

Internal Revenue Service, Treasury**§ 1.706-4**

Answer 1: In the year the deduction is allowed, the deduction will constitute an allocable cash basis item under section 706(d)(2)(B)(iv).

(Secs. 267(f)(2)(B), 706(d)(2)(B)(iv), 1502, and 7805, Internal Revenue Code of 1954 (98 Stat. 704, 26 U.S.C. 267; 98 Stat. 589, 26 U.S.C. 706; 68A Stat. 367, 26 U.S.C. 1502; 68A Stat. 917, 26 U.S.C. 7805))

[T.D. 7991, 49 FR 47001, Nov. 30, 1984]

§ 1.706-3 Items attributable to interest in lower tier partnership. [Reserved]**§ 1.706-4 Determination of distributive share when a partner's interest varies.**

(a) *General rule—(1) Variations subject to this section.* Except as provided in paragraph (a)(2) of this section, this section provides rules for determining the partners' distributive shares of partnership items when a partner's interest in a partnership varies during the taxable year as a result of the disposition of a partial or entire interest in a partnership as described in § 1.706-1(c)(2) and (3), or with respect to a partner whose interest in a partnership is reduced as described in § 1.706-1(c)(3), including by the entry of a new partner (collectively, a "variation").

(2) Coordination with sections 706(d)(2) and 706(d)(3) and other Code sections. Items subject to allocation under other rules, including sections 108(e)(8) and 108(i) (which provide special allocation rules for certain items from the discharge or retirement of indebtedness section), section 704(c) (relating to allocations with respect to certain contributed property), § 1.704-3(a)(6) (relating to allocations with respect to revalued property), section 706(d)(2) (relating to the determination of partners' distributive shares of allocable cash basis items), and section 706(d)(3) (relating the determination of partners' distributive share of any item of an upper tier partnership attributable to a lower tier partnership), are not subject to the rules of this section. In addition, the rules of this section do not apply in making allocation of book items pursuant to § 1.704-1(b)(2)(iv)(e), (f), or (s). In all cases, all partnership items for each taxable year must be allocated among the partners, and no

partnership items may be duplicated, regardless of the particular provision of section 706 (or other Code section) which applies, and regardless of the method or convention adopted by the partnership.

(3) *Allocation of items subject to this section.* In determining the distributive share under section 702(a) of partnership items subject to this section, the partnership shall follow the steps described in this paragraph (a)(3)(i) through (x).

(i) First, determine whether either of the exceptions in paragraph (b) of this section (regarding certain changes among contemporaneous partners and partnerships for which capital is not a material income-producing factor) applies.

(ii) Second, determine which of its items are subject to allocation under the special rules for extraordinary items in paragraph (e) of this section, and allocate those items accordingly.

(iii) Third, determine with respect to each variation whether it will apply the interim closing method or the proration method. Absent an agreement of the partners (within the meaning of paragraph (f) of this section) to use the proration method, the partnership shall use the interim closing method. The partnership may use different methods (interim closing or proration) for different variations within each partnership taxable year; however, the Commissioner may place restrictions on the ability of partnerships to use different methods during the same taxable year in guidance published in the Internal Revenue Bulletin.

(iv) Fourth, determine when each variation is deemed to have occurred under the partnership's selected convention (as described in paragraph (c) of this section).

(v) Fifth, determine whether there is an agreement of the partners (within the meaning of paragraph (f) of this section) to perform regular monthly or semi-monthly interim closings (as described in paragraph (d) of this section). If so, then the partnership will perform an interim closing of its books at the end of each month (in the case of an agreement to perform monthly closings) or at the end and middle of each month (in the case of an agreement to