

partner's adjusted basis (\$5,000), each partner must treat his \$5,000 gain recognized on the sale of the oil property as ordinary income under section 1254(a). Because H elected under section 59(e) to capitalize the \$4,800 of intangible drilling and development costs and amortized only \$960 of the costs in 1995, the \$3,840 of unamortized intangible drilling and development costs are included in H's basis in the oil property. Therefore, at the end of 1995 H's basis in the oil property is \$4,840 ((\$2,000 cost + \$4,800 capitalized intangible drilling and development costs) - (\$960 intangible drilling and development costs amortized + \$1,000 depletion deduction claimed)). H's gain on the sale of the oil property is \$1,160 (\$6,000 amount realized - \$4,840 adjusted basis). H's section 1254 costs are \$1,960 (\$960 intangible drilling and development costs amortized + \$1,000 depletion deductions claimed). Because H's section 1254 costs (\$1,960) exceed H's share of amount realized less H's adjusted basis (\$1,160), H must treat the \$1,160 of gain recognized as ordinary income under section 1254(a).

(c) *Section 1254 costs of a partner—*  
 (1) *General rule.* A partner's section 1254 costs with respect to property held by a partnership include all of the partner's section 1254 costs with respect to the property in the hands of the partnership. In the case of property contributed to a partnership in a transaction described in section 721, a partner's section 1254 costs include all of the partner's section 1254 costs with respect to the property prior to contribution. Section 1.1254-1(b)(1)(iv), which provides rules concerning the treatment of suspended deductions, applies to amounts not deductible pursuant to section 704(d).

(2) *Section 1254 costs of a transferee partner after certain acquisitions—*(i) *Basis determined under section 1012.* If a person acquires an interest in a partnership that holds natural resource recapture property (transferee partner) and the transferee partner's basis for the interest is determined by reference to its cost (within the meaning of section 1012), the amount of the transferee partner's section 1254 costs with respect to the property held by the partnership is zero on the acquisition date.

(ii) *Basis determined by reason of the application of section 1014(a).* If a transferee partner acquires an interest in a partnership that holds natural resource recapture property from a decedent and the transferee partner's basis is determined, by reason of the application of section 1014(a), solely by reference to the fair market value of the partnership interest on the date of the decedent's death or on the applicable date provided in section 2032 (relating to alternate valuation date), the amount of the transferee partner's section 1254

costs with respect to property held by the partnership is zero on the acquisition date.

(iii) *Basis determined by reason of the application of section 1014(b)(9).* If an interest in a partnership that holds natural resource recapture property is acquired before the death of the decedent, the amount of the transferee partner's section 1254 costs with respect to property held by the partnership shall include the amount, if any, of the section 1254 costs deducted by the transferee partner before the decedent's death, to the extent that the basis of the partner's interest (determined under section 1014(a)) is required to be reduced under section 1014(b)(9) (relating to adjustments to basis when the property is acquired before the death of the decedent).

(iv) *Gifts and section 1041 transfers.* If an interest in a partnership is transferred in a transfer that is a gift, a part sale or exchange and part gift, or a transfer that is described in section 1041(a), the amount of the transferee partner's section 1254 costs with respect to property held by the partnership immediately after the transfer is an amount equal to—

(A) The amount of the transferor partner's section 1254 costs with respect to the property immediately before the transfer; minus

(B) The amount of any gain recognized as ordinary income under section 1254 by the transferor partner upon the transfer.

(d) *Property distributed to a partner—*  
 (1) *In general.* The section 1254 costs for any natural resource recapture property received by a partner in a distribution with respect to part or all of an interest in a partnership include—

(i) The aggregate of the partners' section 1254 costs with respect to the natural resource recapture property immediately prior to the distribution; reduced by

(ii) The amount of any gain taken into account as ordinary income under section 751 by the partnership or the partners (as constituted after the distribution) on the distribution of the natural resource recapture property.

(2) *Aggregate of partners' section 1254 costs with respect to natural resource recapture property held by a partnership—*(i) *In general.* The aggregate of partners' section 1254 costs is equal to the sum of each partner's section 1254 costs. The partnership must determine each partner's section 1254 costs under either paragraph (d)(2)(i)(A) (written data) or paragraph (d)(2)(i)(B) (assumptions) of this section. The partnership may determine the section 1254 costs of some of the

partners under paragraph (d)(2)(i)(A) of this section and of others under paragraph (d)(2)(i)(B) of this section.

(A) *Written data.* A partnership may determine a partner's section 1254 costs by using written data provided by a partner showing the partner's section 1254 costs with respect to natural resource recapture property held by the partnership unless the partnership knows or has reason to know that the written data is inaccurate. If a partnership does not receive written data upon which it may rely, the partnership must use the assumptions provided in paragraph (d)(2)(i)(B) of this section in determining a partner's section 1254 costs.

(B) *Assumptions.* A partnership that does not use written data pursuant to paragraph (d)(2)(i)(A) of this section to determine a partner's section 1254 costs must use the following assumptions to determine the partner's section 1254 costs:

(1) The partner deducted his or her share of deductions under section 263(c), 616, or 617 for the first year in which the partner could claim a deduction for such amounts, unless in the case of expenditures under section 263(c) or 616, the partnership elected to capitalize such amounts;

(2) The partner was not subject to the following limitations with respect to the partner's depletion allowance under section 611, except to the extent a limitation applied at the partnership level: the taxable income limitation of section 613(a); the depletable quantity limitations of section 613A(c); or the limitations of section 613A(d)(2), (3), and (4) (exclusion of retailers and refiners).

#### § 1.1254-6 Effective date of regulations.

Sections 1.1254-1 through 1.1254-3 and § 1.1254-5 are effective with respect to any disposition of natural resource recapture property occurring after March 13, 1995. The rule in § 1.1254-1(b)(2)(iv)(A)(2), relating to a nonoperating mineral interest carved out of an operating mineral interest with respect to which an expenditure has been deducted, is effective with respect to any disposition occurring after March 13, 1995 of property (within the meaning of section 614) that is placed in service by the taxpayer after December 31, 1986.

#### § 1.1502-14 [Amended]

**Par. 8.** In § 1.1502-14, the first sentence of paragraph (c)(1) is amended by removing the language "or 1250(a)(1)" and adding "1250(a)(1) or 1254(a)(1)" in its place.