Internal Revenue
bulletin

Bulletin No. 2014–47
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

REG–151416–06, page 870.

This notice of proposed rulemaking (NPRM) provides rules that prescribe how a partner should measure its interest in a partnership's unrealized receivables and inventory items, and that provide guidance regarding the tax consequences of a distribution that causes a reduction in that interest, thus requiring the recognition of ordinary income. The NPRM takes into account statutory changes that have occurred subsequent to the issuance of the existing regulations. The NPRM affects partners in partnerships that own unrealized receivables and inventory items and that make a distribution to one or more partners.

Rev. Rul. 2014–27, page 832.

The "base period T-bill rate" for the period ending September 30, 2014, is published, as required by section 995(f) of the Internal Revenue Code.

Rev. Proc. 2014–59, page 843.

The loss payment patterns and discount factors are set forth for the 2014 accident year. These factors will be used for computing discounted unpaid losses under § 846 of the Code.

Rev. Proc. 2014–60, page 854.

The salvage discount factors are set forth for the 2014 accident year. These factors will be used for computing discounted estimated salvage recoverable under § 832 of the Code.

Rev. Proc. 2014–61, page 860.

This procedure sets forth the 2015 cost-of-living adjustments to certain items due to inflation as required under various provisions of the Code and Service guidance.

Notice 2014–65, page 842.

This notice designates the Ebola virus outbreak in the West African countries of Guinea, Liberia, and Sierra Leone as a qualified disaster for purposes of section 139 of the Code.

Notice 2014–68, page 842.

This notice provides guidance on the treatment of leave-based donation programs to aid victims of the Ebola virus outbreak in the West African countries of Guinea, Liberia, and Sierra Leone for income and employment tax purposes.

ESTATE TAX

Rev. Proc. 2014–61, page 860.

This procedure sets forth the 2015 cost-of-living adjustments to certain items due to inflation as required under various provisions of the Code and Service guidance.

GIFT TAX

Rev. Proc. 2014–61, page 860.

This procedure sets forth the 2015 cost-of-living adjustments to certain items due to inflation as required under various provisions of the Code and Service guidance.

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Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXCISE TAX

Rev. Proc. 2014–61, page 860.
This procedure sets forth the 2015 cost-of-living adjustments to certain items due to inflation as required under various provisions of the Code and Service guidance.

T.D. 9698, page 836.
The final regulations provide guidance on the mandatory filing of *Form 2290*, "Heavy Highway Vehicle Use Tax Return," for 25 or more vehicles; credits or refunds of the highway use tax for sold, destroyed, or stolen vehicles; and the tax liability and computation of tax on the use of certain second-hand vehicles. The regulations affect owners and operators of highway motor vehicles with a taxable gross weight of 55,000 pounds or more. These regulations also remove the temporary regulations that provide guidance on the filing of *Form 2290* and payment of the associated highway use tax for the taxable period beginning July 1, 2011.

ADMINISTRATIVE

Rev. Proc. 2014–61, page 860.
This procedure sets forth the 2015 cost-of-living adjustments to certain items due to inflation as required under various provisions of the Code and Service guidance.

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.

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

Section 1.—Tax Imposed

The Service provides inflation adjustments to the tax rate tables for individuals, trusts, and estates for taxable years beginning in 2015. The Service also provides an inflation adjustment to the amount used to reduce the net unearned income of a minor child subject to the "kiddie tax" for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 23.—Adoption Credit

The Service provides inflation adjustments to the adoption credit allowed for the adoption of a child for taxable years beginning in 2015. The Service also provides inflation adjustments to the value used in calculating the modified adjusted gross income limitations used to determine the amount of adoption credit that is allowed in taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 24.—Child Tax Credit

The Service provides an inflation adjustment for the value used in determining the amount of the credit that may be refundable for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 25A.—Hope and Lifetime Learning Credits

The Service provides an inflation adjustment for the amount of qualified tuition and related expenses that are taken into account in determining the amount of the Hope Scholarship Credit for taxable years beginning in 2015. Also for taxable years beginning in 2015, the Service provides an inflation adjustment for the amount of a taxpayer's modified adjusted gross income that is taken into account in determining the reduction in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise available. See Rev. Proc. 2014–61, page 860.

Section 32.—Earned Income Credit

The Service provides inflation adjustments to the limitations on the earned income credit for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 36B.—Refundable Credit for Coverage Under a Qualified Health Plan

The Service provides an inflation adjustment for calendar year 2015 to the limitation on additional tax owed when advance credit payments exceed the premium tax credit allowed. See Rev. Proc. 2014–61, page 860.

Section 42.—Low-Income Housing Credit

The Service provides inflation adjustments to the amounts used to calculate the State housing credit ceiling used in determining the low-income housing credit, and the per low-income unit qualified basis amount, for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 45R.—Employee Health Insurance Expense of Small Employers

The Service provides the dollar amount used to calculate average annual wages for determining who is eligible for the small employer health insurance credit for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 55.—Exemption Amounts for Alternative Minimum Tax

The Service provides an inflation adjustment for the exemption amounts for the alternative minimum tax for taxable years beginning in 2015. Also for taxable years beginning in 2015, the Service provides an inflation adjustment for the amounts used to determine the phaseout of the exemption amounts for the alternative minimum tax. See Rev. Proc. 2014–61, page 860.

Section 59.—Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax"

The Service provides an inflation adjustment to the exemption amount used in computing the alternative minimum tax for a minor child subject to the "kiddie tax" for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 62.—Adjusted Gross Income Defined

The Service provides inflation adjustments to the amounts an eligible employer may pay in calendar year 2015 to certain welders and heavy equipment mechanics for rig-related expenses that are deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002–41, 2002–1 C.B. 1098. See Rev. Proc. 2014–61, page 860.

Section 63.—Taxable Income Defined

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 68.—Overall Limitation on Itemized Deductions

The Service provides overall limitations on itemized deductions for individuals for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 125.—Cafeteria Plans

The Service provides an inflation adjustment for voluntary employee salary reductions for contributions to health flexible spending arrangements for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 132.—Certain Fringe Benefits

The Service provides inflation adjustments to the limitations on the exclusion of income for a qualified transportation fringe benefit for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 135.—Income from United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service provides inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 137.—Adoption Assistance Programs

The Service provides an inflation adjustment to the maximum amount that can be excluded from an employee's gross income in connection with a qualified adoption assistance program for taxable years beginning in 2015. The Service also provides inflation adjustments to the amounts used to calculate the modified adjusted gross income limitations used to determine the amount that can be excluded from an employee's gross income for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 146.—Private Activity Bonds Volume Cap

The Service provides inflation adjustments to the amounts used to determine the State ceiling for the volume cap of private activity bonds for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 147.—Loan Limits on Agricultural Bonds

The Service provides an inflation adjustment to the loan limit amount on agricultural bonds for first-time farmers for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 148.—Arbitrage

The Service provides inflation adjustments for determining in the calendar year 2015 whether a broker's commission or similar fee with respect to the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable. The Service provides an inflation adjustment to the computation credit determined under permission to rely on § 1.148–3(d)(4) of the proposed Income Tax Regulations for bond years ending in 2015. See Rev. Proc. 2014–61, page 860.

Section 151.—Personal Exemptions

The Service provides an inflation adjustment to the personal exemption amount for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 213.—Medical, Dental, etc., Expenses

The Service provides inflation adjustments to the limitations on the amount of eligible long-term care premiums includible in the term "medical care" for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 220.—Medical Savings Accounts

The Service provides inflation adjustments to the amounts used to determine whether a health plan is a "high deductible health plan" for purposes of determining whether an individual is eligible for a deduction for cash paid to a medical savings account for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 221.—Interest on Education Loans

The Service provides inflation adjustments to the income limitations used to determine the allowable deduction for interest on education loans for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 512.—Unrelated Business Taxable Income

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 513.—Unrelated Trade or Business

The Service provides an inflation adjustment to the maximum cost of a "low cost article" for taxable years beginning in 2015. Funds raised through a charity's distribution of low cost articles will not be treated as unrelated business income to the charity. See Rev. Proc. 2014–61, page 860.

Section 832.—Insurance Company Taxable Income

The salvage discount factors and payment patterns are set forth for 2014. These factors must be used to compute discounted estimated salvage recoverable for purposes of section 832 of the code. See Rev. Proc. 2014–60, page 854.

Section 846.—Discounted Unpaid Losses Defined

The salvage discount factors and payment patterns are set forth for 2014. These factors must be used to compute discounted estimated salvage recoverable for purposes of section 832 of the code. See Rev. Proc. 2014–60, page 854.

Section 846.— Discounted unpaid Losses Defined

The composite loss discount factors for Reinsurance (Nonproportional Assumed Property) published in Rev. Proc. 2014–59, page 843.

Section 877.—Expatriation to Avoid Tax

The Service provides an inflation adjustment to the amount used for calendar year 2015 to determine whether an individual's loss of United States citizenship had the avoidance of United States tax as one of its principal purposes. See Rev. Proc. 2014–61, page 860.

Section 877A.—Tax Responsibilities of Expatriation

The Service provides an inflation adjustment to the amount that reduces the amount that would be includible in the gross income of a covered expatriate for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 911.—Citizens or Residents of the United States Living Abroad

The Service provides an inflation adjustment to the amount of foreign earned income that may be excluded from gross income for taxable years beginning in 2015. See Rev. Proc. 2014–61, page 860.

Section 995.—Taxation of DISC Income to Shareholders

2014 Base Period T-Bill Rate. The "base period T-bill rate" for the period ending September 30, 2014, is published as required by section 995(f) of the Code.

Rev. Rul. 2014–27

Section 995(f)(1) of the Internal Revenue Code provides that a shareholder of a DISC shall pay interest each taxable year in an amount equal to the product of the shareholder's DISC-related deferred tax liability for the year and the "base period T-bill rate." Under section 995(f)(4), the base period T-bill rate is the annual rate of interest determined by the Secretary to be equivalent to the average of the 1-year constant maturity Treasury yields, as published by the Board of Governors of the Federal Reserve System, for the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder. The base period T-bill rate for the period ending September 30, 2014, is 0.11 percent.

Pursuant to section 6222 of the Code, interest must be compounded daily. The table below provides factors for compounding the base period T-bill rate daily for any number of days in the shareholder's taxable year (including a 52–53 week accounting period) for the 2014 base period T-bill rate. To compute the amount of the interest charge for the shareholder's taxable year, multiply the amount of the shareholder's DISC-related deferred tax liability (as defined in section 995(f)(2)) for that year by the base period T-bill rate factor corresponding to the number of days in the shareholder's taxable year for which the interest charge is being computed. Generally, one would use the factor for 365 days. One would use a different factor only if the shareholder's taxable year for which the interest charge being determined is a short taxable year, if the shareholder uses the 52–53 week taxable year, or if the shareholder's taxable year is a leap year.

For the base period T-bill rates for the periods ending in prior years, see Rev. Rul. 2013–24, 2013–49 IRB 534; Rev. Rul. 2012–22, 2012–48 IRB 565; Rev. Rul. 2011–30, 2011–49 IRB 826; Rev. Rul. 2010–28, 2010–49 IRB 804; and Rev. Rul. 2009–36, 2009–47 IRB 650.

DRAFTING INFORMATION

The principal author of this revenue ruling is Anand Desai of the Office of Associate Chief Counsel (International). For further information regarding the revenue ruling, contact Mr. Desai at (202) 317-6939 (not a toll-free number).

ANNUAL RATE,
COMPOUNDED DAILY

0.11 PERCENT

DAYS	FACTOR
1	.000003836
2	.000007671
3	.000011507
4	.000015343
5	.000019178
6	.000023014
7	.000026850
8	.000030685
9	.000034521
10	.000038357
11	.000042193
12	.000046028
13	.000049864
14	.000053700
15	.000057536
16	.000061372
17	.000065207
18	.000069043
19	.000072879
20	.000076715
21	.000080551
22	.000084387
23	.000088223
24	.000092059
25	.000095895
26	.000099731
27	.000103567
28	.000107403

ANNUAL RATE,
COMPOUNDED DAILY

0.11 PERCENT

DAYS	FACTOR
29	.000111239
30	.000115075
31	.000118911
32	.000122747
33	.000126583
34	.000130419
35	.000134255
36	.000138091
37	.000141928
38	.000145764
39	.000149600
40	.000153436
41	.000157272
42	.000161109
43	.000164945
44	.000168781
45	.000172617
46	.000176454
47	.000180290
48	.000184126
49	.000187963
50	.000191799
51	.000195635
52	.000199472
53	.000203308
54	.000207144
55	.000210981
56	.000214817
57	.000218654
58	.000222490
59	.000226327
60	.000230163
61	.000234000
62	.000237836
63	.000241673
64	.000245509
65	.000249346

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
66	.000253182
67	.000257019
68	.000260855
69	.000264692
70	.000268529
71	.000272365
72	.000276202
73	.000280039
74	.000283875
75	.000287712
76	.000291549
77	.000295386
78	.000299222
79	.000303059
80	.000306896
81	.000310733
82	.000314569
83	.000318406
84	.000322243
85	.000326080
86	.000329917
87	.000333754
88	.000337591
89	.000341427
90	.000345264
91	.000349101
92	.000352938
93	.000356775
94	.000360612
95	.000364449
96	.000368286
97	.000372123
98	.000375960
99	.000379797
100	.000383634
101	.000387472

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
102	.000391309
103	.000395146
104	.000398983
105	.000402820
106	.000406657
107	.000410494
108	.000414332
109	.000418169
110	.000422006
111	.000425843
112	.000429681
113	.000433518
114	.000437355
115	.000441192
116	.000445030
117	.000448867
118	.000452704
119	.000456542
120	.000460379
121	.000464216
122	.000468054
123	.000471891
124	.000475729
125	.000479566
126	.000483404
127	.000487241
128	.000491079
129	.000494916
130	.000498754
131	.000502591
132	.000506429
133	.000510266
134	.000514104
135	.000517941
136	.000521779
137	.000525617
138	.000529454

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
139	.000533292
140	.000537129
141	.000540967
142	.000544805
143	.000548643
144	.000552480
145	.000556318
146	.000560156
147	.000563994
148	.000567831
149	.000571669
150	.000575507
151	.000579345
152	.000583183
153	.000587020
154	.000590858
155	.000594696
156	.000598534
157	.000602372
158	.000606210
159	.000610048
160	.000613886
161	.000617724
162	.000621562
163	.000625400
164	.000629238
165	.000633076
166	.000636914
167	.000640752
168	.000644590
169	.000648428
170	.000652266
171	.000656104
172	.000659942
173	.000663781
174	.000667619
175	.000671457

ANNUAL RATE, COMPOUNDED DAILY

0.11 PERCENT

DAYS	FACTOR
176	.000675295
177	.000679133
178	.000682972
179	.000686810
180	.000690648
181	.000694486
182	.000698325
183	.000702163
184	.000706001
185	.000709839
186	.000713678
187	.000717516
188	.000721355
189	.000725193
190	.000729031
191	.000732870
192	.000736708
193	.000740547
194	.000744385
195	.000748224
196	.000752062
197	.000755901
198	.000759739
199	.000763578
200	.000767416
201	.000771255
202	.000775093
203	.000778932
204	.000782770
205	.000786609
206	.000790448
207	.000794286
208	.000798125
209	.000801964
210	.000805802
211	.000809641

ANNUAL RATE, COMPOUNDED DAILY

0.11 PERCENT

DAYS	FACTOR
212	.000813480
213	.000817319
214	.000821157
215	.000824996
216	.000828835
217	.000832674
218	.000836512
219	.000840351
220	.000844190
221	.000848029
222	.000851868
223	.000855707
224	.000859546
225	.000863385
226	.000867223
227	.000871062
228	.000874901
229	.000878740
230	.000882579
231	.000886418
232	.000890257
233	.000894096
234	.000897935
235	.000901774
236	.000905614
237	.000909453
238	.000913292
239	.000917131
240	.000920970
241	.000924809
242	.000928648
243	.000932488
244	.000936327
245	.000940166
246	.000944005
247	.000947844
248	.000951684

ANNUAL RATE, COMPOUNDED DAILY

0.11 PERCENT

DAYS	FACTOR
249	.000955523
250	.000959362
251	.000963201
252	.000967041
253	.000970880
254	.000974719
255	.000978559
256	.000982398
257	.000986238
258	.000990077
259	.000993916
260	.000997756
261	.001001595
262	.001005435
263	.001009274
264	.001013114
265	.001016953
266	.001020793
267	.001024632
268	.001028472
269	.001032311
270	.001036151
271	.001039990
272	.001043830
273	.001047670
274	.001051509
275	.001055349
276	.001059189
277	.001063028
278	.001066868
279	.001070708
280	.001074547
281	.001078387
282	.001082227
283	.001086067
284	.001089906
285	.001093746

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
286	.001097586
287	.001101426
288	.001105266
289	.001109106
290	.001112945
291	.001116785
292	.001120625
293	.001124465
294	.001128305
295	.001132145
296	.001135985
297	.001139825
298	.001143665
299	.001147505
300	.001151345
301	.001155185
302	.001159025
303	.001162865
304	.001166705
305	.001170545
306	.001174385
307	.001178226
308	.001182066
309	.001185906
310	.001189746
311	.001193586
312	.001197426
313	.001201267
314	.001205107
315	.001208947
316	.001212787
317	.001216628
318	.001220468
319	.001224308
320	.001228148
321	.001231989

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
322	.001235829
323	.001239669
324	.001243510
325	.001247350
326	.001251191
327	.001255031
328	.001258871
329	.001262712
330	.001266552
331	.001270393
332	.001274233
333	.001278074
334	.001281914
335	.001285755
336	.001289595
337	.001293436
338	.001297277
339	.001301117
340	.001304958
341	.001308798
342	.001312639
343	.001316480
344	.001320320
345	.001324161
346	.001328002
347	.001331842
348	.001335683
349	.001339524
350	.001343365
351	.001347205
352	.001351046
353	.001354887
354	.001358728
355	.001362569
356	.001366410
357	.001370250
358	.001374091

ANNUAL RATE, COMPOUNDED DAILY 0.11 PERCENT	
DAYS	FACTOR
359	.001377932
360	.001381773
361	.001385614
362	.001389455
363	.001393296
364	.001397137
365	.001400978
366	.001404819
367	.001408660
368	.001412501
369	.001416342
370	.001420183
371	.001424024

Section 2010.—Unified Credit Against Estate Tax

The Service provides an inflation adjustment to the amount of the unified credit against estate tax for the estate of a decedent dying in calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 2032A.—Valuation of Certain Farm, etc., Real Property

The Service provides an inflation adjustment to the maximum amount by which the value of certain farm and other qualified real property included in a decedent's gross estate may be decreased for purposes of valuing the estate of a decedent dying in calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 2503.—Taxable Gifts

The Service provides an inflation adjustment to the amount of gifts that may be made to a person in a calendar year without including the amount in taxable gifts for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 2523.—Gift to Spouse

The Service provides an inflation adjustment to the amount of gifts that may be made in a calendar year to a spouse who is not a citizen of the United States without including the amount in taxable gifts for calendar year 2015. See Rev. Proc. 2014–61, page 860.

Section 4161.—Imposition of Tax

The Service provides an inflation adjustment to the amount of excise tax imposed for calendar year 2015 on the first sale by a manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows. See Rev. Proc. 2014–61, page 860.

Section 4261.—Passenger Air Transportation Excise Tax

The Service provides inflation adjustments for excise taxes on domestic and international passenger air transportation for calendar year 2015. See Rev. Proc. 2014–61, page 860.

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26 CFR Part 41: Highway Use Tax Regulations." The regulations in this part relate to the tax on the use of certain highway vehicles imposed by section 4481 and to certain associated administrative provisions.

T.D. 9698

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 41

Highway Use Tax; Sold Vehicles and Electronic Filing; Taxable Period Beginning July 1, 2011

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance on the mandatory electronic filing of *Form 2290*, "Heavy Highway Vehicle Use Tax Return," for 25 or more vehicles; credits or refunds for sold, destroyed, or stolen vehicles; and the tax liability and computation of tax on the use of certain second-hand vehicles. The regulations affect owners and operators of highway motor vehicles with a taxable gross weight of 55,000 pounds or more. These final regulations also remove the temporary regulations that provide guidance on the filing of *Form 2290* and payment of the associated highway use tax for the taxable period beginning July 1, 2011.

DATES: *Effective Date*: These regulations are effective on July 1, 2015.

Applicability Date: For dates of applicability, see §§ 41.4481–1(e), 41.4481–2(c), 41.6001–2(e), 41.6011(a)–1(d), 41.6071(a)–1(d), and 41.6151(a)–1(b).

FOR FURTHER INFORMATION CONTACT: Natalie Payne, (202) 317-5262 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document amends the Highway Use Tax Regulations (26 CFR Part 41) under sections 4481, 4483, 6001, 6071, and 6151 of the Internal Revenue Code (Code).

Section 4481(a) of the Code imposes an annual tax on the use of highway vehicles with a taxable gross weight of 55,000 pounds or more. Under paragraphs (c)(2) and (c)(4) of section 4482, the taxable period generally runs from July 1 through the following June 30.

Section 867 of the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418 (2004)), (1) added new section 4481(e), which requires electronic filing of a return reporting tax on the use of 25 or more highway motor vehicles, (2) modified section 4481(c)(2) to allow a proration of the tax for vehicles that are sold, and (3) repealed section 6156, eliminating the ability to pay the tax in installments.

On January 16, 2009, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–116699–07, 74 FR 2910) (NPRM 1) in the **Federal Register.** The NPRM 1 provides proposed guidance on mandatory electronic filing of *Form 2290*, "Heavy Highway Vehicle Use Tax Return," for 25 or more vehicles. Specifically, NPRM 1 provides that submitting a *Form 2290* on paper for 25 or more vehicles constitutes a failure to file for purposes of the penalty under section 6651. In addition, NPRM 1 provides that if a taxpayer is required to file *Form 2290* electronically and fails to do so, the IRS will not return to the taxpayer a receipted Schedule 1 (*Form 2290*), which is necessary to register the vehicle with a State.

The NPRM 1 also revises existing regulations to administer the credits and refunds resulting from a statutory overpayment of tax upon the sale of a vehicle, and it clarifies that the triggering event for overpayments is the sale, destruction, or theft of a vehicle. In addition, NPRM 1 clarifies the tax liability and computation of tax upon the first taxable use of a second-hand vehicle for which there was a prior taxable use during the tax period.

The IRS and the Treasury Department received one written comment in response to NPRM 1. No public hearing was requested or held.

On July 20, 2011, the IRS and the Treasury Department published final and temporary regulations (TD 9537, 76 FR 43121) (the Temporary Regulations) in the **Federal Register.** The same day, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–122813–11, 76 FR 43225) (NPRM 2) by cross-reference to the Temporary Regulations in the **Federal Register.** At the time the IRS and the Treasury Department published NPRM 2, the highway use tax was scheduled to expire at the close of September 30, 2011, which would have resulted in a short taxable period for the taxable period beginning on July 1, 2011 (the effective date of the tax has since been statutorily extended through September 30, 2017). The Temporary Regulations provide guidance on the filing of *Form 2290* and the payment of the associated highway use tax for the taxable period beginning July 1, 2011. Specifically, the Temporary Regulations postponed the deadline by which a taxpayer must file a *Form 2290* return for taxable uses during the taxable period beginning July 1, 2011, to November 30, 2011. Further, the Temporary Regulations discouraged the filing of a *Form 2290*, or sub-

mission of associated payment, before November 1, 2011, for taxable uses during the taxable period beginning July 1, 2011. No comments were received in response to NPRM 2, and no public hearing was requested or held.

These final regulations adopt NPRM 1 with two substantive changes (described in the next paragraph). In addition, the IRS and the Treasury Department have made certain nonsubstantive changes to the regulatory text, including minor wording changes, to improve the clarity and readability of the final regulations.

To reduce the burden on small business, the final regulations remove the proposals in NPRM 1 related to the effect of a failure to file a *Form 2290* electronically for 25 or more vehicles. Thus, under the final regulations, the filing of a *Form 2290* on paper for 25 or more vehicles does not constitute a failure to file for purposes of the penalty under section 6651, and the IRS will not withhold from the taxpayer a receipted Schedule 1 (*Form 2290*). The IRS and the Treasury Department continue to consider ways to ensure compliance with the electronic filing requirement in section 4481(e). Accordingly, the IRS and the Treasury Department request comments on how to enforce the electronic filing requirement in a manner that does not unduly burden taxpayers. Comments on this issue should be submitted in writing and can be mailed to the Office of Associate Chief Counsel (Passthroughs and Special Industries), Re: REG–116699–07, CC:PSI:B7, Room 5314, 1111 Constitution Avenue NW., Washington, DC 20224. All comments received will be available for public inspection at *http://www.regulations.gov* (IRS REG–116699–07).

These final regulations do not adopt NPRM 2 because the period to which NPRM 2 applies has ended. In addition, these final regulations remove the Temporary Regulations.

Summary of Comment

The comment received in response to NPRM 1 suggested that the IRS modify its rule under § 41.6001–2(b)(2)(ii) relating to the registration of highway motor vehicles. Under § 41.6001–2(b)(2)(ii), a State that registers vehicles other than on the basis of gross weight must require proof of payment in order to register a highway motor vehicle, unless the State receives a written statement providing that during the taxable period that includes the date on which the State receives the application for registration, the vehicle had a taxable gross weight of less than 55,000 pounds. The commenter noted that many highway motor vehicles in the gross weight range of 8,000 to 54,999 pounds are used in the same manner each year and never reach a gross weight of 55,000 pounds. The commenter suggested that owners of vehicles in the 8,000 to 54,999 pound range be allowed to declare at the initial vehicle registration that the gross weight of the highway motor vehicle is not expected to ever reach 55,000 pounds, provided the owner also certifies that if the gross weight of the vehicle ever reaches a gross weight of 55,000 pounds or more the owner will make timely payments of any highway vehicle use tax due.

The final regulations do not adopt the change proposed by the commenter. The IRS and the Treasury Department have determined that the written statement required by § 41.6001–2(b)(2)(ii) provides information that is essential to the effective and efficient administration of the tax under section 4481 without unduly burdening taxpayers.

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. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. The regulations affect owners and operators of highway motor vehicles with a taxable gross weight of 55,000 pounds or more, some of which may be small entities. Although a substantial number of small entities may be subject to the requirements of this rule, any economic impact is minimal. The regulations provide guidance for claiming a refund or credit when a vehicle is sold during the tax year. Specifically, the regulations provide that the claim must be made on *Form 2290* or *Form 8849*, "Claim for Refund of Excise Taxes." The information to complete these forms is readily available to the taxpayer and the forms take little time to complete. Without the claim information, the IRS could not determine taxpayer eligibility or determine the accuracy of the claim. Accordingly, these regulations do not impose a collection of information on small entities within the meaning of the Regulatory Flexibility Act and a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Code, NPRM 1 and NPRM 2 were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small entities. No comments were received.

Drafting Information

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

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 41 is amended as follows:

PART 41—EXCISE TAX ON USE OF CERTAIN HIGHWAY MOTOR VEHICLES

Paragraph 1. The authority citation for part 41 is revised to read as follows:

Authority: 26 U.S.C. 7805.

Section 41.4482(b)–1 also issued under 26 U.S.C. 4482(b).

Section 41.4483–1 also issued under 26 U.S.C. 4483(a).

Section 41.4483–2 also issued under 26 U.S.C. 4483(c).

Section 41.4483–3 also issued under 26 U.S.C. 4483(d).

Section 41.6001–1 also issued under 26 U.S.C. 6001.

Section 41.6001–2 also issued under 26 U.S.C. 6001.

Section 41.6001–3 also issued under sec. 507, Public Law 100–17 (101 Stat. 260).

Section 41.6011(a)–1 also issued under 26 U.S.C. 6011(a).

Section 41.6060–1 also issued under 26 U.S.C. 6060(a).

Section 41.6071(a)–1 also issued under 26 U.S.C. 6071(a).

Section 41.6091–1 also issued under 26 U.S.C. 6091(a).

Section 41.6101–1 also issued under 26 U.S.C. 6101.

Section 41.6109–1 also issued under 26 U.S.C. 6109(a).

Section 41.6109–2 also issued under 26 U.S.C. 6109(a).

Section 41.6151(a)–1 also issued under 26 U.S.C. 6151(a).

Section 41.6695–1 also issued under 26 U.S.C. 6695(b).

Par. 2. Section 41.4481–1 is amended by:

1. Revising the section heading.

2. Removing the third sentence from paragraph (b).

3. Adding headings to paragraphs (c)(1), (c)(2), and (c)(3).

4. In the introductory text of paragraph (c)(1), removing the language "Except as provided in paragraph (c)(2) of this section" and adding in its place "Except as otherwise provided in this paragraph (c)".

5. Revising paragraphs (c)(4) and (c)(5).

6. Removing paragraphs (c)(6) and (d).

7. Redesignating paragraph (e) as paragraph (d) and revising the introductory text in newly-redesignated paragraph (d).

8. In newly-redesignated paragraph (d), revising *Example* (3) and adding *Example* (4).

9. Adding new paragraph (e).

The revisions and additions read as follows:

§ 41.4481–1 Imposition and computation of tax.

* * * * *

(c) * * *

(1) *In general*. * * *

* * * * *

(2) *Certain prorated taxable periods*. * * *

(3) *Increase in taxable gross weight during the taxable period*. * * *

(4) *Prorated taxable period for sold, destroyed, or stolen vehicles*—(i) *In general*. The tax on a taxpayer's use of a highway vehicle for a taxable period is determined under paragraph (c)(4)(ii) of this section if—

(A) The vehicle is destroyed or stolen before the first day of the last month in the taxable period and is not later used by the taxpayer during the period; or

(B) The taxpayer sells the vehicle before the first day of the last month in the taxable period and does not later use the vehicle during the period.

(ii) *Computation of tax*. If the tax on a taxpayer's use of a highway vehicle for a taxable period is determined under this paragraph (c)(4)(ii), the tax is computed by multiplying the amount of tax that would be due for a full taxable period, as computed under paragraph (c)(1) of this section, by a fraction. The fraction has as its numerator the number of months in the period from the first day of the month in the period in which the first taxable use of the highway motor vehicle occurs to and including the last day of the month in which the highway motor vehicle was sold, destroyed, or stolen, and as its denominator the number of months in the entire taxable period. (See paragraph (d) *Example* (3)(i) of this section.)

(iii) *Overpayment*. If a taxpayer's liability for the tax on the use of a highway vehicle for a taxable period is determined under paragraph (c)(4)(ii) of this section, any tax the taxpayer paid under section 4481(a) on the use of the vehicle for such period in excess of the tax calculated under paragraph (c)(4)(ii) of this section is an overpayment of tax.

(iv) *Definition of destroyed vehicle*. For purposes of this paragraph (c)(4), a highway motor vehicle is destroyed if the vehicle is damaged due to an accident or other casualty to such an extent that it is not economical to rebuild.

(v) *Form and content of claim*. A claim for refund of an overpayment described in paragraph (c)(4)(iii) of this section must be made on *Form 8849*, "Claim for Refund of Excise Taxes" (or such other form as the Commissioner may designate) in accordance with the instructions for that form. A claim for a credit must be made on *Form 2290*, "Heavy Highway Vehicle Use Tax Return" (or such other form as the Commissioner may designate) in accordance with the instructions for that form. A claim for refund or credit for any vehicle must include—

(A) The vehicle identification number and taxable gross weight of the vehicle;

(B) The date of the sale, destruction, or theft of the vehicle; and

(C) If the vehicle was sold, the name and address of the purchaser of the vehicle.

(vi) *Tax on buyer's use of second-hand vehicles*. If a vehicle is sold during the taxable period and a credit or refund of the tax imposed by section 4481 is allowable upon the sale under paragraph (c)(4)(iii) of this section, tax is imposed on the use of the vehicle after the sale and before the end of the taxable period. (See paragraph (c)(4)(vii) of this section for the rules regarding the computation of tax after the sale and before the end of the taxable period.)

(vii) *Computation of tax on second-hand vehicles*. The tax under paragraph (c)(4)(vi) of this section on the use of a vehicle after a sale upon which a credit or refund is allowable is computed by multiplying the amount of tax that would be due for a full taxable period as computed under paragraph (c)(1) of this section by a fraction. The fraction has as its numerator the number of months in the period from the first day of the month in which the first taxable use of the vehicle after the sale occurs (the first day of the month after such month if the first taxable use after the sale occurs in the month of the sale) through the end of the taxable period, and as its denominator the number of months in the entire taxable period. (See paragraph (d) *Example* (3)(ii) of this section.)

(5) *Decrease in taxable gross weight, discontinued use, or converted use*. The computation of the tax is not affected, and no right to a credit or refund of any tax paid under section 4481 arises, if in any taxable period—

(i) The taxable gross weight of a highway motor vehicle is decreased;

(ii) The use of a highway motor vehicle is discontinued (for reasons other than sale, destruction, or theft as described in paragraph (c)(4) of this section); or

(iii) The highway motor vehicle is converted to a use that is exempt from the tax imposed by section 4481(a).

(d) *Examples*. The application of §§ 41.4481–1, 41.4481–2, and 41.4482(c)–1(c) may be illustrated by the following examples:

* * * * *

Example (3). (i) In July, X uses a vehicle that is registered in X's name and has a taxable gross weight of 70,000 pounds. The vehicle is not a logging vehicle. X pays the $430 of tax imposed by section 4481 for the taxable period. On September 2 of the same calendar year, X sells the vehicle to Y. X's tax is calculated under paragraph (c)(4)(ii) by multiplying the amount of tax that would be due for a full taxable period by a fraction that has as its numerator the number of months in the period from the first day of the month in which X's first taxable use of the highway motor vehicle occurs to and including the last day of the month in which the vehicle was sold, and as its denominator the number of months in the entire taxable period. Thus, X's tax for the period is $107.50 (3/12 of $430), and X may claim a credit or refund of $322.50 ($430.00 – $107.50) in accordance with § 41.4481–1(c)(4)(v) after X sells the vehicle.

(ii) On September 23, Y uses the vehicle. Y is liable for tax on the use of the vehicle during the taxable period ending June 30 of the following calendar year. Y's tax is calculated under paragraph (c)(4)(vii) by multiplying the amount of tax that would be due for a full taxable period by a fraction that has as its numerator the number of months in the period from the first day of the month in which Y's first taxable use of the vehicle after the sale occurs (the first day of the month after such month if the first taxable use after the sale occurs in the month of the sale) through the end of the taxable period, and as its denominator the number of months in the entire taxable period. Y's first use of the vehicle occurs in the month of the sale. Accordingly, Y's tax is based on the number of months in the period from the first day of October (the month following the month of the first taxable use) through the end of June, and Y owes a section 4481 tax of $322.50 (9/12 of $430) for the taxable period.

Example (4). Assume the same facts as in *Example* (3)(i), except that on September 2, X sells the vehicle to Dealer, a dealer in highway motor vehicles. X may claim a credit or refund of $322.50. Dealer operates the vehicle exclusively for the purpose of demonstration, which is not a "use" of the vehicle under § 41.4482(c)–1(c). On May 2 of the following calendar year, Dealer sells the vehicle to Y. Dealer does not owe a section 4481 tax and may not claim a refund. Y's first taxable use of the vehicle occurs on May 3. Y's first taxable use of the vehicle does not occur in the month of a sale upon which a credit or refund is allowable. Accordingly, Y's tax is calculated under paragraph (c)(2) by multiplying the amount of tax that would be due for a full taxable period by a fraction which has as its numerator the number of months in the taxable period beginning with the month of first taxable use and as its denominator the number of months in the entire taxable period. The numerator is the number of months in the period from the first day of May (the month of Y's first taxable use after the sale) through the end of June, and Y owes a section 4481 tax of $71.67 (2/12 of $430) for the taxable period.

(e) *Effective/applicability date*. This section applies on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.4481–1 (revised as of April 1, 2014).

Par. 3. Section 41.4481–2 is amended by:

1. Removing the language "or any installment payment of the tax" in paragraph (a)(1)(i)(D).

2. Revising paragraph (a)(2) and adding paragraph (a)(3).

3. Adding a sentence at the end of paragraph (b).

4. Revising paragraph (c).

The revisions and additions read as follows:

§ 41.4481–2 Persons liable for tax.

(a) * * *

(2) If a vehicle is sold during the taxable period and a credit or refund is allowable upon the sale under § 41.4481–1(c)(4)(iii), paragraph (a)(1) of this section is applied with the following modifications:

(i) For purposes of determining the person liable for the tax determined under § 41.4481–1(c)(4)(ii), each reference to a taxable period in paragraph (a)(1) of this section is treated as a reference to the period that begins on the first day of the taxable period in which the vehicle is sold and ends on the date of sale.

(ii) For purposes of determining the person liable for the tax determined under § 41.4481–1(c)(4)(vi), each reference to a taxable period in paragraph (a)(1) of this section is treated as a reference to the period that begins on the date of the sale and ends on the last day of the taxable period in which the vehicle is sold.

(3) The application of paragraph (a) of this section may be illustrated by *Examples* (3) and (4) in § 41.4481–1(d).

(b) * * * For provisions relating to penalties for aiding and abetting an understatement of tax liability, see section 6701 of the Internal Revenue Code.

(c) *Effective/applicability date*. This section applies on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.4481–2 (revised as of April 1, 2014).

Par. 4. Section 41.4483–3 is amended as follows:

1. In the fourth sentence of paragraph (f), removing the language "to the extent that the tax or an installment payment of the tax has" and adding "(determined in the case of a transfer described in § 41.4481–1(c)(4)(i) under § 41.4481–1(c)(4)(ii)) to the extent that the tax has" in its place.

2. Adding paragraph (i).

The addition reads as follows:

§ 41.4483–3 Exemption for trucks used for 5,000 or fewer miles and agricultural vehicles used for 7,500 or fewer miles on public highways.

* * * * *

(i) *Effective/applicability date*. This section applies on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.4483–3 (revised as of April 1, 2014).

§ 41.4483–7 [Removed]

Par. 5. Section 41.4483–7 is removed.

§ 41.6001–1 [Amended]

Par. 6. Section 41.6001–1 is amended as follows:

1. In the first sentence of paragraph (a), the language "district director" is removed and "Commissioner" is added in its place.

2. In paragraph (a)(3), the language "In the case of any such vehicle acquired after June 30, 1956, the date" is removed and "The date" is added in its place.

Par. 7. Section 41.6001–2 is amended by:

1. Removing the third sentence of paragraph (a).

2. In the last sentence of paragraph (a), removing the language "an application for registration which is mailed will be considered to be received by a State on the date on which it was postmarked" and adding in its place "the rules of section 7502 and § 301.7502–1 of this chapter (relating to timely mailing treated as timely filing) determine when an application for registration is considered to be received by a State".

3. Redesignating paragraph (b)(1)(i) as paragraph (b)(1) and revising newly-redesignated paragraph (b)(1) heading.

4. Removing and reserving paragraph (b)(1)(ii).

5. Redesignating paragraph (b)(4)(i) as paragraph (b)(4) and revising newly-redesignated paragraph (b)(4) heading.

6. Removing and reserving paragraph (b)(4)(ii).

7. Revising paragraph (c).

8. Adding paragraph (e).

The revisions and addition read as follows:

§ 41.6001–2 Proof of payment for State registration purposes.

* * * * *

(b) *Proof of payment required*—(1) *In general*. * * *

* * * * *

(4) *Registration during certain months* * * *

* * * * *

(c) *Proof of payment*—(1) *In general*. The proof of payment required in paragraph (b) of this section consists of a receipted Schedule 1 (*Form 2290* "Heavy Highway Vehicle Use Tax Return") that is returned by the Internal Revenue Service, by mail or electronically, to a taxpayer that files a return of tax under section 4481(a), meets the requirements of § 41.6011(a)–1, and pays the amount of tax due with such return. A photocopy of such receipted Schedule 1 also serves as proof of payment. Such Schedule 1 serves as proof of suspension of such tax under § 41.4483–3 for the number of vehicles entered in that part of the Schedule 1 designated for vehicles for which tax has been suspended. The vehicle identification number of the vehicle being registered must appear on the Schedule 1 (or an attached page) in order for the Schedule 1 to be a valid proof of payment for such vehicle.

(2) *Acceptable substitute for receipted Schedule 1*. For purposes of this section, a State must accept as proof of payment a photocopy of the *Form 2290* (with the Schedule 1 attached) that was filed with the Internal Revenue Service for the vehicle being registered with sufficient documentation of payment of tax due at the time the *Form 2290* was filed (such as a photocopy of both sides of a cancelled check). This substitute proof of payment may be used to register a vehicle when, for example, the receipted Schedule 1 has been lost, or when at the time required for registration of a vehicle, a receipted Schedule 1 has not been received by a taxpayer who has filed a *Form 2290* with respect to such vehicle.

* * * * *

(e) *Effective/applicability date*. Paragraph (c) of this section applies to registrations of highway motor vehicles pursuant to applications that are received by a State on or after July 1, 2015. The rules of section 7502 and § 301.7502–1 of this chapter (relating to timely mailing treated as timely filing) determine when an application for registration is considered to be received by a State. For rules applicable to applications before that date, see 26 CFR 41.6001–2 (revised as of April 1, 2014).

§ 41.6001–2T [Removed]

Par. 8. Section 41.6001–2T is removed.

Par. 9. Section 41.6011(a)–1 is amended by adding paragraphs (a)(4), (c) and (d) to read as follows:

§ 41.6011(a)–1 Returns.

(a) * * *

(4) A person that is liable for tax under § 41.4481–2(a)(1)(i)(A), (B), (C), or (D), after taking into account the modification required under § 41.4481–2(a)(2), is treated as liable for tax by the same provision of § 41.4481–2(a)(1)(i) for purposes of this section and must file a return.

* * * * *

(c) *Required use of electronic filing*—(1) *In general*. A person that files any return reporting 25 or more vehicles must file the return electronically, as prescribed by the Commissioner. For this purpose, the number of vehicles reported on a return is the total number of vehicles for which tax is reported and does not include vehicles for which a suspension of tax is claimed.

(2) *Examples*. The application of this paragraph (c) may be illustrated by the following examples:

Example 1. A has 100 vehicles registered in its name, all of which have a taxable gross weight in excess of 55,000 pounds. Seventy-five of the vehicles are in use on July 1. Twenty-five are in dead storage as described in § 41.4482(c)–1(c). The vehicles in dead storage are not in use and they are not listed on the Schedule 1. A files *Form 2290* electronically for the 75 vehicles in use on July 1 and receives a receipted Schedule 1. On August 23 of the same calendar year, A uses the remaining 25 vehicles. A does not file *Form 2290* electronically but uses a paper *Form 2290*. A has failed to meet the requirements of section 4481(e) for the remaining 25 vehicles.

Example 2. Assume the same facts as in *Example* 1 except that on August 23, A uses 15 of the vehicles that were not used in July. The remaining 10 vehicles are not used in August. A does not file *Form 2290* electronically but uses a paper *Form 2290*. A has correctly filed a return as required by section 4481(e).

(d) *Effective/applicability date*. Paragraphs (a)(4) and (c) of this section apply to returns filed on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.6011(a)-1 (revised as of April 1, 2014).

Par. 10. Section 41.6071(a)–1 is amended as follows:

1. In paragraph (a) introductory text, the language "paragraph (b) or paragraph (c)" is removed and "paragraph (b)" is added in its place.

2. Revising paragraph (c).

3. Adding paragraph (d).

The additions and revision read as follows:

§ 41.6071(a)–1 Time for filing returns.

* * * * *

(c) *Effect of sale during taxable period*. A person that is liable for tax under § 41.4481–2(a)(1)(i)(A), (B), (C), or (D) after taking into account the modification required under § 41.4481–2(a)(2) is treated as liable for tax under the same provision of § 41.4481–2(a)(1)(i) for purposes of this section.

(d) *Effective/applicability date*. Paragraph (c) of this section applies on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.6071(a)–1 (revised as of April 1, 2014).

§ 41.6071(a)–1T [Removed]

Par. 11. Section 41.6071(a)–1T is removed.

§ 41.6151(a)–1 [Revised]

Par. 12. Section 41.6151(a)–1 is revised to read as follows:

§ 41.6151(a)–1 Time and place for paying tax.

(a) *In general*. The tax must be paid at the time prescribed in § 41.6071(a)–1 for

filing the return and at the place prescribed in § 41.6091–1 for filing the return.

(b) *Effective/applicability date*. This section applies on and after July 1, 2015. For rules applicable before that date, see 26 CFR 41.6151(a)–1 and 41.6151(a)–1T (revised as of April 1, 2014).

§ 41.6151(a)–1T [Removed]

Par. 13. Section 41.6151(a)–1T is removed.

§ 41.6156–1 [Removed]

Par. 14. Section 41.6156–1 is removed.

John Dalrymple
Deputy Commissioner for Services and Enforcement.

Approved: September 9, 2014

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

(Filed by the Office of the Federal Register on October 28, 2014, 8:45 a.m., and published in the issue of the Federal Register for October 29, 2014, 79 F.R. 64313)

Section 6033.—Returns by Exempt Organizations

The Service provides an inflation adjustment to the amount of dues certain exempt organizations with nondeductible lobbying expenditures can charge and still be excepted from reporting requirements for taxable years beginning in 2015. See Rev. Proc. 2014–61, page.

Section 6039F.—Notice of Large Gifts Received From Foreign Persons

The Service provides an inflation adjustment to the amount of gifts received in a taxable year from foreign persons that triggers a reporting requirement for a United States person for taxable years beginning in 2015. See Rev. Proc. 2014–61, page.

Section 6323.—Validity and Priority against Certain Persons

The Service provides inflation adjustments for calendar year 2015 to (1) the maximum amount of a casual sale of personal property below which a federal tax lien will not be valid against a purchaser of the property, and (2) the maximum amount of a contract for the repair or improvement of certain residential property at or below which a federal tax lien will not be valid against a mechanic's lienor. See Rev. Proc. 2014–61, page.

Section 6334.—Property Exempt From Levy

The Service provides inflation adjustments to the value of certain property exempt from levy (fuel, provisions, furniture, household personal effects, arms for personal use, livestock, poultry, and books and tools of a trade, business, or profession) for calendar year 2015. See Rev. Proc. 2014–61, page.

Section 6601.—Interest on Underpayment, Nonpayment or Extension of Time for Payment, of Tax

The Service provides an inflation adjustment to the amount used to determine the amount of interest charged on a certain portion of the estate tax payable in installments for the estate of a decedent dying in calendar year 2015. See Rev. Proc. 2014–61, page.

Section 7430.—Awarding of Costs and Certain Fees

The Service provides an inflation adjustment to the hourly limit on attorney fees incurred in calendar year 2015 that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty. See Rev. Proc. 2014–61, page.

Section 7702B.—Treatment of Qualified Long-Term Care Insurance

The Service provides an inflation adjustment to the stated dollar amount for calendar year 2015 of the per diem limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual. See Rev. Proc. 2014–61, page.

Part III. Administrative, Procedural, and Miscellaneous

Ebola Virus Disease Outbreak Occurring in Guinea, Liberia, and Sierra Leone Designated as a Qualified Disaster under § 139 of the Internal Revenue Code

Notice 2014–65

This notice designates the Ebola Virus Disease (EVD) outbreak occurring in the West African countries of Guinea, Liberia, and Sierra Leone as a qualified disaster for purposes of § 139 of the Internal Revenue Code. As a result of the designation of the EVD outbreak as a qualified disaster for purposes of § 139, payments of qualified disaster relief to assist victims affected by the EVD outbreak in the three countries (Guinea, Liberia, and Sierra Leone) are excludable from the recipients' gross income.

EVD OUTBREAK

As of October 22, 2014, more than 4,800 EVD-related deaths and more than 9,900 suspected and confirmed cases of EVD have been reported by Guinea, Liberia, and Sierra Leone. *See www.usaid.gov/ebola*. In addition, the reported number of cases of EVD continues to increase rapidly in those countries. *USAID West Africa – Ebola Outbreak – Fact Sheet No. 4 (FY15)* (October 22, 2014). President Obama has stated that the EVD outbreak in West Africa is a public health emergency, a humanitarian crisis, and a national security priority, and has directed U.S. agencies and departments (including the Departments of State, Defense, and Health and Human Services, the Centers for Disease Control and Prevention, and the U.S. Agency for International Development) to assist West African governments in their responses. *See www.whitehouse.gov/ebola-response*. The President has also called on other nations regarding the need for more robust commitments and rapid delivery of assistance by the international community.

QUALIFIED DISASTER RELIEF PAYMENTS EXCLUDED FROM RECIPIENTS' GROSS INCOME

Section 139(a) provides that gross income shall not include any amount received by an individual as a qualified disaster relief payment.

Section 139(b) provides that a qualified disaster relief payment includes any amount paid to or for the benefit of an individual—

(1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses (not otherwise compensated for by insurance or otherwise) incurred as a result of a qualified disaster, or

(2) to reimburse or pay reasonable and necessary expenses (not otherwise compensated for by insurance or otherwise) incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster.

Under § 139(c)(3) the term "qualified disaster" includes a disaster resulting from an event that is determined by the Secretary to be of a catastrophic nature.

DESIGNATION AS QUALIFIED DISASTER

The Commissioner of Internal Revenue, pursuant to a general delegation by the Secretary, has determined that the EVD outbreak occurring in the West African countries of Guinea, Liberia, and Sierra Leone is an event of a catastrophic nature under § 139(c)(3). Therefore, the EVD outbreak occurring in those countries is designated as a qualified disaster under § 139.

SECTION 501(c)(3) ORGANIZATIONS

Employer-sponsored private foundations may choose to provide disaster relief to employee victims of the EVD outbreak in Guinea, Liberia, and Sierra Leone. Like all organizations described in § 501(c)(3), private foundations should exercise due diligence when providing disaster relief as set forth in Publication 3833, *Disaster Relief: Providing Assistance Through Charitable Organizations*.

DRAFTING INFORMATION

The principal author of this notice is Sheldon Iskow of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact Mr. Iskow at (202) 317-4718 (not a toll-free number).

Treatment of Certain Amounts Paid to Section 170(c) Organizations under Certain Employer Leave-Based Donation Programs to Aid Victims of the Ebola Virus Disease (EVD) Outbreak in Guinea, Liberia, and Sierra Leone

Notice 2014–68

This notice provides guidance on the treatment of leave-based donation programs to aid victims of the Ebola Virus Disease (EVD) outbreak in the West African countries of Guinea, Liberia, and Sierra Leone for income and employment tax purposes.

EVD OUTBREAK

As of October 22, 2014, more than 4,800 EVD-related deaths and more than 9,900 suspected and confirmed cases of EVD have been reported by Guinea, Liberia, and Sierra Leone. See *www.usaid-.gov/ebola*. In addition, the reported number of cases of EVD continues to increase rapidly in those countries. *USAID West Africa – Ebola Outbreak – Fact Sheet No. 4 (FY15)* (October 22, 2014). President Obama has stated that the EVD outbreak in West Africa is a public health emergency, a humanitarian crisis, and a national security priority, and has directed U.S. agencies and departments (including the Departments of State, Defense, and Health and Human Services, the Centers for Disease Control and Prevention, and the U.S. Agency for Interna-

tional Development) to assist West African governments in their responses. *See www.whitehouse.gov/ebola-response*. The President has also called on other nations regarding the need for more robust commitments and rapid delivery of assistance by the international community.

TREATMENT OF LEAVE-BASED DONATION PAYMENTS

In view of the extreme need for charitable relief due to the EVD outbreak in Guinea, Liberia, and Sierra Leone, employers may have adopted or may be considering adopting leave-based donation programs to aid victims of the EVD outbreak in Guinea, Liberia, and Sierra Leone. Under these programs employees elect to forgo vacation, sick, or personal leave in exchange for cash payments an employer makes to organizations described in § 170(c) of the Internal Revenue Code (§ 170(c) organizations) for the relief of victims of the EVD outbreak in Guinea, Liberia, and Sierra Leone. This notice provides guidance on the treatment of these payments for income and employment tax purposes.

Notice 2012–69, 2012–51 I.R.B. 712, and Notice 2005–68, 2005–2 C.B. 622, provided similar guidance in view of the extreme need for charitable relief following Hurricane Sandy and Hurricane Katrina, respectively. *See also* Notice 2001–69, 2001–2 C.B. 491, as modified and superseded by Notice 2003–1, 2003–1 C.B. 257, regarding charitable relief following the September 11, 2001, terrorist attacks.

The Service will not assert that cash payments an employer makes to § 170(c) organizations in exchange for vacation, sick, or personal leave that its employees elect to forgo constitute gross income or wages of the employees if the payments are: (1) made to the § 170(c) organizations for the relief of victims of the EVD outbreak in Guinea, Liberia, and Sierra Leone; and (2) paid to the § 170(c) organizations before January 1, 2016.

Similarly, the Service will not assert that the opportunity to make such an election results in constructive receipt of gross income or wages for employees. Electing employees may not claim a charitable contribution deduction under § 170 with respect to the value of forgone leave excluded from compensation and wages.

The Service will not assert that an employer will be only permitted to deduct these cash payments under the rules of § 170 rather than the rules of § 162. Cash payments to which this guidance applies need not be included in Box 1, 3 (if applicable), or 5 of an employee's Form W-2, Wage and Tax Statement.

DRAFTING INFORMATION

For further information, please contact Sheldon Iskow of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 317-4718 (not a toll-free number).

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26 CFR 601.201: Rulings and determination letters.
(Also: Part I, Sections 846; 1.846–1.)

Rev. Proc. 2014–59

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns and discount factors for the 2014 accident year. These factors will be used to compute discounted unpaid losses under § 846 of the Internal Revenue Code. *See* Rev. Proc. 2012–44, 2012–49 I.R.B. 645, for background concerning the loss payment patterns and application of the discount factors.

SECTION 2. SCOPE

This revenue procedure applies to any taxpayer that is required to discount unpaid losses under § 846 for a line of business using the discount factors published by the Secretary.

SECTION 3. TABLES OF DISCOUNT FACTORS

.01 The following tables present separately for each line of business the discount factors under § 846 for accident year 2014. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2014, which is 1.79 percent, and by assuming all loss payments occur in the middle of the calendar year.

.02 If the groupings of individual lines of business on the annual statement change, taxpayers must discount unpaid losses on the resulting line of business in accordance with the discounting patterns that would have applied to those unpaid losses based on their classification on the 2010 annual statement. *See* Rev. Proc. 2012–44, 2012–49 I.R.B. 645, section 2, for additional background on discounting under § 846 and the use of the Secretary's tables.

.03 Section V of Notice 88–100, 1988–2 C.B. 439, sets forth a composite method for computing discounted unpaid losses for accident years that are not separately reported on the annual statement. The tables separately provide discount factors for taxpayers who elect to use the composite method of section V of Notice 88–100. *See* Rev. Proc. 2002–74, 2002–2 C.B. 980.

.04 Tables.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Taxpayers that do not use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the 2014 and later taxable years.

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount all unpaid losses in this line of business that are outstanding at the end of the 2014 taxable year.

Auto Physical Damage

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors
2014	90.2657	90.2657	9.7343	9.6418	99.0495
2015	99.7478	9.4822	0.2522	0.2478	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years		0.1261	0.1261	0.1250	98.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2013 and prior years and that are outstanding at the end of the 2016 taxable year.

Commercial Auto/Truck Liability/Medical

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors
2014	25.7034	25.7034	74.2966	71.4890	96.2212
2015	48.2664	22.5629	51.7336	50.0047	96.6580
2016	67.8834	19.6171	32.1166	31.1079	96.8595
2017	82.0630	14.1795	17.9370	17.3589	96.7769
2018	90.4161	8.3532	9.5839	9.2420	96.4332
2019	94.6293	4.2132	5.3707	5.1568	96.0164
2020	97.0203	2.3910	2.9797	2.8368	95.2026
2021	98.2283	1.2081	1.7717	1.6687	94.1900
2022	98.6653	0.4370	1.3347	1.2578	94.2342
2023	98.8635	0.1982	1.1365	1.0803	95.0540

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		0.1982	0.9382	0.8996	95.8817
2025		0.1982	0.7400	0.7157	96.7157
2026		0.1982	0.5417	0.5285	97.5525
2027		0.1982	0.3435	0.3379	98.3798
2028 and later years		0.1982	0.1453	0.1440	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 95.9970 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Composite

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	39.5281	39.5281	60.4719	57.4533	95.0081
2015	62.0267	22.4986	37.9733	35.7826	94.2309
2016	73.7017	11.6750	26.2983	24.6441	93.7097
2017	80.0846	6.3830	19.9154	18.6454	93.6230
2018	85.7818	5.6971	14.2182	13.2312	93.0581
2019	90.2809	4.4992	9.7191	8.9288	91.8690
2020	91.9588	1.6778	8.0412	7.3959	91.9740
2021	92.9722	1.0134	7.0278	6.5058	92.5719
2022	94.0835	1.1113	5.9165	5.5010	92.9776
2023	94.7469	0.6634	5.2531	4.9302	93.8528

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		0.6634	4.5898	4.3492	94.7583
2025		0.6634	3.9264	3.7578	95.7050
2026		0.6634	3.2631	3.1558	96.7121
2027		0.6634	2.5997	2.5430	97.8186
2028 and later years		0.6634	1.9364	1.9193	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 94.8470 percent to discount unpaid losses incurred in this line of business in 2013 and prior years and that are outstanding at the end of the 2024 taxable year.

Fidelity/Surety

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	22.8449	22.8449	77.1551	75.3264	97.6298
2015	55.8585	33.0137	44.1415	43.3670	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years		22.0707	22.0707	21.8758	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

Financial Guaranty/Mortgage Guaranty

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	6.2515	6.2515	93.7485	91.4394	97.5370
2015	43.0154	36.7639	56.9846	55.9847	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years		28.4923	28.4923	28.2407	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 98.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

International (Composite)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	39.5281	39.5281	60.4719	57.4533	95.0081
2015	62.0267	22.4986	37.9733	35.7826	94.2309
2016	73.7017	11.6750	26.2983	24.6441	93.7097
2017	80.0846	6.3830	19.9154	18.6454	93.6230
2018	85.7818	5.6971	14.2182	13.2312	93.0581
2019	90.2809	4.4992	9.7191	8.9288	91.8690
2020	91.9588	1.6778	8.0412	7.3959	91.9740
2021	92.9722	1.0134	7.0278	6.5058	91.5719
2022	94.0835	1.1113	5.9165	5.5010	92.9776
2023	94.7469	0.6634	5.2531	4.9302	93.8528

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		0.6634	4.5898	4.3492	94.7583
2025		0.6634	3.9264	3.7578	95.7050
2026		0.6634	3.2631	3.1558	96.7121
2027		0.6634	2.5997	2.5430	97.8186
2028 and later years		0.6634	1.9364	1.9193	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 94.8470 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Medical Professional Liability — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	6.3462	6.3462	93.6538	88.5243	94.5230
2015	23.0958	16.7496	76.9042	73.2101	95.1965
2016	41.6827	18.5868	58.3173	55.7681	95.6287
2017	56.5267	14.8440	43.4733	41.7901	96.1281
2018	71.2882	14.7615	28.7118	27.6451	96.2847
2019	82.3023	11.0141	17.6977	17.0277	96.2140
2020	86.5143	4.2120	13.4857	13.0830	97.0134
2021	91.1422	4.6279	8.8578	8.6480	97.6313
2022	94.8664	3.7242	5.1336	5.0454	98.2819
2023	97.5408	2.6745	2.4592	2.4375	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024 and later years		2.4592	–	–	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Medical Professional Liability — Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	1.2044	1.2044	98.7956	90.6806	91.7861
2015	4.3376	3.1332	95.6624	89.1427	93.1846
2016	11.8161	7.4785	88.1839	83.1932	94.3405
2017	24.7088	12.8928	75.2912	71.6747	95.1967
2018	42.3863	17.6774	57.6137	55.1228	95.6764
2019	57.1600	14.7738	42.8400	41.2040	96.1813
2020	68.9797	11.8196	31.0203	30.0167	96.7644
2021	82.4247	13.4450	17.5753	16.9891	96.6647
2022	86.7084	4.2837	13.2916	12.9714	97.5906
2023	91.6701	4.9617	8.3299	8.1977	98.4120

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024 and later years		4.9617	3.3683	3.3385	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.0243 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Miscellaneous Casualty

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	69.0731	69.0731	30.9269	30.2773	97.8996
2015	85.5169	16.4438	14.4831	14.2290	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years		7.2415	7.2415	7.1776	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

Multiple Peril Lines (Homeowners/Farmowners, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	60.9719	60.9719	39.0281	37.7427	96.7063
2015	82.9059	21.9341	17.0941	16.2888	95.2890
2016	89.2783	6.3724	10.7217	10.1511	94.6789
2017	91.5605	2.2822	8.4395	8.0303	95.1520
2018	94.4255	2.8649	5.5745	5.2836	94.7811
2019	96.5899	2.1644	3.4101	3.1945	93.6765
2020	97.6023	1.0124	2.3977	2.2302	93.0150
2021	98.0034	0.4011	1.9966	1.8655	93.4323
2022	98.3410	0.3376	1.6590	1.5583	93.9272
2023	98.5727	0.2317	1.4273	1.3524	94.7512

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		0.2317	1.1957	1.1429	95.5863
2025		0.2317	0.9640	0.9297	96.4337
2026		0.2317	0.7324	0.7126	97.2960
2027		0.2317	0.5007	0.4916	98.1802
2028 and later years		0.2317	0.2691	0.2667	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 95.6622 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Other (Including Credit)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	54.6589	54.6589	45.3411	44.5308	98.2129
2015	84.2314	29.5725	15.7686	15.4919	98.2453

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years		7.8843	7.8843	7.8146	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

Other Liability — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	7.4270	7.4270	92.5730	87.1655	94.1587
2015	25.2808	17.8538	74.7192	70.7129	94.6382
2016	44.2108	18.9301	55.7892	52.8800	94.7853
2017	56.4956	12.2848	43.5044	41.4323	95.2370
2018	69.2838	12.7883	30.7162	29.2717	95.2975
2019	77.6662	8.3823	22.3338	21.3387	95.5442
2020	83.1572	5.4910	16.8428	16.1807	96.0688
2021	88.1777	5.0205	11.8223	11.4051	96.4709
2022	93.1315	4.9539	6.8685	6.6113	96.2552
2023	92.9490	−0.1826	7.0510	6.9138	98.0536

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		3.2639	3.7871	3.7446	98.8760
2025 and later years		3.2639	0.5232	0.5186	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 98.8835 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Other Liability — Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	10.0721	10.0721	89.9279	83.2624	92.5879
2015	24.3995	14.3274	75.6005	70.2978	92.9858
2016	37.3366	12.9372	62.6634	58.5036	93.3618
2017	52.4142	15.0776	47.5858	44.3389	93.1768
2018	64.3437	11.9295	35.6563	33.0968	92.8218
2019	73.7950	9.4512	26.2050	24.1538	92.1723
2020	79.7756	5.9807	20.2244	18.5522	91.7317
2021	84.0963	4.3206	15.9037	14.5251	91.3315
2022	85.6878	1.5915	14.3122	13.1794	92.0851

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2023	86.9224	1.2346	13.0776	12.1698	93.0577

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		1.2346	11.8431	11.1420	94.0805
2025		1.2346	10.6085	10.0959	95.1680
2026		1.2346	9.3740	9.0311	96.3421
2027		1.2346	8.1394	7.9472	97.6382
2028 and later years		1.2346	6.9048	6.8439	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 94.1596 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Private Passenger Auto Liability/Medical

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	42.9881	42.9881	57.0119	55.4898	97.3301
2015	71.9931	29.0051	28.0069	27.2195	97.1887
2016	84.8250	12.8318	15.1750	14.7605	97.2687
2017	92.3500	7.5251	7.6500	7.4327	97.1594
2018	96.2665	3.9165	3.7335	3.6143	96.8084
2019	97.9880	1.7214	2.0120	1.9422	96.5308
2020	98.7958	0.8078	1.2042	1.1620	96.4928
2021	99.2445	0.4487	0.7555	0.7300	96.6335
2022	99.4543	0.2097	0.5457	0.5315	97.3919
2023	99.6370	0.1827	0.3630	0.3567	98.2513

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024 and later years		0.1827	0.1803	0.1787	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Products Liability — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	4.5270	4.5270	95.4730	87.9108	92.0792
2015	16.0134	11.4865	83.9866	77.8956	92.7476
2016	45.1313	29.1179	54.8687	49.9126	90.9673
2017	39.2459	−5.8854	60.7541	56.7438	93.3992
2018	44.8357	5.5898	55.1643	52.1199	94.4813
2019	72.1615	27.3258	27.8385	25.4836	91.5409
2020	80.4448	8.2834	19.5552	17.5826	89.9130
2021	73.2957	−7.1491	26.7043	25.1102	94.0305

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2022	87.4824	14.1866	12.5176	11.2466	89.8460
2023	87.7500	0.2677	12.2500	11.1779	91.2480

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		0.2677	11.9823	11.1079	92.7025
2025		0.2677	11.7147	11.0367	94.2127
2026		0.2677	11.4470	10.9642	95.7823
2027		0.2677	11.1793	10.8904	97.4156
2028 and later years		0.2677	10.9117	10.8153	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 94.4051 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Products Liability – Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	7.1936	7.1936	92.8064	85.1351	91.7341
2015	16.9555	9.7619	83.0445	76.8101	92.4927
2016	28.3624	11.4069	71.6376	66.6765	93.0747
2017	39.7945	11.4321	60.2055	56.3360	93.5729
2018	54.3906	14.5961	45.6094	42.6183	93.4419
2019	60.9060	6.5154	39.0940	36.8077	94.1518
2020	67.7760	6.8700	32.2240	30.5353	94.7596
2021	75.7119	7.9359	24.2881	23.0753	95.0067
2022	79.5966	3.8847	20.4034	19.5690	95.9107
2023	83.9430	4.3464	16.0570	15.5342	96.7441

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		4.3464	11.7107	11.4272	97.5795
2025		4.3464	7.3643	7.2467	98.4026
2026 and later years		4.3464	3.0179	2.9913	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.9028 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Reinsurance — Nonproportional Assumed Property

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	20.1003	20.1003	79.8997	77.0575	96.4428
2015	59.2833	39.1830	40.7167	38.9047	95.5497
2016	73.0867	13.8034	26.9133	25.6747	95.3978
2017	80.3675	7.2808	19.6325	18.7886	95.7015
2018	87.7278	7.3603	12.2722	11.6990	95.3295

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2019	94.4454	6.7175	5.5546	5.1310	92.3737
2020	96.5143	2.0689	3.4857	3.1355	89.9532
2021	97.9468	1.4326	2.0532	1.7463	85.0551
2022	97.4560	−0.4909	2.5440	2.2728	89.3394
2023	97.0652	−0.3908	2.9348	2.7078	92.2638

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		0.1836	2.7512	2.5710	93.4497
2025		0.1836	2.5675	2.4317	94.7098
2026		0.1836	2.3839	2.2900	96.0596
2027		0.1836	2.2003	2.1457	97.5193
2028 and later years		0.1836	2.0166	1.9988	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 93.6157 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Reinsurance — Nonproportional Assumed Liability

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	3.4987	3.4987	96.5013	88.6033	91.8156
2015	23.2170	19.7183	76.7830	70.2953	91.5505
2016	43.7483	20.5313	56.2517	50.8393	90.3782
2017	38.9131	−4.8352	61.0869	56.6276	92.7001
2018	47.9298	9.0167	52.0702	48.5442	93.2284
2019	80.0315	32.1017	19.9685	17.0254	85.2613
2020	76.5053	−3.5292	23.4947	20.8878	88.9042
2021	78.1701	1.6649	21.8299	19.5820	89.7028
2022	80.0717	1.9015	19.9283	18.0141	90.3941
2023	79.8791	−0.1926	20.1209	18.5308	92.0972

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		1.1246	18.9963	17.7279	93.3227
2025		1.1246	17.8717	16.9106	94.6220
2026		1.1246	16.7471	16.0787	96.0085
2027		1.1246	15.6225	15.2318	97.4993
2028 and later years		1.1246	14.4979	14.3699	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 93.5114 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Reinsurance — Nonproportional Assumed Financial Lines

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	1.5423	1.5423	98.4577	92.2737	93.7191
2015	20.9273	19.3850	79.0727	74.3677	94.0497
2016	30.4705	9.5433	69.5295	66.0705	95.0253
2017	46.3043	15.8337	53.6957	51.2784	95.4981
2018	51.8464	5.5421	48.1536	46.6047	96.7836
2019	72.7869	20.9405	27.2131	26.3119	96.6884
2020	82.0967	9.3097	17.9033	17.3902	97.1337
2021	89.2630	7.1664	10.7370	10.4712	97.5250
2022	95.3692	6.1062	4.6308	4.4981	97.1342
2023	96.7995	1.4303	3.2005	3.1355	97.9710

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2024		1.4303	1.7702	1.7486	98.7822
2025 and later years		1.4303	0.3399	0.3369	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 98.8072 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary and Theft)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	55.6145	55.6145	44.3855	43.7162	98.4922
2015	89.3328	33.7182	10.6672	10.4801	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years	5.3336	5.3336	5.2865	99.1168	

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

Warranty

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	85.4101	85.4101	14.5899	14.4490	99.0347
2015	99.5388	14.1287	0.4612	0.4531	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

2016 and later years	0.2306	0.2306	0.2286	99.1168	

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2016 taxable year.

Workers' Compensation

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2014	21.8973	21.8973	78.1027	71.7286	91.8388
2015	43.4962	21.5989	56.5038	51.2212	90.6509
2016	56.0061	12.5099	43.9939	39.5167	89.8231
2017	63.5544	7.5482	36.4456	32.6085	89.4717
2018	68.9880	5.4337	31.0120	27.7101	89.3530
2019	73.9567	4.9687	26.0433	23.1932	89.0563
2020	76.0580	2.1013	23.9420	21.4883	89.7517
2021	77.6365	1.5785	22.3635	20.2804	90.6854
2022	80.1194	2.4828	19.8806	18.1385	91.2368
2023	81.3456	1.2262	18.6544	17.2260	92.3427

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses incurred in this line of business in the 2014 accident year and that are outstanding at the end of the tax year shown.

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors %)
2024		1.2262	17.4281	16.2971	93.5104
2025		1.2262	16.2019	15.3517	94.7524
2026		1.2262	14.9757	14.3893	96.0846
2027		1.2262	13.7494	13.4097	97.5293
2028 and later years		1.2262	12.5232	12.4126	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 94.5527 percent to discount unpaid losses incurred in this line of business in 2014 and prior years and that are outstanding at the end of the 2024 taxable year.

SECTION 4. DRAFTING INFORMATION

The principal author of this revenue procedure is David Remus of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Mr. Remus on (202) 317-6995 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters.
(Also: Part I, Section 832, 846; 1.832–4, 1.846–1.)

Rev. Proc. 2014–60

SECTION 1. PURPOSE

This revenue procedure prescribes the salvage discount factors for the 2014 accident year. These factors must be used to compute discounted estimated salvage recoverable under § 832 of the Internal Revenue Code.

SECTION 2. BACKGROUND

Section 832(b)(5)(A) requires that all estimated salvage recoverable (including that which cannot be treated as an asset for state accounting purposes) be taken into account in computing the deduction for losses incurred. Under § 832(b)(5)(A), paid losses are reduced by salvage and reinsurance recovered during the taxable year. This amount is adjusted to reflect changes in discounted unpaid losses on nonlife insurance contracts and in unpaid losses on life insurance contracts. An adjustment is then made to reflect any changes in discounted estimated salvage recoverable and in reinsurance recoverable.

Pursuant to § 832(b), the amount of estimated salvage is determined on a discounted basis in accordance with procedures established by the Secretary.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount estimated salvage recoverable under § 832.

SECTION 4. TABLES OF DISCOUNT FACTORS

.01 The following tables present separately for each line of business the discount factors under § 832 for the 2014 accident year. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2014, which is 1.79 percent, and by assuming all estimated salvage is recovered in the middle of the calendar year.

.02 These tables must be used by taxpayers irrespective of whether they elected to discount unpaid losses using their own experience under § 846(e).

.03 Section V of Notice 88–100, 1988–2 C.B. 439, provides a composite discount factor to be used in determining the discounted unpaid losses for accident years that are not separately reported on the annual statement approved by the National Association of Insurance Commissioners. The tables separately provide discount factors for taxpayers who elect to use the composite method. Rev. Proc. 2002–74, 2002–2 C.B. 980, clarifies that

for certain insurance companies subject to tax under § 831 the composite method for discounting unpaid losses set forth in Notice 88–100, section V, is permitted but not required. Rev. Proc. 2002–74 further provides alternative methods for computing discounted unpaid losses that are permitted for insurance companies not using the composite method, and sets forth a procedure for insurance companies to obtain automatic consent of the Commissioner to change to one of the methods described therein.

.04 Tables.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Taxpayers that do not use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable with respect to losses incurred in this line of business in the 2014 accident year as of the end of the 2014 and later taxable years.

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount all salvage recoverable in this line of business as of the end of the 2014 taxable year.

Auto Physical Damage

Tax Year	Discount Factors (%)
2014	98.7423
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Commercial Auto/Truck Liability/Medical

2014	96.7325
2015	96.3843
2016	96.6665
2017	96.2440
2018	96.5723
2019	96.3659
2020	93.6195
2021	92.4758
2022	94.2956
2023	95.1153

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	95.9425
2025	96.7754
2026	97.6093
2027	98.4282
2028 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 96.0678 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Composite

Tax Year	Discount Factors (%)
2014	96.5134
2015	96.3694
2016	96.5122
2017	95.5187
2018	95.8346
2019	95.5449
2020	95.4539
2021	95.8855
2022	95.9009
2023	96.7345

Composite

Tax Year	Discount Factors (%)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	97.5703
2025	98.3948
2026 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.8773 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Fidelity/Surety

Tax Year	Discount Factors (%)
2014	97.1917
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Financial Guaranty/Mortgage Guaranty

Tax Year	Discount Factors (%)
2014	96.8703
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

International (Composite)

2014	96.5134
2015	96.3694
2016	96.5122
2017	95.5187
2018	95.8346
2019	95.5449
2020	95.4539
2021	95.8855
2022	95.9009
2023	96.7345

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	97.5703
2025	98.3948
2026 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.8773 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Medical Professional Liability — Claims-Made

Tax Year	Discount Factors (%)
2014	96.0526
2015	96.6202
2016	95.0588
2017	96.8818
2018	97.0316
2019	97.3423
2020	97.9353
2021	98.3367
2022	98.3235
2023	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Medical Professional Liability — Occurrence

Tax Year	Discount Factors (%)
2014	96.4719
2015	97.8218
2016	97.4678
2017	98.2840
2018	97.6293
2019	98.5357
2020	98.1177
2021	98.1691
2022	96.9838
2023	97.8150

Medical Professional Liability — Occurrence

Tax Year	Discount Factors (%)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	98.6191
2025 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 98.6898 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Miscellaneous Casualty

Tax Year	Discount Factors (%)
2014	97.6023
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Multiple Peril Lines (Homeowners/Farmowners, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))

Tax Year	Discount Factors (%)
2014	96.9791
2015	96.9479
2016	97.2874
2017	96.0346
2018	97.0669
2019	97.3816
2020	97.4797
2021	97.4149
2022	97.1966
2023	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Other (Including Credit)

Tax Year	Discount Factors (%)
2014	98.0762
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Other (Including Credit)

Tax Year	Discount Factors (%)

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Other Liability — Claims-Made

Tax Year	Discount Factors (%)
2014	95.9092
2015	96.1565
2016	96.1868
2017	96.9451
2018	96.9744
2019	97.0833
2020	97.8158
2021	97.7968
2022	97.9792
2023	98.7913

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Other Liability – Occurrence

Tax Year	Discount Factors (%)
2014	93.8186
2015	94.5698

Other Liability – Occurrence

Tax Year	Discount Factors (%)
2016	*95.3574*
2017	95.7908
2018	96.3014
2019	97.0076
2020	97.1268
2021	97.0645
2022	98.2897
2023	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Private Passenger Auto Liability/ Medical

Tax Year	Discount Factors (%)
2014	97.5561
2015	97.4705
2016	97.4544
2017	97.0578
2018	97.0480
2019	97.1429
2020	96.9880
2021	97.1983
2022	98.0209
2023	98.8382

Private Passenger Auto Liability/ Medical

Tax Year	Discount Factors (%)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Products Liability — Claims-Made

Tax Year	Discount Factors (%)
2014	93.4898
2015	94.5254
2016	93.3374
2017	96.8473
2018	95.5103
2019	98.8605
2020	97.7007
2021	90.7891
2022	98.9061
2023	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Products Liability — Claims-Made

Tax Year	Discount Factors (%)

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Products Liability — Occurrence

Tax Year	Discount Factors (%)
2014	94.0709
2015	94.1348
2016	94.6993
2017	95.5583
2018	95.9410
2019	96.5187
2020	96.4711
2021	97.9185
2022	97.5355
2023	98.3655

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Reinsurance — Nonproportional Assumed Property

Tax Year	Discount Factors (%)
2014	95.4619

Reinsurance — Nonproportional Assumed Property

Tax Year	Discount Factors (%)
2015	*96.9712*
2016	95.5913
2017	94.7682
2018	96.2298
2019	95.5500
2020	98.0696
2021	93.7236
2022	97.4473
2023	98.2942

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.7839 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Reinsurance — Nonproportional Assumed Liability

Tax Year	Discount Factors (%)
2014	91.8961
2015	93.4287
2016	89.8887
2017	90.7734
2018	94.6399
2019	96.6265
2020	96.0780
2021	96.4434
2022	95.3130
2023	97.8830

Reinsurance — Nonproportional Assumed Liability

Tax Year	Discount Factors (%)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	98.6881
2025 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 98.7373 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Reinsurance — Nonproportional Assumed Financial Lines

Tax Year	Discount Factors (%)
2014	92.4687
2015	93.5870
2016	95.9473
2017	96.0353
2018	96.9299
2019	95.6978
2020	96.9455
2021	96.9062
2022	98.9756
2023	99.1168

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary and Theft)

Tax Year	Discount Factors (%)
2014	97.7085
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Warranty

Tax Year	Discount Factors (%)
2014	97.4036
2015	98.2453

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2016 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 99.1168 percent to discount salvage recoverable as of the end of the 2016 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

Workers' Compensation

Tax Year	Discount Factors (%)
2014	94.5251
2015	*95.5384*
2016	96.0785
2017	95.1114
2018	94.7198
2019	94.2792
2020	94.6788
2021	95.6107
2022	95.7908
2023	96.6277

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in the 2014 accident year.

2024	97.4704
2025	98.3125
2026 and later years	99.1168

Taxpayers that use the composite method of Notice 88–100 should use 97.8091 percent to discount salvage recoverable as of the end of the 2024 taxable year with respect to losses incurred in this line of business in 2014 and prior years.

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is David Remus of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Mr. Remus on (202) 317-6995 (not a toll free number).

26 CFR 601.602: Tax forms and instructions.
(Also Part I, §§ 1, 23, 24, 25A, 32, 36B, 42, 45R, 55, 59, 62, 63, 68, 125, 132(f),135, 137, 146, 147, 148, 151, 213, 220, 221, 512, 513, 877, 877A, 911, 2010, 2032A, 2503, 2523, 4161, 4261, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B; 1.148–5.)

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SECTION 1. PURPOSE

This revenue procedure sets forth inflation-adjusted items for 2015.

SECTION 2. CHANGES

Section 1401 of the Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111–148, 124 Stat. 119 (PPACA), added § 36B to the Internal Revenue Code. Section 36B creates a refundable tax credit ("the premium tax credit") for eligible individuals and families who purchase health insurance through a Health Insurance Marketplace. Taxpayers who meet certain criteria may have some or all of their estimated premium tax credit paid in advance directly to the insurance company to assist with the cost of monthly premiums. These amounts are called advance credit payments. The amount of a taxpayer's premium tax credit allowed for a taxable year is reduced by the amount of the advance credit payments made for the taxpayer during the year. If a taxpayer's advance credit payments for a taxable year exceed the premium tax credit allowed for the year, the taxpayer owes the excess as an additional tax, subject to a limitation in § 36B(f)(2)(B). The limitation amounts on the increase of tax for excess advance credit payments under § 36B(f)(2)(B) are adjusted for inflation for taxable years beginning after December 31, 2014. The U.S. Department of the Treasury and the IRS will issue future guidance as necessary to provide the applicable inflation adjusted items under section 36B(b)(3)(A)(ii) that are used to determine (1) a taxpayer's premium assistance amount under section 36B(b)(2), and (2) the required contribution percentage under section 36B(c)(2)(C)(i)(II) for determining the employer-sponsored minimum essential coverage.

SECTION 3. 2015 ADJUSTED ITEMS

.01 *Tax Rate Tables*. For taxable years beginning in 2015, the tax rate tables under § 1 are as follows:

TABLE 1 — Section 1(a) — Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income Is:	*The Tax Is:*
Not over $18,450	10% of the taxable income
Over $18,450 but not over $74,900	$1,845 plus 15% of the excess over $18,450
Over $74,900 but not over $151,200	$10,312.50 plus 25% of the excess over $74,900
Over $151,200 but not over $230,450	$29,387.50 plus 28% of the excess over $151,200
Over $230,450 but not over $411,500	$51,577.50 plus 33% of the excess over $230,450
Over $411,500 but not over $464,850	$111,324 plus 35% of the excess over $411,500
Over $464,850	$129,996.50 plus 39.6% of the excess over $464,850

TABLE 2 — Section 1(b) — Heads of Households

If Taxable Income Is:	*The Tax Is:*
Not over $13,150	10% of the taxable income
Over $13,150 but not over $50,200	$1,315 plus 15% of the excess over $13,150
Over $50,200 but not over $129,600	$6,872.50 plus 25% of the excess over $50,200
Over $129,600 but not over $209,850	$26,722.50 plus 28% of the excess over $129,600
Over $209,850 but not over $411,500	$49,192.50 plus 33% of the excess over $209,850
Over $411,500 not over $439,000	$115,737 plus 35% of the excess over $411,500
Over $439,000	$125,362 plus 39.6% of the excess over $439,000

TABLE 3 — Section 1(c) — Unmarried Individuals (other than Surviving Spouses and Heads of Households)

If Taxable Income Is:	*The Tax Is:*
Not over $9,225	10% of the taxable income
Over $9,225 but not over $37,450	$922.50 plus 15% of the excess over $9,225
Over $37,450 but not over $90,750	$5,156.25 plus 25% of the excess over $37,450
Over $90,750 but not over $189,300	$18,481.25 plus 28% of the excess over $90,750
Over $189,300 but not over $411,500	$46,075.25 plus 33% of the excess over $189,300
Over $411,500 not over $413,200	$119,401.25 plus 35% of the excess over $411,500
Over $413,200	$119,996.25 plus 39.6% of the excess over $413,200

TABLE 4 — Section 1(d) — Married Individuals Filing Separate Returns

If Taxable Income Is:	*The Tax Is:*
Not over $9,225	10% of the taxable income
Over $9,225 but not over $37,450	$922.50 plus 15% of the excess over $9,225
Over $37,450 but not over $75,600	$5,156.25 plus 25% of the excess over $37,450
Over $75,600 but not over $115,225	$14,693.75 plus 28% of the excess over $75,600
Over $115,225 but not over $205,750	$25,788.75 plus 33% of the excess over $115,225
Over $205,750 not over $232,425	$55,662 plus 35% of the excess over $205,750
Over $232,425	$64,998.25 plus 39.6% of the excess over $232,425

TABLE 5 — Section 1(e) — Estates and Trusts

If Taxable Income Is:	*The Tax Is:*
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For taxable years beginning in 2015, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $1,050. This $1,050 amount is the same as the amount provided in § 63(c)(5)(A), as adjusted for inflation. The same $1,050 amount is used for purposes of § 1(g)(7) (that is, to determine whether a parent may elect to include a child's gross income in the parent's gross income and to calculate the "kiddie tax"). For example, one of the requirements for the parental election is that a child's gross income is more than the amount referenced in § 1(g)(4)(A)(ii)(I) but less than 10 times that amount; thus, a child's gross income for 2015 must be more than $1,050 but less than $10,500.

.03 *Adoption Credit*. For taxable years beginning in 2015, under § 23(a)(3) the credit allowed for an adoption of a child with special needs is $13,400. For taxable years beginning in 2015, under § 23(b)(1) the maximum credit allowed for other adoptions is the amount of qualified adoption expenses up to $13,400. The available adoption credit begins to phase out under § 23(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $201,010 and is completely phased out for taxpayers with modified adjusted gross income of $241,010 or more. (See section 3.19 of this revenue procedure for the adjusted items relating to adoption assistance programs.)

.04 *Child Tax Credit*. For taxable years beginning in 2015, the value used in § 24(d)(1)(B)(i) to determine the amount of credit under § 24 that may be refundable is $3,000.

.05 *Hope Scholarship, American Opportunity, and Lifetime Learning Credits*.

(1) For taxable years beginning in 2015, the Hope Scholarship Credit under § 25A(b)(1), as increased under § 25A(i) (the American Opportunity Tax Credit), is an amount equal to 100 percent of qualified tuition and related expenses not in excess of $2,000 plus 25 percent of those expenses in excess of $2,000, but not in excess of $4,000. Accordingly, the maximum Hope Scholarship Credit allowable under § 25A(b)(1) for taxable years beginning in 2015 is $2,500.

(2) For taxable years beginning in 2015, a taxpayer's modified adjusted gross income in excess of $80,000 ($160,000 for a joint return) is used to determine the reduction under § 25A(d)(2) in the amount of the Hope Scholarship Credit otherwise allowable under § 25A(a)(1). For taxable years beginning in 2015, a taxpayer's modified adjusted gross income in excess of $55,000 ($110,000 for a joint return) is used to determine the reduction under § 25A(d)(2) in the amount of the Lifetime Learning Credit otherwise allowable under § 25A(a)(2).

.06 *Earned Income Credit*.

(1) *In general*. For taxable years beginning in 2015, the following amounts are used to determine the earned income credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income credit is allowed. The "threshold phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) at or above which no credit is allowed. The threshold phaseout amounts and the completed phaseout amounts shown in the table below for married taxpayers filing a joint return include the increase provided in § 32(b)(3)(B)(i), as adjusted for inflation for taxable years beginning in 2015.

	Number of Qualifying Children			
Item	One	Two	Three or More	None
Earned Income Amount	$9,880	$13,870	$13,870	$6,580
Maximum Amount of Credit	$3,359	$5,548	$6,242	$503
Threshold Phaseout Amount (Single, Surviving Spouse, or Head of Household)	$18,110	$18,110	$18,110	$8,240
Completed Phaseout Amount (Single, Surviving Spouse, or Head of Household)	$39,131	$44,454	$47,747	$14,820
Threshold Phaseout Amount (Married Filing Jointly)	$23,630	$23,630	$23,630	$13,750
Completed Phaseout Amount (Married Filing Jointly)	$44,651	$49,974	$53,267	$20,330

The instructions for the Form 1040 series provide tables showing the amount of the earned income credit for each type of taxpayer.

(2) *Excessive Investment Income*. For taxable years beginning in 2015, the earned income tax credit is not allowed under § 32(i) if the aggregate amount of certain investment income exceeds $3,400.

.07 *Refundable Credit for Coverage Under a Qualified Health Plan*. For taxable years beginning in 2015, the limitation on tax imposed under § 36B(f)(2)(B) for excess advance credit payments is determined using the following table:

If the household income (expressed as a percent of poverty line) is:	The limitation amount for unmarried individuals (other than surviving spouses and heads of household) is:	The limitation amount for all other taxpayers is:
Less than 200%	$300	$600
At least 200% but less than 300%	$750	$1,500
At least 300% but less than 400%	$1,250	$2,500

.08 *Rehabilitation Expenditures Treated as Separate New Building*. For calendar year 2015, the per low-income unit qualified basis amount under § 42(e)(3)(A)(ii)(II) is $6,600.

.09 *Low-Income Housing Credit*. For calendar year 2015, the amount used under § 42(h)(3)(C)(ii) to calculate the State housing credit ceiling for the low-income housing credit is the greater of (1) $2.30 multiplied by the State population, or (2) $2,680,000.

.10 *Employee Health Insurance Expense of Small Employers*. For taxable years beginning in 2015, the dollar amount in effect under § 45R(d)(3)(B) is $25,800. This amount is used under § 45R(c) for limiting the small employer health insurance credit and under § 45R(d)(1)(B) for determining who is an eligible small employer for purposes of the credit.

.11 *Exemption Amounts for Alternative Minimum Tax*. For taxable years beginning in 2015, the exemption amounts under § 55(d)(1) are:

Joint Returns or Surviving Spouses	$83,400
Unmarried Individuals (other than Surviving Spouses)	$53,600
Married Individuals Filing Separate Returns	$41,700
Estates and Trusts	$23,800

For taxable years beginning in 2015, under § 55(b)(1), the excess taxable income above which the 28 percent tax rate applies is:

Married Individuals Filing Separate Returns	$92,700
Joint Returns, Unmarried Individuals (other than surviving spouses), and Estates and Trusts	$185,400

For taxable years beginning in 2015, the amounts used under § 55(d)(3) to determine the phaseout of the exemption amounts are:

Joint Returns or Surviving Spouses	$158,900
Unmarried Individuals (other than Surviving Spouses)	$119,200
Married Individuals Filing Separate Returns and Estates and Trusts	$79,450

.12 *Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax."* For taxable years beginning in 2015, for a child to whom the § 1(g) "kiddie tax" applies, the exemption amount under §§ 55 and 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (1) the child's earned income for the taxable year, plus (2) $7,400.

.13 *Transportation Mainline Pipeline Construction Industry Optional Expense Substantiation Rules for Payments to Employees under Accountable Plans*. For calendar year 2015, an eligible employer may pay certain welders and heavy equipment mechanics an amount of up to $17 per hour for rig-related expenses that are deemed substantiated under an accountable plan if paid in accordance with Rev. Proc. 2002–41, 2002–1 C.B. 1098. If the employer provides fuel or otherwise reimburses fuel expenses, up to $11 per hour is deemed substantiated if paid under Rev. Proc. 2002–41.

.14 *Standard Deduction*.
(1) *In general*. For taxable years beginning in 2015, the standard deduction amounts under § 63(c)(2) are as follows:

Filing Status	*Standard Deduction*
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$12,600
Heads of Households (§ 1(b))	$9,250
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$6,300
Married Individuals Filing Separate Returns (§ 1(d))	$6,300

(2) *Dependent*. For taxable years beginning in 2015, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer cannot exceed the greater of (1) $1,050, or (2) the sum of $350 and the individual's earned income.

(3) *Aged or blind*. For taxable years beginning in 2015, the additional standard deduction amount under § 63(f) for the aged or the blind is $1,250. The additional standard deduction amount is increased to $1,550 if the individual is also unmarried and not a surviving spouse.

.15 *Overall Limitation on Itemized Deductions*. For taxable years beginning in 2015, the applicable amounts under § 68(b) are $309,900 in the case of a joint return or a surviving spouse, $284,050 in the case of a head of household, $258,250 in the case of an individual who is not married and who is not a surviving spouse or head of household, $154,950 in the case of a married individual filing a separate return.

.16 *Cafeteria Plans*. For the taxable years beginning in 2015, the dollar limitation under § 125(i) on voluntary employee salary reductions for contributions to health flexible spending arrangements is $2,550.

.17 *Qualified Transportation Fringe Benefit*. For taxable years beginning in 2015, the monthly limitation under § 132(f)(2)(A) regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $130. The monthly limitation under § 132(f)(2)(B) regarding the fringe benefit exclusion amount for qualified parking is $250.

.18 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses*. For taxable years beginning in 2015, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $115,750 for joint returns and $77,200 for all other returns. The exclusion is completely phased out for modified adjusted gross income of $145,750 or more for joint returns and $92,200 or more for all other returns.

.19 *Adoption Assistance Programs*. For taxable years beginning in 2015, under § 137(a)(2), the amount that can be excluded from an employee's gross income for the adoption of a child with special needs is $13,400. For taxable years beginning in 2015, under § 137(b)(1) the maximum amount that can be excluded from an employee's gross income for the amounts paid or expenses incurred by an employer for qualified adoption expenses furnished pursuant to an adoption assistance program for other adoptions by the employee is $13,400. The amount excludable from an employee's gross income begins to phase out under § 137(b)(2)(A) for taxpayers with modified adjusted gross income in excess of $201,010 and is completely phased out for taxpayers with modified adjusted gross income of $241,010 or more. (See section 3.03 of this revenue procedure for the adjusted items relating to the adoption credit.)

.20 *Private Activity Bonds Volume Cap*. For calendar year 2015, the amounts used under § 146(d)(1) to calculate the State ceiling for the volume cap for private activity bonds is the greater of (1) $100 multiplied by the State population, or (2) $301,515,000.

.21 *Loan Limits on Agricultural Bonds*. For calendar year 2015, the loan limit amount on agricultural bonds under § 147(c)(2)(A) for first-time farmers is $517,700.

.22 *General Arbitrage Rebate Rules*. For bond years ending in 2015, the amount of the computation credit determined under the permission to rely on § 1.148–3(d)(4) of the proposed Income Tax Regulations is $1,650.

.23 *Safe Harbor Rules for Broker Commissions on Guaranteed Investment Contracts or Investments Purchased for a Yield Restricted Defeasance Escrow*. For calendar year 2015, under § 1.148–5(e)(2)(iii)(B)(1), a broker's commission or similar fee for the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable if (1) the amount of the fee that the issuer treats as a qualified administrative cost does not exceed the lesser of (A) $39,000, and (B) 0.2 percent of the computational base (as defined in § 1.148–5(e)(2)(iii)(B)(*2*)) or, if more, $4,000; and (2) the issuer does not treat more than $110,000 in brokers' commissions or similar fees as qualified administrative costs for all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

.24 *Personal Exemption*.

(1) For taxable years beginning in 2015, the personal exemption amount under § 151(d) is $4,000.

(2) *Phaseout*. For taxable years beginning in 2015, the personal exemption phases out for taxpayers with the following adjusted gross income amounts:

Filing Status	*AGI – Beginning of Phaseout*	*AGI – Completed Phaseout*
Married Individuals Filing Joint Returns and Surviving Spouses (§ 1(a))	$309,900	$432,400
Heads of Households (§ 1(b))	$284,050	$406,550
Unmarried Individuals (other than Surviving Spouses and Heads of Households) (§ 1(c))	$258,250	$380,750
Married Individuals Filing Separate Returns (§ 1(d))	$154,950	$216,200

.25 *Eligible Long-Term Care Premiums*. For taxable years beginning in 2015, the limitations under § 213(d)(10), regarding eligible long-term care premiums includible in the term "medical care," are as follows:

Attained Age Before the Close of the Taxable Year	*Limitation on Premiums*
40 or less	$380
More than 40 but not more than 50	$710
More than 50 but not more than 60	$1,430
More than 60 but not more than 70	$3,800
More than 70	$4,750

.26 *Medical Savings Accounts*.

(1) *Self-only coverage*. For taxable years beginning in 2015, the term "high deductible health plan" as defined in § 220(c)(2)(A) means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,200 and not more than $3,300, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $4,450.

(2) *Family coverage*. For taxable years beginning in 2015, the term "high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $4,450 and not more than $6,650, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $8,150.

.27 *Interest on Education Loans*. For taxable years beginning in 2015, the $2,500 maximum deduction for interest paid on qualified education loans under § 221 begins to phase out under § 221(b)(2)(B) for taxpayers with modified adjusted gross income in excess of $65,000 ($130,000 for joint returns), and is completely phased out for taxpayers with modified adjusted gross income of $80,000 or more ($160,000 or more for joint returns).

.28 *Treatment of Dues Paid to Agricultural or Horticultural Organizations*. For taxable years beginning in 2015, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $160.

.29 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns*.

(1) *Low cost article*. For taxable years beginning in 2015, for purposes of defining the term "unrelated trade or business" for certain exempt organizations under § 513(h)(2), "low cost articles" are articles costing $10.50 or less.

(2) *Other insubstantial benefits*. For taxable years beginning in 2015, under § 170, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90–12, 1990–1 C.B. 471 (as amplified by Rev. Proc. 92–49, 1992–1 C.B. 987, and modified by Rev. Proc. 92–102, 1992–2 C.B. 579), for the value of insubstantial benefits that may be received by a donor in return for a contribution, without causing the contribution to fail to be fully deductible, are $10.50, $52.50, and $105, respectively.

.30 *Expatriation to Avoid Tax*. For calendar year 2015, under § 877A(g)(1)(A), unless an exception under § 877A(g)(1)(B) applies, an individual is a covered expatriate if the individual's "average annual net income tax" under § 877(a)(2)(A) for the five taxable years ending before the expatriation date is more than $160,000.

.31 *Tax Responsibilities of Expatriation*. For taxable years beginning in 2015, the amount that would be includible in the gross income of a covered expatriate by reason of § 877A(a)(1) is reduced (but not below zero) by $690,000.

.32 *Foreign Earned Income Exclusion*. For taxable years beginning in 2015, the foreign earned income exclusion amount under § 911(b)(2)(D)(i) is $100,800.

.33 *Unified Credit Against Estate Tax*. For an estate of any decedent dying during calendar year 2015, the basic exclusion amount is $5,430,000 for determining the amount of the unified credit against estate tax under § 2010.

.34 *Valuation of Qualified Real Property in Decedent's Gross Estate*. For an estate of a decedent dying in calendar year 2015, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A for purposes of the estate tax cannot exceed $1,100,000.

.35 *Annual Exclusion for Gifts*.

(1) For calendar year 2015, the first $14,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2015, the first $147,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.36 *Tax on Arrow Shafts*. For calendar year 2015, the tax imposed under § 4161(b)(2)(A) on the first sale by the manufacturer, producer, or importer of any shaft of a type used in the manufacture of certain arrows is $0.49 per shaft.

.37 *Passenger Air Transportation Excise Tax*. For calendar year 2015, the tax under § 4261(b)(1) on the amount paid for each domestic segment of taxable air transportation is $4. For calendar year 2015, the tax under § 4261(c)(1) on any amount paid (whether within or without the United States) for any international air transportation, if the transportation begins or ends in the United States, generally is $17.70. Under § 4261(c)(3), however, a lower amount applies under § 4261(c)(1) to a domestic segment beginning or ending in Alaska or Hawaii, and the tax applies only to departures. For calendar year 2015, the rate is $8.90.

.38 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures*. For taxable years beginning in 2015, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98–19, 1998–1 C.B. 547), regarding certain exempt organizations with nondeductible lobbying expenditures, is $111 or less.

.39 *Notice of Large Gifts Received from Foreign Persons*. For taxable years beginning in 2015, § 6039F authorizes the Treasury Department and the Internal Revenue Service to require recipients of gifts from certain foreign persons to report these gifts if the aggregate value of gifts received in the taxable year exceeds $15,601.

.40 *Persons Against Whom a Federal Tax Lien Is Not Valid*. For calendar year 2015, a federal tax lien is not valid against (1) certain purchasers under § 6323(b)(4) who purchased personal property in a casual sale for less than $1,520, or (2) a mechanic's lienor under § 6323(b)(7) who repaired or improved certain residential property if the contract price with the owner is not more than $7,590.

.41 *Property Exempt from Levy*. For calendar year 2015, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) cannot exceed $9,080. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) cannot exceed $4,540.

.42 *Interest on a Certain Portion of the Estate Tax Payable in Installments*. For an estate of a decedent dying in calendar year 2015, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is $1,470,000.

.43 *Attorney Fee Awards*. For fees incurred in calendar year 2015, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is $200 per hour.

.44 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts*. For calendar year 2015, the stated dollar amount of the per diem limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $330.

SECTION 4. EFFECTIVE DATE

.01 *General Rule*. Except as provided in section 4.02, this revenue procedure applies to taxable years beginning in 2015.

.02 *Calendar Year Rule*. This revenue procedure applies to transactions or events occurring in calendar year 2015 for purposes of sections 3.08 (rehabilitation expenditures treated as separate new building), 3.09 (low-income housing credit), 3.13 (transportation mainline pipeline construction industry optional expense substantiation rules for payments to employees under accountable plans), 3.20 (private activity bonds volume cap), 3.21 (loan limits on agricultural bonds), 3.22 (general arbitrage rebate rules), 3.23 (safe harbor rules for broker commissions on guaranteed investment contracts or investments purchased for a yield restricted defeasance escrow), 3.30 (expatriation to avoid tax), 3.34 (valuation of qualified real property in decedent's gross estate), 3.35 (annual exclusion for gifts), 3.36 (tax on arrow shafts), 3.37 (passenger air transportation excise tax), 3.40 (persons against whom a federal tax lien is not valid), 3.41 (property exempt from levy), 3.42 (interest on a certain portion of the estate tax payable in installments), 3.43 (attorney fee awards), and 3.44 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is William Ruane of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Ruane at (202) 317-4718 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking Certain Distributions Treated as Sales or Exchanges

REG–151416–06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that prescribe how a partner should measure its interest in a partnership's unrealized receivables and inventory items, and that provide guidance regarding the tax consequences of a distribution that causes a reduction in that interest. The proposed regulations take into account statutory changes that have occurred subsequent to the issuance of the existing regulations. The proposed regulations affect partners in partnerships that own unrealized receivables and inventory items and that make a distribution to one or more partners.

DATES: Comments and requests for a public hearing must be received by February 2, 2015.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–151416–06), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–151416–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., 20224, or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–151416–06).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Allison R. Carmody at (202) 317-5279 or Frank J. Fisher at (202) 317-6850; concerning submissions of comments and requests for hearing, Oluwafunmilayo Taylor at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE-:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 2, 2015.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information required by this proposed regulation is in § 1.751–1(b)(3) and (b)(6), and in § 1.755–1(c)(2)(vi). This information is required for a partnership and certain partners to report the information to the IRS necessary to ensure that the partners of the partnership properly report in accordance with the rules of the proposed regulations the correct amount of ordinary income and/or capital gain upon a distribution of property from the partnership to its partners. The collection of information is necessary to ensure tax compliance.

The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 22,500 hours.

Estimated average annual burden hours per respondent vary from 30 minutes to 2 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 22,500.

Estimated annual frequency of responses: annually.

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 tax return information are confidential, as required by section 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 751(b) of the Internal Revenue Code (the Code). In 1954, Congress enacted section 751 to prevent the use of a partnership to convert potential ordinary income into capital gain. *See* H.R. Rep. No. 1337 at 70 (1954), reprinted in 1954 U.S.C.C.A.N. 4017, 4097. To that end, section 751(a) provides that the amount of any money, or the fair market value of any property, received by a transferor partner in exchange for all or part of that partner's interest in the partnership's unrealized receivables and inventory items is considered as an amount realized from the sale or exchange of property other than a capital asset. Further, section 751(b) overrides the nonrecognition provisions of section 731 to the extent a partner receives a distribution from the partnership that causes a shift between the partner's interest in the part-

nership's unrealized receivables or substantially appreciated inventory items (collectively, the partnership's "section 751 property") and the partner's interest in the partnership's other property.

Whether section 751(b) applies depends on the partner's interest in the partnership's section 751 property before and after a distribution. The statute does not define a partner's interest in a partnership's section 751 property, but the legislative history indicates that Congress believed a partner's interest in a partnership's section 751 property equals the partner's rights to income from the partnership's section 751 property:

> The provisions relating to unrealized receivables and appreciated inventory items are necessary to prevent the use of the partnership as a device for obtaining capital-gain treatment on fees or other rights to income and on appreciated inventory. Amounts attributable to such rights would be treated as ordinary income if realized in normal course by the partnership. The sale of a partnership interest or distributions to partners should not be permitted to change the character of this income. *The statutory treatment proposed, in general, regards the income rights as severable from the partnership interest and as subject to the same tax consequences which would be accorded an individual entrepreneur.*

S. Rep. No. 1622 at 99 (1954), reprinted in 1954 U.S.C.C.A.N. 4621, 4732. (Emphasis added.)

In 1984, Congress amended section 704(c), making mandatory its application to property contributed to a partnership. While Congress did not specifically address the overlap of section 704(c) and section 751, the Conference Report indicates that the 1984 Congress understood that the section 704(c) amendment would impact other provisions in subchapter K and provides regulatory authority to the Secretary of the Treasury to address those repercussions. *See* H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess., June 23, 1984, reprinted in 1984 U.S.C.C.A.N. 1445, 1545.

The IRS and the Treasury Department first issued regulations implementing section 751 in 1956. Following the changes to section 704(c) making its application mandatory, the IRS and the Treasury Department amended the regulations under section 751(a) to provide generally that a partner's interest in section 751 property is the amount of income or loss from section 751 property that would be allocated to the partner if the partnership had sold all of its property in a fully taxable transaction for cash in an amount equal to the fair market value of such property. (*See* TD 8847, 64 FR 69903, Dec. 15, 1999.) However, the 1956 regulations with respect to section 751(b) remained unchanged.

The examples in the current regulations under section 751(b) determine a partner's interest in section 751 property by reference to the partner's share of the gross value of the partnership's assets (the "gross value" approach), not by reference to the partner's share of the unrealized gain or loss in the property. *See*, for example, § 1.751–1(g), *Example 2*. Because the gross value approach focuses on a partner's share of the asset's value rather than the partner's share of the unrealized gain, the examples in the current regulations may be too narrow in some respects, and too broad in others, to carry out the intended purpose of section 751(b). That is, the gross value approach may allow a distribution that reduces a partner's share of the unrealized gain in the partnership's section 751 property without triggering section 751(b), and, conversely, may trigger section 751(b) even if the partner's share of the unrealized gain in the partnership's section 751 property is not reduced. For example, Rev. Rul. 84–102 (84–102 CB 119) provides that deemed distributions under section 752 resulting from shifting allocations of indebtedness may result in the partners' shares of asset gross value changing, even though the partners' shares of unrealized gain associated with section 751 property would not necessarily have changed.

If the distribution results in a shift between the partner's interest in the partnership's section 751 property and the partnership's other property, the current regulations require a deemed asset exchange of both section 751 property and other property between the partner and the partnership to determine the tax consequences of the distribution (the "asset exchange" approach). *See*, for example, § 1.751–1(g), *Example 6*, of the current regulations. The asset exchange approach is complex, requiring the partnership and partner to determine the tax consequences of both a deemed distribution of relinquished property and a deemed taxable exchange of that property back to the partnership. The asset exchange approach also often accelerates capital gain unnecessarily by requiring certain partners to recognize capital gain even when their shares of partnership capital gain have not been reduced.

In 2006, the IRS and the Treasury Department published Notice 2006–14 (2006–1 CB 498), which suggested, and requested comments on, alternative approaches to section 751(b) that were intended to better achieve the purpose of the statute while providing greater simplicity. *See* § 601.601(d)(2)(ii)(*b*). Specifically, Notice 2006–14 asked for comments on: (1) replacing the gross value approach with a "hypothetical sale" approach for purposes of determining a partner's interest in the partnership's section 751 property, and (2) replacing the asset exchange approach with a "hot asset sale" approach to determine the tax consequences when section 751(b) applies. The hypothetical sale approach and the hot asset sale approach are described in Parts 1.A and 3, respectively, of the Summary of Comments and Explanation of Provisions section of this preamble. Notice 2006–14 also requested comments on other possible approaches to simplifying compliance with section 751(b).

As described in Notice 2006–14, the hypothetical sale approach for section 751(b) is similar to the approach taken in the 1999 regulations issued under section 751(a), shifting the focus to tax gain and away from gross value. Under the hypothetical sale approach, a partner's interest in section 751 property is determined by reference to the amount of ordinary income that would be allocated to the partner if the partnership disposed of all of its property for fair market value immediately before the distribution. More specifically, the hypothetical sale approach applies section 704(c) principles in comparing: (1) the amount of ordinary income that each partner would recognize if the partnership sold all of its property

for fair market value immediately before the distribution, with (2) the amount of ordinary income each partner would recognize if the partnership sold all of its property (and the distributee partners sold the distributed assets) for fair market value immediately after the distribution. If the distribution reduces the amount of ordinary income (or increases the amount of ordinary loss) from section 751 property that would be allocated to, or recognized by, a partner (thus reducing that partner's interest in the partnership's section 751 property), the distribution triggers section 751(b).

Notice 2006–14 indicated that changes to the framework of subchapter K since the promulgation of the existing regulations would work in tandem with the hypothetical sale approach to achieve the statute's objective of ensuring that a partner recognizes its proper share of the partnership's income from section 751 property without unnecessarily accelerating the recognition of that income. For example, regulations under section 704(b) allow a partnership to revalue its assets upon a distribution in consideration of a partnership interest. Any revaluation gain or loss is subject to the rules of section 704(c), which generally preserve each partner's share of the unrealized gain and loss in the partnership's assets.

Notice 2006–14 also requested comments on using the hot asset sale approach, rather than the asset exchange approach, to determine the tax consequences of the distribution that is subject to section 751(b). The hot asset sale approach deems the partnership to distribute the relinquished section 751 property to the partner whose interest in the partnership's section 751 property is reduced, and then deems the partner to sell the relinquished section 751 property back to the partnership immediately before the actual distribution.

Summary of Comments and Explanation of Provisions

The IRS and the Treasury Department received both formal and informal responses to Notice 2006–14. In addition, a number of commentators published articles analyzing the proposals outlined in Notice 2006–14. Commentators' responses to Notice 2006–14 were predominantly favorable.

These proposed regulations adopt many of the principles described in Notice 2006–14. Part 1 of this section describes the rules included in the proposed regulations for determining partners' interests in section 751 property. Part 2 of this section sets forth the proposed regulations' test to determine whether section 751(b) applies to a partnership distribution, including anti-abuse principles that may apply in certain situations in which the test would not otherwise be satisfied. Part 3 of this section explains the tax consequences of a section 751(b) distribution under the proposed regulations. Finally, Part 4 of this section describes certain ancillary issues relating to the proposed regulations, including a clarification to the scope of § 1.751–1(a).

1. *Determination of a Partner's Interest in Section 751 Property*

Section 751(b) applies to a partnership distribution to the extent the distribution reduces a partner's interest in section 751 property. As discussed further in this Part 1, the proposed regulations establish an approach for measuring partners' interests in section 751 property, provide new rules under section 704(c) to help partnerships compute partner gain in section 751 property more precisely, and describe how basis adjustments under sections 734(b) and 743(b) affect the computation of partners' interests in section 751 property.

A. *Adoption of Hypothetical Sale Approach*

The first step in computing the effect of section 751(b) is to measure the partners' interests in section 751 property. Commentators generally agreed that the hypothetical sale approach is a substantial improvement over the gross value approach in the existing regulations. As described in this preamble, the hypothetical sale approach requires a partnership to compare: (1) the amount of ordinary income (or ordinary loss) that each partner would recognize if the partnership sold its property for fair market value immediately before the distribution with (2) the amount of ordinary income (or ordinary loss) each partner would recognize if the partnership sold its property, and the distributee partner sold the distributed assets, for fair market value immediately after the distribution. The commentators agreed that, when compared against the gross value approach, the hypothetical sale approach is more consistent with Congress's intent in enacting section 751(b), is easier to apply, and reduces the likelihood that section 751(b) would unnecessarily accelerate ordinary income. Accordingly, these proposed regulations adopt the hypothetical sale approach as the method by which the partners must measure their respective interests in section 751 property for the purpose of determining whether a distribution reduces a partner's interest in the partnership's section 751 property. (A distribution that reduces a partner's interest in the partnership's section 751 property is referred to as a "section 751(b) distribution.")

B. *Revaluations*

Because the hypothetical sale approach relies on the principles of section 704(c) to preserve a partner's share of the unrealized gain and loss in the partnership's section 751 property, these proposed regulations make several changes to the regulations relating to section 704(c). Specifically, the proposed regulations revise § 1.704–1(b)(2)(iv)(*f*), regarding revaluations of partnership property, to make its provisions mandatory if a partnership distributes money or other property to a partner as consideration for an interest in the partnership, and the partnership owns section 751 property immediately after the distribution. (A partnership that does not own section 751 property immediately after the distribution may still revalue its property under the existing regulation, but is not required to do so under these proposed regulations.) If a partnership does not maintain capital accounts in accordance with § 1.704–1(b)(2)(iv), the partnership must comply with this requirement by computing each partner's share of gain or loss in each partnership asset prior to a distribution, and making future allocations of partnership items in a manner that takes these amounts into account (making subsequent adjustments for cost recovery and other events that affect the property basis of each such asset).

In addition, the proposed regulations contain a special revaluation rule for distributing partnerships that own an interest in a lower-tier partnership. Because a partnership's section 751 property includes, under section 751(f), the partnership's proportionate share of section 751 property owned by any other partnership in which the distributing partnership is a partner, these proposed regulations also require a partnership in which the distributing partnership owns a controlling interest (which is defined as a greater than 50 percent interest) to revalue its property if the lower-tier partnership owns section 751 property immediately after the distribution. If the distributing partnership owns a non-controlling (that is, less than or equal to 50 percent) interest in a lower-tier partnership, these proposed regulations require the distributing partnership to allocate its distributive share of the lower-tier partnership's items among its partners in a manner that reflects the allocations that would have been made had the lower-tier partnership revalued its partnership property. The IRS and the Treasury Department are aware that in some instances a distributing partnership may be unable to obtain sufficient information to comply with this requirement from a lower-tier partnership in which the distributing partnership holds a non-controlling interest. We request comments on reasonable approaches to address this issue.

Upon the revaluation of partnership property in connection with a partnership distribution, the regulations under section 704(c) permit a partnership to choose any reasonable method to account for the built-in gain or built-in loss that is consistent with the purpose of section 704(c). If property with built-in gain decreases in value (or property with built-in loss increases in value), then the partnership may be unable to allocate tax losses (or gains) to a non-contributing partner in an amount equal to the partner's economic loss (or gain). If the property with built-in gain (or loss) is section 751 property, then the inability to allocate those tax losses (or gains) may cause ordinary income to shift among the partners. The regulations under section 704(c) provide two reasonable methods for a partnership to allocate items to cure or remediate that shift. However, the regulations under section 704(c) also provide a third reasonable method, the traditional method, under which the shift of ordinary income is not cured. The IRS and the Treasury Department are aware that distortions created under the section 704(c) traditional method may cause ordinary income to shift among partners. However, the regulations under section 704(c) contain an anti-abuse rule that provides that a method is not reasonable if, for example, the event that results in a reverse section 704(c) allocation and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or built-in loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. The IRS and the Treasury Department believe that this anti-abuse provision under section 704(c) properly addresses the possibility that taxpayers would use the traditional method to shift ordinary income.

Some commentators suggested changing the regulations under section 704(c) to minimize the situations in which section 751(b) applies. Generally, when a partnership revalues its assets, the partnership allocates a reverse section 704(c) amount with respect to each partnership asset, as opposed to an aggregate section 704(c) amount with respect to all assets (subject to certain exceptions). As a result, any distribution of appreciated section 751 property in which another partner has a share of income would trigger section 751(b) under the hypothetical sale approach. The commentators recommended that the IRS and the Treasury Department narrow the application of section 751(b) by allowing partners (subject to the substantiality requirements of § 1.704–1(b)(2)(iii)) to "exchange" reverse section 704(c) amounts resulting from a section 751 distribution. These proposed regulations do not adopt this comment because it is beyond the scope of these regulations and would impact other provisions of subchapter K. However, the IRS and the Treasury Department believe that the issue merits further study and request comments on how such permissible exchanges of reverse section 704(c) amounts might be addressed in future regulations.

C. *Effect of Basis Adjustments on Section 751(b) Computations*

While section 704(c) revaluations generally preserve partners' interests in section 751 property upon a partnership distribution, certain basis adjustments under sections 732(c) or 734(b) may alter partners' interests in section 751 property following the distribution. Accordingly, these proposed regulations provide rules on the effect of these basis adjustments on the computation of partners' interests in section 751 property.

If a distribution of capital gain property results in a basis adjustment under section 734(b), that basis adjustment is allocated to capital gain property of the partnership under § 1.755–1(c)(1). However, some property that is characterized as capital gain property for purposes of section 755 can also result in ordinary income when sold. For example, section 1231 property is characterized as a capital asset for purposes of section 755, but selling the property can also result in ordinary income from recapture under section 1245(a)(1). The regulations under section 755 do not differentiate between the capital gain aspect of the property and the ordinary income aspect of the property for this purpose. Accordingly, allocating a section 734(b) positive basis adjustment to such property as capital gain property may reduce the amount of ordinary income that would result on a sale of the property. Under these proposed regulations, that reduction in ordinary income would constitute a reduction in the partners' shares of unrealized gain in the partnership's section 751 property, which could trigger section 751(b) in situations in which 751(b) would not have otherwise applied. A similar reduction in section 751 property could occur if the basis of the distributed property increases under section 732.

One commentator recommended allowing partnerships to avoid this result by eliminating a positive section 734(b) adjustment to the extent the section 734(b) adjustment would reduce the partnership's ordinary income. Another commentator recommended allocating the section 734(b) adjustment to other partnership capital gain property. The same commentator alternatively recommended treating a positive section 734(b) adjustment that re-

duced the partnership's ordinary income as a separate asset.

Although these proposed regulations do not treat the section 734(b) adjustment as a separate asset, the proposed regulations reach a similar result to this last recommendation. They provide that a basis adjustment under section 732(c) or section 734(b) (as adjusted for recovery of the basis adjustment) that is allocated to capital gain property and that reduces the ordinary income (attributable, for example, to recapture under section 1245(a)(1)) that the partner or partnership would recognize on a taxable disposition of the property is not taken into account in determining (1) the partnership's basis for purposes of sections 617(d)(1), 1245(a)(1), 1250(a)(1), 1252(a)(1), and 1254(a)(1), and (2) the partner or partnership's respective gain or loss for purposes of sections 995(c), 1231(a), and 1248(a). The IRS and the Treasury Department intend for these amendments to apply for purposes of other provisions that cross-reference those sections (for example, the reference in § 1.367(b)–2(c) to section 1248). The IRS and the Treasury Department are aware that these rules may result in additional administrative burden and, therefore, permit a partnership and its partners to elect to recognize ordinary income currently under section 751(b) in lieu of applying these rules.

In addition, one commentator raised questions about the application of section 751(b) upon the distribution to a partner of section 751 property for which another partner has a basis adjustment under section 743(b) (the transferee partner). The commentator questioned whether the distributee partner's share of section 751 property could be increased inappropriately if the special basis adjustment is not taken into account in determining the distributee's basis in the section 751 property under section 732. The IRS and the Treasury Department believe that although the distributee partner does not take the section 743(b) basis adjustment into account in determining its basis in the distributed property, the reallocation of the section 743(b) basis adjustment pursuant to § 1.743–1(g)(2)(ii) should generally reduce the transferee partner's share of section 751 property, triggering an income inclusion to that partner under section 751(b) which is offset by the basis adjustment. The IRS and the Treasury Department acknowledge that, in situations in which the partnership holds no other section 751 property (and the section 743(b) basis adjustment is temporarily suspended under §§ 1.743–1(g)(2)(ii) and 1.755–1(c)(4) until the partnership acquires additional ordinary income property), the application of section 751(b) may be unclear. Accordingly, the proposed regulations require that partners include the effect of carryover basis adjustments when determining their shares of section 751 property, as though those basis adjustments were immediately allocable to ordinary income property. *See Example 4* in § 1.751–1(g) of the proposed regulations.

2. *Distributions to which Section 751(b) Applies*

A. *General Principle*

The purpose of section 751 is to prevent a partner from converting its share of potential ordinary income into capital gain. A distribution of partnership property (including money) is a section 751(b) distribution if the distribution reduces any partner's share of net section 751 unrealized gain or increases any partner's share of net section 751 unrealized loss (as determined under the hypothetical sale approach described in Part 1.A of the Summary of Comments and Explanation of Provisions section of this preamble). For this purpose, a partner's net section 751 unrealized gain or loss immediately before a distribution equals the amount of net gain or loss, as the case may be, from section 751 property that would be allocated to the partner if the partnership disposed of all of the partnership's assets for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)). A partner's net section 751 unrealized gain or loss includes any remedial allocations under § 1.704–3(d).

A partner's net section 751 unrealized gain or loss also takes into account any section 743 basis adjustment pursuant to § 1.743–1(j)(3), including any carryover basis adjustment that results under any of § 1.743–1(g)(2)(ii), § 1.755–1(b)(5)(iii)(D), or § 1.755–1(c)(4) when the partnership must adjust the basis of a specific class of assets, but that adjustment is suspended because the partnership does not own assets in that class. The regulations take such suspended basis adjustments into account as though the basis adjustment is applied to the basis of notional partnership section 751 property with a fair market value of zero. For example, if A and B are partners in the AB partnership, which owns capital assets and a single ordinary income asset that is the subject of a section 743(b) adjustment with respect to B, and that asset is distributed to partner A, B's basis adjustment is suspended because the partnership lacks other ordinary income property. However, the basis adjustment will eventually benefit B when the partnership acquires new ordinary income property. For this reason, the proposed regulations require B to take the suspended adjustment into account when determining whether section 751(b) applies to B with respect to the distribution.

A partner's share of net section 751 unrealized gain or loss from section 751 property immediately following a distribution is computed using the same formula. However, the distributee partner also includes in its post-distribution amount its share of net income or loss from a hypothetical sale of the distributed section 751 property.

If section 751(b) applies to a distribution, each partner must generally recognize or take into account currently ordinary income equal to its "section 751(b) amount." If a partner has net section 751 unrealized gain both before and after the distribution, then the partner's section 751(b) amount equals the partner's net section 751 unrealized gain immediately before the distribution less the partner's net section 751 unrealized gain immediately after the distribution. If a partner has net section 751 unrealized loss both before and after the distribution, then the partner's section 751(b) amount equals the partner's net section 751 unrealized loss immediately after the distribution less the partner's net section 751 unrealized loss immediately before the distribution. If a partner has net section 751 unrealized gain before the distribution and net section 751 unrealized loss after the distribution, then the partner's section 751(b) amount equals the sum of the partner's net

section 751 unrealized gain immediately before the distribution and the partner's net section 751 unrealized loss immediately after the distribution.

Commentators requested a de minimis exception to section 751(b). The IRS and the Treasury Department continue to study the issue and request comments describing the parameters of a de minimis rule that would be helpful.

B. *Section 751 Anti-Abuse Rule*

The IRS and the Treasury Department believe that, despite the general principle that section 751(b) should apply only at the time that a partner's share of net section 751 unrealized gain is reduced (or net section 751 loss is increased), the deferral of ordinary income upon the receipt of a distribution is inappropriate in certain circumstances. Specifically, deferral is inappropriate if a partner engages in a transaction that relies on the rules of section 704(c) to defer or eliminate ordinary income while monetizing most of the value of the partnership interest. Accordingly, these proposed regulations provide an anti-abuse rule that requires taxpayers to apply the rules set forth in the proposed regulations in a manner consistent with the purpose of section 751, and that allows the Commissioner to recast transactions for federal tax purposes as appropriate to achieve tax results that are consistent with the purpose of section 751.

The proposed regulations provide a list of situations that are presumed inconsistent with the purpose of section 751. Under this list, a distribution is presumed inconsistent with the purpose of section 751 if section 751(b) would apply but for the application of section 704(c) principles, and one or more of the following conditions exists: (1) a partner's interest in net section 751 unrealized gain is at least four times greater than the partner's capital account immediately after the distribution, (2) a distribution reduces a partner's interest to such an extent that the partner has little or no exposure to partnership losses and does not meaningfully participate in partnership profits aside from a preferred return for the use of capital, (3) the net value of the partner (or its successor) becomes less than its potential tax liability from section 751 property as a result of a transaction, (4) a partner transfers a portion of its partnership interest within five years after the distribution to a tax-indifferent party in a manner that would not trigger ordinary income recognition in the absence of this anti-abuse rule, or (5) a partnership transfers to a corporation in a nonrecognition transaction section 751 property other than pursuant to a transfer of all property used in a trade or business (excluding assets that are not material to a continuation of the trade or business). In addition, the proposed regulations provide that an amendment to the partnership agreement that results in a reduction in a partner's interest in section 751 property is also presumed inconsistent with the purpose of section 751. A partnership or a partner taking a position on its return that section 751 does not apply to a transaction that meets one or more of these situations must disclose its position on Form 8275, Disclosure Statement.

3. *Tax Consequences of a Section 751(b) Distribution*

If section 751(b) applies to a distribution under the principles set forth in Part 2 of the Summary of Comments and Explanation of Provisions section of this preamble, then the partners must determine the consequences of its application to the partnership and its partners. As described in the Background section of this preamble, Notice 2006–14 discussed replacing the asset exchange approach with a hot asset sale approach to determine these consequences. While most commentators agreed that the hot asset sale approach is an improvement over the existing regulations' asset exchange approach, commentators were able to identify situations in which the hot asset sale approach fails to achieve the correct result or causes undesirable results under other Code provisions. Two commentators advocated adopting, in lieu of the hot asset sale approach, an approach similar to that taken in section 704(c)(1)(B) (referred to in this preamble as a "deemed gain" approach), in which a section 751(b) distribution results in: (1) the partnership recognizing ordinary income in the aggregate amount of each partner's reduction in the partner's interest in section 751 property, (2) the partnership allocating ordinary income to the partner or partners whose interest in section 751(b) property was reduced by the distribution, and (3) the partnership making appropriate basis adjustments to its assets to reflect its ordinary income recognition. One variation of the deemed gain approach would require capital gain recognition in certain cases.

The IRS and the Treasury Department determined that a deemed gain approach produces an appropriate outcome in the greatest number of circumstances out of the approaches under consideration, and that the hot asset sale approach also produced an appropriate outcome in most circumstances. However, no one approach produced an appropriate outcome in all circumstances. Therefore, these proposed regulations withdraw the asset exchange approach of the current regulations, but do not require the use of a particular approach for determining the tax consequences of a section 751(b) distribution. Instead, these proposed regulations provide that if, under the hypothetical sale approach, a distribution reduces a partner's interest in the partnership's section 751 property, giving rise to a section 751(b) amount, then the partnership must use a reasonable approach that is consistent with the purpose of section 751(b) to determine the tax consequences of the reduction. Except in limited situations, a partnership must continue to use the same approach, once chosen, including after a termination of the partnership under section 708(b)(1)(B). These proposed regulations include examples in which the approach adopted is generally reasonable based on the facts of the examples, and one example in which it is determined that the adopted approach is not reasonable based on the facts of the example.

Finally, some commentators recommended allowing taxpayers to elect to recognize capital gain in certain situations (for example, in the situation described in *Example 2* in Notice 2006–14 involving distributions of section 751(b) property to a partner that has insufficient basis in its partnership interest to absorb fully the partnership's basis in the distributed property). Recognition of gain may be appropriate where failing to recognize gain would cause an adjustment to the basis of distributed property (under section 732) or to the basis of partnership property (under

section 734(b)) if those basis adjustments would change the partners' shares of ordinary income already determined under the principles described in Part 1 of the Summary of Comments and Explanation of Provisions section of this preamble. Such changes in ordinary income amounts could (in the case of certain adjustments under section 734(b)) decrease partners' shares of partnership ordinary income, requiring the recognition of additional income under section 751(b), or could (in the case of certain adjustments under section 732) convert a distributee partner's share of capital gain into ordinary income. Thus, these proposed regulations require that distributee partners recognize capital gain in certain situations, and permit distributee partners to elect to recognize capital gain in certain other situations.

The proposed regulations require a distributee partner to recognize capital gain to the extent necessary to prevent the distribution from triggering a basis adjustment under section 734(b) that would reduce other partners' shares of net unrealized section 751 gain or loss. Capital gain recognition is necessary in this situation because the section 734(b) basis adjustment was not taken into account in determining the partners' net section 751 unrealized gain or loss immediately after the section 751 distribution, and the IRS and the Treasury Department believe that an approach under which a partnership redetermines a partner's net section 751 unrealized gain or loss to account for section 734(b) basis adjustments would be both administratively burdensome and would accelerate ordinary income unnecessarily. *See Examples 5* and *6* in § 1.751–1(g) of the proposed regulations. Gain recognized in this event is generally capital; however, if the partnership makes an election under § 1.755–1(c)(2)(vi), then the partner must characterize all or a portion of the gain recognized under this rule as ordinary income or a dividend, as appropriate, to preserve the character of the gain in the adjusted asset. *See Example 9* in § 1.751–1(g) of the proposed regulations.

These proposed regulations also allow distributee partners to elect to recognize capital gain in certain circumstances to avoid decreases to the basis of distributed section 751 property. Elective capital gain recognition is appropriate to eliminate a negative section 732(a)(2) or (b) basis adjustment to the asset or assets received in distribution if, and to the extent that, the distributee partner's net section 751 unrealized gain would otherwise be greater immediately after the distribution than it was immediately before the distribution (or would cause the distributee partner's net section 751 unrealized loss to be less immediately after the distribution than it was immediately before the distribution). For example, elective capital gain recognition is appropriate if a partner with zero basis in its partnership interest receives a distribution of partnership section 751 property with basis in the hands of the partnership equal to its value, and the distribution otherwise increases the distributee partner's net section 751 unrealized gain.

4. *Miscellaneous*

A. *Section 751(a)*

As described in Parts 2.A and 2.B of this preamble, these proposed regulations generally defer the recognition of ordinary income upon a distribution when the partner's unrealized gain and loss in the partnership's section 751 property is preserved through the application of the principles of section 704(c). This approach is consistent with the 1984 amendment to section 704(c). By mandating the application of section 704(c) principles, that amendment partially severed the relationship that had generally existed between a partner's distributive share (that is, the right to share in the economic gain or loss) associated with a partnership item and the partner's share of tax gain or loss from the sale of that item. The IRS and the Treasury Department believe that, by mandating the application of section 704(c) principles in 1984, Congress intended that impacted provisions be interpreted consistent with this new emphasis on tax gain or loss. Congress provided a broad delegation of authority to the Treasury Department to address these repercussions of amending section 704(c) on other provisions in subchapter K.

Some commentators interpret section 751(a) as limiting the amount of ordinary income that a transferor partner may recognize upon a transfer of a partnership interest to the amount of any money or property received by the transferor partner, without taking into account the total amount of ordinary income attributable to the partnership interest transferred that relates to section 751 property. However, interpreting section 751(a) as limiting ordinary income in this way would contravene Congress's intent to tax partners on their shares of partnership ordinary income as determined by applying section 704(c) principles. The IRS and the Treasury Department believe that section 751(a) should be interpreted in a manner that accounts for the impact of section 704(c). Thus, these proposed regulations provide that the amount of money or the fair market value of property received for purposes of section 751(a) takes into account the transferor partner's share of income or gain from section 751 property.

The IRS and the Treasury Department alternatively considered addressing this issue by deeming a partner that sells or exchanges its partnership interest to receive a distribution of the partner's share of the section 751 property, followed by a sale of the property back to the partnership for its fair market value, recognizing the deferred ordinary income inherent in the section 751 property. The partner would then be deemed to contribute the cash proceeds to the partnership thereby increasing the partner's basis in the partner's partnership interest. Finally, upon the sale or exchange of the partnership interest, the partner would recognize the appropriate amount of capital loss. This potential multi-step deemed approach would result in additional complexity and would reach the same result that the current regulations under § 1.751–1(a) reach as clarified by these proposed regulations. Therefore, the IRS and the Treasury Department are not proposing this alternative approach.

B. *Previously Contributed Property Exception*

Section 751(b)(2)(A) provides that section 751(b) does not apply to a distribution of property that the distributee contributed to the partnership ("previously contributed property exception"). Unlike other provisions in subchapter K that include similar previously contributed property exceptions, the current regulations

under section 751(b) do not contain successor rules for purposes of applying the section 751(b) previously contributed property exception. These proposed regulations add successor rules to section 751(b) similar to the successor rules contained in other previously contributed property exceptions within subchapter K.

C. *Mergers and Divisions*

A commentator requested guidance confirming how the rules of section 751(b) apply in the case of an incorporation, merger, or division of a partnership. The proposed regulations do not adopt this comment because the IRS and the Treasury Department believe such guidance is beyond the scope of these proposed regulations.

D. *Substantial Appreciation Test*

These proposed regulations also make a number of technical corrections to account for changes in the law since the issuance of existing regulations under section 751. For example, these proposed regulations remove the language "substantially appreciated" from the first sentence of § 1.751–1(a)(1), which applies with respect to sales or exchanges of an interest in a partnership. In addition to conforming the language of the regulations to that of the Code, this change is intended to clarify that, upon a sale or exchange of a partnership interest, unrealized receivables and inventory items are treated in the same manner. Thus, a transferor partner may recognize an ordinary loss with respect to inventory items pursuant to section 751(a) to the extent the transferor would be allocated a net ordinary loss pursuant to § 1.751–1(a)(2). These proposed regulations also update the definition of "inventory items which have appreciated substantially in value" with respect to section 751(b) to reflect the 1993 amendment to the statute that eliminated the 10-percent test from the definition of "*substantial appreciation*." *See* Public Law 103–66, Sec. 13206(e)(1). These proposed regulations also clarify that unrealized receivables are not included in the term "inventory items which have appreciated substantially in value."

E. *Other Changes Relating to Revaluations*

Finally, these proposed regulations address some of the comments received in response to Notice 2009–70 (2009–2 CB 255), in which the IRS and the Treasury Department requested comments on, among other things, whether additional events should be added to the list of events permitting a revaluation of partnership property pursuant to § 1.704–1(b)(2)(iv)(*f*) and whether, in a tiered partnership structure, a revaluation at one partnership in the tier should permit another partnership in the tier to revalue that partnership's property. Commentators recommended that partnership recapitalizations (changes to the way partners agree to share partnership profits and losses) be added as a permissible revaluation event. The IRS and the Treasury Department agree that partnership recapitalizations should be added as a permissible event because, absent providing for a special allocation of any unrealized gain or loss in partnership assets that arose prior to the recapitalization, a revaluation is necessary to preserve each partner's share of such unrealized amounts. In addition, commentators recommended that a partnership in a tiered partnership structure be able to revalue its partnership property if another partnership in the tiered structure was permitted to revalue its partnership property. The IRS and the Treasury Department agree and believe that permitting successive revaluations in a tiered partnership structure is necessary to properly allocate items with respect to a reverse section 704(c) allocation to the appropriate partner.

Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Effect on Other Documents

The following publication will be obsolete as of the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**:

Rev. Rul. 84–102 (1984–2 CB 119).

Proposed Effective/Applicability Date

The regulations, as proposed, apply to distributions occurring in any taxable period ending on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register.** The rules contained in § 1.751–1(a)(2) would apply to transfers of partnership interests that occur on or after November 3, 2014. However, the rules contained in § 1.751–1(a)(2) are a clarification of existing rules, and no inference is intended from the change to § 1.751–1(a)(2) with respect to sales or exchanges of partnership interests prior to the effective date for § 1.751–1(a)(2). The rules contained in § 1.751–1(a)(3) continue to apply to transfers of partnership interests that occur on or after December 15, 1999. A partnership and its partners would be able to rely on § 1.751–1(b)(2) of these proposed regulations for purposes of determining a partner's interest in the partnership's section 751 property on or after November 3, 2014, provided the partnership and its partners apply each of § 1.751–1(a)(2), § 1.751–1(b)(2), and § 1.751–1(b)(4) of these proposed regulations consistently for all partnership distributions and sales or exchanges, including for any distributions and sales or exchanges the partnership makes after a termination of the partnership under section 708(b)(1)(B).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13653. 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 amount of time necessary to prepare the required disclosure is not lengthy and few small businesses are likely to be partners or partnerships required to make the disclosures required by the rule. Accordingly, a Regulatory Flex-

ibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

The IRS and the Treasury Department request comments on all aspects of the proposed rules. In particular, the IRS and the Treasury Department request comments, in addition to those previously requested in this preamble, on: (1) whether and how carryover adjustments to ordinary income property under sections 734(b) and 743(b) should be taken into account under the hypothetical sale approach, (2) whether the final regulations should exclude certain types of transactions from the previously contributed property successor rules provided in these proposed regulations, (3) whether the regulations should specifically describe approaches as generally reasonable approaches for determining the tax consequences of a section 751(b) distribution, and which approaches should be specified as generally reasonable, (4) whether the final regulations should provide rules similar to those proposed in new § 1.755–1(c)(2)(iii) through (vi) in § 1.755–1(b)(5) with respect to section 743(b) adjustments in substituted basis transactions, and (5) what disclosures the IRS and the Treasury Department should require from partners and partnerships that either recognize gain under section 751(a) or (b), or rely on reverse section 704(c) allocations to defer the gain recognition required by section 751(a) or (b).

The IRS and the Treasury Department also request comments on a topic that, although not specific to section 751, may impact the rules under section 751. The IRS and the Treasury Department are aware that the regulations under § 1.1245–1(e)(3) (concerning the interaction of section 1245 and section 743), and § 1.1250–1(f), by reference to § 1.1245–1(e)(3), are out of date. The intent of the regulations under § 1.1245–1(e)(3) is, in part, to ensure that a transferee partner does not recognize ordinary income with respect to section 1245 property to the extent a section 743 adjustment has displaced that ordinary income. For example, if a partner sells in a fully taxable exchange its interest in a partnership that has elected under section 754, and the selling partner recognizes ordinary income under section 751(a) with respect to partnership section 1245 property, then the rules under sections 1245 and 743 are intended to ensure that the transferee partner recognizes no ordinary income on an immediately subsequent disposition of the section 1245 property in a fully taxable transaction. However, the regulations under § 1.1245–1(e)(3) have not been amended to take into account changes to subchapter K, including the regulations under section 751, resulting in issues and uncertainties. The IRS and the Treasury Department are studying these issues and request comments in this area.

Finally, the IRS and the Treasury Department request comments as to how section 751(b) should interact with rules for withholding and reporting with respect to nonresident aliens and foreign corporations. For example, the IRS and the Treasury Department are considering whether regulations should provide that for purposes of withholding under chapter 3 of Subtitle A (for example, under section 1446), income recognized as a result of a section 751(b) distribution is treated as recognized by the partnership regardless of the approach chosen to determine the U.S. tax consequences of the section 751(b) distribution. The IRS and the Treasury Department are also considering whether additional guidance with respect to tax or information returns (for example, pursuant to section 6031(b) or section 6050K) is necessary for gain recognized on section 751(b) distributions affecting these taxpayers.

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. All comments will be available at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person who submits timely written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register.**

Drafting Information

The principal authors of these regulations are Allison R. Carmody and Frank J. Fisher, 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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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.617–4 is amended by adding a new sentence at the end of paragraph (c)(3)(ii)(*g*) to read as follows:

§ 1.617–4 Treatment of gain from disposition of certain mining property.

* * * * *

(c) * * *

(3) * * *

(ii) * * *

(*g*) * * * *See also* §§ 1.732–1(c)(2)(iii) and 1.755–1(c)(2)(iii) for rules governing the application of section 617 to partnership property in certain situations.

* * * * *

Par. 3. Section 1.704–1 is amended by:

a. Revising paragraph (b)(2)(iv)(*f*) introductory text.

b. Redesignating paragraph (b)(2)(iv)(*f*)(*5*)(*v*) as paragraph (b)(2)(iv)(*f*)(*5*)(*vi*).

c. Adding new paragraph (b)(2)(iv)(*f*)(*5*)(*v*).

d. Designating the undesignated text after paragraph (b)(2)(iv)(*f*)(*5*)(*vi*) as paragraph (b)(2)(iv)(*f*)(*5*)(*vii*).

The revisions and additions read as follows:

§ 1.704–1 Partner's distributive share.

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(*f*) *Revaluations of property*. A partnership agreement may, upon the occurrence of certain events, and must in the circumstances described in § 1.751–1(b)(2)(iv), increase or decrease the capital accounts of the partners to reflect a revaluation of partnership property (including intangible assets such as goodwill) on the partnership's books. If a partnership that revalues its property pursuant to this paragraph owns an interest in another partnership, that partnership in which it owns an interest may also revalue its property in accordance with this section. Similarly, if an interest in a partnership that revalues its property pursuant to this paragraph is owned by another partnership, the partnership owning that interest may also revalue its property in accordance with this section. Capital accounts so adjusted will not be considered to be determined and maintained in accordance with the rules of this paragraph (b)(2)(iv) unless—

* * * * *

(5) * * *

(v) In connection with an agreement to change (other than a de minimis change) the manner in which the partners share any item or class of items of income, gain, loss, deduction or credit of the partnership under the partnership agreement, or

* * * * *

Par. 4. Section 1.704–3 is amended in paragraph (a)(9) by adding a sentence immediately following the first sentence to read as follows:

§ 1.704–3 Contributed property.

(a) * * *

(9) * * * If a partnership (the upper-tier partnership) owns an interest in another partnership (the lower-tier partnership), and both the upper-tier partnership and the lower-tier partnership simultaneously revalue partnership property pursuant to § 1.704–1(b)(2)(iv)(*f*), the principles of this paragraph (a)(9) shall apply to any reverse section 704(c) allocations created upon the revaluation. * * *

* * * * *

Par. 5. Section 1.732–1 is amended by adding paragraphs (c)(2)(iii), (iv), (v), (vi), and (vii), and revising paragraph (c)(5) to read as follows:

§ 1.732–1 Basis of distributed property other than money.

* * * * *

(c) * * *

(2) * * *

(iii) *Property subject to section 1245*. Any increase in basis allocated to capital gain property pursuant to the second sentence in paragraph (c)(2)(ii) of this section is not taken into account in determining the recomputed or adjusted basis in the property for purposes of section 1245(a)(1). Notwithstanding the prior sentence, any depreciation or amortization of the increase in basis that is allowed or allowable is taken into account in computing the property's recomputed basis. In the case of property that is subject to section 617(d)(1), section 1250(a)(1), section 1252(a)(1), or section 1254(a)(1), rules similar to the rule in this paragraph (c)(2)(iii) shall apply. *See Examples 2* and *3* in § 1.755–1(c)(6).

(iv) *Section 1231 property*. Any increase in basis allocated to capital gain property pursuant to the second sentence in paragraph (c)(2)(ii) of this section is not taken into account in determining section 1231 gain and loss, as defined in section 1231(a)(3). *See Examples 2* and *3* in § 1.755–1(c)(6).

(v) *Property subject to section 1248*. Any increase in basis allocated to stock in a foreign corporation pursuant to the second sentence in paragraph (c)(2)(ii) of this section or any decrease in basis allocated to stock in a foreign corporation pursuant to the second sentence in paragraph (c)(2)(i) of this section is not taken into account in determining the amount of gain recognized on the sale or exchange of such stock for purposes of section 1248(a). In the case of property that is subject to section 995(c), rules similar to the rule set forth in this paragraph (c)(2)(v) shall apply. *See Examples 8* and *9* in § 1.751–1(g).

(vi) *Special rule*. Any basis adjustment to an asset that is not taken into account under paragraph (c)(2)(iii), (iv), or (v) of this section shall, upon a taxable disposition, be treated as gain or loss, as the case may be, from the sale or exchange of a capital asset with the same holding period as the underlying asset. *See Examples 2* and *3* in § 1.755–1(c)(6).

(vii) *Election not to apply the provisions of paragraphs (c)(2)(iii), (iv), and (v). See* § 1.755–1(c)(2)(vi) for rules regarding an election to have the provisions of paragraphs (c)(2)(iii), (iv), and (v) of this section, and § 1.755–1(c)(2)(iii), (iv), and (v) not apply. *See Examples 2* and *3* in § 1.755–1(c)(6).

* * * * *

(5) *Effective/applicability date*. This paragraph (c) applies to distributions of property from a partnership that occur on or after December 15, 1999, except that paragraphs (c)(2)(iii), (iv), (v), (vi), and (vii) of this section apply to distributions of property from a partnership that occur on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register.**

* * * * *

§ 1.736–1 [Amended]

Par. 6. Section 1.736–1 is amended in paragraph (b)(4) by removing the language "paragraph (b)(3)(iii)" from the last sentence and adding the language "paragraph (b)(3)" in its place.

Par. 7. Section 1.751–1 is amended by:

a. Revising paragraphs (a)(1) and (2).

b. Revising the first sentence of paragraph (b)(1)(i) and adding a new sentence at the end of paragraph (b)(1)(i).

c. Removing the last four sentences of paragraph (b)(1)(ii).

d. Revising paragraphs (b)(1)(iii) and (b)(2) and (3).

e. Redesignating paragraphs (b)(4) and (5) as paragraphs (b)(5) and (6).

f. Adding a new paragraph (b)(4).

g. Revising the paragraph heading of newly designated paragraph (b)(5).

h. Further redesignating newly redesignated paragraph (b)(5)(ii) as paragraph (b)(5)(vi) and adding paragraphs (b)(5)(ii), (iii), (iv), and (v).

i. Revising newly designated paragraph (b)(6).

j. Revising paragraph (c)(4)(vi).

k. Adding paragraph (c)(4)(x).

l. Removing paragraphs (c)(5) and (6).

m. Revising the first and second sentences of paragraph (d)(1).

n. Revising paragraphs (e), (f), and (g).

The additions and revisions read as follows:

§ 1.751–1 Unrealized receivables and inventory items.

(a) * * * (1) *Character of amount realized.* To the extent that money or property received by a partner in exchange for all or part of his partnership interest is attributable to his share of the value of partnership unrealized receivables or inventory items, the money or fair market value of the property received shall be considered as an amount realized from the sale or exchange of property other than a capital asset. The remainder of the total amount realized on the sale or exchange of the partnership interest is realized from the sale or exchange of a capital asset under section 741. For definition of "unrealized receivables" and "inventory items," see section 751(c) and (d). *See* paragraph (e) of this section for the definition of section 751 property.

(2) *Determination of gain or loss.* The income or loss realized by a partner upon the sale or exchange of its interest in section 751 property is the amount of income or loss from section 751 property (taking into account allocations of tax items applying the principles of section 704(c), including any remedial allocations under § 1.704–3(d), and any section 743 basis adjustment pursuant to § 1.743–1(j)(3)) that would have been allocated to the partner (to the extent attributable to the partnership interest sold or exchanged) if the partnership had sold all of its property in a fully taxable transaction for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)) immediately prior to the partner's transfer of the interest in the partnership. Any gain or loss recognized that is attributable to section 751 property will be ordinary gain or loss. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 and the amount of ordinary income or loss determined under this paragraph (a)(2) is the transferor's capital gain or loss on the sale of its partnership interest. For purposes of section 751(a) and paragraph (a) of this section, the amount of money or the fair market value of property received by the partner in exchange for all or part of his partnership interest must take into account the partner's share of income or gain from section 751 property. *See Example 1* in paragraph (g) of this section. *See* § 1.460–4(k)(2)(iv)(E) for rules relating to the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting.

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(b) *Certain distributions treated as sales or exchanges*—(1) *In general.* (i) Certain distributions to which section 751(b) applies are treated in whole or in part as sales or exchanges of property, and not as distributions to which sections 731 through 736 apply. * * * For purposes of section 751 and this section, a partner's interest in the partnership's section 751 property includes allocations of tax items applying the principles of section 704(c).

* * * * *

(iii) If a distribution is a section 751(b) distribution, as described in paragraph (b)(2)(i) of this section, the tax consequences of the section 751(b) distribution, as determined under paragraph (b)(3) of this section, shall first apply, and then the rules of sections 731 through 736 shall apply. *See* paragraph (b)(5)(vi) of this section for treatment of payments under section 736(a).

(2) *Distributions to which section 751(b) applies*—(i) *Section 751(b) amount.* A distribution is a section 751(b) distribution if it gives rise to a "section 751(b) amount" for any partner. A partner's section 751(b) amount (if any) associated with a distribution of partnership property (including money) equals the greatest of—

(A) The amount by which the partner's net section 751 unrealized gain immediately before the distribution exceeds the partner's net section 751 unrealized gain immediately after the distribution;

(B) The amount by which the partner's net section 751 unrealized loss immediately after the distribution exceeds the partner's net section 751 unrealized loss immediately before the distribution; and

(C) The amount of the partner's net section 751 unrealized gain immediately before the distribution, increased by the total amount of the partner's net section 751 unrealized loss immediately after the distribution (where neither of those numbers equals zero).

(ii) *Net section 751 unrealized gain or loss before a distribution.* A partner's net section 751 unrealized gain or loss immediately before a distribution equals the amount of net income or loss, as the case may be, from section 751 property that would be allocated to the partner if the partnership disposed of all of the partnership's assets for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)). For this purpose, a partner's net section 751 unrealized gain or loss includes any remedial allocations under § 1.704–3(d), and takes into account any section 743 basis adjustment pursuant to § 1.743–1(j)(3) and any carryover basis adjustment described in §§ 1.743–1(g)(2)(ii), 1.755–1(b)(5)(iii)(D), or 1.755–1(c)(4) as though the carryover basis adjustment was applied to the basis of new partnership section 751 property with fair market value of zero.

(iii) *Net section 751 unrealized gain or loss after a distribution.* A partner's net section 751 unrealized gain or loss immediately after a distribution equals the sum of (to the extent applicable)—

(A) With respect to a partner remaining in the partnership immediately after the distribution (including a distributee partner remaining in the partnership), the amount of net income or loss, as the case may be (including any remedial allocations under § 1.704–3(d) and taking into account any section 743 basis adjustment pursuant to § 1.743–1(j)(3) and any carryover basis adjustment described in §§ 1.743–1(g)(2)(ii), 1.755–1(b)(5)(iii)(D), or 1.755–1(c)(4) as though the carryover basis adjustment was applied to the basis of new partnership section 751 property with fair market value of zero), from section 751 property that would be allocated to the partner if the partnership disposed of all of the partnership's assets for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)); and

(B) With respect to a partner receiving a distribution, the amount of net income or loss, as the case may be, from section 751 property that would be recognized by the distributee if, immediately after the distribution, the distributee disposed of the distributed assets for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)).

(iv) *Revaluation of assets.* For a partnership that distributes money or property (other than a de minimis amount) to a partner as consideration for an interest in

the partnership, and that owns section 751 property immediately after the distribution, if the partnership maintains capital accounts in accordance with § 1.704–1(b)(2)(iv), the partnership must revalue its assets immediately prior to the distribution in accordance with § 1.704–1(b)(2)(iv)(*f*). If a partnership does not maintain capital accounts in accordance with § 1.704–1(b)(2)(iv), the partnership must comply with this section by computing its partners' shares of partnership gain or loss immediately before the distribution as if the partnership assets were sold for cash in a fully taxable transaction (taking into account section 7701(g)), and by taking those computed shares of gain or loss into account under the principles of section 704(c) (making subsequent adjustments for cost recovery and other events that affect the basis of the property). In addition, if the partnership (upper-tier partnership) owns another partnership directly or indirectly through one or more partnerships (lower-tier partnership), and the same persons own, directly or indirectly (through one or more entities), more than 50 percent of the capital and profits interests in both the upper-tier partnership and the lower-tier partnership, the lower-tier partnership must also revalue its assets immediately prior to the distribution in accordance with § 1.704–1(b)(2)(iv)(*f*) if the lower-tier partnership owns section 751 property. If the same persons do not own, directly or indirectly, more than 50 percent of the capital and profits interests in both the upper-tier partnership and the lower-tier partnership, the upper-tier partnership must allocate its distributive share of the lower-tier partnership's items among its partners in a manner that reflects the allocations that would have been made had the lower-tier partnership revalued its property.

(3) *Tax consequences of a section 751(b) distribution*—(i) *Reasonable approach*. In the case of a section 751(b) distribution described in paragraph (b)(2) of this section, the partnership must choose a reasonable approach that is consistent with the purpose of section 751(b) under which each partner with a section 751(b) amount recognizes ordinary income (or takes it into account by eliminating a basis adjustment) equal to that section 751(b) amount immediately prior to the section 751(b) distribution. In certain circumstances described in paragraph (b)(3)(ii) of this section, a distributee partner may also be permitted or required to recognize capital gain. To be reasonable, an approach must conform to the general principles and anti-abuse rules described in paragraph (b)(4) of this section. An approach is not necessarily unreasonable merely because another approach would result in a higher aggregate tax liability. Once the partnership has adopted a reasonable approach, it must apply that approach consistently for all section 751(b) distributions, including for any distributions the partnership makes after a termination of the partnership under section 708(b)(1)(B). If the application of the adopted approach to a later section 751(b) distribution produces results inconsistent with the purpose of section 751, the partnership must adopt another reasonable approach that achieves the purposes of section 751 for that distribution only. *See Example 3* through *Example 8* in paragraph (g) of this section.

(ii) *Gain Recognition*—(A) *Mandatory recognition*. A partner's net section 751 unrealized gain or net section 751 unrealized loss for purposes of paragraph (b)(3)(i) of this section is determined before taking into account any basis adjustments required by paragraph (b)(3)(iii) of this section. In certain instances, the application of paragraph (b)(3)(iii) of this section may cause a partner to receive distributed property with a basis that differs from the basis of the property in the hands of the distributing partnership. If an adjustment to the basis of the distributed section 751 property results in a section 734(b) basis adjustment, and that basis adjustment would have altered the amount of net section 751 unrealized gain or loss computed under paragraph (b)(2) of this section if the section 734(b) adjustment had been included immediately prior to the distribution, then the distributee partner must recognize capital gain immediately prior to the distribution in an amount sufficient to eliminate that section 734(b) basis adjustment. *See Examples 5* and *6* in paragraph (g) of this section. If, however, the partnership makes an election under § 1.755–1(c)(2)(vi), then the partner must characterize all or a portion of the gain recognized under this paragraph as ordinary income or a dividend, as appropriate, to preserve the character of the gain in the adjusted asset. *See Example 9* in paragraph (g) of this section.

(B) *Elective recognition*. A distributee partner may elect to recognize capital gain (in addition to amounts required to be recognized under this section) to eliminate section 732(a)(2) or (b) basis adjustments to the asset or assets received in distribution if, and to the extent that, the basis adjustments required by paragraph (b)(3)(iii) of this section would otherwise cause the distributee partner's net section 751 unrealized gain to be greater immediately after the distribution than it was immediately before the distribution or would cause the distributee partner's net section 751 unrealized loss to be less immediately after the distribution than it was immediately before the distribution. A distributee partner elects under this paragraph (b)(3)(ii)(B) by providing the partnership with written notification of its intent to make the election and reporting the capital gain on its return. An extension of time to make an election under this paragraph (b)(3)(ii)(B) will not be granted under § 301.9100–3 of this chapter. The requirement in paragraph (b)(1)(i) of this section that a partnership apply a chosen reasonable method consistently across all partnership distributions does not apply for purposes of this paragraph. *See Example 7* in paragraph (g) of this section.

(iii) *Adjustments to Basis*. The partnership and its partners must make appropriate adjustments to the adjusted basis of the partners' interests in the partnership, and of section 751 property and other property held by the partnership or partners, in a manner consistent with the adopted approach to reflect any ordinary income or capital gain recognized upon application of paragraph (b)(3) of this section, and section 704(c) amounts must be adjusted accordingly.

(4) *General principles and anti-abuse rules*. (i) The purpose of section 751 is to prevent a partner from converting its rights to ordinary income into capital gain, including by relying on the rules of section 704(c) to defer ordinary income while monetizing most of the value of the partnership interest. The partnership and all partners of the partnership must apply the rules of section 751 and § 1.751–1 in a manner consistent with the purpose of

section 751. Accordingly, if a principal purpose of a transaction is to achieve a tax result that is inconsistent with the purpose of section 751, the Commissioner may recast the transaction for federal tax purposes as appropriate to achieve tax results that are consistent with the purpose of section 751. The Commissioner will determine whether a tax result is inconsistent with the purpose of section 751 based on all the facts and circumstances. The existence of one or more of the situations set forth below is presumed to establish that a transaction is inconsistent with the purpose of section 751 and disclosure to the Internal Revenue Service in accordance with § 1.751–1(b)(4)(ii) is required.

(A) Circumstances in which a partner received a distribution that would otherwise be subject to section 751(b), but for the application of the principles of section 704(c), and one or more of the following conditions exist (whether at the time of the distribution or, in the case of paragraph (b)(4)(i)(A)(*2*), (*3*), (*4*), or (*5*) of this section, a later date):

(*1*) The partner's interest in net section 751 unrealized gain is at least four times greater than the partner's capital account immediately after the distribution, pursuant to § 1.704–1(b)(2)(iv) (or comparable amount for partnerships not maintaining capital accounts under § 1.704–1(b)(2)(iv));

(*2*) The partner is substantially protected from losses from the partnership's activities and has little or no participation in the profits from the partnership's activities other than a preferred return that is in the nature of a payment for the use of capital;

(*3*) The partner engages in a transaction that, at the time of the transaction, causes the net value of the partner (or its successor) to be less than the tax liability that the partner (or its successor) would incur with respect to its interest in the partnership's section 751 property upon a sale of its partnership interest for its fair market value at the time of the transaction. For this purpose, the net value of the partner (or its successor) equals—

(*i*) The fair market value of all assets owned by the partner (or its successor) that may be subject to creditor's claims under local law (including the partner's enforceable right to contributions from its owner or owners), less

(*ii*) All obligations of the partner (or its successor) other than the partner's obligation with respect to the tax liability for which the net value is being determined;

(*4*) The partner transfers a portion of its partnership interest within five years after the distribution in a manner that does not trigger ordinary income recognition, and ordinary income or gain with respect to the partnership interest is subject to Federal income tax in the hands of the transferor partner immediately before the transfer, but any ordinary income or gain with respect to the partnership interest is exempt from, or otherwise not subject to, Federal income tax in the hands of the transferee partner immediately after the transfer;

(*5*) The partnership transfers to a corporation in a nonrecognition transaction section 751 property other than pursuant to a transfer of all property used in a trade or business (excluding assets that are not material to a continuation of the trade or business); or

(B) The partners agree to change (other than a de minimis change) the manner in which the partners share any item or class of items of income, gain, loss, deduction or credit of the partnership under the partnership agreement and that change reduces the partner's net section 751 unrealized gain.

(ii) If a partner participates in a transaction described in paragraph (b)(4)(i)(A) or (B) of this section and does not recognize and report its share of ordinary income from section 751 property on its tax return for the taxable year of the transaction, the partner must file Form 8275-R, Regulation Disclosure Statement, or any appropriate successor form, disclosing its participation in the transaction for the taxable year in which the transaction occurred.

(5) *Special rules*. * * *

* * * * *

(ii) The transferee in a nonrecognition transaction of all or a portion of the partnership interest of a contributing partner is treated as the contributing partner for purposes of section 751(b)(2) in an amount attributable to the interest transferred.

(iii) For purposes of section 751(b)(2), if a partnership disposes of contributed section 751 property in a nonrecognition transaction, the substituted basis property (within the meaning of section 7701(a)(42)) received in exchange for such substituted basis property is treated as the contributed section 751 property with regard to the contributing partner. If a partnership transfers contributed section 751 property together with other property in a nonrecognition transaction, the substituted basis property (within the meaning of section 7701(a)(42)) is treated as the contributed section 751 property with regard to the contributing partner in the same proportion as the fair market value of the contributed section 751 property, at the time of the transfer, bears to the fair market value of the other property transferred at the time of the transfer. If a transfer described in this paragraph (b)(5)(iii) was in exchange for an interest in an entity, the interest in the entity will not be treated as the contributed section 751 property with regard to the contributing partner to the extent the value of the interest is attributable to other property the partnership contributed to the entity.

(iv) For purposes of section 751(b)(2), an interest in an entity previously contributed to the partnership is not treated as previously contributed property to the extent the value of the interest is attributable to property the partnership contributed to the entity after the interest was contributed to the partnership. The preceding sentence does not apply to the extent that the property contributed to the entity was contributed to the partnership by the partner that also contributed the interest in the entity to the partnership.

(v) For purposes of section 751(b)(2), the distribution of an undivided interest in property is treated as the distribution of previously contributed property to the extent that the undivided interest does not exceed the undivided interest, if any, contributed by the distributee partner in the same property.

* * * * *

(6) *Statements required*— (i) *Partnership*. A partnership that makes a section 751(b) distribution must submit with its return for the year of the distribution a statement for each section 751(b) distribution made during the year that includes the following:

(A) A caption identifying the statement as the disclosure of a section 751(b) distribution and the date of the distribution; and

(B) A brief description of the reasonable approach adopted by the partnership pursuant to paragraph (b)(3)(i) of this sec-

tion for recognizing the ordinary income; if applicable, the capital gain required to be recognized; and if relevant, whether the approach varies from an approach previously adopted within any of the three tax years preceding the current tax year.

(ii) *Partner*. A partnership that makes a section 751(b) distribution during the partnership's tax year must submit with its return for the year of the distribution a statement for each partner that has a section 751(b) amount greater than $0 in connection with that distribution. The statement must be attached to the statement for that partner required by section 6031(b) and § 1.6031(b)–1T(a), and must include the following:

(A) The date of the section 751(b) distribution;

(B) The amount of ordinary income the partner recognized pursuant to paragraph (b)(3)(i) of this section; and

(C) The amount of capital gain the partner recognized, if any, pursuant to paragraph (b)(3)(ii)(A) or (B) of this section.

(c) * * *

(4) * * *

(vi) With respect to any taxable year of a partnership beginning after July 18, 1984, amounts treated as ordinary income under section 467 are treated as ordinary income under this section in the same manner as amounts treated as ordinary income under section 1245 (*see* paragraph (c)(4)(iii) of this section) or section 1250 (*see* paragraph (c)(4)(v) of this section).

* * * * *

(x) With respect to any taxable year of a partnership beginning after July 18, 1984, the term *unrealized receivables,* for purposes of this section and sections 731, 732, and 741 (but not for purposes of section 736), includes any market discount bond (as defined in section 1278) and any short-term obligation (as defined in section 1283) but only to the extent of the amount that would be treated as ordinary income if (at the time of the transaction described in this section or section 731, 732, or 741, as the case may be) such property had been sold by the partnership.

* * * * *

(d) *Inventory items which have substantially appreciated in value*— (1) *Substantial appreciation*. Partnership inventory items shall be considered to have appreciated substantially in value if, at the time of the distribution, the total fair market value of all the inventory items of the partnership exceeds 120 percent of the aggregate adjusted basis for such property in the hands of the partnership (without regard to any special basis adjustment to the partner). The terms "inventory items which have appreciated substantially in value" or "substantially appreciated inventory items" refer to the aggregate of all partnership inventory items but do not include any unrealized receivables. * * *

* * * * *

(e) *Section 751 property and other property*. For purposes of paragraph (a) of this section, *section 751 property* means unrealized receivables or inventory items. For purposes of paragraph (b) of this section, *section 751 property* means unrealized receivables or substantially appreciated inventory items. For purposes of all paragraphs of this section, *other property* means all property (including money) that is not section 751 property.

(f) *Applicability date.* The rules contained in paragraph (a)(2) of this section apply to transfers of partnership interests that occur on or after November 3, 2014. The rules contained in paragraph (a)(3) of this section apply to transfers of partnership interests that occur on or after December 15, 1999. The rules contained in paragraphs (b)(2) and (3) of this section apply to distributions of partnership property that occur on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register.** However, a partnership and its partners may apply the rules contained in paragraph (b)(2) of this section for purposes of determining a partner's interest in the partnership's section 751 property on or after November 3, 2014, provided the partnership and its partners apply paragraphs (a)(2), (b)(2), and (b)(4) of this section consistently for all partnership sales, exchanges, and distributions, including for any distributions the partnership makes after a termination of the partnership under section 708(b)(1)(B).

(g) *Examples*. Application of the provisions of section 751 may be illustrated by the following examples. In each of *Examples 2* through *9* of this paragraph (g), none of the section 751 property qualifies as property that the distributee previously contributed as described in section 751(b)(2)(A), and no distribution to a retiring partner is a payment described in section 736(a):

Example 1. (i)(A) A and B are equal partners in personal service partnership PRS. A contributed nondepreciable capital assets (the "Capital Assets") to PRS with a basis and fair market value of $14,000. B contributed unrealized receivables described in paragraph (c) of this section (the "Unrealized Receivables") to PRS with a basis of zero and fair market value of $14,000. Later, when the fair market value of the Capital Assets had declined to $2,000, B transferred its interest in PRS to T for $9,000 when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) was as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Cash	$ 4,000	$ 4,000
Capital Assets	14,000	2,000
Unrealized Receivables	0	14,000
Total	18,000	20,000
	Liabilities and Capital	
	Adjusted Basis	Fair Market Value
Liabilities	$2,000	$2,000
Capital:		
A	15,000	9,000
B	1,000	9,000
Total	18,000	20,000

(B) The total amount realized by B is $10,000, consisting of the cash received, $9,000, plus $1,000, B's share of the partnership liabilities assumed by T. *See* section 752. B's interest in the partnership property includes an interest in the partnership's Unrealized Receivables. B's basis in its partnership interest is $2,000 ($1,000, plus $1,000, B's share of partnership liabilities). If section 751(a) did not apply to the sale, B would recognize $8,000 of capital gain from the sale of the interest in PRS. However, section 751(a) does apply to the sale.

(ii) For purposes of section 751(a), the amount of money or the fair market value of property received by the partner in exchange for all or part of his partnership interest must take into account the partner's share of income or gain from section 751 property. If PRS sold all of its section 751 property in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would have been allocated $14,000 of ordinary income from the sale of PRS's Unrealized Receivables under section 704(c). Therefore, B will recognize $14,000 of ordinary income with respect to the Unrealized Receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($8,000) and the amount of ordinary income or loss determined under paragraph (a)(2) of this section ($14,000) is the transferor's capital gain or loss on the sale of its partnership interest. In this case, B will recognize a $6,000 capital loss.

Example 2. (i) A, B, and C each contribute $120 to partnership ABC in exchange for a 1/3 interest. A, B, and C each share in the profits and losses of ABC in accordance with their 1/3 interest. ABC purchases land for $100 in Year 1. At the end of Year 3, when ABC holds $260 in cash and land with a value of $100 and has generated $90 in zero-basis unrealized receivables, ABC distributes $50 cash to C in a current distribution, reducing C's interest in ABC from 1/3 to 1/4. ABC has a section 754 election in effect. To determine if the distribution is a distribution to which section 751(b) applies, ABC must apply the test set forth in paragraph (b)(2) of this section.

(ii)(A) Pursuant to paragraph (b)(2)(iv) of this section, ABC revalues its assets and its partners' capital accounts are increased under § 1.704–1(b)(2)(iv)(*f*) to reflect each partner's share of the unrealized gain in the partnership's assets. Before the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$260	$260	A	$120	$150
Unrealized Receivable	0	90	B	120	150
Real Property	100	100	C	120	150
Totals	360	450		360	450

(B) If ABC disposed of all of its assets for cash in an amount equal to the fair market value of such property immediately before the distribution, A, B, and C would each be allocated $30 of net income from ABC's section 751 property. Accordingly, A, B, and C's net section 751 unrealized gain immediately before the distribution is $30 each under paragraph (b)(2)(ii) of this section.

(iii)(A) After the distribution (but before taking into account any consequences under this section), ABC's balance sheet would be as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$210	$210	A	$120	$150
Unrealized Receivable	0	90	B	120	150
Real Property	100	100	C	70	100
Totals	310	400		310	400

(B) If ABC disposed of all of its assets in exchange for cash in amounts equal to the fair market values of those assets immediately after the distribution, A, B, and C would each still be allocated $30 of net income from ABC's section 751 property pursuant to § 1.704–3(a)(6). C did not receive any section 751 property in the distribution. Accordingly, A, B, and C's net section 751 unrealized gain immediately after the distribution is $30 each under paragraph (b)(2)(iii) of this section.

(iv) Because no partner's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, and because no partner's net section 751 unrealized loss is greater immediately after the distribution than immediately before the distribution, the distribution is not a section 751(b) distribution under paragraph (b)(2)(i) of this section. Accordingly, section 751(b) does not apply to the distribution.

Example 3. (i) Assume the same facts as in *Example 2* of this paragraph (g), but assume ABC distributes $150 cash to C in complete liquidation of C's interest. To determine if the distribution is a distribution to which section 751(b) applies, ABC must apply the test set forth in paragraph (b)(2) of this section.

(ii)(A) Pursuant to paragraph (b)(2)(iv) of this section, ABC revalues its assets and its partners' capital accounts are increased under § 1.704–1(b)(2)(iv)(*f*) to reflect each partner's share of the unrealized gain in the partnership's assets. Before the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$260	$260	A	$120	$150
Unrealized Receivable	0	90	B	120	150
Real Property	100	100	C	120	150
Totals	360	450		360	450

(B) If ABC disposed of all of its assets in exchange for cash in amounts equal to the fair market values of these assets immediately before the distribution, A, B, and C would each be allocated $30 of net income from ABC's section 751 property. Accordingly, A, B, and C's net section 751 unrealized gain immediately before the distribution is $30 each under paragraph (b)(2)(ii) of this section.

(iii)(A) Because ABC has elected under section 754, and because A recognizes $30 gain on the distribution of cash, the basis of the real property is increased to $130 under section 734(b). After the distribution (but before taking into account any consequences under this section), ABC's balance sheet would be as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$110	$110	A	$120	$150
Unrealized Receivable	0	90	B	120	150
Real Property	130	100	C	0	0
Totals	240	300		240	300

(B) Because C is no longer a partner in ABC, C would not be allocated any net income from ABC's section 751 property immediately after the distribution. Also, C did not receive any section 751 property in the distribution. Accordingly, C's net section 751 unrealized gain immediately after the distribution is $0 under paragraph (b)(2)(iii) of this section.

(iv) Because C's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, section 751(b) applies to the distribution. Under paragraph (b)(2)(i) of this section, C has a section 751(b) amount equal to $30, the amount by which C's share of pre-distribution net section 751 unrealized gain ($30) exceeds C's share of post-distribution net section 751 unrealized gain ($0). Accordingly, paragraph (b)(3)(i) of this section requires C to recognize $30 of ordinary income using a reasonable approach consistent with the purpose of this section. ABC considers two approaches, the first of which is described in paragraphs (v) and (vi) of this example, and the second of which is described in paragraphs (vii) and (viii) of this example.

(v) Assume ABC adopts an approach under which, immediately before the section 751(b) distribution, C is deemed to recognize $30 of ordinary income. To reflect C's recognition of $30 of ordinary income, C increases its basis in its ABC partnership interest by $30, and the partnership increases its basis in the unrealized receivable by the $30 of income recognized by C, immediately before the distribution. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the section 751(b) distribution immediately prior to the cash distribution, ABC's modified balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$260	$260	A	$120	$150
Unrealized Receivable	30	90	B	120	150
Real Property	100	100	C	150	150
Totals	390	450		390	450

(vi) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Accordingly, C recognizes no gain or loss under section 731(a) upon the distribution. Because C recognizes no gain on the distribution, the basis of the partnership real property is not adjusted. After the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Cash	$110	$110	A	$120	$150
Unrealized Receivable	30	90	B	120	150
Real Property	100	100	C	0	0
Totals	240	300		240	300

(vii) Assume alternatively that ABC adopts an approach under which, immediately before the section 751(b) distribution, C is deemed to—

(A) Receive a distribution of ABC's unrealized receivables with a fair market value of $30 and a tax basis of $0;

(B) Sell the unrealized receivable to ABC in exchange for $30, recognizing $30 of ordinary income; and

(C) Contribute the $30 to ABC. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the section 751(b) distribution immediately prior to the cash distribution, ABC's modified balance sheet is the same as the balance sheet shown in paragraph (v) of this example.

(viii) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. The tax consequences under

the rules of sections 731 through 736 are the same tax consequences described in paragraph (vi) of this example.

Example 4. (i) A and B are equal partners in a partnership, AB, that owns Unrealized Receivable with a fair market value of $50 and nondepreciable real property with a basis of $50 and a fair market value of $100. A has an adjusted basis in its partnership interest of $25, and B has an adjusted basis in its partnership interest of $50. The partnership has a section 754 election in effect, and B has a basis adjustment under section 743(b) of $25 that is allocated to Unrealized Receivable. AB distributes Unrealized Receivable to A in a current distribution. To determine if the distribution is a distribution to which section 751(b) applies, AB must apply the test set forth in paragraph (b)(2) of this section.

(ii)(A) AB makes a non-mandatory revaluation of its assets and its partners' capital accounts are increased under § 1.704–1(b)(2)(iv)(*f*) to reflect each partner's share of the unrealized gain in the partnership's assets. Before the distribution, AB's balance sheet is as follows:

	Tax	*Basis Adj.*	*Book*	*Capital*	*Tax*	*Special Basis*	*Book*
Unrealized Receivable	0	25	50	A	25		75
Real Property	50		100	B	25	25	75
Totals	50	25	150		50	25	150

(B) If AB disposed of all of its assets in exchange for cash in amounts equal to the fair market values of these assets immediately before the distribution, A and B would each be allocated $25 of net income from AB's section 751 property. However, B's net income from Unrealized Receivable would be offset by its $25 section 743 adjustment. § 1.743–1(j)(3). Accordingly, A and B's net section 751 unrealized gain immediately before the distribution are $25 and $0, respectively, under paragraph (b)(2)(ii) of this section.

(iii)(A) After the distribution (but before taking into account any consequences under this section), AB's balance sheet would be as follows:

	Tax	*Basis Adj.*	*Book*	*Capital*	*Tax*	*Carryover Adjustment*	*Book*
Carryover Adjustment		25	0	A	25		25
Real Property	50		100	B	25	25	75
Totals	50	25	100		50	25	100

(B) If AB disposed of all of its assets in exchange for cash in amounts equal to the fair market values of those assets immediately after the distribution, no partner would be allocated net income or loss from section 751 property. However, B has a carryover basis adjustment to ordinary income property of $25 under §§ 1.743–1(g)(2)(ii) and 1.755–1(c)(4), which B must treat as applied to section 751 property with fair market value of $0 pursuant to paragraph (b)(2)(ii) of this section. Accordingly, B's net section 751 unrealized loss immediately after the distribution is $25 under paragraph (b)(2)(iii)(A) of this section. If, immediately after the distribution, A disposed of Unrealized Receivable in exchange for $50 cash, A would recognize $50 of net income from section 751 property. Accordingly, A's net section 751 unrealized gain immediately after the distribution is $50 under paragraph (b)(2)(iii)(B) of this section.

(iv) Because B's net section 751 unrealized loss immediately after the distribution ($25) exceeds B's net section 751 unrealized loss immediately before the distribution ($0), the distribution is a section 751(b) distribution. Under paragraph (b)(2)(i) of this section, B has a section 751(b) amount equal to $25, the difference of B's share of pre-distribution net section 751 unrealized gain ($0) and B's share of post-distribution net section 751 unrealized loss ($25). Accordingly, paragraph (b)(3)(i) of this section requires B to account for $25 of ordinary income using a reasonable approach consistent with the purpose of this section.

(v) Assume AB adopts an approach under which, immediately before the section 751(b) distribution, B is deemed to—

(A) Receive a distribution of Unrealized Receivable with a fair market value of $25 and a tax basis of $25 (which consists of B's section 743(b) basis adjustment and is determined solely for purposes of applying a reasonable method consistent with the purposes of section 751(b));

(B) Sell Unrealized Receivable to AB in exchange for $25, so that B recognizes $0 of ordinary income, and AB receives Unrealized Receivable with a basis of $25; and

(C) Contribute the $25 to AB. Provided the partnership applies the approach consistently for all section 751(b) distributions, AB's adopted approach is reasonable. After taking into account the tax consequences of the section 751(b) distribution, AB's modified balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
			A	0	25
Real Property	50	100	B	50	75
Totals	50	100		50	100

(vi) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Accordingly, A recognizes no gain on the distribution of Unrealized Receivable, which A takes with a basis of $25.

Example 5. Capital Gain Recognition Required. (i) A, B, and C are each 1/3 partners in a partnership, ABC, that holds Unrealized Receivable 1 with a fair market value of $90, Unrealized Receivable 2 with a fair market value of $30, and nondepreciable real property with a fair market value of $180. The partnership has a section 754 election in effect. Each of the partners has an adjusted basis in its partnership interest of $0 with a fair market value of $100. None of the partners has a capital loss carryforward. ABC distributes to A Unrealized Receivable 1 in a current distribution. To determine if the distribution is a distribution to which section 751(b) applies, ABC must apply the test set forth in paragraph (b)(2) of this section.

(ii)(A) Pursuant to paragraph (b)(2)(iv) of this section, ABC revalues its assets and its partners' capital accounts are increased under § 1.704–1(b)(2)(iv)(*f*) to reflect each partner's share of the unrealized gain in the partnership's assets. Before the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Unrealized Receivable 1	$0	$90	A	$0	$100
Unrealized Receivable 2	0	30	B	0	100
Real Property	0	180	C	0	100
Totals	0	300		0	300

(B) If ABC disposed of all of its assets for cash in an amount equal to the fair market value of such property immediately before the distribution, A, B, and C would each be allocated $40 of net income from ABC's section 751 property ($30 each from Unrealized Receivable 1 and $10 each from Unrealized Receivable 2). Accordingly, A, B, and C's net section 751 unrealized gain immediately before the distribution is $40 each under paragraph (b)(2)(ii) of this section.

(iii)(A) After the distribution (but before taking into account any consequences under this section), ABC's balance sheet would be as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Unrealized Receivable 2	$0	$30	A	$0	$10
			B	0	100
Real Property	0	180	C	0	100
Totals	0	210		0	210

(B) If ABC disposed of all of its assets in exchange for cash in amounts equal to the fair market values of those assets immediately after the distribution, A, B, and C would each be allocated $10 of net income from ABC's section 751 property ($10 each from Unrealized Receivable 2). If immediately after the distribution, A disposed of Unrealized Receivable 1 in exchange for $90 cash, A would recognize $90 of net income from section 751 property. Accordingly, B and C's net section 751 unrealized gain immediately after the distribution is $10 each under paragraph (b)(2)(iii)(A) of this section, and A's is $100 under paragraphs (b)(2)(iii)(A) and (B) of this section.

(iv) Because B and C's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, the distribution is a section 751(b) distribution. Under paragraph (b)(2)(i) of this section, each of B and C has a section 751(b) amount equal to $30, the amount by which each partner's share of pre-distribution net section 751 unrealized gain ($40) exceeds its share of post-distribution net section 751 unrealized gain ($10). Accordingly, paragraph (b)(3)(i) of this section requires each of B and C to recognize $30 of ordinary income using a reasonable approach consistent with the purpose of this section. ABC considers three approaches, the first of which is described in paragraphs (v) and (vi) of this example, the second of which is described in paragraphs (vii) and (viii) of this example, and the third of which is described in paragraph (ix) of this example.

(v) Assume ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to recognize $30 of ordinary income. To reflect B and C's recognition of $30 of ordinary income, B and C increase their bases in their ABC partnership interests by $30 each, and the partnership increases its basis in Unrealized Receivable 1 by $60 immediately before the distribution to A. Following the distribution to A, A's basis in Unrealized Receivable 1 is $0 under section 732(a)(2). Because ABC has elected under section 754, the distribution of Unrealized Receivable 1 to A would result in a $60 section 734(b) adjustment to Unrealized Receivable 2. *See* § 1.755–1(c)(1). Because that basis adjustment would have altered the amount of net section 751 unrealized gain or loss computed under paragraph (b)(2) of this section, A must recognize $60 of capital gain prior to the distribution of Unrealized Receivable 1 pursuant to paragraph (b)(3)(ii)(A) of this section. This gain recognition increases A's basis in its ABC partnership interest by $60 immediately before the distribution to A, eliminating the section 734(b) adjustment. *See* section 732(a)(2). In addition, the partnership increases its basis in Real Property by $60 pursuant to paragraph (b)(3)(iii) of this section, and treats A's gain recognized as reducing A's $60 reverse section 704(c) amount in the Real Property. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the deemed gain approach described in this example, ABC's modified balance sheet immediately prior to the distribution is as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 1	$60	$90	A	$60	$100
Unrealized Receivable 2	0	30	B	30	100
Real Property	60	180	C	30	100
Totals	120	300		120	300

(vi) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Thus, Unrealized Receivable 1 would take a $60 basis in A's hands under section 732(a), and no section 734(b) adjustment would be made to Unrealized Receivable 2. After the distribution, ABC's balance sheet is as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 2	$0	$30	A B	$0 30	$10 100
Real Property	60	180	C	30	100
Totals	60	210		60	210

(vii) Assume alternatively that ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to:

(A) Receive a distribution of Unrealized Receivable 1 with a fair market value of $30 and tax basis of $0;

(B) Sell the unrealized receivable to ABC for $30, recognizing $30 of ordinary income; and

(C) Contribute the $30 to ABC. For the same reasons stated in paragraph (v) of this example, A recognizes capital gain of $60. To accomplish this, A, immediately before the section 751(b) distribution, is deemed to:

(*1*) Receive a distribution of Real Property with a fair market value of $60 and tax basis of $0;

(*2*) Sell the Real Property to ABC for $60, recognizing $60 of capital gain; and

(*3*) Contribute the $60 to ABC.

(viii) The partnership treats the $60 of gain recognized by A as reducing A's $60 reverse section 704(c) amount in the Real Property. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. Before taking into account the tax consequences of the section 751(b) distribution, ABC's balance sheet is the same as the balance sheet shown in paragraph (v) of this example. After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. The tax consequences under the rules of sections 731 through 736 are the same tax consequences described in paragraph (vi) of this example.

(ix) Assume alternatively that A does not recognize capital gain of $60. As a result, upon the distribution of Unrealized Receivable 1 to A, ABC makes a $60 section 734(b) adjustment to Unrealized Receivable 2. The adopted approach is not reasonable because it is contrary to paragraph (b)(3)(ii)(A) of this section.

Example 6. Capital Gain Recognition Required. (i)(A) Assume the same facts as *Example 5* of this paragraph (g), except that Unrealized Receivable 1 has a $9 tax basis, and each of the partners has an adjusted basis in its partnership interest of $3. Before the distribution, ABC's balance sheet is as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 1	$9	$90	A	$3	$100
Unrealized Receivable 2	0	30	B	3	100
Real Property	0	180	C	3	100
Totals	9	300		9	300

(B) If ABC disposed of all of its assets for cash in an amount equal to the fair market value of such property immediately before the distribution, A, B, and C would each be allocated $37 of net income from ABC's section 751 property ($27 each from Unrealized Receivable 1 and $10 each from Unrealized Receivable 2). Accordingly, A, B, and C's net section 751 unrealized gain immediately before the distribution is $37 each under paragraph (b)(2)(ii) of this section.

(ii)(A) After the distribution (but before taking into account any consequences under this section), ABC's balance sheet would be as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 2	$6	$30	A	$0	$10
			B	3	100
Real Property	0	180	C	3	100
Totals	6	210		6	210

(B) If ABC disposed of all of its assets for cash in an amount equal to the fair market value of such property immediately after the distribution, taking into account the $6 section 734(b) adjustment allocated to Unrealized Receivable 2, A, B, and C would each be allocated $8 of net income from ABC's section 751 property ($8 each from Unrealized Receivable 2). If, immediately after the distribution, A disposed of Unrealized Receivable 1 for cash in an amount equal to its fair market value, A would recognize $87 of net income from section 751 property. Accordingly, B and C's net section 751 unrealized gain immediately after the distribution is $8 each under paragraph (b)(2)(iii)(A) of this section, and A's is $95 under paragraphs (b)(2)(iii)(A) and (B) of this section.

(iii) Because B and C's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, the distribution is a section 751(b) distribution. Under paragraph (b)(2)(i) of this section, each of B and C has a section 751(b) amount equal to $29, the amount by which each partner's share of pre-distribution net section 751 unrealized gain ($37) exceeds its share of post-distribution net section 751 unrealized gain ($8). Accordingly, paragraph (b)(3)(i) of this section requires each of B and C to recognize $29 of ordinary income using a reasonable approach consistent with the purpose of this section. ABC considers two approaches, the first of which is described in paragraphs (iv) and (v) of this example, and the second of which is described in paragraphs (vi) and (vii) of this example.

(iv) Assume ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to recognize $29 of ordinary income. To reflect B and C's recognition of $29 of ordinary income, B and C increase their bases in their ABC partnership interests by $29 each, and the partnership increases its basis in Unrealized Receivable 1 by $58 to $67 immediately before the distribution to A. Following the distribution to A, A's basis in Unrealized Receivable 1 is $3 under section 732(a)(2). Because ABC has elected under section 754, the distribution of Unrealized Receivable 1 to A would result in a $64 section 734(b) adjustment to Unrealized Receivable 2 (rather than the $6 section 734(b) adjustment computed prior to the application of this section). *See* § 1.755–1(c)(1). Because that additional basis adjustment would have altered the amount of net section 751 unrealized gain or loss computed under paragraph (b)(2) of this section, A must recognize $58 of capital gain prior to the distribution of Unrealized Receivable 1 pursuant to paragraph (b)(3)(ii)(A) of this section. This gain recognition increases A's basis in its ABC partnership interest by $58 to $61 immediately before the distribution to A. In addition, the partnership increases its basis in Real Property by $58 pursuant to paragraph (b)(3)(iii) of this section, and treats A's gain recognized as reducing A's $60 reverse section 704(c) amount in the Real Property. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the deemed gain approach described in this example, ABC's modified balance sheet immediately prior to the distribution is as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 1	$67	$90	A	$61	$100
Unrealized Receivable 2	0	30	B	32	100
Real Property	58	180	C	32	100
Totals	125	300		125	300

(v) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Thus, A would take a $61 tax basis in Unrealized Receivable 1 under section 732(a), and a $6 section 734(b) adjustment would be made to Unrealized Receivable 2. After the distribution, ABC's balance sheet is as follows:

	Tax	Book	Capital	Tax	Book
Unrealized Receivable 2	$6	$30	A	$0	$10
			B	32	100
Real Property	58	180	C	32	100
Totals	64	210		64	210

(vi) Assume alternatively that ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to:

(A) Receive a distribution of Unrealized Receivable 1 with a fair market value of $29 and tax basis of $0;

(B) Sell the unrealized receivable to ABC for $29, recognizing $29 of ordinary income; and

(C) Contribute the $29 to ABC. For the same reasons stated in paragraph (iv) of this example, A recognizes capital gain of $58. To accomplish this, A, immediately before the section 751(b) distribution, is deemed to:

(*1*) Receive a distribution of Real Property with a fair market value of $58 and tax basis of $0;

(*2*) Sell the Real Property to ABC for $58, recognizing $58 of capital gain; and

(3) Contribute the $58 to ABC.

(vii) The partnership treats the $58 of gain recognized by A as reducing A's $60 reverse section 704(c) amount in the Real Property. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the section 751(b) distribution, ABC's balance sheet is the same as the balance sheet shown in paragraph (iv) of this example. After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. The tax consequences under the rules of sections 731 through 736 are the same tax consequences described in paragraph (v) of this example.

Example 7. Capital Gain Recognition Elective. (i)(A) Assume the same facts as described in *Example 6* of this paragraph (g), including that ABC adopts the deemed gain approach described in paragraph (iv), except that ABC does not have a section 754 election in effect. As in *Example 6*, each of A, B, and C has net section 751 unrealized gain of $37 immediately before the distribution. After the distribution (but before taking into account any consequences under this section), ABC's balance sheet would be as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Unrealized Receivable 2	$0	$30	A	0	10
			B	3	100
Real Property	0	180	C	3	100
Totals	0	210		6	210

(B) If ABC disposed of all of its assets for cash in an amount equal to the fair market value of such property immediately after the distribution, because there is no section 734(b) adjustment allocated to Unrealized Receivable 2, A, B, and C would each be allocated $10 of net income from ABC's section 751 property ($10 each from Unrealized Receivable 2). If, immediately after the distribution, A disposed of Unrealized Receivable 1 for cash in an amount equal to its fair market value, A would recognize $87 of net income from section 751 property. Accordingly, B and C's net section 751 unrealized gain immediately after the distribution is $10 each under paragraph (b)(2)(iii)(A) of this section, and A's is $97 under paragraphs (b)(2)(iii)(A) and (B) of this section.

(ii) Because B and C's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, the distribution is a section 751(b) distribution. Under paragraph (b)(2)(i) of this section B and C each have a section 751(b) amount equal to $27, the amount by which those partners' shares of pre-distribution net section 751 unrealized gain ($37), exceeds their shares of post-distribution net section 751 unrealized gain ($10). Accordingly, paragraph (b)(3)(i) of this section requires each of B and C to recognize $27 of ordinary income using a reasonable approach consistent with the purpose of this section.

(iii) Assume ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to recognize $27 of ordinary income. To reflect B and C's recognition of $27 of ordinary income, B and C increase their bases in their ABC partnership interests by $27, and the partnership increases its basis in Unrealized Receivable 1 by $54 to $63 immediately before the distribution to A. The distribution to A results in an adjustment to the basis of the distributed Unrealized Receivable 1 under section 732(a)(2), reducing the basis of Unrealized Receivable 1 in the hands of A to $3. Because ABC has not elected under section 754 and does not have a substantial basis reduction under section 734(d), this $60 decrease to the basis of Unrealized Receivable 1 will not affect the basis of other assets held by ABC. Thus, the distribution does not alter the amount of net section 751 unrealized gain or loss computed under paragraph (b)(2) of this section. Accordingly, A is not obligated under paragraph (b)(3)(ii)(A) of this section to recognize gain or income upon the distribution of Unrealized Receivable 1. However, A may elect to recognize $60 of capital gain under paragraph (b)(3)(ii)(B) of this section to eliminate the section 732 basis adjustment to the distributed Unrealized Receivable 1 which would otherwise cause A's net section 751 unrealized gain to be greater immediately after the distribution than it was immediately before the distribution. This gain recognition increases A's basis in its ABC partnership interest by $60 immediately before the distribution to A. In addition, the partnership increases its basis in Real Property by $60 pursuant to paragraph (b)(3)(iii) of this section, and treats A's gain recognized as reducing A's $60 reverse section 704(c) amount in the Real Property. A receives the distributed Unrealized Receivable 1 with a basis of $63, so that the distribution does not increase A's net section 751 unrealized gain. After the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
Unrealized Receivable 2	$0	$30	A	0	10
			B	30	100
Real Property	60	180	C	30	100
Totals	60	210		60	210

Example 8. (i) A, B, and C, each domestic corporations, are 1/3 partners in a domestic partnership ABC. ABC purchased 100% of the stock in two foreign corporations, X and Y. X and Y each have one share of stock outstanding. ABC has a basis of $15 in its X share with a fair market value of $150, and a basis of $3 in its Y share with a fair market value of $30. The earnings and profits of X that are attributable to ABC's X stock under section 1248 are $135; the earnings and profits of Y that are attributable to ABC's Y stock are $27. ABC has a section 754 election in effect. Each of A, B, and C has a

partnership interest with an adjusted basis of $6 and a fair market value of $60. On January 1, 2013, ABC distributes the Y share to A in a current distribution. To determine if the distribution is a distribution to which section 751(b) applies, ABC must apply the test set forth in paragraph (b)(2) of this section.

(ii)(A) Pursuant to paragraph (b)(2)(iv) of this section, ABC revalues its assets. Its partners' capital accounts are increased under § 1.704–1(b)(2)(iv)(*f*) to reflect each partner's share of the unrealized gain in the partnership's assets. Before the distribution, ABC's balance sheet is as follows (with the shares of X and Y each reflected as having both an unrealized receivable component and a capital gain component):

	Tax	*Book*	*Capital*	*Tax*	*Book*
X stock (total)	$15	$150	A	$6	$60
Unrealized receivable	0	135	B	6	60
Capital gain asset	15	15	C	6	60
Y stock (total)	3	30			
Unrealized receivable	0	27			
Capital gain asset	3	3			
Totals	18	180		18	180

(B) If ABC disposed of all of its assets for cash in an amount equal to the assets' fair market value immediately before the distribution, A, B, and C would each be allocated $54 of net income from ABC's section 751 property ($45 each from X stock and $9 each from Y stock). Accordingly, A, B, and C's net section 751 unrealized gain immediately before the distribution is $54 each under paragraph (b)(2)(ii) of this section.

(iii)(A) After the distribution (but before taking into account any consequences under this section), ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
X stock (total)	$15	$150	A	$3	$30
Unrealized receivable	0	135	B	6	60
Capital gain asset	15	15	C	6	60
Totals	15	150		15	150

(B) If ABC disposed of its asset for cash in an amount equal to the fair market value of that asset immediately after the distribution, A, B, and C would each be allocated $45 of net income from ABC's section 751 property pursuant to § 1.704–3(a)(6). A, however, received Y stock, which continues to be section 751 property in A's hands under section 735(a), with a holding period that includes the partnership's holding period under section 735(b). If A disposed of its Y stock for cash in an amount equal to its fair market value, A would recognize $27 of gain under section 751(b) on the Y stock (a foreign corporation described in section 1248) that is included in A's income under section 1248 as a dividend to the extent of the attributable earnings. Accordingly, B and C's net section 751 unrealized gain immediately after the distribution is $45 each under paragraph (b)(2)(iii)(A) of this section, and A's is $72 under paragraphs (b)(2)(iii)(A) and (B) of this section.

(iv) Because B and C's net section 751 unrealized gain is greater immediately before the distribution than immediately after the distribution, the distribution is a section 751(b) distribution. Under paragraph (b)(2)(i) of this section, B and C each have a section 751(b) amount equal to $9, the amount by which those partners shares of pre-distribution net section 751 unrealized gain ($54) exceeds their shares of post-distribution net section 751 unrealized gain ($45). Accordingly, paragraph (b)(3)(i) of this section requires each of B and C to recognize $9 as a dividend under section 1248 using a reasonable approach consistent with the purpose of this section. ABC considers two approaches, the first of which is described in paragraphs (v) and (vi) of this example, and the second of which is described in paragraph (vii) of this example.

(v) Assume ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to recognize $9 of gain includible as a dividend with respect to the distribution of the Y stock, which is treated as a sale or exchange for purposes of section 1248. To reflect B and C's recognition of $9 of dividend income, B and C increase the bases in their ABC partnership interests by $9 each, and the partnership increases its basis in the Y share unrealized receivable component by $18 immediately before the distribution. The portion of the unrealized receivable component of the Y share that is deemed to be sold or exchanged under section 1248 has a new holding period beginning on the day after the section 751(b) distribution ("the new holding period portion"). The earnings and profits of $18 attributable to the new holding period portion of the Y share are 2/3 of the total earnings and profits attributable to the Y share immediately before the distribution (B and C's $18 aggregate gain recognized under section 751(b) divided by $27, the aggregate of all the partners' net section 751 unrealized gain immediately before the distribution). The remaining earnings and profits are allocated to the remainder of the Y share. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the deemed gain approach described in this example, ABC's modified balance sheet immediately before the distribution is as follows:

	Tax	Book	Capital	Tax	Book
X stock	$15	$150	A	$6	$60
Unrealized receivable	0	135	B	15	60
Capital gain asset	15	15	C	15	60
Y stock	21	30			
New holding period portion	18	18			
Unrealized receivable	0	9			
Capital gain asset	3	3			
Totals	36	180		36	180

(vi) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Accordingly, the basis of the distributed Y stock in A's hands is limited under section 732(a)(2) to A's $6 basis in its partnership interest. Pursuant to section 732(c)(3)(B), the $15 decrease in basis from $21 to $6 must be allocated to the distributed components of the Y stock in proportion to their respective adjusted bases. A must allocate the $15 decrease in basis in the Y stock between the new holding period portion (which has a basis of $18) and the remainder of the Y share (which has a basis of $3). Accordingly, A receives the new holding period portion of the Y share with an adjusted basis of $5.14 ($6 multiplied by ($18 divided by $21)), and the remainder of the Y share with an adjusted basis of $0.86 ($6 multiplied by ($3 divided by $21)). Because the basis of the distributed Y stock in A's hands was reduced from $21 (the basis of the Y stock in the hands of ABC) to $6 (the basis in A's hands), ABC must increase the basis of its remaining asset under section 734(b)(1)(B) by $15. ABC must allocate the $15 under § 1.755–1(c)(1)(i) to the capital gain portion of the X stock. After the distribution, ABC's balance sheet is as follows:

	Tax	Book	Capital	Tax	Book
X stock	$30	$150	A	$0	$30
Unrealized receivable	0	135	B	15	60
Capital gain asset	30	15	C	15	60
Totals	30	150		30	150

(vii) Assume alternatively that ABC adopts an approach under which, immediately before the section 751(b) distribution, B and C are each deemed to:

(A) Receive a distribution of the portion of the partnership's Y stock with a fair market value of $9 and a tax basis of $0;

(B) Sell the Y stock back to ABC for $9, recognizing $9 of gain includible as a dividend; and

(C) Contribute the $9 to ABC. ABC will be deemed to have purchased for $18 a portion of the Y stock unrealized receivable component, which will have a new holding period. The deemed sale of Y stock by B and C to ABC will be treated as a sale or exchange for purposes of section 1248. Provided that the partnership applies the approach consistently for all section 751(b) distributions, Partnership ABC's adopted approach is reasonable. After taking into account the tax consequences of the deemed transaction, ABC's balance sheet is the same as the balance sheet shown in paragraph (v) of this example. After taking into account the tax consequences of the section 751(b) distribution, ABC's balance sheet is the same as the balance sheet shown in paragraph (vi) of this example.

(viii) Assume that in a later unrelated transaction, A sells its Y stock at a time when its fair market value, earnings and profits, and adjusted basis have not changed. The sale of Y stock by A is a sale or exchange subject to section 1248. Pursuant to § 1.732–1(c)(2)(v), in determining the dividend portion of its gain on the Y stock under section 1248, A does not take into account the $15 decrease in basis under section 732. Accordingly, upon the sale of the Y stock, A recognizes $9 of gain, the lesser of $9 ($0 gain on the new holding period portion ($18 fair market value minus $18 basis) plus $9 gain on the remainder ($12 fair market value minus $3 basis)) or $9 (earnings and profits attributable to the remainder of the Y share) as dividend income under section 1248. A recognizes $15 of capital gain in addition to the $9 of dividend income ($30 amount realized minus $15 ($6 aggregate basis in Y share plus $9 section 1248 dividend income)).

(ix) Assume that ABC also sells its X stock in a later unrelated transaction at a time when its fair market value has declined to $120 but earnings and profits have remained the same. ABC has not made an election under § 1.755–1(c)(2)(vi). In determining the dividend portion of its gain on the X stock under section 1248, ABC does not take into account the $15 increase in basis under section 734(b). Upon the sale of the stock, ABC recognizes $105, the lesser of $105 ($120 – $15) or $135 (earnings and profits attributable to the X stock for the partnership's holding period) as dividend income. In addition to the $105 of gain includible as a dividend, ABC recognizes $15 of capital loss ($120 amount realized minus $135 ($30 aggregate basis in X stock plus $105 section 1248 dividend income)).

Example 9. (i) Assume the same facts as in *Example 8* of this paragraph (g), except assume that Partnership ABC makes an election under § 1.755–1(c)(2)(vi). As in *Example 8*, paragraph (b)(3)(i) of this section requires each of B and C to recognize $9 as a dividend under section 1248 using a reasonable approach consistent with the purpose of this section for the reasons described in paragraphs (ii) through (iv) of *Example 8*. Further assume that ABC adopts the deemed gain approach described in paragraph (v) of *Example 8*. As in *Example 8*, B and C are each deemed to recognize $9 of dividend income with respect to the distribution of the Y stock, which is treated as a sale or exchange for purposes of section 1248. To reflect B and C's recognition of $9 of dividend income, B and C increase the bases in their ABC partnership interests by $9 each. The partnership increases its basis in the Y share unrealized receivable component by $18 immediately before the distribution. The portion of the unrealized receivable component of the Y share that is deemed to be sold or exchanged under section 1248 has a new holding period beginning on the day after the section 751(b) distribution ("the new holding period portion").

(ii) Because ABC makes an election under § 1.755–1(c)(2)(vi), the distribution of the Y share to

A results in a $15 section 734(b) adjustment to the unrealized receivable component of the X share. Because that basis adjustment would have altered the amount of net section 751 unrealized gain or loss computed under paragraph (b)(2) of this section, A must recognize $15 of gain with respect to the X share pursuant to paragraph (b)(3)(ii)(A) of this section. Also pursuant to paragraph (b)(3)(ii)(A) of this section, A's recognition of income with respect to the X stock is a sale or exchange for purposes of section 1248 and begins a new holding period for this portion of ABC's X stock, including for purposes of attributing earnings and profits. This income recognition increases A's basis in its ABC partnership interest by $15 immediately before the distribution to A. In addition, the partnership increases its basis in the X share by $15, immediately before the distribution to A. The partnership treats the $15 of dividend income recognized by A as reducing A's $15 reverse section 704(c) amount in the X stock. Provided the partnership applies the approach consistently for all section 751(b) distributions, ABC's adopted approach is reasonable. After taking into account the tax consequences of the deemed gain approach described above, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
X stock	$30	$150	A	$21	$60
Unrealized receivable	0	120	B	15	60
Capital gain asset	30	30	C	15	60
Y stock	21	30			
Unrealized receivable	0	9			
Capital gain asset	21	21			
Totals	51	180		51	180

(iii)(A) After determining the tax consequences of the section 751(b) distribution, the rules of sections 731 through 736 apply. Accordingly, the Y stock would take a $21 basis in A's hands under section 732(a), and no section 734(b) adjustment would be made to the X stock. After the distribution, ABC's balance sheet is as follows:

	Tax	*Book*	*Capital*	*Tax*	*Book*
X stock	$30	$150	A	$0	$30
Unrealized receivable	0	120	B	15	60
Capital gain asset	30	30	C	15	60
Totals	30	150		30	**150**

(B) If the partnership sells the X stock, the gain recognized is $120 ($150 – $30), all of which is recharacterized as a dividend under section 1248. Because A's recognition of $15 of dividend income reduced A's reverse section 704(c) amount in the X stock, this gain is allocated $45 to B, $45 to C, and $30 to A.

Par. 8. Section 1.755–1 is amended by:

a. Adding paragraphs (c)(2)(iii), (iv), (v), and (vi).

b. Revising the paragraph heading and the introductory text of paragraph (c)(6).

c. Removing the paragraph heading "*Example*." in paragraph (c)(6) and adding "*Example 1*." in its place.

d. Adding *Examples 2* and *3* to paragraph (c)(6).

e. Revising paragraph (e)(2).

The additions and revisions read as follows:

§ 1.755–1 Rules for allocation of basis.

* * * * *

(c) * * *

(2) * * *

(iii) *Coordination with section 1245 and similar provisions*. Any increase in basis allocated to capital gain property pursuant to the second sentence in paragraph (c)(2)(i) of this section is not taken into account in determining the recomputed or adjusted basis in the property for purposes of section 1245(a)(1). Notwithstanding the prior sentence, any depreciation or amortization of the increase in basis that is allowed or allowable is taken into account in computing the property's recomputed basis. In the case of property that is subject to section 617(d)(1), 1250(a)(1), 1252(a)(1), or 1254(a)(1), rules similar to the rule in this paragraph (c)(2)(iii) shall apply.

(iv) *Coordination with section 1231*. Any increase in basis allocated to capital gain property pursuant to the second sentence in paragraph (c)(2)(i) of this section is not taken into account in determining section 1231 gain and loss, as defined in section 1231(a)(3). Any basis adjustment to an asset not taken into account pursuant to this paragraph (c)(2)(iv) shall be treated as gain from the sale or exchange of a capital asset with the same holding period as the underlying asset.

(v) *Coordination with sections 1248 and 995*. Any increase in basis allocated to stock in a foreign corporation pursuant to the second sentence in paragraph (c)(2)(i) of this section, or any decrease in basis allocated to stock in a foreign corporation pursuant to the second sentence in paragraph (c)(2)(ii) of this section, is not taken into account in determining the amount of gain recognized on the sale or

exchange of such stock for purposes of section 1248(a). In the case of property that is subject to section 995(c), rules similar to the rule set forth in this paragraph (c)(2)(v) shall apply.

(vi) *Election not to apply the provisions of paragraphs (c)(2)(iii), (iv), and (v)*. A partnership may elect not to apply paragraphs (c)(2)(iii), (iv), and (v) of this section, and § 1.732–1(c)(2)(iii), (iv), and (v). An election made under this paragraph (c)(2)(vi) shall apply to all property distributions taking place in the partnership taxable year for which the election is made and in all subsequent partnership taxable years (including after a termination of the partnership under section 708(b)(1)(B)). An election under this paragraph (c)(2)(vi) must be made in a written statement filed with the partnership return for the first taxable year in which any of paragraph (c)(2)(iii), (iv), or (v) of this section, or § 1.732–1(c)(2)(iii), (iv), and (v), would have applied if no election was made. An election under this paragraph (c)(2)(vi) is valid only if the required statement is included with a partnership return that is filed not later than the time prescribed by paragraph (e) of this section or § 1.6031(a)–1 (including extensions thereof) for filing the return for such taxable year. This election is a method of accounting under section 446, and once the election is made, it can be revoked only with the consent of the Commissioner. The revocation of the election, or the making of a late election, under this paragraph (c)(2)(vi) is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. *See* paragraph (c)(6), *Example 3*, of this section for the treatment of a section 734(b) adjustment if an election under this paragraph (c)(2)(vi) is made, and certain consequences of the election under section 751(b). The statement required by this paragraph (c)(2)(vi) shall—

(A) Set forth the name and address of the partnership making the election;

(B) Be signed by any officer, manager, or member of the partnership who is authorized (under local law or the partnership's organizational documents) to make the election and who represents to having such authorization under penalties of perjury; and

(C) Contain a declaration that the partnership elects not to apply paragraphs (c)(2)(iii), (iv), and (v) of this section and § 1.732–1(c)(2)(iii), (iv), and (v).

* * * * *

(6) *Examples*. The following examples illustrate this paragraph (c):

* * * * *

Example 2. (i) A, B, and C are equal partners in ABC. Each partner has an outside basis in its partnership interest of $20. ABC owns depreciable equipment X with an adjusted basis of $30 and a fair market value of $150 and depreciable equipment Y with an adjusted basis of $30 and a fair market value of $30. ABC has made an election under section 754.

(ii) The depreciable equipment X has $120 of adjustments reflected in its adjusted basis within the meaning of § 1.1245–2(a)(2). Accordingly, the entire $120 of the gain with respect to depreciable equipment X would be treated as gain to which section 1245(a)(1) would apply if the partnership sold the depreciable equipment X for its fair market value. ABC, therefore, has a $120 unrealized receivable within the meaning of § 1.751–1(c)(4)(iii). Assume ABC makes a current distribution of the depreciable equipment Y to A. Because A's basis in his partnership interest is only $20, A's basis in the depreciable equipment Y will be limited to $20 under section 732(a). Under section 734(b), ABC will increase the basis in its capital gain property by $10 and will not adjust the basis of ordinary income property. Assume ABC has not made an election under § 1.755–1(c)(2)(vi).

(iii) *Allocation between classes*. Pursuant to § 1.755–1(a)(1), ABC's $120 unrealized receivable associated with the depreciable equipment X is treated as a separate asset that is ordinary income property. Thus, ABC is treated as having two assets (each actually a component of the single asset, equipment X) after the distribution, one that is capital gain property with a basis of $30 and a fair market value of $30, and one that is ordinary income property with a basis of $0 and a fair market value of $120.

(iv) *Allocation within class*. ABC must allocate the $10 basis increase entirely to the capital gain portion of the depreciable equipment X, as it holds no other capital gain property after it distributes the depreciable equipment Y to A. Therefore, ABC increases the basis of the capital gain property to $40.

(v) *Treatment of section 734(b) adjustment*. Pursuant to paragraph (c)(2)(iii) of this section, if ABC sold its depreciable equipment X for $150 immediately after the distribution to A, ABC would not take into account the $10 section 734(b) adjustment in determining ABC's recomputed or adjusted basis in the depreciable equipment X for purposes of section 1245(a)(1) and, accordingly, would recognize $120 of ordinary income. Also pursuant to paragraph (c)(2)(iv) of this section, the $10 section 734(b) adjustment is not taken into account for purposes of determining section 1231 gain or loss. Thus, pursuant to paragraph (c)(2)(vi) of this section, ABC would recognize a $10 capital loss.

(vi) *Treatment of additional depreciation and appreciation*. (A) Assume, instead, that ABC continues to own the equipment and takes additional depreciation deductions of $16 ($15 with respect to the original remaining $30 basis and $1 with respect to the additional $10 basis resulting from the section 734(b) adjustment). At a time when the equipment has appreciated in value to $170, ABC sells the depreciable equipment X for $170 in a taxable transaction. In that same taxable year, ABC does not sell any other property used in its trade or business.

(B) Pursuant to section 1245(a)(1), ABC must recognize ordinary income in an amount by which the lesser of the following two amounts exceeds ABC's adjusted basis in the depreciable equipment X—

(*1*) ABC's recomputed basis in the depreciable equipment, or

(*2*) ABC's amount realized;

(C) Pursuant to section 1245(a)(2)(A), ABC's recomputed basis is an amount equal to the sum of—

(*1*) ABC's adjusted basis of the property, plus

(*2*) The amount of adjustments reflected in the adjusted basis on account of deductions allowed or allowable.

(D) Pursuant to (c)(2)(iii) of this section, the $9 remaining section 734(b) adjustments is not taken into account in determining ABC's recomputed or adjusted basis in the property for purposes of section 1245(a)(1). Thus, ABC's adjusted basis in the property is $15 (the remaining original basis). Also pursuant to (c)(2)(iii) of this section, however, any depreciation, or amortization of the section 734(b) adjustment that is allowed or allowable is taken into account in computing the property's recomputed basis. Thus, ABC's amount of adjustments reflected in the adjusted basis is $136 (the original $120 adjustment for depreciation deductions plus the additional $15 adjustment for depreciation deductions plus the additional $1 adjustment for depreciation deductions taken with respect to the section 734(b) adjustment). Accordingly, ABC's recomputed basis is $151 ($15 adjusted basis plus $136 of adjustments), which is lower than ABC's amount realized of $170. ABC, therefore, must recognize ordinary income in an amount by which ABC's recomputed basis of $151 exceeds ABC's adjusted basis in the depreciable equipment X. Pursuant to (c)(2)(iii) of this section, the $9 remaining section 734(b) adjustments is not taken into account in determining the adjusted basis in the property for purposes of section 1245(a)(1). Accordingly, ABC must recognize $136 of ordinary income (the excess of ABC's $151 recomputed basis in the depreciable equipment X over ABC's $15 adjusted basis in the depreciable equipment X).

(E) Pursuant to paragraph (c)(2)(iv) of this section, the section 734(b) adjustment is not taken into account in determining ABC's section 1231 gain or loss. Accordingly, pursuant to section 1231(a)(1), ABC recognizes $19 of capital gain (ABC's $170 amount realized on the disposition of the depreciable equipment X over ABC's adjusted basis of $15 in the depreciable equipment X, reduced by the $136 of ordinary income ABC recognized under section 1245(a)(1)). Pursuant to paragraph (c)(2)(vi) of this section, ABC also recognizes a capital loss equal to the remaining $9 section 734(b) adjustment.

Example 3. (i) Assume the same facts as *Example 2* of this paragraph (c), except ABC has made an election under paragraph (c)(2)(vi) of this section.

(ii) *Treatment of section 734(b) adjustment*. Because ABC has made an election under paragraph (c)(2)(vi) of this section, paragraph (c)(2)(iii) of this section does not apply. Thus, if ABC sold its depreciable equipment X immediately after the distribution to A, ABC would take into account the $10 section 734(b) adjustment in determining ABC's recomputed or adjusted basis in the depreciable equipment X for purposes of section 1245(a)(1) and, accordingly, would recognize $110 of ordinary income (including for purposes of applying section 751).

* * * * *

(e) * * *

(2) *Special rules*. Paragraphs (a) and (b)(3)(iii) of this section apply to transfers of partnership interests and distributions of property from a partnership that occur on or after June 9, 2003, and paragraphs (c)(2)(iii), (iv), (v), (vi), and (c)(6) of this section and *Examples 2* and *3* of paragraph (c) of this section apply to distributions of property from a partnership that occur on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register.**

Par. 9. Section 1.995–4 is amended by revising the section heading and adding a new sentence at the end of paragraph (a)(1) to read as follows:

§ 1.995–4 Gain on certain dispositions of stock in a DISC.

(a) * * * (1) * * * *But see* §§ 1.732–1(c)(2)(v) and 1.755–1(c)(2)(v) for rules governing the application of section 995(c) to partnership property in situations in which the basis of the property is increased or decreased under section 732 or 734(b).

* * * * *

Par. 10. Section 1.1231–1 is amended by adding a new sentence after the third sentence in the introductory text of paragraph (d) to read as follows:

§ 1.1231–1 Gains and losses from the sale or exchange of certain property used in the trade or business.

* * * * *

(d) * * * *See also* §§ 1.732–1(c)(2)(iv) and 1.755–1(c)(2)(iv) for rules governing the application of section 1231 to partnership property in situations in which the basis of the property is increased under section 732 or 734(b). * * *

* * * * *

§ 1.1245–2 [Amended]

Par. 11. Section 1.1245–2 is amended by removing paragraph (c)(6)(ii) and redesignating paragraph (c)(6)(iii) as paragraph (c)(6)(ii).

Par. 12. Section 1.1245–4 is amended by revising paragraphs (f)(2)(ii) and (f)(3) and *Example 2* to read as follows:

§ 1.1245–4 Exceptions and limitations.

* * * * *

(f) * * *

(2) * * *

(ii) The portion of such potential section 1245 income which is recognized as ordinary income under paragraphs (b)(3)(i) and (b)(4)(i) of § 1.751–1.

(3) * * *

Example 2. Assume the same facts as in *Example 1* of this paragraph (f) except that the machine had been purchased by the partnership. Assume further that upon the distribution, $4,000 of gain is recognized as ordinary income under section 751(b). Under section 1245(b)(3), gain to be taken into account under section 1245(a)(1) by the partnership is limited to $4,000. Immediately after the distribution, the amount of adjustments reflected in the adjusted basis of the property is $2,000 (that is, potential section 1245 income of the partnership, $6,000, minus gain recognized under section 751(b), $4,000). Thus, if the adjusted basis of the machine in the hands of C were $10,000, the recomputed basis of the machine would be $12,000 ($10,000 plus $2,000).

* * * * *

Par. 13. Section 1.1248–1 is amended by adding a new sentence at the end of paragraph (a)(1) to read as follows:

§ 1.1248–1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

(a) * * * (1) * * * *See also* §§ 1.732–1(c)(2)(v) and 1.755–1(c)(2)(v) for rules governing the application of section 1248 to partnership property in situations in which the basis of the property is increased or decreased under section 732 or 734(b).

* * * * *

Par. 14. Section 1.1250–1 is amended by revising the section heading and adding a new sentence at the end of paragraph (f) to read as follows:

§ 1.1250–1 Gain from disposition of certain depreciable property.

(f) * * * *See also* §§ 1.732–1(c)(2)(iii) and 1.755–1(c)(2)(iii) for rules governing the application of section 1250 to partnership property in situations in which the basis of the property is increased under section 732 or 734(b).

* * * * *

Par. 15. Section 1.1252–2 is amended by adding a new sentence at the end of paragraph (c)(2)(vii) to read as follows:

§ 1.1252–2 Special rules.

* * * * *

(c) * * *

(2) * * *

(vii) * * * *See also* §§ 1.732–1(c)(2)(iii) and 1.755–1(c)(2)(iii) for rules governing the application of section 1252 to partnership property in situations in which the basis of the property is increased under section 732 or 734(b).

* * * * *

Par. 16. Section 1.1254–5 is amended by revising the introductory text of paragraph (b)(1) to read as follows:

§ 1.1254–5 Special rules for partnerships and their partners.

* * * * *

(b) *Determination of gain treated as ordinary income under section 1254 upon the disposition of natural resource recapture property by a partnership*—(*1*) *General rule*. Upon a disposition of natural resource recapture property by a partnership, the amount treated as ordinary income under section 1254 is determined at the partner level. *See also* §§ 1.732–1(c)(2)(iii) and 1.755–1(c)(2)(iii) for rules governing the application of section 1254 to partnership property in certain situations. Each partner must recognize as ordinary income under section 1254 the lesser of—

* * * * *

Par. 17. Section 1.6050K–1 is amended by revising paragraph (a)(4)(ii) and adding a new sentence after the third sentence of paragraph (c) introductory text to read as follows:

§ 1.6050K–1 Returns relating to sales or exchanges of certain partnership interests.

(a) * * *

(4) * * *

(ii) *Section 751 property*. For purposes of this section, the term "section 751 property" means unrealized receivables, as defined in section 751(c) and the regulations, and inventory items, as defined in section 751(d) and the regulations.

* * * * *

(c) * * * With respect to any statement required to be furnished to a transferor, the statement shall, in addition to the other information required, include the amount of any gain or loss attributable to section 751 property that is required to be recognized pursuant to paragraph (a)(2) of § 1.751–1. * * *

* * * * *

Par. 18. For each section listed in the table, remove the language in the "Remove" column and add in its place the language in the "Add" column as set forth below:

Section	Remove	Add
§ 1.704–3, paragraph (a)(6)(ii)	§ 1.743–1(b) or 1.751–1(a)(2)	§ 1.743–1(b), 1.751–1(a)(2), or 1.751–1(b)
§ 1.751–1, paragraph (c)(4)(i) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(ii), first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(iii) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(iv) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(v) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(vii) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(viii) First and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (c)(4)(ix) first and last sentences	sections 731, 736, 741, and 751	sections 731, 732, and 741 (but not for purposes of section 736)
§ 1.751–1, paragraph (d)(2)(i) last sentence	section 1221(1)	section 1221(a)(1)
§ 1.751–1, paragraph (d)(2)(ii) second sentence	section 1221(4)	section 1221(a)(4)
§ 1.1245–1, paragraph (a) last sentence	see section 1245(b) and § 1.1245–4.	*see* section 1245(b), and §§ 1.732–1(c)(2)(iii), 1.755–1(c)(2)(iii), and 1.1245–4.
§ 1.1245–2, paragraph (c)(6)(i)	1245(b)(6)(B)	1245(b)(5)(B)

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

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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.
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