Internal Revenue
bulletin

Bulletin No. 2013-30
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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

T.D. 9622, page 64.

Final regulations under section 108(i) provide guidance to C corporations regarding the accelerated inclusion of deferred COD income and accelerated deduction of deferred OID, including special rules for members of consolidated groups. In addition, these regulations provide rules applicable to all taxpayers regarding deferred OID deductions under section 108(i)(2).

T.D. 9623, page 73.

Final regulations under section 108(i) of the Code provide rules regarding partnerships and S corporations. Section 108(i) allows a taxpayer to defer discharge of indebtedness income (and in certain cases, deductions for original issue discount) arising from a reacquisition of an applicable debt instrument that occurs in 2009 or 2010 for a four or five taxable-year period (unless an acceleration event occurs earlier). Once the deferral period ends, taxpayers take into account the deferred income and deductions ratably over a five taxable-year period.

Finding Lists begin on page ii.

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.

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.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 108.—Income from Discharge of Indebtedness

T.D. 9622

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Guidance Regarding Deferred Discharge of Indebtedness Income of Corporations and Deferred Original Issue Discount Deductions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 108(i) of the Internal Revenue Code (Code). These regulations primarily affect C corporations and provide necessary guidance regarding the accelerated inclusion of deferred discharge of indebtedness (also known as cancellation of debt (COD)) income (deferred COD income) and the accelerated deduction of deferred original issue discount (OID) (deferred OID deductions) under section 108(i)(5)(D) (acceleration rules), and the calculation of earnings and profits as a result of an election under section 108(i). In addition, these regulations provide rules applicable to all taxpayers regarding deferred OID deductions under section 108(i) as a result of a reacquisition of an applicable debt instrument by an issuer or related party.

DATES: *Effective Dates:* These regulations are effective on July 2, 2013.

Applicability Dates: For dates of applicability, see §1.108(i)–0(b).

FOR FURTHER INFORMATION CONTACT: Concerning the acceleration rules for deferred COD income and deferred OID deductions, and the rules for earnings and profits, Robert M. Rhyne (202) 622–7790; concerning the generally applicable rules for deferred OID deductions, William E. Blanchard (202) 622–3950 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–2147. The collection of information in these final regulations is in §1.108(i)–1(b)(3). Under §1.108(i)–1(b)(3), an electing member (other than the common parent) of a consolidated group may elect to accelerate the inclusion of its remaining deferred COD income with respect to all applicable debt instruments by filing a statement.

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

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

Background

Section 108(i) was added to the Code by section 1231 of the American Recovery and Reinvestment Tax Act of 2009 (Public Law 111–5, 123 Stat. 338), enacted on February 17, 2009. Section 108(i)(1) provides an election for deferral of the inclusion of COD income arising in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument. If an election is made, a taxpayer's deferred COD income generally is includible in gross income ratably over a 5-taxable-year period, beginning with the taxpayer's fourth or fifth taxable year following the taxable year of the reacquisition (inclusion period).

Section 108(i)(2) provides that if, as part of a reacquisition to which section 108(i)(1) applies, a debt instrument is issued (or is treated as issued) for the applicable debt instrument and there is any OID with respect to the newly issued debt instrument, then the deduction for all or a portion of the OID may be deferred. A debt instrument is treated as issued for an applicable debt instrument if the proceeds of the debt instrument are used directly or indirectly by the issuer to reacquire the applicable debt instrument of the issuer. Section 108(i)(2)(B). In general, the aggregate amount of the deferred OID deductions is allowed ratably over the inclusion period.

Section 108(i)(5)(D) requires a taxpayer to accelerate the inclusion or deduction of any remaining items of deferred COD income or deferred (and otherwise allowable) OID (deferred items) under certain circumstances, including the death of the taxpayer, the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), the cessation of business by the taxpayer, or similar circumstances. Section 108(i)(7) authorizes the Secretary to issue guidance necessary or appropriate for purposes of applying section 108(i), including extending the application of the rules of section 108(i)(5)(D) to other appropriate circumstances.

On August 17, 2009, the IRS and Treasury Department issued Rev. Proc. 2009–37, 2009–36 I.R.B. 309, which outlined the procedures for making a section 108(i) election, and required annual reporting of additional information regarding the amount of deferred COD income included in income in the taxable year, the amount of deferred OID deducted in the taxable year, and the amount of any remaining deferred items. See §601.601(d)(2)(ii)(*b*). On August 13, 2010, the IRS and Treasury Department published temporary regulations (TD 9497) in the **Federal Register** (75 FR 49394) addressing the acceleration rules for C corporations under section 108(i)(5)(D) and the calculation of a C corporation's earnings and profits as a result of an election under section 108(i). In addition, the temporary regulations addressed the deduction of deferred OID under section 108(i)(2). A notice of proposed rulemak-

ing (REG–142800–09) cross-referencing the temporary regulations was published in the **Federal Register** on the same day (75 FR 49428). Comments responding to the notice of proposed rulemaking were received and are available for public inspection at *http://www.regulations.gov* or upon request. No public hearing was requested or held. After consideration of all comments, the proposed regulations are adopted without substantive change by this Treasury decision, and the corresponding temporary regulations are removed.

Summary of Comments

A. Acceleration Rules for an Electing Corporation in Bankruptcy Proceedings

One commenter requested clarification of the acceleration rules applicable to a C corporation in bankruptcy proceedings. Section 108(i)(5)(D) provides, in relevant part, that in the case of the liquidation or sale of substantially all of the assets of the taxpayer (including in a title 11 or similar case), the taxpayer must accelerate the inclusion or deduction of its remaining deferred items in the taxable year in which such event occurs (or in the case of a title 11 case, the day before the petition is filed). Section 108(i)(7)(A) further authorizes the Secretary to prescribe such regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying section 108(i), including extending the application of the rules of section 108(i)(5)(D) to other circumstances, where appropriate.

The rules provided in the proposed regulations are intended to focus on the underlying purpose of section 108(i)(5)(D) to ensure that the government's ability to collect the tax liability associated with the deferred COD income is not impaired. Consistent with this interpretation, the proposed regulations provide for accelerated inclusion of deferred COD income in circumstances in which a C corporation has impaired its ability to pay the latent tax liability. Under the proposed regulations, any C corporation with deferred COD income by reason of a section 108(i) election (an electing corporation) must accelerate the inclusion of its remaining deferred COD income, whether in bankruptcy proceedings or not, immediately before the occurrence of any one of the following events: the electing corporation (i) changes its tax status, (ii) ceases its corporate existence in a transaction to which section 381(a) does not apply, or (iii) engages in a transaction that impairs its ability to pay the tax liability associated with its deferred COD income (the net value acceleration rule). The acceleration rules under §1.108(i)–2 also apply to C corporations that are direct or indirect partners of an electing partnership. The proposed regulations do not provide any special acceleration rules for an electing corporation in a title 11 or similar case with regard to either (i) acceleration events or (ii) the time of inclusion of deferred COD income resulting from the occurrence of any acceleration event. Accordingly, all deferred COD income of any electing corporation is required to be taken into account by the electing corporation immediately before the occurrence of any acceleration event enumerated in the proposed regulations.

The IRS and Treasury Department believe that the acceleration rules provided in the proposed regulations, including with respect to the inclusion of deferred COD income immediately before the occurrence of an enumerated acceleration event, are sufficient to protect the collectability of tax relating to deferred COD income in the case of all electing corporations, whether or not in a title 11 or similar case. Accordingly, consistent with the proposed regulations, these final regulations do not provide special acceleration rules for an electing corporation in bankruptcy proceedings. However, to remove any doubt, the final regulations include non-substantive changes to clearly provide that the acceleration rules contained therein apply with respect to any electing corporation regardless of whether the electing corporation is in a title 11 or similar case at the time a mandatory acceleration event occurs.

B. Guidance on Built-in Items

Commenters made requests for guidance on how the treatment of built-in items under section 382 interacts with section 108(i). The IRS and Treasury Department believe that this issue is better addressed in more general guidance regarding the treatment of built-in items under section 382. Accordingly, no guidance on this issue is provided in these final regulations.

C. Adjustments to Earnings and Profits

The proposed regulations provide that deferred COD income generally increases earnings and profits in the taxable year that it is realized, and deferred OID deductions generally decrease earnings and profits in the taxable year or years in which the deductions would be allowed without regard to the deferral rules of section 108(i). The approach adopted in the proposed regulations reflects the view that an electing corporation has recognized economic income in the year of the discharge, enhancing its dividend paying capacity, and has recognized an economic cost in the year the OID accrues, decreasing its dividend paying capacity. Therefore, earnings and profits are appropriately adjusted. The IRS and Treasury Department also recognized that it was important to provide general guidance regarding the timing for adjustments to earnings and profits so that an electing corporation would understand the consequences of making a section 108(i) election.

A question was raised concerning why the proposed regulations did not provide a rule similar to section 301(e) in conjunction with the general rule for earnings and profits. The IRS and Treasury Department do not believe that such a rule is necessary to achieve the purposes of section 108(i). In addition, because adjustments to earnings and profits for the relevant years have already been made in accordance with the proposed regulations (and Rev. Proc. 2009–37 (2009–36 I.R.B. 309)), the IRS and Treasury Department believe that a change to the earnings and profits rules in these final regulations would be burdensome. Accordingly, these final regulations adopt these rules of the proposed regulations without change.

D. Transitional Rules

The proposed regulations provide that the rules for acceleration of deferred COD income and deferred OID deductions apply prospectively. However, electing corporations were given the option to apply these rules to acceleration events occurring prior to the effective date of the proposed regulations if applied consistently. Because certain provisions of the acceleration rules are time sensitive (for example, the time for restoring value under the net

value acceleration rule), the proposed regulations included transitional rules extending the period of time in which an electing corporation needed to comply with the provision's requirements in order to allow electing corporations the ability to use and benefit from these provisions for prior periods.

These transitional rules are no longer necessary because additional time is no longer needed to comply with these provisions. Accordingly, these final regulations amend the proposed regulations by removing these transitional rules.

Special Analyses

It has been determined that this Treasury decision 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 these regulations. It is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations merely provide more specific guidance for the timing of the inclusion of deferred COD income and the deduction of deferred OID that is otherwise includible or deductible under the Code. Therefore, a Regulatory Flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received.

Drafting Information

The principal author of these regulations is Robert M. Rhyne of the Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §1.108(i)–0T, §1.108(i)–1T, and §1.108(i)–3T, and adding the entries for §1.108(i)–0, §1.108(i)–1, and §1.108(i)–3, to read, in part, as follows:

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

Section 1.108(i)–0 also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

Section 1.108(i)–1 also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

Section 1.108(i)–3 also issued under 26 U.S.C. 108(i)(7) and 1502. * * *

Par. 2. Section 1.108(i)–0 is added to read as follows:

§1.108(i)–0 Definitions and Effective/Applicability Dates.

(a) *Definitions*. For purposes of regulations under section 108(i)—

(1) *Acquisition*. An *acquisition*, with respect to any applicable debt instrument, includes an acquisition of the debt instrument for cash or other property, the exchange of the debt instrument for another debt instrument (including an exchange resulting from a modification of the debt instrument), the exchange of the debt instrument for corporate stock or a partnership interest, the contribution of the debt instrument to capital, the complete forgiveness of the indebtedness by the holder of the debt instrument, and a direct or an indirect acquisition within the meaning of §1.108–2.

(2) *Applicable debt instrument*. An *applicable debt instrument* is a debt instrument that was issued by a C corporation or any other person in connection with the conduct of a trade or business by such person. In the case of an intercompany obligation (as defined in §1.1502–13(g)(2)(ii)), *applicable debt instrument* includes only an instrument for which COD income is realized upon the instrument's deemed satisfaction under §1.1502–13(g)(5).

(3) *C corporation issuer*. *C corporation issuer* means a C corporation that issues a debt instrument with any deferred OID deduction.

(4) *C corporation partner*. A *C corporation partner* is a C corporation that is a direct or indirect partner of an electing partnership or a related partnership.

(5) *COD income*. *COD income* means income from the discharge of indebtedness, as determined under sections 61(a)(12) and 108(a) and the regulations under those sections.

(6) *COD income amount*. A *COD income amount* is a partner's distributive share of COD income with respect to an applicable debt instrument of an electing partnership.

(7) *Debt instrument*. *Debt instrument* means a bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness (within the meaning of section 1275(a)(1)).

(8) *Deferral period*. For a reacquisition that occurs in 2009, *deferral period* means the taxable year of the reacquisition and the four taxable years following such taxable year. For a reacquisition that occurs in 2010, *deferral period* means the taxable year of the reacquisition and the three taxable years following such taxable year.

(9) *Deferred amount*. A *deferred amount* is the portion of a partner's COD income amount with respect to an applicable debt instrument that is deferred under section 108(i).

(10) *Deferred COD income*. *Deferred COD income* means COD income that is deferred under section 108(i).

(11) *Deferred item*. A *deferred item* is any item of deferred COD income or deferred OID deduction that has not been previously taken into account under section 108(i).

(12) *Deferred OID deduction*. A *deferred OID deduction* means an otherwise allowable deduction for OID that is deferred under section 108(i)(2) with respect to a debt instrument issued (or treated as issued under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a).

(13) *Deferred section 465 amount*. A *deferred section 465 amount* is described in paragraph (d)(3) of §1.108(i)–2.

(14) *Deferred section 752 amount*. A *deferred section 752 amount* is described in paragraph (b)(3) of §1.108(i)–2.

(15) *Direct partner*. A *direct partner* is a person that owns a direct interest in a partnership.

(16) *Electing corporation*. An *electing corporation* is a C corporation with deferred COD income by reason of a section 108(i) election.

(17) *Electing entity*. An *electing entity* is an entity that is a taxpayer that makes an election under section 108(i).

(18) *Electing member*. An *electing member* is an electing corporation that is a member of an affiliated group that files a consolidated return.

(19) *Electing partnership*. An *electing partnership* is a partnership that makes an election under section 108(i).

(20) *Electing S corporation*. An *electing S corporation* is an S corporation that makes an election under section 108(i).

(21) *Included amount*. An *included amount* is the portion of a partner's COD income amount with respect to an applicable debt instrument that is not deferred under section 108(i) and is included in the partner's distributive share of partnership income for the taxable year of the partnership in which the reacquisition occurs.

(22) *Inclusion period*. The *inclusion period* is the five taxable years following the last taxable year of the deferral period.

(23) *Indirect partner*. An *indirect partner* is a person that owns an interest in a partnership through an S corporation and/or one or more partnerships.

(24) *Issuing entity*. An *issuing entity* is any entity that is—

(i) A related partnership;

(ii) A related S corporation;

(iii) An electing partnership that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a); or

(iv) An electing S corporation that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a).

(25) *OID*. *OID* means original issue discount, as determined under sections 1271 through 1275 (and the regulations under those sections). If the amount of OID with respect to a debt instrument is less than a *de minimis* amount as determined under §1.1273–1(d), the OID is treated as zero for purposes of section 108(i)(2).

(26) *Reacquisition*. A *reacquisition*, with respect to any applicable debt instrument, is any event occurring after December 31, 2008, and before January 1, 2011, that causes COD income with respect to such applicable debt instrument, including any acquisition of the debt instrument by the debtor that issued (or is otherwise the obligor under) the debt instrument or a person related to such debtor (within the meaning of section 108(i)(5)(A)).

(27) *Related partnership*. A *related partnership* is a partnership that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a).

(28) *Related S corporation*. A *related S corporation* is an S corporation that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a).

(29) *Separate interest*. A *separate interest* is a direct interest in an electing partnership or in a partnership or S corporation that is a direct or indirect partner of an electing partnership.

(30) *S corporation partner*. An *S corporation partner* is an S corporation that is a direct or indirect partner of an electing partnership or a related partnership.

(b) *Effective/Applicability dates*—(1) *In general*. The rules of this section, §1.108(i)–1, and §1.108(i)–2, apply on or after July 2, 2013, to reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008. In addition, the rules of §1.108(i)–3 apply on or after July 2, 2013, to debt instruments issued after December 31, 2008, in connection with reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008.

(2) *Prior periods*. For rules applying before July 2, 2013, see §1.108(i)–0T, §1.108(i)–1T, §1.108(i)–2T, and §1.108(i)–3T, as contained in 26 CFR part 1, revised April 1, 2013.

§1.108(i)–0T [Removed]

Par. 3. Section 1.108(i)–0T is removed.

Par. 4. Section 1.108(i)–1 is added to read as follows:

§1.108(i)–1 Deferred discharge of indebtedness income and deferred original issue discount deductions of C corporations.

(a) *Overview*. Section 108(i)(1) provides an election for the deferral of COD income arising in connection with the reacquisition of an applicable debt instrument. An electing corporation generally includes deferred COD income ratably over the inclusion period. Paragraph (b) of this section provides rules for the mandatory acceleration of an electing corporation's remaining deferred COD income, the mandatory acceleration of a C corporation issuer's deferred OID deductions, and for the elective acceleration of an electing member's (other than the common parent's) remaining deferred COD income. Paragraph (c) of this section provides examples illustrating the application of the mandatory and elective acceleration rules. Paragraph (d) of this section provides rules for the computation of an electing corporation's earnings and profits. Paragraph (e) of this section refers to the effective/applicability dates.

(b) *Acceleration events*—(1) *Deferred COD income*. Except as otherwise provided in paragraphs (b)(2) and (3) of this section, and §1.108(i)–2(b)(6) (in the case of a corporate partner), an electing corporation's deferred COD income is taken into account ratably over the inclusion period.

(2) *Mandatory acceleration events*. An electing corporation takes into account all of its remaining deferred COD income, including its share of an electing partnership's deferred COD income, immediately before the occurrence of any one of the events described in this paragraph (b)(2) (mandatory acceleration events), regardless of whether the electing corporation is in a title 11 or similar case at the time the mandatory acceleration event occurs.

(i) *Changes in tax status*. The electing corporation changes its tax status. For purposes of the preceding sentence, an electing corporation is treated as changing its tax status if it becomes one of the following entities:

(A) A tax-exempt entity as defined in §1.337(d)–4(c)(2).

(B) An S corporation as defined in section 1361(a)(1).

(C) A qualified subchapter S subsidiary as defined in section 1361(b)(3)(B).

(D) An entity operating on a cooperative basis within the meaning of section 1381.

(E) A regulated investment company (RIC) as defined in section 851 or a real estate investment trust (REIT) as defined in section 856.

(F) A qualified REIT subsidiary as defined in section 856(i), but only if the qualified REIT subsidiary was not a REIT immediately before it became a qualified REIT subsidiary.

(ii) *Cessation of corporate existence*—(A) *In general*. The electing corporation ceases to exist for Federal income tax purposes.

(B) *Exception for section 381(a) transactions*—(*1*) *In general*. The electing corporation is not treated as ceasing to exist and is not required to take into account its remaining deferred COD income solely because its assets are acquired in a transaction to which section 381(a) applies. In such a case, the acquiring corporation succeeds to the electing corporation's remaining deferred COD income and becomes subject to section 108(i) and the regulations thereunder, including all reporting requirements, as if the acquiring corporation were the electing corporation. A transaction is not treated as one to which section 381(a) applies for purposes of this paragraph (b)(2)(ii)(B) in the following circumstances—

(*i*) The acquisition of the assets of an electing corporation by an S corporation, if the acquisition is described in section 1374(d)(8);

(*ii*) The acquisition of the assets of an electing corporation by a RIC or REIT, if the acquisition is described in §1.337(d)–7(a)(2)(ii);

(*iii*) The acquisition of the assets of a domestic electing corporation by a foreign corporation;

(*iv*) The acquisition of the assets of a foreign electing corporation by a domestic corporation, if as a result of the transaction, one or more exchanging shareholders include in income as a deemed dividend the all earnings and profits amount with respect to stock in the foreign electing corporation pursuant to §1.367(b)–3(b)(3);

(*v*) The acquisition of the assets of an electing corporation by a tax-exempt entity as defined in §1.337(d)–4(c)(2); or

(*vi*) The acquisition of the assets of an electing corporation by an entity operating on a cooperative basis within the meaning of section 1381.

(*2*) *Special rules for consolidated groups*—(*i*) *Liquidations*. For purposes of paragraph (b)(2)(ii)(B) of this section, the acquisition of assets by distributee members of a consolidated group upon the liquidation of an electing corporation is not treated as a transaction to which section 381(a) applies, unless immediately prior to the liquidation, one of the distributee members owns stock in the electing corporation meeting the requirements of section 1504(a)(2) (without regard to §1.1502–34). See §1.1502–80(g).

(*ii*) *Taxable years*. In the case of an intercompany transaction to which section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(iii) *Net value acceleration rule*—(A) *In general*. The electing corporation engages in an impairment transaction and, immediately after the transaction, the gross value of the electing corporation's assets (gross asset value) is less than one hundred and ten percent of the sum of its total liabilities and the tax on the net amount of its deferred items (the net value floor) (the net value acceleration rule). Impairment transactions are any transactions, however effected, that impair an electing corporation's ability to pay the amount of Federal income tax liability on its deferred COD income and include, for example, distributions (including section 381(a) transactions), redemptions, below-market sales, charitable contributions, and the incurrence of additional indebtedness without a corresponding increase in asset value. Value-for-value sales or exchanges (for example, an exchange to which section 351 or section 721 applies), or mere declines in the market value of the electing corporation's assets are not impairment transactions. In addition, an electing corporation's investments and expenditures in pursuance of its good faith business judgment are not impairment transactions. For purposes of determining an electing corporation's gross asset value, the amount of any distribution that is not treated as an impairment transaction under paragraph (b)(2)(iii)(D) of this section (distributions and charitable contributions consistent with historical practice) or under paragraph (b)(2)(iii)(E) of this section (special rules for RICs and REITs) is treated as an asset of the electing corporation. Solely for purposes of computing the amount of the net value floor, the tax on the deferred items is determined by applying the highest rate of tax specified in section 11(b) for the taxable year.

(B) *Transactions integrated*. Any transaction that occurs before the reacquisition of an applicable debt instrument, but that occurs pursuant to the same plan as the reacquisition, is taken into account in determining whether the gross asset value of the electing corporation is less than the net value floor.

(C) *Corrective action to restore net value*. An electing corporation is not required to take into account its deferred COD income under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section if, before the due date of the electing corporation's return (including extensions), value is restored in a transaction in an amount equal to the lesser of—

(*1*) The amount of value that was removed from the electing corporation in one or more impairment transactions (net of amounts previously restored under this paragraph (b)(2)(iii)(C)); or

(*2*) The amount by which the electing corporation's net value floor exceeds its gross asset value.

For example, assume an electing corporation incurs $50 of debt, distributes the $50 of proceeds to its shareholder, and immediately after the distribution, the electing corporation's gross asset value is below the net value floor by $25. The electing corporation may avoid the inclusion of its remaining deferred COD income if value of at least $25 is restored to it before the due date of the electing corporation's tax return (including extensions) for the taxable year that includes the distribution. The value that must be restored is determined at the time of the impairment transaction on a net value basis (for example, additional borrowings by an electing corporation do not restore value).

(D) *Exceptions for distributions and charitable contributions that are consistent with historical practice*. An electing corporation's distributions are not treated as impairment transactions (and are not taken into account as a reduction of the electing corporation's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the distributions are described in section 301(c) and the amount of these distributions, in the aggregate, for the applicable taxable year (applicable distribution amount) does not exceed the annual average amount of section 301(c) distributions over the preceding three taxable years (average distribution amount). If an electing corporation's applicable distribution amount exceeds its average distribution amount (excess amount), then the amount of the impairment transaction equals the excess amount. Appropriate adjustments must be made to take into account any issuances or redemptions of stock, or similar transactions, occurring during the taxable year of distribution or any of the preceding three taxable years. If the electing corporation has a short taxable year for the year of the distribution or for any of the preceding three taxable years, the amounts are determined on an annualized basis. If an electing corporation has been in existence for less than three years, the period during which the electing corporation has been in existence is substituted for the preceding three taxable years. For purposes of determining an electing corporation's average distribution amount, the electing corporation does not take into account the distribution history of a distributor or transferor in a transaction to which section 381(a) applies (other than a transaction described in section 368(a)(1)(F)). Rules similar to those prescribed in this paragraph (b)(2)(iii)(D) also apply to an electing corporation's charitable contributions (within the meaning of section 170(c)) that are consistent with its historical practice.

(E) *Special rules for RICs and REITs*—(*1*) *Distributions*. Notwithstanding paragraph (b)(2)(iii)(D) of this section, in the case of a RIC or REIT, any distribution with respect to stock that is treated as a dividend under section 852 or 857 is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(*2*) *Redemptions by RICs*. Any redemption of a redeemable security, as defined in 15 U.S.C. section 80a–2(a)(32), by a RIC in the ordinary course of business is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(F) *Special rules for consolidated groups*—(*1*) *Impairment transactions and net value acceleration rule*. In the case of an electing member, the determination of whether the member has engaged in an impairment transaction is made on a group-wide basis. An electing member is treated as engaging in an impairment transaction if any member's transaction impairs the group's ability to pay the tax liability associated with all electing members' deferred COD income. Accordingly, intercompany transactions are not impairment transactions. Similarly, the net value acceleration rule is applied by reference to the gross asset value of all members (excluding stock of members whether or not described in section 1504(a)(4)), the liabilities of all members, and the tax on all members' deferred items. For example, assume P is the common parent of the P-S consolidated group, S has a section 108(i) election in effect, and S makes a $100 distribution to P which, on a separate entity basis, would reduce S's gross asset value below the net value floor. S's intercompany distribution to P is not an impairment transaction. However, if P makes a $100 distribution to its shareholder, P's distribution is an impairment transaction (unless the distribution is consistent with its historical practice under paragraph (b)(2)(iii)(D) of this section), and the net value acceleration rule is applied by reference to the assets, liabilities, and deferred items of the P-S group.

(*2*) *Departing member*. If an electing member that previously engaged in one or more impairment transactions on a separate entity basis ceases to be a member of a consolidated group (departing member), the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A) of this section is applied to the departing member on a separate entity basis immediately after ceasing to be a member (and taking into account the impairment transaction(s) that occurred on a separate entity basis). If the departing member's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's deferred COD income is not accelerated, the departing member is subject to the reporting requirements of section 108(i) on a separate entity basis. If the departing member becomes a member of another consolidated group, the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A) of this section is applied by reference to the assets, liabilities, and the tax on deferred items of the members of the acquiring group immediately after the transaction. If the acquiring group's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's remaining deferred COD income is not accelerated, the common parent of the acquiring group succeeds to the reporting requirements of section 108(i) with respect to the departing member.

(3) *Elective acceleration for certain consolidated group members*—(i) *In general*. An electing member (other than the common parent) of a consolidated group may elect at any time to accelerate in full (and not in part) the inclusion of its remaining deferred COD income with respect to all applicable debt instruments by filing a statement described in paragraph (b)(3)(ii) of this section. Once made, an election to accelerate deferred COD income under this paragraph (b)(3) is irrevocable.

(ii) *Time and manner for making election*—(A) *In general*. The election to accelerate the inclusion of an electing member's remaining deferred COD income with respect to all applicable debt instruments is made on a statement attached to a timely filed tax return (including extensions) for the year in which the deferred COD income is taken into account. The election is made by the common parent on behalf of the electing member. See §1.1502–77(a).

(B) *Additional information*. The statement must include—

(*1*) *Label*. A label entitled "SECTION 1.108(i)–1 ELECTION AND INFORMATION STATEMENT BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF THE ELECTING MEMBER]"; and

(*2*) *Required Information*. An identification of each applicable debt instrument to which an election under this paragraph (b)(3) applies and the corresponding amount of—

(*i*) Deferred COD income that is accelerated under this paragraph (b)(3); and

(*ii*) Deferred OID deductions that are accelerated under paragraph (b)(4) of this section.

(4) *Deferred OID deductions*—(i) *In general*. Except as otherwise provided in paragraph (b)(4)(ii) of this section and §1.108(i)–2(b)(6) (in the case of a C corporation partner), a C corporation issuer's deferred OID deductions are taken into account ratably over the inclusion period.

(ii) *OID acceleration events*. A C corporation issuer takes into account all of its remaining deferred OID deductions with respect to a debt instrument immediately before the occurrence of any one of the events described in this paragraph (b)(4)(ii), regardless of whether the C corporation issuer is in a title 11 or similar case.

(A) *Inclusion of deferred COD income*. An electing entity or its owners take into account all of the remaining deferred COD income to which the C corporation issuer's deferred OID deductions relate. If, under §1.108(i)–2(b) or (c), an electing entity or its owners take into account only a portion of the deferred COD income to which the deferred OID deductions relate, then the C corporation issuer takes into account a proportionate amount of the remaining deferred OID deductions.

(B) *Changes in tax status*. The C corporation issuer changes its tax status within the meaning of paragraph (b)(2)(i) of this section.

(C) *Cessation of corporate existence*—(*1*) *In general*. The C corporation issuer ceases to exist for Federal income tax purposes.

(*2*) *Exception for section 381(a) transactions*—(*i*) *In general*. A C corporation issuer is not treated as ceasing to exist and does not take into account its remaining deferred OID deductions in a transaction to which section 381(a) applies, taking into account the application of §1.1502–34, as appropriate. See §1.1502–80(g). This exception does not apply to a transaction that is not treated as one to which section 381(a) applies under paragraph (b)(2)(iii)(B)(*1*) of this section.

(*ii*) *Taxable years*. In the case of an intercompany transaction to which section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(c) *Examples*. The application of this section is illustrated by the following examples. Unless otherwise stated, P, S, S1, and X are domestic C corporations, and each files a separate return on a calendar year basis:

Example 1. Net value acceleration rule. (i) *Facts*. On January 1, 2009, S reacquires its own note and realizes $400 of COD income. Pursuant to an election under section 108(i), S defers recognition of the entire $400 of COD income. Therefore, absent a mandatory acceleration event, S will take into account $80 of its deferred COD income in each year of the inclusion period. On December 31, 2010, S makes a $25 distribution to its sole shareholder, P, and this is the only distribution made by S in the past four years. Immediately following the distribution, S's gross asset value is $100, S has no liabilities, and the Federal income tax on S's $400 of deferred COD income is $140. Accordingly, S's net value floor is $154 (110% x $140).

(ii) *Analysis*. Under paragraph (b)(2)(iii)(A) of this section, S's distribution is an impairment transaction. Immediately following the distribution, S's gross asset value of $100 is less than the net value floor of $154. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S takes into account its $400 of deferred COD income immediately before the distribution.

(iii) *Corrective action to restore value*. The facts are the same as in paragraph (i) of this *Example 1*, except that P contributes assets with a value of $25 to S before the due date of S's 2010 return (including extensions). Because P restores $25 of value to S (the lesser of the amount of value removed in the distribution ($25) or the amount by which S's net value floor exceeds its gross asset value ($54)), under paragraph (b)(2)(iii)(C) of this section, S does not take into account its $400 of deferred COD income.

Example 2. Distributions consistent with historical practice. (i) *Facts*. P, a publicly traded corporation, makes a valid section 108(i) election with respect to COD income realized in 2009. On December 31, 2009, P distributes $25 million on its 5 million shares of common stock outstanding. As of January 1, 2006, P has 10 million shares of common stock outstanding, and on March 31, 2006, P distributes $10 million on those 10 million shares. On September 15, 2006, P effects a 2:1 reverse stock split, and on December 31, 2006, P distributes $10 million on its 5 million shares of common stock outstanding. In each of 2007 and 2008, P distributes $5 million on its 5 million shares of common stock outstanding. All of the distributions are described in section 301(c).

(ii) *Amount of impairment transaction*. Under paragraph (b)(2)(iii)(D) of this section, P's 2009 distributions are not treated as impairment transactions (and are not taken into account as a reduction of P's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the aggregate amount distributed in 2009 (the applicable distribution amount) does not exceed the annual average amount of distributions (the average distribution amount) over the preceding three taxable years. Accordingly, P's applicable distribution amount for 2009 is $25 million, and its average distribution amount is $10 million ($20 million (2006) plus $5 million (2007) plus $5 million (2008) divided by 3). The reverse stock split in 2006 is not a transaction requiring an adjustment to the determination of the average distribution amount. Because P's applicable distribution amount of $25 million exceeds its average distribution amount of $10 million, under paragraph (b)(2)(iii)(D) of this section, the amount of P's 2009 distribution that is treated as an impairment transaction is $15 million. The balance of the 2009 distribution, $10 million, is not treated as an impairment transaction (and is not taken into account as a reduction in P's gross asset value when applying the net value acceleration rule to any impairment transaction).

(iii) *Distribution history*. The facts are the same as in paragraph (i) of this *Example 2*, except that in 2010, P merges into X in a transaction to which section 381(a) applies, with X succeeding to P's deferred COD income, and X makes a distribution to its shareholders. For purposes of determining whether X's distribution is consistent with its historical practice, the average distribution amount is determined solely with respect to X's distribution history.

Example 3. Cessation of corporate existence. (i) *Transaction to which section 381(a) applies*. P owns all of the stock of S. In 2009, S reacquires its own note and elects to defer recognition of its $400 of COD income under section 108(i). On December 31, 2010, S liquidates into P in a transaction that qualifies under section 332. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A) of this section, S's distribution to P is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor) immediately following the distribution. If S's deferred COD income is not taken into account under the net value acceleration rule of (b)(2)(iii) of this section, P succeeds to S's remaining deferred COD income and to S's reporting requirements as if P were the electing corporation.

(ii) *Debt-laden distributee*. The facts are the same as in paragraph (i) of this *Example 3*, except that in the liquidation, S distributes $100 of assets to P, a holding company whose only asset is its stock in S. Assume that immediately following the distribution, P's gross

asset value is $100, P has $60 of liabilities, and the Federal income tax on the $400 of deferred COD income is $140. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A) of this section, S's distribution to P is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor). Immediately following the distribution, P's gross asset value of $100 is less than the net value floor of $220 [110% x ($60 + $140)]. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S is required to take into account its $400 of deferred COD income immediately before the distribution, unless value is restored to P pursuant to paragraph (b)(2)(iii)(C) of this section.

(iii) *Foreign acquirer*. The facts are the same as in paragraph (i) of this *Example 3*, except that P is a foreign corporation. Although S's assets are acquired in a transaction to which section 381(a) applies, under paragraph (b)(2)(ii)(B)(*1*)(*iii*) of this section, the exception to accelerated inclusion does not apply and S takes into account its remaining deferred COD income immediately before the liquidation. See also section 367(e)(2) and the regulations thereunder.

(iv) *Section 338 transaction*. P, the common parent of a consolidated group (P group), owns all the stock of S1, one of the members of the P group. In 2009, S1 reacquires its own indebtedness and realizes $30 of COD income. Pursuant to an election under section 108(i), S1 defers recognition of the entire $30 of COD income. In 2010, P sells all the stock of S1 to X, an unrelated corporation, for $300, and P and X make a timely section 338(h)(10) election with respect to the sale. Under paragraph (b)(2)(ii)(A) of this section, an electing corporation takes into account its remaining deferred COD income when it ceases its existence for Federal income tax purposes unless the exception in paragraph (b)(2)(ii)(B) of this section applies. Pursuant to section 338(h)(10) and the regulations, S1 is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the discharge of its liabilities. This deemed value-for-value exchange is not an impairment transaction. Following the deemed sale, while S1 is still a member of the P group, S1 is treated as distributing all of its assets to P and as ceasing its existence. Under these facts, the distribution of all of S1's assets constitutes a deemed liquidation, and is a transaction to which sections 332 and 381(a) apply. Although S1 ceases its corporate existence as a result of the liquidation, S1 is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. P succeeds to S1's remaining deferred COD income and to S1's reporting requirements as if P were the electing corporation. Under paragraph (b)(2)(iii)(F)(*1*) of this section, the intercompany distribution from S1 to P is not an impairment transaction.

(d) *Earnings and profits*—(1) *In general*. Deferred COD income increases earnings and profits in the taxable year that it is realized and not in the taxable year or years that the deferred COD income is includible in gross income. Deferred OID deductions decrease earnings and profits in the taxable year or years in which the deduction would be allowed without regard to section 108(i).

(2) *Exceptions*—(i) *RICs and REITs*. Notwithstanding paragraph (d)(1) of this section, deferred COD income increases earnings and profits of a RIC or REIT in the taxable year or years in which the deferred COD income is includible in gross income and not in the year that the deferred COD income is realized. Deferred OID deductions decrease earnings and profits of a RIC or REIT in the taxable year or years that the deferred OID deductions are deductible.

(ii) *Alternative minimum tax*. For purposes of calculating alternative minimum taxable income, any items of deferred COD income or deferred OID deduction increase or decrease, respectively, adjusted current earnings under section 56(g)(4) in the taxable year or years that the item is includible or deductible.

(e) *Effective/applicability dates*. For *effective/applicability dates*, see §1.108(i)–0(b).

§1.108(i)–1T [Removed].

Par. 5. Section 1.108(i)–1T is removed.

Par. 6. Section 1.108(i)–3 is added to read as follows:

§1.108(i)–3 Rules for the deduction of OID.

(a) *Deemed debt-for-debt exchanges*—(1) *In general*. For purposes of section 108(i)(2) (relating to deferred OID deductions that arise in certain debt-for-debt exchanges involving the reacquisition of an applicable debt instrument), if the proceeds of any debt instrument are used directly or indirectly by the issuer or a person related to the issuer (within the meaning of section 108(i)(5)(A)) to reacquire an applicable debt instrument, the debt instrument shall be treated as issued for the applicable debt instrument being reacquired. Therefore, section 108(i)(2) may apply, for example, to a debt instrument issued by a corporation for cash in which some or all of the proceeds are used directly or indirectly by the corporation's related subsidiary in the reacquisition of the subsidiary's applicable debt instrument.

(2) *Directly or indirectly*. Whether the proceeds of an issuance of a debt instrument are used directly or indirectly to reacquire an applicable debt instrument depends upon all of the facts and circumstances surrounding the issuance and the reacquisition. The proceeds of an issuance of a debt instrument will be treated as being used indirectly to reacquire an applicable debt instrument if—

(i) At the time of the issuance of the debt instrument, the issuer of the debt instrument anticipated that an applicable debt instrument of the issuer or a person related to the issuer would be reacquired by the issuer, and the debt instrument would not have been issued if the issuer had not so anticipated such reacquisition;

(ii) At the time of the issuance of the debt instrument, the issuer of the debt instrument or a person related to the issuer anticipated that an applicable debt instrument would be reacquired by a related person and the related person receives cash or property that it would not have received unless the reacquisition had been so anticipated; or

(iii) At the time of the reacquisition, the issuer or a person related to the issuer foresaw or reasonably should have foreseen that the issuer or a person related to the issuer would be required to issue a debt instrument, which it would not have otherwise been required to issue if the reacquisition had not occurred, in order to meet its future economic needs.

(b) *Proportional rule for accruals of OID*. For purposes of section 108(i)(2), if only a portion of the proceeds from the issuance of a debt instrument are used directly or indirectly to reacquire an applicable debt instrument, the rules of section 108(i)(2)(A) will apply to the portion of OID on the debt instrument that is equal to the portion of the proceeds from such instrument used to reacquire the outstanding applicable debt instrument. Except as provided in the last sentence of section 108(i)(2)(A), the amount of deferred OID deduction that is subject to section 108(i)(2)(A) for a taxable year is equal to the product of the amount of OID that

accrues in the taxable year under section 1272 or section 1275 (and the regulations under those sections), whichever section is applicable, and a fraction, the numerator of which is the portion of the total proceeds from the issuance of the debt instrument used directly or indirectly to reacquire the applicable debt instrument and the denominator of which is the total proceeds from the issuance of the debt instrument.

(c) *No acceleration*—(1) *Retirement*. Retirement of a debt instrument subject to section 108(i)(2) does not accelerate deferred OID deductions.

(2) *Cross-reference*. See §1.108(i)–1 and §1.108(i)–2 for rules relating to the acceleration of deferred OID deductions.

(d) *Examples*. The application of this section is illustrated by the following examples. Unless otherwise stated, all taxpayers in the following examples are calendar-year taxpayers, and P and S each file separate returns:

Example 1. (i) *Facts*. P, a domestic corporation, owns all of the stock of S, a domestic corporation. S has a debt instrument outstanding that has an adjusted issue price of $100,000. On January 1, 2010, P issues for $160,000 a four-year debt instrument that has an issue price of $160,000 and a stated redemption price at maturity of $200,000, resulting in $40,000 of OID. In P's discussion with potential lenders/holders, and as described in offering materials provided to potential lenders/holders, P disclosed that it planned to use all or a portion of the proceeds from the issuance of the debt instrument to reacquire outstanding debt of P and its affiliates. Following the issuance, P makes a $70,000 capital contribution to S. S then reacquires its debt instrument from X, a person not related to S within the meaning of section 108(i)(5)(A), for $70,000. At the time of the reacquisition, the adjusted issue price of S's debt instrument is $100,000. Under §1.61–12(c), S realizes $30,000 of COD income. S makes a section 108(i) election for the $30,000 of COD income.

(ii) *Analysis*. Under the facts, at the time of P's issuance of its $160,000 debt instrument, P anticipated that the loan proceeds would be used to reacquire the debt of S, and P's debt instrument would not have been issued for an amount greater than $90,000 if P had not anticipated that S would use the proceeds to reacquire its debt. Pursuant to paragraph (a) of this section, the proceeds from P's issuance of its debt instrument are treated as being used indirectly to reacquire S's applicable debt instrument. Therefore, section 108(i)(2)(B) applies to P's debt instrument and P's OID deductions on its debt instrument are subject to deferral under section 108(i)(2)(A). However, because only a portion of the proceeds from P's debt instrument are used by S to reacquire its applicable debt instrument, only a portion of P's total OID deductions will be deferred under section 108(i)(2)(A). See section 108(i)(2)(B). Accordingly, a maximum of $17,500 ($40,000 x $70,000/$160,000) of P's $40,000 total OID deductions is subject to deferral under section 108(i)(2)(A). Under paragraph (b) of this section, the amount of P's deferred OID deduction each taxable year under section 108(i)(2)(A) is equal to the product of the amount of OID that accrues in the taxable year under section 1272 for the debt instrument and a fraction ($70,000/$160,000). As a result, P's deferred OID deductions are the following amounts: $4,015.99 for 2010 ($ 9,179.40 x $70,000/$160,000); $4,246.39 for 2011 ($9,706.04 x $70,000/$160,000); $4,490.01 for 2012 ($10,262.88 x $70,000/$160,000); and $4,747.61 for 2013 ($10,851.68 x $70,000/$160,000).

Example 2. (i) *Facts*. The facts are the same as in *Example 1*, except that S makes a section 108(i) election for only $10,000 of the $30,000 of COD income.

(ii) *Analysis*. The maximum amount of P's deferred OID deductions under section 108(i)(2)(A) is $10,000 rather than $17,500 because S made a section 108(i) election for only $10,000 of the $30,000 of COD income. Under section 108(i)(2)(A), because the amount of OID that accrues prior to 2014 attributable to the portion of the debt instrument issued to indirectly reacquire S's applicable debt instrument under paragraph (b) of this section ($17,500) exceeds the amount of deferred COD income under section 108(i) ($10,000), P's deferred OID deductions are the following amounts: $4,015.99 for 2010; $4,246.39 for 2011; $1,737.62 for 2012; and $0 for 2013.

Example 3. (i) *Facts*. The facts are the same as in *Example 1*, except that P pays $200,000 in cash to the lenders/holders on December 31, 2012, to retire the debt instrument. P did not directly or indirectly obtain the funds to retire the debt instrument from the issuance of another debt instrument with OID.

(ii) *Analysis*. Under paragraph (c)(1) of this section, the retirement of P's debt instrument is not an acceleration event for the deferred OID deductions of $4,015.99 for 2010, $4,246.39 for 2011, and $4,490.01 for 2012. Except as provided in §1.108(i)–1(b)(4), these amounts will be taken into account during the inclusion period. P, however, paid a repurchase premium of $10,851.68 in 2012 ($200,000 minus the adjusted issue price of $189,148.32) to retire the debt instrument. If otherwise allowable, P may deduct this amount in 2012 under §1.163–7(c).

(e) *Effective/applicability dates*. For *effective/applicability dates*, see §1.108(i)–0(b).

§1.108(i)–3T [Removed]

Par. 7. Section 1.108(i)–3T is removed.

Part 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is revised as follows:

1. The following entry to the table is removed:

§602.101 OMB Control Numbers.

* * * * *

(b) * * *

CFR part or section where Identified and described	Current OMB Control No.
* * * * *	
1.108(i)–1T	1545–2147
* * * * *	

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2. The following entry is added in numerical order to the table:

§602.101 OMB Control Numbers.

(b) * * *

* * * * *

CFR part or section where Identified and described	Current OMB Control No.
* * * * *	
1.108(i)–1	1545–2147
* * * * *	

Beth Tucker,
Deputy Commissioner for Operations Support.

Approved June 11, 2013.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 2, 2013, 8:45 a.m., and published in the issue of the Federal Register for July 3, 2013, 78 F.R. 39984)

T.D. 9623

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Application of Section 108(i) to Partnerships and S Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the application of section 108(i) of the Internal Revenue Code (Code) to partnerships and S corporations and provides rules regarding the deferral of discharge of indebtedness income and original issue discount deductions by a partnership or an S corporation with respect to reacquisitions of applicable debt instruments after December 31, 2008, and before January 1, 2011. The regulations affect partnerships and S corporations with respect to reacquisitions of applicable debt instruments and their partners and shareholders.

DATES: *Effective Date:* These regulations are effective on July 2, 2013.

Applicability Date: For dates of applicability, see §1.108(i)–0(b).

FOR FURTHER INFORMATION CONTACT: Joseph R. Worst, Office of Associate Chief Counsel (Passthroughs and Special Industries), (202) 622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–2147. The collection of information in these final regulations is in §1.108(i)–2(b)(3)(iv). Under §1.108(i)–2(b)(3)(iv), when a partnership makes an election under section 108(i), one or more of the partners in the partnership may be required to provide certain information to the partnership so that the partnership can correctly determine each such partner's deferred section 752 amount with respect to an applicable debt instrument.

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

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

Background

Section 108(i) was added to the Code by section 1231 of the American Recovery and Reinvestment Tax Act of 2009, Public Law 111–5 (123 Stat. 338 (2009)), and generally provides for an elective deferral of cancellation of debt income (COD income) realized by a taxpayer from a reacquisition of an applicable debt instrument that occurs after December 31, 2008, and before January 1, 2011. COD income deferred under section 108(i) is included in gross income ratably over a five taxable-year period (inclusion period) beginning with the taxpayer's fourth or fifth taxable year following the taxable year of the reacquisition.

When a debt instrument is issued (or treated as issued) as part of the reacquisition, some or all of any original issue discount (OID) expense accruing from the debt instrument in a taxable year prior to the first taxable year of the inclusion period may also be required to be deferred (deferred OID deduction). The aggregate amount of deferred OID deductions is limited to the amount of COD income deferred with respect to the applicable debt instrument for which the section 108(i) election is made, and the aggregate amount of deferred OID deductions is taken into account ratably over the inclusion period.

In general, COD income deferred under section 108(i) and related deferred OID deductions with respect to an applicable debt instrument that have not been previously taken into account (deferred items) are accelerated and taken into account in the taxable year in which an acceleration event occurs.

A section 108(i) election is irrevocable and, if a section 108(i) election is made, sections 108(a)(1)(A), (B), (C), and (D) do not apply to the COD income that is deferred under section 108(i). Section 108(i)(7) authorizes the Secretary to prescribe regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying section 108(i).

In August 2009, the IRS and the Treasury Department issued Rev. Proc. 2009–37 (2009–36 I.R.B. 309), which provides election procedures for taxpayers (including partnerships and S corporations) and other guidance under section 108(i). Partnerships and S corporations that make an election under section 108(i) (electing partnership or electing S corporation) must follow the election procedures

and reporting requirements of Rev. Proc. 2009–37.

Temporary regulations (TD 9498, 75 FR 49380) and a notice of proposed rulemaking (REG–144762–09, 75 FR 49427) (proposed regulations) cross-referencing the temporary regulations were published in the **Federal Register** on August 13, 2010. No public hearing was requested or held. However, written comments responding to the notice of proposed rulemaking were received from the public. These comments were considered and are available for public inspection at *http://www.regulations.gov* or upon request. After consideration of the comments, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The revisions are discussed in this preamble.

Summary of Comments and Explanation of Provisions

A. *Partnership-Level Election*

Section 108(i)(5)(B)(iii) provides that in the case of a partnership, S corporation, or other passthrough entity that reacquires an applicable debt instrument, the election under section 108(i) shall be made by the partnership, S corporation, or other entity involved. One commenter suggested that the final regulations permit a partner in a partnership to make a section 108(i) election if the partnership does not make the election. The commenter reasoned that a partner-level election rule would align section 108(i) with section 108(d)(6), which generally applies the rules under section 108 at the partner level. Additionally, the commenter noted that a partner-level election would be beneficial when the partners who control the partnership have no interest in making a section 108(i) election, but a non-controlling partner does. Section 108(i)(5)(B)(iii) is unambiguous as to permitting only a partnership to make the election and, therefore, the IRS and the Treasury Department do not adopt the commenter's suggestion in the final regulations.

B. *Applicable Debt Instrument Safe Harbors*

Section 108(i) applies to the reacquisition of an "applicable debt instrument," which is defined under section 108(i)(3)(A) as any debt instrument issued by a C corporation or any other person in connection with the conduct of a trade or business by such person. The statute does not define what "in connection with the conduct of a trade or business" means in this context. The proposed regulations do not explicitly define the phrase either but, rather, provide five safe harbors under which a debt instrument is deemed to be issued in connection with a partnership's or S corporation's conduct of a trade or business for purposes of section 108(i) (trade or business safe harbors). If none of the trade or business safe harbors apply, then the determination of whether a debt instrument is an applicable debt instrument is based on the facts and circumstances.

One commenter recommended that the final regulations add an additional trade or business safe harbor providing that a debt instrument issued by a partnership to acquire or improve real property held for rental purposes is treated as issued in connection with a trade or business for purposes of section 108(i) if at least 30 percent of the total tax basis (without reduction for depreciation deductions) of the partnership's property is allocable to depreciable property. Section 167(a) provides that a depreciation deduction is allowed for the exhaustion, wear and tear (1) of property used in a trade or business or (2) of property held for the production of income. Thus, the fact that property is depreciable does not necessarily indicate that the property is used in a trade or business. The final regulations, therefore, do not adopt this comment.

One of the trade or business safe harbors in the proposed regulations requires that the gross fair market value of the trade or business assets of the partnership that issued the debt instrument be at least 80 percent of the gross fair market value of that partnership's total assets on the date of issuance. The commenter also requested that, because many partnerships own interests in lower-tier partnerships, the final regulations should permit an upper-tier electing partnership to take into account its proportionate share of assets held through lower-tier partnerships in which the upper-tier electing partnership holds a significant percentage of the interests (for example, at least 20 percent) as part of its trade or business assets. After consideration of the comment, the IRS and the Treasury Department have decided to not adopt the comment in the final regulations because doing so would add undue complexity to the trade or business safe harbors. No inference should be drawn from the decision not to adopt the comments as to whether a partnership described in the comments is or is not engaged in a trade or business.

C. *Deferred Section 752 Amount Rules*

Section 108(i)(6) provides that any decrease in a partner's share of partnership liabilities as a result of the discharge shall not be taken into account for purposes of section 752 at the time of the discharge to the extent it would cause the partner to recognize gain under section 731 (section 108(i)(6) deferral). The decrease in a partner's share of a partnership liability under section 752(b) resulting from the reacquisition of an applicable debt instrument that is not treated as a current distribution of money to the partner under section 752(b) by reason of the section 108(i)(6) deferral is referred to as a partner's "deferred section 752 amount." Under the proposed regulations, a partner's deferred section 752 amount cannot exceed the partner's share of deferred COD income. The partner's deferred section 752 amount is treated as a distribution of money to the partner under section 752(b) at the same time and, to the extent remaining, in the same amount as the partner recognizes the deferred COD income (the last sentence of section 108(i)(6)).

Some commenters are unsure how to apply the last sentence of section 108(i)(6) during the inclusion period when a partner's deferred section 752 amount is less than the partner's deferred COD income. The final regulations clarify the last sentence of section 108(i)(6) by adding an example to illustrate that the deferred section 752 amount is treated as a deemed distribution under section 752(b) in a taxable year of the inclusion period to the extent that the deferred section 752 amount (less any deferred section 752 amount that has already been treated as a deemed distribution under section 752(b) in a prior taxable year of the inclusion period) is equal to or less than the partner's deferred COD income that is recognized in such taxable year.

D. *Acceleration Events*

1. *Bankruptcy Issues*

The proposed regulations provide that the deferred section 108(i) items are accelerated in the taxable year that includes the day before the day on which an electing partnership or S corporation files a petition in a title 11 or similar case (filing acceleration rule). Some commenters questioned when this rule applies. The filing acceleration rule applies to partnerships and S corporations that make an election under section 108(i) before filing a petition in a title 11 or similar case. Without this rule, the period of limitations on assessment under section 6501 may prevent the IRS from assessing tax on deferred COD income. The filing acceleration rule, however, does not apply to partnerships and S corporations that file a petition in a title 11 or similar case before making an election under section 108(i).

A commenter also suggested that the final regulations permit partnerships and S corporations that have made an election under section 108(i) after filing bankruptcy to reorganize, recapitalize, or liquidate in bankruptcy without triggering acceleration of the deferred items under section 108(i). The commenter explained that a bankruptcy reorganization will in many cases cause an acceleration of the deferred items under section 108(i) because the bankrupt partnerships or S corporations may sell, exchange or transfer substantially all of their assets or liquidate as part of the reorganization. The IRS and the Treasury Department do not adopt this comment because the same acceleration events that apply to partnerships and S corporations that do not file bankruptcy should apply to partnerships and S corporations that make an election under section 108(i) after filing bankruptcy.

2. *Calculation of "Substantially All" of the Assets*

The proposed regulations provide that a sale, exchange, transfer, or gift of "substantially all" of the assets of an electing partnership or S corporation triggers an acceleration of the deferred section 108(i) items. The proposed regulations provide that "substantially all" of a partnership's or S corporation's assets means assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets (90/70 test), as measured immediately prior to the sale, exchange, transfer, or gift in question.

One commenter advocated for a facts and circumstance test rather than the 90/70 test in determining whether a partnership or S corporation transfers substantially all of its assets for purposes of accelerating the deferred items under section 108(i). The IRS and the Treasury Department considered the comment but decided to retain the rule in the proposed regulations, because the 90/70 test provides electing partnerships and S corporations clear guidance on when a sale, exchange, transfer, or gift of their assets accelerates their deferred items.

3. *Exceptions for Certain Distributions and Section 381 Transactions*

Section 1.108(i)–2(b)(6)(ii)(A) of the proposed regulations provides that when a direct or indirect partner of an electing partnership sells, exchanges, transfers (including contributions and distributions), or gifts all or a portion of its "separate interest" (a direct interest in an electing partnership or in a partnership or S corporation that is a direct or indirect partner of an electing partnership), its deferred items with respect to the separate interest are accelerated and must be taken into account.

The proposed regulations provide an exception to this acceleration rule under §1.108(i)–2(b)(6)(iii)(E) for certain distributions of separate interests. Under §1.108(i)–2(b)(6)(iii)(E), if a partnership (upper-tier partnership) that is a direct or indirect partner of an electing partnership distributes its entire separate interest (distributed separate interest) to one or more of its partners (distributee partners) that have a share of the electing partnership's deferred items from the upper-tier partnership with respect to the distributed separate interest, the distributee partners' shares of the electing partnership's deferred items with respect to the distributed separate interest are not accelerated.

The proposed regulations also provide an exception to the acceleration rule in §1.108(i)–2(b)(6)(ii)(A) for section 381 transactions. Under §1.108(i)–2(b)(6)(iii)(F), a C corporation partner's share of an electing partnership's deferred items is not accelerated if, as part of a transaction described in §1.108(i)–2(b)(6)(ii)(A), the assets of the C corporation partner are acquired by another C corporation in a transaction that is treated, under §1.108(i)–1(b)(2)(ii)(B), as a transaction to which section 381(a) applies. An S corporation partner's share of an electing partnership's deferred items is not accelerated if, as part of a transaction described in §1.108(i)–2(b)(6)(ii)(A), the assets of the S corporation partner are acquired by another S corporation in a transaction to which section 381(a) applies.

Since the publication of the proposed regulations, the IRS and the Treasury Department have considered whether the exceptions in §1.108(i)–2(b)(6)(iii)(E) and §1.108(i)–2(b)(6)(iii)(F) should apply when the electing partnership terminates under section 708(b)(1)(A). In that situation, the electing partnership no longer exists and cannot report any deferred items to its partners. Therefore, the final regulations clarify that the exceptions to acceleration for distributions of entire separate interests under §1.108(i)–2(b)(6)(iii)(E) and for section 381 transactions under §1.108(i)–2(b)(6)(iii)(F), do not apply if the electing partnership terminates under section 708(b)(1)(A).

E. *Real Estate Investment Trusts*

Section 2.01 of Rev. Proc. 2009–37 provides that for purposes of section 108(i), real estate investment trusts (REITs) are not passthrough entities. One commenter recommended that, for purposes of clarity, the final regulations should reiterate the statement in Rev. Proc. 2009–37 that REITs are not passthrough entities for purposes of section 108(i).

As stated in Rev. Proc. 2009–37, the IRS and the Treasury Department believe that REITs are not passthrough entities for purposes of section 108(i). However, the IRS and the Treasury Department do not believe it is necessary to add a rule in the final regulations to that effect because the issue is addressed in Rev. Proc. 2009–37.

Special Analyses

It has been determined that this Treasury decision 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 these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information imposed on partners of partnerships is minimal in that it requires partners to share information with partnerships that partners already maintain. Moreover, it should take a partner no more than one hour to satisfy the information-sharing requirement in these regulations. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

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

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.108(i)–2 also issued under 26 U.S.C. 108(i)(7). * * *

Par. 2. Section 1.108(i)–2 is added to read as follows:

§1.108(i)–2 Application of section 108(i) to partnerships and S corporations.

(a) *Overview*. Under section 108(i), a partnership or an S corporation may elect to defer COD income arising in connection with a reacquisition of an applicable debt instrument for the deferral period. COD income deferred under section 108(i) is included in gross income ratably over the inclusion period, or earlier upon the occurrence of any acceleration event described in paragraph (b)(6) or (c)(3) of this section. If a debt instrument is issued (or treated as issued under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in §1.108(i)–3(a), some or all of the deductions for OID with respect to such debt instrument must be deferred during the deferral period. The aggregate amount of OID deductions deferred during the deferral period is generally allowed as a deduction ratably over the inclusion period, or earlier upon the occurrence of any acceleration event described in paragraph (b)(6) or (c)(3) of this section. Paragraph (b) of this section provides rules that apply to partnerships. Paragraph (c) of this section provides rules that apply to S corporations. Paragraph (d) of this section provides general rules that apply to partnerships and S corporations. Paragraph (e) of this section provides election procedures and reporting requirements. Paragraph (f) of this section contains the effective/applicability date. See §1.108(i)–0(a) for definitions that apply to this section.

(b) *Specific rules applicable to partnerships*—(1) *Allocation of COD income and partner's deferred amounts*. An electing partnership that defers any portion of COD income realized from a reacquisition of an applicable debt instrument under section 108(i) must allocate all of the COD income with respect to the applicable debt instrument to its direct partners that are partners in the electing partnership immediately before the reacquisition in the manner in which the income would be included in the distributive shares of the partners under section 704 and the regulations under section 704, including §1.704–1(b)(2)(iii), without regard to section 108(i). The electing partnership may determine, in any manner, the portion, if any, of a partner's COD income amount with respect to an applicable debt instrument that is the deferred amount, and the portion, if any, that is the included amount. However, no partner's deferred amount with respect to an applicable debt instrument may exceed that partner's COD income amount with respect to such applicable debt instrument, and the aggregate amount of the partners' COD income amounts and deferred amounts with respect to each applicable debt instrument must equal the electing partnership's COD income amount and deferred amount, respectively, with respect to each such applicable debt instrument.

(2) *Basis adjustments and capital account maintenance*—(i) *Basis adjustments*. The adjusted basis of a partner's interest in a partnership is not increased under section 705(a)(1) by the partner's deferred amount in the taxable year of the reacquisition. The adjusted basis of a partner's interest in a partnership is not decreased under section 705(a)(2) by the partner's share of any deferred OID deduction in the taxable year in which the deferred OID accrues. The adjusted basis of a partner's interest in a partnership is adjusted under section 705(a) by the partner's share of the electing partnership's deferred items for the taxable year in which the partner takes into account such deferred items under this section.

(ii) *Capital account maintenance*. For purposes of maintaining a partner's capital account under §1.704–1(b)(2)(iv) and notwithstanding §1.704–1(b)(2)(iv)(*n*), the capital account of a partner of a partnership is adjusted under §1.704–1(b)(2)(iv) for a partner's share of an electing partnership's deferred items as if no election under section 108(i) were made.

(3) *Deferred section 752 amount*—(i) *In general*. An electing partnership shall determine, for each of its direct partners with a deferred amount, the partner's deferred section 752 amount, if any, with respect to an applicable debt instrument. A partner's deferred section 752 amount with respect to an applicable debt instrument equals the decrease in the partner's share of a partnership liability under section 752(b) resulting from the reacquisition of the applicable debt instrument that is not treated as a current distribution of money under section 752(b) by reason of section 108(i)(6) (deferred section 752 amount). A partner's deferred section 752 amount is treated as a distribution of money by the partnership to the partner under section

752(b) at the same time and, to the extent remaining, in the same amount as the partner recognizes the deferred amount with respect to the applicable debt instrument.

(ii) *Electing partnership's computation of a partner's deferred section 752 amount*. To compute a partner's deferred section 752 amount, the electing partnership must first determine the amount of gain that its direct partner would recognize in the taxable year of a reacquisition under section 731 as a result of the reacquisition of one or more applicable debt instruments during the taxable year absent the deferral provided in the second sentence of section 108(i)(6) (the section 108(i)(6) deferral). If a direct partner of an electing partnership would not recognize any gain under section 731 as a result of the reacquisition of one or more applicable debt instruments during the taxable year absent the section 108(i)(6) deferral, the partner will not have a deferred section 752 amount with respect to any applicable debt instrument that is reacquired during the taxable year. If a direct partner of an electing partnership would recognize gain under section 731 as a result of the reacquisition of one or more applicable debt instruments during the taxable year absent the section 108(i)(6) deferral, the partner's deferred section 752 amount for all applicable debt instruments that are reacquired during the taxable year is equal to the lesser of the partner's aggregate deferred amounts from the electing partnership for all applicable debt instruments reacquired during the taxable year, or the gain that the partner would recognize in the taxable year of the reacquisitions under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral. In determining the amount of gain that the direct partner would recognize in the taxable year of a reacquisition under section 731 as a result of the reacquisition of one or more applicable debt instruments during the taxable year absent the section 108(i)(6) deferral, the rule under §1.731–1(a)(1)(ii) applies to any deemed distribution of money under section 752(b) resulting from a decrease in the partner's share of a reacquired applicable debt instrument that is treated as an advance or drawing of money. The amount of any deemed distribution of money under section 752(b) resulting from a decrease in the partner's share of a reacquired applicable debt instrument that is treated as an advance or drawing of money under §1.731–1(a)(1)(ii) is determined as if no COD income resulting from the reacquisition of the applicable debt instrument is deferred under section 108(i).

(iii) *Multiple section 108(i) elections*. If a direct partner of an electing partnership has a deferred section 752 amount under paragraph (b)(3)(ii) of this section for the taxable year of a reacquisition, and the partner has a deferred amount with respect to more than one applicable debt instrument from the electing partnership for which a section 108(i) election is made in that taxable year, the partner's deferred section 752 amount with respect to each such applicable debt instrument equals the partner's deferred section 752 amount as determined under paragraph (b)(3)(ii) of this section, multiplied by a ratio, the numerator of which is the partner's deferred amount with respect to such applicable debt instrument, and the denominator of which is the partner's aggregate deferred amounts from the electing partnership for all applicable debt instruments reacquired during the taxable year.

(iv) *Electing partnership's request for information*. At the request of an electing partnership, each direct partner of the electing partnership that has a deferred amount with respect to such partnership must provide to the electing partnership a written statement containing information requested by the partnership that is necessary to determine the partner's deferred section 752 amount (such as the partner's adjusted basis in the partner's interest in the electing partnership). The written statement must be signed under penalties of perjury and provided to the requesting partnership within 30 days of the date of the request by the electing partnership.

(v) *Examples*. The following examples illustrate the rules under paragraph (b)(3) of this section:

Example 1. (i) A and B each hold a 50 percent interest in Partnership, a calendar-year partnership. As of January 1, 2009, A and B each have an adjusted basis of $50 in their partnership interests. Partnership has two applicable debt instruments outstanding, debt one of $300 and debt two of $200. A and B share equally in the debt for section 752(b) purposes. On March 1, 2009, debt one is cancelled and Partnership realizes $300 of COD income. On December 1, 2009, debt two is cancelled and Partnership realizes $200 of COD income. The Partnership has no other income or loss items for 2009. A and B are each allocated $150 of COD income from debt one and $100 of COD income from debt two. Partnership makes an election under section 108(i) to defer $225 of the $300 of COD income realized from the reacquisition of debt one, $150 of which is A's deferred amount, and $75 of which is B's deferred amount. Partnership also makes an election under section 108(i) to defer $125 of the $200 of COD income realized from the reacquisition of debt two, $100 of which is A's deferred amount, and $25 of which is B's deferred amount. A has no included amount for either debt. B has an included amount of $75 with respect to debt one and an included amount of $75 with respect to debt two for 2009.

(ii) Under paragraph (b)(3)(ii) of this section, the amount of gain that A would recognize under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral is $200. Thus, A's deferred section 752 amount with respect to debt one and debt two equals $200 (the lesser of A's aggregate deferred amounts with respect to debt one and debt two of $250, or gain that A would recognize under section 731 in 2009, as a result of the reacquisitions absent the section 108(i)(6) deferral, of $200). Under paragraph (b)(3)(iii) of this section, $120 of A's $200 deferred section 752 amount relates to debt one ($200 x $150/$250) and $80 relates to debt two ($200 x $100/$250).

(iii) Under paragraph (b)(3)(ii) of this section, the amount of gain that B would recognize under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral is $50. Thus, B's deferred section 752 amount with respect to debt one and debt two equals $50 (the lesser of B's aggregate deferred amounts with respect to debt one and debt two of $100, or gain that B would recognize under section 731 in 2009, as a result of the reacquisitions absent the section 108(i)(6) deferral, of $50). Under paragraph (b)(3)(iii) of this section, $37.50 of B's $50 deferred section 752 amount relates to debt one ($50 x $75/$100) and $12.50 relates to debt two ($50 x $25/$100).

(iv) A will recognize $50 of deferred COD income ($30 with respect to debt one and $20 with respect to debt two) in each of the five taxable years of the inclusion period, provided there are no earlier acceleration events under paragraph (b)(6) of this section. Under paragraph (b)(3)(i) of this section, A will be treated as receiving a $30 deemed distribution under section 752(b) with respect to debt one and a $20 deemed distribution with respect to debt two in each of the first, second, third, and fourth taxable years of the inclusion period. A will not have any remaining deferred section 752 amounts in the fifth taxable year of the inclusion period.

(v) B will recognize $20 of deferred COD income ($15 with respect to debt one and $5 with respect to debt two) in each of the five taxable years of the inclusion period, provided there are no earlier acceleration events under paragraph (b)(6) of this section. Under paragraph (b)(3)(i) of this section, B will be treated as receiving a $15 deemed distribution under section 752(b) with respect to debt one and a $5 deemed distribution with respect to debt two in the first and second taxable year of the inclusion period, and a $7.50 deemed distribution under section 752(b) with respect to debt one ($10 x $15/$20) and a $2.50 deemed distribution with respect to debt two ($10 x $5/$20) in the third taxable year of the inclusion period. B will not have any remaining deferred section

752 amounts in the fourth and fifth taxable years of the inclusion period.

Example 2. (i) The facts are the same as in *Example 1*, except that Partnership has gross income for the year (including the $500 of COD income) of $700 and other separately stated losses of $500. A's and B's distributive share of each item is 50 percent.

(ii) In determining the amount of gain that A would recognize under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral, Partnership first increases A's $50 adjusted basis in his interest in Partnership by A's distributive share of Partnership income (other than the deferred amounts relating to debt one and debt two) of $100, and then decreases A's adjusted basis in Partnership by deemed distributions under section 752(b) of $250 and, thereafter, by A's distributive share of Partnership losses of $250, but only to the extent that A's basis is not reduced below zero. Under paragraph (b)(3)(ii) of this section, the amount of gain that A would recognize under section 731 as a result of the reacquisitions absent section 108(i)(6) deferral is $100. Thus, A's deferred section 752 amount with respect to debt one and debt two equals $100 (the lesser of A's aggregate deferred amounts with respect to debt one and debt two of $250, or gain that A would recognize under section 731 as a result of the reacquisitions absent the deferral section 108(i)(6) deferral of $100). Under paragraph (b)(3)(iii) of this section, A's deferred section 752 amount with respect to debt one is $60 ($100 x $150/$250), and A's deferred section 752 amount with respect to debt two is $40 ($100 x $100/$250). A's $250 of Partnership losses are suspended under section 704(d).

(iii) In determining the amount of gain that B would recognize under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral, Partnership first increases B's $50 adjusted basis in his interest in Partnership by B's distributive share of Partnership income (other than the deferred amounts relating to debt one and debt two) of $250 ($100 other income plus $150 included amount with respect to debt one and debt two), and then decreases B's adjusted basis in Partnership by deemed distributions under section 752(b) of $250 and, thereafter, by B's distributive share of Partnership losses of $250, but only to the extent that B's basis is not reduced below zero. Under paragraph (b)(3)(ii) of this section, B would not recognize any gain under section 731 as a result of the reacquisitions absent the section 108(i)(6) deferral. Thus, B has no deferred section 752 amount with respect to either debt one or debt two. B may deduct his distributive share of Partnership losses to the extent of $50, with the remaining $200 suspended under section 704(d).

(4) *Tiered partnerships*—(i) *In general*. If a partnership (upper-tier partnership) is a direct or indirect partner of an electing partnership and directly or indirectly receives an allocation of a COD income amount from the electing partnership, all or a portion of which is deferred under section 108(i), the upper-tier partnership must allocate its COD income amount to its partners that are partners in the upper-tier partnership immediately before the reacquisition in the manner in which the income would be included in the distributive shares of the partners under section 704 and the regulations under section 704, including §1.704–1(b)(2)(iii), without regard to section 108(i). The upper-tier partnership may determine, in any manner, the portion, if any, of a partner's COD income amount with respect to an applicable debt instrument that is the deferred amount, and the portion, if any, that is the included amount. However, no partner's deferred amount with respect to an applicable debt instrument may exceed that partner's COD income amount with respect to such applicable debt instrument, and the aggregate amount of the partners' COD income amounts and deferred amounts with respect to each applicable debt instrument must equal the upper-tier partnership's COD income amount and deferred amount, respectively, with respect to each such applicable debt instrument.

(ii) *Deferred section 752 amount*. The computation of a partner's deferred section 752 amount, as described in paragraph (b)(3)(ii) of this section, is calculated only for direct partners of the electing partnership. An upper-tier partnership's deferred section 752 amount with respect to an applicable debt instrument of the electing partnership is allocated only to those partners of the upper-tier partnership that have a deferred amount with respect to that applicable debt instrument, and in proportion to such partners' share of the upper-tier partnership's deferred amount with respect to that applicable debt instrument. A partner's share of the upper-tier partnership's deferred section 752 amount with respect to an applicable debt instrument must not exceed that partner's share of the upper-tier partnership's deferred amount with respect to the applicable debt instrument to which the deferred section 752 amount relates. The deferred section 752 amount of a partner of an upper-tier partnership is treated as a distribution of money by the upper-tier partnership to the partner under section 752(b), at the same time and, to the extent remaining, in the same amount as the partner recognizes the deferred amount with respect to the applicable debt instrument.

(iii) *Examples*. The following examples illustrate the rules under paragraph (b)(4) of this section:

Example 1. (i) PRS, a calendar-year partnership, has two equal partners, A, an individual, and XYZ, a partnership. As of January 1, 2009, A and XYZ each have an adjusted basis of $50 in their partnership interests. PRS has a $500 applicable debt instrument outstanding. On June 1, 2009, the creditor agrees to cancel the $500 indebtedness. PRS realizes $500 of COD income as a result of the reacquisition. PRS has no other income or loss items for 2009. PRS makes an election under section 108(i) to defer $200 of the $500 of COD income. PRS allocates the $500 of COD income equally between its partners ($250 each). PRS determines that, for each partner, $100 of the COD income amount is the deferred amount, and $150 is the included amount. For 2009, each of A's and XYZ's share of the decrease in PRS's reacquired applicable debt instrument is $250.

(ii) XYZ has two equal partners, individuals X and Y. X and Y share equally in XYZ's liabilities. XYZ allocates the $250 COD income amount from PRS equally between X and Y ($125 each). XYZ determines that X has a deferred amount of $100 and an included amount of $25. All $125 of Y's COD income amount is Y's included amount. For 2009, each of X's and Y's share of XYZ's $250 decrease in liability with respect to the reacquired applicable debt instrument of PRS is $125.

(iii) Under paragraph (b)(3)(ii) of this section, PRS determines that XYZ has a deferred section 752 amount of $50. Therefore, for 2009, of XYZ's $250 share of the decrease in PRS's reacquired applicable debt instrument, $200 is treated as a deemed distribution under section 752(b) and $50 is the deferred section 752 amount.

(iv) Under paragraph (b)(4)(ii) of this section, none of XYZ's $50 deferred section 752 amount is allocated to Y because Y does not have a deferred amount with respect to the reacquired applicable debt interest. XYZ's entire $50 of deferred section 752 amount is allocated to X. Therefore, of X's $125 share of the XYZ's decrease in liability with respect to the reacquired applicable debt instrument of PRS, $75 is treated as a deemed distribution under section 752(b) and $50 is X's deferred section 752 amount. Y's $125 share of XYZ's decrease in liability with respect to the reacquired applicable debt instrument of PRS is treated as a deemed distribution under section 752(b) and none is a deferred section 752 amount.

Example 2. (i) The facts are the same as in *Example 1*, except for the following: XYZ has three partners, X, Y, and Z. The profits and losses of XYZ are shared 25 percent by X, 25 percent by Y, and 50 percent by Z. XYZ allocates its $250 COD income amount from PRS $62.50 to each of X and Y, and $125 to Z. XYZ determines that X has a deferred amount of $50 and an included amount of $12.50, Y has a deferred amount of $0 and an included amount of $62.50, and Z has a deferred amount of $50 and an included amount of $75 with respect to the applicable debt instrument. X's, Y's, and Z's share of XYZ's decrease in liability with respect to the reacquired applicable debt instrument of PRS is $62.50, $62.50 and $125, respectively.

(ii) Under paragraph (b)(4)(ii) of this section, none of XYZ's $50 deferred section 752 amount is allocated to Y because Y does not have a deferred amount with respect to the reacquired applicable debt instrument. XYZ's $50 deferred section 752 amount is allocated to X and Z in proportion to X's and Z's share of XYZ's deferred amount, or $25

each ($50 x ($50/$100)). Therefore, of X's $62.50 share of XYZ's decrease in liability with respect to the reacquired applicable debt instrument, $37.50 is treated as a deemed distribution under section 752(b) and $25 is X's deferred section 752 amount. All of Y's $62.50 share of XYZ's decrease in liability with respect to the reacquired applicable debt instrument is treated as a deemed distribution under section 752(b). Of Z's $125 share of XYZ's decrease in liability with respect to the reacquired applicable debt instrument, $100 is treated as a deemed distribution under section 752(b) and $25 is Z's deferred section 752 amount.

(5) *S corporation partner*—(i) *In general*. If an S corporation partner has a deferred amount with respect to an applicable debt instrument of an electing partnership, such deferred amount is shared *pro rata* only among those shareholders that are shareholders of the S corporation partner immediately before the reacquisition of the applicable debt instrument.

(ii) *Basis adjustments*. The adjusted basis of a shareholder's stock in an S corporation partner is not increased under section 1367(a)(1) by the shareholder's share of the S corporation partner's deferred amount in the taxable year of the reacquisition. The adjusted basis of a shareholder's stock in an S corporation partner is not decreased under section 1367(a)(2) by the shareholder's share of the S corporation partner's deferred OID deduction in the taxable year in which the deferred OID accrues. The adjusted basis of a shareholder's stock in an S corporation partner is adjusted under section 1367(a) by the shareholder's share of the S corporation partner's share of the electing partnership's deferred items for the taxable year in which the shareholder takes into account its share of such deferred items under this section.

(iii) *Accumulated adjustments account*. The accumulated adjustments account (AAA), as defined in section 1368(e)(1), of an S corporation partner that has a deferred amount with respect to an applicable debt instrument of an electing partnership is not increased by its deferred amount in the taxable year of the reacquisition. The AAA of an S corporation partner is not decreased by its share of any deferred OID deduction in the taxable year in which the deferred OID accrues. The AAA of an S corporation partner is adjusted under section 1368(e) by a shareholder's share of the S corporation partner's share of the electing partnership's deferred items for the S period (as defined in section 1368(e)(2)) in which the shareholder of the S corporation partner takes into account its share of the deferred items under this section.

(6) *Acceleration of deferred items*—(i) *Electing partnership-level events*

(A) *General rules*. Except as provided in paragraph (b)(6)(iii) of this section, a direct or indirect partner's share of an electing partnership's deferred items is accelerated and must be taken into account by such partner—

(*1*) In the taxable year in which the electing partnership liquidates;

(*2*) In the taxable year in which the electing partnership sells, exchanges, transfers (including contributions and distributions), or gifts substantially all of its assets;

(*3*) In the taxable year in which the electing partnership ceases doing business; or

(*4*) In the taxable year that includes the day before the day on which the electing partnership files a petition in a title 11 or similar case.

(B) *Substantially all requirement*. For purposes of this paragraph (b)(6), substantially all of a partnership's assets means assets representing at least 90 percent of the fair market value of the net assets, and at least 70 percent of the fair market value of the gross assets, held by the partnership immediately prior to the sale, exchange, transfer, or gift. For purposes of applying the rule in paragraph (b)(6)(i)(A)(*2*) of this section, a sale, exchange, transfer, or gift by any direct or indirect lower-tier partnership of the electing partnership (lower-tier partnership) of all or part of its assets is not treated as a sale, exchange, transfer, or gift of the assets of any partnership that holds, directly or indirectly, an interest in such lower-tier partnership. However, for purposes of applying the rule in paragraph (b)(6)(i)(A)(*2*) of this section, a sale, exchange, transfer, or gift of substantially all of the assets of a transferee partnership (as described in paragraph (b)(6)(iii)(A)(*1*) of this section), or of a lower-tier partnership that received assets of the electing partnership from a transferee partnership or another lower-tier partnership in a transaction governed all or in part by section 721, is treated as a sale, exchange, transfer, or gift by the holder of an interest in such transferee partnership or lower-tier partnership of its entire interest in that transferee partnership or lower-tier partnership.

(ii) *Direct or indirect partner-level events*—(A) *General rules*. Except as provided in paragraph (b)(6)(iii) of this section, a direct or indirect partner's share of an electing partnership's deferred items with respect to a separate interest is accelerated and must be taken into account by such partner in the taxable year in which—

(*1*) The partner dies or liquidates;

(*2*) The partner sells, exchanges (including redemptions treated as exchanges under section 302), transfers (including contributions and distributions), or gifts (including transfers treated as gifts under section 1041) all or a portion of its separate interest;

(*3*) The partner's separate interest is redeemed within the meaning of paragraph (b)(6)(ii)(B)(*2*) of this section; or

(*4*) The partner abandons its separate interest.

(B) *Meaning of terms; special rules*—(*1*) *Partial transfers*. For purposes of paragraph (b)(6)(ii)(A)(*2*) of this section, if a partner sells, exchanges (including redemptions treated as exchanges under section 302), transfers (including contributions and distributions), or gifts (including transfers treated as gifts under section 1041) a portion of its separate interest, such partner's share of the electing partnership's deferred items with respect to the separate interest proportionate to the separate interest sold, exchanged, transferred, or gifted is accelerated and must be taken into account by such partner.

(*2*) *Redemptions*. For purposes of paragraph (b)(6)(ii)(A)(*3*) of this section, a partner's separate interest is redeemed if the partner receives a distribution of cash and/or property in complete liquidation of such separate interest.

(*3*) *S corporation partners*. In addition to the rules in paragraphs (b)(6)(i) and (ii) of this section, an S corporation partner's share of the electing partnership's deferred items is accelerated and the shareholders of the S corporation partner must take into account their respective shares of the S corporation partner's share of the electing partnership's deferred items in the taxable year in which the S corporation partner's election under section 1362(a) terminates.

(*4*) *C corporation partners*. In addition to the rules in paragraphs (b)(6)(i), (ii), and (iii) of this section, the acceleration rules in

§1.108(i)–1(b) and the earnings and profits rules in §1.108(i)–1(d) apply to partners that are electing corporations.

(iii) *Events not constituting acceleration*. Notwithstanding the rules in paragraphs (b)(6)(i) and (ii) of this section, a direct or indirect partner's share of an electing partnership's deferred items with respect to a separate interest is not accelerated by any of the events described in this paragraph (b)(6)(iii).

(A) *Section 721 contributions*—(*1*) *Electing partnership contributions*. A direct or indirect partner's share of an electing partnership's deferred items is not accelerated if the electing partnership contributes all or a portion of its assets in a transaction governed all or in part by section 721(a) to another partnership (transferee partnership) in exchange for an interest in the transferee partnership provided that the electing partnership does not terminate under section 708(b)(1)(A) or transfer its assets and liabilities in a transaction described in section 708(b)(2)(A) or section 708(b)(2)(B). See paragraph (b)(6)(iii)(D) of this section for transactions governed by section 708(b)(2)(A). Notwithstanding the rules in this paragraph (b)(6)(iii)(A)(*1*), the rules in paragraphs (b)(6)(i)(A) and (b)(6)(ii)(A) of this section apply to any part of the transaction to which section 721(a) does not apply.

(*2*) *Partner contributions*. A direct or indirect partner's share of an electing partnership's deferred items with respect to a separate interest is not accelerated if the holder of such interest (contributing partner) contributes its entire separate interest (contributed separate interest) in a transaction governed all or in part by section 721(a) to another partnership (transferee partnership) in exchange for an interest in the transferee partnership provided that the partnership in which the separate interest is held does not terminate under section 708(b)(1)(A) or transfer its assets and liabilities in a transaction described in section 708(b)(2)(A) or section 708(b)(2)(B). See paragraph (b)(6)(iii)(D) of this section for transactions governed by section 708(b)(2)(A). The transferee partnership becomes subject to section 108(i), including all reporting requirements under this section, with respect to the contributing partner's share of the electing partnership's deferred items associated with the contributed separate interest. The transferee partnership must allocate and report the share of the electing partnership's deferred items that is associated with the contributed separate interest to the contributing partner to the same extent that such share of the electing partnership's deferred items would have been allocated and reported to the contributing partner in the absence of such contribution. Notwithstanding the rules in this paragraph (b)(6)(iii)(A)(*2*), the rules in paragraph (b)(6)(ii)(A) of this section apply to any part of the transaction to which section 721(a) does not apply.

(B) *Section 1031 exchanges*. A direct or indirect partner's share of the electing partnership's deferred items is not accelerated if the electing partnership transfers property held for productive use in a trade or business or for investment in exchange for property of like kind which is to be held either for productive use in a trade or business or for investment in a transaction to which section 1031(a)(1) applies. Notwithstanding the rules in this paragraph (b)(6)(iii)(B), to the extent the electing partnership receives money or other property which does not meet the requirements of section 1031(a) (boot) in the exchange, a proportionate amount of the property transferred by the electing partnership equal to the proportion of the boot to the total consideration received in the exchange shall be treated as sold for purposes of paragraph (b)(6)(i)(A)(*2*) of this section.

(C) *Section 708(b)(1)(B) terminations*. A direct or indirect partner's share of the deferred items of an electing partnership with respect to a separate interest is not accelerated if the electing partnership or a partnership that is a direct or indirect partner of the electing partnership terminates under section 708(b)(1)(B). Notwithstanding the rules in this paragraph (b)(6)(iii)(C), the rules in paragraph (b)(6)(ii)(A) of this section apply to the event that causes the termination under section 708(b)(1)(B) to the extent not otherwise excepted under paragraph (b)(6)(iii) of this section.

(D) *Section 708(b)(2)(A) mergers or consolidations*. A direct or indirect partner's share of the deferred items of an electing partnership with respect to a separate interest is not accelerated if the partnership in which the separate interest is held (the merger transaction partnership) merges into or consolidates with another partnership in a transaction to which section 708(b)(2)(A) applies. The resulting partnership or new partnership, as determined under §1.708–1(c)(1), becomes subject to section 108(i), including all reporting requirements under this section, to the same extent that the merger transaction partnership was so subject prior to the transaction, and must allocate and report any merger transaction partnership's deferred items to the same extent and to the same partners that the merger transaction partnership allocated and reported such items prior to such transaction. Notwithstanding the rules in this paragraph (b)(6)(iii)(D), the rules in paragraphs (b)(6)(i)(A)(*2*) and (b)(6)(ii)(A)(*2*) of this section apply to that portion of the transaction that is treated as a sale, and the rules of (b)(6)(ii)(A)(*3*) apply if, as part of the transaction, the partner's separate interest is redeemed and the partner does not receive an interest in the resulting partnership with respect to such separate interest.

(E) *Certain distributions of separate interests*. If a partnership (upper-tier partnership) that is a direct or indirect partner of an electing partnership distributes its entire separate interest (distributed separate interest) to one or more of its partners (distributee partners) that have a share of the electing partnership's deferred items from upper-tier partnership with respect to the distributed separate interest, the distributee partners' shares of the electing partnership's deferred items with respect to such distributed separate interest are not accelerated. The partnership, the separate interest in which was distributed, must allocate and report the share of the electing partnership's deferred items associated with the distributed separate interest only to such distributee partners that had a share of the electing partnership's deferred items from the upper-tier partnership with respect to the distributed separate interest prior to the distribution. This paragraph (b)(6)(iii)(E) does not apply if the electing partnership terminates under section 708(b)(1)(A).

(F) *Section 381 transactions*. A C corporation partner's share of an electing partnership's deferred items is not accelerated if, as part of a transaction described in paragraph (b)(6)(ii)(A) of this section, the assets of the C corporation partner are ac-

quired by another C corporation (acquiring C corporation) in a transaction that is treated, under §1.108(i)–1(b)(2)(ii)(B), as a transaction to which section 381(a) applies. An S corporation partner's share of an electing partnership's deferred items is not accelerated if, as part of a transaction described in paragraph (b)(6)(ii)(A) of this section, the assets of the S corporation partner are acquired by another S corporation (acquiring S corporation) in a transaction to which section 381(a) applies. In such cases, the acquiring C corporation or acquiring S corporation, as the case may be, succeeds to the C corporation partner's or the S corporation partner's remaining share of the electing partnership's deferred items and becomes subject to section 108(i), including all reporting requirements under this section, as if the acquiring C corporation or acquiring S corporation were the C corporation partner or the S corporation partner, respectively. The acquiring S corporation must allocate and report the S corporation partner's deferred items to the same extent as the S corporation partner would have been required to allocate and report those deferred items, and only to those shareholders of the S corporation partner who had a share of the S corporation partner's deferred items from the electing partnership prior to the transaction. This paragraph (b)(6)(iii)(F) does not apply if the electing partnership terminates under section 708(b)(1)(A).

(G) *Intercompany transfers*. A C corporation partner's share of an electing partnership's deferred items is not accelerated if, as part of a transaction described in paragraph (b)(6)(ii)(A) of this section, the C corporation partner transfers its entire separate interest in an intercompany transaction, as described in §1.1502–13(b)(1)(i), and the electing partnership does not terminate under section 708(b)(1)(A) as a result of the intercompany transaction.

(H) *Retirement of a debt instrument*. See §1.108(i)–3(c)(1) for rules regarding the retirement of a debt instrument that is subject to section 108(i).

(I) *Other non-acceleration events*. A direct or indirect partner's share of an electing partnership's deferred items is not accelerated with respect to any transaction if the Commissioner makes a determination by published guidance that such transaction is not an acceleration event under the rules of this paragraph (b)(6).

(iv) *Related partnerships*. A direct or indirect partner's share of a related partnership's deferred OID deduction (as determined in paragraph (d)(2) of this section) that has not previously been taken into account is accelerated and taken into account by the direct or indirect partner in the taxable year in which, and to the extent that, the deferred COD income to which the related partnership's deferred OID deduction relates is taken into account by the electing entity or its owners.

(v) *Examples*. The following examples illustrate the rules under this paragraph (b)(6):

Example 1. Meaning of "separate interest." (i) Electing partnership (EP) has three partners, MT1, MT2, and UT, each of which is a partnership. The partners of MT1 are X and UT. The partners of MT2 are Y, UT, and B. The partners of UT are A, B, and C. In addition to their interests in the partnerships noted, MT1, MT2, and UT own other assets.

(ii) Within the meaning of paragraph (a)(29) of §1.108(i)–0, A and C each hold one separate interest (their interests in UT), B holds two separate interests (its interests in UT and MT2), UT holds three separate interests (its interests in MT1, MT2, and EP), MT1 and MT2 each hold one separate interest (their interests in EP), and X and Y each hold one separate interest (their interests in MT1 and MT2, respectively) with respect to EP.

Example 2. Distributions of separate interests in an electing partnership. (i) The facts are the same as in *Example 1*, except that A, as a direct partner of UT, has a share of EP's deferred items with respect to UT's interests in MT1 and EP. A does not have a share of EP's deferred items with respect to UT's interest in MT2. B, as a direct partner of UT, has a share of EP's deferred items with respect to UT's interest in MT1 and MT2, but not with respect to UT's interest in EP. B also has a share of EP's deferred items with respect to its separate interest in MT2. C does not have any share of EP's deferred items with respect to UT's interest in MT1, MT2, or EP.

(ii) UT distributes 40 percent of its separate interest in MT1 to A in redemption of A's interest in UT. Under paragraphs (b)(6)(ii)(A)(*2*) and (b)(6)(ii)(B)(*1*) of this section, a portion of UT's interest in MT1 has been transferred and a corresponding portion (40 percent) of UT's share of EP's deferred items from MT1 is accelerated. Thus, 40 percent of A's and B's share of EP's deferred items from UT with respect to UT's interest in MT1 is accelerated. Further, because A's interest in UT is redeemed within the meaning of paragraph (b)(6)(ii)(B)(*2*) of this section, all of A's shares of EP's deferred items from UT are accelerated under paragraph (b)(6)(ii)(A)(*3*) of this section. UT continues to allocate and report to B its remaining share of EP's deferred items from its separate interest in MT1 that was not distributed to A.

(iii) UT distributes its entire separate interest in MT1 to B (other than in redemption of B's interest in UT). Under paragraph (b)(6)(ii)(A)(*2*) of this section, UT's share of EP's deferred items from MT1 would be accelerated. However, because UT distributes its entire separate interest in MT1 to B, B's share of EP's deferred items from UT with respect to UT's separate interest in MT1 is not accelerated under paragraph (b)(6)(iii)(E) of this section. MT1 allocates and reports to B B's share of EP's deferred items from UT's separate interest in MT1 that was distributed to B.

(iv) UT distributes its entire separate interest in MT1 to A and B (other than in redemption of their interests in UT). Under paragraph (b)(6)(iii)(E) of this section, none of A's or B's shares of EP's deferred items from UT with respect to UT's separate interest in MT1 is accelerated, and MT1 allocates and reports to A and B their respective share of EP's deferred items from UT's separate interest in MT1 that was distributed to A and B.

Example 3. Partial sale of interest by an indirect partner. (i) Individual A holds a 50 percent partnership interest in UTP, a partnership that holds a 50 percent interest in EP, a partnership that makes an election to defer COD income under section 108(i). A's share of UTP's deferred amount with respect to EP's election under section 108(i) is $100. During a taxable year within the deferral period, A sells 25 percent of his partnership interest in UTP to an unrelated third party.

(ii) Under paragraphs (b)(6)(ii)(A)(*2*) and (b)(6)(ii)(B)(*1*) of this section, 25 percent of A's $100 deferred amount is accelerated as a result of A's partial sale of his interest in UTP. Thus, A must recognize $25 of his deferred amount in the taxable year of the sale. A's remaining deferred amount is $75.

Example 4. Section 708(b)(1)(B) termination of electing partnership. (i) A and B are equal partners in partnership AB. On January 1, 2009, AB reacquires an applicable debt instrument and makes an election under section 108(i) to defer $400 of COD income. A and B each have a deferred amount with respect to the applicable debt instrument of $200. On January 1, 2010, A sells its entire 50 percent interest in AB to C in a transfer that terminates the partnership under section 708(b)(1)(B).

(ii) Under paragraph (b)(6)(iii)(C) of this section, the technical termination of AB under section 708(b)(1)(B) does not cause A's or B's shares of AB's deferred items to be accelerated. However, A's $200 deferred amount is accelerated under paragraph (b)(6)(ii)(A)(*2*) of this section as a result of the sale.

Example 5. Section 708(b)(2)(A) mergers. (i) A, B, and C are equal partners in partnership X, which has made an election under section 108(i) to defer $150 of COD income. The fair market value of each interest in partnership X is $100. A, B, and C each has a deferred amount of $50 with respect to partnership X's election under section 108(i). E, F, and G are partners in partnership Y. Partnership X and partnership Y merge in a taxable year during the deferral period of partnership X's election under section 108(i). Under section 708(b)(2)(A), the resulting partnership is considered a continuation of partnership Y and partnership X is considered terminated. Under state law, partnerships X and Y undertake the assets-over form of §1.708–1(c)(3)(i) to accomplish the merger. C does not want to become a partner in partnership Y, and partnership X does not have the resources to redeem C's interest before the merger. C, partnership X, and partnership Y enter into a merger agreement

that satisfies the requirements of §1.708–1(c)(4) and specifies that partnership Y will purchase C's interest in partnership X for $100 before the merger, and as part of the agreement, C consents to treat the transaction in a manner that is consistent with the agreement. As part of the merger, partnership X receives from partnership Y $100 (which will be distributed to C immediately before the merger), $100 (which will be distributed equally to A and B ($50 each)), and interests in partnership Y with a value of $100 (which will be distributed equally to A and B) in exchange for partnership X's assets and liabilities.

(ii) Under the general rule of paragraph (b)(6)(iii)(D) of this section, and except as provided below, the deferred items of partnership X are not accelerated as a result of the merger with partnership Y. Partnership Y, the resulting partnership that is considered the continuation of partnership X, becomes subject to section 108(i), including all reporting requirements under section 108(i), to the same extent that partnership X was subject to such rules. Under paragraph (b)(6)(iii)(D) of this section, partnership Y must allocate and report partnership X's deferred items to A and B in the same manner as partnership X had prior to the merger transaction.

(iii) Under §1.708–1(c)(4), C is treated as selling its interest in partnership X immediately before the merger. As a result, C's $50 deferred amount is accelerated under paragraph (b)(6)(ii)(A)(*2*) of this section.

(iv) Under section 707(a)(2)(B), partnership X is deemed to have sold a portion of its assets to partnership Y. Because partnership X is not treated as selling substantially all of its assets under paragraph (b)(6)(i)(B) of this section, A's and B's deferred amounts are not accelerated under paragraph (b)(6)(i)(A)(*2*) of this section.

(v) Because A's and B's interests in partnership X are redeemed within the meaning of paragraph (b)(6)(ii)(B)(*2*) of this section, all of their shares of partnership X's deferred items would be accelerated under paragraph (b)(6)(ii)(A)(*3*). However, because they receive an interest in partnership Y in the merger, none of A's and B's share of partnership X's deferred items is accelerated.

(7) *Withholding under section 1446*. See section 1446 regarding withholding by a partnership on a foreign partner's share of income effectively connected with a U.S. trade or business.

(c) *Specific rules applicable to S corporations*—(1) *Deferred COD income*. An electing S corporation's COD income deferred under section 108(i) (an S corporation's deferred COD income) is shared *pro rata* among those shareholders that are shareholders of the electing S corporation immediately before the reacquisition of the applicable debt instrument. Any COD income deferred under section 108(i) is taken into account under section 1366(a) by those shareholders in the inclusion period, or earlier upon the occurrence of an acceleration event described in paragraph (c)(3) of this section.

(2) *Basis adjustments and accumulated adjustments account*—(i) *Basis adjustments*. The adjusted basis of a shareholder's stock in an electing S corporation is not increased under section 1367(a)(1) by the shareholder's share of the S corporation's deferred COD income in the taxable year of the reacquisition. The adjusted basis of a shareholder's stock in an electing S corporation or a related S corporation is not decreased under section 1367(a)(2) by the shareholder's share of the S corporation's deferred OID deduction in the taxable year in which the deferred OID accrues. The adjusted basis of a shareholder's stock in an electing S corporation or a related S corporation is adjusted under section 1367(a) by the shareholder's share of the S corporation's deferred items for the taxable year in which the shareholder takes into account its share of the deferred items under this section.

(ii) *Accumulated adjustments account*. The AAA of an electing S corporation is not increased by the S corporation's deferred COD income in the taxable year of a reacquisition. The AAA of an electing S corporation or a related S corporation is not decreased by the S corporation's deferred OID deduction in the taxable year in which the deferred OID accrues. The AAA of an electing S corporation or a related S corporation is adjusted under section 1368(e) by a shareholder's share of the S corporation's deferred items for the S period (as defined in section 1368(e)(2)) in which a shareholder of the S corporation takes into account its share of the deferred items under this section.

(3) *Acceleration of deferred items*—(i) *Electing S corporation-level events*—(A) *General rules*. Except as provided in paragraph (c)(3)(iii) of this section, a shareholder's share of an electing S corporation's deferred items is accelerated and must be taken into account by such shareholder—

(*1*) In the taxable year in which the electing S corporation liquidates;

(*2*) In the taxable year in which the electing S corporation sells, exchanges, transfers (including contributions and distributions), or gifts substantially all of its assets;

(*3*) In the taxable year in which the electing S corporation ceases doing business;

(*4*) In the taxable year in which the electing S corporation's election under section 1362(a) terminates; or

(*5*) In the taxable year that includes the day before the day on which the electing S corporation files a petition in a title 11 or similar case.

(B) *Substantially all requirement*. For purposes of this paragraph (c)(3), substantially all of an electing S corporation's or partnership's assets means assets representing at least 90 percent of the fair market value of the net assets, and at least 70 percent of the fair market value of the gross assets, held by the S corporation or partnership immediately prior to the sale, exchange, transfer, or gift. For purposes of applying the rule in paragraph (c)(3)(i)(A)(*2*) of this section, a sale, exchange, transfer, or gift by any direct or indirect lower-tier partnership of the electing S corporation (lower-tier partnership) of all or part of its assets is not treated as a sale, exchange, transfer, or gift of the assets of any person that holds, directly or indirectly, an interest in such lower-tier partnership. However, for purposes of applying the rule in paragraph (c)(3)(i)(A)(*2*) of this section, a sale, exchange, transfer, or gift of substantially all of the assets of a transferee partnership (as described in paragraph (c)(3)(iii)(A) of this section), or of a lower-tier partnership that received assets of the electing S corporation from a transferee partnership of the electing S corporation or another lower-tier partnership in a transaction governed all or in part by section 721, is treated as a sale, exchange, transfer, or gift by the holder of an interest in such transferee partnership or lower-tier partnership of its entire interest in that transferee partnership or lower-tier partnership.

(ii) *Shareholder events*—(A) *General rules*. Except as provided in paragraph (c)(3)(iii) of this section, a shareholder's share of an electing S corporation's deferred items is accelerated and must be taken into account by such shareholder in the taxable year in which—

(*1*) The shareholder dies;

(*2*) The shareholder sells, exchanges (including redemptions treated as exchanges under section 302), transfers (including contributions and distributions), or gifts (including transfers treated as gifts under section 1041) all or a portion of its interest in the electing S corporation; or

(*3*) The shareholder abandons its interest in the electing S corporation.

(B) *Partial transfers*. For purposes of paragraph (c)(3)(ii)(A)(*2*) of this section, if a shareholder of an electing S corporation sells, exchanges (including redemptions treated as exchanges under section 302), transfers (including contributions or distributions), or gifts (including transfers treated as gifts under section 1041) a portion of its interest in the electing S corporation, such shareholder's share of the electing S corporation's deferred items proportionate to the interest that was sold, exchanged, transferred, or gifted is accelerated and must be taken into account by such shareholder.

(iii) *Events not constituting acceleration*. Notwithstanding the rules in paragraphs (c)(3)(i) and (ii) of this section, a shareholder's share of an electing S corporation's deferred items is not accelerated by any of the events described in this paragraph (c)(3)(iii).

(A) *Electing S corporation's contributions*. A shareholder's share of an electing S corporation's deferred items is not accelerated if the electing S corporation contributes all or a portion of its assets in a transaction governed all or in part by section 721(a) to a partnership (transferee partnership) in exchange for an interest in the transferee partnership. Notwithstanding the rules in this paragraph (c)(3)(iii)(A), the rules in paragraph (c)(3)(i)(A) of this section apply to any part of the transaction to which section 721(a) does not apply.

(B) *Section 1031 exchanges*. A shareholder's share of an electing S corporation's deferred items is not accelerated if the electing S corporation transfers property held for productive use in a trade or business or for investment in exchange for property of like kind which is to be held either for productive use in a trade or business or for investment in a transaction to which section 1031(a)(1) applies. Notwithstanding the rules in this paragraph (c)(3)(iii)(B), to the extent the electing S corporation receives money or other property which does not meet the requirements of section 1031(a) (boot) in the exchange, a proportionate amount of the property transferred by the electing S corporation equal to the proportion of the boot to the total consideration received in the exchange shall be treated as sold for purposes of paragraph (c)(3)(i)(A)(*2*) of this section.

(C) *Section 381 transactions*. A shareholder's share of an electing S corporation's deferred items is not accelerated if, as part of a transaction described in paragraph (c)(3)(i)(A) of this section, the electing S corporation's assets are acquired by another S corporation (acquiring S corporation) in a transaction to which section 381(a) applies. In such a case, the acquiring S corporation succeeds to the electing S corporation's remaining deferred items and becomes subject to section 108(i), including all reporting requirements under this section, as if the acquiring S corporation were the electing S corporation. The acquiring S corporation must allocate and report the electing S corporation's deferred items to the same extent that the electing S corporation would have been required to allocate and report those deferred items, and only to those shareholders who had a share of the electing S corporation's deferred items prior to the transaction.

(D) *Retirement of a debt instrument*. See §1.108(i)–3(c)(1) for rules regarding the retirement of a debt instrument that is subject to section 108(i).

(E) *Other non-acceleration events*. A shareholder's share of an electing S corporation's deferred items is not accelerated with respect to any transaction if the Commissioner makes a determination by published guidance that such transaction is not an acceleration event under the rules of this paragraph (c)(3).

(iv) *Related S corporations*. A shareholder's share of a related S corporation's deferred OID deduction (as determined in paragraph (d)(2) of this section) that has not previously been taken into account is accelerated and taken into account by the shareholder in the taxable year in which, and to the extent that, deferred COD income to which the related S corporation's deferred OID deduction relates is taken into account by the electing entity or its owners.

(d) *General rules applicable to partnerships and S corporations*—(1) *Applicable debt instrument (trade or business requirement)*. The determination of whether a debt instrument issued by a partnership or an S corporation is treated as a debt instrument issued in connection with the conduct of a trade or business by the partnership or S corporation for purposes of this section is based on all the facts and circumstances. However, a debt instrument issued by a partnership or an S corporation shall be treated as an applicable debt instrument for purposes of this section if the electing partnership or electing S corporation can establish that—

(i) The gross fair market value of the trade or business assets of the partnership or S corporation that issued the debt instrument represented at least 80 percent of the gross fair market value of that partnership's or S corporation's total assets on the date of issuance;

(ii) The trade or business expenditures of the partnership or S corporation that issued the debt instrument represented at least 80 percent of the partnership's or S corporation's total expenditures for the taxable year of issuance;

(iii) At least 95 percent of interest paid or accrued on the debt instrument issued by the partnership or S corporation was allocated to one or more trade or business expenditures under §1.163–8T for the taxable year of issuance;

(iv) At least 95 percent of the proceeds from the debt instrument issued by the partnership or S corporation were used by the partnership or S corporation to acquire one or more trades or businesses within six months from the date of issuance; or

(v) The partnership or S corporation issued the debt instrument to a seller of a trade or business to acquire the trade or business.

(2) *Deferral of OID at entity level*—(i) *In general*. For each taxable year during the deferral period, an issuing entity determines the amount of its deferred OID deduction with respect to a debt instrument, if any. An issuing entity's deferred OID deduction for a taxable year is the lesser of:

(A) The OID that accrues in a current taxable year during the deferral period with respect to the debt instrument (less any of such OID that is allowed as a deduction in the current taxable year as a result of an acceleration event), or

(B) The excess, if any, of the electing entity's deferred COD income (less the aggregate amount of such deferred COD income that has been included in income in the current taxable year and any previous taxable year during the deferral period) over the aggregate amount of OID that accrued in previous taxable years during the deferral period with respect to the

debt instrument (less the aggregate amount of such OID that has been allowed as a deduction in the current taxable year and any previous taxable year during the deferral period).

(ii) *Excess deferred OID deduction*. If, as a result of an acceleration event during a taxable year in the deferral period, an issuing entity's aggregate deferred OID deduction for previous taxable years with respect to a debt instrument (less the aggregate amount of such deferred OID deduction that has been allowed as a deduction in a previous taxable year during the deferral period) exceeds the amount of the electing entity's deferred COD income (less the aggregate amount of such deferred COD income that has been included in income in the current taxable year and any previous taxable year during the deferral period), the excess deferred OID deduction shall be allowed as a deduction in the taxable year in which the acceleration event occurs.

(iii) *Examples*. The following examples illustrate the rules under paragraph (d)(2) of this section:

Example 1. Partner joins partnership during deferral period. (i) A and B each hold a 50 percent interest in AB partnership, a calendar-year partnership. On January 1, 2009, AB partnership issues a new debt instrument with OID and uses all of the proceeds to reacquire an outstanding applicable debt instrument of AB partnership, realizing $100 of COD income, and makes an election under section 108(i) to defer $50 of the COD income. During the deferral period, a total of $150 of OID accrues on the new debt instrument issued as part of the reacquisition. A and B each have a deferred amount of $25 with respect to the applicable debt instrument reacquired by AB partnership. For 2009, $28 of OID accrues on the new debt instrument and A and B are each allocated $14 of accrued OID with respect to the new debt instrument. On January 1, 2010, C contributes cash to AB partnership in exchange for a 1/3 partnership interest. For 2010, $29 of OID accrues on the new debt instrument, and A, B, and C are each allocated $9.67 of accrued OID.

(ii) Under paragraph (d)(2) of this section, AB partnership's deferred OID deduction for 2009 is the lesser of: $28 of OID that accrues on the new debt instrument in 2009, or the excess of AB partnership's deferred COD income of $50 over the aggregate amount of OID that accrued on the debt instrument in previous taxable years during the deferral period of $0, or $50. Thus, all $28 of the OID that accrues on the debt instrument in 2009 is deferred under section 108(i).

(iii) Under paragraph (d)(2) of this section, AB partnership's deferred OID deduction for 2010 is the lesser of: $29 of OID that accrues on the new debt instrument in 2010, or the excess of AB partnership's deferred COD income of $50 over the aggregate amount of OID that accrued on the debt instrument in previous taxable years during the deferral period of $28, or $22. Thus, $22 of the $29 of OID that accrues in 2010 is deferred under section 108(i). A, B, and C will each defer $7.33 of the $9.67 of accrued OID that was allocated to each of them.

Example 2. Acceleration of deferred items during deferral period. (i) On January 1, 2009, ABC partnership, a calendar-year partnership with three partners, issues a new debt instrument with OID and uses all of the proceeds to reacquire an outstanding applicable debt instrument of ABC partnership. ABC partnership realizes $150 of COD income and makes an election under section 108(i) to defer the $150 of COD income. A's deferred amount with respect to the applicable debt instrument is $75, while B and C each have a deferred amount of $37.50. In 2009, $28 of OID accrues on the new debt instrument and is allocated $7.00 to A and $10.50 to each of B and C. In 2010, $29 of OID accrues on the new debt instrument and is allocated $7.25 to A and $10.87 to each of B and C. In 2011, $30 of OID accrues on the new debt instrument and is allocated $7.50 to A and $11.25 to each of B and C. In 2012, $31 of OID accrues on the new debt instrument and is allocated $7.75 to A and $11.62 to each of B and C. On December 31, 2012, A's entire share of ABC partnership's deferred items is accelerated under paragraph (b)(6) of this section. For 2012, A includes $75 of COD income in income and is allowed a deduction of $21.75 for A's share of ABC partnership's deferred OID deduction for taxable years 2009 through 2011, and a deduction of $7.75 for A's share of ABC partnership's OID that accrues on the debt instrument in 2012.

(ii) Under paragraph (d)(2) of this section, ABC partnership's deferred OID deduction for 2012 is the lesser of: $23.25 ($31 of OID that accrues on the new debt instrument in 2012 less $7.75 of this OID that is allowed as a deduction to A in 2012) or $9.75 (the excess of $75 (ABC partnership's deferred COD income of $150 less A's share of ABC partnership's deferred COD income that is included in A's income for 2012 of $75) over $65.25 (the aggregate amount of OID that accrued in previous taxable years of $87 less the aggregate amount of such OID that has been allowed as a deduction by A in 2012 of $21.75)). Thus, of the $31 of OID that accrues in 2012, $9.75 is deferred under section 108(i).

(3) *Effect of an election under section 108(i) on recapture amounts under section 465(e)*—(i) *In general*. To the extent that a decrease in a partner's or shareholder's amount at risk (as defined in section 465) in an activity as a result of a reacquisition of an applicable debt instrument would cause a partner with a deferred amount or a shareholder with a share of the S corporation's deferred COD income to have income under section 465(e) in the taxable year of the reacquisition, such decrease (not to exceed the partner's deferred amount or the shareholder's share of the S corporation's deferred COD income with respect to that applicable debt instrument) (deferred section 465 amount) shall not be taken into account for purposes of determining the partner's or shareholder's amount at risk in an activity under section 465 as of the close of the taxable year of the reacquisition. A partner's or shareholder's deferred section 465 amount is treated as a decrease in the partner's or shareholder's amount at risk in an activity at the same time, and to the extent remaining in the same amount, as the partner recognizes its deferred amount or the S corporation shareholder recognizes its share of the S corporation's deferred COD income.

(ii) *Example*. The following example illustrates the rules in paragraph (d)(3) of this section:

Example. (i) PRS is a calendar-year partnership with two equal partners, individuals A and B. PRS is engaged in an activity described in section 465(c) (Activity). PRS has a $500 recourse applicable debt instrument outstanding. Each partner's amount at risk on January 1, 2009, is $50. On June 1, 2009, the creditor agrees to cancel the $500 indebtedness. PRS realizes $500 of COD income as a result of the reacquisition. The partners' share of the liabilities of PRS decreases by $500 under section 752(b), and each partner's amount at risk is decreased by $250. Other than the $500 of COD income, PRS's income and expenses for 2009 are equal. PRS makes an election under section 108(i) to defer $200 of the $500 COD income realized in connection with the reacquisition. PRS allocates the $500 of COD income equally between its partners, A and B. A and B each have a COD income amount of $250 with respect to the applicable debt instrument. PRS determines that, for both partners A and B, $100 of the $250 COD income amount is the deferred amount, and $150 is the included amount. Beginning in each taxable year 2014 through 2018, A and B each include $20 of the deferred amount in gross income.

(ii) Under paragraph (d)(3)(i) of this section, $50 of the $250 decrease in A's and B's amount at risk in Activity is the deferred section 465 amount for each of A and B and is not taken into account for purposes of determining A's and B's amount at risk in Activity at the close of 2009. In taxable year 2014, A's and B's amount at risk in Activity is decreased by $20 (deferred section 465 amount that equals the deferred amount included in A's and B's gross income in 2014). In taxable year 2015, A's and B's amount at risk in Activity is decreased by $20 for the deferred section 465 amount that equals the deferred amount included in A's and B's gross income in 2015. In taxable year 2016, A's and B's amount at risk in Activity is decreased by $10 (the remaining amount of the deferred section 465 amount).

(e) *Election procedures and reporting requirements*—(1) *Partnerships*—(i) *In general*. A partnership makes an election under section 108(i) by following procedures outlined in guidance and applicable forms and instructions issued by the Commissioner. An electing partnership (or its successor) must provide to its partners certain information as required by guid-

ance and applicable forms and instructions issued by the Commissioner.

(ii) *Tiered passthrough entities*. A partnership that is a direct or indirect partner of an electing partnership (or its successor) or a related partnership or an S corporation partner must provide to its partners or shareholders, as the case may be, certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(iii) *Related partnerships*. A related partnership must provide to its partners certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(2) *S corporations*—(i) *In general*. An S corporation makes an election under section 108(i) by following procedures outlined in guidance and applicable forms and instructions issued by the Commissioner. An electing S corporation (or its successor) must provide to its shareholders certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(ii) *Related S corporations*. A related S corporation must provide to its shareholders certain information as required by guidance and applicable forms and instructions issued by the Commissioner.

(f) *Effective/applicability dates*. For the applicability dates of this section, see §1.108(i)–0(b).

§1.108(i)–2T [Removed]

Par. 3. Section 1.108(i)–2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended as follows:

1. The following entry to the table is removed:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where Identified and described	Current OMB Control No.
* * * * *	
1.108(i)–2T	1545–2147
* * * * *	

2. The following entry is added in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

(b) * * *

* * * * *

CFR part or section where Identified and described	Current OMB Control No.
* * * * *	
1.108(i)–2	1545–2147
* * * * *	

Beth Tucker,
Deputy Commissioner for Operations Support.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 2, 2013, 8:45 a.m., and published in the issue of the Federal Register for July 3, 2013, 78 F.R. 39973)

Approved June 25, 2013.

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.

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2013–1 through 2013–26 is in Internal Revenue Bulletin 2013–26, dated June 24, 2013.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2013–1 through 2013–26 is in Internal Revenue Bulletin 2013–26, dated June 24, 2013.

Internal Revenue Service
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INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

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WE WELCOME COMMENTS ABOUT THE INTERNAL REVENUE BULLETIN

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