Note 3: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Seattle ACO.

Special Flight Permit

(c) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be accomplished.

Issued in Renton, Washington, on March 30, 2000.

Donald L. Riggin,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 00–8390 Filed 4–4–00; 8:45 am]

BILLING CODE 4910–13–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–209601–92]

RIN 1545–AR19

Taxation of Tax-Exempt Organizations' Income From Corporate Sponsorship; Correction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to a notice of proposed rulemaking and notice of public hearing which was published in the **Federal Register** on Wednesday, March 1, 2000 (65 FR 11012), relating to the tax treatment of sponsorship payments received by exempt organizations.

FOR FURTHER INFORMATION CONTACT: Stephanie Lucas Caden at (202) 622–6080.

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations that are the subject of this correction are under section 512 of the Internal Revenue Code.

Need for Correction

As published, the proposed regulations [REG–209601–92] contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the proposed regulations [REG–209601–92], which were the subject of FR Doc. 00–4848, is corrected as follows:

1. On page 11012, third column, in the preamble, the last sentence under the caption **ADDRESSES** is corrected to read, ''The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.''.

2. On page 11012, third column, in the preamble, the text under the caption **FOR FURTHER INFORMATION CONTACT** is corrected to read, ''Concerning the regulations, Stephanie Lucas Caden at (202) 622–6080; concerning submissions and the hearing, LaNita VanDyke at (202) 622–7180 (not toll-free numbers).''.

3. On page 11015, second column, the first sentence of the second paragraph under the caption Comments and Public Hearing is corrected to read, ''A public hearing has been scheduled for June 21, 2000, at 10 a.m. in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.''.

§ 1.513–4 [Corrected]

4. On page 11018, third column, in the 22nd line of § 1.513–4(f) *Example 8,* the language ''Music Shop's name and address in the lobby'' is corrected to read, ''Music Shop's name, address and telephone number in the lobby''.

Dale D. Goode,

Federal Register Liaison, Assistant Chief Counsel (Corporate).

[FR Doc. 00–8030 Filed 4–4–00; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–107872–99]

RIN 1545–AXI8

Coordination of Sections 755 and 1060 Relating to Allocation of Basis Adjustments Among Partnership Assets

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the allocation of basis adjustments among partnership assets under section 755. The proposed regulations are necessary to implement section 1060(d), which applies the residual method to certain partnership transactions. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by July 5, 2000.

Outlines of topics to be discussed at the public hearing scheduled for July 12, 2000, must be received by June 21, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–107872–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. 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–107872–99), 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 on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/tax regs/reglist.html. The public hearing will be held in room 2716, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Matthew Lay or Craig Gerson, (202) 622–3050; concerning submissions, 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:

Background

As part of the Tax Reform Act of 1986, Congress enacted section 1060, which generally requires the use of the residual method in order to allocate the purchase price of ''applicable asset acquisitions'' among individual assets purchased. An applicable asset acquisition is defined as any transfer of assets that constitute a trade or business where the transferee's basis is determined wholly by reference to the consideration paid for the assets. Both direct and indirect transfers of a business were intended to be covered by the provision, including ''the sale of a partnership interest in which the basis of the purchasing partner's proportionate share of the partnership's assets is adjusted to reflect the purchase price.'' See section 1060(c) and S. Rep. No. 99–313, 1986–3 C.B. Vol. 3 at 254–255.

In July of 1988, the IRS and the Treasury Department issued temporary and proposed regulations, which, among other things, provided guidance concerning the application of section 1060 and coordinated the application of sections 755 and 1060. TD 8215 (1988–2 C.B. 305).

In 1988, shortly after the IRS and the Treasury Department issued its temporary and proposed regulations, Congress enacted section 1060(d), which expressly addresses the extent to which section 1060 should apply to transactions involving partnerships. As amended in 1993, section 1060(d)(1) applies the section 1060 residual method in the case of a distribution of partnership property or a transfer of an interest in a partnership, but only in determining the value of section 197 intangibles for purposes of applying section 755. Section 1060(d)(2) provides that if section 755 applies, such distribution or transfer (as the case may be) shall be treated as an applicable asset acquisition for purposes of section 1060(b) (which imposes certain reporting requirements for applicable asset acquisitions).

Section 755 governs the allocation of certain adjustments to the basis of partnership property among partnership assets. Section 1.755–2T applies the residual method to transfers and distributions which trigger basis adjustments under section 743(b) (involving certain transfers of partnership interests) or section 732(d) (involving certain distributions within two years of a partnership interest transfer) if the assets of the partnership constitute a trade or business for purposes of section 1060(c). Section 1.755–2T(c) contains a cross reference to the reporting requirements applicable to such transfers and distributions.

Explanation of Provisions

1. Application of Proposed Regulations

The temporary regulations under section 755 apply only if the assets of the partnership comprise a trade or business within the meaning of section 1060(c), and the basis adjustments are made under section 743(b) or section 732(d). They do not apply the residual method in valuing partnership property for the purpose of allocating basis adjustments under section 734(b). However, the temporary regulations were issued prior to the enactment of section 1060(d)(1), which expressly refers to basis adjustments triggered by partnership distributions, and does not reference a trade or business requirement.

The IRS and the Treasury Department anticipate that the regulations under § 1.755–2, when finalized, will apply to all transfers of partnership interests and partnership distributions to which section 755 applies, and not just to transfers and distributions relating to partnerships conducting a trade or business. This approach is consistent with the language of section 1060(d) and is supported by language contained in the legislative history. See H.R. Rep. No. 100–795, at 70 n.34 (1988) (the IRS is not precluded from applying the residual method under other provisions of the Code).

Proposed § 1.755–2(d) contains a cross reference to the reporting requirements applicable to such transfers and distributions.

2. Basis Adjustments Under Section 743(b) or 732(d)

In the case of a basis adjustment under section 743(b) or section 732(d), the proposed regulations determine the fair market value of partnership assets in two steps. In most situations, it first is necessary to determine partnership gross value. Second, partnership gross value must be allocated among partnership property.

(a) Partnership gross value. In general, partnership gross value equals the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner equal to the transferee's basis in the transferred partnership interest immediately following the relevant transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities). Here, the amount paid for the partnership interest provides the frame of reference for valuing the entire partnership.

In the case of basis adjustments which are triggered by an exchange of a partnership interest in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest (transferred basis exchange), the transferee's basis does not necessarily have any connection to the value of partnership assets. Accordingly, a transferred basis exchange provides no frame of reference for valuing partnership assets. Furthermore, if the valuation rules which apply to other transfers were applied to transferred basis exchanges, then partners could use these exchanges to shift basis from capital gain assets to ordinary income assets, or vice versa. The proposed regulations do not provide a rule addressing transferred basis exchanges. Comments are requested as to how the residual method should apply if basis adjustments under section 743(b) are triggered by transferred basis exchanges, or if basis adjustments under section 732(d) relate to prior transferred basis exchanges.

(b) Allocating partnership gross value among partnership property. Once determined, partnership gross value is allocated among five classes of property, as follows: first among cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions (referred to hereafter as cash); then among partnership assets other than cash, capital assets, section 1231(b) property, and section 197 intangibles (referred to hereafter as ordinary income property); then among capital assets and section 1231(b) property other than section 197 intangibles; then among section 197 intangibles other than goodwill and going concern value; and finally to goodwill and going concern value (referred to hereafter as goodwill).

In determining the values to be assigned to assets in the third, fourth, and fifth classes, properties or potential gain within these classes that are treated as unrealized receivables under the flush language in section 751(c) are not counted as assets in the second class. To provide otherwise would be inconsistent with the residual method, because the residual method is justified, at least in part, by the fact that goodwill is not readily subject to valuation. Where goodwill is subject to amortization under section 197, the portion of the intangible that is subject to recapture under section 1245 will be treated as an unrealized receivable under the flush language of section 751(c). To assign value to this portion of the asset in the second class would require a determination that the goodwill has a value equal to at least the amount of the recapture. If these assets are not readily subject to valuation, this determination presumably could not be made. Accordingly, in allocating value among the five classes under the residual method, it is appropriate to include properties or potential gain treated as unrealized receivables under the flush language of section 751(c) within the overall class to which the underlying property belongs rather than treating the section 751(c) portion of such property as a separate asset included in the second class.

Although properties or potential gain treated as unrealized receivables under the flush language of section 751(c) are not included in the second class of assets under these proposed regulations for purposes of allocating value, they are treated as separate assets that are ordinary income property for purposes of allocating basis adjustments among such assets under § 1.755–1.

With respect to allocating value within the asset classes, in general, if the value assigned to a class is less than the sum of the fair market values of the assets in that class (determined without regard to the residual method), then the assigned value must be allocated among the individual assets in proportion to their fair market values. Although, as discussed above, it is not appropriate to treat properties or potential gain treated as unrealized receivables under the flush language of section 751(c) as separate ordinary income assets, it is appropriate to allocate value within each class by giving priority to the portions of the assets that will be taxed at higher rates as ordinary income. Such treatment better equates the basis adjustments of the transferee with the higher taxed income recognized by the transferor, thereby avoiding duplicative recognition of ordinary income on subsequent transfers with respect to the same asset. Accordingly, once values have been assigned generally to the third, fourth, and fifth classes of assets, such values will be assigned within each of these classes first to properties or potential gain treated as unrealized receivables under the flush language in section 751(c), if any, in proportion to the income that would be recognized if the underlying assets were sold for their fair market values (determined without regard to the residual method), but only to the extent of the income attributable to the unrealized receivables. Any remaining value in each class will be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined without regard to the residual method).

In general, the value assigned to an asset (other than goodwill) cannot exceed the fair market value (determined without regard to the residual method) of that asset on the date of the relevant transfer. Therefore, if partnership gross value exceeds the aggregate value of the partnership's individual assets, the excess must be allocated entirely to the value of goodwill. However, an exception is provided if partnership gross value exceeds the aggregate value of the partnership's individual assets, and goodwill could not under any circumstances attach to the assets. Under this exception, the excess partnership gross value must be allocated among all partnership assets other than cash in proportion to their fair market values (determined without regard to the residual method).

(c) Special situations. In general, partnership gross value may be determined without reference to the value of individual partnership assets. In calculating partnership gross value, it is only necessary to determine the relevant partner's share of book value in partnership assets and how much book gain or loss must be recognized by the partnership on the disposition of all such assets to cause the partner to receive the appropriate liquidating distribution. The manner in which the book gain or loss is allocated among the partnership's assets generally will not affect the amount of the liquidating distribution to the partner.

In certain circumstances, however, such as where book income or loss with respect to particular partnership properties is allocated differently among partners, partnership gross value may vary depending on the value of particular partnership assets. In these situations, it is not possible to first determine the total value of the partnership (i.e., partnership gross value) and then apply the residual method to allocate that value to the partnership's individual assets. Instead, it is necessary first to determine the fair market value of the partnership's individual assets (determined taking into account all relevant facts and circumstances), and then to assign such value among the asset tiers described in the residual method such that the combined value of all partnership assets would cause the appropriate distribution to the relevant partner. The proposed regulations include a rule to address these special situations. In addition, under this rule, if the value determined for assets in the first four asset classes is not sufficient to cause the appropriate liquidating distribution, then, so long as goodwill could attach to the assets of the partnership, the value of goodwill is presumed to be an amount that, if assigned to such property, would cause the appropriate liquidating distribution.

3. Basis Adjustments Under Section 734(b)

The proposed regulations do not provide a rule for valuing partnership assets in the case of distributions that result in a basis adjustment under section 734(b). The IRS and the Treasury Department have considered several alternative approaches, described below. Two of these approaches utilize a method similar to the one provided for basis adjustments under sections 743(b) and 732(d); that is, first determine partnership gross value and then allocate such amount among the partnership property applying the residual method. The third approach does not rely on the concept of partnership gross value. The IRS and the Treasury Department request comments as to which, if any, of these approaches should be utilized in applying the residual method in the context of basis adjustments under section 734(b). In addition, comments are requested concerning whether the second or third approach should be adopted in the context of basis adjustments under sections 743(b) and 732(d) involving transferred basis transactions.

Under the first approach, in the case of a distribution which results in a basis adjustment under section 734(b) and which causes the distributee partner's interest in the partnership to decrease, partnership gross value would be deemed to equal the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner (attributable to the reduction in interest) equal to the value of the consideration received by the distributee partner in the distribution. Under this approach, the amount distributed in exchange for the relinquished interest would provide the frame of reference for valuing the entire partnership. The reduction in a partner's interest could be measured as the difference between the partner's interest in the partnership immediately before the distribution and the partner's interest in the partnership immediately after the distribution. However, the IRS and the Treasury Department recognize that measuring the reduction in a partner's interest in the partnership in connection with a distribution can be difficult in some situations (for example, situations in which partners do not share profits or other items in proportion to their relative capital account balances). Moreover, in the case of a distribution that results in a basis adjustment under section 734(b) and does not reduce the distributee partner's interest in the partnership (such as in a pro rata distribution of cash), the transaction provides no frame of reference to value the partnership.

A second approach would be to determine partnership gross value as the value of the entire partnership as a going concern, and to apply the residual method by reference to that overall value. This method has the disadvantage of divorcing the valuation of partnership property from the transaction that gives rise to the adjustment. However, there would be no need to measure the reduction in the distributee partner's interest or even to have a reduction in the distributee partner's interest to apply this method. The method would work equally well for distributions where the partner's interest in the partnership is reduced and for distributions where it is not.

Under a third possible approach, the concept of partnership gross value would be disregarded, and, instead, value would be allocated to goodwill for section 755 purposes only if the amount of a positive basis adjustment under section 734(b) exceeds the appreciation in all assets of the character required to be adjusted which are not goodwill. This approach avoids the problems relating to the measurement or presence of a reduction in the distributee partner's interest and has the added benefit of avoiding a valuation of the partnership's overall operations. In contrast with the second approach, however, the value that is assigned to goodwill under this approach would not necessarily bear any relation to the actual value of goodwill in the hands of the partnership. In addition, this rule arguably would be inconsistent with the rule in § 1.755–1(c), which requires that positive basis adjustments must be allocated to undistributed property of like character to the distributed property (or capital gain property in the case of adjustments attributable to gain recognized by the distributee partner) first in proportion to unrealized appreciation with respect to such property and then in proportion to fair market value. Under the third approach, a basis adjustment under section 734(b) to the class of assets composed of capital assets and property described in section 1231(b) could not exceed the unrealized appreciation with respect to any such partnership property other than goodwill. Accordingly, a section 734(b) basis adjustment never would be made in proportion to the fair market value of the property in the class of capital assets and property described in section 1231(b).

4. Effect on § 1.755–1

Section 1.755–1(b)(3)(ii)(B) of the Income Tax Regulations published on December 15, 1999 (64 FR 69903) contains a rule allocating discounts among capital assets following the transfer of a partnership interest that results in a basis adjustment under section 743(b). Because proposed § 1.755–2 takes discounts and premiums into account when assigning values to partnership property for purposes of section 755 in such cases, the rule in § 1.755–1(b)(3)(ii)(B) would become unnecessary.

5. Possible Expansion of Regulations

With respect to transfers of partnership interests, the IRS and the Treasury Department are considering applying the rules contained in these proposed regulations not just for valuing partnership assets for purposes of applying section 755, but also to determine the value of assets for purposes of applying section 1(h)(6)(B) (collectibles gain or loss) with respect to partnerships, section 1(h)(7) (section 1250 capital gain), and section 751(a) (ordinary income treatment upon sale or exchange of an interest in a partnership). Applying the rules in these proposed regulations in connection with these provisions is consistent with the legislative history to section 1060(d) and would provide greater uniformity with respect to the amount and character of income recognized upon the transfer of a partnership interest and the basis adjustments to partnership assets to which the different income character is attributable. However, this application of the rules could cause an increase in complexity, particularly if a section 754 election is not in effect for a year in which the transfer of a partnership interest occurs (so that application of the residual method otherwise would not be required). The IRS and the Treasury Department request comments on whether partnerships should value partnership assets using the residual method for purposes of sections 1(h)(6)(B), 1(h)(7), and 751(a).

Proposed Effective Date

The regulations are proposed to be effective for any basis adjustment resulting from any distribution of partnership property or transfer of a partnership interest that occurs 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 the regulations do 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 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 businesses.

Comments and 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) that are timely submitted to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for July 12, 2000, beginning at 10 a.m., in room 2716 of the Internal Revenue Building. 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 the 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 written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 21, 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 proposed regulations is Matthew Lay of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of 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 in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.755–2 also issued under 26 U.S.C. 755 and 26 U.S.C. 1060. * * *

Par. 2. Section 1.755–2 is added to read as follows:

§ 1.755–2 Coordination of sections 755 and 1060.

(a) *Coordination with section 1060*—(1) *In general.* If there is a basis adjustment to which this section applies, the partnership must determine the fair market value of each item of partnership property under the residual method, as described in paragraph (b) of this section, and the rules of § 1.755–1 must be applied using the values so determined.

(2) *Application of this section.* This section applies to any basis adjustment made under section 743(b) (relating to certain transfers of interests in a partnership) or section 732(d) or section 734(b) (relating to certain partnership distributions).

(b) *Residual method*—(1) *In general*—(i) *Five classes.* (A) Except as provided in paragraph (b)(3) of this section, partnership gross value (as defined in paragraph (c) of this section) is allocated among five asset classes in the following order—

(*1*) Among cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions (referred to hereafter as cash);

(*2*) Among partnership assets other than cash, capital assets, section 1231(b) property, and section 197 intangibles (referred to hereafter as ordinary income property);

(*3*) Among capital assets and section 1231(b) property other than section 197 intangibles;

(*4*) Among section 197 intangibles other than goodwill and going concern value; and

(*5*) To goodwill and going concern value (referred to hereafter as goodwill).

(B) In determining the values to be assigned to each class, properties or potential gain treated as unrealized receivables under the flush language in section 751(c) are not counted as assets in the second class. For example, any portion of goodwill that would result in ordinary income under section 1245 if the goodwill were sold would be included in the residual class for goodwill.

(ii) *Impaired classes.* If the value assigned to a class is less than the sum of the fair market values (determined under paragraph (b)(2)(i) of this section) of the assets in that class, then the assigned value generally must be allocated among the individual assets in proportion to such fair market values. However, in the third, fourth, and fifth classes, values must be assigned first to properties or potential gain treated as unrealized receivables under the flush language in section 751(c), if any, in proportion to the income that would be recognized if the underlying assets were sold for their fair market values (determined under paragraph (b)(2)(i) of this section), but only to the extent of the income attributable to the unrealized receivables. Any remaining value in each class will be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined under paragraph (b)(2)(i) of this section).

(2) *Special rules.* For purposes of this section:

(i) Except as otherwise provided in this section, the fair market value of each item of partnership property (other than goodwill) shall be determined on the basis of all the facts and circumstances, taking into account section 7701(g).

(ii) If goodwill could not under any circumstances attach to the assets of a partnership, then the value of goodwill is zero. This might occur, for example, if a partnership's only asset is a vacant parcel of real estate that does not produce current income.

(iii) (A) The value assigned to an asset (other than goodwill) shall not exceed the fair market value (determined under paragraph (b)(2)(i)) of that asset on the date of the relevant transfer, unless—

(*1*) Partnership gross value (as defined in paragraph (c) of this section) exceeds the aggregate value of the partnership's individual assets; and

(*2*) Goodwill could not under any circumstances attach to the assets.

(B) If both of these conditions are satisfied, the excess must be allocated among all partnership assets other than cash in proportion to such fair market values.

(3) *Special situations.* In certain circumstances, such as where book income or loss with respect to particular partnership properties is allocated differently among partners, partnership gross value may vary depending on the value of particular partnership assets. In these special situations, the fair market value of each item of partnership property (other than goodwill) first shall be determined on the basis of all the facts and circumstances, taking into account section 7701(g). Such value then shall be assigned within the first four asset classes under the residual method described in paragraph (b)(1) of this section in a manner that is consistent with the ordering rule used in paragraph (b)(1) of this section (together with the special rules in paragraph (b)(2) of this section) so that the amount of the liquidating distribution described in paragraph (c)(1) of this section would equal the transferee's basis in the transferred partnership interest. If the value so determined for the assets in the first four asset classes is not sufficient to cause the appropriate liquidating distribution, then, so long as goodwill may attach to the assets of the partnership, the fair market value of goodwill shall be presumed to equal an amount that if assigned to goodwill would cause the appropriate liquidating distribution.

(c) *Partnership gross value*—(1) *Basis adjustments under section 743(b) and section 732(d)*—(i) *In general.* In the case of a basis adjustment under section 743(b) or 732(d), partnership gross value generally is equal to the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner equal to the transferee's basis in the transferred partnership interest immediately following the relevant transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities) pursuant to the hypothetical transaction (as defined in paragraph (c)(3) of this section). Solely for the purpose of determining partnership gross value under the preceding sentence, where a partnership interest is transferred as a result of the death of a partner, the transferee's basis in its partnership interest is determined without regard to section 1014(c), and is deemed to be adjusted for that portion of the interest, if any, which is attributable to items representing income in respect of a decedent under section 691.

(ii) *Transferred basis transactions.* [Reserved]

(2) *Basis adjustments under section 734(b).* [Reserved]

(3) *Hypothetical transaction.* For purposes of this paragraph (c), the hypothetical transaction means the disposition by the partnership of all partnership property in a fully taxable transaction for cash, followed by the payment of all partnership liabilities (within the meaning of section 752 and the regulations thereunder), and the distribution of all remaining proceeds to the partners.

(d) *Required statements.* See § 1.743–1(k)(2) for provisions requiring the transferee of a partnership interest to provide information to the partnership relating to the transfer of an interest in the partnership. See § 1.743–1(k)(1) for a provision requiring the partnership to attach a statement to the partnership return showing the computation of a basis adjustment under section 743(b) and the partnership properties to which the adjustment is allocated under section 755. See § 1.732–1(d)(3) for a provision requiring a transferee partner to attach a statement to its return showing the computation of a basis adjustment under section 732(d) and the partnership properties to which the adjustment is allocated under section 755. See § 1.732–1(d)(5) for a provision requiring the partnership to provide information to a transferee partner reporting a basis adjustment under section 732(d).

(e) *Examples.* The provisions of this section are illustrated by the following examples, which assume that the partnerships have an election in effect under section 754 at the time of the transfer. Except as provided, no partnership asset (other than inventory) is property described in section 751(a). The examples are as follows:

Example 1. (i) A is the sole general partner in ABC, a limited partnership. ABC has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000, a building (a capital asset) worth $2,000,000, and section 197 intangibles (other than goodwill) worth $800,000. ABC has one liability of $1,000,000, for which A bears the entire risk of loss under section 752 and the regulations thereunder. Each partner has a one-third interest in partnership capital and profits. D purchases A's partnership interest for $1,000,000.

(ii) D's basis in the transferred partnership interest (reduced by the amount of such basis that is attributable to partnership liabilities) is $1,000,000 ($2,000,000–$1,000,000). Under paragraph (c) of this section, partnership gross value is $4,000,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to D equal to $1,000,000).

(iii) Under paragraph (b) of this section, partnership gross value is allocated first to the inventory ($1,000,000), then to the building ($2,000,000), and third to section 197 intangibles $800,000. The partnership must allocate the remainder of partnership gross value, $200,000, to goodwill ($4,000,000–$3,800,000). D's section 743(b) adjustment must be allocated under § 1.755–1 using these fair market value calculations for the partnership's assets.

Example 2. (i) D is the sole general partner in DEF, a limited partnership. DEF has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000, a building (a capital asset) worth $2,000,000, and equipment (section 1231(b) property) worth $750,000. DEF has one liability of $1,000,000, for which D bears the entire risk of loss under section 752 and the regulations thereunder. Each partner has a one-third interest in partnership capital and profits. If the equipment were sold for $750,000, $250,000 would be depreciation recapture treated as an unrealized receivable under the flush language in section 751(c). G purchases E's limited partnership interest for $750,000.

(ii) Under paragraph (c) of this section, partnership gross value is $3,250,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to G equal to $750,000).

(iii) Under paragraph (b) of this section, partnership gross value is allocated first to inventory ($1,000,000), and then to the class containing capital assets and section 1231(b) property ($2,250,000). Within that class, value must be assigned first to the $250,000 ordinary gain portion of the equipment (properties or potential gain treated as unrealized receivables under the flush language in section 751(c)). The remaining value in the class ($2,250,000 minus $250,000, which is $2,000,000) must be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined under paragraph (b)(2)(i) of this section). The remaining portion of the building is $2,000,000. The remaining portion of the equipment is $500,000 ($750,000, its fair market value, minus $250,000, the section 751(c) portion). Thus, the remaining portion of the building will be allocated $1,600,000 ($2,000,000 multiplied by $2,000,000/$2,500,000) and the remaining portion of the equipment will be allocated $400,000 ($2,000,000 multiplied by $500,000/$2,500,000). Nothing is allocated to goodwill. G's section 743(b) adjustment must be allocated under § 1.755–1 using these fair market value calculations for the partnership's assets.

Example 3. (i) G and H are partners in partnership GH. GH has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000 and two buildings (capital assets), each worth $500,000. GH has no liabilities. The GH partnership agreement provides that the partners will allocate all income, gain, loss, and deductions equally, except with respect to depreciation, loss, and gain from the buildings. With respect to the buildings, depreciation and loss are allocated two-thirds to G and one-third to H. Gain from the disposition of the buildings is charged back two-thirds to G and one-third to H to the extent of accrued depreciation, and then is allocated equally between G and H. G transfers one-half of its interest in GH to I for $450,000. At the time of the transfer, the book value of the inventory is $900,000, the book value of each building is $300,000, and $150,000 of book depreciation has accrued with respect to each building. The capital account attributable to the partnership interest purchased by I from G is equal to $350,000. H's capital account is equal to $800,000, and the capital account attributable to G's retained partnership interest is equal to $350,000.

(ii) Because gain with respect to the inventory and buildings are shared in different ratios as between H, and G and I, a partnership gross value cannot be determined without assuming values for the individual assets of the partnership. Accordingly, the rule for special situations in paragraph (b)(3) of this section must be used to compute the value of the partnership's assets.

(iii) Applying paragraph (b)(2)(i) of this section, the fair market value of the inventory is $1,000,000 and the fair market value of each building is $500,000. These values would result in a liquidating distribution to I under paragraph (c)(1) of this section equal to $500,000, determined as follows. The book gain from the sale of the inventory would equal $100,000 ($1,000,000 − $900,000) and the book gain from the sale of each building would equal $200,000 ($500,000 − $300,000). Book gain from the inventory equal to $25,000 ($100,000 × 1/4) and book gain from each building equal to $62,500 (($150,000 × 1/3) + ($50,000 × 1/4)) would be allocated to I. The sum of this book gain ($25,000 + $62,500 + $62,500 = $150,000) and I's capital account inherited from G ($350,000) would equal $500,000.

(iv) Because I's basis in the transferred partnership interest is only $450,000, under paragraph (b)(2)(ii) of this section, the value with respect to the buildings must be reduced in proportion to the fair market values of such assets to an amount that would cause a liquidating distribution to I equal to $450,000. This calculation is accomplished as follows. In order for I to receive a liquidating distribution of $450,000, the book gain attributable to the buildings that is allocated to I must equal $75,000 ($350,000 inherited capital account + $25,000 book gain from inventory + $75,000 book gain from buildings). Each building has the same book value and fair market value, and the allocations with respect to each building are the same as between G, H, and I. Accordingly, I's share of book gain should be allocated equally between the two buildings, $37,500 to each. In order for I to be allocated $37,500 of book gain with respect to each building, the total amount of book gain with respect to each building would have to be $112,500 ($112,500 × 1/3 = $37,500). Adding this book gain to the current book value of each building results in a value for each building of $412,500 ($300,000 + $112,500). Nothing is allocated to goodwill. I's section 743(b) adjustment must be allocated under § 1.755–1 using these fair market value calculations for the partnership's assets.

Example 4. The facts are the same as *Example 3*, except that I purchases one-half of G's partnership interest for $550,000. Because the fair market value of the partnership's assets (as determined under paragraph (b)(2)(i) of this section) in the first four asset classes under the residual method is not sufficient to cause a liquidating distribution to I equal to its basis in the purchased interest (i.e., $550,000), the additional value necessary to cause such a distribution must be allocated to goodwill.

Accordingly, under paragraph (b)(3) of this section, the value of the partnership's assets is as follows: inventory $1,000,000, each building $500,000, and goodwill $200,000. I's section 743(b) adjustment must be allocated under § 1.755–1 using these fair market value calculations for the partnership's assets.

(f) *Effective date.* This section applies to any basis adjustment resulting from any distribution of partnership property or transfer of a partnership interest that occurs on or after the date final regulations are published in the **Federal Register.**

§ 1.755–2T [Removed]

Par. 3. Section 1.755–2T is removed.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, and 25

[REG–100291–00]

RIN 1545–AX74

Lifetime Charitable Lead Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: These proposed regulations relate to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. The proposed regulations will affect taxpayers who make transfers to charitable lead trusts. The purpose of these proposed regulations is to restrict the permissible terms for charitable lead trusts in order to eliminate the potential for abuse. This document also provides notice of a public hearing.

DATES: Written and electronic comments must be received by June 23, 2000. Outlines of topics to be discussed at the public hearing scheduled for June 29, 2000, must be received by June 8, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–100291–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–100291–00), 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 on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax regs/regslist.html. The public hearing will be held in room 4718, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Scott S. Landes, (202) 622–3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

In general, if interests in the same property are transferred for both charitable and noncharitable purposes, the charitable interest will qualify for the charitable deduction for federal income, gift, and estate tax purposes only if the interest is in one of certain prescribed forms. If the charitable interest is not a remainder interest, sections 170, 2522, and 2055 of the Internal Revenue Code (Code) require that the charitable interest be in the form of either a guaranteed annuity interest or a fixed percentage of the annual fair market value of the property (unitrust interest). In addition, an income tax charitable deduction is available only if the grantor is treated as the owner of the entire trust under subpart E, part I of subchapter J of the Code.

The requirement that a nonremainder interest passing to charity be in the form of a guaranteed annuity interest or a unitrust interest was added to the Code by the Tax Reform Act of 1969. That Act also added the requirement that a remainder interest passing to charity must generally be in the form of a charitable remainder unitrust or annuity trust or a pooled income fund. The statutory provisions for charitable remainder trusts and pooled income funds specifically state the permissible terms for these entities. Section 664(d)(1)(A) and (d)(2)(A) provide that the permissible term for a charitable remainder trust is a period of years (not to exceed 20 years) or the life or lives of individuals who are living at the creation of the trust. Similarly, section 642(c)(5)(A) provides that the permissible term for the noncharitable income interest in a pooled income fund is the life of one or more beneficiaries living at the time of the transfer.

Unlike the statutory provisions for charitable remainder trusts and pooled income funds, neither the statute nor the legislative history sets forth the permissible term for which a charitable guaranteed annuity interest or a unitrust interest must be paid. Rather, the permissible term for these interests is set forth in the regulations as either a specified term of years, or the life or lives of an individual or individuals, each of whom must be living at the date of the transfer and can be ascertained at such date.

The IRS and the Treasury Department are aware of situations in which taxpayers attempt to take advantage of the regulations by using an unrelated individual's measuring life, as the term of a charitable lead trust, to artificially inflate the charitable deduction. Taxpayers select as a measuring life an individual who is seriously ill but not ''terminally ill'' within the meaning of the section 7520 regulations. Because the individual is not ''terminally ill'' as defined in the regulations, the charitable interest is valued based on the actuarial tables. These tables take into account the life expectancies of all individuals of the same age as the individual who is the measuring life, even though such individual has been carefully chosen because he or she likely will not live to an average life expectancy. When the seriously ill individual dies prematurely, the amount the charity actually receives will be significantly less than the amount on which the gift or estate tax charitable deduction was based. Conversely, the amount of the actual transfer to the remainder beneficiaries will be significantly greater than the amount subject to gift or estate tax.

These charitable lead trusts are being marketed in a package which includes the name of a seriously ill individual and access to the individual's medical records. A token payment is made to the ill individual who is serving as a measuring life. Sometimes the individual is led to believe that a charitable organization interested in the individual's particular illness will receive some benefit from the transaction. In the words of one author, ''[t]his technique (which is not strictly speaking wealth transfer planning for the terminally ill, but rather wealth transfer planning using the terminally ill) falls somewhere between ghoulish and grotesque.'' Marketing schemes that exploit the misfortunes of some for the benefit of others are contrary to public policy.

The IRS and the Treasury Department believe that this scheme is abusive and frustrates the Congressional purpose in limiting the charitable deduction to specific types of split-interest transfers.