

contract accounted for under a long-term contract method of accounting only if the partnership's books are properly closed with respect to that contract under section 706. If the partnership's books are not closed with respect to the contract, the partnership shall compute its income or loss from each contract accounted for under a long-term contract method of accounting for the period that includes the date of the transfer or liquidation as though no change in taxpayer had occurred with respect to that contract, and may pro rate income from the contract under a reasonable method complying with section 706. Similar rules are provided for distributions of property (other than a contract accounted for under a long-term contract method of accounting) from a partnership holding a long-term contract, and for contributions of property (other than a contract accounted for under a long-term contract method of accounting) to a partnership holding a contract accounted for under a long-term contract method of accounting.

Comments are requested regarding whether similar rules should be provided with respect to transfers of stock in an S corporation holding a contract accounted for under a long-term contract method of accounting. See section 1377(a)(1) and § 1.1377-1(a) (providing that each shareholder's pro rata share of any S corporation item for any taxable year is generally the sum of the amounts determined with respect to the shareholder by assigning an equal portion of the item to each day of the S corporation's taxable year, and then dividing that portion pro rata among the shares outstanding on that day); and section 1377(a)(2) and § 1.1377-1(b) (providing that an S corporation may elect to close its books if a shareholder's entire interest in an S corporation is terminated during the S corporation's taxable year, and the corporation and all affected shareholders agree).

6. Look-Back Method

The final section 460 regulations generally require any old taxpayer that accounted for income from a long-term contract under the PCM, and that transfers the contract to a new taxpayer in a step-in-the-shoes transaction, to provide the information described in § 1.460-6(g)(3)(ii)(D) to the new taxpayer. The proposed regulations provide that, if the step-in-the-shoes transaction is a contribution of property (other than a contract accounted for under a long-term contract method of accounting) to a partnership, the distribution of property (other than a

contract accounted for under a long-term contract method of accounting) by a partnership, or a transfer of a partnership interest, the old taxpayer is not required to provide this information, because information necessary for the new taxpayer to apply the look-back method is provided by the partnership. A similar exception is provided if the step-in-the-shoes transaction is a transfer of stock in an S corporation, or a conversion to or from an S corporation.

7. Distribution of a Contract by a Partnership

The distribution of a contract accounted for under a long-term contract method of accounting by a partnership to a partner is a constructive completion transaction. The proposed regulations provide that, in determining the partnership's income on the constructive completion transaction, the fair market value of the contract is treated as the amount realized from the transaction. The proposed regulations also clarify that, for purposes of determining each partner's distributive share of partnership items, any income or loss resulting from the constructive completion must be allocated among the partners of the partnership as though the partnership closed its books on the date of the distribution.

Section 732 determines the basis of property (other than money) distributed by a partnership to a partner. Section 734(b) provides for an adjustment to the basis of partnership property as a result of certain distributions from partnerships that have a section 754 election in effect. The proposed regulations provide that, if a contract accounted for under a long-term contract method of accounting is distributed to a partner, then, for purposes of determining the partner's basis in the contract (including the uncompleted property, if applicable) under section 732 and the amount of any basis adjustment under section 734(b), the partnership's basis in the contract (including the uncompleted property, if applicable) immediately prior to the distribution is the partnership's allocable contract costs (including transaction costs), increased (or decreased) by the amount of cumulative taxable income (or loss) recognized by the partnership on the contract through the date of the distribution (including amounts recognized as a result of the constructive completion), and decreased by the amounts that the partnership has received or reasonably expects to receive under the contract.

The proposed regulations provide that, if a contract accounted for under a long-term contract method of accounting is distributed to a partner, then, in computing the total contract price (or gross contract price) for the new contract, the partner's basis in the contract (including the uncompleted property, if applicable) after the distribution (as determined under section 732) is treated as consideration paid by the partner that is allocable to the contract. Thus, the total contract price (or gross contract price) of the new contract is reduced by the partner's basis in the contract (including the uncompleted property, if applicable) immediately after the distribution.

Section 751(b)(1) provides that, to the extent a partner receives in a distribution partnership property which is unrealized receivables or inventory items which have appreciated substantially in value, in exchange for all or a part of the partner's interest in other partnership property (including money), the transaction is considered a sale or exchange of the property between the distributee partner and the partnership. The same treatment applies if a partner receives in a distribution partnership property (including money) other than unrealized receivables and substantially appreciated inventory in exchange for the partner's interest in the partnership's unrealized receivables or substantially appreciated inventory. Because the distribution of a contract accounted for under a long-term contract method of accounting is the distribution of an unrealized receivable, section 751(b) may apply to the distribution. Therefore, the proposed regulations provide an ordering rule under which a partnership that distributes a contract accounted for under a long-term contract method of accounting to apply the constructive completion rules before applying the rules of section 751(b) to the distribution.

8. Treatment of Progress Payments Under Section 752

In Rev. Rul. 73-301 (1973-2 C.B. 215), the IRS addressed whether unrestricted progress payments received by a partnership reporting its income under the CCM constitute a partnership liability under section 752. In that revenue ruling, the partnership performed all of the services required to be entitled to receive the progress payments, and there was no obligation to return the payments or perform any additional services in order to retain the payments. The IRS ruled that the progress payments described in the ruling did not constitute a liability