

approaches that maximize net benefits (including potential economic, environmental, public health and safety and other advantages, distributive impacts, and equity). The agency believes that this proposed rule is consistent with the regulatory philosophy and principles identified in the Executive Order. In addition, the proposed rule is not a significant regulatory action as defined by the Executive Order and so is not subject to review under the Executive Order.

The Regulatory Flexibility Act requires agencies to analyze regulatory options that would minimize any significant impact of a rule on small entities. Based on the May 9, 1997 (62 FR 25477), **Federal Register**, a final rule was issued establishing a performance standard for electrode lead wires and patient cables, which included and applied to the cardiopulmonary bypass accessory equipment that involves an electrical connection to the patient, the goniometer, and the electrode cable. The FDA's analysis determined that the imposition of the performance standard would not have a significant economic impact on a substantial number of small entities. This reclassification, if finalized, will have no economic effect other than the imposition of this standard. In addition, the proposed rule, if finalized, will not impose costs of \$100 million or more on either the private sector or state, local, and tribal governments in the aggregate, and therefore a summary statement or analysis under section 202 (a) of the Unfunded Mandates Reform Act of 1995 is not required.

## XII. Paperwork Reduction Act of 1995

FDA has tentatively determined that this proposed rule contains no collections of information. Therefore, clearance from the Office of Management and Budget under the Paperwork Reduction Act of 1995 is not required.

## XIII. Submission of Comments

Interested persons may, on or before November 8 1999, submit to the Dockets Management Branch (address above) written comments regarding this proposal. Two copies of any comments are to be submitted, except that individuals may submit one copy. Comments are to be identified with the docket number found in brackets in the heading of this document. Received comments may be seen in the office above between 9 a.m. and 4 p.m., Monday through Friday.

## List of Subjects in 21 CFR Parts 870, 888, and 890

Medical Devices.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under the authority delegated to the Commissioner of Food and Drugs, it is proposed that 21 CFR parts 870, 888, and 890 be amended as follows:

### PART 870—CARDIOVASCULAR DEVICES

1. The authority citation for 21 CFR part 870 continues to read as follows:

**Authority:** 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

2. Section 870.4200 is revised to read as follows:

#### § 870.4200 Cardiopulmonary bypass accessory equipment

(a) *Identification.* Cardiopulmonary bypass accessory equipment is a device that has no contact with blood and that is used in the cardiopulmonary bypass circuit to support, adjoin, or connect components, or to aid in the setup of the extracorporeal line, e.g., an oxygenator mounting bracket or system-priming equipment.

(b) *Classification.* (1) Class I. The device is classified as class I if it does not involve an electrical connection to the patient. The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to § 870.9.

(2) Class II (special controls). The device is classified as class II if it involves an electrical connection to the patient. The special controls are as follows:

(1) The performance standard under part 898 of this chapter and

(2) The guidance document entitled, "Guidance on the Performance Standard for Electrode Lead Wires and Patient Cables." The device is exempt from the premarket notification procedures in subpart E of part 807 of this chapter subject to § 870.9.

### PART 888—ORTHOPEDIC DIAGNOSTIC DEVICES

3. The authority citation for 21 CFR part 888 continues to read as follows:

**Authority:** 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

4. Section 888.1500 is amended by revising paragraph (b) to read as follows:

#### § 888.1500 Goniometer.

\* \* \* \* \*

(b) *Classification.* Class II (special controls). The special controls consist of:

(1) The performance standard under part 898 of this chapter and

(2) The guidance entitled, "Guidance on the Performance Standard for Electrode Lead Wires and Patient Cables." This device is exempt from the premarket notification procedures of subpart E of part 807 of this chapter subject to § 888.9.

### PART 890—PHYSICAL MEDICINE PROSTHETIC DEVICES

5. The authority citation for 21 CFR part 890 continues to read as follows:

**Authority:** 21 U.S.C. 351, 360, 360c, 360e, 360j, 371.

6. Section 890.1175 is amended by revising paragraph (b) to read as follows:

#### § 890.1175 Electrode cable.

\* \* \* \* \*

(b) *Classification.* Class II (special controls). The special controls consist of:

(1) The performance standard under part 898 of this chapter and

(2) The guidance document entitled, "Guidance on the Performance Standard for Electrode Lead Wires and Patient Cables." This device is exempt from the premarket notification procedures of subpart E of part 807 of this chapter subject to § 890.9.

Dated: July 25, 1999.

**Linda S. Kahan,**

*Deputy Director for Regulations Policy, Center for Devices and Radiological Health.*

[FR Doc. 99-20357 Filed 8-6-99; 8:45 am]

BILLING CODE 4160-01-F

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-106527-98]

RIN 1545-AW22

### Capital Gains, Partnership, Subchapter S, and Trust Provisions

**AGENCY:** Internal Revenue Service (IRS), Treasury.

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

**SUMMARY:** This document contains proposed regulations relating to sales or exchanges of interests in partnerships, S corporations, and trusts. The proposed regulations interpret the look-through provisions of section 1(h), added by section 311 of the Taxpayer Relief Act of 1997 and amended by sections 5001 and 6005(d) of the Internal Revenue Service Restructuring and Reform Act of 1998, and explain the rules relating to the division of the holding period of a

partnership interest. The proposed regulations affect partnerships, partners, S corporations, S corporation shareholders, trusts, and trust beneficiaries.

**DATES:** Written comments must be received by November 8, 1999. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for November 18, 1999, must be received by October 28, 1999.

**ADDRESSES:** Send submissions to: CC:DOM:CORP:R (REG-106527-98), 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-106527-98), 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/regslst.html](http://www.irs.ustreas.gov/tax_regs/regslst.html). The public hearing will be held in room 3411, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Jeanne Sullivan (202) 622-3050; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke (202) 622-7180 (not toll-free numbers).

#### **SUPPLEMENTARY INFORMATION**

##### **Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the IRS, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by October 8, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the collections will have a practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in § 1.1(h)-1(e). This information is required by the IRS to implement section 311 of the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998. The collections of information are required to provide information to the IRS regarding the capital gain attributable to collectibles and section 1250 property held by a partnership when a partner sells or exchanges an interest in that partnership and the capital gain attributable to collectibles when a shareholder sells or exchanges an interest in an S corporation or a trust beneficiary sells or exchanges an interest in a trust. This information will be used to verify compliance with section 1(h) and to determine that the tax on capital gains has been computed correctly. The collection of information is mandatory. The likely respondents are individuals and businesses.

Respondent taxpayers provide information by attaching a statement to the appropriate tax return. The burden for this requirement is reflected in the burden estimates for: Form 1040, U.S. Individual Income Tax Return; Form 1065, U.S. Partnership Return of Income; Form 1041, U.S. Income Tax Return for Estates and Trusts; and Form 1120S, U.S. Income Tax Return for an S Corporation. The estimated burden of information collection for the statement required is 10 minutes.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

##### **Background**

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to taxation of capital gains in the case of sales or exchanges of interests in partnerships, S corporations, and trusts. The Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788, 831 (1997 Act), amended section 1(h) of the Internal Revenue Code to reduce the maximum statutory tax rates for long-term capital gains of individuals in general. Certain technical corrections and other amendments to section 1(h) were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206, 112 Stat. 685, 787, 800 (1998 Act).

Section 1(h) provides that intermediate level rates apply to long-term capital gains from certain transactions, such as sales or exchanges of collectibles, section 1202 stock (with respect to a portion of the gain), and section 1250 property with gain attributable to straight-line depreciation. Section 1(h)(11) provides authority to the Secretary to issue such regulations as are appropriate to apply these rules in the case of sales or exchanges by pass-thru entities and of interests in pass-thru entities. This document provides rules for sales or exchanges of interests in partnerships, S corporations, and trusts. This document also provides rules relating to dividing the holding period of a partnership interest.

##### **Explanation of Provisions**

In general, prior to the 1997 Act, individuals were taxed on capital gains at the same rate as ordinary income, except that the rate for net capital gain was capped at 28 percent. The 1997 Act provided for lower maximum rates of taxation on gain from the sale or exchange of certain types of property. As amended by the 1998 Act, section 1(h) currently provides for maximum capital gains rates on the sale or exchange of certain types of property in three categories: 20-percent rate gain, 25-percent rate gain, and 28-percent rate gain. Twenty percent rate gain is net capital gain from the sale or exchange of capital assets held for more than one year, reduced by the sum of 25-percent rate gain and 28-percent rate gain. Twenty-five percent rate gain is limited to unrecaptured section 1250 gain. Unrecaptured section 1250 gain is the amount of long-term capital gain (not otherwise treated as ordinary income) which would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were

100 percent, reduced by any net loss in the 28-percent rate gain category. Twenty-eight percent rate gain is capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to section 408(m)(3)) held for more than one year, a portion of the gain attributable to the sale of section 1202 stock, and capital gains and losses determined under the rules of section 1(h)(13), reduced by net short-term capital loss for the taxable year and any long-term capital loss carryover under section 1212(b)(1)(B).

#### *Collectibles Gain and Unrecaptured Section 1250 Gain*

The sale or exchange of an interest in a partnership with a long-term holding period generally will result in capital gain in the 20-percent rate gain category to the extent that section 751(a) is not applicable. Section 751(a) generally provides that an amount received in exchange for a partnership interest, to the extent attributable to unrealized receivables and inventory, shall be considered as an amount realized from the sale or exchange of property other than a capital asset. Section 1250 property is treated as an unrealized receivable for purposes of section 751 to the extent of the amount that would be treated as gain to which section 1250(a) would apply.

The sale or exchange of stock in an S corporation with a long-term holding period generally will result in gain or loss in the 20-percent rate gain category, unless an exception to capital gain treatment applies. Certain of those exceptions are provided in sections 304, 306, 341, and 1254.

The sale or exchange of an interest in a trust with a long-term holding period generally will result in gain or loss in the 20-percent rate gain category. However, if the transferor is treated as the owner of the portion of the trust attributable to an interest under sections 673 through 679, the transferor is treated as transferring an undivided interest in the assets of the trust rather than an interest in the trust itself.

Effective for taxable years ending after May 6, 1997, when an interest in a partnership, an S corporation, or a trust held for more than one year (or more than 18 months during certain periods in 1997) is sold or exchanged, section 1(h) provides special treatment for "collectibles gain" in property held by a partnership, S corporation, or trust and for "section 1250 capital gain" in property held by a partnership. Specifically, section 1(h)(6)(B) provides that any gain from the sale of an interest in a partnership, S corporation, or trust

which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible, applying rules similar to section 751(a) to determine the amount of the gain. In addition, under section 1(h)(7)(A) (in conjunction with sections 751(a) and (c)), the amount of long-term capital gain (not otherwise treated as ordinary income under section 751(a)) that would be treated as ordinary income under section 751(a) if section 1250 applied to all depreciation (section 1250 capital gain) must be taken into account in computing unrecaptured section 1250 gain when an interest in a partnership (with a holding period of more than one year, or more than 18 months during certain periods in 1997) is sold or exchanged. See H. Rep. No. 105-356, 105th Cong. 1st Sess. (1997), at 16, fn. 11; S. Rep. No. 105-174, 105th Cong. 2d Sess. (1998), at 149, fn. 65.

The proposed regulations provide guidance with respect to the application of these rules to a sale or exchange of an interest in a partnership, S corporation, or trust holding assets with collectibles gain and a partnership holding assets with section 1250 capital gain. Generally, the amount of such gain is determined by reference to the gain that would be allocated to the selling partner, shareholder, or beneficiary (to the extent attributable to the portion of the transferred interest that is subject to long-term capital gain) if the partnership, S corporation, or trust had sold all of its collectibles or if the partnership had sold all of its section 1250 property in a fully taxable transaction immediately before the transfer of the partnership, S corporation, or trust interest. Special rules are provided where the partner, S corporation shareholder, or trust beneficiary recognizes less than all of the gain upon the sale or exchange of its interest.

In addition, for purposes of applying section 1(h)(7)(B), which provides that a taxpayer's unrecaptured section 1250 gain cannot exceed the taxpayer's net section 1231 gain, gain from the sale of a partnership interest that results in section 1250 capital gain is not treated as section 1231 gain even if section 1231 could apply to the disposition of the underlying partnership property. Although section 1(h)(7) (in combination with section 751) applies a limited look-thru rule for purposes of determining the capital gain rate applicable to the sale of a partnership interest, no similar look-thru rule applies for purposes of applying section 1231. Anomalous results would follow if section 1250 capital gain derived from

the sale of a partnership interest were treated as section 1231 gain for purposes of applying the limitation in section 1(h)(7)(B) but not for purposes of actually applying section 1231.

#### *Determination of Holding Period in a Partnership*

In view of the long-established principle that a partner has a single basis in a partnership interest (see Rev. Rul. 84-53 (1984-1 C.B. 159)), there is some confusion under current law as to how the principles of section 1223 apply to the sale of an interest, or a portion of an interest, in a partnership. The proposed regulations provide rules relating to the allocation of a divided holding period with respect to an interest in a partnership. These rules generally provide that the holding period of a partnership interest will be divided if a partner acquires portions of an interest at different times or if an interest is acquired in a single transaction that gives rise to different holding periods under section 1223. The holding period of a portion of a partnership interest shall be determined based on a fraction that is equal to the fair market value of the portion of the partnership interest to which the holding period relates (determined immediately after the acquisition) over the fair market value of the entire partnership interest. A selling partner may use the actual holding period of the portion of a partnership interest sold if the partnership is a "publicly traded partnership" (as defined under section 7704(b)), the partnership interest is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the interest transferred. Otherwise, the holding period(s) of the transferred interest must be divided in the same ratio as the holding period(s) of the partner's entire partnership interest.

These proposed regulations do not contain a specific anti-abuse rule regarding holding periods. However, there may be situations where taxpayers will attempt to undertake abusive transactions using the rules in these regulations. For instance, taxpayers may attempt to shift gain from property with a short-term holding period to property with a long-term holding period by contributing the short-term property to a partnership and selling the partnership interest. Because the basis of a partnership interest cannot be segregated to a portion of an interest, basis in the portion of a partnership interest with a long-term holding period could reduce gain attributable to the portion of a partnership interest with a short-term holding period in situations

where such interest was recently received in exchange for contributed short-term capital gain property. In appropriate situations, the IRS may attack such abusive transactions under a variety of judicial doctrines, including substance over form or step transaction, or under § 1.701-2 of the regulations.

#### Proposed Effective Date

The amendments are proposed to be effective for all transfers of interests in a partnership, S corporation, or trust and for all distributions from a partnership on or after the date the regulations are published as final regulations 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. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the facts that: (1) the time required to prepare and file the statement is minimal (currently estimated at 10 minutes per statement); and (2) it is anticipated that, as a result of these regulations, small entities will file no more than one statement per year. Furthermore, taxpayers will have to respond to the requests for information contained in § 1.1(h)-1(e) only if there is a sale or exchange of an interest in a partnership, an S corporation, or a trust that holds certain property. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

#### 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 submitted timely to the IRS. The IRS and Treasury 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 November 18, 1999, beginning at 1 p.m. in room 3411 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to

building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must request to speak and 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 October 28, 1999. 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 Jeanne Sullivan, Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

**PARAGRAPH 1.** The authority citation for part 1 continues to read in part as follows:

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

#### **PAR. 2. SECTION 1.1(H)-1 IS ADDED TO READ AS FOLLOWS:**

##### **§ 1.1(h)-1 Capital gains look-through rule for sales or exchanges of interests in a partnership, S corporation, or trust.**

(a) *In general.* When an interest in a partnership held for more than one year is sold or exchanged, the transferor may recognize ordinary income (e.g., section 751(a)), collectibles gain, section 1250 capital gain, and residual long-term capital gain or loss. When stock in an S corporation held for more than one year

is sold or exchanged, the transferor may recognize ordinary income (e.g., sections 304, 306, 341, 1254), collectibles gain, and residual long-term capital gain or loss. When an interest in a trust held for more than one year is sold or exchanged, a transferor who is not treated as the owner of the portion of the trust attributable to the interest sold or exchanged (sections 673 through 679) (a non-grantor transferor) may recognize collectibles gain and residual long-term capital gain or loss.

(b) *Look-through capital gain*—(1) *In general.* Look-through capital gain is the share of collectibles gain allocable to an interest in a partnership, S corporation, or trust, plus the share of section 1250 capital gain allocable to an interest in a partnership, determined under paragraphs (b)(2) and (3) of this section.

(2) *Collectibles gain and collectibles loss*—(i) *Definitions.* For purposes of this section, *collectibles gain* and *collectibles loss* mean gain or loss, respectively, from the sale or exchange of a collectible (as defined in section 408(m) without regard to section 408(m)(3)) that is a capital asset held for more than 1 year, but only to the extent such gain is taken into account in computing gross income, and such loss is taken into account in computing taxable income.

(ii) *Share of collectibles gain allocable to an interest in a partnership, S corporation, or trust.* When an interest in a partnership, S corporation, or trust held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the transferor shall recognize as collectibles gain the amount of net collectibles gain (but not net collectibles loss) that would be allocated to that partner (taking into account any remedial allocation under § 1.704-3(d)), shareholder, or beneficiary (to the extent attributable to the portion of the partnership interest, S corporation stock, or trust interest transferred that was held for more than one year) if the partnership, S corporation, or trust transferred all of its collectibles in a fully taxable transaction immediately before the transfer of the interest in the partnership, S corporation, or trust. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, S corporation, or trust, the same methodology shall apply to determine the collectibles gain recognized by the transferor, except that the partnership, S corporation, or trust shall be treated as transferring only a proportionate amount of each of its collectibles determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of

gain realized in the sale or exchange. With respect to the transfer of an interest in a trust, this paragraph applies only to transfers by non-grantor transferors (as defined in paragraph (a) of this section).

(3) *Section 1250 capital gain*—(i) *Definition.* For purposes of this section, *section 1250 capital gain* means the long-term capital gain (not otherwise treated as ordinary income) that would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent.

(ii) *Share of section 1250 capital gain allocable to interest in partnership.* When an interest in a partnership held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, there shall be taken into account under section 1(h)(7)(A)(i) in determining the partner's unrecaptured section 1250 gain the amount of section 1250 capital gain that would be allocated (taking into account any remedial allocation under § 1.704-3(d)) to that partner (to the extent attributable to the portion of the partnership interest transferred that was held for more than one year) if the partnership transferred all of its section 1250 property in a fully taxable transaction immediately before the transfer of the interest in the partnership. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, the same methodology shall apply to determine the section 1250 gain recognized by the transferor, except that the partnership shall be treated as transferring only a proportionate amount of each section 1250 property determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of gain realized in the sale or exchange.

(iii) *Limitation with respect to net section 1231 gain.* In determining a transferor partner's net section 1231 gain (as defined in section 1231(c)(3)) for purposes of section 1(h)(7)(B), the transferor partner's allocable share of section 1250 capital gain in partnership property shall not be treated as section 1231 gain, regardless of whether the partnership property is used in the trade or business (as defined in section 1231(b)).

(c) *Residual long-term capital gain or loss.* The amount of residual long-term capital gain or loss recognized by a partner, shareholder of an S corporation, or beneficiary of a trust on account of the sale or exchange of an interest in a partnership, S corporation, or trust shall equal the amount of long-term capital gain or loss that the partner would

recognize under section 741, that the shareholder would recognize upon the sale or exchange of stock of an S corporation, or that the beneficiary would recognize upon the sale or exchange of an interest in a trust (pre-look-through long-term capital gain or loss) minus the amount of long-term capital gain determined under paragraph (b) of this section (look-through capital gain).

(d) *Special rule for tiered entities.* In determining whether a partnership, S corporation, or trust has collectibles gain and whether a partnership has section 1250 capital gain, such partnership, S corporation, or trust shall be treated as owning its proportionate share of the property of any partnership, S corporation, or trust in which it owns an interest, either directly or indirectly through a chain comprised exclusively of such entities.

(e) *Notification requirements.* Rules similar to those that apply to the partners and the partnership under section 751(a) shall apply in the case of sales or exchanges of interests in a partnership, S corporation, or trust that holds property with collectibles gain and in the case of sales or exchanges of interests in a partnership that holds property with section 1250 capital gain. See § 1.751-1(a)(3).

(f) *Examples.* The following examples illustrate the requirements of this section:

*Example 1. Collectibles gain.* (i) A and B are equal partners in a personal service partnership (PRS). B transfers B's interest in PRS to T for \$15,000 when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	
	Adjusted basis	Market value
Cash .....	\$3,000	\$3,000
Loans owed to partnership .....	10,000	10,000
Collectibles .....	1,000	3,000
Other capital assets .....	6,000	2,000
Capital assets .....	7,000	5,000
Unrealized receivables .....	0	14,000
Total .....	\$20,000	\$32,000
Liabilities and capital		
Liabilities .....	\$2,000	\$2,000
Capital:		
A .....	9,000	15,000
B .....	9,000	15,000
Total .....	\$20,000	\$32,000

(ii) At the time of the transfer, B has held the interest in PRS for more than one year, and none of the property owned by PRS is section 704(c) property. The total amount realized by B is \$16,000, consisting of the cash received, \$15,000, plus \$1,000, B's share of the partnership liabilities assumed by T. See section 752. B's basis for the partnership interest is \$10,000 (\$9,000 plus \$1,000, B's share of partnership liabilities). B's undivided one-half interest in PRS includes a one-half interest in the partnership's unrealized receivables and a one-half interest in the partnership's collectibles.

(iii) If PRS were to sell all of its section 751 property in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would be allocated \$7,000 of ordinary income from the sale of PRS's unrealized receivables. Therefore, B will recognize \$7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 (\$6,000) and the amount of ordinary income or loss determined under § 1.751-1(a)(2) (\$7,000) is the partner's capital gain or loss on the sale of the partnership interest under section 741. In this case, the transferor has a \$1,000 pre-look-through long-term capital loss.

(iv) If PRS were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would be allocated \$1,000 of collectibles gain from the sale of the collectibles. Therefore, B will recognize \$1,000 of collectibles gain on account of the collectibles held by PRS.

(v) The difference between the transferor's pre-look-through long-term capital gain or loss (–\$1,000) and the look-through capital gain determined under this section (\$1,000) is the transferor's residual long-term capital gain or loss on the sale of the partnership interest. Under these facts, B will recognize a \$2,000 residual long-term capital loss on account of the sale or exchange of the interest in PRS.

*Example 2. Special allocations.* Assume the same facts as in *Example 1*, except that under the partnership agreement, all gain from the sale of the collectibles is specially allocated to B, and B transfers B's interest to T for \$16,000. All items of income, gain, loss, or deduction of PRS, other than the collectibles gain, are divided equally between A and B. Under these facts, B's pre-look-through long-term capital gain would be \$0. If PRS were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would be allocated \$2,000 of collectibles gain from the sale of the collectibles. Therefore, B will recognize \$2,000 of collectibles gain on account of the collectibles held by PRS. B also will recognize \$7,000 of ordinary income (determined under § 1.751-1(a)(2)) and a \$2,000 long-term capital loss on account of the sale of B's interest in PRS.

*Example 3. Net collectibles loss ignored.* Assume the same facts as in *Example 1*, except that the collectibles held by PRS have an adjusted basis of \$3,000 and a fair market

value of \$1,000, and the other capital assets have an adjusted basis of \$4,000 and a fair market value of \$4,000. If *PRS* were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated \$1,000 of collectibles loss. Because none of the gain from the sale of the interest in *PRS* is attributable to unrealized appreciation in the value of collectibles held by *PRS*, the net loss in collectibles held by *PRS* is not recognized at the time *B* transfers the interest in *PRS*. *B* will recognize \$7,000 of ordinary income (determined under § 1.751-1(a)(2)) and a \$1,000 long-term capital loss on account of the sale of *B*'s interest in *PRS*.

**Example 4. Collectibles gain in an S corporation.** (i) A corporation (*X*) has always been an S corporation and is owned by individuals *A*, *B*, and *C*. In 1996, *X* invested in antiques. Subsequent to their purchase, the antiques appreciated in value by \$300. *A* owns one-third of the shares of *X* stock and has held that stock for more than one year. *A*'s adjusted basis in the *X* stock is \$100. If *A* were to sell all of the *X* stock to *T* for \$150, *A* would realize \$50 of pre-look-through long-term capital gain.

(ii) If *X* were to sell its antiques in a fully taxable transaction immediately before the transfer to *T*, *A* would be allocated \$100 of collectibles gain on account of the sale. Therefore, *A* will recognize \$100 of collectibles gain (look-through capital gain) on account of the collectibles held by *X*.

(iii) The difference between the transferor's pre-look-through long-term capital gain or loss (\$50) and the look-through capital gain determined under this section (\$100) is the transferor's residual long-term capital gain or loss on the sale of the S corporation stock. Under these facts, *A* will recognize \$100 of collectibles gain and a \$50 residual long-term capital loss on account of the sale of *A*'s interest in *X*.

(g) **Effective date.** This section applies to transfers of interests in partnerships, S corporations, and trusts that occur on or after the date these regulations are published as final regulations in the **Federal Register**.

**Par. 3.** Section 1.1223-3 is added to read as follows:

**§ 1.1223-3 Rules relating to the holding periods of partnership interests.**

(a) *In general.* A partner shall have a divided holding period in an interest in a partnership if:

(1) The partner acquired portions of an interest at different times; or  
(2) The partner acquired portions of the partnership interest in exchange for property transferred at the same time but resulting in different holding periods determined under section 1223.

(b) *Accounting for holding periods of an interest in a partnership.* The portion of a partnership interest to which a holding period relates shall be determined by reference to a fraction that is the fair market value of the

portion of the partnership interest received in the transaction to which the holding period relates over the fair market value of the entire partnership interest (determined immediately after the transaction).

(c) *Sale or exchange of all or a portion of an interest in a partnership—*(1) *Sale or exchange of entire interest in a partnership.* If a partner sells or exchanges the partner's entire interest in a partnership, any capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the holding period of the interest in the partnership is divided between the portion of the interest held for more than one year and the portion of the interest held for one year or less.

(2) *Sale or exchange of a portion of an interest in a partnership.* (i) If the ownership interest in a publicly traded partnership (as defined under section 7704(b)) is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the partnership interest transferred, the selling partner may use the actual holding period of the portion transferred.

(ii) If a partner has a divided holding period in a partnership interest, and paragraph (c)(2)(i) of this section does not apply, then the holding period of the transferred interest shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the transferor partner would realize if the entire interest in the partnership were transferred in a fully taxable transaction immediately before the actual transfer.

(d) *Distributions—*(1) *In general.* A partner's holding period in a partnership interest is not affected by distributions from the partnership.

(2) *Character of capital gain or loss recognized as a result of a distribution from a partnership.* If a partner is required to recognize capital gain or loss as a result of a distribution from a partnership, then the capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the distributee partner would realize if such partner's entire interest in the partnership were transferred in a fully taxable transaction immediately before the distribution.

(e) *Examples.* The provisions of this section are illustrated by the following examples:

**Example 1. Division of holding period—contribution of money and a capital asset.** (i) *A* contributes \$5,000 of cash and a

nondepreciable capital asset *A* has held for two years to a partnership (*PRS*) for a 50% interest in *PRS*. *A*'s basis in the capital asset is \$5,000, and the fair market value of the asset is \$10,000. After the exchange, *A*'s basis in *A*'s interest in *PRS* is \$10,000, and the fair market value of the interest is \$15,000. *A* received one-third of the interest in *PRS* for a cash payment of \$5,000 (\$5,000/\$15,000). Therefore, *A*'s holding period in one-third of the interest received (attributable to the contribution of money to the partnership) begins on the day after the contribution. *A* received two-thirds of the interest in *PRS* in exchange for the capital asset (\$10,000/\$15,000). Accordingly, pursuant to section 1223(1), *A* has a two-year holding period in two-thirds of the interest received in *PRS*.

(ii) Six months later, when *A*'s basis in *PRS* is \$12,000 (due to a \$2,000 allocation of partnership income to *a*), *A* sells the interest in *PRS* for \$15,000. Assuming *PRS* holds no inventory or unrealized receivables (as defined under section 751(c)) and no collectibles or section 1250 property, *a* will realize \$3,000 of capital gain. As determined above, one-third of *A*'s interest in *PRS* has a holding period of one year or less, and two-thirds of *A*'s interest in *PRS* has a holding period equal to two years and six months. Therefore, one-third of the capital gain will be short-term capital gain, and two-thirds of the capital gain will be long-term capital gain.

**Example 2. Division of holding period—contribution of money, section 1231 property, and other property.** In exchange for a 30% interest in a partnership (*ABC*), *A* contributes to *ABC* \$50,000 cash and equipment used in a trade or business and held for more than one year with a fair market value of \$100,000 and an adjusted basis of \$40,000. The equipment has a recomputed basis under section 1245 of \$60,000. Accordingly, a portion of the equipment equal in value to \$20,000 is section 1245 property that is not section 1231 property. See § 1.1245-6(a). *A*'s partnership interest has a fair market value of \$150,000, a basis of \$90,000, and a divided holding period. *A* received 46.67% (\$70,000/\$150,000) of the interest in *ABC* in exchange for property that is neither a capital asset nor section 1231 property (that is, cash of \$50,000 and a portion of the equipment attributable to section 1245 recapture in an amount equal to \$20,000). Therefore, *A*'s holding period for 46.67% of *A*'s interest begins on the day after the exchange of the property for the partnership interest. *A* received 53.33% (\$80,000/\$150,000) of *A*'s interest in *ABC* in exchange for section 1231 property.

Accordingly, *A*'s holding period for 53.33% of *A*'s interest includes *A*'s holding period for the section 1231 property.

**Example 3. Division of holding period when capital account is increased by contribution.** *A*, *B*, *C*, and *D* are equal partners in a partnership (*PRS*), and the fair market value of a 25% interest in *PRS* is \$90x. *A*, *B*, *C*, and *D* each contribute an additional \$10x to partnership capital, thereby increasing the fair market value of each partner's interest to \$100x. As a result of the contribution, each partner has a new holding period in the portion of the partner's

interest in *PRS* that is attributable to the contribution. That portion equals 10% (\$10x/\$100x) of each partner's interest in *PRS*.

**Example 4. Sale or exchange of a portion of an interest in a partnership.** (i) *A* contributes \$5,000 in cash and a capital asset with a fair market value of \$5,000 and a basis of \$2,000 to a partnership (*PRS*) in exchange for an interest in *PRS*. At the time of the contribution, *A* had held the contributed property for two years. Six months later, when *A*'s basis in *PRS* is \$7,000, *A* transfers one-half of *A*'s interest in *PRS* to *T* for \$6,000 at a time when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	Market value
	Adjusted basis	
Cash .....	\$5,000	\$5,000
Unrealized Receivables .....	0	6,000
Capital Asset 1 .....	3,000	8,000
Capital Asset 2 .....	2,000	5,000
Capital Assets .....	5,000	13,000
Total .....	\$10,000	\$24,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50% of the fair market value of *A*'s interest in *PRS* was received in exchange for property with a long-term holding period. Therefore, 50% of *A*'s interest in *PRS* has a long-term holding period.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated \$3,000 of ordinary income. One-half of that amount (\$1,500) is attributable to the portion of *A*'s interest in *PRS* transferred to *T*. Accordingly, *A* will recognize \$1,500 ordinary income and \$1,000 (\$2,500 - \$1,500) of capital gain on account of the transfer to *T* of one-half of *A*'s interest in *PRS*. Fifty percent (\$500) of that gain is long-term capital gain and 50% (\$500) is short-term capital gain.

**Example 5. Sale or exchange of a portion of an interest in a partnership.** (i) The facts are the same as in *Example 4*, except that capital asset 1 is a collectible that was purchased by *PRS* more than one year earlier. If capital asset 1 were sold or exchanged in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated \$2,500 of collectibles gain. Fifty percent of that amount (\$1,250) is attributable to the portion of *A*'s interest in *PRS* sold to *T*. The collectibles gain allocable to the portion of the transferred interest in *PRS* with a long-term holding period is \$625 (50% of \$1,250). Accordingly, *A* will recognize \$625 of collectibles gain on account of the transfer of one-half of the interest in *PRS*.

(ii) The difference between the amount of pre-look-through long-term capital gain or loss (\$500) and the look-through capital gain (\$625) is the amount of residual long-term capital gain or loss that *A* will recognize on

account of the transfer of one-half of the interest in *PRS*. Under these facts, *A* will recognize a residual long-term capital loss of \$125 and a short-term capital gain of \$500.

**Example 6. Sale of units of interests in partnership.** A publicly traded partnership (*PRS*) has ownership interests that are segregated into identifiable units of interest. *A* owns 10 limited partnership units in *PRS* for which *A* paid \$10,000 three years ago. Later, *A* purchases five additional units for \$10,000 at a time when the fair market value of each unit has increased to \$2,000. *A*'s holding period for one-third (\$10,000/\$30,000) of the interest in *PRS* begins on the day after the purchase of the five additional units. Less than one year later, *A* sells five units of ownership in *PRS* for \$11,000. At the time, *A*'s basis in the 15 units of *PRS* is \$20,000, and *A*'s capital gain on the sale of 5 units is \$4,333 (amount realized of \$11,000—one-third of the adjusted basis or \$6,667). For purposes of determining the holding period, *A* can designate the specific units of *PRS* sold. If *A* properly identifies the five units sold as five of the ten units for which *A* has a long-term holding period, the capital gain realized will be long-term capital gain.

**Example 7. Disproportionate distribution.** In 1997, *A* and *B* each contribute cash of \$50,000 to form and become equal partners in a partnership (*PRS*). Sometime later, *A* receives a distribution worth \$22,000 from *PRS*, which reduces *A*'s interest in *PRS* to 36%. After the distribution, *B* owns 64% of *PRS*. The holding periods of *A* and *B* in their interests in *PRS* are not affected by the distribution.

**Example 8. Gain or loss as a result of a distribution.** In 1996, *A* contributes property with a basis of \$10 and a fair market value of \$10,000 in exchange for an interest in a partnership (*ABC*). In 1999, when *A*'s interest in *ABC* is worth \$12,000, *A* contributes \$6,000 cash in exchange for an additional interest in *ABC*, bringing the fair market value of *A*'s interest to \$18,000. The holding period of *A*'s interest in *ABC* is determined immediately after that exchange. *A*'s holding period in one-third of *A*'s interest in *ABC* (\$6,000 cash contributed over the \$18,000 value of the entire interest) begins on the day after the cash contribution. (*ABC* holds no inventory or unrealized receivables.) Later in 1999, *ABC* makes a cash distribution to *A* of \$10,000. *A*'s basis in *ABC* immediately before the distribution is \$6,010. Accordingly, *A* must recognize \$3990 of capital gain as a result of the distribution. See section 731(a)(1). One-third of the capital gain recognized as a result of the distribution is short-term capital gain, and two-thirds of the capital gain is long-term capital gain. After the distribution, *A*'s basis in the interest in *PRS* is \$0, and the holding period for the interest in *PRS* continues to be divided in the same proportions as before the distribution.

(f) **Effective date.** This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after the date final regulations are published in the **Federal Register**.

**Par. 4.** Section 1.741-1 is amended by adding paragraphs (e) and (f) to read as follows:

**§ 1.741-1 Recognition and character of gain or loss on sale or exchange.**

\* \* \* \* \*

(e) For rules relating to the capital gain or loss recognized when a partner sells or exchanges an interest in a partnership that holds appreciated collectibles or section 1250 property with section 1250 capital gain, see § 1.1(h)-1.

(f) For rules relating to dividing the holding period of an interest in a partnership, see § 1.1223-3.

**Robert E. Wenzel,**

*Deputy Commissioner of Internal Revenue.*

[FR Doc. 99-20368 Filed 8-6-99; 8:45 am]

BILLING CODE 4830-01-U

## ENVIRONMENTAL PROTECTION AGENCY

### 40 CFR Part 62

[Region 2 Docket No. NY 32-194b, FRL-6414-2]

### Approval and Promulgation of State Plans for Designated Facilities; New York

**AGENCY:** Environmental Protection Agency (EPA).

**ACTION:** Proposed rule.

**SUMMARY:** The Environmental Protection Agency (EPA) is proposing to approve the State Plan submitted by New York to implement and enforce the Emission Guidelines (EG) for existing Hospital/Medical/Infectious Waste Incinerators (HMIWI). The EG require states to develop plans to reduce toxic air emissions from all HMIWIs. In the final rules section of this **Federal Register**, EPA is approving New York's HMIWI State Plan as a direct final rule without prior proposal because the Agency views this as a noncontroversial action and anticipates no relevant adverse comments. A detailed rationale for the approval is set forth in the direct final rule. If EPA receives no adverse comments to that direct final rule, EPA will not take action on this proposed rule. If EPA receives adverse comments, EPA will withdraw the direct final rule and it will not take effect. EPA will address all public comments received in a subsequent final rule based on this proposed rule. The EPA will not institute a second comment period on this action. Any parties interested in commenting on this action should do so at this time.