unescorted access to the utilization facility as any individual who has the ability to access licensee-designated ''areas of significance'' without continuous direct supervision or monitoring by an authorized individual.

The NRC Seeks Stakeholders' Views on the Following Questions

4. Is the proposed definition of individuals with unescorted access reasonable and sufficient? If not, why? For example, should persons granted unescorted access to ''areas of significance'' be permitted access to the facility at times when no supervision or oversight is present (*e.g.*, evenings or weekends)? Should the NRC require access controls such as maintaining records of the time and duration of persons accessing an ''area of significance'' without escorts?

Implementation of the Orders

To develop the proposed requirements for fingerprint-based criminal history record checks, the NRC would like feedback from stakeholders on their experiences in implementing the orders that were issued in April 2007, such as:

5. What has worked well, what has not, and why?

6. What requirements were found to be the most burdensome? Are there less burdensome alternatives that would accomplish the same level of protection?

7. Are there requirements in the orders that appear to contribute little to the security of the facility? Could the same resources be used more effectively in other ways?

8. Are there other enhancements that could be made?

9. Has the implementation of the orders identified any new issues that should be addressed through rulemaking?

Others Items of Interest to the NRC

Because RTRs all have unique site-specific configurations, the NRC is seeking stakeholders' views on the most effective way to formulate regulations that continue to provide adequate safety to the public without imposing an unnecessary burden on any individual licensee. During the development and implementation of the orders, the NRC identified several issues for which it planned to provide clarification in the rulemaking process. One issue was obtaining the fingerprints of a person for whom an FBI fingerprint-based criminal history record check is unlikely to yield reliable results. The FBI criminal history record check does not provide information on individuals who are under eighteen years of age, and will only obtain information on an individual's criminal history record within the United States. Thus, for foreign nationals who have never lived in the United States, students who are 18 years old or younger, or even U.S. citizens who have lived abroad for much or all of their adult lives, the criminal history record check is unlikely to provide any useful information regarding a person's trustworthiness and reliability. However, as noted earlier, Section 149 of the AEA requires the obtaining of fingerprints for all persons granted unescorted access, except if these persons are relieved by rule.

In Light of This, the NRC Seeks Stakeholders' Views on the Following Questions

10. Regarding alternatives to fingerprinting foreign nationals and/or minors regarding a trustworthiness and reliability determination: (a) Do foreign nationals and/or minors require unescorted access to ''areas of significance''? (b) are there alternative methods to obtain information upon which a licensee could base a trustworthiness and reliability determination for these individuals?

11. Is there any additional information that the NRC should consider in preparing the proposed rule?

Proposed rule language was not included in this ANPR. During the public comment period for this ANPR, the NRC plans to conduct a public workshop to discuss this rulemaking with stakeholders. Thus, RTR licensees and other interested stakeholders will have several opportunities to provide their comments for the NRC's consideration.

Dated at Rockville, Maryland, this 8th day of April 2009.

For the Nuclear Regulatory Commission.

J. Samuel Walker,

Acting Secretary of the Commission.

[FR Doc. E9–8461 Filed 4–13–09; 8:45 am]

BILLING CODE 7590–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–144689–04]

RIN 1545–BD71

Determination of Distributive Share When a Partner's Interest Changes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the determination of partners' distributive shares of partnership items of income, gain, loss, deduction and credit when a partner's interests varies during a partnership taxable year. Also, the proposed regulations modify the existing regulations regarding the required taxable year of a partnership. These proposed regulations affect partnerships and their partners.

DATES: Written or electronic comments and requests for a public hearing must be received by July 13, 2009.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–144689–04), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–144689–04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC; or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–144689–04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Laura Fields or Jonathan Cornwell at (202) 622–3050, concerning submissions of comments and the hearing, Richard Hurst at (202) 622–7180 (not toll-free numbers) or *Richard.A.Hurst@irscounsel.treas.gov*.

SUPPLEMENTARY INFORMATION:

Background

These proposed regulations contain amendments to the Income Tax Regulations (26 CFR part 1) under section 706 of the Internal Revenue Code (Code). These amendments are proposed to conform the Income Tax Regulations for certain of the provisions of section 1246 of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788 (1997)) (the 1997 Act) and section 72 of the Deficit Reduction Act

of 1984, Public Law 98–369 (98 Stat. 494 (1984)) (the 1984 Act).

Also, under section 706(d)(1), the Treasury Secretary may provide in regulations various methods for determining a partner's distributive share of partnership items of income, gain, loss, deduction and credit that takes into account the varying interests of the partners for any taxable year of the partnership in which there is a change in the interest of a partner. Pursuant to that grant of regulatory authority, the proposed regulations provide methods for determining a partner's distributive share of partnership items to take into account the varying interests of the partners in any year in which there is a change in a partner's interest in the partnership. Also, the proposed regulations provide that a deemed disposition of a partner's entire interest under other sections of the regulations is a deemed disposition of a partner's entire interest for the purpose of section 706(d).

Finally, the proposed regulations amend the rules applicable to the determination of the taxable year of a partnership in those instances in which partnership interests are held by ''disregarded foreign partners'' (as that term is defined in § 1.706–1(b)(6)(i)).

1. Varying Interest Rule

a. In General

Section 702(a) of the Code provides that the partner in determining the partner's income tax shall take into account separately the partner's distributive share of partnership items of income, gain, loss, deduction, or credit.

Section 706(a) provides that, in computing the taxable income of a partner for a taxable year, the inclusions required by sections 702 and 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

Section 706(c)(1) provides that, except in the case of a termination of a partnership and except as provided in section 706(c)(2), the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership. Under section 706(c)(2)(A), the taxable year of a partnership shall close with respect to a partner whose entire interest terminates (whether by reason of death, liquidation, or otherwise). Under section 706(c)(2)(B), the taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under section 706(b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced (whether by entry of a new partner, partial liquidation of a partner's interest, gift, or otherwise).

Section 706(d)(1) provides that, except as required by sections 706(d)(2) and (d)(3), if there is a change in a partner's interest in the partnership during the partnership's taxable year, each partner's distributive share of any partnership item of income, gain, loss, deduction or credit for such taxable year is determined by the use of any method prescribed by the Secretary by regulations which takes into account the varying interests of the partners in the partnership during such taxable year (the varying interests rule). Section 706(d)(1) was added by the 1984 Act, in part, to clarify that the varying interests rule applies to the disposition of a partner's entire interest in the partnership as well as the disposition of less than a partner's entire interest, and to authorize the Secretary to prescribe methods for determining a partner's distributive share of partnership items when there is a change in the partners' interests during the taxable year of the partnership.

The existing regulations under section 706 have not been revised to reflect the changes made to that section by the 1984 Act. Section 1.706–1(c)(2)(ii) provides that in the case of a disposition of a partner's entire interest in a partnership the partner's distributive share of partnership items for the taxable year of the partnership in which the disposition occurs may be determined by a closing of the partnership's books as of the date of disposition (interim closing method). Alternatively, the partners by agreement may determine the departing partner's distributive share by taking his pro rata part of the amount of partnership items that such partner would have included in his taxable income had he remained a partner until the end of the partnership taxable year (proration method). Section 1.706–1(c)(2)(ii). The proration may be based on the portion of the taxable year that has elapsed prior to the disposition or may be determined under any other method that is reasonable. Moreover, the transferee of such departing partner's interest shall include in his taxable income as his distributive share of partnership items with respect to the acquired interest the pro rata part (determined by the method used by the transferor partner) of the amount of such items that would have been included had he been a partner from the beginning of the partnership's taxable year. The existing regulations, however, do not specifically provide for the use of these methods when there has been a disposition of less a partner's entire interest in the partnership.

In Rev. Rul. 77–310 (1977–2 CB 217) (see § 601.601(d)(2)(ii)(*b*)), the IRS provided an example of an acceptable method for allocating a partnership loss for the partnership's taxable year among the partners where their profit and loss sharing percentages were changed substantially one month before the end of the taxable year as a result of capital contributions of several existing partners. The ruling provided that an acceptable method, under the facts of the ruling, was to allocate the partnership's loss among the partners based on their differing profit and loss sharing percentages and the periods during the year each partner's differing percentage interests existed. See also Rev. Rul. 77–311 (1977–2 CB 218), (applying the same method to a partnership's distributive share of a loss from a lower-tier partnership). See § 601.601(d)(2)(ii)(*b*).

Finally, the existing regulations under section 706 have not been revised to reflect the change to that section by the 1997 Act requiring that the taxable year of the partnership shall close with respect to a partner whose entire interest in the partnership terminates by reason of death. In that regard, § 1.706–1(c)(3) provides that, when a partner dies, the partnership taxable year shall not close with respect to such partner prior to the end of the partnership's taxable year.

b. Change in Partnership Allocations Among Contemporaneous Partners

Section 761(c) provides that a partnership agreement includes any modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions). In *Lipke* v. *Commissioner,* 81 T.C. 689 (1983), the Tax Court held that section 706(c)(2)(B) (as in effect prior to the 1984 Act) prohibited retroactive allocations of partnership losses where the allocations resulted from additional capital contributions made by both new and existing partners. However, the Tax Court held that the prohibition on retroactive allocations under section 706(c)(2)(B) did not apply to changes in the allocations among partners who were members of the partnership for the entire year (contemporaneous partners)

if the changes in the allocations did not result from capital contributions. *Lipke v. Commissioner,* supra, at 696 (1983).

As previously discussed, the 1984 Act amended section 706, in part, to clarify that the varying interests rule applies to any change in a partner's interest, whether in connection with a complete disposition of the partner's interest or otherwise. To that end, Congress in the 1984 Act replaced the varying interests rule in section 706(c)(2)(B) with the rule that now appears in Section 706(d)(1). The legislative history pertaining to this amendment reflects Congress's intention that the new rule of section 706(d)(1) be comparable to the pre-1984 law without overruling the longstanding rule of section 761(c).

> The committee wishes to make clear that the varying interests rule is not intended to override the longstanding rule of section 761(c) with respect to interest shifts among partners who are members of the partnership for the entire taxable year, provided such shifts are not, in substance, attributable to the influx of new capital from such partners. *See Lipke v. Commissioner*, 81 T.C. 689 (1983).

S. Prt. 98–169, Vol. I, 98th Cong., 2d Sess. 218–19 (1984); see also H. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess. 1212–13 (1984) (containing similar language).

c. Conventions

Section 1.706–1(c)(2)(ii) provides that, in determining the distributive share of partnership items under section 702(a) with respect to a partner whose entire interest in the partnership terminates, a partnership may use the interim closing method or alternatively, the partners may by agreement choose to use the proration method. Under the proration method, the partnership's income and losses may be prorated based on the portion of the taxable year that has elapsed prior to the date upon which the partners' interests varied, or ''under any other method that is reasonable.'' These other reasonable methods have become known as conventions.

Staff of J. Comm. On Taxation, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 222 (Comm. Print 1984), provides,

> [I]n any case in which there is a disposition of less than an entire interest in the partnership by a partner (including the entry of a new partner), the partners may elect to determine the varying interests of the partners by using one or more conventions that treat any change in any partner's interest in the partnership during a particular month as occurring on one or more specified days in the month. The actual method for applying a convention is to be provided by Treasury regulations. The regulations may deny the use of any convention when the occurrence of significant, discrete events (e.g., a large, unusual gain or loss) would mean that use of the convention could result in significant tax avoidance.
>
> * * * Congress intended that the regulations providing for these conventions will be effective on a prospective basis only. Until these regulations are proposed, and for a reasonable transition period thereafter, it is expected that Treasury will permit any reasonable convention to be used. This may include a method under which any partner entering during a month is treated as entering on the first day of the month, a method under which partners entering during the first 15 days of a month are treated as entering on the first day of the month and partners entering after the 15th of the month are treated as entering on the 16th day of the month, or any other method that is not abusive under the relevant facts and circumstances. As a general rule, use of a convention is not permitted when the occurrence of significant, discrete events (e.g., a large, unusual gain or loss) would result in significant tax avoidance if the convention is used.

On December 13, 1984, the IRS issued a news release (IR–84–129) (*http://www.irs.gov/puv/irs-drop/ir-84–129.pdf*) announcing that partnerships using the interim closing method were permitted to use a semi-monthly convention. Under a semi-monthly convention, partners entering during the first 15 days of the month are treated as entering on the first day of the month, and partners entering after the 15th day of the month (but before the end of the month) are treated as entering on the 16th day of the month (except to the extent that section 706(c)(2)(A) applied). The news release provided that, until regulations were issued, partnerships that use the proration method were required to use a daily convention.

d. Deemed Dispositions

Section 1.1502–76(b)(2)(i) provides that the federal income tax returns for the years that end and begin with a corporation becoming (or ceasing to be) a member (as defined in § 1.1502–1(b)) of a consolidated group (as defined in § 1.1502–1(h)) are separate tax years for all Federal income tax purposes. The periods ending and beginning with the corporation's change in status are different tax years, and the corporation's items of income, gain, loss, deduction and credit must be allocated between such separate tax years. Under § 1.1502–76(b)(2)(vi), if the corporation is a partner in a partnership, the corporation is treated for purposes of determining the year to which the partnership's items are allocated as selling the corporation's entire interest in the partnership immediately before the corporation's change in status.

Section 1.1362–3(a) provides that, if an S election (as defined in section 1362(a)) terminates under section 1362(d) on a date other than the first day of the taxable year of the S corporation (as defined in section 1361(a)), the portion of the year ending as of the close of the day prior to the termination is treated as a short taxable year for which the corporation is an S corporation (S short year) and the portion of the S termination year beginning on the day of the termination is effective is treated as a short taxable year for which the corporation is a C corporation (as defined in section 1362(a)(2)) (C short year). Under § 1.1362–3(a), the corporation's items of income, gain, loss, deduction and credit must be allocated between the S short year and C short year using the pro rata allocation approach stated in section 1362(e)(2) unless an election is made to allocate the items using its normal accounting method or in certain other instances described in sections 1362(e)(3), 1362(e)(6)(C) or 1362(e)(6)(D). Under § 1.1362–3(c)(1), for purposes of section 706(c) only, the termination of the S election of a corporation that is a partner in a partnership is treated as a sale or exchange of the corporation's entire interest in the partnership on the last day of the S short year if (i) the pro rata allocation rules do not apply and (ii) the taxable year of the partnership ends with or within the C short year.

Under section 1377(a)(2), if a shareholder terminates the shareholder's entire interest in an S corporation and all affected shareholders (as defined in section 1377(a)(2)(B)) and the corporation agree, the S corporation may elect under section 1377(a)(2) (terminating election) to apply the pro rata allocation method (as defined in section 1377(a)(1)) as if the S corporation's taxable year consisted of two separate taxable years, the first of which ends at the close of the day on which the shareholder's entire interest in the S corporation is terminated. (See § 1.1377–1(b)(1) for certain exceptions to the preceding rule.) Under § 1.1377(b)(3)(iv), a terminating election by an S corporation that is a partner in a partnership is treated as a sale or exchange of the corporation's entire interest in the partnership for purposes of section 706(c) if the taxable year of the partnership ends after the shareholder's interest is terminated and within the taxable year of the S corporation.

2. Taxable Years of Partnerships

A partnership must determine its taxable year under section 706(b)(1)(B)

unless the partnership establishes to the satisfaction of the Secretary a business purpose for a different year. In general, the required taxable year of a partnership is determined by reference to the taxable year of its partners. If partners owning a majority interest in a partnership have the same taxable year, the partnership is required to have the same taxable year as the majority interest owners (majority interest taxable year). If a taxable year for the partnership cannot be determined under the majority interest taxable year rule, the taxable year of the partnership shall be the taxable year of all of its principal partners (principal partner taxable year). Finally, if there is not taxable year described under the majority interest taxable year rule or principal partner taxable year rule, then the partnership is required under the regulations to have the taxable year that results in the least aggregate deferral of income. Section 1.706–1(b)(2)(C).

Under § 1.706–1(b)(6)(i), the interest held by a disregarded foreign partner is not taken into account in determining the taxable year of the partnership under the foregoing rules. A foreign partner is a disregarded foreign partner unless such partner is allocated gross income that was effectively connected with the conduct of a trade or business of the partnership within the U.S. and taxation of such income is not otherwise precluded under any U.S. income tax treaty. The interest of a disregarded foreign partner is taken into account in determining the taxable year of the partnership, however, if the partners that are not disregarded foreign partners (regarded partners) hold a minority interest in the partnership (minority interest rule). Section 1.706–1(b)(6)(iii). Regarded partners hold a minority interest for this purpose if each regarded partner holds less than a 10-percent interest in capital or profits of the partnership, and the regarded partners in the aggregate hold less than a 20-percent interest in the capital or profits of the partnership.

Explanation of Provisions

1. Varying Interests Rule

a. In General

The proposed regulations amend § 1.706–1(c) to reflect the change made to section 706(c)(2)(A) in the 1997 Act which requires that the taxable year of the partnership close with respect to a partner who dies. The proposed regulations do not change the provisions in § 1.706–1(c)(3)(iv) that the sale or exchange of a partnership interest does not include any transfer of a partnership interest which occurs at death as a result of inheritance or any testamentary disposition or in § 1.706–1(c)(5) that the transfer of a partnership interest by gift does not close the partnership taxable year with respect to the donor.

Also, the proposed regulations add § 1.706–4 to provide for the application of the varying interests rule in all cases in which a partner's interest changes during the taxable year, whether by reason of a disposition of the partner's entire interest in the partnership or a disposition of less than the partner's entire interest in the partnership.

b. Methods and Conventions

Proposed § 1.706–4(a) provides that, if a partner's interest changes during the partnership's taxable year, the partnership shall determine the partner's distributive share using the interim closing method. However, the partnership by agreement of the partners may use the proration method. For each partnership taxable year in which a partner's interest varies, the proposed regulations provide that the partnership must use the same method to take into account all changes occurring within that year.

Proposed § 1.706–4(c) generally provides that a partnership shall take into account any variation in the partners' interests in the partnership during the taxable year by determining the distributive share of partnership items under section 702(a) for each segment of that taxable year using an interim closing of the books method and by allocating those items among the partners in accordance with their respective partnership interests during that segment. Proposed § 1.706–4(c)(1) and (2) incorporate the principles of the former § 1.706–1(c)(2)(ii) (as finalized in TD 6175).

Proposed § 1.706–4(d) provides that by agreement among the partners a partnership may use a proration method, rather than the interim closing method, to take into account any variation in a partner's interest in the partnership during the taxable year. Under this method, except for extraordinary items (as defined in § 1.706–4(d)(3)), the partnership allocates the distributive share of partnership items under section 702(a) among the partners in accordance with their pro rata shares of these same items for the entire taxable year. In determining a partner's pro rata share of partnership items, the partnership shall take into account that partner's interest in such items during each segment of the taxable year. Proposed § 1.706–4(d)(1) and (2) incorporate the principles of the former § 1.706–2(c)(2)(ii) (as finalized in TD 6175).

For purposes of accounting for the partners' varying interests in the partnership, proposed § 1.706–4 requires that for each partner whose interest changes in the taxable year the partnership shall maintain segments to account for such changes. A segment is specific portion of a partnership's taxable year. The first segment of a taxable year for a partner that incurs a change will begin on the partnership's first day of its taxable year and end as of the close of business immediately preceding the date of the change as determined under the applicable convention (discussed in this preamble) used by the partnership and its partners. The next segment will begin on the day prescribed by the applicable convention and end on the earlier of the close of the day immediately preceding the date of the subsequent change as determined by the applicable convention, or the end of the partnership's taxable year. Proposed § 1.706–4(a)(2) provides that the partnership shall determine the items for each segment of the taxable year created by the variation event for a partner in accordance with the partnership's method of accounting used for its entire taxable year. Each segment is treated as a separate period.

For purposes of the interim closing method in § 1.706–4(c) and the proration method in § 1.706–4(d), the proposed regulations provide a special accounting rule that must be used to account for certain items. For example, for an interim closing method, the partnership may compute a net capital loss for a segment even though the partnership has net capital gain for the complete taxable year. Also, any limitation applicable to the partnership year as a whole (for example, the limitation under section 179) must be apportioned among the segments using any reasonable method provided that the method may not exceed any limitation applicable to the partnership as a whole. See proposed §§ 1.706–4(a)(2)(i) and (ii).

In addition, proposed § 1.706–4(d)(3) requires a partnership using the proration method to allocate extraordinary items among the partners in proportion to their interests at the beginning of the day on which they are taken into account. For this purpose, an extraordinary item is (i) any item from the disposition or abandonment (other than in the ordinary course of business) of a capital asset as defined in section 1221 (determined without the application of any other rules of law); (ii) any item from the disposition or abandonment of property used in a trade or business (other than in the ordinary course of business) as defined

in section 1231(b) (determined without the application of any holding period requirement); (iii) any item from the disposition or abandonment of an asset described in sections 1221(1), (3), (4), or (5), if substantially all the assets in the same category from the same trade or business are disposed of or abandoned in one transaction (or series of related transactions); (iv) any item from assets disposed of in an applicable asset acquisition under section 1060(c); (v) any section 481(a) adjustment; (vi) any item from the discharge or retirement of indebtedness (for example, if a debtor partnership transfers a capital or profits interest in such partnership to a creditor in satisfaction of its recourse or nonrecourse indebtedness, any discharge of indebtedness income recognized under section 108(e)(8) must be allocated among the persons who were partners in the partnership immediately before the discharge); (vii) any item from the settlement of a tort or similar third-party liability; (viii) any credit, to the extent it arises from activities or items that are not ratably allocated (for example, the rehabilitation credit under section 47, which is based on placement in service); and (ix) any item which, in the opinion of the Commissioner, would, if ratably allocated, result in a substantial distortion of income in any consolidated return or separate return in which the item is included. The IRS and the Treasury Department request comments concerning whether any items should be added to or removed from the definition of extraordinary items.

Under proposed § 1.706–4(e), a partnership using the interim closing method may use either a calendar day convention or a semi-monthly convention. A partnership using the proration method may use only the calendar day convention. The calendar day convention requires that, with respect to a partner whose interest terminates, the partnership's taxable year closes as of the close of the day on which the change occurs. Section 1.706–4(e)(1). The semi-monthly convention requires that any variation in a partner's interest occurring during the first through 15th day of the calendar month is deemed to occur at the beginning of the first day of the month, and any variation in a partner's interest occurring during the 16th through the last day of the month is deemed to occur at the beginning of the 16th day of that month. Section 1.706–4(e)(2).

A partnership must use the same method and convention for all variations in the partners' interests during the taxable year of the partnership. For example, a partnership could not use the proration method and interim closing method in the same taxable year. Additionally, a partnership using the interim closing method could not use the calendar day convention to account for a variation in one partner's interest during the partnership's taxable year while using a monthly convention to account for that partner's, or a different partner's, variation in an interest during the partnership's taxable year. Comments are requested with regard to the possible expansion of this rule to include other conventions or other methods.

The IRS and the Treasury Department are aware that some publicly traded partnerships (as defined in section 7704) are using conventions other than a monthly or semi-monthly convention and are using these conventions with the proration method. Thus, the IRS and the Treasury Department are requesting comments concerning the use of conventions other than monthly or semi-monthly convention. The proposed regulations regarding the use of conventions will not apply to existing publicly traded partnerships.

c. Change in Partnership Allocations Among Contemporaneous Partners

Proposed § 1.706–4(b)(1) provides that the varying interests rule will not preclude changes in the allocations among contemporaneous partners resulting from amendments to the partnership agreement made no later than the due date of the partnership return for the taxable year (excluding extensions). This exception applies only to allocations that are valid under section 704(b) and the regulations promulgated in association with that section. Moreover, consistent with the Tax Court's decision in *Lipke*, this exception to the varying interests rule will not apply to any changes in interests of the partners attributable to contributions of money or other property to the partnership. The proposed regulations further provide that this exception will not apply to changes in the interests of the partners as a result of distributions of capital from the partnership to a partner.

d. Safe Harbors for Service Partnerships and Publicly Traded Partnerships

Proposed § 1.706–4(b)(2) provides that service partnerships (as defined in that section) may allocate items relating to the provision of services among the partners whose interests vary during the year using any reasonable method to account for such changes even though such method is not described in paragraph (a) of the proposed regulations and the partnership does not use the methods or conventions described in paragraphs (c) and (d), and paragraph (e) of the proposed regulations, respectively. However, the allocations must be valid under section 704(b).

Proposed § 1.706–4(b)(3) provides that publicly traded partnerships (as defined in section 7704(b)) may treat all transfers of its publicly traded units (as described in § 1.7704–1(b)(1)) during a calendar month as occurring on the first day of the following month under a consistent method adopted by the partnership or may use the semi-monthly convention described in § 1.706–4(e)(2). Block transfers of publicly traded partnership (PTP) units (as described in § 1.7704–1(e)(2)) will not qualify for this safe harbor.

e. Deemed Dispositions

The proposed regulations amend § 1.706–1(c) to provide that a deemed disposition of a partner's entire interest in the partnership pursuant to §§ 1.1502–76(b)(2)(vi), 1.1362–3(c)(1), and 1.1377–1(b)(3)(iv) shall be treated as a disposition of the partner's entire interest for purposes of section 706. The IRS and Treasury Department request comments concerning the relationship of § 1.1502–76(b)(2)(vi)(B) and the proposed regulations regarding the deemed disposition of partnership interests.

2. Taxable Years of Partnerships

The proposed regulations amend the minority interest rule in § 1.706–1(b)(6)(iii) to provide that regarded partners have a minority interest only if each regarded partner has less than a 10-percent interest in capital and profits, and the regarded partners collectively have less than a 20-percent interest in partnership capital and profits. This modification means that the interests of foreign partners will be taken into account in determining the taxable year of the partnership only if the regarded partners have interests below the stated thresholds in partnership capital and profits, rather than the current rule which requires only an interest below the threshold in either capital or profits. For example, under the current regulations, the taxable year of disregarded foreign partners would not be ignored in determining the taxable year of the partnership if the regarded partners had aggregate capital interests of less than 20-percent but profits interests of more than 20-percent. By contrast, under the proposed regulations, in that example, the taxable year of the disregarded foreign partners

would not be applicable in determining the taxable year of the partnership.

Additional Requests for Comments

The IRS and the Treasury Department are also requesting comments relating to any other outstanding issues arising under section 706(d). Specifically, the IRS and the Treasury Department are seeking comments with regard to issues that arise concerning allocable cash basis items and/or tiered partnerships.

Section 706(d)(2)(A) provides a special rule for determining a partner's distributive share of an allocable cash basis item. Section 706(d)(2) effectively requires a cash method partnership to use an economic accrual method solely for the purpose of allocating certain items. Under the statute, a partner's distributive share of any allocable cash basis item is determined by assigning a pro rata share of any allocable cash basis item to each day within a specified period to which it is attributable and then allocating each day's portion in an amount equivalent to each partner's interest in the partnership on that day. A list of allocable cash basis items is found in section 706(d)(2)(B). The IRS and the Treasury Department are seeking comments as to whether that list should be expanded (to include, for example, items such as property insurance), as well as on any other issue with regard to allocating cash basis items.

Section 706(d)(3) provides that if during any taxable year of the partnership there is a change in any partner's interest in the partnership (upper-tier partnership), and such partnership is a partner in another partnership (lower-tier partnership), then (except to the extent provided by regulations) each partner's distributive share of any item of the upper-tier partnership attributable to the lower-tier partnership shall be determined by first assigning the appropriate portion of each such item to the appropriate days during which the upper-tier partnership is a partner in the lower-tier partnership, and then allocating the portion assigned to any such day among the partners in proportion to their interests in the upper-tier partnership at the close of such day. Thus, the daily allocation method, used for cash basis items, is applicable to all items of the lower-tier partnership if there is a change in the partnership interests in the upper-tier partnership. The IRS and the Treasury Department are seeking comments on this and any other issue related to tiered partnerships and determining a partner's varying interests.

Proposed Effective Date

In accord with the legislative history to section 706(d), the proposed regulations provide a reasonable transition period for taxpayers in the effective date provisions of this proposed regulation. Thus, the proposed amendments to §§ 1.706–1 (with the exception of the change to § 1.706–1(b)(6)(iii)), 1.706–4, and 1.706–5 are proposed to apply to partnership taxable years that begin after the date the final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009.

The proposed amendment to § 1.706–1(b)(6)(iii) generally is applicable to the first taxable year of a partnership that begins on or after the date final regulations are published in the **Federal Register**, subject to two special rules. First, under the current regulations, partnerships formed prior to September 23, 2002 (''existing partnerships'') generally are exempt from the rules of § 1.706–1(b)(6) unless they have voluntarily elected to apply them or unless they have undergone a technical termination under section 708(b)(1)(B). The proposed regulation retains this special rule, such that an existing partnership will not be subject to the modified minority interest rule in proposed § 1.706–1(b)(6)(iii) unless there has been such an election or technical termination. Second, because the proposed regulation would modify § 1.706–1(b)(6)(iii) but otherwise leave the rules of § 1.706–1(b)(6) unchanged, it is appropriate to exempt other partnerships from the modified minority interest rule if they are already subject to § 1.706–1(b)(6) and the minority interest rule of the current regulations (''interim period partnerships''). Thus, interim period partnerships will be exempt from the modified minority interest rule of proposed § 1.706–1(b)(6)(iii) unless they voluntarily elect to be subject to this rule or undergo a technical termination. Accordingly, the proposed amendment to § 1.706–1(b)(6)(iii) would apply to the first taxable year of a partnership that begins on or after the date final regulations are published in the **Federal Register**, subject to these special rules for existing partnerships and interim period partnerships.

The proposed amendments in §§ 1.706–4(c)(2) and (d)(2) are proposed to apply for the taxable year of a partnership other than an existing publicly traded partnership that begin after the date the final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009.

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 has also 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 the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for a Public Hearing

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

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the pubic hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Laura Fields and Jonathan Cornwell, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the 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 is amended by adding a new entry in numerical order to read as follows:

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

Section 1.706–2 also issued under 26 U.S.C. 706(d). * * *

Par. 2. Section 1.706–0 is added to read as follows:

§ 1.706–0 Table of contents.

This section lists the captions contained in the regulations under section 706.

§ 1.706–1 Taxable years of partner and partnership.

(a) Year in which partnership income is includible.
(b) Taxable year.
(1) Partnership treated as taxpayer.
(2) Partnership's taxable year.
(i) Required taxable year.
(ii) Exceptions.
(3) Least aggregate deferral.
(i) Taxable year that results in the least aggregate deferral of income.
(ii) Determination of the taxable year of a partner or partnership that uses a 52–53 week taxable year.
(iii) Special de minimis rule.
(iv) Examples.
(4) Measurement of partner's profits and capital interest.
(i) In general.
(ii) Profits interest.
(A) In general.
(B) Percentage share of partnership net income.
(C) Distributive share.
(iii) Capital interest.
(5) Taxable year of a partnership with tax-exempt partners.
(i) Certain tax-exempt partners disregarded.
(ii) Example.
(iii) Effective date.
(6) Certain foreign partners disregarded.
(i) Interests of disregarded foreign partners not taken into account.
(ii) Definition of foreign partner.
(iii) Minority interest rule.
(iv) Example.
(v) Effective date.
(A) Generally.
(B) Voluntary change in taxable year.
(C) Subsequent sale or exchange of interests.
(D) Transition rule.
(7) Adoption of taxable year.
(8) Change in taxable year.
(i) Partnerships.
(A) Approval required.
(B) Short period tax return.
(C) Change in required taxable year.
(ii) Partners.
(9) Retention of taxable year.
(10) Procedures for obtaining approval or making a section 444 election.
(11) Effect on partner elections under section 444.
(i) Election taken into account.
(ii) Effective date.
(c) Closing of partnership year.
(1) General rule.
(2) Disposition of entire interest
(i) In general.
(ii) Example.
(iii) Deemed dispositions.
(3) Disposition of less than entire interest.
(4) Determination of distributive shares.
(5) Transfer of interest by gift.
(d) Effective/applicability date.

§ 1.706–2 Certain cash basis items prorated over period to which attributable. [Reserved]

§ 1.706–3 Items attributable to interest in lower-tier partnership prorated over entire taxable year. [Reserved]

§ 1.706–4 Determination of distributive share when a partner's interest varies.

(a) General rule.
(1) Methods.
(2) Segments.
(i) General rule.
(ii) Other provisions.
(b) Exceptions.
(1) Permissible changes among contemporaneous partners.
(2) Safe harbor for certain service partnerships.
(3) Safe harbor for publicly traded units of publicly traded partnerships.
(c) Interim closing method.
(1) In general.
(2) Conventions.
(3) Example.
(d) Proration method.
(1) In general.
(2) Conventions.
(3) Extraordinary items.
(4) Example.
(e) Conventions.
(1) Calendar day convention.
(2) Semi-monthly convention.
(f) Effective/applicability date.

§ 1.706–5 Taxable year determination.

(a) General rule.
(b) Effective/applicability date.

Par. 3. Section 1.706–1 is amended as follows:

1. The language ''capital or profits'' in the first sentence in paragraph (b)(6)(iii) is removed and the language ''capital and profits'' is added in its place.
2. Paragraph (b)(6)(v)(A) is revised.
3. The last sentence of paragraph (b)(6)(v)(B) is removed and four new sentences are added in its place.
4. Paragraph (b)(6)(v)(C) is revised.
5. Add a new sentence at the end of paragraph (b)(6)(v)(D).
6. Paragraph (c)(2) is revised.
7. Paragraph (c)(3) is removed.
8. Paragraph (c)(4) is redesignated as (c)(3) and the last sentence of newly designated paragraph (c)(3) is removed.
9. New paragraph (c)(4) is added.
10. Paragraph (d) is revised.

The additions and revisions read as follows:

§ 1.706–1 Taxable years of partner and partnership.

* * * * *

(b) * * *

(6) * * *

(v) * * * (A) *Generally.* The provisions of this paragraph (b)(6) (other than paragraph (b)(6)(iii) of this section) are applicable for the first taxable year of a partnership other than an existing partnership that begins on or after July 23, 2002. The provisions of paragraph (b)(6)(iii) of this section are applicable for the first taxable year of a partnership other than an existing partnership or an interim period partnership that begins on or after the date these regulations become effective. For this purpose, an existing partnership is a partnership that was formed prior to September 23, 2002, and an interim period partnership is a partnership that was formed on or after September 23, 2002, and prior to the date these regulations become effective.

(B) * * * An existing partnership that makes such a change prior to the date these regulations become effective will cease to be exempted from the requirements of paragraph (b)(6) (other than paragraph (b)(6)(iii)) of this section. An existing partnership that makes such a change on or after the date these regulations become effective will cease to be exempted from the requirements of paragraph (b)(6) of this section. An interim period partnership may change its taxable year to a year determined in accordance with paragraph (b)(6)(iii) of this section. An interim period partnership that makes such a change will cease to be exempted from the requirements of paragraph (b)(6)(iii) of this section.

(C) *Subsequent sale or exchange of interests.* If an existing partnership or an interim period partnership terminates under section 708(b)(1)(B), the resulting partnership is not an existing partnership or an interim period partnership for purposes of paragraph (b)(6)(v)(A) of this section.

(D) * * * If, in the first taxable year beginning on or after the date these regulations become effective, an interim period partnership voluntarily changes its taxable year to a year determined in accordance with paragraph (b)(6)(iii) of this section, then the partners of that partnership may apply the provisions of § 1.702–3T to take into account all items of income, gain, loss, deduction, and credit attributable to the partnership year of change ratably over a four-year period.

* * * * *

(c) * * *

(2) *Disposition of entire interest*—(i) *In general.* A partnership taxable year shall close with respect to a partner who sells or exchanges his entire interest in the partnership, with respect to a partner whose entire interest in the partnership is liquidated and with respect to a partner who dies. In the case of a death or liquidation, or sale or

exchange of a partner's entire interest in the partnership, the partner shall include in his taxable income for his taxable year within or with which the partner's membership in the partnership ends, the partner's distributive share of items described in section 702(a), and any guaranteed payments under section 707(c), for the partner's partnership taxable year ending with the date of such termination. If the decedent partner's estate or other successor sells or exchanges its entire interest in the partnership, or if its entire interest is liquidated, the partnership taxable year with respect to the estate or other successor in interest shall close on the date of such sale or exchange, or the date of the completion of the liquidation. The sale or exchange of a partnership interest does not, for the purpose of this rule, include any transfer of a partnership interest which occurs at death as a result of inheritance or any testamentary disposition.

(ii) Example. H is a member of a partnership having a taxable year ending December 31. Both H and his wife W are on a calendar year and file joint returns. H dies on March 31, 2010. Administration of the estate is completed and the estate, including the partnership interest, is distributed to W as legatee on November 30, 2010. Such distribution by the estate is not a sale or exchange of H's partnership interest. The taxable year of the partnership will close with respect to H on March 31, 2010, and H will include in his final return for his final taxable year (January 1 through March 31, 2010) his distributive share of partnership items for that period under the rules of § 1.706–4. W will include in her return for the taxable year ending December 31, 2010, her distributive share of partnership items for the period of April 1 through December 31, 2010, under the rules of § 1.706–4.

(iii) *Deemed dispositions.* A deemed disposition of the partner's interest pursuant to §§ 1.1502–76(b)(2)(vi) (relating to corporate partners that become or cease to be members of a consolidated group within the meaning of § 1.1502–1(h)), 1.1362–3(c)(1) (relating to the termination of the subchapter S election of an S corporation partner), and 1.1377–1(b)(3)(iv) (regarding an election to terminate the taxable year of an S corporation partner), shall be treated as a disposition of the partner's entire interest in the partnership.

* * * * *

(4) *Determination of distributive shares.* See § 1.706–4 for rules regarding the methods to be used in determining the distributive shares of items described in section 702(a) for partners whose interests in the partnership vary as a result of a disposition of a partner's entire interest in a partnership as described in paragraph (c)(2) of this section or as a result of a disposition of less than an entire interest as described in paragraph (c)(3) of this section during the partnership's taxable year.

* * * * *

(d) *Effective/applicability date.* The rules for paragraphs (a) and (b) of this section are applicable for partnership taxable years ending on or after May 17, 2002, except for paragraph (b)(6)(iii) of this section which applies to partnership taxable years beginning the day after final regulations are published in the **Federal Register**. The rules for paragraph (c)(1) of this section apply for partnership taxable years beginning after December 31, 1953. All other paragraphs under paragraph (c) of this section apply for partnership taxable years that begin after the date the final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009.

Par. 4. Section 1.706–2 is added and reserved to read as follows:

§ 1.706–2 Certain cash basis items prorated over period to which attributable. [Reserved]

Par. 5. Section 1.706–3 is added and reserved to read as follows:

§ 1.706–3 Items attributable to interest in lower-tier partnership prorated over entire taxable year. [Reserved]

Par. 6. Section 1.706–4 is added to read as follows:

§ 1.706–4 Determination of distributive share when a partner's interest varies.

(a) *General rule*—(1) *Methods.* Except as provided in paragraph (b) of this section, if a partner's interest in a partnership varies during the taxable year as a result of a disposition of an entire interest in a partnership as described in § 1.706–1(c)(2) or as a result of the disposition of less than the entire interest in a partnership or with respect to a partner whose interest in a partnership is reduced as described in § 1.706–1(c)(3), the partnership shall determine the partner's distributive share of partnership items by using the interim closing method (described in paragraph (c) of this section). Alternatively, a partnership may, by agreement of the partners, use the proration method (described in paragraph (d) of this section). The partnership and all of its partners shall use the same method (interim closing or proration) and, if applicable, the same convention (described in paragraph (e) of this section) for all variations in the partners' interests occurring within each partnership taxable year.

(2) *Segments*—(i) *General rule.* For purposes of accounting for a variation in a partner's interest within a taxable year of the partnership as a result of dispositions or reductions of interests as described in § 1.706–1(c)(2) or (c)(3), the partnership shall maintain segments, which are specific periods of the partnership's taxable year. The first segment to account for a change in a partner's interest shall commence with the beginning of the taxable year of the partnership and end at the close of the day specified by the convention used by the partnership to account for such change. Any additional segment shall commence with the day specified by the convention used by the partnership to account for a previous change in the partner's interest and shall end as a result of an additional change in the partner's interest at the close of the day specified by the convention used by the partnership to account for such change, provided, however, that the last segment of the taxable year of the partnership shall end no later than the close of the day of the partnership's taxable year. The partnership shall determine the items of income, gain, loss, deduction and credit of the partnership for each segment in accordance with the method of accounting that it uses for the partnership's entire taxable year. In general, a partnership using the interim closing method shall treat each segment as though the segment were a separate distributive share period. For example, a partnership using the interim closing method may compute a net capital loss for a segment of a taxable year even though the partnership has a net capital gain for the entire taxable year.

(ii) *Other provisions.* Any limitation applicable to the partnership year as a whole (for example, the limitation under section 179, relating to elections to expense certain depreciable business assets) must be in connection with the interim closing method apportioned among the segments by the partnership using any reasonable method, provided, however, that the amounts apportioned among segments shall not exceed the limitation applicable to the partnership as a whole.

(b) *Exceptions*—(1) *Permissible changes among contemporaneous partners.* The general rule of paragraph (a) of this section, with respect to the varying interests of a partner described in § 1.706–1(c)(3), will not preclude changes in the allocations of the distributive share of items described in section 702(a) among contemporaneous partners for the entire partnership taxable year, provided that—

(i) Any variation in a partner's interest is not attributable to a contribution of money or property by a partner to the capital of the partnership or a

distribution of money or property by the partnership to a partner that is a return of capital; and

(ii) The allocations resulting from the modification satisfy the provisions of section 704(b) and the regulations promulgated in association with that section.

(2) *Safe harbor for certain service partnerships.* Notwithstanding paragraph (a) of this section, with respect to any taxable year in which there is a change in any partner's interest in a service partnership (as defined below in this subsection), the partnership and such partner may choose to determine the partner's distributive share of partnership income, gain, loss, deduction and credit using any reasonable method to account for the varying interests of the partners in the partnership during the taxable year provided that the allocations are valid under section 704(b). A service partnership is a partnership in which substantially all the activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, or consulting.

(3) *Safe harbor for publicly traded units of publicly traded partnerships.* Notwithstanding paragraph (a) of this section, a publicly traded partnership (PTP) (as defined in section 7704(b)) using either the interim closing of the books method in paragraph (c) of this section or the proration method in paragraph (d) of this section may treat all transfers of its publicly traded units (as described in § 1.7704–1(b)(1)) during a calendar month as occurring for purposes of determining partner status on the first day of the following month under a consistent method adopted by the partnership or may use the semi-monthly convention described in paragraph (e)(2) of this section. For example, PRS, a PTP, uses the proration method in paragraph (d) of this section. PRS adopts a method treating all transfers of its publicly traded units as occurring on the first day of the month following the transfer. If on May 5, A, a partner in PRS, sells a unit in PRS to B, and on May 12 B sells that unit to C, who holds the interest beyond May 31, PRS may allocate all items with respect to that unit for the month of May to A, and may allocate all partnership items with respect to that unit for the month of June to C. B will not be considered a partner and will receive no allocation of partnership items. Block transfers of PTP units (as described in § 1.7704–1(e)(2)) will not qualify for this safe harbor.

(c) *Interim closing method*—(1) *In general.* A partnership shall take into account any variation in a partner's interest in the partnership as described in § 1.706–1(c)(2) or (c)(3) during the partnership's taxable year by determining the distributive share of partnership items under section 702(a) for each segment of that taxable year using an interim closing of the books method, and by allocating those items among the partners in accordance with their respective partnership interests during that segment.

(2) *Conventions.* A partnership using the interim closing method may use either the calendar day convention provided in paragraph (e)(1) of this section or the semi-monthly convention provided in paragraph (e)(2) of this section to determine when the segments within that taxable year end.

(3) Example. PRS is a partnership that was formed in 2004. It has three partners, P,R, and S, who each own a one-third interest in the partnership. PRS owns and operates a skiing enterprise and under section 706(b)(1)(C), has adopted a calendar year end of June 30th. Each partner is an individual who is on the calendar year. On December 31, 2010, S sold her entire interest in PRS to Y. PRS, for its fiscal year ending June 30, 2011, earned $150,000 of income, and under an interim closing of the books on December 31, 2010, $90,000 of income was earned for the period beginning after December 31, 2010, and $60,000 of income was earned before January 1, 2011. The partnership has no specific provision in the partnership agreement relating to which section 706 method to use with regard to varying interests of the partnership. Thus, pursuant to § 1.706–4(a)(1), PRS will be required to use the interim closing of the books method to account for the varying interests of S and Y in the partnership. As a result, S is allocated one-third of the income earned prior to January 1, 2011, or $20,000. Y is allocated $30,000 which is one-third of the income earned after December 31, 2010. Since S sold her entire interest in PRS, the partnership taxable year closes with respect to her pursuant to § 1.706–1(c)(2)(i). Thus, she must include her share of PRS's income on her 2010 federal income tax return.

(d) *Proration method*—(1) *In general.* Except as provided in paragraph (d)(3) of this section, a partnership may, by agreement of the partners, take into account any variation in a partner's interest in the partnership described in § 1.706–1(c)(2) or (c)(3) during the partnership's taxable year by allocating the distributive share of partnership items under section 702(a) among the partners according to their pro rata shares of such items for the entire taxable year. In determining a partner's pro rata share of partnership items, the partnership shall take into account that partner's interest in such items during each segment. For purposes of this paragraph (d), specific items that are aggregated by the partnership at the end of the year (other than extraordinary items as defined in paragraph (d)(3) of this section) shall be disregarded, and the aggregate of the items shall be considered to be the partnership item for the year.

(2) *Conventions.* A partnership using the proration method shall use the calendar day convention described in paragraph (e)(1) of this section.

(3) *Extraordinary items.* A partnership must allocate extraordinary items among the partners in proportion to their interests at the beginning of the calendar day of the day on which they are taken into account. For purposes of this paragraph (d), an extraordinary item is—

(i) Any item from the disposition or abandonment of a capital asset (other than in the ordinary course of business) as defined in section 1221 (determined without the application of any other rules of law);

(ii) Any item from the disposition or abandonment of property used in a trade or business (other than in the ordinary course of business) as defined in section 1231(b) (determined without the application of any holding period requirement);

(iii) Any item from the disposition or abandonment of an asset described in section 1221(1), (3), (4), or (5), if substantially all the assets in the same category from the same trade or business are disposed of or abandoned in one transaction (or series of related transactions);

(iv) Any item from assets disposed of in an applicable asset acquisition under section 1060(c);

(v) Any section 481(a) adjustment;

(vi) Any item from the discharge or retirement of indebtedness (for example, if a debtor partnership transfers a capital or profits interest in such partnership to a creditor in satisfaction of its recourse or nonrecourse indebtedness, any discharge of indebtedness income recognized under section 108(e)(8) must be allocated among the persons who were partners in the partnership immediately before the discharge);

(vii) Any item from the settlement of a tort or similar third-party liability or payment of a judgment;

(viii) Any credit, to the extent it arises from activities or items that are not ratably allocated (for example, the rehabilitation credit under section 47, which is based on placement in service); or

(ix) Any item which, in the opinion of the Commissioner, would, if ratably allocated, result in a substantial distortion of income in any return in which the item is included.

(4) Example. PRS is a partnership that was formed in 2004. It has three partners, P, R, and S, who each own a one-third interest in the partnership. PRS owns and operates a skiing enterprise, and under section 706(b)(1)(C), has adopted a calendar year end of June 30th. Each partner is an individual who is on the calendar year. On December 31, 2010, S sold her entire interest in PRS to Y. PRS, for its fiscal year ending June 30, 2010, earned $150,000 of income. The partnership has a specific provision in the partnership agreement agreeing to use the proration method when accounting for varying interests in the partnership. (See § 1.706–4(a)(1)). Using the proration method, $75,000 of income is included in the first segment of the year that begins July 1, 2010 and ends December 31, 2010, and $75,000 is included in the second segment of the year that begins January 1, 2011 and ends June 30, 2011. For the first segment, S's distributive share of partnership income is one-third of $75,000, or $25,000. For the second segment, Y's distributive share of partnership income is one-third of $75,000, or $25,000. Because S sold her entire interest in PRS, the partnership taxable year closes with respect to her pursuant to § 1.706–1(c)(2)(i). Thus, she must include her distributive share of PRS's income, or $25,000, on her 2010 Federal income tax return.

(e) *Conventions*—(1) *Calendar day convention.* Under the calendar day convention, the first segment of the partnership's taxable year commences with the beginning of the partnership's taxable year and ends at the close of any day on which the variation occurs in the partner's interest in the partnership. Any additional segment shall commence with the beginning of the day following a prior variation in a partner's interest and end on the earlier of the close of the day on which an additional variation occurs in the partner's interest or the close of the partnership's taxable year, as applicable.

(2) *Semi-monthly convention.* Under the semi-monthly convention, the first segment of the partnership's taxable year commences with the beginning of the partnership's taxable year, and with respect to a partner's variation in interest occurring on the first through the 15th day of a calendar month, is deemed to close at the end of the last day of the immediately preceding calendar month, and with respect to any variation in interest occurring on the 16th through the last day of a calendar month, is deemed to close at the end of the 15th calendar day of that month. Any additional segment of the partnership taxable year shall commence with beginning of the first day, or 16th day of the month of the last segment, as the case may be, as determined for a prior change and shall close at the earlier of the close of the partnership's taxable year, or with respect to a partner's variation in interest occurring on the first through 15th day of a calendar month, is deemed to close at the end of the last day of the immediately preceding calendar month, and with respect to any variation in interest occurring on the 16th through the last day of a calendar month, is deemed to close at the end of the 15th calendar day of that month.

(f) *Effective/applicability date.* Except with respect to paragraphs (c)(2) and (d)(2) of this section, this section is applicable for partnership taxable years that begin the day after the date final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009. The rules of paragraphs (c)(2) and (d)(2) of this section are applicable for the taxable year of partnerships other than existing publicly traded partnerships that begin after the date the final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009. For purposes of the immediately preceding sentence, an existing publicly traded partnership is a partnership described in section 7704(b) of the Internal Revenue Code that was formed on a date before these proposed regulations are published in the **Federal Register**. However, existing publicly traded partnerships may rely on the provisions of this section.

Par. 7. Section 1.706–5 is added to read as follows:

§ 1.706–5 Taxable year determination.

(a) *In general.* For purposes of § 1.706–4, the taxable year of a partnership shall be determined without regard to section 706(c)(2)(A) and the regulations promulgated under that Internal Revenue Code section.

(b) *Effective/applicability date.* This section is applicable for partnership taxable years that begin the day after the date final regulations are published in the **Federal Register**, but not before taxable years beginning after December 31, 2009.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E9–8438 Filed 4–13–09; 8:45 am]

BILLING CODE 4830–01–P

POSTAL SERVICE

39 CFR Part 111

Express Mail Refunds for Shipments of Live Animals

AGENCY: Postal Service.

ACTION: Proposed rule.

SUMMARY: The Postal Service proposes to revise its refund guarantees for Express Mail® shipments of live animals in an effort to maintain the economic viability of shipping animals as a service.

DATES: Submit comments on or before May 14, 2009.

ADDRESSES: Mail or deliver written comments to the Manager, Mailing Standards, U.S. Postal Service, 475 L'Enfant Plaza, SW., Room 3436, Washington, DC 20260–3436. You may inspect and photocopy all written comments at USPS Headquarters Library, 475 L'Enfant Plaza, SW., 11th Floor N, Washington, DC between 9 a.m. and 4 p.m., Monday through Friday. E-mail comments, containing the name and address of the commenter, may be sent to *MailingStandards@usps.gov*, with a subject line of ''Express Mail Refunds for Shipments of Lives Comments.'' Faxed comments will not be accepted.

FOR FURTHER INFORMATION CONTACT: Joel Rosen, 202–268–4329 or Monica Grein, 202–268–8411.

SUPPLEMENTARY INFORMATION: The Postal Service proposes to revise the *Mailing Standards of the United States Postal Service*, Domestic Mail Manual (DMM®) by changing the refund guarantees for Express Mail shipments of live animals delivered within 3 days of the date of mailing. In some instances, the Postal Service must reroute Express Mail shipments of live animals to alternative flights or routes in order to protect the well-being of the live animals. This is particularly necessary if other shipments on the same flight contain dry ice or solid carbon dioxide, which will evaporate en route and may displace oxygen. If live animals were shipped in the same cargo hold, the carbon dioxide could cause asphyxiation. The use of alternative flights and rerouting to protect the well-being of the live animals can delay shipments. Therefore, even though the live animals arrive as promptly as possible and in good health, these shipments may not meet normal Express Mail service guarantees. In those instances, some mailers then apply for full postage refunds.

Currently, postage refunds for Express Mail shipments of live animals are granted based on the next day or second day delivery guarantee provided at the time of mailing. This current postage refund policy does not account for the flight changes that may occur to protect the well-being of the animals. Therefore, the Postal Service is proposing that