EFTPS. To enroll separately, a taxpayer must submit a completed Form 9779, EFTPS Business Enrollment Form, or Form 9783, EFTPS Individual Enrollment Form, to the EFTPS Enrollment Processing Center at the address provided in the applicable form's instructions. See Rev. Proc. 97-33 for more information.

.03 A Filer that is the taxpayer must:

(1) absent a specific retention period prescribed by regulations, retain the payment information and any supporting material at its principal place of business for as long as the contents thereof may become material in the administration of any internal revenue law; and

(2) retain copies of each enrollment at its principal place of business for 4 years after the prescribed due date of the return to which the last FTD or FTP relates, unless otherwise notified by the Service.

SECTION 16. ADVERTISING STANDARDS

.01 A Filer must comply with the advertising and solicitation provisions of 31 C.F.R. Part 10 (Treasury Department Circular No. 230). This circular prohibits the use or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive, or unfair statement or claim.

.02 A Filer must adhere to all relevant federal, state, and local consumer protection laws that relate to advertising and soliciting.

.03 A Filer must not use the Service's name, "Internal Revenue Service" or "IRS", within a firm's name.

.04 A Filer must not use improper or misleading advertising in relation to EFTPS.

.05 Advertising materials must not carry the Service, FMS, or other Treasury Seals.

.06 If a Filer uses radio or television broadcasting to advertise, the broadcast must be pre-recorded. The Filer must keep a copy of the pre-recorded advertisement for a period of at least 36 months from the date of the last transmission or use.

.07 If a Filer uses direct mail or fax communications to advertise, the Filer must retain a copy of the actual mailing or fax, along with a list or other description of the firms, organizations, or individuals to whom the communication was mailed, faxed, or otherwise distributed for a period of at least 36 months from the date of the last mailing, fax, or distribution.

.08 If a Filer uses a Web site or print media (including newspapers, magazines, or yellow pages) to advertise, the Filer must retain a copy of the advertising for a period of at least 36 months from the date of the last posting or publication.

.09 Acceptance in the Batch Filer or Bulk Filer programs is not an endorsement by the Service, FMS, or the Treasury Department of the quality of the services provided by the Filer.

SECTION 17. REASONS FOR SUSPENSION

.01 The Service reserves the right to suspend a Filer from the Batch Filer or Bulk Filer programs for the following reasons (this list is not all-inclusive):

(1) failing to submit payment information in accordance with this revenue procedure and the applicable implementation guides;

(2) failing to maintain and make available the required records for the period specified in section 15 of this revenue procedure;

(3) submitting payment information on behalf of taxpayers for which the Service did not receive Authorizations;

(4) failing to abide by the advertising standards in section 16 of this revenue procedure;

(5) failing to cooperate with the Service's efforts to monitor Filers and investigate abuse in the Batch Filer or Bulk Filer programs; or

(6) generating significant complaints about the Filer's performance in the Batch Filer or Bulk Filer programs.

.02 If the Service informs a Filer that a certain action is a reason for suspension and the action continues, the Service may send the Filer a notice proposing suspension of the Filer from the Batch Filer or Bulk Filer program. However, a notice proposing suspension may be sent without a warning if the Filer's action indicates an intentional disregard of rules. A notice proposing suspension will describe the reason(s) for the proposed suspension, and indicate the length of the suspension and the conditions that need to be met before the suspension will terminate.

SECTION 18. ADMINISTRATIVE REVIEW PROCESS FOR PROPOSED SUSPENSION

.01 A Filer that receives a notice proposing suspension from the Batch Filer or Bulk Filer program, as described in section 17.02 of this revenue procedure, may request an administrative review prior to the proposed suspension taking effect.

.02 The request for an administrative review must be in writing and contain detailed reasons, with supporting documentation, for withdrawal of the proposed suspension.

.03 The written request for an administrative review and a copy of the notice proposing suspension must be delivered to the address designated in the notice within 30 days of the effective date on the notice.

.04 After consideration of the written request for an administrative review, the Service will either issue a suspension letter or notify the Filer in writing that the proposed suspension is withdrawn.

.05 If a Filer receives a suspension letter, the Service's subsequent determination of whether a reason for suspension has been corrected is not subject to administrative review or appeal.

.06 Failure to submit a written request for an administrative review within the

30-day period described in section 18.03 of this revenue procedure irrevocably terminates the Filer's right to an administrative review of the proposed suspension, and the Service will issue a suspension letter.

SECTION 19. EFFECT OF SUSPENSION

.01 The Filer's suspension will continue for the length of time specified in the suspension letter, or until the conditions for terminating the suspension have been met, whichever is later.

.02 After suspension, a Filer may submit an FTD under the Batch Filer or Bulk Filer program only if the FTD is due not more than 30 days after the effective date on the suspension letter. No FTPs may be submitted by the Filer under the Batch Filer or Bulk Filer programs during the suspension period.

.03 A Filer must provide written notification of a suspension from the Batch Filer or Bulk Filer programs to each taxpayer in the program(s) within 10 days from the date on the suspension letter. This notification must be provided even though the Filer may believe that the Filer will be able to meet the conditions for terminating the suspension within the 30-day period provided in section 19.02 of this revenue procedure.

.04 A Filer will be able to submit payment information under the Batch Filer or Bulk Filer programs without reregistering for those programs after:

(1) the stated suspension period expires; and

(2) the reason(s) for suspension are corrected.

SECTION 20. APPEAL OF A SUSPENSION

.01 If a Filer receives a suspension letter from the Service, the Filer is entitled to appeal, by written protest, to the Service. The written protest must be delivered to the address designated on the suspension letter. During the appeals process, the suspension remains in effect.

.02 The written protest must be received by the Service within 30 days of the effective date on the suspension letter. The written protest must contain detailed reasons, with supporting documentation, for withdrawal of the suspension.

.03 Failure to appeal within the 30-day period described in section 20.02 of this revenue procedure irrevocably terminates the Filer's right to appeal the suspension under section 20.01 of this revenue procedure.

SECTION 21. PENALTIES

.01 Section 6656 imposes a failure-to-deposit penalty if a taxpayer does not make a timely FTD, unless such failure is due to reasonable cause and not due to willful neglect. *See* Rev. Rul. 94–46, 1994–2 C.B. 278. Absent reasonable cause, a taxpayer that is required to deposit federal taxes by EFTPS is subject to the failure-to-deposit penalty if FTDs are made by means other than EFTPS (for example, using a paper FTD coupon). See Rev. Rul. 95–68, 1995–2 C.B. 272. However, for a taxpayer that was first required to deposit by EFTPS on or after July 1, 1997, this penalty will not be imposed solely by reason of a failure to deposit by EFTPS prior to July 1, 1998.

.02 Section 6655 imposes a penalty for underpayments of estimated tax by a corporation, private foundation, tax-exempt organization, or qualified settlement fund.

.03 Section 6651 imposes a failure-to-pay penalty if a taxpayer does not make a timely FTP, unless such failure is due to reasonable cause and not due to willful neglect.

SECTION 22. FORMS, PUBLICATIONS, IMPLEMENTATION GUIDES, AND ADDITIONAL INFORMATION

.01 A Filer may obtain copies of this revenue procedure, enrollment forms (Forms 9779 and 9783), implementation guides, payment instruction booklets, registration letters, and additional information on EFTPS by calling EFTPS Customer Service at (800) 945-0966 (First Chicago) or (800) 555-4477 (NationsBank).

.02 A Filer may obtain enrollment forms and Authorizations (Forms 8655) by calling the IRS Distribution Center at (800) TAX-FORM ((800) 829-3676).

.03 A Filer may obtain information on the submission of Authorizations by calling the EFTPS Coordinator at (901) 546-4103 (not a toll-free call).

SECTION 23. EFFECT ON OTHER DOCUMENTS

Section 9.03 of Rev. Proc. 97–33, 1997–30 I.R.B. 10, 13, is modified to provide the same rule (regarding the FRB's nonacceptance of late ETA payments) as set forth in section 11.04 of this revenue procedure.

SECTION 24. EFFECTIVE DATE

.01 *In general.* This revenue procedure is effective April 27, 1998.

.02 *Grandfather rule.* A power of attorney on Form 2848, Power of Attorney and Declaration of Representative, or other document that satisfies the requirements of § 601.503(a) of the Statement of Procedural Rules, that was submitted to the Service on or before April 27, 1998, will be treated as an Authorization for purposes of this revenue procedure, even though it does not comply with section 7.02 of this revenue procedure.

SECTION 25. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1601.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 5, 6, 7, 8, 12, 14, 15, and 16 of this revenue procedure. This information is required to implement EFTPS, and verify that taxpayers have met their obligations to pay their taxes and make FTDs by EFTPS. This information will be used to identify persons paying taxes and making FTDs on behalf of taxpayers and to credit taxpayers' tax accounts for FTDs and FTPs made through EFTPS. The collections of information are mandatory. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and recordkeeping burden will be 51,885 hours.

The estimated annual burden per respondent/recordkeeper will vary from 71 hours to 91 hours, depending on individual circumstances, with an estimated average of 74.33 hours. The estimated number of respondents and recordkeepers is 620.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Part IV. Items of General Interest

Partial Withdrawal of, and Amendment to, Notice of Proposed Rulemaking; Notice of Proposed Rulemaking and Notice of Public Hearing

Adjustments Following Sales of Partnership Interests

REG–209682–94

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking, amendment to notice of proposed rulemaking; notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document withdraws a portion of the notice of proposed rulemaking published in the **Federal Register,** February 16, 1984 (49 F.R. 5940); contains proposed regulations relating to the optional adjustments to the basis of partnership property following certain transfers of partnership interests under section 743, the calculation of gain or loss under section 751(a) following the sale or exchange of a partnership interest, the allocation of basis adjustments among partnership assets under section 755, and the allocation of a partner's basis in its partnership interest to properties distributed to the partner by the partnership under section 732(c); and, finally, amends proposed regulations relating to the computation of a partner's proportionate share of the adjusted basis of depreciable property (or depreciable real property) under section 1017. The changes are necessary to provide clearer guidance on the the proper application of these sections and will effect partnerships and partners where there are transfers of partnership interests, distributions of property, or elections under sections 108(b)(5) or (c). In addition, the proposed regulations under section 732(c) reflect changes to the law made by the Taxpayer Relief Act of 1997.

DATES: Written comments must be received by April 29, 1998. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, July 8, 1998, at 10 a.m. must be received by Wednesday, June 24, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209682–94), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209682–94), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Terri A. Belanger, (202) 622-3070; concerning submissions and the hearing, LaNita VanDyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 30, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service,** including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up cost and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §§1.743–1(b), 1.743–1(k), and 1.755–1. This information is required in order for partners to have adequate knowledge to comply with section 743 and for the IRS to verify compliance with section 743. This information will be used to determine whether the amount of tax has been computed correctly. Responses to this collection of information are mandatory for partnerships that have made an election under section 754 and for which a section 743 transfer has been made. The likely respondents are businesses or other for-profit institutions.

Estimated total annual recordkeeping burden under §1.743–1(b): 600,000 hours

The estimated annual burden per recordkeeper varies from **1 hour** to **300 hours,** depending on the individual circumstances, with an estimated average of **4 hours.**

Estimated number of recordkeepers: 150,000

Estimated total annual reporting burden under §1.743–1(k)(1): 225,000 hours

The estimated annual burden per respondent is estimated at an average of **3 hours.**

Estimated number of respondents: 75,000

Estimated frequency of responses: On occasion.

Estimated total annual reporting burden under §1.743–1(k)(2): 75,000 hours

The estimated annual burden per respondent is estimated at an average of **1 hour.**

Estimated number of respondents: 75,000

Estimated frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document proposes to (a) revise §§1.743–1 and 1.755–1 of the Income Tax Regulations (26 CFR part 1), (b) withdraw §1.168–2(n) of the proposed Income Tax Regulations published on February 16, 1984 (49 F.R. 5940), and (c) amend §§1.732–1, 1.732–2, 1.734–1, 1.751–1 of the Income Tax Regulations, and §1.1017–1 of the proposed Income Tax Regulations published January 7, 1997 (62 F.R. 955).

Section 743(b) provides for an optional adjustment to the basis of partnership property following certain transfers of partnership interests. The Code provides for basis adjustments in an attempt to coordinate the transferee's tax consequences and economic consequences. The amount of the basis adjustment is the difference between the transferee's basis in the partnership interest (outside basis) and its share of the partnership's basis in the partnership's assets (inside basis). Once the amount of the basis adjustment is determined, it is allocated among the partnership's various assets pursuant to section 755.

The proposed regulations coordinate sections 704(c), 743, 751, and 755, and reflect changes in the Code and Income Tax Regulations since the adoption of the current regulations. The proposed regulations also provide rules concerning adjustments to the basis of partnership property made pursuant to section 1017(b)(3)(C). The proposed regulations describe how to determine a partner's proportionate share of the adjusted basis of depreciable property (or depreciable real property) under section 1017, and clarify that an adjustment to the basis of partnership property made under section 1017(b)(3)(C) is treated in the same manner as an adjustment to the basis of partnership property made under section 743.

Section 732(c) provides for the allocation of a partner's basis in its partnership interest upon certain distributions of property to the partner by the partnership. Section 732(c) was amended by the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, §1061, 111 Stat. 788, 945–46 (1997). Under prior law, the allocation was made based on the adjusted basis of the distributed property to the partnership immediately before the distribution. Under the new law, the allocation is made, in general, based on the fair market value of the distributed property on the date of distribution. The proposed regulations amend the existing regulations under section 732 to reflect this change.

Explanation of Provisions

A. *Section 743*

In General

If an election is in effect under section 754, section 743 requires the partnership to adjust the basis of partnership property upon the transfer of an interest in the partnership by sale or exchange or on the death of a partner. The partnership is required to increase the adjusted basis of partnership property by the excess of the transferee's basis in the transferred partnership interest over the transferee's share of the adjusted basis to the partnership of the partnership's property. The partnership is also required to decrease the adjusted basis of partnership property by the excess of the transferee's share of the adjusted basis to the partnership of partnership property over the transferee's basis in the transferred partnership interest.

The proposed regulations address a number of issues raised in connection with the calculation, treatment, and reporting of basis adjustments under section 743. In particular, the proposed regulations (i) clarify the manner in which the partnership calculates a transferee's income, gain, loss, or deduction when the transferee has a basis adjustment under section 743 (including the recovery of negative basis adjustments) and (ii) coordinate sections 743 and 704(c) when partnerships elect the remedial allocation method under §1.704–3(d). The proposed regulations also provide that partnerships (rather than partners) are required to make and report the basis adjustments under section 743(b). Partnerships are required to adjust the transferee's distributive share of partnership tax items so that the information reported on the transferee's Schedule K–1 reflects the adjustments to the transferee's distributive share of the partnership items affected by the basis adjustment.

Determining the Amount of the Basis Adjustment

The amount of the basis adjustment with respect to partnership property under section 743 is the difference between the transferee's share of the partnership's inside basis and the transferee's outside basis. The current regulations provide that a partner's share of the adjusted basis of partnership property is equal to the sum of the partner's interest as a partner in partnership capital and surplus, plus the partner's share of partnership liabilities. The current regulations also provide that where section 704(c) applies to property contributed to the partnership, section 704(c) is taken into account in determining a partner's share of the adjusted basis of partnership property.

The current regulations do not provide, other than by example, specific guidance on how to determine a transferee partner's share of the adjusted basis of partnership property. The proposed regulations provide that a transferee's share of the adjusted basis to the partnership of partnership property is equal to the sum of the transferee's interest as a partner in the partnership's previously taxed capital, plus the transferee's share of partnership liabilities. The partner's share of the partnership's previously taxed capital is determined by reference to a hypothetical transaction in which (immediately after the transfer of the partnership interest) the partnership is assumed to have sold all of its assets in a fully taxable transaction for cash equal to the fair market value of the assets. The partner's share of the partnership's previously taxed capital is equal to (i) the amount of cash that the transferee would receive on liquidation of the partnership immediately following the hypothetical transaction, increased by (ii) the amount of tax loss that would be allocated

to the transferee from the hypothetical transaction, and decreased by (iii) the amount of tax gain that would be allocated to the transferee from the hypothetical transaction.

Calculation of Income, Gain, or Loss

The basis adjustment under section 743, like any other basis amount, is a reference used to calculate income, gain, loss, and deduction. However, generally the basis adjustment under section 743 is an adjustment with respect to the transferee. No adjustment is made to the common basis of partnership property (i.e., the partnership's adjusted basis for the property). Thus, for purposes of income, deduction, gain, loss, and distribution, the transferee will have a special basis for those partnership properties that are adjusted under section 743(b). The proposed regulations clarify the rules contained in the current regulations.

The basis adjustment under section 743 does not affect the partnership's computation of any item under section 703, and does not have any effect on the partners' capital accounts. Partnerships compute their tax items at the partnership level under section 703 without regard to the basis adjustments. Partnership level tax items (including any remedial allocations under §1.704–3(d)) are then allocated among the partners, including the transferee, in accordance with section 704. Finally, the partnership adjusts the transferee's distributive share of partnership tax items to reflect the transferee's special basis in the properties that give rise to the tax items. A transferee's income, gain, or loss from the sale of partnership property in which the transferee has a basis adjustment is equal to the transferee's distributive share of partnership income, gain, or loss (including any remedial allocations under §1.704–3(d)) from the sale of the property adjusted to account for the amount of the transferee's basis adjustment with respect to the property.

Coordination of Section 743 with Section 704(c)

Section 704(c) is taken into account in determining a transferee's share of the partnership's basis in the partnership's assets. As a result, some or all of a transferee's basis adjustment may be attributable to section 704(c) built-in gain or loss when a transferee purchases a partnership interest from a partner that contributed section 704(c) property to the partnership. For example, assume that A contributes property with a fair market value of $100 and an adjusted tax basis of $10 to a partnership for a fifty percent interest and B contributes $100 of cash for the remaining fifty percent interest. Immediately after the formation of the partnership, A's share of the partnership's basis in the partnership property is $10, while B's share is $100. The contributed asset then appreciates in value to $120, and A transfers its entire interest to T for $110 while an election is in effect under section 754. T will have a basis adjustment of $100. The first $90 of the basis adjustment is attributable to the section 704(c) built-in gain, while the remaining $10 of the basis adjustment is attributable to T's fifty percent share of the $20 of post-contribution appreciation in the contributed property.

Despite the fact that a portion of the basis adjustment may be attributable to a property's section 704(c) built-in gain, section 704(c) and section 743 operate independently. Section 1.704–1(b)(2)(iv)-(g)(3) requires a partnership to recover the value of section 704(c) property on the books of the partnership over the property's remaining useful life, determined with reference to the property's useful life in the hands of the contributing partner. At the same time, §1.168–2(n)(1) of the proposed Income Tax Regulations provides that the entire basis adjustment is recovered as though it is new property. Cf. Sections 168(i)(7) and 197(f)(2). As a result, the book and tax items representing the section 704(c) built-in gain are recovered over different periods.

Although a portion of the basis adjustment may represent actual tax basis equal to the amount of the section 704(c) built-in gain, the deductions attributable to the basis adjustment cannot be allocated to the noncontributing partner. The basis adjustment does not, therefore, eliminate any book-tax disparities that result from ceiling rule problems relating to the section 704(c) property. Because the basis adjustment only affects the transferee, the Service and Treasury believe that it is appropriate for sections 704(c) and 743(b) to operate independently.

When a partnership adopts the remedial allocation method, however, the partners may be viewed as agreeing to shift, over time, a portion of the partnership's basis in its assets from the noncontributing partner to the contributing partner. Partnership basis that was considered part of the noncontributing partner's share of the partnership's basis at the time the adjustment to basis was made will be transferred to the contributing partner as the property is recovered on the partnership's books. In addition, a partnership that adopts the remedial allocation method with respect to contributed property must depreciate or amortize the portion of the contributed property's book basis that is attributable to section 704(c) built-in gain as though it is new property at the time of contribution. As a result, the Service and Treasury believe that it is appropriate to coordinate the recovery periods of the section 704(c) built-in gain and the built-in gain portion of the basis adjustment where the partnership uses the remedial allocation method.

Where a partnership adopts the remedial allocation method, the proposed regulations treat the portion of any basis adjustment that is attributable to section 704(c) built-in gain differently from the rest of the basis adjustment. Instead of treating the section 704(c) built-in gain portion of the basis adjustment and the basis adjustment in excess of such amount as newly acquired property, the section 704(c) built-in gain portion of the basis adjustment is recovered over the remaining cost recovery period for the section 704(c) built-in gain. The recovery period for the partner's share of common basis continues to be determined by reference to the property's useful life in the hands of the contributing partner, and the remaining basis adjustment in excess of the section 704(c) built-in gain portion of the basis adjustment is recovered as if it were new property.

If a partnership receives remedial allocations of income under §1.704–3(d) with respect to an item of adjusted partnership property, the partner does not offset the cost recovery deductions from the property against the remedial allocations of income. Rather, the partner will receive an allocation of remedial income and a separate cost recovery deduction. If a partner receives remedial allocations of deductions under §1.704–3(d) with respect to an item of partnership property that has a

negative basis adjustment, the partner first adds the amount of the remedial allocation of deduction to any common basis deductions received from the property. The partner then reduces the total amount of deductions from the property by the amount of the negative basis adjustment recovered in that year.

One result of this proposal is that the interests in a partnership will generally be fungible (i.e. the tax consequences that stem from the purchase of a partnership interest do not vary with the identity of the transferor), if (i) each partnership interest has an identical right in capital and profits, and (ii) each item of the partnership's section 704(c) property is subject to the remedial allocation method. The Service and Treasury request comments on situations in which the fungibility of partnership interests may otherwise be accommodated without significantly adding to the complexity of subchapter K. In addition, comments are requested concerning the application of the remedial allocation method to contributed property where there are no distortions caused by the ceiling rule at the time the property is contributed to the partnership.

Recovery of Negative Basis Adjustments

Section 1.168–2(n)(2) of the proposed Income Tax Regulations provides that a negative basis adjustment to depreciable property is recovered over the property's remaining recovery period in the hands of the partnership (i.e., the adjustment made to the common basis of the partnership property). The portion of the adjustment that is recovered in any year is equal to the product of (i) the amount of the decrease to the item's adjusted basis (determined as of the date of the transfer), multiplied by (ii) a fraction, the numerator of which is the portion of the adjusted basis of the item recovered by the partnership in that year, and the denominator of which is the adjusted basis of the item on the date of transfer (determined prior to any basis adjustments).

Because the basis adjustment under section 743 is personal to the transferee, the primary method adopted by the proposed regulations for recovering a negative basis adjustment provides that the basis adjustment does not affect the common basis of partnership property and does not affect the tax consequences of partners other than the transferee. Under this method, the recovery of the negative basis adjustment may generate ordinary income to the extent that it exceeds the transferee's share of the depreciation deductions. The proposed regulations provide that, unless the partnership elects to make a common basis adjustment, as described below, the amount of the basis adjustment recovered in any year first decreases the transferee's distributive share of the partnership's deductions from the adjusted item of property for that year. If, in any year, a partnership does not allocate to a transferee sufficient deductions from the adjusted property to offset the recovery of the negative basis adjustment, then the transferee's distributive share of the deductions from other items of partnership property is decreased. The transferee then recognizes income equal to the excess of the amount of the negative basis adjustment recovered in the year over the transferee's share of deductions from the other items of property for the year.

As an alternative, the proposed regulations also allow partnerships to elect to follow the approach of the old proposed regulations. If this election is made, the partnership treats the amount of the negative basis adjustment as an item of built-in gain, decreasing the total amount of depreciation or amortization that the partnership may allocate for tax purposes. This election would prevent the transferee from ever recognizing income in situations where the partnership did not allocate to the transferee sufficient depreciation to offset the negative basis adjustment. It should be noted, however, that this election has no effect on the partners' capital accounts, which continue to be adjusted to reflect the depreciation or amortization of the adjusted property as though there was no basis adjustment to the property. Consequently, to the extent that the basis adjustment causes the amount of the deductions allocated to the non-transferee partners for book purposes to exceed the amount of tax depreciation available to be allocated to them by the partnership, a book-tax disparity results for the non-transferee partners.

The Service and Treasury request comments concerning the recovery of negative basis adjustments under section 743. Specifically, the Service and Treasury request comments regarding whether there are other possible ways of accounting for the recovery of negative basis adjustments that treat the basis adjustment as personal to the transferee and, at the same time, do not interfere with the economic agreement among the partners.

Reporting and Returns

The statutory language of section 743(b) indicates that partnerships are responsible for making the basis adjustments. This mandate is repeated in the language of the current regulations issued under both sections 743 and 755. Notwithstanding that partnerships are required to make and allocate basis adjustments under the current regulations, transferees are required to report the basis adjustments. Transferees accomplish this by attaching statements to their returns that show how the section 743(b) adjustment was determined and how the adjustment was allocated among the various partnership properties. No existing guidance indicates when (i.e., before or after the Schedule K–1) the effect of the basis adjustment to specific partnership items is to be determined or who is required to make and report the adjustments to the partnership items.

The proposed regulations clarify that partnerships are required to make the basis adjustments. In addition, the proposed regulations place the responsibility for reporting basis adjustments on partnerships. Partnerships report basis adjustments by attaching statements to their partnership returns when they acquire knowledge of transfers subject to section 743. In addition, partnerships are required to adjust specific partnership items in light of the basis adjustments. Consequently, amounts reported on the transferee's Schedule K–1 are adjusted amounts.

Transferees are subject to an affirmative obligation to notify partnerships of their basis in acquired partnership interests. To accommodate partnership concerns about the reliability of the information provided, partnerships are entitled to rely on the written representations of transferees concerning either the amount paid for the partnership interest or the transferee's basis in the partnership interest under section 1014 (unless clearly erroneous).

B. *Section 751*

Section 751(a) provides that to the extent an amount realized on the sale or exchange of a partnership interest is attributable to the transferor's interest in unrealized receivables or inventory items of the partnership, the amount realized is considered to be an amount realized from the sale or exchange of property other than a capital asset. Thus, the transferor partner may recognize ordinary income or loss on the sale or exchange of its partnership interest. Under the current section 751 regulations, the amount of income or loss realized by a partner on the sale or exchange of an interest in section 751 property is equal to the difference between (i) the portion of the total amount realized for the partnership interest allocated to section 751 property, and (ii) the portion of the transferor partner's basis in its partnership interest allocated to the property. Generally, the portion of the total amount realized allocated to section 751 property is determined by the seller and purchaser in an arm's length agreement. The portion of the partner's adjusted basis in the partnership interest allocated to the section 751 property equals the basis that the property would have had under section 732 if the transferor partner had received its proportionate share of the property in a current distribution immediately before the sale.

The proposed regulations amend these rules for determining the transferor partner's gain or loss from the sale or exchange of its interest in section 751 property. Rather than attempting to allocate a portion of the transferor partner's amount realized and adjusted basis to the section 751 property, the proposed regulations adopt a hypothetical sale approach. Thus, the income or loss realized by a partner from section 751 property upon the sale or exchange of its interest is the amount of income or loss that would have been allocated to the partner from section 751 property (to the extent attributable to the partnership interest sold or exchanged) if the partnership had sold all of its property in a fully taxable transaction for fair market value immediately prior to the partner's transfer of the partnership interest.

C. *Section 755*

In General

The current regulations under section 755 contain a number of problems that prevent partnerships from allocating the section 743(b) basis adjustments to appropriate assets. The proposed regulations resolve these problems and implement the purposes of section 743(b) by focusing on the items that the transferee partner would receive upon a fair market value sale of all of the partnership's assets.

At the same time, the proposed regulations recognize that adjustments under section 734 differ significantly from adjustments under section 743. Specifically, adjustments under section 743(b) are intended to affect the transferee partner only. In contrast, adjustments under section 734 affect all of the partners. As a result, the proposed regulations under section 755 contain two separate regimes—one that applies to adjustments under section 734, and another that applies to adjustments under section 743. While the regime allocating adjustments under section 743 focuses on the transferee, the regime allocating adjustments under section 734 focuses on the difference between value and basis at the partnership entity level.

Allocating Adjustments under Section 743(b)

The proposed regulations provide that allocations of basis adjustments under section 743 among partnership assets are made based on the amount of income, gain, or loss (including remedial allocations under §1.704–3(d)) that the transferee would be allocated if, immediately after the section 743(b) transfer, all of the partnership's assets were disposed of in a fully taxable transaction at fair market value. By adopting this method, in some situations the proposed regulations will require adjustments to be made that increase the basis of some assets and decrease the basis of others.

Hypothetical sale

The current regulations do not take each partner's interest in specific assets into account. The amount of the section 743 adjustment is allocated among partnership properties to reduce the difference between the fair market value and the adjusted basis of partnership properties at the partnership entity level rather than at the partner level. This formulation of the rule fails to take into account special allocations or the varying treatment of different partners by virtue of the operation of section 704(c) or the minimum gain chargeback. Therefore, basis adjustments will often be made to the wrong assets, exposing the partners to tax consequences that may vary significantly from the partners' economic consequences.

Rather than attempt to define a partner's share of the basis or fair market value of a specific partnership asset, the proposed regulations focus on the actual tax items that would be allocated to the transferee in a fully taxable, fair market value sale. Under the proposed regulations, partnerships are required to adjust the basis of partnership assets in a manner that reflects the amount of income, gain, or loss that the transferee would recognize if all of the partnership's assets were sold in the hypothetical transaction.

Two-way Adjustments

Under the current regulations, the partnership may not increase the basis of assets that have a fair market value in excess of basis and, at the same time, decrease the basis of assets that have a basis in excess of fair market value. Thus, if the section 743(b) adjustment is positive, the partnership may only increase the basis of assets that have a basis that is less than their fair market value. This restriction prevents the partnership from adjusting the basis of its assets in a manner that coordinates a transferee's tax consequences with its economic consequences.

The proposed regulations remove this restriction. Instead, the amount of the section 743 adjustment is viewed as a net adjustment. This net amount is then allocated between the partnership's two classes of assets (capital gain property and ordinary income property). The amount of the adjustment allocated to ordinary income property may be an increase while the amount of the adjustment allocated to capital gain property is a decrease. The amount of the adjustment al-

located to each class is then allocated among the assets within each class. The amount of the adjustment allocated to one item within the class may also be an increase even if the amount allocated to another item is a decrease.

Allocation between Classes

The amount of the basis adjustment allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the sale of all ordinary income property in the hypothetical transaction. The amount of the basis adjustment to capital gain property is equal to (i) the total amount of the basis adjustment under section 743, less (ii) the amount of the basis adjustment allocated to ordinary income; provided, however, that in no event may the amount of any decrease in basis allocated to capital gain property exceed the partnership's basis in capital gain property. In the event that a decrease in basis allocated to capital gain property exceeds the partnership's basis in capital gain property, the excess is applied to reduce the basis of ordinary income property.

Allocation within Classes

The amount of the basis adjustment allocated to each item of property within the class of ordinary income property equals:

(a) the amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical sale of the item, minus

(b) the product of (1) any decrease to the amount of the basis adjustment to ordinary income property required because the partnership did not have enough basis in capital gain property to reduce, multiplied by (2) a fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all items of the partnership's ordinary income property.

The amount of the basis adjustment allocated to each item of property within the class of capital gain property equals:

(a) the amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical sale of the item, minus

(b) the product of (1) the total amount of gain or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical sale of all items of capital gain property, minus the amount of the positive basis adjustment to all items of capital gain property or plus the amount of the negative basis adjustment to all items of capital gain property, multiplied by (2) a fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all of the partnership's items of capital gain property.

Allocating Adjustments under Section 734

As under the current regulations, the proposed regulations provide that allocations of section 734 adjustments among partnership assets are made based on the difference between the value of the property and the property's basis. Where there is a distribution of partnership property resulting in an adjustment to the basis of undistributed partnership property under section 734(b)(1)(B) or (b)(2)(B), the adjustment must be allocated to remaining partnership property of a character similar to that of the distributed property with respect to which the adjustment arose. If there is an increase in basis to be allocated within a class of property, the increase must be allocated first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to their fair market values. If there is a decrease in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to their adjusted bases (as adjusted under the preceding sentence).

D. *Section 1017*

Section 1017 provides rules concerning basis reductions resulting from a taxpayer's exclusion of cancellation of indebtedness income. In general, under §1.1017–1(f) of the proposed Income Tax Regulations, if a partner makes an election under section 108(b)(5) or section 108(c), the partner may treat a partnership interest as depreciable property (or depreciable real property) to the extent the partnership correspondingly reduces the partner's proportionate share of the adjusted basis of depreciable property (or depreciable real property) held by the partnership. These proposed regulations provide guidance regarding the determination of a partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property) and the consequences of the basis reductions required under sections 108 and 1017.

In general, these proposed regulations provide that a partner's share of the partnership's basis in depreciable property (or depreciable real property) equals the sum of (a) the partner's section 743(b) basis adjustment, if any, in the partnership items of depreciable property (or depreciable real property) and (b) the common basis depreciation deductions (not including remedial allocations of depreciation under §1.704–3(d)) that are reasonably expected to be allocated to the partner over the partnership property's remaining useful life. The amount of common basis depreciation deductions that a partner may reasonably expect to be allocated over the partnership property's useful life is based on all the facts and circumstances in effect at the time of the basis reduction. It is per se unreasonable, however, for the partnership to treat the same depreciation deductions as "reasonably expected" by more than one partner. Thus, the amount of the partners' total basis reductions under sections 108(b)(5) and 108(c) cannot exceed the partnership's basis in depreciable property (or depreciable real property).

The proposed regulations further provide that any reduction to the basis of depreciable property required under sections 108 and 1017 constitutes an adjustment to the basis of partnership property with respect to the partner only. These adjustments, therefore, are similar to the basis

adjustments required under section 743(b). Accordingly, the proposed regulations provide that these adjustments have the same effect and are recovered in the same manner as basis adjustments required under section 743(b); provided, however, that the election to treat the negative basis adjustment as an item of built-in gain (which decreases the amount of depreciation or amortization that the partnership may allocate) is not applicable. Consequently, if a partner's actual share of the partnership's common basis depreciation deductions in any year is less than the amount that was included in determining the partner's proportionate share of the partnership's common basis depreciation deductions for that year, the partner will recognize income.

E. *Section 732*

In General

With some exceptions, partners generally may receive distributions of partnership property without recognition of gain or loss. Rules are provided for determining the basis of the distributed property in the hands of the distributee. In the event that multiple properties are distributed by a partnership, section 732(c) provides allocation rules for determining their bases in the distributee partner's hands.

Section 732(c) was amended by the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, §1061, 111 Stat. 788, 945–46 (1997). Under prior law, a partner's basis in its partnership interest was allocated among property distributed to the partner based on the distributed properties' adjusted bases. The rules allocated the partner's basis in its partnership interest first to unrealized receivables and inventory items in an amount equal to the partnership's adjusted basis (or if the basis to be allocated was less than the partnership's basis, then in proportion to the partnership's basis). To the extent that there was any basis remaining to be allocated among distributed properties, the basis was allocated among the other properties in proportion to their adjusted bases to the partnership.

Section 1061 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, § 1061, 111 Stat. 788, 945–46 (1997), revised the allocation rules for determining basis in the distributee partner's hands. As under prior law, basis is allocated first to any distributed unrealized receivables and inventory items before it is allocated to any other distributed property. Basis is then allocated among the other distributed properties to the extent of each such property's adjusted basis to the partnership. Any remaining basis adjustment, if an increase, is allocated among properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation (to the extent of each property's appreciation), and then in proportion to their respective fair market values. If the remaining basis adjustment is a decrease, it is allocated among properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation (to the extent of each property's depreciation), and then in proportion to their respective adjusted bases (taking into account the adjustment already made). The proposed regulations amend the current regulations to incorporate these changes to section 732(c).

Section 732(d)

Section 732(d) provides a special rule that applies to determine the basis of property distributed to a transferee partner who acquired any part of its partnership interest in a transfer when an election under section 754 was not in effect. When the special rule applies, the basis of distributed property is adjusted immediately before the distribution to reflect the basis that the property would have had if the partnership had a section 754 election in effect at the time the transferee acquired the partnership interest. As a result, the basis of the distributed property in the hands of the partnership immediately before the distribution more closely approximates its fair market value. Consequently, the transferee's basis in the distributed property will also more closely approximate its fair market value.

Section 1.732–1(d)(4) of the current regulations requires transferees to apply the special basis rule in certain cases. Specifically, transferees are required to apply the special basis rule if at the time of the acquisition of the partnership interest—

(i) the fair market value of all partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership,

(ii) an allocation of basis under section 732(c) upon a liquidation of the partnership interest immediately after the transfer of the interest would have resulted in a shift of basis from property not subject to an allowance for depreciation, depletion, or amortization, to property subject to such an allowance, and

(iii) a basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

The purpose of §1.732–1(d)(4) was to prevent distortions caused by section 732(c) that might inflate the basis of depreciable, depletable, or amortizable property above its fair market value. At the time that the regulations were adopted, such distortions might occur because section 732(c) allocated basis among distributed properties based on their relative bases. The changes made to section 732(c) by the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, §1061, 111 Stat. 788, 945–46 (1997), make the distortions targeted by the regulations less likely to occur. As a result, the Service and Treasury request comments on the proper scope of section 732(d), and specifically, under what circumstances, if any, the Secretary should exercise its authority to mandate the application of section 732(d) to a transferee.

Proposed Effective Date

The regulations are proposed to be effective (i) for all transfers of partnership interests on and after the date the regulations are published as final regulations in the Federal Register, (ii) for all distributions from partnerships on and after the date the regulations are published as final regulations in the Federal Register, and (iii) for all elections under sections 108(b)(5) and 108(c) made on or after the date the regulations are published as final regulations in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. An initial regulatory flexibility analysis has been prepared for the collection of information in this notice of proposed rulemaking under 5 U.S.C.

603. A summary of the analysis is set forth below under the heading "Summary of Initial Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Summary of Initial Regulatory Flexibility Analysis

This initial analysis is prepared pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). In general, the proposed regulations require a transferee that acquires an interest in a partnership with an election under section 754 in effect, to notify the partnership of the transfer. This notification must include the name and taxpayer identification number of the transferee and the transferee's basis in the acquired partnership interest. The partnership is required to include a statement with its Form 1065, U.S. Partnership Return of Income for the taxable year in which the partnership acquires knowledge of the transfer. This statement must identify the name and taxpayer identification number of the transferee and the computation of the basis adjustment and the allocation of that adjustment to partnership properties. These requirements will ensure that the partnership has notice that a transfer has occurred and that the proper basis adjustments are computed. The legal basis for this requirement is contained in sections 743(b), 6001, 7805(a).

There were approximately 1,494,000 partnerships in 1994. However, these proposed regulations apply only to partnerships that have made an election under section 754. The election under section 754 is generally not made unless there has been a transfer of a partnership interest or a distribution by the partnership. Moreover, the effects of the election attach to specific items of partnership property and may provide only temporary benefits for the partners. The election also cannot be revoked without the consent of the Secretary. Accordingly, the Service and Treasury believe that most partnerships do not make the election under section 754. Therefore, most partnerships will not be affected by the proposed regulations in any given year.

After a partner conveys information to the partnership concerning a transfer of a partnership interest, the partnership must adjust the partner's interest in the basis of partnership property. Because these basis adjustments will affect the partner's share of depreciation or amortization deductions and amounts of gain or loss on the disposition of certain items of partnership property, the partnership must prepare and maintain special entries on its books. However, in many cases, partnership returns are prepared using computer software that can prepare and maintain these special entries after the initial year.

The IRS and Treasury Department are not aware of any federal rules that may duplicate, overlap, or conflict with the proposed rule.

As an alternative to the disclosure described above, the Service and Treasury considered, but rejected, a rule that would have required the partners, and not the partnerships, to make the basis reductions and to determine the effects of the basis adjustments on the partner's distributive shares. This alternative was rejected because the Service and Treasury believe that partnerships generally have better access to the information necessary to report section 743 basis adjustments properly. To require the partners rather than the partnerships to bear the burden of reporting would require the partnerships to provide the partners with significant amounts of information not otherwise needed by the partners. There are no known alternative rules that are less burdensome to the partnerships and their partners but that accomplish the purpose of the statute. The Service and Treasury request comments concerning possible alternatives.

Comments and 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) that are timely submitted to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, July 8, 1998, at 10 a.m. in the IRS Auditorium of the Internal Revenue Building. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments by April 29, 1998, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Wednesday, June 24, 1998.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Brian M. Blum and Terri A. Belanger of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in their development.

Partial Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §1.168–2(n) in the notice of proposed rulemaking published February 16, 1984 (49 F.R. 5940) is withdrawn.

* * * * *

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 is amended by adding entries in numerical order to read as follows:

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

Section 1.168–2 also issued under 26 U.S.C. 168. * * *

Section 1.732–1 also issued under 26 U.S.C. 732.

Section 1.732–2 also issued under 26 U.S.C. 732.

Section 1.734–1 also issued under 26 U.S.C. 734.

Section 1.743–1 also issued under 26 U.S.C. 743.

Section 1.751–1 also issued under 26 U.S.C. 751.

Section 1.755–1 also issued under 26 U.S.C. 755. * * *

Section 1.1017–1 also issued under 26 U.S.C. 1017. * * *

Par. 2. Section 1.732–1 is amended by revising paragraphs (c), (d)(1)(vi), (d)(4)(iii) and the last sentence in paragraph (d)(1)(v) and removing the undesignated text including the examples immediately following paragraph (d)(4)(iii) to read as follows:

§1.732–1 Basis of distributed property other than money.

* * * * *

(c) *Allocation of basis among properties distributed to a partner*—(1) *General rule*—(i) *Unrealized receivables and inventory items.* The basis to be allocated to properties distributed to a partner under section 732(a)(2) or (b) is allocated first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)(2)) in an amount equal to the adjusted basis of each such property to the partnership immediately before the distribution. If the basis to be allocated is less than the sum of the adjusted bases to the partnership of the distributed unrealized receivables and inventory items, the adjusted basis of the distributed property must be decreased in the manner provided in paragraph (c)(2)(i) of this section.

(ii) *Other distributed property.* Any basis not allocated to unrealized receivables or inventory items under paragraph (c)(1)(i) of this section is allocated to any other property distributed to the partner in the same transaction by assigning to each distributed property an amount equal to the adjusted basis of the property to the partnership immediately before the distribution. However, if the sum of the adjusted bases to the partnership of such other distributed property does not equal the basis to be allocated among the distributed property, any increase or decrease required to make the amounts equal is allocated among the distributed property as provided in paragraph (c)(2) of this section.

(2) *Adjustment to basis allocation*—(i) *Decrease in basis.* Any decrease to the basis of distributed property required under paragraph (c)(1) of this section is allocated first to distributed property with unrealized depreciation in proportion to each property's respective amount of unrealized depreciation before any decrease (but only to the extent of each property's unrealized depreciation). If the required decrease exceeds the amount of unrealized depreciation in the distributed property, the excess is allocated to the distributed property in proportion to the adjusted bases of the distributed property, as adjusted pursuant to the immediately preceding sentence.

(ii) *Increase in basis.* Any increase to the basis of distributed property required under paragraph (c)(1)(ii) of this section is allocated first to distributed property (other than unrealized receivables and inventory items) with unrealized appreciation in proportion to each property's respective amount of unrealized appreciation before any increase (but only to the extent of each property's unrealized appreciation). If the required increase exceeds the amount of unrealized appreciation in the distributed property, the excess is allocated to the distributed property (other than unrealized receivables or inventory items) in proportion to the fair market value of the distributed property.

(3) *Unrealized receivables and inventory items.* If the basis to be allocated upon a distribution in liquidation of the partner's entire interest in the partnership is greater than the adjusted basis to the partnership of the unrealized receivables and inventory items distributed to the partner, and if there is no other property distributed to which the excess can be allocated, the distributee partner sustains a capital loss under section 731(a)(2) to the extent of the unallocated basis of the partnership interest.

(4) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. A is a one-fourth partner in partnership PRS and has an adjusted basis in its partnership interest of $650. PRS distributes inventory items and Assets X and Y to A in liquidation of A's entire partnership interest. The distributed inventory items have a basis to the partnership of $100 and a fair market value of $200. Asset X has an adjusted basis to the partnership of $50 and a value of $400. Asset Y has an adjusted basis to the partnership and value of $100. Neither Asset X nor Asset Y consists of inventory items or unrealized receivables. Under this paragraph (c), A's basis in its partnership interest is allocated first to the inventory items in an amount equal to their adjusted basis to the partnership. A, therefore, has an adjusted basis in the inventory items of $100. The remaining basis, $550, is allocated to the distributed property first in an amount equal to the property's adjusted basis to the partnership. Thus, Asset X is allocated $50 and Asset Y is allocated $100. Asset X is then allocated $350, the amount of unrealized appreciation in Asset X. Finally, the remaining basis, $50, is allocated to Assets X and Y in proportion to their fair market values: $40 to Asset X (400/500 x $50), and $10 to Asset Y (100/500 x $50). Therefore, after the distribution, A has an adjusted basis of $440 in Asset X and $110 in Asset Y.

Example 2. B is a one-fourth partner in partnership PRS and has an adjusted basis in its partnership interest of $200. PRS distributes Asset X and Asset Y to B in liquidation of its entire partnership interest. Asset X has an adjusted basis to the partnership and fair market value of $150. Asset Y has an adjusted basis to the partnership of $150 and a fair market value of $50. Neither of the assets consists of inventory items or unrealized receivables. Under this paragraph (c), B's basis is first assigned to the distributed property to the extent of the partnership's basis in each distributed property. Thus, Asset X and Asset Y are each assigned $150. Because the aggregate adjusted basis of the distributed property, $300, exceeds the basis to be allocated, $200, a decrease of $100 in the basis of the distributed property is required. Assets X and Y have unrealized depreciation of zero and $100, respectively. Thus, the entire decrease is allocated to Asset Y. After the distribution, B has an adjusted basis of $150 in Asset X and $50 in Asset Y.

Example 3. C, a partner in partnership PRS, receives a distribution in liquidation of its entire partnership interest of $6,000 cash, inventory items having an adjusted basis to the partnership of $6,000, and real property having an adjusted basis to the partnership of $4,000. C's basis in its partnership interest is $9,000. The cash distribution reduces C's basis to $3,000, which is allocated entirely to the inventory items. The real property has a zero basis in C's hands. The partnership bases not carried over to C for the distributed properties are lost unless an election under section 754 is in effect requiring the partnership to adjust the bases of remaining partnership properties under section 734(b).

Example 4. Assume the same facts as in *Example 3* of this paragraph except C receives a distribution in liquidation of its entire partnership interest of $1,000 cash and inventory items having a basis to the partnership of $6,000. The cash distribution reduces C's basis to $8,000, which can be allocated only to the extent of $6,000 to the inventory items. The remaining $2,000 basis, not allocable to the distributed property, constitutes a capital loss to partner C under section 731(a)(2). If the election under section 754 is in effect, see section 734(b) for adjustment of the basis of undistributed partnership property.

(5) *Effective date.* This paragraph (c) applies to distributions of property from a partnership that occur on or after the date final regulations are published in the Federal Register.

(d) * * *

(1) * * *

(v) * * * (For a shift of transferee's basis adjustment to like property, see §1.743–1(g).)

(vi) The provisions of this paragraph (d)(1) may be illustrated by the following example:

Example. (i) Transferee partner, T, purchased a one-fourth interest in partnership PRS for $17,000. At the time T purchased the partnership interest, the election under section 754 was not in effect and the partnership inventory had a basis to the partnership of $14,000 and a value of $16,000. T's purchase price reflected $500 of this difference. Thus, $4,000 of the $17,000 paid by T for the partnership interest was attributable to T's share of partnership inventory with a basis of $3,500. Within 2 years after T acquired the partnership interest, T retired from the partnership and received in liquidation of its entire partnership interest the following property:

	Assets	
	Adjusted Basis to PRS	Market Value
Cash	$1,500	$1,500
Inventory	$3,500	$4,000
Asset X	$2,000	$4,000
Asset Y	$4,000	$5,000

(ii) The value of the inventory received by T was one-fourth of the value of all partnership inventory and was T's share of such property. It is immaterial whether the inventory T received was on hand when T acquired the interest. In accordance with T's election under section 732(d), the amount of T's share of partnership basis that is attributable to partnership inventory is increased by $500 (one-fourth of the $2,000 difference between the value of the property, $16,000, and its $14,000 basis to the partnership at the time T purchased its interest). This adjustment under section 732(d) applies only for purposes of distributions to T, and not for purposes of partnership depreciation, depletion, or gain or loss on disposition. Thus, the amount to be allocated among the properties received by T in the liquidating distribution is $15,500 ($17,000, T's basis for the partnership interest, reduced by the amount of cash received, $1,500). This amount is allocated as follows: The basis of the inventory items received is $4,000, consisting of the $3,500 common partnership basis, plus the basis adjustment of $500 which T would have had under section 743(b). The remaining basis of $11,500 ($15,500 minus $4,000) is allocated among the remaining property distributed to T by assigning to each property the adjusted basis to the partnership of such property and adjusting that basis by any required increase or decrease. Thus, the adjusted basis to T of Asset X is $5,111 ($2,000, the adjusted basis of Asset X to the partnership, plus $2,000, the amount of unrealized appreciation in Asset X, plus $1,111 ($4,000/9000 multiplied by $2,500). Similarly, the adjusted basis of Asset Y to T is $6,389 ($4,000, the adjusted basis of Asset Y to the partnership, plus $1,000, the amount of unrealized appreciation in Asset Y, plus, $1,389 ($5,000/$9,000 multiplied by $2,500).

* * * * *

(4) * * *

(iii) A basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

* * * * *

Par. 3. Section 1.732–2 is amended by adding a new sentence at the end of the Example in paragraph (b) to read as follows:

§1.732–2 Special partnership basis of distributed property.

* * * * *

(b) * * *

Example. * * * See §1.743–1(g).

* * * * *

Par. 4. In §1.734–1, paragraph (e) is added to read as follows:

§1.734–1 Optional adjustment to basis of undistributed partnership property.

* * * * *

(e) *Recovery of adjustments to basis of partnership property*—(1) *Increases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the distribution of property to a partner, then the increased portion of the basis must be taken into account as if it were newly-purchased recovery property placed in service when the distribution occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Decreases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is decreased as a result of the distribution of property to a partner, then the decrease in basis must be accounted for over the remaining recovery period of the property beginning with the recovery period in which the basis is decreased.

(3) *Effective date.* This paragraph (e) applies to distributions of property from a partnership that occur on or after the date final regulations are published in the Federal Register.

Par. 5. Section 1.743–1 is revised to read as follows:

§1.743–1 Optional adjustment to basis of partnership property.

(a) *Generally.* The basis of partnership property is adjusted as a result of the transfer of an interest in a partnership by sale or exchange or on the death of a partner only if the election provided by section 754 (relating to optional adjustments to the basis of partnership property) is in effect with respect to the partnership. Whether or not the election provided in section 754 is in effect, the basis of partnership property is not adjusted as the result of a contribution of property, including money, to the partnership.

(b) *Determination of adjustment.* In the case of the transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, a partnership that has an election under section 754 in effect—

(1) Increases the adjusted basis of partnership property by the excess of the transferee's basis for the transferred partnership interest over the transferee's share of the adjusted basis to the partnership of the partnership's property; or

(2) Decreases the adjusted basis of partnership property by the excess of the transferee's share of the adjusted basis to the partnership of the partnership's property over the transferee's basis for the transferred partnership interest.

(c) *Determination of transferee's basis in the transferred partnership interest.* In the case of the transfer of a partnership interest by sale or exchange or as a result of the death of a partner, the transferee's basis in the transferred partnership interest is determined under section 742. See also section 752 and §§1.752–1 through 1.752–5.

(d) *Determination of transferee's share of the adjusted basis to the partnership of the partnership's property*—(1) *Generally.* A transferee's share of the adjusted basis to the partnership of partnership property is equal to the sum of the transferee's interest as a partner in the partnership's previously taxed capital, plus the transferee's share of partnership liabilities. Generally, a transferee's interest as a partner in the partnership's previously taxed capital is equal to—

(i) The amount of cash that the transferee would receive on a liquidation of the

partnership following the hypothetical transaction, as defined in paragraph (d)(2) of this section; increased by

(ii) The amount of tax loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical transaction, as defined in paragraph (d)(2) of this section; and decreased by

(iii) The amount of tax gain (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical transaction, as defined in paragraph (d)(2) of this section.

(2) *Hypothetical transaction defined.* For purposes of paragraph (d)(1) of this section, the hypothetical transaction means the disposition by the partnership of all of the partnership's assets, immediately after the transfer of the partnership interest, in a fully taxable transaction for cash equal to the fair market value of the assets. For example, if the partnership properly maintains capital accounts under the rules of §1.704–1(b)(2)(iv), the transferee's interest as a partner in the partnership's previously taxed capital is equal to—

(i) The transferee's capital account adjusted for the hypothetical transaction; increased by

(ii) The amount of tax loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical transaction; and decreased by

(iii) The amount of tax gain (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee from the hypothetical transaction.

(3) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. (i) A is a member of partnership PRS in which the partners have equal interests in capital and profits. The partnership has made an election under section 754, relating to the optional adjustment to the basis of partnership property. A sells its interest to T for $22,000. The balance sheet of the partnership at the date of sale shows the following:

	Assets	
	Adjusted Basis	Market Value
Cash	$ 5,000	$5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Depreciable assets	20,000	40,000
Total	$55,000	$76,000

	Liabilities and Capital	
	Adjusted per books	Market value
Liabilities	$10,000	$10,000
Capital:		
A	15,000	22,000
B	15,000	22,000
C	15,000	22,000
Total	$55,000	$76,000

(ii) The amount of the basis adjustment under section 743(b) is the difference between the basis of T's interest in the partnership and T's share of the adjusted basis to the partnership of the partnership's property. Under section 742, the basis of T's interest is $25,333 (the cash paid for A's interest, $22,000, plus $3,333, T's share of partnership liabilities). T's interest in the partnership's previously taxed capital is $15,000 ($22,000, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by $7,000, the amount of tax gain allocated to T from the hypothetical transaction). T's share of the adjusted basis to the partnership of the partnership's property is $18,333 ($15,000 share of previously taxed capital, plus $3,333 share of the partnership's liabilities). The amount of the basis adjustment to partnership property therefore, is $7,000, the difference between $25,333 and $18,333.

Example 2. A, B, and C form partnership PRS, to which A contributes land worth $1,000 (Asset 1) with an adjusted basis to A of $400, and B and C each contribute $1,000 cash. Each partner has $1,000 credited to it on the books of the partnership as its capital contribution. The partners share in profits equally. During the partnership's first taxable year, Asset 1 appreciates in value to $1,300. A sells its one-third interest in the partnership to T for $1,100, when an election under section 754 is in effect. The amount of tax gain that would be allocated to T from the hypothetical transaction is $700 ($600 section 704(c) built-in gain, plus one-third of the additional gain). Thus, T's interest in the partnership's previously taxed capital is $400 ($1,100, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by $700, T's share of gain from the hypothetical transaction). The amount of T's basis adjustment to partnership property is $700 (the excess of $1,100, T's cost basis for its interest, over $400, T's share of the adjusted basis to the partnership of partnership property).

(e) *Allocation of basis adjustment.* For the allocation of the basis adjustment under this section among the individual items of partnership property, see section 755 and the regulations thereunder.

(f) *Subsequent transfers.* Where there has been more than one transfer of a partnership interest, a transferee's basis adjustment is determined without regard to any prior transferee's basis adjustment. In the case of a gift of an interest in a partnership, the donor is treated as transferring, and the donee as receiving, that portion of the basis adjustment attributable to the gifted partnership interest. The provisions of this paragraph (f) may be illustrated by the following example:

Example. (i) A, B, and C form partnership PRS. A and B each contribute $1,000 cash and C contributes land with a basis and value of $1,000. When the land has appreciated in value to $1,300, A sells its interest to T1 for $1,100 (one-third of $3,300, the value of the partnership property). An election under section 754 is in effect; therefore, T1 has a basis adjustment of $100.

(ii) After the land has further appreciated in value to $1,600, T1 sells its interest to T2 for $1,200 (one-third of $3,600, the value of the partnership property). T2 has a basis adjustment of $200. This amount is determined without regard to any basis adjustment that T1 may have had in the partnership assets.

(iii) During the following year, T2 makes a gift to T3 of fifty percent of T2's interest in PRS. At the time of the transfer, T2 has a $200 basis adjustment. T2 is treated as transferring $100 of the basis adjustment to T3 with the gift of the partnership interest.

(g) *Distributions*—(1) *Distribution of adjusted property to the transferee*—(i) *Coordination with section 732.* If a partnership distributes property to a transferee and the transferee has a basis adjustment for the property, the basis adjustment is taken into account under section 732. See §1.732–2(b).

(ii) *Coordination with section 734.* For certain adjustments to the common basis of remaining partnership property after the distribution of adjusted property to a transferee, see §1.734–2(b).

(2) *Distribution of adjusted property to another partner*—(i) *Coordination with section 732.* If a partner receives a distribution of property with respect to which another partner has a basis adjustment, the distributee does not take the basis adjustment into account under section 732.

(ii) *Reallocation of basis.* A transferee with a basis adjustment in property that is distributed to another partner reallocates the basis adjustment among the remaining items of partnership property pursuant to §1.755–1(c).

(3) *Distributions in complete liquidation of a partner's interest.* If a transferee receives a distribution of property (whether or not the transferee has a basis adjustment in such property) in liquidation of its interest in the partnership, the adjusted basis to the partnership of the distributed property immediately before the distribution includes the transferee's basis adjustment for the property in which the transferee relinquished an interest (ei-

ther because it remained in the partnership or was distributed to another partner). Any basis adjustment to property in which the transferee is deemed to relinquish its interest is reallocated among the properties distributed to the transferee under §1.755–1(c).

(4) *Coordination with other provisions.* The rules of sections 704(c)(1)(B), 731, 737, and 751 apply before the rules of this paragraph (g).

(5) *Example.* The provisions of this paragraph (g) are illustrated by the following example:

Example. (i) A, B, and C are equal partners in partnership PRS. Each partner originally contributed $10,000 in cash, and PRS used the contributions to purchase five nondepreciable capital assets. PRS has no liabilities. After five years, PRS's balance sheet appears as follows:

	Assets	
	Adjusted Basis	Market Value
Asset 1	$10,000	$10,000
Asset 2	4,000	6,000
Asset 3	6,000	6,000
Asset 4	7,000	4,000
Asset 5	3,000	13,000
Total	$30,000	$39,000

	Capital	
	Adjusted per books	Market Value
Partner A	$10,000	$13,000
Partner B	10,000	13,000
Partner C	10,000	13,000
Total	$30,000	$39,000

(ii) A sells its interest to T for $13,000 when PRS has an election in effect under section 754. T receives a basis adjustment in the partnership property that is equal to $3,000 (the excess of T's basis in the partnership interest, $13,000, over T's share of the adjusted basis to the partnership of partnership property, $10,000). The basis adjustment is allocated under section 755, and the partnership's balance sheet appears as follows:

	Assets		
	Adjusted Basis	Market Value	Basis Adjustment
Asset 1	$10,000	$10,000	$ 0.00
Asset 2	4,000	6,000	666.67
Asset 3	6,000	6,000	0.00
Asset 4	7,000	4,000	(1,000.00)
Asset 5	3,000	13,000	3,333.33
Total	$30,000	$39,000	$3,000.00

	Capital		
	Adjusted per books	Market Value	Special Basis
Partner T	$10,000	$13,000	$3,000
Partner B	10,000	13,000	0
Partner C	10,000	13,000	0
Total	$30,000	$39,000	$3,000

(iii) Assume that PRS distributes Asset 2 to T in partial liquidation of T's interest in the partnership. T has a basis adjustment of $666.67 in Asset 2. Under paragraph (g)(1)(i) of this section, T takes the basis adjustment into account under section 732. Therefore, T will have a basis in Asset 2 of $4,666.67 following the distribution.

(iv) Assume instead that PRS distributes Asset 5 to C in complete liquidation of C's interest in PRS. T has a basis adjustment of $3,333.33 in Asset 5. Under paragraph (g)(2)(i) of this section, C does not take T's basis adjustment into account under section 732. Therefore, the partnership's basis for purposes of sections 732 and 734 is $3,000. Under paragraph (g)(2)(ii) of this section, T's $3,333.33 basis adjustment is reallocated among the remaining partnership assets under §1.755–1(c).

(v) Assume instead that PRS distributes Asset 5 to T in complete liquidation of its interest in PRS. Under paragraph (g)(3) of this section, immediately prior to the distribution of Asset 5 to T, PRS must adjust the basis of Asset 5. Therefore, immediately prior to the distribution, PRS's basis in Asset 5 is equal to $6,000, which is the sum of (A) $3,000, PRS's common basis in Asset 5, plus (B) $3,333.33, T's basis adjustment to Asset 5, plus (C) ($333.33), the sum of T's basis adjustments in Assets 2 and 4. For purposes of sections 732 and 734, therefore, PRS will be treated as having a basis in Asset 5 equal to $6,000.

(h) *Contributions of adjusted property*—(1) *Section 721(a) transactions.* If, in a transaction described in section 721(a), a partnership (the upper tier) contributes to another partnership (the lower tier) property with respect to which a basis adjustment has been made, the basis adjustment is treated as contributed to the lower tier, regardless of whether the lower tier partnership makes a section 754 election. The lower tier's basis in the contributed assets and the upper tier's basis in the partnership interest received in the transaction are determined with reference to the basis adjustment. However, that portion of the basis of the upper tier's interest in the lower tier attributable to the basis adjustment must be segregated and allocated solely to the transferee partner for whom the basis adjustment was made. Similarly, that portion of the lower tier's basis in its assets attributable to the basis adjustment must be segregated and allocated solely to the upper tier and the transferee. A partner with a basis adjustment in property held by a partnership that terminates under section 708(b)(1)(B) will continue to have the same basis adjustment with respect to property deemed contributed by the terminated partnership to the new partnership under §1.708–1(b)(1)(iv), regardless of whether the new partnership makes a section 754 election.

(2) *Section 351 transactions*—(i) *Basis in transferred property.* A corporation's adjusted tax basis in property transferred to the corporation by a partnership in a transaction described in section 351 is determined with reference to any basis adjustment to the property under section 743(b) (other than any basis adjustment that reduces a partner's gain under paragraph (h)(2)(ii) of this section).

(ii) *Partnership gain.* The amount of gain, if any, recognized by the partnership on a transfer of property by the partnership to a corporation in a transfer described in section 351 is determined without reference to any basis adjustment to the transferred property under section 743(b). The amount of gain, if any, recognized by the partnership on the transfer that is allocated to a partner with a basis adjustment in the transferred property is adjusted to reflect the partner's basis adjustment in the transferred property.

(iii) *Basis in stock.* The partnership's adjusted tax basis in stock received from a corporation in a transfer described in section 351 is determined without reference to the basis adjustment in property transferred to the corporation in the section 351 exchange. A partner with a basis adjustment in property transferred to the corporation, however, has a special basis adjustment in the stock received by the partnership in the section 351 exchange in an amount equal to the partner's basis adjustment in the transferred property, reduced by any basis adjustment that reduced the partner's gain under paragraph (h)(2)(ii) of this section.

(i) [Reserved].

(j) *Effect of basis adjustment*—(1) *In general.* The basis adjustment constitutes an adjustment to the basis of partnership property with respect to the transferee only. No adjustment is made to the common basis of partnership property. Thus, for purposes of income, deduction, gain, loss, and distribution, the transferee will have a special basis for those partnership properties the bases of which are adjusted under section 743(b) and this section. The adjustment to the basis of partnership property under section 743 has no effect on the partnership's computation of any item under section 703.

(2) *Computation of partner's distributive share of partnership items.* The partnership first computes its items of in-

come, deduction, gain, or loss at the partnership level under section 703. The partnership then allocates the partnership items among the partners, including the transferee, in accordance with section 704, and adjusts the partners' capital accounts accordingly. The partnership then adjusts the transferee's distributive share of the items of partnership income, deduction, gain, or loss, in accordance with paragraphs (j)(3) and (4) of this section, to reflect the effects of the transferee's basis adjustment to the property that is the source of the item of partnership income, deduction, gain, or loss. These adjustments to the transferee's distributive shares do not affect the transferee's capital account.

(3) *Effect of basis adjustment in determining items of income, gain, or loss*—(i) *In general.* The amount of a transferee's income, gain, or loss from the sale or exchange of a partnership asset in which the transferee has a basis adjustment is equal to the transferee's share of the partnership's gain or loss from the sale of the asset (including any remedial allocations of gain or loss under §1.704–3(d)), minus the amount of the transferee's positive basis adjustment for the partnership asset (determined by taking into account the recovery of the basis adjustment under paragraph (j)(4)(i)(B) of this section) or plus the amount of the transferee's negative basis adjustment for the partnership asset (determined by taking into the account the recovery of the basis adjustment under paragraph (j)(4)(ii)(B) of this section).

(ii) *Examples.* The following examples illustrate the principles of this paragraph (j)(3):

Example 1. A and B form equal partnership PRS. A contributes nondepreciable property with a fair market value of $50 and an adjusted tax basis of $100. PRS will use the traditional allocation method under §1.704–3(b). B contributes $50 cash. A sells its interest to T for $50. PRS has an election in effect to adjust the basis of partnership property under section 754. T receives a negative $50 basis adjustment that, under section 755, is allocated to the nondepreciable property. PRS then sells the property for $60. PRS recognizes a book gain of $10 and a tax loss of $40. T will receive an allocation of $40 of tax loss under the principles of section 704(c). Because T has a negative $50 basis adjustment in the nondepreciable property, T recognizes a $10 gain from the partnership's sale of the property.

Example 2. A and B form equal partnership PRS. A contributes nondepreciable property with a fair market value of $100 and an adjusted tax basis of $50. B contributes $100 cash. PRS will use the traditional allocation method under §1.704–3(b). A sells its interest to T for $100. PRS has an election in effect to adjust the basis of partnership property under section 754. Therefore, T receives a $50 basis adjustment that, under section 755, is allocated to the nondepreciable property. PRS then sells the nondepreciable property for $90. PRS recognizes a book loss of $10 and a tax gain of $40. T will receive an allocation of the entire $40 of tax gain under the principles of section 704(c). Because T has a $50 basis adjustment in the property, T recognizes a $10 loss from the partnership's sale of the property.

Example 3. A and B form equal partnership PRS. PRS will make allocations under section 704(c) using the remedial allocation method described in §1.704–3(d). A contributes property with a fair market value of $100 and an adjusted tax basis of $150. B contributes $100 cash. A sells its partnership interest to T for $100. PRS has an election in effect to adjust the basis of partnership property under section 754. T receives a negative $50 basis adjustment that, under section 755, is allocated to the property. The partnership then sells the property for $120. The partnership recognizes a $20 book gain and a $30 tax loss. The book gain will be allocated equally between the partners. The entire $30 tax loss will be allocated to T under the principles of section 704(c). To match its $10 share of book gain, B will be allocated $10 of remedial gain and T will be allocated an offsetting $10 of remedial loss. T was allocated a total of $40 of tax loss with respect to the property. Because T has a negative $50 basis adjustment to the property, T recognizes a $10 gain from the partnership's sale of the property.

(4) *Effect of basis adjustment in determining items of deduction*—(i) *Increases*—(A) *Additional deduction.* The amount of any positive basis adjustment that is recovered by the transferee in any year is added to the transferee's distributive share of the partnership's depreciation or amortization deductions for the year. The basis adjustment is adjusted under section 1016(a)(2) to reflect the recovery of the basis adjustment.

(B) *Recovery period*—(1) *In general.* Except as provided in paragraph (j)(4)(i)-(B)(2) of this section, for purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the transfer of a partnership interest, then the increased portion of the basis is taken into account as if it were newly-purchased recovery property placed in service when the transfer occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Remedial allocation method.* If a partnership elects to use the remedial allocation method described in §1.704–3(d) with respect to an item of the partnership's recovery property, then the portion of any increase in the basis of the item of the partnership's recovery property under section 743(b) that is attributable to section 704(c) built-in gain is recovered over the remaining recovery period for the partnership's excess book basis in the property as determined in the final sentence of §1.704–3(d)(2). Any remaining portion of the basis increase is recovered under paragraph (j)(4)(i)(B)(*1*) of this section.

(C) *Examples.* The provisions of this paragraph (j)(4)(i) are illustrated by the following examples:

Example 1. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 1, an item of depreciable property that has a fair market value in excess of its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, increases the basis of Asset 1 with respect to T.

(ii) Assume that in the year following the transfer of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 1 is $1,000. Also assume that, under paragraph (j)(4)(i)(B) of this section, the amount of the basis adjustment that T recovers during the year is $500. The total amount of depreciation deductions from Asset 1 reported by T is equal to $1,500.

Example 2. (i) A and B form equal partnership PRS. A contributes property with an adjusted basis of $100,000 and a fair market value of $500,000. B contributes $500,000 cash. When PRS is formed, the property has five years remaining in its recovery period. The partnership's adjusted basis of $100,000 will, therefore, be recovered over the five years remaining in the property's recovery period. PRS elects to use the remedial allocation method under §1.704–3(d) with respect to the property. If PRS had purchased the property at the time of the partnership's formation, the basis of the property would have been recovered over a 10 year period. The $400,000 of section 704(c) built-in gain will, therefore, be amortized under §1.704–3(d) over a 10 year period beginning at the time of the partnership's formation.

(ii) Except for the depreciation deductions, PRS's expenses equal its income in each year of the first two years commencing with the year the partnership is formed. After two years, A's share of the adjusted basis of partnership property is $120,000, while B's is $440,000:

	Capital Accounts			
	A		B	
	Book	*Tax*	*Book*	*Tax*
Initial Contribution	$500,000	$100,000	$500,000	$500,000
Depreciation Year 1	(30,000)		(30,000)	(20,000)
Remedial		10,000		(10,000)
	470,000	110,000	470,000	470,000
Depreciation Year 2	(30,000)		(30,000)	(20,000)
Remedial		10,000		(10,000)
	$440,000	$120,000	$440,000	$440,000

(iii) A sells its interest in PRS to T for its fair market value of $440,000. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, PRS makes an adjustment, pursuant to section 743(b), to increase the basis of partnership property. Under section 743(b), the amount of the basis adjustment is equal to $320,000. Under section 755, the entire basis adjustment is allocated to the property.

(iv) At the time of the transfer, $320,000 of section 704(c) built-in gain from the property was still reflected on the partnership's books, and all of the basis adjustment is attributable to section 704(c) built-in gain. Therefore, the basis adjustment will be recovered over the remaining recovery period for the section 704(c) built-in gain under §1.704–3(d).

(ii) *Decreases*—(A) *Effect on depreciation deductions*—(*1*) *Reduced deduction to transferee.* Except as provided in paragraph (j)(4)(ii)(A)(2) of this section, the amount of the basis adjustment to an item of depreciable or amortizable property that is recovered in any year first decreases the transferee's distributive share of the partnership's depreciation or amortization deductions from that item of property for the year. If the amount of the basis adjustment recovered in any year exceeds the transferee's distributive share of the partnership's depreciation or amortization deductions from the item of property, then the transferee's distributive share of the partnership's depreciation or amortization deductions from other items of partnership property is decreased. The transferee then recognizes ordinary income to the extent of the excess, if any, of the amount of the basis adjustment recovered in any year over the transferee's distributive share of the partnership's depreciation or amortization deductions from all items of property.

(2) *Election to reduce deduction of other partners by excess adjustment.* The partnership may elect to treat the amount of the basis adjustment as an item of built-in gain, decreasing the amount of depreciation or amortization that the partnership may allocate for tax purposes. This election has no effect on the depreciation or amortization of the property on the books of the partnership. The partnership must make this election on the statement required to be attached to its return pursuant to paragraph (k) of this section for the year that the adjustment is made to the item of property.

(B) *Recovery period.* For purposes of section 168, if the basis of an item of a partnership's recovery property is decreased as the result of the transfer of an interest in the partnership then the decrease is recovered over the remaining useful life of the item of the partnership's recovery property. The portion of the decrease that is recovered in any year during the recovery period is equal to the product of—

(*1*) The amount of the decrease to the item's adjusted basis (determined as of the date of the transfer); multiplied by

(*2*) A fraction, the numerator of which is the portion of the adjusted basis of the item recovered by the partnership in that year, and the denominator of which is the adjusted basis of the item on the date of the transfer (determined prior to any basis adjustments).

(C) *Examples.* The provisions of this paragraph (j)(4)(ii) are illustrated by the following examples:

Example 1. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 2, an item of depreciable property that has a fair market value that is less than its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, decreases the basis of Asset 2 with respect to T.

(ii) Assume that in the year following the transfer of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 2 is $1,000. Also assume that, under paragraph (j)(4)(ii)(B) of this section, the amount of the basis adjustment that T recovers during the year is $500. The total amount of depreciation deductions from Asset 2 reported by T is equal to $500.

Example 2. (i) A and B form equal partnership PRS. A contributes property with an adjusted basis of $100,000 and a fair market value of $50,000. B contributes $50,000 cash. When PRS is formed, the property has five years remaining in its recovery period. The partnership's adjusted basis of $100,000 will, therefore, be recovered over the five years remaining in the property's recovery period. PRS uses the traditional allocation method under §1.704–3(b) with respect to the property. As a result, B will receive $5,000 of depreciation deductions from the property in each of years 1–5, and A, as the contributing partner, will receive $15,000 of depreciation deductions in each of these years.

(ii) Except for the depreciation deductions, PRS's expenses equal its income in each of the first two years commencing with the year the partnership is formed. After two years, A's share of the adjusted basis of partnership property is $70,000, while B's is $40,000. A sells its interest in PRS to T for its fair market value of $40,000. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, PRS makes an adjustment, pursuant to section 743(b), to decrease the basis of partnership property. Under section 743(b), the amount of the adjustment is equal to ($30,000). Under section 755, the entire adjustment is allocated to the property.

(iii) The basis of the property at the time of the transfer of the partnership interest was $60,000. In each of years 3 through 5, the partnership will realize depreciation deductions of $20,000 from the property. Thus, one third of the negative basis adjustment ($10,000) will be recovered in each of years 3 through 5. Consequently, T will be allocated for tax purposes depreciation of $15,000 each year from the partnership and will recover $10,000 of its negative basis adjustment. Thus, T's net depreciation deduction from the partnership in each year is $5,000.

Example 3. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 2, an item of depreciable property that has a fair market value that is less than its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, decreases the basis of Asset 2 with respect to T.

(ii) Assume that in the year following the transfer of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 2 is $500. PRS allocates no other depreciation to T. Also assume that, under paragraph (j)(4)(ii)(B) of this section, the amount of the negative basis adjustment that T recovers during the year is $1,000. T will report $500 of ordinary income because the amount of the negative basis adjustment recovered during the year exceeds T's distributive share of the partnership's common basis depreciation deductions from Asset 2.

Example 4. (i) A and B are equal partners in partnership PRS. PRS has one depreciable asset that it purchased with cash. On the first day of a year, A transfers its interest to T at a time when the fair market value of the depreciable asset is $50 and its adjusted tax basis is $200. The partnership has an election in effect under section 754, resulting in a $75 decrease in the basis of the depreciable asset to T under section 743.

(ii) The depreciable asset has a remaining useful life of two years and is being recovered using the straight-line method. The partnership elects, under paragraph (j)(4)(ii)(A)(*2*) of this section, to treat the decrease in basis under section 743 as an item of built-in gain, decreasing the amount of depreciation that the partnership can allocate from $200 to $125. This reduces the amount of depreciation available to be allocated to the partners in each year from $100 to $62.50. This election has no effect on the depreciation or amortization of the property on the books of the partnership. Therefore, the partnership will recover $100 of depreciation on its books in each year.

(iii) At the end of the year, the partnership allocates each partner $50 of depreciation for book purposes. Under the principles of section 704(c), the first $50 of tax depreciation is allocated to B. The remaining $12.50 of tax depreciation is allocated to T.

(5) *Depletion.* Where an adjustment is made under section 743(b) to the basis of partnership property subject to depletion, any depletion allowance is determined separately for each partner, including the transferee partner, based on the partner's interest in such property. See §1.702–1(a)(8).

(6) *Example.* The provisions of paragraph (j)(5) of this section are illustrated by the following example:

Example. A, B, and C each contributes $5,000 cash to form partnership PRS, which purchases oil property for $15,000. A, B, and C have equal interests in capital and profits. C subsequently sells its partnership interest to T for $100,000 when the election under section 754 is in effect. T has a basis adjustment for the oil property of $95,000 (the difference between T's basis, $100,000, and its share of the basis of partnership property, $5,000). Assume that the depletion allowance computed under the percentage method would be $21,000 for the taxable year so that each partner would be entitled to $7,000 as its share of the deduction for depletion. However, under the cost depletion method, at an assumed rate of 10 percent, the allowance with respect to T's one-third interest which has a basis to him of $100,000 ($5,000, plus its basis adjustment of $95,000) is $10,000, although the cost depletion allowance with respect to the one-third interest of A and B in the oil property, each of which has a basis of $5,000, is only $500. For partners A and B, the percentage depletion is greater than cost depletion and each will deduct $7,000 based on the percentage depletion method. However, as to T, the transferee partner, the cost depletion method results in a greater allowance and T will, therefore, deduct $10,000 based on cost depletion. See section 613(a).

(k) *Returns*—(1) *Statement of adjustments.* A partnership that must adjust the bases of partnership properties under section 743 must attach a statement to the partnership return for the year of the transfer setting forth the name and taxpayer identification number of the transferee as well as the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(2) *Requirement that transferee notify partnership*—(i) *Sale or exchange.* A transferee that acquires, by sale or exchange, an interest in a partnership with an election under section 754 in effect, must notify the partnership, in writing, within 30 days of the sale or exchange (or, if earlier, by January 15 of the calendar year following the calendar year in which the sale or exchange occurred). The written notice to the partnership must include the names and addresses of both parties to the sale or exchange, the taxpayer identification numbers of the transferee and (if known) of the transferor, the date of the transfer, and the amount of any money and the fair market value of any other property delivered or to be delivered for the transferred interest in the partnership.

(ii) *Transfer on death.* A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect, must notify the partnership, in writing, within one year of the death of the deceased partner. The written notice to the partnership must include the names and addresses of the deceased partner and the transferee, the taxpayer identification numbers of the deceased partner and the transferee, the date on which the transferee became the owner of the partnership interest, the fair market value of the partnership interest on the applicable date of valuation set forth in section 1014, and the manner in which the fair market value of the partnership interest was determined.

(3) *Reliance.* In making the adjustments under section 743 and any statement or return relating to such adjustments under this section, a partnership may rely on the written notice provided by a transferee pursuant to paragraph (k)(2) of this section to determine the transferee's basis in a partnership interest. The previous sentence shall not apply if the tax matters partner (as defined under section 6231(a)(7)) or any other partner who has responsibility for federal income tax reporting by the partnership has knowledge of facts indicating that the statement is clearly erroneous.

(4) *Partnership not required to make or report adjustments under section 743 until it has notice of the transfer.* A partnership is not required to make the adjustments under section 743 (or any statement or return relating to those adjustments) with respect to any transfer until it has been notified of the transfer. For purposes of this section, a partnership is notified of a transfer when either—

(i) The partnership receives the written notice from the transferee required under paragraph (k)(2) of this section; or

(ii) The tax matters partner (as defined under section 6231(a)(7)) or any other partner who has responsibility for federal income tax reporting by the partnership has knowledge that there has been a transfer of a partnership interest.

(5) *Effect on partnership of the failure of the transferee to comply.* If the transferee fails to provide the partnership with the written notice required by paragraph (k)(2) of this section, the partnership must attach a statement to its return in the year that the partnership is otherwise notified of the transfer. This statement must set forth the name and taxpayer identification number (if known) of the transferee. In addition, the following statement must be prominently displayed in capital letters on the first page of the partnership's return for such year, and on the first page of any schedule or information statement relating to such transferee's share of income, credits, deductions, etc.: "RETURN FILED PURSUANT TO §1.743–1(k)(5)." The partnership will then be entitled to report the transferee's share of partnership items without adjustment to reflect the transferee's basis adjustment in partnership property. If, following the filing of a return pursuant to this paragraph (k)(5), the transferee provides the applicable written notice to the partnership, the partnership must make such adjustments as are necessary to adjust the basis of partnership property (as of the date of the transfer) in any amended return otherwise to be filed by the partnership or in the next annual partnership return of income to be regularly filed by the partnership. At such time, the partnership must also provide the transferee with such informa-

tion as is necessary for the transferee to amend its prior returns to properly reflect the adjustment under section 743.

(l) *Effective date.* This section applies to transfers of partnership interests that occur on or after the date final regulations are published in the **Federal Register.**

Par. 6. Section 1.751–1 is amended by:

1. Revising paragraphs (a)(2) and (a)(3) and *Example 1* of paragraph (g).

2. Adding a sentence at the end of paragraph (f).

The addition and revisions read as follows:

§1.751–1 Unrealized receivables and inventory items.

(a) * * *

(2) *Determination of gain or loss.* The income or loss realized by a partner upon the sale or exchange of its interest in section 751 property is the amount of income or loss from section 751 property (including any remedial allocation under §1.704–3(d)) that would have been allocated to the partner (to the extent attributable to the partnership interest sold or exchanged) if the partnership had sold all of its property in a fully taxable transaction immediately prior to the partner's transfer of the interest in the partnership. Any gain or loss recognized that is attributable to section 751 property will be ordinary gain or loss. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 and the amount of ordinary income or loss determined under this paragraph (a)(2) is the transferor's capital gain or loss on the sale of its partnership interest.

(3) *Statement required.* A partner selling or exchanging any part of an interest in a partnership that has any section 751 property at the time of sale or exchange must submit with its income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information—

(i) The date of the sale or exchange;

(ii) The amount of any gain or loss attributable to the section 751 property; and

(iii) The amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

* * * * *

(f) * * * The rules contained in paragraphs (a)(2) and (3) of this section apply to transfers of partnership interests that occur on or after the date final regulations are published in the Federal Register.

(g) * * *

Example 1. (i) A and B are equal partners in personal service partnership PRS. B transfers its interest in PRS to T for $15,000 when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted Basis	Market Value
Cash	$ 3,000	$ 3,000
Loans Receivable	10,000	10,000
Capital Assets	7,000	5,000
Unrealized receivables	0	14,000
Total	20,000	32,000

	LIABILITIES AND CAPITAL	
	Adjusted Per books	Market Value
Liabilities	$ 2,000	$ 2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
Total	20,000	32,000

(ii) None of the assets owned by PRS is section 704(c) property. The total amount realized by B is $16,000, consisting of the cash received, $15,000, plus $1,000, B's share of the partnership liabilities assumed by T. See section 752. B's undivided half-interest in the partnership property includes a half-interest in the partnership's unrealized receivables items. B's basis for its partnership interest is $10,000 ($9,000, plus $1,000, B's share of partnership liabilities). If section 751(a) did not apply to the sale, B would recognize $6,000 of capital gain from the sale of the interest in PRS. However, section 751(a) does apply to the sale.

(iii) If PRS sold all of its section 751 property in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would have been allocated $7,000 of ordinary income from the sale of PRS's unrealized receivables. Therefore, B will recognize $7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($6,000) and the amount of ordinary income or loss determined under paragraph (a)(2) of this section ($7,000) is the transferor's capital gain or loss on the sale of its partnership interest. In this case, B will recognize a $1,000 capital loss.

* * * * *

Par. 7. Section 1.755–1 is revised to read as follows:

§1.755–1 Rules for allocation of basis.

(a) *Generally.* A partnership that has an election in effect under section 754 must adjust the basis of partnership property under the provisions of section 734(b) and section 743(b) pursuant to the provisions of this section. The basis adjustment is first allocated between the two classes of property described in section 755(b). These classes of property consist of—

(1) Capital assets and section 1231(b) property (capital gain property); and

(2) Any other property of the partnership (ordinary income property). The portion of the basis adjustment allocated to each class is then allocated among the items within the class. Adjustments under section 743(b) are allocated under paragraph (b) of this section. Adjustments under section 734(b) are allocated under paragraph (c) of this section.

(b) *Adjustments under section 743(b)—*(1) *Generally.* In general, the allocation of the basis adjustment under section 743 between the classes of property and among the items of property within each class are made based on the allocations of income, gain, or loss (including remedial allocations under §1.704–3(d)) that the transferee partner would receive (to the extent attributable to the acquired partnership interest) if, immediately after the transfer of the partnership interest, all of the partnership's assets were disposed of in a fully taxable transaction for fair market value (the hypothetical transaction). The portion of the basis adjustment allocated to one class of property may be an increase while the portion allocated to the other class is a decrease. This would be the case even though the total amount of the basis adjustment is zero. The portion of the basis adjustment allocated to one item of property within a class may be an increase while the portion allocated to another is a decrease. This would be the case even though the basis adjustment allocated to the class is zero.

(2) *Allocations between classes of property*—(i) *In general.* The amount of the basis adjustment allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the sale of all ordinary income property in the hypothetical transaction. The amount of the basis adjustment to capital gain property is equal to—

(A) The total amount of the basis adjustment under section 743; less

(B) The amount of the basis adjustment allocated to ordinary income property under the preceding sentence; provided, however, that in no event may the amount of any decrease in basis allocated to capital gain property exceed the partnership's basis (or in the case of property subject to the remedial allocation method, the transferee's share of any remedial loss under §1.704–3(d) from the hypothetical transaction) in capital gain property. In the event that a decrease in basis allocated to capital gain property would otherwise exceed the partnership's basis in capital gain property, the excess must be applied to reduce the basis of ordinary income property.

(ii) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following example:

Example 1. (i) A and B form equal partnership PRS. A contributes $50,000 and Asset 1, a capital asset with a fair market value of $50,000 and an adjusted tax basis of $25,000. B contributes $100,000. PRS uses the cash to purchase Assets 2, 3, and 4. After a year, A sells its interest in PRS to T for $120,000. At the time of the transfer, A's share of the partnership's basis in partnership assets is $75,000. Therefore, T receives a $45,000 basis adjustment.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted Basis	Market Value
Capital Gain Property:		
Asset 1	$ 25,000	$ 75,000
Asset 2	100,000	117,500
Ordinary Income Property:		
Asset 3	$ 40,000	$ 45,000
Asset 4	10,000	2,500
Total	$175,000	$240,000

(iii) If PRS sold all of its assets in a fully taxable transaction at fair market value immediately after the transfer of the partnership interest to T, the total amount of capital gain that would be allocated to T is equal to $46,250 ($25,000 section 704(c) built-in gain from Asset 1, plus fifty percent of the $42,500 appreciation in capital gain property). T would also be allocated a $1,250 ordinary loss from the sale of the ordinary income property.

(iv) The amount of the basis adjustment that is allocated to ordinary income property is equal to ($1,250) (the amount of the loss allocated to T from the hypothetical sale of the ordinary income property).

(v) The amount of the basis adjustment that is allocated to capital gain property is equal to $46,250 (the amount of the basis adjustment, $45,000, less ($1,250), the amount of loss allocated to T from the hypothetical sale of the ordinary income property).

Example 2. (i) A and B form equal partnership PRS. A and B each contribute $1,000 cash which the partnership uses to purchase Assets 1, 2, 3, and 4. After a year, A sells its partnership interest to T for $1,000. T's basis adjustment under section 743 is zero.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted Basis	Market Value
Capital Gain Property:		
Asset 1	$ 500	$ 750
Asset 2	500	500
Ordinary Income Property:		
Asset 3	$ 500	$ 250
Asset 4	500	500
Total	$2,000	$2,000

(iii) If, immediately after the transfer of the partnership interest to T, PRS sold all of its assets in a fully taxable transaction at fair market value, T would be allocated a loss of $125 from the sale of the ordinary income property. Thus, the amount of the basis adjustment to ordinary income property is ($125). The amount of the basis adjustment to capital gain property is $125 (zero, the amount of the basis adjustment under section 743, less ($125), amount of the basis adjustment allocated to ordinary income property).

(3) *Allocation within the class*—(i) *Ordinary income property.* The amount of the basis adjustment to each item of property within the class of ordinary income property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; reduced by

(B) The product of—

(*1*) Any decrease to the amount of the basis adjustment to ordinary income property required pursuant to the last sentence of paragraph (b)(2)(i) of this section; multiplied by

(*2*) A fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all of the partnership's items of ordinary income property.

(ii) *Capital gain property.* The amount of the basis adjustment to each item of property within the class of capital gain property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; minus

(B) The product of—

(*1*) The total amount of gain or loss (including any remedial allocations under §1.704–3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all items of capital gain property, minus the amount of the positive basis adjustment to all items of capital gain property or plus the amount of the negative basis adjustment to capital gain property; multiplied by

(*2*) A fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all of the partnership's items of capital gain property.

(iii) *Examples.* The provisions of this paragraph (b)(3) are illustrated by the following example:

Example 1. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section. Of the $45,000 basis adjustment, $46,250 was allocated to capital gain property. The amount allocated to ordinary income property was ($1,250).

(ii) Asset 1 is a capital gain asset, and T would be allocated $37,500 from the sale of Asset 1 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 1 is $37,500.

(iii) Asset 2 is a capital gain asset, and T would be allocated $8,750 from the sale of Asset 2 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 2 is $8,750.

(iv) Asset 3 is ordinary income property, and T would be allocated $2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is $2,500.

(v) Asset 4 is ordinary income property, and T would be allocated ($3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is ($3,750).

Example 2. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section, except that A sold its interest in PRS to T for $110,000 rather than $120,000. T, therefore, receives a basis adjustment under section 743 of $35,000. Of the $35,000 basis adjustment, ($1,250) is allocated to ordinary income property, and $36,250 is allocated to capital gain property.

(ii) Asset 3 is ordinary income property, and T would be allocated $2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is $2,500.

(iii) Asset 4 is ordinary income property, and T would be allocated ($3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is ($3,750).

(iv) Asset 1 is a capital gain asset, and T would be allocated $37,500 from the sale of Asset 1 in the hypothetical transaction. Asset 2 is a capital gain asset, and T would be allocated $8,750 from the sale of Asset 2 in the hypothetical transaction. The total amount of gain that would be allocated to T from the sale of the capital gain assets in the hypothetical transaction is $46,250, which exceeds the amount of the basis adjustment allocated to capital gain property. The amount of the adjustment to Asset 1 is $33,604 (the sum of $37,500, less $3,896 ($10,000 × $75,000/192,500)). The amount of the basis adjustment to Asset 2 is $2,646 (the sum of $8,750, less $6,104 ($10,000 × $117,500/192,500)).

(c) *Adjustments under section 734(b)*—(1) *Allocations between classes of property*—(i) *General rule.* Where there is a distribution of partnership property resulting in an adjustment to the basis of undistributed partnership property under section 734(b)(1)(B) or (b)(2)(B), the adjustment must be allocated to remaining partnership property of a character similar to that of the distributed property with respect to which the adjustment arose. Thus, when the partnership's adjusted basis of distributed capital gain property immediately prior to distribution exceeds the basis of the property to the distributee partner (as determined under section 732), the basis of the undistributed capital gain property remaining in the partnership is increased by an amount equal to the excess. Conversely, when the basis to the distributee partner (as determined under section 732) of distributed capital gain property exceeds the partnership's adjusted basis of such property immediately prior to the distribution, the basis of the undistributed capital gain property remaining in the partnership is decreased by an amount equal to such excess. Similarly, where there is a distribution of ordinary income property, and the basis of the property to the distributee partner (as determined under section 732) is not the same as the partnership's adjusted basis of the property immediately prior to distribution, the adjustment is made only to undistributed property of the same class remaining in the partnership.

(ii) *Special rule.* Where there is a distribution resulting in an adjustment under section 734(b)(1)(A) or (b)(2)(A) to the basis of undistributed partnership property, the adjustment is allocated only to capital gain property.

(2) *Allocations within the classes*—(i) *Increases.* If there is an increase in basis to be allocated within a class, the increase must be allocated first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to their fair market values.

(ii) *Decreases.* If there is a decrease in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to their adjusted bases (as adjusted under the preceding sentence).

(3) *Limitation in decrease of basis.* Where a decrease in the basis of partnership assets is required under section 734(b)(2) and the amount of the decrease exceeds the adjusted basis to the partnership of property of the required character, the basis of such property is reduced to zero (but not below zero).

(4) *Carryover adjustment.* Where, in the case of a distribution, an increase or a decrease in the basis of undistributed property cannot be made because the partnership owns no property of the character required to be adjusted, or because the basis of all the property of a like character has been reduced to zero, the adjustment is made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(5) *Goodwill.* The application of the rules with respect to the allocation of an adjustment in basis under this paragraph (c) requires that a portion of the adjustment be allocated to partnership goodwill, to the extent that goodwill exists and is reflected in the value of the property distributed in accordance with the difference between such value of the goodwill and its adjusted basis at the time of the distribution.

(6) *Example.* The following example illustrates this paragraph (c):

Example. (i) A, B, and C form equal partnership PRS. A contributes $50,000 and Asset 1, capital gain property with a fair market value of $50,000 and an adjusted tax basis of $25,000. B and C each contributes $100,000. PRS uses the cash to purchase Assets 2, 3, 4, 5, and 6. None of the partnership's assets are section 751 property. The partnership has an election in effect under section 754. After five years, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted Basis	Market Value
Capital Gain Property:		
Asset 1	$ 25,000	$ 75,000
Asset 2	100,000	117,500
Asset 3	50,000	60,000
Ordinary Income Property:		
Asset 4	$ 40,000	$ 45,000
Asset 5	50,000	60,000
Asset 6	10,000	2,500
Total	$275,000	$360,000

(ii) *Allocation between classes.* Assume that PRS distributes Assets 3 and 5 to A in complete liquidation of A's interest in the partnership. A's basis in the partnership interest was $75,000. The partnership's basis in Assets 3 and 5 was $50,000 each. A's $75,000 basis in its partnership interest is allocated between Assets 3 and 5 under sections 732(b) and (c). A will, therefore, have a basis of $37,500 in each of Assets 3 and 5. The distribution results in a $12,500 increase in the basis of both capital gain property and ordinary income property.

(iii) *Allocation within classes*—(A) *Capital gain property.* The amount of the basis increase to capital gain property is $12,500, and must be allocated among the remaining capital gain assets in proportion to the difference between the value and basis of each. The fair market value of Asset 1 exceeds its basis by $50,000. The fair market value of Asset 2 exceeds its basis by $17,500. Therefore, the basis of Asset 1 will be increased by $9,260 ($12,500, multiplied by $50,000, divided by $67,500), and the basis of Asset 2 will be increased by $3,240 ($12,500 multiplied by $17,500, divided by $67,500).

(B) *Ordinary income property.* The amount of the basis increase to ordinary income property is $12,500, and must be allocated among the remaining ordinary income assets in proportion to the difference between the value and basis of each. Because the basis of Asset 6 exceeds its fair market value, no part of the basis adjustment will be allocated to Asset 6. The fair market value of Asset 4, $45,000, exceeds its basis, $40,000, by $5,000. Because the partnership owns no other ordinary income property that has a value in excess of its basis, the entire basis adjustment will be allocated to Asset 4, increasing its basis from $40,000 to $52,500.

(d) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after the date final regulations are published in the Federal Register.

Par. 8. Section 1.1017–1 as proposed to be revised at 62 F.R. 958, January 7, 1997, is amended by:

1. Revising paragraph (f)(2)(iv).

2. Adding paragraph (f)(2)(v).

The addition and revision read as follows:

§1.1017–1 Basis reductions following a discharge of indebtedness.

* * * * *

(f) * * *

(2) * * *

(iv) *Partner's share of partnership basis*—(A) *In general.* For purposes of this paragraph (f), a partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property) is equal to the sum of—

(*1*) The partner's section 743(b) basis adjustments to items of partnership depreciable property (or depreciable real property); and

(*2*) The common basis depreciation deductions (but not including remedial allocations of depreciation deductions under §1.704–3(d)) that, under the terms of the partnership agreement, are reasonably expected to be allocated to the partner over the property's remaining useful life. The assumptions made by a partnership in determining the reasonably expected allocation of depreciation deductions must be consistent for each partner. For example, a partnership may not treat the same depreciation deductions as being reasonably expected by more than one partner.

(B) *Effective date.* This paragraph (f)(2)(iv) applies to elections made under sections 108(b)(5) and 108(c) on or after the date the regulations are published as final regulations in the Federal Register.

(v) *Treatment of basis reduction*—(A) *Basis adjustment.* The amount of the reduction to the basis of depreciable partnership property constitutes an adjustment to the basis of partnership property with respect to the partner only. No adjustment is made to the common basis of partnership property. Thus, for purposes of income, deduction, gain, loss, and distribution, the partner will have a special basis for those partnership properties the bases of which are adjusted under section 1017 and this section.

(B) *Recovery of adjustments to basis of partnership property.* Adjustments to the basis of partnership property under this section are recovered in the manner described in §1.743–1.

(C) *Effect of basis reduction.* Adjustments to the basis of partnership property under this section are treated in the same manner and have the same effect as an adjustment to the basis of partnership property under section 743, provided, however, that the election in §1.743–1(j)(4)(ii)(A)(*2*) is not available. The following example illustrates this paragraph (f)(2)(v):

Example. (i) A, B, and C are equal partners in partnership PRS, which owns (among other things) Asset 1, an item of depreciable property with a basis of $30,000. A's basis in its partnership interest is $20,000. Under the terms of the partnership agreement, A's share of the depreciation deductions from Asset 1 over its remaining useful life will be $10,000. Under section 1017, A requests, and PRS agrees to decrease the basis of Asset 1 with respect to A by $10,000.

(ii) In the year following the reduction of basis under section 1017, PRS amends its partnership agreement to provide that items of depreciation and loss from Asset 1 will be allocated equally between B and C. In that year, A's distributive share of the partnership's common basis depreciation deductions from Asset 1 is now $0. Under §1.743–1(j)(4)(ii)(B), the amount of the section 1017 basis adjustment that A recovers during the year is $1,000. A will report $1,000 of ordinary income because A's distributive share of the partnership's common basis depreciation deductions from Asset 1 ($0) is insufficient to offset the amount of the section 1017 basis adjustment recovered by A during the year ($1,000).

(iii) In the following year, PRS sells Asset 1 for $15,000 and recognizes a $12,000 loss. This loss is allocated equally between B and C, and A's share of the loss is $0. Upon the sale of Asset 1, A recovers its entire remaining section 1017 basis adjustment ($9,000). A will report $9,000 of ordinary income.

(D) *Effective date.* This paragraph (f)(2)(v) applies to elections made under sections 108(b)(5) and 108(c) on or after the date the regulations are published as final regulations in the Federal Register.

* * * * *

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 28, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 29, 1998, 63 F.R. 4408)

Penalty Relief for Failure to Timely File the 1997 Form 3520–A

Announcement 98–30

Because the 1997 Form 3520–A, Annual Information Return of Foreign Trust With a U.S. Owner, was not available in time for foreign trusts to meet their filing requirements, no penalties will be imposed under section 6677 of the Internal Revenue Code on the U.S. owner of a foreign trust for failure to timely file if a foreign trust files its 1997 Form 3520–A with the Philadelphia Service Center and furnishes the required statements to the U.S. owners and U.S. beneficiaries by the later of the—

- Fifteenth day of the seventh month following the end of its taxable year beginning in 1997, **or**
- Extension date granted under Form 2758, Application for Extension of Time To File Certain Excise, Income, Information, and Other Returns.

In section VIII of Notice 97–34, 1997–1 C.B. 422, the Service provided that no penalties would be imposed under section 6677 on U.S. owners of foreign trusts under certain circumstances if the foreign trust filed Form 3520–A for its taxable year that included August 20, 1996 ("1996 Form 3520–A") by the due date for filing the trust's 1997 Form 3520–A. The relief discussed in this announcement (98–30) also applies to the filing of the 1996 Form 3520–A by these trusts. If such a trust has not yet filed Form 3520–A pursuant to Section IV of Notice 97–34 for its 1996 taxable year, the trust should file a 1997 Form 3520–A to report information for that year and strike out "1997" at the top right-hand corner and replace it with "1996". If a trust has already filed Form 3520–A pursuant to Section IV of Notice 97–34 for its 1996 and 1997 taxable years, the trust is not required to refile the revised forms.

The relief discussed in this announcement does not extend the time for (1) payment of any income taxes due for the owner's 1996 and 1997 taxable years or (2) filing the 1996 Form 3520 and the 1997 Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Because Form 3520 is filed on an annual basis with the U.S. owner's or U.S. beneficiary's income tax return, an extension of time to file Form 3520 may be obtained by getting an extension of time to file the applicable income tax return.

Notice of Correction

Announcement 98–32

This announcement withdraws the notice issued in Internal Revenue Bulletin Number 1997–52, dated December 29, 1997, under section 7428(c) validation of certain contributions made during pendency of declaratory judgment proceedings, with respect to the organization listed below.

At Cost Services, Inc.
New York, NY

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 98–33

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organizaion has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on (**Date**) 1998, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428 (c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Bala Books, Inc.
San Diego, CA

De'Unique, Inc.
Cheverly, MD

Michigan Affordable Housing Coalition
Denver, CO

Foundations Status of Certain Organizations

Announcement 98–34

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

W A M What About Me, Dubuque, IA
W D Smith Environmental Foundation, Hammond, LA
W O R K Inc. of Charleston, Charleston, SC
Wade Hampton Cherokees Youth Organization Inc., Greenville, SC
Wakulla Adult Education Foundation Inc., Crawfordville, FL
Walk of Faith Ministries Inc., New Hope, PA
Walk Thru Ministries Inc., Mount Vernon, IN
Wallingford Youth Football Association, Wallingford, PA
Walton Clean & Beautiful Inc., Monroe, GA
Walton Regional Hospital Booster Club Incorporated, DeFuniak Springs, FL
Wamego Area Senior Citizens Association, Wamego, KS
Warbirds of Indiana Inc., Indianapolis, IN
Warcry Ministries, Irvington, AL
Ward County Community Corrections Advisory Board, Minot, ND
Warm Souls Projects Inc., Nashville, TN
Warriors Youth Basketball Association, El Paso, TX
Warwick Education Systems Inc., Newport News, VA
Wasatch Eye Foundation, Salt Lake City, UT
Washington County African American Aids Network Incorporated, Greenville, MS
Washington High School Baseball Boosters Club Inc., Pensacola, FL
Washington International Foundation for Global Strategy, Richmond, VA
Washington Place Inc., Sumter, SC
Waste Reduction Action Coalition, Edwardsville, IL
Water Development International Inc., Golden, CO
Waterman Foundation, Columbus, OH
Waxahachie Community Development Council, Waxahachie, TX
Wayne Caretakers Preservation Club Inc., Lebanon, OH
Wayne County Performing Arts Council, Wooster, OH
Wayne County Track Club, Wooster, OH
We Help Others, Denver, CO
Webster Illinois Shepherd E Upshur Inc., Washington, DC
Wedr Relief Foundation Inc., Miami, FL
Wee World Incorporated, Landover, MD
Welcome-Homes for the Parentless Child Inc., Bartlesville, OK
Wellington Community Education Foundation Inc., Wellington, FL
Wellington Farm Park Inc., Grayling, MI
Wellspring Inc., Sarasota, FL
Welte Institute for Oaxacan Studies Inc., Atlanta, GA
Wesley Day Care Services, Andalusia, AL
Wesleyan Foundation of South Dakota Inc., Rapid City, SD
West Alabama Diabetes Education Center Inc., Eutaw, AL
West Broward Quilters Guild Inc., Plantation, FL
West Conn Affordable Housing Corp., Beverly Hills, FL

West Georgia Christian Campus Fellowship, Carrollton, GA
West Michigan Wildlife Rescue, Caledonia, MI
West Texas Heat, Midland, TX
West Virginia Rails-To-Trails Council Inc., Cairo, WV
West Virginia Youth Alliance Inc., Charleston, WV
Westbury-Parkwest Citizens on Patrol, Houston, TX
Western Arkansas NSCIA Inc., Fort Smith, AR
Western Carteret Baseball & Softball League, Emerald Isle, NC
Western Colorado Songwriters Group, Clifton, CO
Western Springs Foundation for Education Excellence, Western Springs, IL
Western Valley Arts Council, Monte Vista, CO
Westfield Downtown Committee Inc., Westfield, NJ
Westlake Youth Basketball Association, Austin, TX
Westside All Stars, Fort Worth, TX
WFPNJ Scholarship Fund, Newark, NJ
Wheelin Around, Tucson, AZ
White Deer Volunteer EMS, White Deer, TX
White Rock United Methodist Church Foundation Inc., Dallas, TX
Whiteville Christian Association, Hot Springs, AR
Whitewing Productions Company, Baton Rouge, LA
Whitfield County Foster Care Association, Dalton, GA
Whitley County Wild Game Club Inc., Williamsburg, KY
Whitney House II, Ann Arbor, MI
Whos for Dinner Inc., Dallas, TX
Widowed Persons Service of Helena Area Inc., Helena, MT
Wild Care, Harrisburg, PA
Wild Life Theatre Company, Chicago, IL
Wild Pine Nature Center of Southwest Florida Inc., Sarasota, FL
Wildcare Inc., Lawrence, KS
Wildcats Baseball Club, Orient, OH
Wildlife Response Inc., Chesapeake, VA
Wiley Branton Community Development Corporation, Washington, DC
William B. Fitzgerald Scholarship Fund, Washington, DC.
William J. Fanning Foundation, New Orleans, LA
Willow Run Adventist Apartments Inc., Huntsville, AL
Willow Run Nutrition Food Program, Houston, TX
Willowood Crime Watch Association, Houston, TX
Win for Life Foundation Inc., Grapevine, TX
Windom Park Citizens in Action, Minneapolis, MN
Windsor Terrace Resident Council Rosewind Inc., Columbus, OH
Wings for Life Inc., Atlanta, GA
Wings of Eagles Inc., Kensington, MD
Wings of Eagles Ministries Inc., Morganton, NC
Wings of Praise Inc., Lauderhill, FL
Wings Women in Need of Growth Services Inc., Naples, FL
Winnebago Countryside Bible Chapel, Winnebago, IL
Winning Decisions Inc., Mansfield, TX
Winter Park Committee Inc., Mahwah, NJ
Wisconsin CISO Network Inc., Milton, WI
Wisdoms Way, Jerome, AZ
Wise County Crime Stoppers Inc., Chico, TX
Wish-U-Well Foundation, Sandy, UT
Wish Upon a Star Foundation, Pittsburgh, PA
Wishingstar Foundation Inc., Suches, GA
Witnessing Ministries Inc., San Antonio, TX
Womack Foundation Inc., Indianapolis, IN
Womans Exchange of Greater Harrisburg Inc., Harrisburg, PA
Women Children & Families at Risk, Phoenix, AZ
Women to Women Retreat, Columbia, SC
Women Working the Word Inc., Philadelphia, PA
Woodford County River Association Inc., Versailles, KY
Woodridge Foundation Inc., Clayton, GA
Woodrow Stanley Foundation, Flint, MI
Woodside Housing Resource Foundation, Kissimmee, FL
Woodson County Presevation Inc., Yates Center, KS
Woodstock Animal Foundation Inc., Hanover Park, IL
Wooster All-Sports Booster Club, Wooster, OH
World Bible Ministry Incorporated, Boca Raton, FL
World Community School of Music Inc., Washington, DC
World Food Museum, Philadelphia, PA
World Freestyle Federation, Carrollton, TX
World Heritage Center Inc., Gentry, AR
World Institute for Spiritually Centered Education, Phoenix, AZ
World Mission Centre Inc., Columbia, SC
World Mission Partners Inc., Dallas, TX
World Model Soldier Federation Inc., Chicago, IL
World of Raptors Inc., Knoxville, TN
Worldreach-the Childrens Foundation, Westfield, NJ
Worldworks Communication Inc., Washington, DC
Worshipworks Inc., Knoxville, TN
WWOCB We Want Our Children Back, Tanner, AL
Wyandotte Christian Counseling and Family Life Center, Kansas City, KS

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

New Revision of Publication 954, *Tax Incentives for Empowerment Zones and Other Distressed Communities*

Announcement 98–35

Publication 954, recently updated, is now available from the Internal Revenue Service. It replaces the December 1993 revision.

This publication is primarily for business owners who want to find out whether they qualify for certain tax incentives created to increase business activity in distressed communities.

You can get a copy of this publication by calling 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS

Forms Distribution Center nearest you. Check your income tax package for the address. The publication is also available on the IRS Internet Web Site at www.irs.ustreas.gov.

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organizations listed below have recently filed timely declaratory judgment suits under section 7428 of the Code, challenging revocation of their status as eligible donees under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Hanover Society for the Deaf, Inc.
Ashland, VA

Saint Matthew Publishing, Inc.
Los Angeles, CA

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997–27 through 1997–52 will be found in Internal Revenue Bulletin 1998–1, dated January 5, 1998.

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