Internal Revenue bulletin

Bulletin No. 2012-9
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG–109369–10, page 434.

Proposed regulations under section 469 of the Code provide guidance regarding the definition of an "interest in a limited partnership as a limited partner" for purposes of determining whether a taxpayer materially participates in an activity.

Notice 2012–13, page 421.

This notice provides guidance for employers that seek to claim the Work Opportunity Tax Credit (WOTC) for hiring veterans. The notice also provides information on alternative methods for filing Form 8850 with the Department of Labor/Designated Local Agencies. Announcement 2002–44 supplemented.

Notice 2012–15, page 424.

This notice addresses the application of section 367 of the Code to transfers of stock subject to section 304.

EMPLOYEE PLANS

Notice 2012–16, page 427.

Weighted average interest rate update; corporate bond indices; 30-year Treasury securities; segment rates. This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in February 2012; the 24-month average segment rates; the funding transitional segment rates applicable for February 2012; and the minimum present value transitional rates for January 2012.

EMPLOYMENT TAX

Notice 2012–13, page 421.

This notice provides guidance for employers that seek to claim the Work Opportunity Tax Credit (WOTC) for hiring veterans. The notice also provides information on alternative methods for filing Form 8850 with the Department of Labor/Designated Local Agencies. Announcement 2002–44 supplemented.

EXCISE TAX

Notice 2012–17, page 430.

This notice answers to frequently asked questions from employers regarding certain provisions of the Patient Protection and Affordable Care Act, specifically the provisions dealing with automatic enrollment, employer shared responsibility and waiting periods.

Finding Lists begin on page ii.
Index for January through February begins on page iv.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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Part III. Administrative, Procedural, and Miscellaneous

Work Opportunity Tax Credit

Notice 2012–13

I. PURPOSE

This notice provides guidance on Returning Heroes and Wounded Warriors Work Opportunity Tax Credits, included as § 261 of the VOW to Hire Heroes Act of 2011, Tit. II, subtitle D, of Pub. L. No. 112–056 (Act), enacted on November 21, 2011. Section 261 of the Act amended §§ 51, 52, and 3111 of the Internal Revenue Code to provide a credit for hiring certain qualified veterans. This notice also provides employers who hire qualified veterans additional time beyond the 28-day deadline in § 51(d)(13) for submitting Form 8850, *Pre-screening Notice and Certification Request for the Work Opportunity Credit,* to Designated Local Agencies (DLAs)

This notice provides additional guidance on electronic signature and electronic submission of Form 8850 and also informs all employers that the Internal Revenue Service (IRS) will allow the signature and submission of Form 8850 by facsimile to DLAs that choose to accept such submissions.

This notice also requests comments on alternative methods for certification of a veteran as a qualified veteran described in clause (ii)(II), (iii), or (iv) of § 51(d)(3)(A),

II. BACKGROUND

Section 51 provides for a Work Opportunity Tax Credit (WOTC) for employers who hire individuals who are members of targeted groups. An employer must obtain certification that an individual is a targeted group member before the employer may claim the credit. Certification of an individual's targeted group status is obtained from a DLA. A DLA is a State employment security agency established in accordance with 29 U.S.C. §§ 49–49n. An employer must submit Form 8850 to the DLA not later than the 28th day after the individual begins work for the employer.

The WOTC applies to certain wages paid or incurred by employers with respect to a member of a targeted group. Prior to enactment of the Act, § 51(c)(4)(B) provided that wages paid or incurred with respect to an individual who begins work for the employer after December 31, 2011, are not taken into account for purposes of the WOTC. Thus, the credit is not available with respect to wages for persons who begin work after December 31, 2011, other than qualified veterans. The Act extended the credit only with respect to qualified veterans who begin work for the employer on or before December 31, 2012.

The Act amends § 51(d)(3) to add two new categories to the qualified veteran targeted group. Under new § 51(d)(3)(A)(iii) and (iv), a qualified veteran is a veteran certified as having aggregate periods of unemployment of at least 4 weeks but less than 6 months in the year prior to being hired or certified as having aggregate periods of unemployment of 6 months or more in the year prior to being hired.

The amount of wages that an employer may take into account in computing the credit differs for the various categories of qualified veterans. The Act amends § 51(b)(3), which provides the amount of qualified wages that an employer may take into account in calculating the WOTC. Section 51(b)(3), as amended, provides that the amount of qualified wages taken into account is limited to $6,000 per year in the case of any individual who is a qualified veteran by reason of subsection (d)(3)(A)(i) (a veteran certified as being a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for at least a 3-month period ending during the 12-month period ending on the hiring date) and subsection (d)(3)(A)(iii) (a veteran certified as having aggregate periods of unemployment of at least 4 weeks but less than 6 months in the year prior to being hired); $12,000 per year in the case of any individual who is a qualified veteran by reason of subsection (d)(3)(A)(ii)(I) (a disabled veteran who is certified as having a hiring date which is not more than 1 year after discharge or release from active duty); $14,000 per year in the case of any individual who is a qualified veteran by reason of subsection (d)(3)(A)(iv) (a veteran certified as having aggregate periods of unemployment of 6 months or more in the year prior to being hired); and $24,000 per year in the case of any individual who is a qualified veteran by reason of subsection (d)(3)(A)(ii)(II) (a disabled veteran who is certified as having aggregate periods of unemployment of 6 months or more in the year prior to being hired).

The Act amends § 51(d)(13)(D) to provide that a veteran will be treated as being certified as having the requisite aggregate period of unemployment by the DLA if the veteran is certified as being in receipt of unemployment compensation for the applicable period. The Act also allows the Secretary of the Treasury to provide, at the Secretary's discretion, alternative methods for certification of a veteran as a qualified veteran described in clause (ii)(II), (iii), or (iv) of § 51(d)(3)(A).

The Act amends § 51(c)(4)(B) to extend the credit and allow an employer to claim the WOTC for qualified wages paid or incurred by the employer to a qualified veteran who begins work on or before December 31, 2012.

The Act also amends § 52 and § 3111 to make a credit available to "qualified tax-exempt organizations" that hire qualified veterans for which the WOTC would have been allowable under § 51 if the organization were not a qualified tax-exempt organization. Specifically, the Act adds new § 3111(e), which permits qualified tax-exempt organizations that hire qualified veterans on or after November 22, 2011, to claim a credit against the employer share of social security tax imposed under § 3111(a).

The credit under § 3111(e)(1) is a credit against the tax imposed by § 3111(a) on wages paid by the qualified tax-exempt organization with respect to employment of all employees of the organization during the applicable period. Section 3111(e)(4) defines the "applicable period" as the 1-year period beginning with the day the qualified veteran begins work for the organization. The amount of the credit under § 3111(e) equals the amount of the credit determined under § 51 (after application of the modifications under § 3111(e)(3)) with respect to wages paid to the qualified veteran during the applicable period. However, under § 3111(e)(2), the aggregate amount allowed as a credit under

§ 3111(e) for all qualified veterans for any period with respect to which tax is imposed under § 3111(a) cannot exceed the amount of the employer social security tax imposed by § 3111(a) on all wages paid by the employer during such period.

As indicated above, the amount of the credit under § 3111(e) is determined under § 51 but is subject to modifications under § 3111(e)(3). Specifically, § 3111(e)(3) modifies the amount of the credit available to the qualified tax-exempt organization to 16.25 percent (rather than 25 percent) of the qualified first-year wages for the applicable period if the veteran performs less than 400 hours but at least 120 hours of service, or 26 percent (rather than 40 percent) of the qualified first-year wages for the applicable period if the veteran performs at least 400 hours of service for the qualified tax-exempt organization. Further, to calculate the amount of the credit, the qualified tax-exempt organization only takes into account the wages paid to a qualified veteran for services in furtherance of activities related to the purpose or function constituting the basis of the organization's exemption under § 501. For example, wages for services in an unrelated trade or business (as defined in § 513) are not counted for purposes of the credit. Although wages are defined for purposes of the WOTC under § 51 as wages under the Federal Unemployment Tax Act, for purposes of the credit available to qualified tax-exempt organizations under § 3111(e), the term "wages" refers to wages under the Federal Insurance Contributions Act.

New § 3111(e)(5)(A) defines "qualified tax-exempt organization" as an employer that is an organization described in § 501(c) and exempt from taxation under § 501(a). Accordingly, an employer that is an agency or instrumentality of the federal government, or of a state, local, or Indian tribal government, is not a qualified tax-exempt organization unless it is an organization described in § 501(c) that is exempt from tax under § 501(a).

The requirements for certification under § 51, as amended by the Act, apply to qualified tax-exempt organizations as well as to taxable employers. Accordingly, a qualified tax-exempt organization must obtain certification, as required under § 51, that an individual is a qualified veteran before it may claim the credit. The transition relief, guidance on filing Forms 8850 with electronic signatures, and allowance of signature and submission of Form 8850 by facsimile provided for in this notice apply to all employers, including qualified tax-exempt organizations.

III. TRANSITION RELIEF

Section 51(d)(13)(A) provides that an individual shall not be treated as a member of a targeted group unless (1) on or before the day the individual begins work, the employer obtains certification from the DLA that the individual is a member of a targeted group; or (2) the employer completes a pre-screening notice (Form 8850) on or before the day the individual is offered employment and submits such notice to the DLA to request certification not later than 28 days after the individual begins work. Because the credit, as amended, became effective on the day after enactment, the Treasury Department and the IRS believe it is appropriate to provide employers with additional time to file Form 8850 with a DLA. Accordingly, any employer who hires any qualified veteran described in § 51(d)(3) on or after November 22, 2011, and before May 22, 2012, will be considered to satisfy the requirements of § 51(d)(13)(A)(ii) if the employer submits the completed pre-screening notice to the DLA to request certification not later than June 19, 2012.

IV. FILING OF FORM 8850 WITH ELECTRONIC SIGNATURES

Before any employer may claim the WOTC for hiring any member of a targeted group (or, for qualified tax-exempt organizations, the § 3111(e) credit for hiring a qualified veteran), that individual must be certified by the DLA as a member of a targeted group. Section 51(d)(13)(A)(ii)(II) requires that, not later than the 28^{th} day after the individual begins work for the employer, the employer submit a notice, signed by the employer and the individual under penalties of perjury, to the DLA as part of a written request for certification. For purposes of this Section IV, "employer" refers to any employer required to submit a Form 8850 in order to obtain the WOTC under § 51 or the equivalent credit under § 3111(e), or an authorized representative of such an employer.

Employers may submit Form 8850 to the DLA electronically if the employer's system satisfies the requirements in Ann. 2002–44, 2002–1 C.B. 809. This notice makes available to employers two alternative methods of certification using electronic signatures in addition to the electronic submission of Form 8850 as provided in Ann. 2002–44. The alternative methods are available to any employer required to submit a Form 8850 in order to obtain the WOTC for any member of any targeted group under § 51 or the equivalent credit under § 3111(e).

First, an employer may print out a paper copy of the Form 8850 that was signed electronically by both the applicant and the employer in accordance with the requirements of Ann. 2002–44, and transmit that paper copy to the DLA (by mail or by facsimile following the rules in Section V of this notice).

Second, an employer may file Form 8850 using a method under which the applicant signs electronically but the employer signs in ink. More specifically, the applicant signs Form 8850 electronically and the Form 8850 is transmitted electronically to the employer in accordance with the requirements detailed below. Once received and printed out, the paper copy of the Form 8850 shows "signed electronically" in the field for the applicant's signature. The employer signs that paper copy of that Form 8850 in ink, complying with the signature and jurat requirements on Form 8850 and the Form 8850 instructions for the paper copy of Form 8850, and transmits that paper copy to the DLA (by mail or by facsimile following the rules in Section V of this notice). Under this second alternative method, the employer must satisfy all five of the following requirements with respect to the Form 8850 that is electronically signed by the applicant:

(i) *In General.* The electronic system must ensure that the information received is the information sent, and it must document all occasions of access that result in the transmission of a Form 8850. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the applicant signing the Form 8850, accessing the system, and submitting the Form 8850 is the applicant identified in the form.

(ii) *Same Information as Paper Form 8850.* The electronically signed Form

8850 must provide the DLA with exactly the same information as the paper Form 8850.

(iii) *Jurat and Signature Requirements*. The Form 8850 must be signed electronically by the applicant under penalties of perjury.

(A) *Jurat.* The jurat (perjury statement) must contain the language that appears on the paper Form 8850 for the applicant. The electronic system must inform the applicant that he or she must make the declaration contained in the jurat and that the declaration is made by signing the Form 8850. The instructions and the language of the jurat must immediately follow the information provided by the applicant, and must immediately precede the applicant's electronic signature.

(B) *Electronic Signature.* The electronic signature must (1) identify the applicant whose name is on the Form 8850 and the employer submitting the Form 8850, and (2) authenticate and verify the form. For this purpose, the terms "authenticate" and "verify" have the same meaning as they do when applied to a written signature on a paper Form 8850. An electronic signature can be in any form that satisfies the foregoing requirements.

(iv) *Copies of Form 8850.* The employer must be able to supply and, upon request by the IRS, the employer must supply (1) a paper copy of the Form 8850 submitted to the DLA, and (2) a statement that, to the best of the employer's knowledge, the Form 8850 was submitted by the employer with respect to the named applicant. The paper copy of the electronically signed Form 8850 must provide exactly the same information as, but need not be a facsimile of, the paper Form 8850.

(v) *Retention of Forms 8850 by the DLAs and Employers.* Forms 8850 with an applicant's electronic signature have the same status as paper Forms 8850. Therefore, guidance that applies to paper Forms 8850 also applies to these Forms 8850. For example, as is the case for paper Forms 8850, electronic Forms 8850 are required to be retained by employers under their established record-keeping systems. For further information, see Rev. Proc. 98–25, 1998–1 C.B. 689, on information regarding the retention of records within an Automatic Data Processing System.

V. ALTERNATIVE METHOD OF FILING OR SIGNING FORM 8850—FILING OR SIGNING BY FACSIMILE

In addition to the electronic signature method of filing Form 8850 described in Section IV, the IRS will also allow the facsimile transmission of applicant and employer signatures on a Form 8850 if the applicable DLA accepts Form 8850 via facsimile, the applicant and employer intend the signatures on the faxed copy to be their signatures for purposes of the document, and the requirements of paragraphs (1) and (2) below are satisfied:

(1) *Same Information as Paper Form 8850.* The facsimile submission is a reproduction of Form 8850 that provides the DLA with exactly the same information as the paper Form 8850.

(2) *Signature and Transmission Requirements.* The Form 8850 is signed by the applicant and the employer, under penalties of perjury, and transmitted to the DLA in the following manner:

(i) An original Form 8850 is completed in paper copy and then signed in ink by the applicant;

(ii) The original Form 8850, signed by the applicant, is delivered to the employer either in person or by facsimile;

(iii) The employer signs in ink either the paper copy of Form 8850 that was signed by the applicant or the facsimile of that paper copy; and

(iv) The employer mails or faxes the signed Form 8850 to the DLA within the time prescribed by § 51(d)(13)(A)(ii) (or within the period authorized under Section III of this notice).

For purposes of this Section V, "employer" refers to any employer required to submit a Form 8850 in order to obtain the WOTC for any member of any targeted group under § 51 or the equivalent credit under § 3111(e), or an authorized representative of such an employer.

VI. GUIDANCE FOR TAX-EXEMPT ORGANIZATIONS

Qualified tax-exempt organizations entitled to a credit under § 3111(e) must use Form 5884–C, *Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans*, to claim the credit. Although the credit under § 3111(e) is applied against the employer social security tax liability for the employment tax period in which the credit is claimed, the liability reported on the qualified tax-exempt organization's employment tax return (*e.g.,* Form 941) is not reduced when that return is filed. Rather, the IRS will process Form 5884–C separately and refund the amount properly claimed on Form 5884–C to the qualified tax-exempt organization, subject to the limit of the amount of employer social security tax liability for the period in which the credit is claimed. Because Form 5884–C will generally not be processed simultaneously with the qualified tax-exempt organization's employment tax return, it is recommended that qualified tax-exempt organizations not reduce their required deposits in anticipation of any credit. A qualified tax-exempt organization that reduces its required employment tax deposits in anticipation of a credit under § 3111(e) may receive a system-generated notice; however, the balance due, including any related penalties and interest, resulting from the reduction in deposits to reflect the credit under § 3111(e), will be abated when the credit is applied, generally without any taxpayer action.

Form 5884–C is filed separately and should not be attached to any other return filed by the qualified tax-exempt organization. Form 5884–C should be filed after the qualified tax-exempt organization files its employment tax return for the tax period for which the credit is claimed and in accordance with the Form 5884–C instructions. Form 5884–C can be filed immediately after the qualified tax-exempt organization files its employment tax return and it must be filed within 2 years from the date the tax reported on the employment tax return was paid, or 3 years from the date the employment tax return was filed, whichever is later.

The qualified tax-exempt organization using Form 5884–C must calculate the cumulative credit to which the qualified tax-exempt organization is entitled under § 3111(e) for all qualified veterans hired on or after November 22, 2011. The qualified tax-exempt organization must reduce the cumulative credit by any credits claimed on any Forms 5884–C filed for prior tax periods. The amount refunded will be limited to the amount of employer social security tax reported on the employment tax return filed by the qualified tax-exempt organization for the employment tax period for which the credit is claimed. Any excess credit (*i.e.*, any credit that exceeds the employer social security tax for the period the credit is claimed) may be carried forward and will be included in the qualified tax-exempt organization's cumulative calculation on Form 5884–C filed for a subsequent tax period to the extent provided in the instructions to Form 5884–C.

VII. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on alternative methods for certification of a veteran as a qualified veteran described in § 51(d)(3) in addition to the methods of signing and filing electronically or by facsimile described in this notice. In particular, comments related to certification of a veteran as a qualified veteran described in clause (ii)(II), (iii), or (iv) of § 51(d)(3)(A) are requested. Comments are also requested on alternative methods of filing Form 8850. Comments must be submitted by April 12, 2012. All materials submitted will be available for public inspection and copying. Comments should be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2012–13), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2012–13), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov.* Include the notice number (Notice 2012–13) in the subject line.

VIII. EFFECT ON OTHER DOCUMENTS

This notice supplements Ann. 2002–44, 2002–1 C.B. 809.

EFFECTIVE DATE

Amendments made to § 51, § 52, and § 3111 by the Act are effective for individuals who begin work for the employer on or after November 22, 2011. As described in Section III, any employer who hires any qualified veteran described in § 51(d)(3) on or after November 22, 2011, and before May 22, 2012, will be considered to satisfy the requirements of § 51(d)(13)(A)(ii) if the employer submits the completed prescreening notice to the DLA to request certification not later than June 19, 2012. The alternative methods of signing and filing Forms 8850, as described in Sections IV and V, are effective for Forms 8850 filed with a DLA on or after March 10, 2012.

DRAFTING INFORMATION

The principal authors of this notice are Robin Ehrenberg and Ligeia Donis of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information on the submission of comments or the comments submitted, contact Regina Johnson at (202) 622–7180 (not a toll-free number). For further information regarding the WOTC for qualified veterans, electronic filing, and facsimile submissions, contact Ms. Ehrenberg at (202) 622–6080 (not a toll-free number). For further information on how to claim the WOTC on behalf of tax-exempt organizations, contact Ligeia Donis at (202) 622–6040 (not a toll-free number).

Application of Section 367 to Section 304 Transactions

Notice 2012–15

SECTION 1. OVERVIEW

This notice provides guidance under section 367(a) and (b) of the Internal Revenue Code (Code) in the case of certain transfers of stock to foreign corporations in exchange for property under section 304. The Internal Revenue Service (IRS) and the Department of the Treasury (Treasury Department) will amend the regulations under section 367 to incorporate the guidance described in this notice. The amendments to the regulations will apply to transfers occurring on or after February 10, 2012.

SECTION 2. BACKGROUND

.01 Section 367(a)

Section 367(a)(1) generally provides that if a United States person transfers property to a foreign corporation in an exchange described in section 332, 351, 354, 356, or 361, the foreign corporation shall not be considered a corporation for purposes of determining the extent to which the United States person recognizes gain on such transfer. Section 367(a)(2) and (3) provide specific exceptions to the general rule, and the Secretary has authority under section 367(a)(6) to promulgate regulations providing exceptions for other transfers.

Section 1.367(a)–3 provides exceptions to the general rule of section 367(a)(1) for certain transfers by a U.S. person of stock or securities to a foreign corporation. In some cases, these exceptions require the U.S. person to file a gain recognition agreement (GRA) and other related documents under the provisions of § 1.367(a)–8 (GRA regulations). The GRA regulations were revised in 2009 (T.D. 9446, 2009–1 C.B. 607) to provide further guidance, including examples addressing when a GRA needs to be filed, when it will be triggered, and when exceptions to these triggering events apply. The triggering event exceptions address distributions in redemption of stock, including by reason of the application of section 304(a)(1). See § 1.367(a)–8(n)(1) and (q)(2), *Example 14*. The GRA regulations also include a general exception that, under certain circumstances, applies to dispositions or other events not otherwise specifically excepted. See § 1.367(a)–8(k)(14).

.02 Section 367(b)

Section 367(b)(1) provides that in the case of an exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. Section 367(b)(2) provides that the regulations prescribed pursuant to section 367(b)(1) shall include (but shall not be limited to) regulations dealing with the sale or exchange of stock or securities in a foreign corporation by a United States person, including regulations providing the circumstances under which gain is recognized or deferred, amounts are included in gross income as a dividend, adjustments are made to earnings and profits, or adjustments are made to the basis of stock or securities.

Regulations under section 367(b) generally provide that if the potential application of section 1248 cannot be preserved following the acquisition of the stock or assets of a foreign corporation (foreign acquired corporation) by another foreign corporation in an exchange subject to section 367(b), including an exchange described in section 351, then certain exchanging shareholders of the foreign acquired corporation must include in income as a dividend the section 1248 amount (as defined in § 1.367(b)–2(c)) attributable to the stock of the foreign acquired corporation. See § 1.367(b)–4(b).

.03 Section 304

Section 304(a)(1) generally provides that, for purposes of sections 302 and 303, if one or more persons are in control of each of two corporations and in return for property one of the corporations (the acquiring corporation) acquires stock in the other corporation (the issuing corporation) from the person (or persons) so in control, then such property shall be treated as a distribution in redemption of the stock of the acquiring corporation. To the extent section 301 applies to the distribution, the transferor and the acquiring corporation are treated as if (1) the transferor transferred the stock of the issuing corporation to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and (2) the acquiring corporation then redeemed the stock it is deemed to have issued in the transaction.

.04 Application of Section 367 to Section 304 Transactions

On February 21, 2006, the IRS and the Treasury Department issued final regulations (T.D. 9250, 2006–1 C.B. 588) providing that section 367(a) and (b) shall not apply to certain transfers of stock of a foreign or domestic corporation to a foreign acquiring corporation to which section 351 applies (deemed section 351 exchange) by reason of section 304(a)(1) (2006 regulations).

The preamble to the 2006 regulations stated that the policies underlying section 367(a) and (b) are preserved even if a deemed section 351 exchange is not subject to section 367(a) and (b) because generally the income recognized by the transferor in the transaction (dividend income, capital gain, or both) should equal or exceed the built-in gain in the transferred stock. The preamble further explained that the application of section 367 to deemed section 351 exchanges results in complexity and uncertainty.

Comments were received, however, stating that the transferor may not recognize income equal to or greater than the built-in gain in the transferred stock if, under section 301(c)(2), the transferor is permitted to recover the basis of shares of the foreign acquiring corporation held before (and after) the transaction. In response to these comments, temporary regulations were published on February 11, 2009 (T.D. 9444, 2009–1 C.B. 603) (2009 regulations), which modified the treatment of section 304 transactions provided by the 2006 regulations. The 2009 regulations retain the general rule that the deemed section 351 exchange will not be a transfer to a foreign corporation subject to section 367(a). However, the 2009 regulations provide an exception if a U.S. person reduces its basis under section 301(c)(2), in whole or in part, in its stock of the foreign acquiring corporation other than the stock deemed issued to the U.S. person in the deemed section 351 exchange. In such case, the U.S. person recognizes gain under section 367(a)(1) equal to the amount by which the gain realized by the U.S. person exceeds the amount of the distribution that is treated as a dividend under section 301(c)(1) and included in gross income of the U.S. person. Furthermore, the 2009 regulations provide that a U.S. person cannot avoid such gain by entering into a GRA.

The 2009 regulations made similar revisions to the 2006 regulations under section 367(b). Specifically, the 2009 regulations provide that § 1.367(b)–4(b) applies to a deemed section 351 exchange only to the extent the distribution received by the exchanging shareholder in redemption of the stock deemed issued by the foreign acquiring corporation is applied against and reduces, pursuant to section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the exchanging shareholder other than the stock deemed issued to the exchanging shareholder in the deemed section 351 exchange.

.05 Section 1248(a)

Section 1248(a) generally provides that if a U.S. person that satisfies certain ownership requirements sells or exchanges stock in a controlled foreign corporation (or a foreign corporation that was a controlled foreign corporation within the past five years), then the gain recognized on the sale or exchange is included in gross income of such person as a dividend to the extent of the earnings and profits of the foreign corporation (and in certain cases, earnings and profits of foreign subsidiaries of such foreign corporation) that are attributable to such stock. The 2009 regulations provide that for purposes of section 1248(a), gain recognized by a shareholder under section 301(c)(3) in connection with a distribution of property by a foreign corporation with respect to its stock is treated as gain from the sale or exchange of stock of such corporation.

SECTION 3. REVISED APPROACH TO SECTION 304 TRANSACTIONS

After consideration of the comments received and the underlying policies of section 367(a) and (b), the IRS and the Treasury Department believe that the amount of income taken into account as a result of a section 304 distribution generally should not affect the application of section 367 to the deemed section 351 exchange. Furthermore, in the case of a transfer of stock by a U.S. person to a foreign corporation, the revised GRA regulations should substantially reduce the complexity and uncertainty resulting from the filing of a GRA in connection with a deemed section 351 exchange. Accordingly, the IRS and the Treasury Department believe it is appropriate to revise the approach to the interaction of sections 367 and 304 under the 2006 regulations and 2009 regulations by providing that section 367(a) and (b) apply fully to the deemed section 351 exchange.

SECTION 4. APPLICATION OF SECTION 367 TO SECTION 304 TRANSACTIONS

The IRS and the Treasury Department will amend the section 367 regulations to provide that the section 351 exchange that is deemed to occur in a section 304 transaction is subject to section 367(a) and (b) in the manner described below.

.01 Application of Section 367(a)

To the extent that, pursuant to section 304(a)(1), a U.S. person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation (foreign acquiring corporation) in a deemed section 351 exchange, the transfer is subject to section 367(a) and the regulations thereunder, including the exceptions described in § 1.367(a)–3(b)(1) and (c)(1), as applicable. Thus, a transferor in a section 304 transaction that is a U.S. person may, in certain cases, be permitted to enter into a GRA pursuant to § 1.367(a)–8 to avoid the recognition of gain under section 367(a)(1).

If the U.S. person (referred to in the GRA regulations as the U.S. transferor) enters into a GRA with respect to a deemed section 351 exchange, the deemed redemption of the stock of the foreign acquiring corporation deemed issued to the U.S. person pursuant to section 304(a)(1) constitutes a disposition of the transferee foreign corporation stock under § 1.367(a)–8. See § 1.367(a)–8(b)(1)(iii) and (n)(1). As a result, the deemed redemption is generally treated as a triggering event within the meaning of § 1.367(a)–8(j). However, consistent with the redemption rules provided in § 1.367(a)–8(n)(1), the redemption will not be treated as a triggering event if the U.S. person that transfers the stock in the deemed section 351 exchange (or a U.S. person that is treated as a successor U.S. transferor as a result of the deemed redemption) enters into a new GRA that includes appropriate provisions to account for the redemption, provided the principles of § 1.367(a)–8(k)(14)(ii) and (iii) are satisfied. Generally, the requirement to file an initial GRA for the deemed section 351 exchange and a new GRA by reason of the deemed redemption will be satisfied if the U.S. person that transfers the stock in the deemed section 351 exchange files a single GRA with respect to the entire section 304 transaction. See § 1.367(a)–8(d)(2)(ii).

.02 Application of Section 367(b)

To the extent that, pursuant to section 304(a)(1), a foreign corporation (foreign acquiring corporation) acquires the stock of a foreign corporation in a deemed section 351 exchange, such exchange is subject to section 367(b) and the regulations thereunder, including § 1.367(b)–4. Thus, for example, if a deemed section 351 exchange results in the loss of status as a section 1248 shareholder as provided in § 1.367(b)–4(b)(1)(i), the exchanging shareholder must include in income as a deemed dividend the section 1248 amount attributable to the foreign stock that is transferred in the deemed section 351 exchange.

.03 Example

Example. (i) *Facts*. USP, a domestic corporation, owns all of the outstanding stock of FT and FA, each a foreign corporation. USP's tax basis in the FT stock is $50x, and the FT stock has a fair market value of $100x. The section 1248 amount (within the meaning of § 1.367(b)–2(c)) with respect to the FT stock is $10x. FA has earnings and profits of $200x, all of which are available for distribution taking into account section 304(b)(5). In a transaction to which section 304(a)(1) applies, USP transfers all of its FT stock to FA in exchange for $100x cash.

(ii) *Application of section 304(a)(1)*. Under section 304(a)(1), USP and FA are treated as if USP transferred its FT stock to FA in a section 351(a) exchange solely for FA stock, and then FA redeemed its deemed issued stock in exchange for the cash. The redemption of the FA stock deemed issued by FA to USP is treated as a distribution to which section 301 applies. The entire distribution is treated under section 301(c)(1) as a dividend (as defined in section 316) out of the earnings and profits of FA.

(iii) *Application of section 367(a)*. Under section 4.01 of this notice, § 1.367(a)–3(b) applies to USP's transfer of the FT stock to FA in exchange for FA stock. As a result, USP recognizes gain on the transfer under section 367(a)(1) unless USP enters into a GRA with respect to the transfer pursuant to § 1.367(a)–3(b)(1)(ii) and § 1.367(a)–8. However, the deemed redemption by FA of the stock it is deemed to issue to USP would constitute a triggering event with respect to such GRA as described in § 1.367(a)–8(j). The redemption will not constitute a triggering event, however, if USP enters into a new GRA that includes appropriate provisions to account for the redemption and that is consistent with the principles of § 1.367(a)–8(k)(14)(ii) and (iii). After the redemption, USP owns at least 5% of the total voting power and the total value of the outstanding stock of FA. Thus, if USP enters into a new GRA that satisfies the requirements of § 1.367(a)–8(k)(14)(iii), the deemed redemption will not constitute a triggering event. In this case, the requirement that an initial GRA be filed for the deemed section 351 exchange and a new GRA be filed by reason of the deemed redemption will be satisfied if USP files a single GRA pursuant to § 1.367(a)–8(d)(2)(ii).

(iv) *Application of section 367(b)*. Under section 4.02 of this notice, § 1.367(b)–4 applies to USP's transfer of the FT stock to FA in exchange for FA stock. Under § 1.367(b)–2(a) and (b), USP is a section 1248 shareholder with respect to FT, a controlled foreign corporation, immediately before the exchange. Section 1.367(b)–4(b)(1)(i) does not apply to require USP to include in income the $10x section 1248 amount with respect to the FT stock because each of FA and FT is a controlled foreign corporation as to which USP is a section 1248 shareholder immediately after the exchange.

SECTION 5. FINALIZATION OF THE 2009 REGULATIONS UNDER SECTION 1248

The IRS and the Treasury Department will finalize the portions of the 2009 regulations that address the application of section 1248 to gain recognized with respect to stock upon distributions, including gain under section 301(c)(3), in separate published guidance effective February 10, 2009.

SECTION 6. EFFECTIVE DATE

The regulations described in this notice shall apply to section 304 transactions occurring on or after February 10, 2012. Pending the issuance of the regulations described in this notice, the IRS will not challenge reasonable interpretations of the application of section 367(a) and (b) to deemed section 351 exchanges and related deemed redemptions completed on or after February 10, 2012, including reasonable interpretations of the GRA rules as applied to such deemed section 351 exchanges and deemed redemptions under the principles of § 1.367(a)–8(k)(14)(ii) and (iii).

SECTION 7. COMMENTS

The IRS and the Treasury Department request comments on the regulations to be issued under this notice.

SECTION 8. PAPERWORK REDUCTION ACT

The collections of information in this notice were previously reviewed and approved by the Office of Management and Budget in connection with Treasury Decision 9446 in accordance with the Paperwork Reduction Act of 1995

(44 U.S.C. 3507(d)) under control number 1545–2056.

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

The collections of information are in sections 4.01 and 4.02 of this notice. Responses to the collections of information are required to avoid recognizing gain under section 367, including under an existing gain recognition agreement, and to facilitate electronic filing. The likely respondents are large corporations.

The estimated burden will change as follows:

The estimated total annual reporting burden will increase by 100 hours.

The estimated annual burden per respondent remains 2 hours. The estimated number of respondents will increase by 50.

The estimated annual frequency of responses remains once per year.

Books and records relating to these collections 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.

SECTION 9. DRAFTING INFORMATION

The principal author of this notice is Ryan A. Bowen of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Mr. Bowen at (202) 622–3860 (not a toll-free call).

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2012–16

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code as in effect for plan years beginning before 2008. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), and the 24-month average segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–2 C.B. 366.

The composite corporate bond rate for January 2012 is 4.56 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted	Permissible Range	
Month	*Year*	Average	90% to	100%
February	2012	5.67	5.10	5.67

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. Section 430(h)(2)G) set forth a transitional rule applicable to plan years beginning in 2008 and 2009 under which the segment rates were blended with the corporate bond weighted average described above, including an election under § 430(h)(2)(G)(iv) for an employer to use the segment rates without the transitional rule.

Notice 2007–81, 2007–2 C.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target.

Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from January 2012 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of January 2012 are, respectively, 1.84, 4.36, and 5.19. The three 24-month average corporate bond segment rates applicable for February 2012 are as follows:

First Segment	Second Segment	Third Segment
1.96	5.01	6.13

The transitional rule of § 430(h)(2)(G) does not apply to plan years beginning after December 31, 2009. Therefore, for a plan year beginning after 2009 with a lookback month to February 2012, the funding segment rates are the three 24-month average corporate bond segment rates applicable for February 2012, listed above without blending for any transitional period.

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for January 2012 is 3.03 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in November 2041.

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in section 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The following rates were determined for plan years beginning in the month shown below.

For Plan Years Beginning in		30-Year Treasury Weighted	Permissible Range	
Month	*Year*	Average	90% to	105%
February	2012	4.04	3.64	4.25

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. For plan years beginning in 2008 through 2011, the applicable interest rates are the monthly spot segment rates blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for January 2012, taking into account the January 2012 30-year Treasury rate of 3.03 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2011	2.08	4.09	4.76
2012	1.84	4.36	5.19

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for January 2012
Derived from January 2012 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	0.55	20.5	4.99	40.5	5.21	60.5	5.29	80.5	5.34
1.0	0.94	21.0	5.00	41.0	5.21	61.0	5.30	81.0	5.34
1.5	1.30	21.5	5.01	41.5	5.22	61.5	5.30	81.5	5.34
2.0	1.61	22.0	5.02	42.0	5.22	62.0	5.30	82.0	5.34
2.5	1.86	22.5	5.02	42.5	5.22	62.5	5.30	82.5	5.34
3.0	2.08	23.0	5.03	43.0	5.23	63.0	5.30	83.0	5.34
3.5	2.27	23.5	5.04	43.5	5.23	63.5	5.30	83.5	5.34
4.0	2.44	24.0	5.05	44.0	5.23	64.0	5.30	84.0	5.34
4.5	2.61	24.5	5.05	44.5	5.23	64.5	5.30	84.5	5.34
5.0	2.78	25.0	5.06	45.0	5.24	65.0	5.31	85.0	5.34
5.5	2.94	25.5	5.07	45.5	5.24	65.5	5.31	85.5	5.34
6.0	3.10	26.0	5.07	46.0	5.24	66.0	5.31	86.0	5.34
6.5	3.26	26.5	5.08	46.5	5.24	66.5	5.31	86.5	5.34
7.0	3.41	27.0	5.09	47.0	5.25	67.0	5.31	87.0	5.34
7.5	3.56	27.5	5.09	47.5	5.25	67.5	5.31	87.5	5.35
8.0	3.70	28.0	5.10	48.0	5.25	68.0	5.31	88.0	5.35
8.5	3.83	28.5	5.11	48.5	5.25	68.5	5.31	88.5	5.35
9.0	3.95	29.0	5.11	49.0	5.25	69.0	5.31	89.0	5.35
9.5	4.05	29.5	5.12	49.5	5.26	69.5	5.32	89.5	5.35
10.0	4.16	30.0	5.12	50.0	5.26	70.0	5.32	90.0	5.35
10.5	4.26	30.5	5.13	50.5	5.26	70.5	5.32	90.5	5.35
11.0	4.35	31.0	5.13	51.0	5.26	71.0	5.32	91.0	5.35
11.5	4.43	31.5	5.14	51.5	5.26	71.5	5.32	91.5	5.35
12.0	4.50	32.0	5.14	52.0	5.27	72.0	5.32	92.0	5.35
12.5	4.56	32.5	5.15	52.5	5.27	72.5	5.32	92.5	5.35
13.0	4.62	33.0	5.15	53.0	5.27	73.0	5.32	93.0	5.35
13.5	4.67	33.5	5.16	53.5	5.27	73.5	5.32	93.5	5.35
14.0	4.71	34.0	5.16	54.0	5.27	74.0	5.32	94.0	5.35
14.5	4.75	34.5	5.17	54.5	5.28	74.5	5.33	94.5	5.35
15.0	4.79	35.0	5.17	55.0	5.28	75.0	5.33	95.0	5.35
15.5	4.82	35.5	5.18	55.5	5.28	75.5	5.33	95.5	5.36
16.0	4.84	36.0	5.18	56.0	5.28	76.0	5.33	96.0	5.36
16.5	4.87	36.5	5.18	56.5	5.28	76.5	5.33	96.5	5.36
17.0	4.89	37.0	5.19	57.0	5.28	77.0	5.33	97.0	5.36
17.5	4.91	37.5	5.19	57.5	5.29	77.5	5.33	97.5	5.36
18.0	4.92	38.0	5.19	58.0	5.29	78.0	5.33	98.0	5.36
18.5	4.94	38.5	5.20	58.5	5.29	78.5	5.33	98.5	5.36
19.0	4.95	39.0	5.20	59.0	5.29	79.0	5.33	99.0	5.36
19.5	4.97	39.5	5.20	59.5	5.29	79.5	5.33	99.5	5.36
20.0	4.98	40.0	5.21	60.0	5.29	80.0	5.33	100.0	5.36

Frequently-Asked-Questions From Employers Regarding Automatic Enrollment, Employer Shared Responsibility, and Waiting Periods

Notice 2012–17

INTRODUCTION

Many provisions of the Patient Protection and Affordable Care Act (Affordable Care Act) that become effective beginning in 2014 are designed to expand access to affordable health coverage. These include provisions for automatic enrollment of full-time employees in an employer's health plan, shared responsibility of employers regarding health coverage, coverage to be offered through State-based Affordable Insurance Exchanges (Exchanges), premium tax credits to assist individuals in purchasing coverage through Exchanges, and other related provisions. The Departments of Labor, Health and Human Services, and the Treasury (the Departments) are working together to develop regulations and other administrative guidance that will respond to questions and assist stakeholders with implementation.

This notice, which is being issued in substantially identical form by the other two Departments, provides information on questions from employers and other stakeholders regarding the provisions of the Affordable Care Act governing automatic enrollment, employer shared responsibility, and the 90-day limitation on waiting periods. Also outlined below are various approaches that the Departments are considering proposing in future regulations or other guidance. Comments and input are welcome on all intended proposals below.

BACKGROUND

Automatic Enrollment

Section 18A of the Fair Labor Standards Act (FLSA), as added by section 1511 of the Affordable Care Act, directs an employer to which the FLSA applies, and that has more than 200 full-time employees, to automatically enroll new full-time employees in one of the employer's health benefits plans (subject to any waiting period authorized by law), and to continue the enrollment of current employees in a health benefits plan offered through the employer. Section 18A further requires adequate notice and the opportunity for an employee to opt out of any coverage in which the employee was automatically enrolled.

On December 22, 2010, the Departments issued frequently asked questions (FAQ) on section 18A of the FLSA, which noted that the statute provides that employer compliance with the automatic enrollment provisions of section 18A shall be carried out "[i]n accordance with regulations promulgated by the Secretary [of Labor]."[1] That FAQ also stated that it is the view of the Department of Labor that, until such regulations are issued, employers are not required to comply with section 18A. Finally, the FAQ indicated that the Department of Labor intends to complete this rulemaking by 2014.

Employer Shared Responsibility

The employer shared responsibility provisions, contained in section 4980H of the Internal Revenue Code (Code), provide that an applicable large employer (for this purpose, an employer with 50 or more full-time equivalent employees) could be subject to an assessable payment if any full-time employee is certified to receive an applicable premium tax credit or cost-sharing reduction payment. Generally, this may occur where either:

(1) The employer does not offer to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan; or

(2) The employer offers its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan that either is unaffordable relative to an employee's household income or does not provide minimum value.

For purposes of section 4980H, a "full-time employee" is an employee who is employed on average at least 30 hours per week.

The Treasury Department and the Internal Revenue Service (IRS) have requested and received comments on a number of issues and potential approaches to interpreting and applying the employer shared responsibility provisions. In particular, IRS Notice 2011–36, 2011–21 I.R.B. 792[2], described and requested comments on a possible approach that would use a "look-back/stability period safe harbor" method that employers might use in determining whether current employees (those who are not newly-hired or transferred) are full-time employees for purposes of the employer shared responsibility provisions. Comments were also requested on potential rules for determining full-time status of new employees and employees who move into full-time status mid-year.

In addition, Treasury and the IRS have described (in IRS Notice 2011–73, 2011–40 I.R.B. 474)[3], a safe harbor allowing employers, for purposes of determining whether they owe an assessable payment under section 4980H(b), to use an employee's Form W–2 wages (as reported in Box 1) instead of household income in determining whether coverage offered is affordable. Treasury and the IRS requested and received comments on the safe harbor.

90-Day Limitation on Waiting Periods

Public Health Service (PHS) Act section 2708, as added by the Affordable Care Act, provides that, in plan years beginning on or after January 1, 2014, a group health plan or group health insurance issuer shall not apply any waiting period that exceeds 90 days.[4] PHS Act section 2704(b)(4), ERISA section 701(b)(4), and Code section 9801(b)(4) define a waiting period to be the period that must pass with respect to the individual before the individual is eligible to be covered for benefits under the terms of the plan. In previous regu-

[1] Available at: *www.dol.gov/ebsa/faqs/faq-aca5.html*.

[2] Available at: *www.irs.gov/pub/irs-drop/n-11-36.pdf*.

[3] Available at: *www.irs.gov/pub/irs-drop/n-11-73.pdf*.

[4] The Affordable Care Act also added section 715(a)(1) to the Employee Retirement Income Security Act (ERISA) and section 9815(a)(1) to the Code to incorporate various provisions of the PHS Act into the Code and ERISA, including the provisions of section 2708 of the PHS Act.

lations, the Departments defined a waiting period to mean the period that must pass before coverage for an employee or dependent who is otherwise eligible to enroll under the terms of a group health plan can become effective.[5] Unlike Code section 4980H, PHS Act section 2708 does not distinguish between full-time and part-time employees.

In addition to requesting comments on the employer shared responsibility provisions, IRS Notice 2011–36 requested comments on behalf of the Departments regarding the 90-day waiting period limitation under PHS Act section 2708, including how rules relating to the potential look-back/stability period safe harbor method for determining the number of full-time employees under Code section 4980H should be coordinated with the 90-day waiting period limitation.

DISCUSSION

The following questions and answers respond to inquiries the Departments are receiving regarding automatic enrollment, employer shared responsibility, and the 90-day limitation on waiting periods. As discussed above, the questions and answers below provide information and identify various approaches that the Departments are considering proposing in future regulations or other guidance. Guidance that employers may rely upon with respect to the issues addressed below will be provided with sufficient lead time for employers to comply. Comments are requested on these approaches.

Q1. What is the current timeline for issuing guidance on automatic enrollment under FLSA section 18A?

A1. The Department of Labor has been working with stakeholders to ensure that it has the necessary information and data to develop regulations relating to automatic enrollment, and is sensitive to stakeholder concerns regarding the need for adequate time to comply with any regulations that are ultimately issued. In addition, the Department of Labor is aware of the need to coordinate the work it will be undertaking to develop guidance relating to automatic enrollment with the guidance being developed regarding other related Affordable Care Act provisions, including the employer shared responsibility provision and the 90-day limitation on waiting periods, described above.

In view of the need for coordinated guidance and a smooth implementation process, including an applicability date that gives employers sufficient time to comply, the Department of Labor has concluded that its automatic enrollment guidance will not be ready to take effect by 2014. It remains the Department of Labor's view that, until final regulations under FLSA section 18A are issued and become applicable, employers are not required to comply with FLSA section 18A.

Q2. Do Treasury and the IRS intend to issue proposed regulations or other guidance permitting employers to use an employee's W–2 wages as a safe harbor in determining the affordability of employer coverage, as outlined in IRS Notice 2011–73?

A2. Yes. As described in Notice 2011–73, Treasury and the IRS intend to issue proposed regulations or other guidance permitting employers to use an employee's Form W–2 wages (as reported in Box 1) as a safe harbor in determining the affordability of employer coverage.

Q3. Do Treasury and the IRS intend to issue proposed regulations or other guidance addressing how the employer shared responsibility provisions under Code section 4980H and the 90-day waiting period limitation under PHS Act section 2708 are coordinated?

A3. Yes. Treasury and the IRS intend to issue proposed regulations or other guidance under Code section 4980H (which imposes shared responsibility on large employers with respect to coverage of full-time employees). That guidance is expected to address the intersection of the Code section 4980H rules and the PHS Act section 2708 rules applicable to the 90-day waiting period limitation and will be coordinated with upcoming tri-Department proposed rules under PHS Act section 2708 (discussed below). Treasury and the IRS are mindful of employers' requests for safe harbors and simplicity and will seek to accommodate those requests to the extent feasible and consistent with the terms of the statute.

The upcoming guidance is expected to provide that, at least for the first three months following an employee's date of hire, an employer that sponsors a group health plan will not, by reason of failing to offer coverage to the employee under its plan during that three-month period, be subject to the employer responsibility payment under Code section 4980H.

Q4. For purposes of determining whether an employee (other than a newly-hired employee) is a full-time employee for purposes of Code section 4980H, do Treasury and the IRS intend to issue proposed regulations or other guidance allowing employers to use a look-back/stability period safe harbor, based on the approach outlined in IRS Notice 2011–36?

A4. Yes. Having reviewed the comments in response to IRS Notice 2011–36, Treasury and the IRS intend to issue proposed regulations or other guidance that would allow employers to use a "look-back/stability period safe harbor" method based on the approach outlined in the notice for purposes of determining whether an employee (other than a newly-hired employee) is a full-time employee. Accordingly, it is anticipated that the guidance will allow look-back and stability periods not exceeding 12 months.

For a description of anticipated guidance regarding newly-hired employees, see Q&A–5.

Q5. For purposes of determining whether a newly-hired employee is a full-time employee, do Treasury and the IRS intend to issue proposed regulations or other guidance under Code section 4980H?

A5. Yes. Treasury and the IRS also intend to issue proposed regulations or other guidance that will address how to determine whether a newly-hired employee is a full-time employee for purposes of Code section 4980H.

As stated in Q&A–3, the upcoming guidance is expected to provide that, at least for the first three months following an employee's date of hire, an employer that sponsors a group health plan will not, by reason of failing to offer coverage to the employee under its plan during that three-month period, be subject to the employer responsibility payment under Code section 4980H. The guidance is also expected to provide that, in certain cir-

[5] 26 CFR 54.9801–3(a)(3)(iii), 29 CFR 2590.701–3(a)(3)(iii), 45 CFR 146.111(a)(3)(iii).

cumstances, employers have six months to determine whether a newly-hired employee is a full-time employee for purposes of section 4980H and will not be subject to a section 4980H payment during that six-month period with respect to that employee. Treasury and the IRS intend to propose an approach under which the period of time that an employer will have to determine whether a newly-hired employee is a full-time employee (within the meaning of section 4980H) will depend upon whether, based on the facts and circumstances, (a) the employee is reasonably expected as of the time of hire to work an average of 30 or more hours per week on an annual basis and (b) the employee's first three months of employment are reasonably viewed, as of the end of that period, as representative of the average hours the employee is expected to work on an annual basis.

Specifically, it is intended that the upcoming proposed regulations or other guidance would provide, for purposes of section 4980H, that:

- If a newly-hired employee is reasonably expected to work full-time on an annual basis and does work full-time during the first three months of employment, the employee must be offered coverage under the employer's group health plan as of the end of that period in order to avoid the possibility that the employer would be subject to a section 4980H payment after the end of that three-month period.
- If, based on the facts and circumstances as of the time of hire, it cannot reasonably be determined that a newly-hired employee is expected to work full-time, the following rules will apply for purposes of determining whether the newly-hired employee is considered a full-time employee in applying section 4980H with respect to the employer's group health plan:
    - If the employee works full-time during the first three months of employment, and the employee's hours during that period are reasonably viewed, as of the end of that period, as representative of the average hours the employee is expected to work on an annual basis, the employee will first be considered a full-time employee for purposes of section 4980H as of the end of that three-month period. (If the employee works part-time during the first three months of employment, then no section 4980H penalty applies during the first or second three-month period.)
    - If the employee works full-time during the first three months of employment, but the employee's hours during that period are reasonably viewed, as of the end of that period, as not representative of the average hours the employee is expected to work on an annual basis, the plan is permitted an additional three-month period to determine the employee's status, and no section 4980H payment would be required with respect to that employee during the first or second three-month periods. (If the employee works part-time during the second three months of employment, then no section 4980H penalty applies during the first, second, or third three-month period.)

This policy describes the applicability of a potential section 4980H payment with respect to newly-hired employees. Forthcoming guidance is expected also to coordinate the rules for newly-hired employees with those applicable to other employees (including employees who are transferred from one employment classification or status to another).

The following examples illustrate the intended approach described above:

Example 1: Newly-hired employee expected to work full time.

Facts: Employer D, an applicable large employer (*i.e.,* an employer with at least 50 full-time equivalent employees), hires Employee X as a computer programmer on December 1. Employee X is expected to work full-time on an annual basis and does work full-time for the months of December, January, and February. Employer D offers health coverage to its full-time workers (and their dependents).

Conclusion: Employee X must be able to enroll in coverage beginning in March or the employer potentially would be subject to a section 4980H payment. However, failure to offer coverage to Employee X during the first three months (December–February) would not subject Employer D to a potential section 4980H payment.

Example 2: Newly-hired employee who seasonally works full-time

Facts: Same as Example 1 except that Employer D hires Employee Y as a salesperson who is expected to work full-time during the holiday season and part-time the rest of the year. Employee Y works an average of 35 hours per week in December, January, and February and 20 hours per week in March, April, and May.

Conclusion: If, based on the facts and circumstances at the end of the period, the three-month period of December through February is reasonably viewed as not representative of the average hours Employee Y is reasonably expected to work on an annual basis, Employer D may use a second three-month period (March–May) as a look-back period. Failure to offer coverage under Employer D's group health plan to Employee Y during the first (December-February) and the second (March–May) three-month periods would not subject Employer D to a potential section 4980H payment. (Failure to offer coverage to Employee Y for June also would not subject Employer D to a potential section 4980H payment because Employee Y was determined to be part-time during the March–May look-back period.)

Q6. When PHS Act section 2708 (which imposes a 90-day limitation on waiting periods) becomes effective in 2014, will it require an employer to offer coverage to part-time employees or to any other particular category of employees?

A6. No. Many employers make distinctions in eligibility for coverage based on full-time or part-time status, as defined by the employer's group health plan (which may differ from the standard under Code section 4980H). PHS Act section 2708 does not require the employer to offer coverage to any particular employee or class of employees, including part-time employees. PHS Act section 2708 merely prohibits requiring an otherwise eligible employee to wait more than 90 days before coverage is effective. Furthermore, nothing in the Affordable Care Act penalizes small employers for choosing not to offer coverage to any employee, or large employers for choosing to limit their offer of coverage to full-time employees, as defined in the employer shared responsibility provisions.

Q7. How do the Departments intend to address the application of the 90-day waiting period limitation in PHS Act section 2708 to an offer of coverage by an employer?

A7. Having reviewed the comments in response to IRS Notice 2011–36, the Departments intend to retain, for purposes of PHS Act section 2708, the definition in existing regulations that the 90-day waiting period begins when an employee is otherwise eligible for coverage under the terms of the group health plan. This is the definition of waiting period used for purposes of Title XXVII of the PHS Act, Part 7 of ERISA, and chapter 100 of the Code.[6] Under this approach, if a plan were to provide that full-time employees are eligible for coverage without satisfying any other condition, and an employee were hired as a full-time employee, the waiting period (if the employer were to choose to impose one) for that employee would begin on the date of hire and could not exceed 90 days. Consistent with PHS Act section 2708, eligibility conditions that are based solely on the lapse of a time period would be permissible for no more than 90 days.

Other conditions for eligibility under the terms of a group health plan would generally be permissible under PHS Act section 2708, unless the condition is designed to avoid compliance with the 90-day waiting period limitation. For example, eligibility conditions such as full-time status, a *bona fide* job category, or receipt of a license would be permissible.

The upcoming guidance under section 2708 is also expected to address situations in which, under the terms of an employer's plan, employees (or certain classes of employees) are eligible for coverage once they complete a specified cumulative number of hours of service within a specified period (such as 12 months). It is anticipated that, under the upcoming guidance, such eligibility conditions will not be treated as designed to avoid compliance with the 90-day waiting period limitation so long as the required cumulative hours of service do not exceed a number of hours to be specified in that guidance.

Comments are requested on how this possible approach would apply to plans that credit hours of service from multiple different employers and plans that use hours banks.

Example 3: Employee ineligible under terms of plan by reason of job classification

Facts: Same as Example 1 except that Employer D's plan does not cover computer programmers.

Conclusion: Unlike Code section 4980H, in which the determination of full-time status is governed by a statutory standard (working an average of 30 hours per week), the waiting period limitation under PHS Act 2708 applies only to employees who are otherwise eligible under the terms of the plan. Because Employee X is excluded under the plan's eligibility criteria, and the plan's terms are not designed to avoid compliance with PHS Act section 2708, the plan's eligibility provision does not violate PHS Act section 2708.

Example 4: Part-time employee, hours of service requirement

Facts: Employer E hires Employee Z to work 20 hours per week. Employer E's plan requires part-time employees to complete 750 hours of service in order to participate. Solely for purposes of illustration in this example, it is assumed that upcoming guidance under PHS Act section 2708 permits plans to require part-time employees to complete up to, but no more than, 750 hours of service in order to participate.

Conclusion: Part-time employees who work 20 hours per week will complete 750 hours of service in $37^1/_2$ weeks or just under 9 months. The waiting period under PHS Act section 2708 begins when Employee Z satisfies the cumulative service requirement, thereby becoming eligible (but for the waiting period) for coverage under the plan. Employer E must provide coverage to Employee Z no later than 90 days after Employee Z completes 750 hours of service, which is about one year after Employee Z is hired and begins working part-time. (No Code section 4980H payment applies because Employee Z is part-time.)

REQUEST FOR COMMENTS

Comments are requested by April 9, 2012. WARNING: Do not include any personally identifiable information (such as name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments are posted on the Internet as received, and can be retrieved by most Internet search engines. Comments may be submitted anonymously. Comments will be shared by the Departments.

Comments may be sent electronically to: *e-ohpsca-er.ebsa@dol.gov*. Alternatively, comments may be sent via mail or hand delivery to: Office of Health Plan Standards and Compliance Assistance, Employee Benefits Security Administration, Room N–5653, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210.

FOR FURTHER INFORMATION

The Departments have coordinated on the information contained in this notice and are publishing substantively identical issuances. Questions concerning the information contained herein may be directed to the Department of Labor's Office of Health Plan Standards and Compliance Assistance at 202–693–8335; the Internal Revenue Service at 202–927–9639; or the Department of Health and Human Services at 410–786–1565 or *phig@cms.hhs.gov*. Additional information for employers regarding the Affordable Care Act is available at *www.healthcare.gov* and *www.dol.gov/ebsa/healthreform*.

[6] 26 CFR 54.9801–3(a)(3)(iii), 29 CFR 2590.701–3(a)(3)(iii), 45 CFR 146.111(a)(3)(iii).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Passive Activity Losses and Credits Limited

REG–109369–10

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the definition of an "interest in a limited partnership as a limited partner" for purposes of determining whether a taxpayer materially participates in an activity under section 469 of the Internal Revenue Code (Code). These proposed regulations affect individuals who are partners in partnerships.

DATES: Written or electronic comments and requests for a public hearing must be received by February 27, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–109369–10), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–109369–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov/* (IRS REG–109369–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michala Irons, (202) 622–3050; concerning submissions of comments and requests for public hearing, Oluwafunmilayo Taylor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 469(a)(1) limits the ability of certain taxpayers to deduct losses from passive activities. Section 469(b) permits passive losses disallowed in one year to be carried over to the next year. Section 469(c)(1) provides that a passive activity means any activity which involves the conduct of any trade or business, and in which the taxpayer does not materially participate. Section 469(h)(1) provides that a taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is regular, continuous, and substantial. The Treasury Department and the IRS promulgated temporary regulations under section 469 in 1988. See T.D. 8175, 1998–1 C.B. 191, 53 FR 5686 (February 25, 1988). Section 1.469–5T(a) provides that an individual taxpayer shall be treated as materially participating in an activity for the taxable year if and only if:

(1) The individual participates in the activity for more than 500 hours during such year;

(2) The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year;

(3) The individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;

(4) The activity is a significant participation activity (within the meaning of §1.469–5T(c)) for the taxable year, and the individual's aggregate participation in all significant participation activities during such year exceeds 500 hours;

(5) The individual materially participated in the activity (determined without regard to §1.469–5T(a)(5)) for any five taxable years (whether or not consecutive) during the ten taxable years that immediately precede the taxable year;

(6) The activity is a personal service activity (within the meaning of §1.469–5T(d)), and the individual materially participated in the activity for any three taxable years (whether or not consecutive) preceding the taxable year; or

(7) Based on all of the facts and circumstances (taking into account the rules in §1.469–5T(b)), the individual participates in the activity on a regular, continuous, and substantial basis during such year.

Section 469(h)(2) presumptively treats losses from interests in limited partnerships as passive. Section 469(h)(2) provides that, except as provided in regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates. Section 1.469–5T(e)(2) permits an individual taxpayer to establish material participation in a limited partnership but constrains the individual taxpayer to only three of the seven regulatory tests in §1.469–5T(a), (§1.469–5T(a)(1), (a)(5), or (a)(6)).

Section 1.469–5T(e)(3)(i) generally provides that a partnership interest shall be treated as a limited partnership interest if (A) such interest is either designated as a limited partnership interest in the limited partnership agreement or the certificate of limited partnership, without regard to whether the liability of the holder of such interest for obligations of the partnership is limited under applicable State law; or (B) the liability of the holder of such interest for obligations of the partnership is limited, under the law of the State in which the partnership is organized, to a determinable fixed amount (for example, the sum of the holder's capital contributions to the partnership and contractual obligations to make additional capital contributions to the partnership). However, even if the interest is characterized as a limited partnership interest under §1.469–5T(e)(3)(i), an exception under §1.469–5T(e)(3)(ii) applies if the individual is a general partner in the partnership at all times during the partnership's taxable year ending with or within the individual's taxable year (or portion of the partnership's taxable year during which the individual (directly or indirectly) owns such limited partnership interest) (the "general partner exception"). If the general partner exception applies, the limited partnership interest will not be treated as such for the year in which the individual taxpayer is a general partner in the partnership. This allows the individual taxpayer to demonstrate material participation through any of the seven regulatory tests in §1.469–5T(a).

Courts have concluded, in certain instances, that the holder of a limited liability company (LLC) interest is not treated as holding an interest in a limited partnership as a limited partner for purposes of applying the section 469 material participation tests. In *Gregg v. U.S.*, 186 F.Supp.2d 1123 (D. Or. 2000), an Oregon district court concluded that, in the absence of regulations to the effect that an LLC member should be treated as a limited partner, the limited partner exception in section 469(h)(2) was not applicable to LLC members. In *Garnett v. Comm'r*, 132 T.C. 368 (2009), the Tax Court found that the taxpayers' ownership interests in limited liability partnerships and LLCs were not interests in limited partnerships because their interests fit within the general partner exception in §1.469–5T(e)(3)(ii). Shortly thereafter, in *Thompson v. U.S.*, 87 Fed. Cl. 728 (2009), the Court of Federal Claims concluded that the regulations under section 469(h)(2) require the taxpayer's ownership interest to be in a partnership under State law rather than a partnership under Federal income tax law. Accordingly, because an LLC member is not a limited partner under State law, the court concluded that section 469(h)(2) did not apply to an LLC member. Most recently, the Tax Court in *Newell v. Comm'r*, T.C. Memo. 2010–23, concluded that section 469(h)(2) did not apply to the managing member of an LLC and that the member fell within the general partner exception in §1.469–5T(e)(3)(ii). On April 5, 2010, the IRS issued an Action on Decision acquiescing in the result only in *Thompson v. U.S.*, AOD 2010–02, 2010–14 I.R.B. 515.

Explanation of Provisions

The proposed regulations provide that an interest in an entity will be treated as an interest in a limited partnership under section 469(h)(2) if (A) the entity in which such interest is held is classified as a partnership for Federal income tax purposes under §301.7701–3; and (B) the holder of such interest does not have rights to manage the entity at all times during the entity's taxable year under the law of the jurisdiction in which the entity was organized and under the governing agreement. Rights to manage include the power to bind the entity. The proposed regulations provide rules concerning an interest in a limited partnership based on the purposes for which section 469 was enacted, and the manner in which the provision is structured and operates within the Code. Accordingly, the rules concerning an interest in a limited partnership in the proposed regulations are provided solely for purposes of section 469 and no inference is intended that the same rules would apply for any other provisions of the Code requiring a distinction between a general partner and a limited partner.

In *Garnett v. Comm'r*, *supra*, the Tax Court noted that Congress enacted section 469(h)(2) to address the limitations on a limited partner's ability to participate in the control of the partnership's business. Under the Uniform Limited Partnership Act of 1916, limited partners could lose their limited liability protection if they participated in the control of the partnership. The regulations under section 469(h)(2) were drafted with these constraints in mind. Today, many states have adopted a variation of the Revised Uniform Limited Partnership Act of 1985 (RULPA). Under RULPA, limited partners may participate in the management and control of the partnership without losing their limited liability. As a consequence, limited partners under RULPA are now more akin to general partners and LLC members with respect to their rights in the management of the entity. Under the Uniform Limited Liability Company Act of 1996, LLC members of member-managed LLCs do not lose their limited liability by participating in the management and conduct of the company's business. In *Newell v. Comm'r*, *supra*, the Tax Court noted that the managing member of the LLC at issue managed the day-to-day operations of the LLC and was the "substantial equivalent" of a general partner. Recognizing that the original presumptions regarding the limitations on a limited partner's participation in the activities of the entity are no longer valid today, and also recognizing the emergence of LLCs, the proposed regulations eliminate the current regulations' reliance on limited liability for purposes of determining whether an interest is an interest in a limited partnership as a limited partner under section 469(h)(2) and instead adopt an approach that relies on the individual partner's right to participate in the management of the entity.

The regulations are proposed to apply to taxable years beginning on or after the date of publication of the Treasury decision adopting these regulations 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, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Michala Irons, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

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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 1.469–0 is amended by:

1. Revising the entries for §1.469–5(a), (b), (c), (d), and (e).

2. Removing the entries for §1.469–5T(e)(1), (e)(2), and (e)(3).

The revisions read as follows:

§1.469–0 Table of contents.

* * * * *

§1.469–5 Material participation.

(a) through (d) [Reserved].

(e) Treatment of an interest in a limited partnership as a limited partner.

(1) In general.

(2) Exceptions.

(3) Interest in a limited partnership as a limited partner.

(i) In general.

(ii) Individual holding an interest other than an interest in a limited partnership as a limited partner.

(4) Effective/applicability date.

* * * * *

Par. 3. In §1.469–5, paragraphs (a), (b), (c), (d), and (e) are revised to read as follows:

§1.469–5 Material Participation.

(a) through (d) [Reserved].

(e) *Treatment of an interest in a limited partnership as a limited partner*—(1) *In general*. Except as otherwise provided in this paragraph (e), an individual shall not be treated as materially participating in any activity in which the individual owns an interest in a limited partnership as a limited partner (as defined in paragraph (e)(3)(i) of this section) for purposes of applying section 469 and the regulations thereunder to—

(i) The individual's share of any income, gain, loss, deduction, or credit from such activity that is attributable to an interest in a limited partnership as a limited partner; and

(ii) Any gain or loss from such activity recognized upon a sale or exchange of such an interest.

(2) *Exceptions*. Paragraph (e)(1) of this section shall not apply to an individual's share of income, gain, loss, deduction, and credit for a taxable year from any activity in which the individual would be treated as materially participating for the taxable year under paragraphs (a)(1), (a)(5), or (a)(6) of §1.469–5T if the individual did not own an interest in a limited partnership as a limited partner (as defined in paragraph (e)(3)(i) of this section) for such taxable year.

(3) *Interest in a limited partnership as a limited partner*—(i) *In general*. Except as provided in paragraph (e)(3)(ii) of this section, for purposes of section 469(h)(2) and this paragraph (e), an interest in an entity shall be treated as an interest in a limited partnership as a limited partner if—

(A) The entity in which such interest is held is classified as a partnership for Federal income tax purposes under §301.7701–3; and

(B) The holder of such interest does not have rights to manage the entity at all times during the entity's taxable year under the law of the jurisdiction in which the entity is organized and under the governing agreement.

(ii) *Individual holding an interest other than an interest in a limited partnership as a limited partner*. An individual shall not be treated as holding an interest in a limited partnership as a limited partner for the individual's taxable year if such individual also holds an interest in the partnership that is not an interest in a limited partnership as a limited partner (as defined in paragraph (e)(3)(i) of this section), such as a state-law general partnership interest, at all times during the entity's taxable year ending with or within the individual's taxable year (or the portion of the entity's taxable year during which the individual (directly or indirectly) owns such interest in a limited partnership as a limited partner).

(4) *Effective/applicability date*. This section applies to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as a final regulation in the **Federal Register**.

* * * * *

Par. 4. Section 1.469–5T paragraph (e) is revised to read as follows:

§1.469–5T Material Participation (Temporary).

* * * * *

(e) *Treatment of Limited Partners*. [Reserved]. See §1.469–5(e) for rules relating to this paragraph (e).

* * * * *

Par. 5. Section 1.469–9 paragraph (f)(1) is revised to read as follows:

§1.469–9 Rules for certain rental real estate activities.

* * * * *

(f) *Limited partnership interests in rental real estate activities*—(1) *In general*. If a taxpayer elects under paragraph (g) of this section to treat all interests in rental real estate as a single rental real estate activity, and at least one interest in rental real estate is held by the taxpayer as an interest in a limited partnership as a limited partner (within the meaning of §1.469–5(e)(3)), the combined rental real estate activity of the taxpayer will be treated as an interest in a limited partnership as a limited partner for purposes of determining material participation. Accordingly, the taxpayer will not be treated under this section as materially participating in the combined rental real estate activity unless the taxpayer materially participates in the activity under the tests listed in §1.469–5(e)(2) (dealing with the tests for determining the material participation of a limited partner).

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on November 25, 2011, 8:45 a.m., and published in the issue of the Federal Register for November 28, 2011, 76 F.R. 72875)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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