

second partnership (transferee partnership) in an exchange described in section 721, followed by a distribution of the interest in the transferee partnership in liquidation of the transferor partnership, under § 1.708-1(b)(4) (relating to terminations under section 708(b)(1)(B)) or § 1.708-1(c)(3)(i) (relating to certain partnership mergers).

(B) *Old taxpayer.* The partnership that distributes the contract is treated as the old taxpayer for purposes of paragraph (k)(2)(ii) of this section. For purposes of determining the total contract price (or gross contract price) under paragraph (k)(2)(ii) of this section, the fair market value of the contract is treated as the amount realized from the transaction. 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 old taxpayer as though the partnership closed its books on the date of the distribution.

(C) *New taxpayer.* The partner receiving the distributed contract is treated as the new taxpayer for purposes of paragraph (k)(2)(iii) of this section. For purposes of determining the total contract price (or gross contract price) under paragraph (k)(2)(iii) of this section, the new taxpayer'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 new taxpayer 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.

(D) *Basis rules.* For purposes of determining the new taxpayer'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 equal to—

(1) The partnership's allocable contract costs (including transaction costs);

(2) 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

(3) Decreased by the amounts that the partnership has received or reasonably expects to receive under the contract.

(E) *Section 751—(1) In general.* Contracts accounted for under a long-term contract method of accounting are unrealized receivables within the meaning of section 751(c). For purposes of section 751, the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting is the amount of income or loss that the partnership would take into account under the constructive completion rules of paragraph (k)(2) of this section if the contract were disposed of for its fair market value in a constructive completion transaction, adjusted to account for any income or loss from the contract that is allocated under section 706 to that portion of the taxable year of the partnership ending on the date of the distribution, sale, or exchange.

(2) *Ordering rules.* 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. A partnership that distributes a contract accounted for under a long-term contract method of accounting must apply paragraph (k)(2)(ii) of this section before applying the rules of section 751(b) to the distribution.

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(3) \* \* \*

(i) \* \* \*

(I) Contributions of contracts accounted for under a long-term contract method of accounting to which section 721(a) applies;

(J) Contributions of property (other than contracts accounted for under a long-term contract method of accounting) to a partnership that holds a contract accounted for under a long-term contract method of accounting;

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(iv) *Special rules related to certain corporate and partnership transactions—(A) Old taxpayer—basis adjustment—(1) In general.* Except as provided in paragraph (k)(3)(iv)(A)(2) of this section, in the case of a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section, the old taxpayer must adjust its basis in the stock or partnership interest of the new taxpayer by—

(i) Increasing such basis by the amount of gross receipts the old taxpayer has recognized under the contract; and

(ii) Reducing such basis by the amount of gross receipts the old taxpayer has received or reasonably expects to receive under the contract.

(2) *Basis adjustment in excess of stock or partnership interest basis.* If the old

and new taxpayer do not join in the filing of a consolidated Federal income tax return, the old taxpayer may not adjust its basis in the stock or partnership interest of the new taxpayer under paragraph (k)(3)(iv)(A)(1) of this section below zero and the old taxpayer must recognize ordinary income to the extent the basis in the stock or partnership interest of the new taxpayer otherwise would be adjusted below zero. If the old and new taxpayer join in the filing of a consolidated Federal income tax return, the old taxpayer must create an (or increase an existing) excess loss account to the extent the basis in the stock of the new taxpayer otherwise would be adjusted below zero under paragraph (k)(3)(iv)(A)(1) of this section. See §§ 1.1502-19 and 1.1502-32(a)(3)(ii).

(3) *Subsequent dispositions of certain contracts.* If the old taxpayer disposes of a contract in a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section that the old taxpayer acquired in a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section, the basis adjustment rule of this paragraph (k)(3)(iv)(A) is applied by treating the old taxpayer as having recognized the amount of gross receipts recognized by the previous old taxpayer under the contract and any amount recognized by the previous old taxpayer with respect to the contract in connection with the transaction in which the old taxpayer acquired the contract. In addition, the old taxpayer is treated as having received or as reasonably expecting to receive under the contract any amount the previous old taxpayer received or reasonably expects to receive under the contract. Similar principles will apply in the case of multiple successive transfers described in paragraph (k)(3)(i)(D), (E), or (I) of this section involving the contract.

(B) *New Taxpayer—(1) Contract price adjustment.* Generally, payments between the old taxpayer and the new taxpayer with respect to the contract in connection with the transaction do not affect the contract price. Notwithstanding the preceding sentence and paragraph (k)(3)(iii)(B) of this section, however, in the case of transactions described in paragraph (k)(3)(i)(B), (D), (E), or (I) of this section, the total contract price (or gross contract price) must be reduced to the extent of any amount recognized by the old taxpayer with respect to the contract in connection with the transaction (e.g., any amount recognized under section 351(b) or section 357 that is attributable to the contract and any income recognized by the old taxpayer pursuant