(i) If shares of stock in a corporation are sold from lots purchased at different dates or at different prices and the identity of the lots cannot be determined, the rules prescribed by the regulations under section 1012 for determining the cost or other basis of such stocks so sold or transferred shall also apply for the purpose of determining the holding period of such stock.

(j) In the case of a person acquiring property, or to whom property passed, from a decedent (within the meaning of section 1014(b)) dying after December 31, 1970, such person shall be considered to have held the property for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) if the property:

(1) Has a basis in the hands of such person which is determined in whole or in part under section 1014, and

(2) Is sold or otherwise disposed of by such person within 6 months after the decedent's death.

The provisions of this paragraph apply to sales of such property included in the decedent's gross estate for the purposes of the estate tax by the executor or administrator of the estate and to sales of such property by other persons who have acquired property from the decedent. The provisions of this paragraph may also be applicable to cases involving joint tenancies, community property, and properties transferred in contemplation of death. Thus, if a surviving joint tenant, who acquired property by right of survivorship, sells or otherwise disposes of such property within 6 months after the date of the decedent's death, and the basis of the property in his hands is determined in whole or in part under section 1014, the property shall be considered to have been held by the surviving joint tenant for more than 6 months. Similarly, a surviving spouse's share of community property shall be considered to have been held by her for more than 6 months if it is sold or otherwise disposed of within 6 months after the date of the decedent's death, regardless of when the property was actually acquired by the marital community. For the purposes of this paragraph, it is immaterial that the sale or other disposition produces gain or loss. If property is considered to have been held for more than 6 months by reason of this paragraph, it also is considered to have been held for that period for purposes of section 1231 (if that section is otherwise applicable).

(k) Any reference in section 1223 or this section to another provision of the Internal Revenue Code of 1954 is, where applicable, to be deemed a reference to the corresponding provision of the Internal Revenue Code of 1939, or prior internal revenue laws. The provisions of prior internal revenue laws here intended are the sections referred to in the sections of the Internal Revenue Code of 1939 which correspond to the sections of the Internal Revenue Code of 1954 referred to in section 1223. Thus, the sections corresponding to section 1081(c) are section 371(c) of the Revenue Act of 1938 (52 Stat. 553) and section 371(c) of the Internal Revenue Code of 1939. The sections corresponding to section 1091 are section 118 of each of the following: The Revenue Acts of 1928 (45 Stat. 826), 1932 (47 Stat. 208), 1934 (48 Stat. 715), 1936 (49 Stat. 1692), 1938 (52 Stat. 503), and the Internal Revenue Code of 1939.

[T.D. 6500, 25 FR 12005, Nov. 26, 1960, as amended by T.D. 7238, 37 FR 28717, Dec. 29, 1972; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1223–3 Rules relating to the holding periods of partnership interests.

(a) *In general.* A partner shall not have a divided holding period in an interest in a partnership unless—

(1) The partner acquired portions of an interest at different times; or

(2) The partner acquired portions of the partnership interest in exchange for property transferred at the same time but resulting in different holding periods (*e.g.,* section 1223).

(b) *Accounting for holding periods of an interest in a partnership*—(1) *General rule.* The portion of a partnership interest to which a holding period relates shall be determined by reference to a fraction, the numerator of which is the fair market value of the portion of the partnership interest received in the transaction to which the holding period relates, and the denominator of which is the fair market value of the entire partnership interest (determined immediately after the transaction).

(2) *Special rule.* For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged (or with respect to which gain or loss is recognized upon a distribution under section 731), if a partner makes one or more contributions of cash to the partnership and receives one or more distributions of cash from the partnership during the one-year period ending on the date of the sale or exchange (or distribution with respect to which gain or loss is recognized under section 731), the partner may reduce the cash contributions made during the year by cash distributions received on a last-in-first-out basis, treating all cash distributions as if they were received immediately before the sale or exchange (or at the time of the distribution with respect to which gain or loss is recognized under section 731).

(3) *Deemed contributions and distributions.* For purposes of paragraphs (b)(1) and (2) of this section, deemed contributions of cash under section 752(a) and deemed distributions of cash under section 752(b) shall be disregarded to the same extent that such amounts are disregarded under § 1.704–1(b)(2)(iv)(c).

(4) *Adjustment with respect to contributed section 751 assets.* For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged, if a partner receives a portion of the partnership interest in exchange for property described in section 751(c) or (d) (section 751 assets) within the one-year period ending on the date of the sale or exchange of all or a portion of the partner's interest in the partnership, and the partner recognizes ordinary income or loss on account of such a section 751 asset in a fully taxable transaction (either as a result of the sale of all or part of the partner's interest in the partnership or the sale by the partnership of the section 751 asset), the contribution of the section 751 asset during the one-year period shall be disregarded. However, if, in the absence of this paragraph, a partner would not be treated as having held any portion of the interest for more than one year (*e.g.,* because the partner's only contributions to the partnership are contributions of section 751 assets or section 751 assets and cash within the prior one-year period), this adjustment is not available.

(5) *Exception.* The Commissioner may prescribe by guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) a rule disregarding certain cash contributions (including contributions of a de minimis amount of cash) in applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged.

(c) *Sale or exchange of all or a portion of an interest in a partnership*—(1) *Sale or exchange of entire interest in a partnership.* If a partner sells or exchanges the partner's entire interest in a partnership, any capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the holding period of the interest in the partnership is divided between the portion of the interest held for more than one year and the portion of the interest held for one year or less.

(2) *Sale or exchange of a portion of an interest in a partnership*—(i) *Certain publicly traded partnerships.* A selling partner in a publicly traded partnership (as defined under section 7704(b)) may use the actual holding period of the portion of a partnership interest transferred if—

(A) The ownership interest is divided into identifiable units with ascertainable holding periods;

(B) The selling partner can identify the portion of the partnership interest transferred; and

(C) The selling partner elects to use the identification method for all sales or exchanges of interests in the partnership after September 21, 2000. The selling partner makes the election referred to in this paragraph (c)(2)(i)(C) by using the actual holding period of the portion of the partner's interest in the partnership first transferred after September 21, 2000 in reporting the transaction for Federal income tax purposes.

(ii) *Other partnerships.* If a partner has a divided holding period in a partnership interest, and paragraph (c)(2)(i) of this section does not apply, then the holding period of the transferred interest shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the transferor partner would realize if the entire interest in the partnership were transferred in a fully taxable transaction immediately before the actual transfer.

(d) *Distributions*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, a partner's holding period in a partnership interest is not affected by distributions from the partnership.

(2) *Character of capital gain or loss recognized as a result of a distribution from a partnership.* If a partner is required to recognize capital gain or loss as a result of a distribution from a partnership, then the capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the distributee partner would realize if such partner's entire interest in the partnership were transferred in a fully taxable transaction immediately before the distribution.

(e) *Section 751(c) assets.* For purposes of this section, properties and potential gain treated as unrealized receivables under section 751(c) shall be treated as separate assets that are not capital assets as defined in section 1221 or property described in section 1231.

(f) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Division of holding period—contribution of money and a capital asset. (i) *A* contributes $5,000 of cash and a nondepreciable capital asset *A* has held for two years to a partnership (*PRS*) for a 50 percent interest in *PRS*. *A*'s basis in the capital asset is $5,000, and the fair market value of the asset is $10,000. After the exchange, *A*'s basis in *A*'s interest in *PRS* is $10,000, and the fair market value of the interest is $15,000. *A* received one-third of the interest in *PRS* for a cash payment of $5,000 ($5,000/$15,000). Therefore, *A*'s holding period in one-third of the interest received (attributable to the contribution of money to the partnership) begins on the day after the contribution. *A* received two-thirds of the interest in *PRS* in exchange for the capital asset ($10,000/$15,000). Accordingly, pursuant to section 1223(1), *A* has a two-year holding period in two-thirds of the interest received in *PRS*.

(ii) Six months later, when *A*'s basis in *PRS* is $12,000 (due to a $2,000 allocation of partnership income to *A*), *A* sells the interest in *PRS* for $17,000. Assuming *PRS* holds no inventory or unrealized receivables (as defined under section 751(c)) and no collectibles or section 1250 property, *A* will realize $5,000 of capital gain. As determined above, one-third of *A*'s interest in *PRS* has a holding period of one year or less, and two-thirds of *A*'s interest in *PRS* has a holding period equal to two years and six months. Therefore, one-third of the capital gain will be short-term capital gain, and two-thirds of the capital gain will be long-term capital gain.

Example 2. Division of holding period—contribution of section 751 asset and a capital asset. *A* contributes inventory with a basis of $2,000 and a fair market value of $6,000 and a capital asset which *A* has held for more than one year with a basis of $4,000 and a fair market value of $6,000, and *B* contributes cash of $12,000 to form a partnership (*AB*). As a result of the contribution, one-half of *A*'s interest in *AB* is treated as having been held for more than one year under section 1223(1). Six months later, *A* transfers one-half of *A*'s interest in *AB* to *C* for $6,000, realizing a gain of $3,000. If *AB* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $4,000 of ordinary income on account of the inventory. Accordingly, *A* will recognize $2,000 of ordinary income and $1,000 of capital gain ($3,000–$2,000) on account of the transfer to *C*. Because *A* recognizes ordinary income on account of the inventory that was contributed to *AB* within the one year period ending on the date of the sale, the inventory will be disregarded in determining the holding period of *A*'s interest in *AB*. All of the capital gain will be long-term.

Example 3. Netting of cash contributions and distributions. (i) On January 1, 2000, *A* holds a 50 percent interest in the capital and profits of a partnership (*PS*). The value of *A*'s *PS* interest is $900, and *A*'s holding period in the entire interest is long-term. On January 2, 2000, when the value of *A*'s *PS* interest is still $900, *A* contributes $100 to *PS*. On June 1, 2000, *A* receives a distribution of $40 cash from the partnership. On September 1, 2000, when the value of *A*'s interest in *PS* is $1,350, *A* contributes an additional $230 cash to *PS*, and on October 1, 2000, *A* receives another $40 cash distribution from *PS*. *A* sells *A*'s entire partnership interest on November 1, 2000, for $1,600. *A*'s adjusted basis in the *PS* interest at the time of the sale is $1,000.

(ii) For purposes of netting cash contributions and distributions in determining the holding period of *A*'s interest in *PS*, *A* is treated as having received a distribution of \$80 on November 1, 2000. Applying that distribution on a last-in-first-out basis to reduce prior contributions during the year, the contribution made on September 1, 2000, is reduced to \$150 (\$230–\$80). The holding period then is determined as follows: Immediately after the contribution of \$100 on January 2, 2000, *A*'s holding period in *A*'s *PS* interest is 90 percent long-term (\$900/(\$900 + \$100)) and 10 percent short-term (\$100/(\$900 + \$100)). The contribution of \$150 on September 1, 2000, causes 10 percent of *A*'s partnership interest (\$150/(\$1,350 + \$150)) to have a short-term holding period. Accordingly, immediately after the contribution on September 1, 2000, *A*'s holding period in *A*'s *PS* interest is 81 percent long-term (.90 × .90) and 19 percent short-term ((.10 × .90) + .10). Accordingly, \$486 (\$600 × .81) of the gain from *A*'s sale of the *PS* interest is long-term capital gain, and \$114 (\$600 × .19) is short-term capital gain.

Example 4. Division of holding period when capital account is increased by contribution. *A*, *B*, *C*, and *D* are equal partners in a partnership (*PRS*), and the fair market value of a 25 percent interest in *PRS* is \$100. *A*, *B*, *C*, and *D* each contribute an additional \$100 to partnership capital, thereby increasing the fair market value of each partner's interest to \$200. As a result of the contribution, each partner has a new holding period in the portion of the partner's interest in *PRS* that is attributable to the contribution. That portion equals 50 percent (\$100/\$200) of each partner's interest in *PRS*.

Example 5. Sale or exchange of a portion of an interest in a partnership. (i) *A*, *B*, and *C* form an equal partnership (*PRS*). In connection with the formation, *A* contributes \$5,000 in cash and a capital asset (capital asset 1) with a fair market value of \$5,000 and a basis of \$2,000; *B* contributes \$7,000 in cash and a capital asset (capital asset 2) with a fair market value of \$3,000 and a basis of \$3,000; and *C* contributes \$10,000 in cash. At the time of the contribution, *A* had held the contributed property for two years. Six months later, when *A*'s basis in *PRS* is \$7,000, A transfers one-half of *A*'s interest in *PRS* to *T* for \$7,000 at a time when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted basis	Market value
Cash	\$22,000	\$22,000
Unrealized Receivables	0	6,000
Capital Asset 1	2,000	5,000
Capital Asset 2	3,000	9,000
Capital Assets	5,000	14,000
Total	27,000	42,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50 percent of the fair market value of *A*'s interest in *PRS* was received in exchange for a capital asset with a long-term holding period. Therefore, 50 percent of *A*'s interest in *PRS* has a long-term holding period.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated \$2,000 of ordinary income. One-half of that amount (\$1,000) is attributable to the portion of *A*'s interest in *PRS* transferred to *T*. Accordingly, *A* will recognize \$1,000 oridnary income and \$2,500 (\$3,500–\$1,000) of capital gain on account of the transfer to *T* of one-half of *A*'s interest in *PRS*. Fifty percent (\$1,250) of that gain is long-term capital gain and 50 percent (\$1,250) is short-term capital gain.

Example 6. Sale of units of interests in a partnership. A publicly traded partnership (*PRS*) has ownership interests that are segregated into identifiable units of interest. *A* owns 10 limited partnership units in *PRS* for which *A* paid \$10,000 on January 1, 1999. On August 1, 2000, *A* purchases five additional units for \$10,000. At the time of purchase, the fair market value of each unit has increased to \$2,000. *A*'s holding period for one-third (\$10,000/\$30,000) of the interest in *PRS* begins on the day after the purchase of the five additional units. Less than one year later, *A* sells five units of ownership in *PRS* for \$11,000. At the time, *A*'s basis in the 15 units of *PRS* is \$20,000, and *A*'s capital gain on the sale of 5 units is \$4,333 (amount realized of \$11,000 − one-third of the adjusted basis or \$6,667). For purposes of determining the holding period, *A* can designate the specific units of *PRS* sold. If *A* properly identifies the five units sold as five of the ten units for which *A* has a long-term holding period and elects to use the identification method for all subsequent sales or exchanges of interests in the partnership by using the actual holding period in reporting the transaction on *A*'s Federal income tax return, the capital gain realized will be long-term capital gain.

Example 7. Disproportionate distribution. In 1997, *A* and *B* each contribute cash of \$50,000 to form and become equal partners in a partnership (*PRS*). More than one year later, *A* receives a distribution worth \$22,000 from *PRS*, which reduces *A*'s interest in *PRS* to 36 percent. After the distribution, *B* owns 64 percent of *PRS*. The holding periods of *A* and *B* in their interests in *PRS* are not affected by the distribution.

Example 8. Gain or loss as a result of a distribution—(i) On January 1, 1996, *A* contributes property with a basis of \$10 and a fair market value of \$10,000 in exchange for an interest in a partnership (*ABC*). On September 30, 2000, when *A*'s interest in *ABC* is worth \$12,000 (and the basis of *A*'s partnership interest is still \$10), *A* contributes \$12,000 cash in exchange for an additional interest in

ABC. A is allocated a loss equal to $10,000 by *ABC* for the taxable year ending December 31, 2000, thereby reducing the basis of *A*'s partnership interest to $2,010. On February 1, 2001, *ABC* makes a cash distribution to *A* of $10,000. *ABC* holds no inventory or unrealized receivables. (assume that *A* is allocated no gain or loss for the taxable year ending December 31, 2001, so that the basis of *A*'s partnership interest does not increase or decrease as a result of such allocations.)

(ii) The netting rule contained in paragraph (b)(2) of this section provides that, in determining the holding period of *A*'s interest in *ABC*, the cash contribution made on September 30, 2000, must be reduced by the distribution made on February 1, 2001. Accordingly, for purposes of determining the holding period of *A*'s interest in *ABC*, *A* is treated as having made a cash contribution of $2,000 ($12,000–$10,000) to *ABC* on September 30, 2000. *A*'s holding period in one-seventh of *A*'s interest in *ABC* ($2,000 cash contributed over the $14,000 value of the entire interest (determined as if only $2,000 were contributed rather than $12,000)) begins on the day after the cash contribution. *A* recognizes $7,990 of capital gain as a result of the distribution. See section 731(a)(1). One-seventh of the capital gain recognized as a result of the distribution is short-term capital gain, and six-sevenths of the capital gain is long-term capital gain. After the distribution, *A*'s basis in the interest in *PRS* is $0, and the holding period for the interest in *PRS* continues to be divided in the same proportions as before the distribution.

(g) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after September 21, 2000.

[T.D. 8902, 65 FR 57099, Sept. 21, 2000]

SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

§ 1.1231–1 Gains and losses from the sale or exchange of certain property used in the trade or business.

(a) *In general.* Section 1231 provides that, subject to the provisions of paragraph (e) of this section, a taxpayer's gains and losses from the disposition (including involuntary conversion) of assets described in that section as *property used in the trade or business* and from the involuntary conversion of capital assets held for more than 6 months shall be treated as long-term capital gains and losses if the total gains exceed the total losses. If the total gains do not exceed the total losses, all such gains and losses are treated as ordinary gains and losses. Therefore, if the taxpayer has no gains subject to section 1231, a recognized loss from the condemnation (or from a sale or exchange under threat of condemnation) of even a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) is an ordinary loss. Capital assets subject to section 1231 treatment include only capital assets involuntarily converted. The noncapital assets subject to section 1231 treatment are (1) depreciable business property and business real property held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) other than stock in trade and certain copyrights and artistic property and, in the case of sales and other dispositions occurring after July 25, 1969, other than a letter, memorandum, or property similar to a letter or memorandum; (2) timber, coal, and iron ore which do not otherwise meet the requirements of section 1231 but with respect to which section 631 applies; and (3) certain livestock and unharvested crops. See paragraph (c) of this section.

(b) *Treatment of gains and losses.* For the purpose of applying section 1231, a taxpayer must aggregate his recognized gains and losses from:

(1) The sale, exchange, or involuntary conversion of property used in the trade or business (as defined in section 1231(b)), and

(2) The involuntary conversion (but not sale or exchange) of capital assets held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

If the gains to which section 1231 applies exceed the losses to which the section applies, the gains and losses are treated as long-term capital gains and losses and are subject to the provisions of parts I and II (section 1201 and following), subchapter P, chapter 1 of the Code, relating to capital gains and losses. If the gains to which section 1231 applies do not exceed the losses to which the section applies, the gains and losses are treated as ordinary gains and losses. Therefore, in the latter