

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-111119-99]

RIN 1545-AX32

Partnership Mergers and Divisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations on the tax consequences of partnership mergers and divisions. The proposed regulations affect partnerships and their partners. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by April 10, 2000.

Requests to speak (with outlines of oral comments) at the public hearing scheduled for May 4, 2000, must be submitted by April 13, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-111119-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-111119-99), 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 of the IRS Home Page, or by submitting comments directly to the IRS Internet site at:

[http://www.irs.ustreas.gov/tax\\_regs/regslst.html](http://www.irs.ustreas.gov/tax_regs/regslst.html). The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Dan Carmody, (202) 622-3080; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

This document proposes to amend sections 708, 743, and 752 of the Income Tax Regulations (26 CFR part 1) regarding partnership mergers and divisions.

Partnership Mergers

**Background**

Section 708(b)(2)(A) provides that in the case of a merger or consolidation of two or more partnerships, the resulting partnership is, for purposes of section 708, considered the continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership. Section 1.708-1(b)(2)(i) of the Income Tax Regulations provides that if the resulting partnership can be considered a continuation of more than one of the merging partnerships, the resulting partnership is the continuation of the partnership that is

credited with the contribution of the greatest dollar value of assets to the resulting partnership. If none of the members of the merging partnerships own more than a 50 percent interest in the capital and profits of the resulting partnership, all of the merged partnerships are considered terminated, and a new partnership results. The taxable years of the merging partnerships that are considered terminated are closed under section 706(c).

Although section 708 and the applicable regulations provide which partnership continues when two or more partnerships merge, the statute and regulations do not prescribe a form for the partnership merger. (Often, state merger statutes do not provide a particular form for a partnership merger.) In revenue rulings, however, the IRS has prescribed the form of a partnership merger for Federal income tax purposes.

In Rev. Rul. 68-289 (1968-1 C.B. 314), three existing partnerships (P1, P2, and P3) merged into one partnership with P3 continuing under section 708(b)(2)(A). The revenue ruling holds that P1 and P2, the two terminating partnerships, are treated as having contributed all of their respective assets and liabilities to P3, the resulting partnership, in exchange for a partnership interest in P3. P1 and P2 are considered terminated and the partners of P1 and P2 receive interests in P3 with a basis under section 732(b) in liquidation of P1 and P2 (Assets-Over Form). Rev. Rul. 77-458 (1977-2 C.B. 220), and Rev. Rul. 90-17 (1990-1 C.B. 119), also follow the Assets-Over Form for a partnership

merger.

### **Explanation of Provisions**

#### **A. Form of a Partnership Merger**

The IRS and Treasury are aware that taxpayers may accomplish a partnership merger by undertaking transactions in accordance with jurisdictional laws that follow a form other than the Assets-Over Form. For example, the terminating partnership could liquidate by distributing its assets and liabilities to its partners who then contribute the assets and liabilities to the resulting partnership (Assets-Up Form). In addition, the partners in the terminating partnership could transfer their terminating partnership interests to the resulting partnership in exchange for resulting partnership interests, and the terminating partnership could liquidate into the resulting partnership (Interest-Over Form).

In the partnership incorporation area, a taxpayer's form generally is respected if the taxpayer actually undertakes, under the relevant jurisdictional law, all the steps of a form that is set forth in one of three situations provided in Rev. Rul. 84-111 (1984-2 C.B. 88). The three situations that Rev. Rul. 84-111 sets forth are the Assets-Over Form, Assets-Up Form, and Interest-Over Form. Rev. Rul. 84-111 explains that, depending on the form chosen to incorporate the partnership, the adjusted basis and holding periods of the various assets received by the corporation and the adjusted basis and holding periods of the stock received by the former partners can vary. Like partnership

incorporations, each form of a partnership merger has potentially different tax consequences.

Under the Assets-Up Form, partners could recognize gain under sections 704(c)(1)(B) and 737 (and incur state or local transfer taxes) when the terminating partnership distributes the assets to the partners. However, under the Assets-Over Form, gain under sections 704(c)(1)(B) and 737 is not triggered. See §§1.704-4(c)(4) and 1.737-2(b). Additionally, under the Assets-Up Form, because the adjusted basis of the assets contributed to the resulting partnership is determined first by reference to section 732 (as a result of the liquidation) and then section 723 (by virtue of the contribution), in certain circumstances, the adjusted basis of the assets contributed may not be the same as the adjusted basis of the assets in the terminating partnership. These circumstances occur if the partners' aggregate adjusted basis of their interests in the terminating partnership does not equal the terminating partnership's adjusted basis in its assets. Under the Assets-Over Form, because the resulting partnership's adjusted basis in the assets it receives is determined solely under section 723, the adjusted basis of the assets in the resulting partnership is the same as the adjusted basis of the assets in the terminating partnership.

The regulations propose to respect the form of a partnership merger for Federal income tax purposes if the partnerships undertake, pursuant to the laws of the applicable jurisdiction,

the steps of either the Assets-Over Form or the Assets-Up Form. (This rule applies even if none of the merged partnerships are treated as continuing for Federal income tax purposes.)

Generally, when partnerships merge, the assets move from one partnership to another at the entity level, or in other words, like the Assets-Over Form. However, if as part of the merger, the partnership titles the assets in the partners' names, the proposed regulations treat the transaction under the Assets-Up Form. If partnerships use the Interest-Over Form to accomplish the result of a merger, the partnerships will be treated as following the Assets-Over Form for Federal income tax purposes.

In the context of partnership incorporations, Rev. Rul. 84-111 distinguishes among all three forms of incorporation. However, with respect to the Interest-Over Form, the revenue ruling respects only the transferors' conveyances of partnership interests, while treating the receipt of the partnership interests by the transferee corporation as the receipt of the partnership's assets (i.e., the Assets-Up Form). The theory for this result, based largely on McCauslen v. Commissioner, 45 T.C. 588 (1966), is that the transferee corporation can only receive assets since it is not possible, as a sole member, for it to receive and hold interests in a partnership (i.e., a partnership cannot have only one member; so, the entity is never a partnership in the hands of the transferee corporation).

Adherence to the approach followed in Rev. Rul. 84-111 creates problems in the context of partnership mergers that are

not present with respect to partnership incorporations. Unlike the corporate rules, the partnership rules impose certain tax results on partners based upon a concept that matches a contributed asset to the partner that contributed the asset. Sections 704(c) and 737 are examples of such rules. The operation of these rules breaks down if the partner is treated as contributing an asset that is different from the asset that the partnership is treated as receiving.

Given that the hybrid treatment of the Interest-Over Form transactions utilized in Rev. Rul. 84-111 is difficult to apply in the context of partnership mergers, another characterization will be applied to such transactions. The Assets-Over Form generally will be preferable for both the IRS and taxpayers. For example, when partnerships merge under the Assets-Over Form, gain under sections 704(c)(1)(B) and 737 is not triggered. Moreover, the basis of the assets in the resulting partnership is the same as the basis of the assets in the terminating partnership, even if the partners' aggregate adjusted basis of their interests in the terminating partnership does not equal the terminating partnership's adjusted basis in its assets.

If partnerships merge under applicable law without implementing a form, the proposed regulations treat the partnerships as following the Assets-Over Form. This approach is consistent with the treatment of partnership to corporation elective conversions under the check-the-box regulations and technical terminations under section 708(b)(1)(B), other formless

movements of a partnership's assets.

B. Adverse Tax Consequences of the Assets-Over Form

The IRS and Treasury are aware that certain adverse tax consequences may occur for partnerships that merge in a transaction that will be taxed in accordance with the Assets-Over Form. These proposed regulations address some of the adverse tax consequences regarding section 752 liability shifts and buyouts of exiting partners.

1. Section 752 Revisions

If a highly leveraged partnership (the terminating partnership) merges with another partnership (the resulting partnership), all of the partners in the terminating partnership could recognize gain because of section 752 liability shifts. Under the Assets-Over Form, the terminating partnership becomes a momentary partner in the resulting partnership when the terminating partnership contributes its assets and liabilities to the resulting partnership in exchange for interests in the resulting partnership. If the terminating partnership (as a momentary partner in the resulting partnership) is considered to receive a deemed distribution under section 752 (after netting increases and decreases in liabilities under §1.752-1(f)) that exceeds the terminating partnership's adjusted basis of its interests in the resulting partnership, the terminating partnership would recognize gain under section 731. The terminating partnership's gain then would be allocated to each partner in the terminating partnership under section 704(b). In

this situation, a partner in the terminating partnership could recognize gain even though the partner's adjusted basis in its resulting partnership interest or its share of partnership liabilities in the resulting partnership is large enough to avoid the recognition of gain, provided that the decreases in liabilities in the terminating partnership are netted against the increases in liabilities in the resulting partnership.

The proposed regulations clarify that when two or more partnerships merge under the Assets-Over Form, increases or decreases in partnership liabilities associated with the merger are netted by the partners in the terminating partnership and the resulting partnership to determine the effect of the merger under section 752. The IRS and Treasury consider it appropriate to treat the merger as a single transaction for determining the net liability shifts under section 752. Therefore, a partner in the terminating partnership will recognize gain on the contribution under section 731 only if the net section 752 deemed distribution exceeds that partner's adjusted basis of its interest in the resulting partnership.

## 2. Buyout of a Partner

Another adverse tax consequence may occur when a partner in the terminating partnership does not want to become a partner in the resulting partnership and would like to receive money or property instead of an interest in the resulting partnership. Under the Assets-Over Form, the terminating partnership will not recognize gain or loss under section 721 when it contributes its

property to the resulting partnership in exchange for interests in the resulting partnership. However, if, in order to facilitate the buyout of the exiting partner, the resulting partnership transfers money or other consideration to the terminating partnership in addition to the resulting partnership interests, the terminating partnership may be treated as selling part of its property to the resulting partnership under section 707(a)(2)(B). Any gain or loss recognized by the terminating partnership generally would be allocated to all the partners in the terminating partnership even though only the exiting partner would receive the consideration.

The IRS and Treasury believe that, under certain circumstances, when partnerships merge and one partner does not become a partner in the resulting partnership, the receipt of cash or property by that partner should be treated as a sale of that partner's interest in the terminating partnership to the resulting partnership, not a disguised sale of the terminating partnership's assets. Accordingly, the proposed regulations provide that if the merger agreement (or similar document) specifies that the resulting partnership is purchasing the exiting partner's interest in the terminating partnership and the amount paid for the interest, the transaction will be treated as a sale of the exiting partner's interest to the resulting partnership. This treatment will apply even if the resulting partnership sends the consideration to the terminating partnership on behalf of the exiting partner, so long as the

designated language is used in the relevant document.

In this situation, the exiting partner is treated as selling a partnership interest in the terminating partnership to the resulting partnership (and the resulting partnership is treated as purchasing the partner's interest in the terminating partnership) immediately prior to the merger. Immediately after the sale, the resulting partnership becomes a momentary partner in the terminating partnership. Consequently, the resulting partnership and ultimately its partners (determined prior to the merger) inherit the exiting partner's capital account in the terminating partnership and any section 704(c) liability of the exiting partner. If the terminating partnership has an election in effect under section 754 (or makes an election under section 754), the resulting partnership will have a special basis adjustment regarding the terminating partnership's property under section 743. The proposed regulations provide that the resulting partnership's basis adjustments under section 743 must be ultimately allocated solely to the partners who were partners in the resulting partnership immediately before the merger; the adjustments do not affect the common basis of the resulting partnership's assets.

C. Merger as Part of a Larger Transaction

The proposed regulations provide that if the merger is part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed for the merger, the form may not be respected,

and the larger series of transactions may be recast in accordance with their substance. An example illustrating the application of this rule is included in the proposed regulations.

D. Measurement of Dollar Value of Assets

As discussed above, the regulations currently provide that in a merger of partnerships, if the resulting partnership can be considered a continuation of more than one of the merging partnerships, the resulting partnership is the continuation of the partnership that is credited with the contribution of the greatest dollar value of assets to the resulting partnership. Commentators have questioned whether this rule refers to the gross or net value of the assets of a partnership. The proposed regulations provide that the value of assets of a partnership is determined net of the partnership's liabilities.

E. Effective Date

The regulations are proposed to apply to mergers occurring on or after the date final regulations are published in the **Federal Register**.

Partnership Divisions

**Background**

Section 708(b)(2)(B) provides that, in the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) are considered a continuation of the prior partnership. Section 1.708-1(b)(2)(ii)

provides that any other resulting partnership is not considered a continuation of the prior partnership but is considered a new partnership. If the members of none of the resulting partnerships owned an interest of more than 50 percent in the capital and profits of the prior partnership, the prior partnership is terminated. Where members of a partnership that has been divided do not become members of a resulting partnership that is considered a continuation of the prior partnership, such partner's interest is considered liquidated as of the date of the division.

Section 708(b)(2)(B) and the applicable regulations do not prescribe a particular form for the division involving continuing partnerships. The IRS has not addressed in published guidance how the assets and liabilities of the prior partnership move into the resulting partnerships. Taxpayers generally have followed either the Assets-Over Form or the Assets-Up Form for partnership divisions.

Under the Assets-Over Form, the prior partnership transfers certain assets to a resulting partnership in exchange for interests in the resulting partnership. The prior partnership then immediately distributes the resulting partnership interests to partners who are designated to receive interests in the resulting partnership.

Under the Assets-Up Form, the prior partnership distributes certain assets to some or all of its partners who then contribute the assets to a resulting partnership in exchange for interests

in the resulting partnership.

### **Explanation of Provisions**

#### **A. Form of a Partnership Division**

As with partnership mergers, the IRS and Treasury recognize that different tax consequences can arise depending on the form of the partnership division. Because of the potential different tax results that could occur depending on the form followed by the partnership, the regulations propose to respect for Federal income tax purposes the form of a partnership division accomplished under laws of the applicable jurisdiction if the partnership undertakes the steps of either the Assets-Over Form or the Assets-Up Form. Thus, the same forms allowed for partnership mergers will be allowed for partnership divisions.

Generally, an entity cannot be classified as a partnership if it has only one member. This universally has been held to be the case in classifying transactions where interests in a partnership are transferred to a single person, so that the partnership goes out of existence. McCauslen v. Commissioner, 45 T.C. 588 (1966); Rev. Rul. 99-6, 1999-6 I.R.B. 6; Rev. Rul. 67-65, 1967-1 C.B. 168; Rev. Rul. 55-68, 1955-1 C.B. 372. However, in at least one instance involving the contribution of assets by an existing partnership to a newly-formed partnership, regulations have provided that the momentary existence of the new partnership will be respected for Federal income tax purposes. See §1.708-1(b)(1)(iv). Pursuant to the proposed regulations, under the Assets-Over Form of a partnership division, the prior

partnership's momentary ownership of all the interests in a resulting partnership will not prevent the resulting partnership from being classified as a partnership on formation.

The example in current §1.708-1(b)(2)(ii) indicates that when a partnership is not considered a continuation of the prior partnership under section 708(b)(2)(B) (partnership considered a new partnership under current §1.708-1(b)(2)(ii)), the new partnership is created under the Assets-Up Form. The regulations propose to modify this result and provide examples illustrating that partnerships can divide and create a new partnership under either the Assets-Over Form or the Assets-Up Form.

Consistent with partnership mergers, if a partnership divides using a form other than the two prescribed, it will be treated as undertaking the Assets-Over Form.

These proposed regulations use four terms to describe the form of a partnership division. Two of these terms, prior partnership and resulting partnership, describe partnerships that exist under the applicable jurisdictional law. The prior partnership is the partnership that exists under the applicable jurisdictional law before the division, and the resulting partnerships are the partnerships that exist under the applicable jurisdictional law after the division. The other two terms, divided partnership and recipient partnership, are Federal tax concepts. A divided partnership is a partnership that is treated, for Federal income tax purposes, as transferring assets in connection with a division, and a recipient partnership is a

partnership that is treated, for Federal income tax purposes, as receiving assets in connection with a division. The divided partnership must be a continuation of the prior partnership. Although the divided partnership is considered one continuing partnership for Federal income tax purposes, it may actually be two different partnerships under the applicable jurisdictional law (i.e., the prior partnership and a different resulting partnership that is considered a continuation of the prior partnership for Federal income tax purposes).

Finally, because in a formless division it generally will be unclear which partnership should be treated, for Federal income tax purposes, as transferring assets (i.e., the divided partnership) to another partnership (i.e., the recipient partnership) where more than one partnership is a continuation of the prior partnership, the proposed regulations provide that the continuing resulting partnership with the assets having the greatest fair market value (net of liabilities) will be treated as the divided partnership. This issue also is present where the partnership that, in form, transfers assets is not a continuation of the prior partnership, but more than one of the other resulting partnerships are continuations of the prior partnership. The same rule applies to these situations.

B. Consequences under Sections 704(c)(1)(B) and 737

Gain under sections 704(c)(1)(B) and 737 may be triggered when section 704(c) property or substituted section 704(c) property is distributed to certain partners. These rules often

will be implicated in the context of partnership divisions.

Where a division is accomplished in a transaction that is taxed in accordance with the Assets-Over Form, the partnership interest in the recipient partnership will be treated as a section 704(c) asset to the extent that the interest is received by the divided partnership in exchange for section 704(c) property. Section 1.704-4(d)(1). Accordingly, the distribution of the partnership interests in the recipient partnership by the divided partnership generally will trigger section 704(c)(1)(B) where the interests in the recipient partnership are received by a partner of the divided partnership other than the partner who contributed the section 704(c) property to the divided partnership. In addition, section 737 may be triggered if a partner who contributed section 704(c) property to the divided partnership receives an interest in the recipient partnership that is not attributable to the section 704(c) property.

Where a division is accomplished under the Assets-Up Form, assets are distributed directly to the partners who will hold interests in the recipient partnership. The distribution could trigger section 704(c)(1)(B) or 737 depending on the identity of the distributed asset and the distributee partner.

The regulations under section 737 provide an exception for certain partnership divisions. Section 737 does not apply when a transferor partnership transfers all the section 704(c) property contributed by a partner to a second partnership in a section 721 exchange, followed by a distribution of an interest in the

transferee partnership in complete liquidation of the interest of the partner that originally contributed the section 704(c) property to the transferor partnership. Section 1.737-2(b)(2). This rule, however, may not apply to many partnership divisions because the original contributing partner often remains a partner in the divided partnership. No similar rule is provided under section 704(c)(1)(B).

In many instances, the application of sections 704(c)(1)(B) and 737 will be appropriate when a partnership divides under either the Assets-Over Form or the Assets-Up Form. Consider the following example: A, B, C, and D form a partnership. A contributes appreciated property X (\$0 basis and \$200 value), B contributes property Y (\$200 basis and \$200 value), and C and D each contribute \$200 cash. The partnership subsequently divides into two partnerships using the Assets-Over Form, distributing interests in the recipient partnership in accordance with each partner's pro rata interest in the prior partnership. Property X remains in the prior partnership, and property Y is contributed to the recipient partnership. Under these facts, section 737 could be avoided if an exception were created for the distribution of the recipient partnership interests. If, subsequent to the division, half of property Y is distributed to A, section 737 would not be triggered because property X (the section 704(c) property) is no longer in the same partnership as property Y.

While the IRS and Treasury generally believe that it is

appropriate to apply sections 704(c)(1)(B) and 737 in the context of partnership divisions, comments are invited on whether it would be appropriate to expand the exceptions to these sections in certain circumstances relating to divisive transactions.

C. Division as Part of a Larger Transaction

The proposed regulations provide the same rule for partnership divisions that applies to partnership mergers.

D. Effective Date

The regulations are proposed to apply to divisions occurring on or after the date final regulations are published 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 Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, 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.

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and the Department of Treasury specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 4, 2000, beginning at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

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 timely written comments and must submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by April 13, 2000.

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

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read as follows:

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

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

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

<u>Old Paragraph</u>	<u>Redesignated Paragraph</u>
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- |                         |            |
|-------------------------|------------|
| (b)(1)(i)               | (b)(1)     |
| (b)(1)(i)( <u>a</u> )   | (b)(1)(i)  |
| (b)(1)(i)( <u>b</u> )   | (b)(1)(ii) |
| (b)(1)(ii)              | (b)(2)     |
| (b)(1)(iii)             | (b)(3)     |
| (b)(1)(iii)( <u>a</u> ) | (b)(3)(i)  |
| (b)(1)(iii)( <u>b</u> ) | (b)(3)(ii) |
| (b)(1)(iv)              | (b)(4)     |
| (b)(1)(v)               | (b)(5)     |

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

§1.708-1 Continuation of partnership.

\* \* \* \* \*

(c) Merger or consolidation--(1) General rule. If two or more partnerships merge or consolidate into one partnership, the resulting partnership shall be considered a continuation of the merging or consolidating partnership the members of which own an interest of more than 50 percent in the capital and profits of the resulting partnership. If the resulting partnership can, under the preceding sentence, be considered a continuation of more than one of the merging or consolidating partnerships, it shall, unless the Commissioner permits otherwise, be considered the continuation 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. The taxable years of such merging or consolidating partnerships which are considered terminated shall be closed in accordance with the provisions of section 706(c), 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 and shall include the names and addresses of the merged or consolidated partnerships. The respective distributive shares of the partners for the periods prior to and subsequent to the date of merger or consolidation shall be shown as a part of the return.

(2) 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)(2)(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 and liabilities, 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 its assets and liabilities to its partners in liquidation of the partners' interests in the terminated partnership; and, immediately thereafter, the partners in the terminated partnership contribute the distributed assets and liabilities to the resulting partnership in exchange for interests in the resulting partnership.

(3) Sale of an interest in the merging or consolidating partnership. In a transaction characterized under the assets-over form, a sale of an 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)(2)(i) of this section, will be respected as a sale of a partnership interest if the merger agreement (or similar

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. 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.

(4) Examples. The following examples illustrate the rules in paragraphs (c)(1) through (3) 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 are also 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 dollar-value of the partnership X assets (net of liabilities) is \$100X, and the dollar-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

dollar-value of partnership Y's assets (net of liabilities) was greater than that of partnership X's, under paragraph (c)(1) of this section, 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)(2)(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) 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)(2)(i) of this section because the partnerships undertook a form that is not the assets-up form described in paragraph (c)(2)(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 4. (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 within the meaning of section 708(b)(2)(A), 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)(2)(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 that specifies that partnership Y will purchase C's interest in partnership X for \$150 immediately before the merger. 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. Partnership X has made an election under section 754.

(ii) Because the merger agreement satisfies the requirements of paragraph (c)(3) of this section, C will be treated as selling its interest in partnership X to partnership Y for \$150

immediately 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)(3) 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)(1) 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) Because partnership X has an election under section 754 in effect, partnership Y, as a momentary partner in partnership X, will have a special basis adjustment regarding the basis of partnership X's property under section 743 and §1.743-1. See section 743 and §1.743-1 for determining the amount of the adjustment. After the merger, the adjustment is allocated solely to D, E, and F--the partners in partnership Y immediately before the merger.

(v) Under paragraph (c)(2)(i) of this section, partnership X contributes 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.

(5) Prescribed form not followed in certain circumstances.

(i) If any transactions described in paragraph (c)(2) or (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.

(ii) Example. The following example illustrates the rules in paragraph (c)(5) 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 interest 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)(2)(ii) of this section, with D and E receiving title to the DE assets and then contributing the assets to ABC in exchange for interests in ABC. As part of a prearranged transaction, the assets acquired from DE are contributed to a new partnership, and the interests in the new partnership are distributed to B and C in complete liquidation of their interests in ABC. The merger and division in this example represent a series of transactions that in substance are an exchange of interests in ABC for interests in DE. Even though paragraph (c)(2)(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 asset-up form are followed, and paragraph (d)(2)(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.

(6) Effective date. This paragraph (c) is applicable to partnership mergers occurring on or after the date final regulations are published in the **Federal Register**.

(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)(3)(iv) of this section) or resulting partnerships shall be considered a continuation of the prior partnership (as defined in paragraph (d)(3)(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 partner's interests shall be considered liquidated as of the date of the division. The resulting partnership that is regarded as continuing shall file a return for the taxable year of the partnership that has been divided. The return shall 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 subsequent to the date of division.

(2) 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)(2)(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)(3)(i) of this section) contributes certain assets and liabilities to a recipient partnership (as defined in paragraph (d)(3)(iv) of this section) or recipient partnerships in exchange for interests in such recipient partnership or partnerships; and, immediately thereafter, 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 and liabilities, the form of a partnership division will be respected for Federal income tax

purposes if the divided partnership, which by definition is a continuing partnership, distributes certain assets and liabilities 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 and liabilities to a recipient partnership or partnerships in exchange for interests in such recipient partnership or partnerships.

(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 and liabilities, the form of a partnership division will be respected for Federal income tax purposes if the prior partnership distributes certain assets and liabilities 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 and liabilities to a resulting partnership or partnerships in exchange for interests in such resulting partnership or partnerships. If the prior partnership does not liquidate under the applicable jurisdictional law, then with respect to the assets and liabilities that, in form, are not transferred to a new resulting partnership, the prior partnership will be treated as transferring these assets and liabilities to a new resulting partnership under the assets over form described in

paragraph (d)(2)(i)(B) of this section.

(3) Definitions--(i) Divided partnership--For purposes of paragraph (d) of this section, the divided partnership is the 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)(2) 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. For example, where a prior partnership divides into two partnerships, both partnerships existing after the division are resulting partnerships.

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

Example 1. Partnership ABCD is in the real estate and insurance business. 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. They agree to separate the real estate and insurance business as of November 1, 1999, and to form two partnerships; partnership AB to take over the real estate business, and partnership CD to take 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 on November 1, 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)(2)(ii) of this section, partnership ABCD will be treated as following the assets-up form for Federal income tax purposes.

Example 3. (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.

(ii) Partnerships AB1 and AB2 both are considered a continuation of partnership ABCD, while partnership CD is considered a new partnership formed on November 1, 1999. Under paragraph (d)(2)(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 4. (i) The facts are the same as in example 3, 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)(3)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(2)(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 5. (i) The facts are the same as in example 3, 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)(3)(i) of this section, partnership AB1 will be treated as the resulting partnership that is the divided partnership. Under paragraph (d)(2)(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) 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)(2)(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)(2)(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)(2)(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.

(5) Prescribed form not followed in certain circumstances.

If any transactions described in paragraph (d)(2) 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.

(6) Effective date. This paragraph (d) is applicable to partnership divisions occurring on or after the date final regulations are published in the **Federal Register**.

Par. 3. Section 1.743-1 is amended by adding two sentences to the end of paragraph (h)(1).

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

\* \* \* \* \*

(h) \* \* \*

(1) \* \* \* When a resulting partnership that is considered a continuation of a merged or consolidated partnership under section 708(b)(2)(A) has a basis adjustment in property held by the merged or consolidated partnership that is considered terminated under §1.708-1(c)(1) (as a result of the resulting partnership acquiring an interest in such merged or consolidated partnership, see §1.708-1(c)(3)), the resulting partnership will continue to have the same basis adjustments with respect to property distributed (see §1.708-1(c)(4), Example 4(v)) by the terminated partnership to the resulting partnership, regardless

of whether the resulting partnership makes a section 754 election. The portion of the resulting partnership's adjusted basis in its assets attributable to the basis adjustment with respect to the property distributed by the terminating partnership must be segregated and allocated solely to the partners who were partners in the resulting partnership immediately before the merger or consolidation.

\* \* \* \* \*

Par. 4. Section 1.752-1 is amended as follows:

1. A sentence is added to the end of paragraph (f).

2. The current Example in paragraph (g) is redesignated as Example 1.

3. Example 2 is added in paragraph (g).  
§1.752-1 Treatment of partnership liabilities.

\* \* \* \* \*

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

(g) \* \* \*

Example 1. \* \* \*

Example 2. Merger or consolidation of partnerships holding property encumbered by liabilities. (i) B owns a 70 percent interest in partnership T. Partnership T's sole asset is property X, which is encumbered by a \$900 liability. Partnership T's adjusted basis in property X is \$600, and the value of

property X is \$1,000. B's adjusted basis in its partnership T interest is \$420. B also owns a 20 percent interest in partnership S. Partnership S's sole asset is property Y, which is encumbered by a \$100 liability. Partnership S's adjusted basis in property Y is \$200, the value of property Y is \$1,000, and B's adjusted basis in its partnership S interest is \$40.

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

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

section 752(b) is \$460 (\$420 + \$40), B will not recognize gain under section 731. After the merger, B's adjusted basis in its partnership S interest is \$60.

\* \* \* \* \*

Deputy Commissioner of Internal Revenue  
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