

(C) the excess of the deductions for depletion over the basis of the property subject to depletion;

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of—

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account; and

(3) decreased (but not below zero) by the amount of the partner's deduction for depletion for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D).

(b) Alternative rule

The Secretary shall prescribe by regulations the circumstances under which the adjusted basis of a partner's interest in a partnership may be determined by reference to his proportionate share of the adjusted basis of partnership property upon a termination of the partnership.

(Aug. 16, 1954, ch. 736, 68A Stat. 242; Pub. L. 94-455, title XIX, §1906(b)(13)(A), title XXI, §2115(c)(3), Oct. 4, 1976, 90 Stat. 1834, 1909; Pub. L. 98-369, div. A, title VII, §722(e)(1), July 18, 1984, 98 Stat. 974.)

AMENDMENTS

1984—Subsec. (a)(3). Pub. L. 98-369 substituted “for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D)” for “under section 611 with respect to oil and gas wells”.

1976—Subsec. (a)(3). Pub. L. 94-455, §2115(c)(3), added par. (3).

Subsec. (b). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

EFFECTIVE DATE OF 1984 AMENDMENT

Pub. L. 98-369, div. A, title VII, §722(e)(3)(A), July 18, 1984, 98 Stat. 974, provided that: “The amendment made by paragraph (1) [amending this section] shall take effect on January 1, 1975.”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 2115(c)(3) of Pub. L. 94-455 effective on Jan. 1, 1975, and applicable to taxable years ending after Dec. 31, 1974, see section 2115(f) of Pub. L. 94-455, set out as a note under section 613A of this title.

§ 706. Taxable years of partner and partnership

(a) Year in which partnership income is includible

In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 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 with or with the taxable year of the partner.

(b) Taxable year

(1) Partnership's taxable year

(A) Partnership treated as taxpayer

The taxable year of a partnership shall be determined as though the partnership were a taxpayer.

(B) Taxable year determined by reference to partners

Except as provided in subparagraph (C), a partnership shall not have a taxable year other than—

(i) the majority interest taxable year (as defined in paragraph (4)),

(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership, or

(iii) if there is no taxable year described in clause (i) or (ii), the calendar year unless the Secretary by regulations prescribes another period.

(C) Business purpose

A partnership may have a taxable year not described in subparagraph (B) if it establishes, to the satisfaction of the Secretary, a business purpose therefor. For purposes of this subparagraph, any deferral of income to partners shall not be treated as a business purpose.

(2) Partner's taxable year

A partner may not change to a taxable year other than that of a partnership in which he is a principal partner unless he establishes, to the satisfaction of the Secretary, a business purpose therefor.

(3) Principal partner

For the purpose of this subsection, a principal partner is a partner having an interest of 5 percent or more in partnership profits or capital.

(4) Majority interest taxable year; limitation on required changes

(A) Majority interest taxable year defined

For purposes of paragraph (1)(B)(i)—

(i) In general

The term “majority interest taxable year” means the taxable year (if any) which, on each testing day, constituted the taxable year of 1 or more partners having (on such day) an aggregate interest in partnership profits and capital of more than 50 percent.

(ii) Testing days

The testing days shall be—

(I) the 1st day of the partnership taxable year (determined without regard to clause (i)), or

(II) the days during such representative period as the Secretary may prescribe.

(B) Further change not required for 3 years

Except as provided in regulations necessary to prevent the avoidance of this section, if, by reason of paragraph (1)(B)(i), the taxable year of a partnership is changed,

such partnership shall not be required to change to another taxable year for either of the 2 taxable years following the year of change.

(5) Application with other sections

Except as provided in regulations, for purposes of determining the taxable year to which a partnership is required to change by reason of this subsection, changes in taxable years of other persons required by this subsection, section 441(i), section 584(h),¹ section 644, or section 1378(a) shall be taken into account.

(c) Closing of partnership year

(1) General rule

Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, 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.

(2) Treatment of dispositions

(A) Disposition of entire interest

The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise).

(B) Disposition of less than entire interest

The taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under subsection (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).

(d) Determination of distributive share when partner's interest changes

(1) In general

Except as provided in paragraphs (2) and (3), if during any taxable year of the partnership there is a change in any partner's interest in the partnership, each partner's distributive share of any item of income, gain, loss, deduction, or credit of the partnership for such taxable year shall be 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.

(2) Certain cash basis items prorated over period to which attributable

(A) In general

If during any taxable year of the partnership there is a change in any partner's interest in the partnership, then (except to the extent provided in regulations) each partner's distributive share of any allocable cash basis item shall be determined—

(i) by assigning the appropriate portion of such item to each day in the period to which it is attributable, and

(ii) by allocating the portion assigned to any such day among the partners in proportion to their interests in the partnership at the close of such day.

(B) Allocable cash basis item

For purposes of this paragraph, the term "allocable cash basis item" means any of the following items with respect to which the partnership uses the cash receipts and disbursements method of accounting:

(i) Interest.

(ii) Taxes.

(iii) Payments for services or for the use of property.

(iv) Any other item of a kind specified in regulations prescribed by the Secretary as being an item with respect to which the application of this paragraph is appropriate to avoid significant misstatements of the income of the partners.

(C) Items attributable to periods not within taxable year

If any portion of any allocable cash basis item is attributable to—

(i) any period before the beginning of the taxable year, such portion shall be assigned under subparagraph (A)(i) to the first day of the taxable year, or

(ii) any period after the close of the taxable year, such portion shall be assigned under subparagraph (A)(i) to the last day of the taxable year.

(D) Treatment of deductible items attributable to prior periods

If any portion of a deductible cash basis item is assigned under subparagraph (C)(i) to the first day of any taxable year—

(i) such portion shall be allocated among persons who are partners in the partnership during the period to which such portion is attributable in accordance with their varying interests in the partnership during such period, and

(ii) any amount allocated under clause (i) to a person who is not a partner in the partnership on such first day shall be capitalized by the partnership and treated in the manner provided for in section 755.

(3) Items attributable to interest in lower tier partnership prorated over entire taxable year

If—

(A) during any taxable year of the partnership there is a change in any partner's interest in the partnership (hereinafter in this paragraph referred to as the "upper tier partnership"), and

(B) such partnership is a partner in another partnership (hereinafter in this paragraph referred to as the "lower tier partnership"),

then (except to the extent provided in regulations) each partner's distributive share of any item of the upper tier partnership attributable to the lower tier partnership shall be determined by assigning the appropriate portion (determined by applying principles similar to the principles of subparagraphs (C) and (D) of

¹ See References in Text note below.

paragraph (2)) of each such item to the appropriate days during which the upper tier partnership is a partner in the lower tier partnership and by 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.

(4) Taxable year determined without regard to subsection (c)(2)(A)

For purposes of this subsection, the taxable year of a partnership shall be determined without regard to subsection (c)(2)(A).

(Aug. 16, 1954, ch. 736, 68A Stat. 242; Pub. L. 94-455, title II, §213(c)(1), title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1547, 1834; Pub. L. 98-369, div. A, title I, §72(a), (b), July 18, 1984, 98 Stat. 589, 591; Pub. L. 99-514, title VIII, §806(a), title XVIII, §1805(a), Oct. 22, 1986, 100 Stat. 2362, 2810; Pub. L. 100-647, title I, §1008(e)(1)-(3), Nov. 10, 1988, 102 Stat. 3439, 3440; Pub. L. 105-34, title V, §507(b)(2), title XII, §1246(a), (b), Aug. 5, 1997, 111 Stat. 857, 1030.)

REFERENCES IN TEXT

Section 584(h), referred to in subsec. (b)(5), was redesignated section 584(i) by Pub. L. 104-188, title I, §1805(a), 110 Stat. 1894.

AMENDMENTS

1997—Subsec. (b)(5). Pub. L. 105-34, §507(b)(2), substituted “section 644” for “section 645”.

Subsec. (c)(2). Pub. L. 105-34, §1246(b), substituted “Treatment of dispositions” for “Partner who retires or sells interest in partnership” as heading.

Subsec. (c)(2)(A). Pub. L. 105-34, §1246(a), amended heading and text of subpar. (A) generally. Prior to amendment, text read as follows: “The taxable year of a partnership shall close—

“(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

“(ii) with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies shall not close prior to the end of the partnership’s taxable year.”

1988—Subsec. (b)(1)(B)(i). Pub. L. 100-647, §1008(e)(1)(A), amended cl. (i) generally. Prior to amendment, cl. (i) read as follows: “The taxable year of 1 or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent.”

Subsec. (b)(1)(B)(iii). Pub. L. 100-647, §1008(e)(2), substituted “unless the Secretary by regulations prescribes another period” for “or such other period as the Secretary may prescribe in regulations”.

Subsec. (b)(4). Pub. L. 100-647, §1008(e)(1)(B), substituted “Majority interest taxable year; limitation on required changes” for “Application of majority interest rule” in heading and amended text generally. Prior to amendment, text read as follows: “Clause (i) of paragraph (1)(B) shall not apply to any taxable year of a partnership unless the period which constitutes the taxable year of 1 or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent has been the same for—

“(A) the 3-taxable year period of such partner or partners ending on or before the beginning of such taxable year of the partnership, or

“(B) if the partnership has not been in existence during all of such 3-taxable year period, the taxable years of such partner or partners ending with or within the period of existence.

This paragraph shall apply without regard to whether the same partners or interests are taken into account in determining the 50 percent interest during any period.”

Subsec. (b)(5). Pub. L. 100-647, §1008(e)(3), added par. (5).

1986—Subsec. (b). Pub. L. 99-514, §806(a)(3), struck out “Adoption of” before “taxable year” in heading.

Subsec. (b)(1). Pub. L. 99-514, §806(a)(1), amended par. (1) generally. Prior to amendment, par. (1) read as follows: “The taxable year of a partnership shall be determined as though the partnership were a taxpayer. A partnership may not change to, or adopt, a taxable year other than that of all its principal partners unless it establishes, to the satisfaction of the Secretary, a business purpose therefor.”

Subsec. (b)(4). Pub. L. 99-514, §806(a)(2), added par. (4). Subsec. (d)(2)(A)(i). Pub. L. 99-514, §1805(a)(1)(A), substituted “such item” for “each such item”.

Subsec. (d)(2)(B). Pub. L. 99-514, §1805(a)(1)(B), in introductory provisions, struck out “which are described in paragraph (1) and” after “the following items”.

Subsec. (d)(2)(C)(i). Pub. L. 99-514, §1805(a)(2), substituted “the first day of the taxable year” for “the first day of such taxable year”.

1984—Subsec. (c)(2)(A). Pub. L. 98-369, §72(b)(1), struck out last sentence providing that such partner’s distributive share of item described in section 702(a) for such year shall be determined, under regulations prescribed by the Secretary, for the period ending with such sale, exchange, or liquidation.

Subsec. (c)(2)(B). Pub. L. 98-369, §72(b)(2), struck out “, but such partner’s distributive share of items described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the taxable year” after “otherwise”.

Subsec. (d). Pub. L. 98-369, §72(a), added subsec. (d). 1976—Subsec. (b)(1), (2). Pub. L. 94-455, §1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (c)(2). Pub. L. 94-455, §§213(c)(1), 1906(b)(13)(A), substituted “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)” for “or with respect to a partner whose interest is reduced”, in par. (B), and struck out “or his delegate” after “Secretary” in par. (A).

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by section 507(b)(2) of Pub. L. 105-34 applicable to sales or exchanges after Aug. 5, 1997, see section 507(c)(2) of Pub. L. 105-34, set out as a note under section 644 of this title.

Pub. L. 105-34, title XII, §1246(c), Aug. 5, 1997, 111 Stat. 1030, provided that: “The amendments made by this section [amending this section] shall apply to partnership taxable years beginning after December 31, 1997.”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 806(a) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with special provisions applicable to taxpayers who are required to change their accounting periods, see section 806(e) of Pub. L. 99-514, set out as a note under section 1378 of this title.

Amendment by section 1805(a) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Pub. L. 98-369, div. A, title I, §72(c), July 18, 1984, 98 Stat. 591, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: “The amendments made by this section [amending this section] shall apply—

“(1) in the case of items described in section 706(d)(2) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as added by subsection (a)), to amounts attributable to periods after March 31, 1984, and

“(2) in the case of items described in section 706(d)(3) of such Code (as added by subsection (a)), to amounts paid or accrued by the other partnership after March 31, 1984.”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 213(c)(1) of Pub. L. 94-455 applicable in the case of partnership taxable years beginning after Dec. 31, 1975, see section 213(f) of Pub. L. 94-455, set out as an Effective Date note under section 709 of this title.

CONSTRUCTION OF SECTION 806 OF PUB. L. 99-514

Nothing in section 806 of Pub. L. 99-514 or in any legislative history relating thereto to be construed as requiring the Secretary of the Treasury or his delegate to permit an automatic change of a taxable year, see section 1008(e)(9) of Pub. L. 100-647, set out as a note under section 1378 of this title.

**PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989**

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§ 1101-1147 and 1171-1177] or title XVIII [§§ 1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 707. Transactions between partner and partnership

(a) Partner not acting in capacity as partner

(1) In general

If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

(2) Treatment of payments to partners for property or services

Under regulations prescribed by the Secretary—

(A) Treatment of certain services and transfers of property

If—

(i) a partner performs services for a partnership or transfers property to a partnership,

(ii) there is a related direct or indirect allocation and distribution to such partner, and

(iii) the performance of such services (or such transfer) and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership,

such allocation and distribution shall be treated as a transaction described in paragraph (1).

(B) Treatment of certain property transfers

If—

(i) there is a direct or indirect transfer of money or other property by a partner to a partnership,

(ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and

(iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property,

such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership.

(b) Certain sales or exchanges of property with respect to controlled partnerships

(1) Losses disallowed

No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between—

(A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1). For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b).

(2) Gains treated as ordinary income

In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221—

(A) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits interests,

any gain recognized shall be considered as ordinary income.

(3) Ownership of a capital or profits interest

For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section.

(c) Guaranteed payments

To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member