

§ 1.708-1 Continuation of partnership.

(a) *General rule.* For purposes of subchapter K, chapter 1 of the Code, an existing partnership shall be considered as continuing if it is not terminated.

(b) *Termination*—(1) *General rule.* A partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. For example, on November 20, 1956, A and B, each of whom is a 20-percent partner in partnership ABC, sell their interests to C, who is a 60-percent partner. Since the business is no longer carried on by any of its partners in a partnership, the ABC partnership is terminated as of November 20, 1956. However, where partners DEF agree on April 30, 1957, to dissolve their partnership, but carry on the business through a winding up period ending September 30, 1957, when all remaining assets, consisting only of cash, are distributed to the partners, the partnership does not terminate because of cessation of business until September 30, 1957.

(i) Upon the death of one partner in a 2-member partnership, the partnership shall not be considered as terminated if the estate or other successor in interest of the deceased partner continues to share in the profits or losses of the partnership business.

(ii) For the continuation of a partnership where payments are being made under section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest), see paragraph (a)(6) of § 1.736-1.

(2) A partnership shall terminate when 50 percent or more of the total interest in partnership capital and profits is sold or exchanged within a period of 12 consecutive months. Such sale or exchange includes a sale or exchange to another member of the partnership. However, a disposition of a partnership interest by gift (including assignment to a successor in interest), bequest, or inheritance, or the liquidation of a partnership interest, is not a sale or exchange for purposes of this subparagraph. Moreover, if the sale or exchange of an interest in a partnership (upper-tier partnership) that holds an interest in another partnership (lower-

tier partnership) results in a termination of the upper-tier partnership, the upper-tier partnership is treated as exchanging its entire interest in the capital and profits of the lower-tier partnership. If the sale or exchange of an interest in an upper-tier partnership does not terminate the upper-tier partnership, the sale or exchange of an interest in the upper-tier partnership is not treated as a sale or exchange of a proportionate share of the upper-tier partnership's interest in the capital and profits of the lower-tier partnership. The previous two sentences apply to terminations of partnerships under section 708(b)(1)(B) occurring on or after May 9, 1997; however, the sentences may be applied to terminations occurring on or after May 9, 1996, provided that the partnership and its partners apply the sentences to the termination in a consistent manner. Furthermore, the contribution of property to a partnership does not constitute such a sale or exchange. See, however, paragraph (c)(3) of § 1.731-1. Fifty percent or more of the total interest in partnership capital and profits means 50 percent or more of the total interest in partnership capital plus 50 percent or more of the total interest in partnership profits. Thus, the sale of a 30-percent interest in partnership capital and a 60-percent interest in partnership profits is not the sale or exchange of 50 percent or more of the total interest in partnership capital and profits. If one or more partners sell or exchange interests aggregating 50 percent or more of the total interest in partnership capital and 50 percent or more of the total interest in partnership profits within a period of 12 consecutive months, such sale or exchange is considered as being within the provisions of this subparagraph. When interests are sold or exchanged on different dates, the percentages to be added are determined as of the date of each sale. For example, with respect to the ABC partnership, the sale by A on May 12, 1956, of a 30-percent interest in capital and profits to D, and the sale by B on March 27, 1957, of a 30-percent interest in capital and profits to E, is a sale of a 50-percent or more interest. Accordingly, the partnership is terminated as of March 27, 1957. However, if, on March 27, 1957,

D instead of B, sold his 30-percent interest in capital and profits to E, there would be no termination since only one 30-percent interest would have been sold or exchanged within a 12-month period.

(3) For purposes of subchapter K, chapter 1 of the Code, a partnership taxable year closes with respect to all partners on the date on which the partnership terminates. See section 706(c)(1) and paragraph (c)(1) of § 1.706-1. The date of termination is:

(i) For purposes of section 708(b)(1)(A), the date on which the winding up of the partnership affairs is completed.

(ii) For purposes of section 708(b)(1)(B), the date of the sale or exchange of a partnership interest which, of itself or together with sales or exchanges in the preceding 12 months, transfers an interest of 50 percent or more in both partnership capital and profits.

(4) If a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up. In the latter case, the new partnership terminates in accordance with (b)(1) of this section. This paragraph (b)(4) applies to terminations of partnerships under section 708(b)(1)(B) occurring on or after May 9, 1997; however, this paragraph (b)(4) may be applied to terminations occurring on or after May 9, 1996, provided that the partnership and its partners apply this paragraph (b)(4) to the termination in a consistent manner. The provisions of this paragraph (b)(4) are illustrated by the following example:

Example. (i) A and B each contribute \$10,000 cash to form AB, a general partnership, as equal partners. AB purchases depreciable Property X for \$20,000. Property X increases

in value to \$30,000, at which time A sells its entire 50 percent interest to C for \$15,000 in a transfer that terminates the partnership under section 708(b)(1)(B). At the time of the sale, Property X had an adjusted tax basis of \$16,000 and a book value of \$16,000 (original \$20,000 tax basis and book value reduced by \$4,000 of depreciation). In addition, A and B each had a capital account balance of \$8,000 (original \$10,000 capital account reduced by \$2,000 of depreciation allocations with respect to Property X).

(ii) Following the deemed contribution of assets and liabilities by the terminated AB partnership to a new partnership (new AB) and the liquidation of the terminated AB partnership, the adjusted tax basis of Property X in the hands of new AB is \$16,000. See Section 723. The book value of Property X in the hands of new partnership AB is also \$16,000 (the book value of Property X immediately before the termination) and B and C each have a capital account of \$8,000 in new AB (the balance of their capital accounts in AB prior to the termination). See § 1.704-1(b)(2)(iv)(I) (providing that the deemed contribution and liquidation with regard to the terminated partnership are disregarded in determining the capital accounts of the partners and the books of the new partnership). Additionally, under § 301.6109-1(d)(2)(iii) of this chapter, new AB retains the taxpayer identification number of the terminated AB partnership.

(iii) Property X was not section 704(c) property in the hands of terminated AB and is therefore not treated as section 704(c) property in the hands of new AB, even though Property X is deemed contributed to new AB at a time when the fair market value of Property X (\$30,000) was different from its adjusted tax basis (\$16,000). See § 1.704-3(a)(3)(i) (providing that property contributed to a new partnership under § 1.708-1(b)(4) is treated as section 704(c) property only to the extent that the property was section 704(c) property in the hands of the terminated partnership immediately prior to the termination).

(5) If a partnership is terminated by a sale or exchange of an interest in the partnership, a section 754 election (including a section 754 election made by the terminated partnership on its final return) that is in effect for the taxable year of the terminated partnership in which the sale occurs, applies with respect to the incoming partner. Therefore, the bases of partnership assets are adjusted pursuant to sections 743 and 755 prior to their deemed contribution to the new partnership. This paragraph

(b)(5) applies to terminations of partnerships under section 708(b)(1)(B) occurring on or after May 9, 1997; however, this paragraph (b)(5) may be applied to terminations occurring on or after May 9, 1996, provided that the partnership and its partners apply this paragraph (b)(5) to the termination in a consistent manner.

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

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

nerships. The respective distributive shares of the partners for the periods prior to and including the date of the merger or consolidation and subsequent to the date of merger or consolidation shall be shown as a part of the return.

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

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

(4) *Sale of an interest in the merging or consolidating partnership.* In a transaction characterized under the assets-over form, a sale of all or part of a partner's interest in the terminated

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

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

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

Example 2. (i) Partnership X, in whose capital and profits A owns a 40-percent interest and B owns a 60-percent interest, and partnership Y, in whose capital and profits B owns a 60-percent interest and C owns a 40-percent interest, merge on September 30, 1999. The fair market value of the partnership X assets (net of liabilities) is \$100X, and the fair market value of the partnership Y

assets (net of liabilities) is \$200X. The merger is accomplished under state law by partnership Y contributing its assets and liabilities to partnership X in exchange for interests in partnership X, with partnership Y then liquidating, distributing interests in partnership X to B and C.

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

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

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

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

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

its partners in liquidation of their interests in partnership X.

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

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

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

(iv) Under paragraph (c)(3)(i) of this section, partnership X contributes its assets and liabilities attributable to the interests of A and B to partnership Y in exchange for interests in partnership Y; and, immediately thereafter, partnership X distributes the interests in partnership Y to A and B in liquidation of their interests in partnership X.

At the same time, partnership X distributes assets to partnership Y in liquidation of partnership Y's interest in partnership X. Partnership Y's bases in the distributed assets are determined under section 732(b).

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

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

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

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

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

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

partnership shall include the name, address, and EIN of the prior partnership.

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

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

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

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

(ii) *Assets-up form*—(A) *Assets-up form where the partnership distributing assets is a continuation of the prior partnership.*

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

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

spect to the assets and liabilities that, in form, are not transferred to a new resulting partnership, the prior partnership will be treated as transferring these assets and liabilities to a new resulting partnership under the assets-over form described in paragraph (d)(3)(i)(B) of this section.

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

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

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

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

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

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

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

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

Example 3. (i) The facts are the same as in *Example 2*, except partnership ABCD distributes property Y to C and titles property Y in C's name. C then contributes property Y to partnership CD. Simultaneously, partnership

ABCD contributes property Z to partnership CD in exchange for an interest in partnership CD. Immediately thereafter, partnership ABCD distributes the interest in partnership CD to D in liquidation of D's interest in partnership ABCD.

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

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

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

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

(ii) Under the last sentence of paragraph (d)(4)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(3)(i)(A) of this section, partnership ABCD will be treated as following the assets-over

form, with partnership ABCD contributing property Y to partnership AB2 and property Z to partnership CD, and distributing the interests in such partnerships to the designated partners.

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

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

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

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

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

(iv) Partnership ABCDE does not liquidate under state law so that, in form, the assets in new partnership DE are not considered to have been transferred under state law. Partnership ABCDE will be treated as undertaking the assets-over form described in

paragraph (d)(3)(i)(B) of this section for Federal income tax purposes with respect to the assets of partnership DE. Thus, partnership ABCDE will be treated as contributing Redacre to partnership DE in exchange for interests in partnership DE; and, immediately thereafter, partnership ABCDE will be treated as distributing interests in partnership DE to D and E in liquidation of their interests in partnership ABCDE. Partnership ABCDE then terminates.

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

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

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8717, 62 FR 25500, May 9, 1997; T.D. 8925, 65 FR 719, Jan. 4, 2001; 67 FR 57330, Sept. 10, 2002]

§ 1.709-1 Treatment of organization and syndication costs.

(a) *General rule.* Except as provided in paragraph (b) of this section, no deduction shall be allowed under chapter 1 of the Code to a partnership or to any partner for any amounts paid or incurred, directly or indirectly, in partnership taxable years beginning after December 31, 1975, to organize a partnership, or to promote the sale of, or to sell, an interest in the partnership.

(b) *Amortization of organization expenses.* (1) Under section 709(b) of the Code, a partnership may elect to treat its organizational expenses (as defined in section 709(b)(2) and in § 1.709-2(a)) paid or incurred in partnership taxable years beginning after December 31, 1976, as deferred expenses. If a partnership elects to amortize organizational expenses, it must select a period of not less than 60 months, over which the