INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2015–37
September 14, 2015

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–103033–11, page 325.

This document contains proposed regulations that provide guidance regarding the amount of the penalty under section 6707A of the Internal Revenue Code (Code) for failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction.

REG–109813–11, page 330.

These proposed regulations would make it easier for individuals to satisfy the presence test for qualifying as a bona fide resident of a U.S. possession or territory under section 937(a). In counting days of presence in the possession under the presence test, the proposed regulations generally would allow an individual to include up to 30 days that the individual was outside the possession and the United States, provided that the individual was present for more days in the possession than in the United States.

REG–136459–09, page 332.

The proposed regulations provide guidance to taxpayers on the amendments made to section 199 by the Energy Improvement and Extension Act of 2008 and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, involving oil related qualified production activities income and qualified films, and the American Taxpayer Relief Act of 2012, involving activities in Puerto Rico. The proposed regulations also provide guidance on (1) determining domestic production gross receipts, (2) the terms manufactured, produced, grown, or extracted, (3) contract manufacturing, (4) hedging transactions, (5) construction activities, (6) allocating cost of goods sold, and (7) agricultural and horticultural cooperatives.

REG–143800–14, page 347.

Proposed regulations under section 36B of the Code provide that an eligible employer-sponsored plan does not meet the minimum value requirement unless it provides substantial coverage of inpatient hospitalization services and physician services.

T.D. 9731, page 314.

Final and temporary regulations relating to the allocation of W–2 wages for purposes of the W–2 wage limitation on the amount of a taxpayer's deduction related to domestic production activities. Specifically, the temporary regulations provide guidance on (1) the allocation of W–2 wages paid by two or more taxpayers that are employers of the same employees during a calendar year and (2) the determination of W–2 wages if the taxpayer has a short taxable year.

EMPLOYEE PLANS

REG–123640–15, page 350.

Notice of proposed rulemaking by cross-reference to temporary regulations that relate to multiemployer pension plans that are projected to have insufficient funds, at some point in the future, to pay the full benefits to which individuals will be entitled under the plans (referred to as plans in "critical and declining status"). The Multiemployer Pension Reform Act of 2014 ("MPRA") amended the Internal Revenue Code to incorporate suspension of benefits provisions that permit these multiemployer plans to reduce pension benefits payable to participants and beneficiaries if certain conditions are satisfied. A suspension of benefits is not permitted to take effect prior to a vote of the participants of the plan with respect to the suspension. These regulations contain guidance relating to the administration of that vote.

(Continued on the next page)

Finding Lists begin on page ii.

Notice 2015–58, page 322.

This notice provides guidance on certain issues relating to the application of the Cooperative and Small Employer Charity Pension Flexibility Act, Pub. L. No. 113–97 (CSEC Act), which specifies minimum funding requirements and related rules that apply with respect to certain defined benefit pension plans maintained by groups of cooperatives and related entities and groups of charities.

T.D. 9735, page 316.

These temporary regulations relate to multiemployer pension plans that are projected to have insufficient funds, at some point in the future, to pay the full benefits to which individuals will be entitled under the plans (referred to as plans in "critical and declining status"). The Multiemployer Pension Reform Act of 2014 ("MPRA") amended the Internal Revenue Code to incorporate suspension of benefits provisions that permit these multiemployer plans to reduce pension benefits payable to participants and beneficiaries if certain conditions are satisfied. A suspension of benefits is not permitted to take effect prior to a vote of the participants of the plan with respect to the suspension. These regulations contain guidance relating to the administration of that vote.

The IRS Mission

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

1.199-2: Wage Limitation

Allocation of W–2 Wages in a Short Taxable Year and in an Acquisition or Disposition

T.D. 9731

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the allocation of W–2 wages for purposes of the W–2 wage limitation on the amount of a taxpayer's deduction related to domestic production activities. Specifically, the temporary regulations provide guidance on: the allocation of W–2 wages paid by two or more taxpayers that are employers of the same employees during a calendar year; and the determination of W–2 wages if the taxpayer has a short taxable year. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–136459–09) on this subject in the Proposed Rules section in this issue of the **Internal Revenue Bulletin.**

DATES: *Effective Date*: These regulations are effective on August 27, 2015.

Applicability Date: For dates of applicability, see § 1.199–8T(i)(10).

FOR FURTHER INFORMATION CONTACT: James A. Holmes 202-317-4137 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 199(b) of the Internal Revenue Code (Code). Section 199(b) was enacted by the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418 (2004)). Subsequent amendments to section 199(b) were made by the Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25 (2005)), the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345 (2005)), the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Public Law 110–343, 122 Stat 3765 (2008)), and the Tax Increase Prevention Act of 2014 (Public Law 113–295, 128 Stat. 4010 (2014)).

Under section 199(b)(1), the amount of the deduction allowable under section 199(a) for any taxable year shall not exceed 50 percent of the W–2 wages of the taxpayer for the taxable year. Section 199(b)(2)(A) generally defines *W–2 wages*, with respect to any person for any taxable year of such person, as the sum of amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 199(b)(3), after its amendment by section 219(b) of the Tax Increase Prevention Act of 2014, provides that the Secretary shall provide for the application of section 199(b) in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business, or the major portion of a separate unit of a trade or business during the taxable year. Section 219(d) of the Tax Increase Prevention Act of 2014 provides that the amendments made by section 219 shall take effect as if included in the provision of the American Jobs Creation Act of 2004 to which they relate. Section 1.199–2(c) provides the current rule for acquisitions and dispositions.

Section 1.199–2(c) currently provides that if a taxpayer (a successor) acquires a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business from another taxpayer (a predecessor), then, for purposes of computing the respective section 199 deduction of the successor and of the predecessor, the W–2 wages paid for that calendar year shall be allocated between the successor and the predecessor based on whether the wages are for employment by the successor or for employment by the predecessor. Thus, the W–2 wages are allocated based on whether the wages are for employment for a period during which the employee was employed by the predecessor or for employment for a period during which the employee was employed by the successor. The W–2 wage allocation under the current regulations is made regardless of which permissible method is used by a predecessor or a successor for reporting wages on Form W–2, as provided in Rev. Proc. 2004–53 (2004–2 CB 320) (see § 601.601(d)(2) of this chapter). Section 1.199–2(e)(1) provides that under section 199(b)(2), the term *W–2 wages* means, with respect to any person for any taxable year of such person, the sum of the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

Rev. Proc. 2006–47 (2006–2 CB 869) (see § 601.601(d)(2)) is the currently effective guidance providing methods of calculating W–2 wages and related rules for purposes of section 199(b). Section 6.02(A) of Rev. Proc. 2006–47 provides that the amount of W–2 wages for a taxpayer with a short taxable year includes only those wages subject to Federal income tax withholding that are reported on Form W–2, "Wage and Tax Statement," for the calendar year ending with or within that short taxable year.

In certain situations, a short taxable year may not include a calendar year ending within such short taxable year. Section 1.199–2(c) of the current regulations does not address these situations and does not reflect the amendment made by the Tax Increase Prevention Act of 2014. In order to provide guidance on the application of section 199(b)(3) to a short taxable year that does not include a calendar year ending within the short taxable year, the IRS and the Treasury Department are revising the regulations to address these situations. To provide immediate effect, the IRS and the Treasury Department are issuing these regulations as temporary regulations. These temporary regulations apply solely for purposes of section 199.

Explanation of Provisions

The final regulations issued in connection with these temporary regulations remove the current language of § 1.199–2(c) and replace it with a cross reference to these temporary regulations. In the place of the current language, these temporary regulations provide rules for calculating W–2 wages for purposes of the W–2 wage limitation in the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, the major portion of a separate unit of a trade or business during the taxable year, or a short taxable year. Specifically, these temporary regulations provide a rule for acquisitions and dispositions if one or more taxpayers may be considered the employer of the employees of the acquired or disposed of trade or business during that calendar year. In that case, the temporary regulations provide that the W–2 wages paid during the calendar year to employees of the acquired or disposed of trade or business are allocated between each taxpayer based on the period during which the employees of the acquired or disposed of trade or business were employed by the taxpayer.

These temporary regulations also provide a rule to apply in the case of a short taxable year in which there is no calendar year ending within such short taxable year (short-taxable-year rule). Wages paid by a taxpayer during the short taxable year to employees for employment by such taxpayer are treated as W–2 wages for such short taxable year for purposes of section 199(b)(1).

These temporary regulations also describe types of transactions that are considered either an acquisition or disposition for purposes of section 199(b)(3). Specifically, these temporary regulations provide that an acquisition or disposition includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

These regulations also contain cross references to § 1.199–2(a), (b), (d), and (e). The IRS and the Treasury Department observe that these rules continue to apply to taxpayers that use these temporary regulations. For example, the non-duplication rule of § 1.199–2(d) applies such that a taxpayer that includes wages as W–2 wages based on these temporary regulations, including by filing an amended return for a short taxable year, may not treat those wages as W–2 wages for any other taxable year. Also, wages qualifying as W–2 wages of one taxpayer based on these temporary regulations cannot be treated as W–2 wages of another taxpayer.

The temporary regulations are applicable for taxable years beginning on or after August 27, 2015 and expire on August 24, 2018. A taxpayer may apply § 1.199–2T(c) to taxable years for which the limitations for assessment of tax has not expired beginning before August 27, 2015.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866 of, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 533(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

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Adoption of Amendment to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.199–2T also issued under 26 U.S.C. 199(b)(3).

* * * * *

Par. 2. Section 1.199–0 is amended by revising the entry for § 1.199–2(c) and adding entries for §§ 1.199–2(c)(1), (c)(2), and (c)(3), and 1.199–8(i)(10) to read as follows:

§ 1.199–0 Table of contents.

* * * * *

§ 1.199–2 Wage limitation.

* * * * *

(c) Acquisitions, dispositions, and short taxable years.

(1) Allocation of wages between more than one taxpayer.

(2) Short taxable years.

(3) Operating rules.

(i) Acquisition or disposition.

(ii) Trade or business.

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§ 1.199–8 Other rules.

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(i) * * *

(10) Acquisitions, dispositions, and short taxable years.

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Par. 3. Section 1.199–2 is amended by revising paragraph (c) to read as follows:

§ 1.199–2 Wage limitation.

* * * * *

(c) [Reserved]. For further guidance see § 1.199–2T(c).

* * * * *

Par. 4. Section 1.199–2T is added to read as follows:

§ 1.199–2T Wage limitation (temporary).

(a) through (b) [Reserved]. For further guidance, see § 1.199–2(a) through (b).

(c) *Acquisitions, dispositions, and short taxable years*—(1) *Allocation of* *wages between more than one taxpayer*. For purposes of computing the section 199 deduction of a taxpayer, in the case of an *acquisition or disposition* (as defined in paragraph (c)(3)(i) of this section) of a *trade or business* (as defined in paragraph (c)(3)(ii) of this section) that causes more than one taxpayer to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W–2 wages of the taxpayer for the calendar year of the acquisition or disposition are allocated between each taxpayer based on the period during which the employees of the acquired or disposed of trade or business were employed by the taxpayer, regardless of which permissible method is used for reporting W–2 wages on Form W–2, "Wage and Tax Statement." For this purpose, the period of employment is determined consistently with the principles for determining whether an individual is an employee described in § 1.199–2(a)(1).

(2) *Short taxable years*. If a taxpayer has a short taxable year that does not contain a calendar year ending during such short taxable year, wages paid to employees for employment by such taxpayer during the short taxable year are treated as W–2 wages for such short taxable year for purposes of § 1.199–2(a)(1) (if the wages would otherwise meet the requirements to be W–2 wages under § 1.199–2 but for the requirement that a calendar year must end during the short taxable year).

(3) *Operating rules*—(i) *Acquisition or disposition*. For purposes of this paragraph (c), the term *acquisition or disposition* includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

(ii) *Trade or business*. For purposes of this paragraph (c), the term *trade or business* includes a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business.

(iii) *Application to section 199 only*. The provisions of this section apply solely for purposes of section 199 of the Internal Revenue Code.

(d) through (e) [Reserved]. For further guidance, see § 1.199–2(d) through (e).

Par. 5. Section 1.199–8 is amended by adding paragraph (i)(10) to read as follows:

§ 1.199–8 Other rules.

* * * * *

(i) * * *

(10) *Acquisitions, dispositions, and short taxable years*. [Reserved]. For further guidance, see § 1.199–8T(i)(10).

Par. 6. Section 1.199–8T is added to read as follows:

§ 1.199–8T Other rules (temporary).

(a) through (h) [Reserved]. For further guidance, see § 1.199–8(a) through (h).

(i) *Effective/applicability dates*. (1) through (9) [Reserved]. For further guidance, see § 1.199–8(i)(1) through (9).

(10) *Acquisitions, dispositions, and short taxable years*. Section 1.199–2T(c) is applicable for taxable years beginning on or after August 27, 2015. A taxpayer may apply § 1.199–2T(c) to taxable years for which the limitations for assessment of tax has not expired beginning before August 27, 2015.

(11) *Expiration date*. The applicability of § 1.199–2T(c) expires on August 24, 2018.

John M. Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: May 29, 2015.

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

(Filed by the Office of the Federal Register on August 26, 2015, 8:45 a.m., and published in the issue of the Federal Register for August 27, 2015, 80 F.R. 51939)

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§ 1.432(e)(9)–1T Benefit suspensions for multiemployer plans in critical and declining status (temporary). 26 CFR Regulation citation will go here.

T.D. 9735

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1

Administration of Multiemployer Plan Participant Vote on an Approved Suspension of Benefits Under MPRA

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: The Multiemployer Pension Reform Act of 2014 (MPRA) pertains to multiemployer plans that are projected to have insufficient funds, at some point in the future, to pay the full plan benefits to which individuals will be entitled (referred to as plans in "critical and declining status"). The sponsor of such a plan is permitted to reduce the pension benefits payable to plan participants and beneficiaries if certain conditions are satisfied (referred to as a "suspension of benefits"). A suspension of benefits is not permitted to take effect prior to a vote of the participants of the plan with respect to the suspension. This document contains temporary regulations that provide guidance relating to the administration of that vote. These temporary regulations affect active, retired, and deferred vested participants and beneficiaries of multiemployer plans that are in critical and declining status as well as employers contributing to, and sponsors and administrators of, those plans. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–123640–15) on this subject in the Proposed Rules section of this issue of the **Internal Revenue Bulletin**.

DATES: *Effective date*: These temporary regulations are effective on September 2, 2015.

Applicability date: These temporary regulations apply on and after June 17, 2015, and expire on June 15, 2018.

FOR FURTHER INFORMATION CONTACT: The Department of the Treasury MPRA guidance information line at (202) 622-1559 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). The collection of information contained in these regulations has been reviewed and approved by the Office of Management and Budget under control number 1545-2260.

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referenced notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Internal Revenue Bulletin**.

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 26 U.S.C. 6103.

Background

Section 432(e)(9) of the Internal Revenue Code (Code), as amended by the Multiemployer Pension Reform Act of 2014 (MPRA), permits plan sponsors of certain multiemployer plans to reduce the plan benefits payable to participants and beneficiaries (referred to as a "suspension of benefits") if specified conditions are satisfied. One key condition is that any such plan must be projected to have insufficient funds, at some point in the future, to pay the full benefits to which individuals will be entitled under the plan (referred to as a plan in "critical and declining status").

Under section 432(e)(9)(H), no suspension of benefits may take effect prior to a vote of the participants of the plan with respect to the suspension. Section 432(e)(9)(H) requires that the vote be administered by the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor (generally referred to in this preamble as the Treasury Department, PBGC, and Labor Department, respectively), within 30 days after approval of a suspension application. The plan sponsor is required to provide a ballot for a vote (subject to approval by the Treasury Department, in consultation with the PBGC and the Labor Department). The statute specifies information that the ballot must contain, including a statement in opposition to the proposed suspension that is compiled from comments received on the application.

On June 19, 2015, the Treasury Department and the Internal Revenue Service published temporary regulations (TD 9723) under section 432(e)(9) in the **Federal Register** (80 FR 35207) (June 2015 temporary regulations). The June 2015 temporary regulations provide general guidance regarding section 432(e)(9) and outline the requirements for a plan sponsor of a plan that is in critical and declining status to apply for a suspension of benefits and for the Treasury Department to begin processing such an application. A notice of proposed rulemaking cross-referencing the temporary regulations (REG–102648–15) was also published in the same issue of the **Federal Register** (80 FR 35262). Both the June 2015 temporary regulations and the related proposed regulations reflect consideration of comments received in response to the Request for Information on Suspensions of Benefits under the Multiemployer Pension Reform Act of 2014 published in the **Federal Register** on February 18, 2015 (80 FR 8578) (February 2015 request for information).

The June 2015 temporary regulations and the related proposed regulations set forth many of the rules relating to the participant vote under section 432(e)(9)(H). However, neither the June 2015 temporary regulations nor the related proposed regulations provide detailed guidance on how the Treasury Department would administer the vote.

Explanation of Provisions

Overview

These temporary regulations provide guidance relating to the administration of the participant vote required under section 432(e)(9)(H). These temporary regulations reflect consideration of comments received in response to the February 2015 request for information. The Treasury Department consulted with the PBGC and the Labor Department on these temporary regulations.

A participant vote requires the completion of three steps. First, a package of ballot materials is distributed to eligible voters. Second, the eligible voters cast their votes and the votes are collected and tabulated. Third, the Treasury Department (in consultation with the PBGC and the Labor Department) determines whether a majority of the eligible voters has voted to reject the proposed suspension. The June 2015 temporary regulations define eligible voters as all plan participants and all beneficiaries of deceased participants.

Under these temporary regulations, the Treasury Department is permitted to designate a service provider or service providers to facilitate the administration of the vote. The service provider may assist in the steps of distributing the ballot package to eligible voters and collecting and tabulating the votes. These temporary regulations provide that if a service provider is designated to collect and tabulate votes, then the service provider will provide the Treasury Department with the report of the results of the vote, which includes a breakdown of the number of eligible voters who voted, the number of eligible voters who voted in support of and to reject the suspension, and certain other information. The Treasury Department will use that information to determine (in consultation with the PBGC and the Labor Department) whether a majority of eligible voters has voted to reject the suspension.

Distribution of the ballot package

These temporary regulations provide that the ballot package sent to eligible voters includes the approved ballot and a unique identifier for each eligible voter. The unique identifier, which is assigned by the Treasury Department or a designated service provider, is intended to ensure the validity of the vote while maintaining the eligible voters' privacy in the voting process.

These temporary regulations provide guidance on the plan sponsor's statutory requirement to provide a ballot. Because the ballot for each eligible voter is accompanied by a unique identifier, the plan sponsor cannot itself distribute the ballot. Instead, the plan sponsor is responsible for furnishing a list of eligible voters so that the ballot can be distributed on the plan sponsor's behalf. The list must include the last known mailing address for each eligible voter (except for those eligible voters for whom the last known mailing address is known to be incorrect). The plan sponsor must also provide a list of eligible voters whom the plan sponsor has been unable to locate using reasonable efforts. In addition, the plan sponsor must furnish current electronic mailing addresses for certain eligible voters, who are identified below. The plan sponsor must also furnish the individualized estimates provided to eligible voters as part of the earlier notices described in section 432(e)(9)(F) (or, if an individualized estimate is no longer accurate for an eligible voter, a corrected version of that estimate) so that an individualized estimate can be included with the ballot for each eligible voter. These materials must be provided no later than 7 days after the date the Treasury Department has approved an application for a suspension of benefits.

Under these temporary regulations, the plan sponsor is responsible for paying all costs associated with the ballot package, including postage. This is because the section 432(e)(9)(H)(iii) requirement that the plan sponsor provide a ballot means that the plan sponsor is responsible for the cost of providing the ballot package to eligible voters, including the costs associated with printing, assembling and mailing those ballot packages.

These temporary regulations provide that ballot packages will be distributed to eligible voters by first-class U.S. mail. A supplemental copy of the mailed ballot package may also be sent by an electronic communication to an eligible voter who has consented to receive electronic notifications. For example, if the ballot sent by first-class U.S. mail is not received, a supplemental ballot may be provided by electronic mail.

These temporary regulations provide additional detail on the plan sponsor's duty to communicate with eligible voters. As part of this communication requirement, these temporary regulations provide that the plan sponsor must notify certain eligible voters (using an electronic communication) that the ballot package is being mailed by first-class U.S. mail. The eligible voters who must be notified under this rule are those who received the notice of the proposed suspension under section 432(e)(9)(F) in electronic form and those who regularly receive plan-related electronic communications from the plan sponsor.[1] This notification must be sent promptly after the plan sponsor is informed of the ballot distribution date. This notification in electronic form ensures that those eligible voters who ordinarily expect to receive communications from the plan sponsor in electronic form are aware that a ballot package will arrive via first-class U.S. mail. Under these temporary regulations, this notification is sent by the plan sponsor, rather than a service provider, so that the communication comes from a familiar source, which would make it less likely that the communication is delivered to a "spam" or "junk" mail folder.

The plan sponsor will have previously made reasonable efforts to contact individuals whose mailed initial notices were returned as undeliverable, and the mailing addresses for the ballot packages that are furnished by the plan sponsor will reflect updates as a result of those reasonable efforts. These temporary regulations require the plan sponsor to make similar reasonable efforts to locate eligible voters after being notified that their ballots were returned as undeliverable.

Voting by eligible voters and collection and tabulation of votes

In accordance with section 432(e)(9)(H)(ii), these temporary regulations require that the Treasury Department (in consultation with the PBGC and the Labor Department) administer the participant vote no later than 30 days following the date of approval of an application for a suspension of benefits. These temporary regulations interpret the term "administer a vote" to mean that the voting period must begin (but need not end) within the 30-day timeframe. As a result, these temporary regulations require that ballot packages be distributed no later than 30 days after the application has been approved and specify that the voting period begins on the ballot distribution date. Although the temporary regulations allow for distribution of ballot packages up to 30 days following approval of an application for suspension of benefits, it is generally expected that ballot packages will be distributed well before that deadline.

These temporary regulations specify that the voting period generally will remain open until the 30th day following the date the Treasury Department approves the application for a suspension of benefits. However, the voting period will not close earlier than 21 days after the ballot distribution date. In addition, the Treasury Department (in consultation with the PBGC and the Labor Department) is permitted to specify a later end to the voting period in appropriate circumstances. For example, an extension might be appropriate if, near the end of the original voting period, there are significant technical difficulties with respect to the collection of votes and those technical difficulties are not resolved in time to provide eligible voters with sufficient time to cast their votes.

These temporary regulations specify that votes must be collected and tabulated using an automated voting system under which each eligible voter must furnish a unique identifier in order to cast a vote. Such a system will be designed to record votes both electronically (through a website) and telephonically (through a toll-free number that will accommodate a touch-tone or interactive voice response). This will permit any voter who lacks internet access or, for any reason, is not comfortable voting via a website, to cast a vote using a toll-free number. It is expected that the system will provide reasonable support to facilitate eligible voters' use of the system's electronic and telephonic features. These temporary regulations clarify that votes are permitted to be cast using only these methods and that responses returned by any other means are invalid.

The temporary regulations do not provide for the collection of votes using paper ballots because casting votes using a website or a telephonic system will be convenient for participants and will save time and money while providing reliable results. Providing a third voting option by also permitting votes to be cast using paper ballots would require additional time, in order for ballots to be returned by mail and authenticated and counted by hand. Voting by marking and mailing back paper ballots would also entail significant

[1]The plan sponsor is also permitted to send this notification to any other eligible voters for whom the plan sponsor has an electronic mailing address.

additional costs to process (such as employing additional personnel for processing and providing return postage and envelopes). The temporary regulations therefore reflect the conclusion that the most efficient and fairest approach to implementing the statutory provisions on administration of the vote on an approved suspension of benefits is to provide eligible voters with sufficient time to carefully consider the information furnished to them before casting their votes while seeking to avoid unnecessary time and expense processing those votes once they have been cast. The automated methods of voting, collecting, and tabulating votes set forth in these temporary regulations also have been used by pension plans for other types of elections that involve voting by plan participants (including retirees).

Determination that a majority of eligible voters has voted to reject the suspension

Within 7 days after the end of the voting period, these temporary regulations provide that the Treasury Department (in consultation with the PBGC and the Labor Department) will either certify that a majority of all eligible voters has voted to reject the suspension or, if a majority of eligible voters did not vote to reject the suspension, issue a final authorization to suspend. These temporary regulations permit the Treasury Department (in consultation with the PBGC and the Labor Department) to establish necessary policies and procedures to facilitate the vote. These policies and procedures may include, but are not limited to, establishing a process for an eligible voter to challenge the vote. It is expected that the Treasury Department will resolve any challenges before the conclusion of the 7-day period following the end of the voting period.

Items related to the contents of the ballot

Under these temporary regulations, the statement in opposition to the proposed suspension that is compiled from comments received on the application will be prepared by the Labor Department. Under these temporary regulations, this statement in opposition must be written in a manner that is readily understandable to the average plan participant. It is intended that the statement in opposition will be written in a manner to ensure parity with the statement in support of the suspension. If there are no comments in opposition to the proposed suspension, then the statement in opposition will indicate that there were no such comments.

These temporary regulations provide that a model ballot may be published in the form of a revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin.

Effective/Applicability Date

As with the previously published temporary regulations, these regulations apply on and after June 17, 2015, and expire on June 15, 2018.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) please refer to the Special Analyses section of the preamble to the cross-referenced notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Internal Revenue Bulletin.** Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Contact Information

For general questions regarding these temporary regulations, please contact the Department of the Treasury MPRA guidance information line at (202) 622-1559 (not a toll-free number). For information regarding a specific application for a suspension of benefits, please contact the Department of the Treasury at (202) 622-1534 (not a toll-free number).

* * * * *

Amendments to the Regulations

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 1.432(e)(9)–1T(h) is amended by:

1. Revising paragraph (h)(2).

2. Adding paragraphs (h)(3)(iv), (h)(3)(v), (h)(7) and (h)(8).

The revisions and additions read as follows:

§ 1.432(e)(9)–1T Benefit suspensions for multiemployer plans in critical and declining status (temporary).

* * * * *

(h) * * *

(2) *Participant vote*—(i) *In general*. The participant vote described in paragraph (h)(1)(i) of this section requires completion of the following steps—

(A) Distribution of the ballot package described in paragraph (h)(2)(iii) of this section to the eligible voters;

(B) Voting by eligible voters and collection and tabulation of the votes, as described in paragraph (h)(2)(iv) of this section; and

(C) Determination of whether a majority of the eligible voters has voted to reject the suspension, as described in paragraph (h)(2)(v) of this section.

(ii) *Designation of service provider for limited functions*. The Secretary of the Treasury is permitted to designate one or more service providers to perform, under the supervision of the Secretary, any of the functions described in paragraphs (h)(2)(i)(A) and (B) of this section. If the Secretary designates a service provider to perform these functions then the service provider will provide the Secretary with a written report of the results of the vote, including (as applicable)—

(A) The number of ballot packages distributed to eligible voters;

(B) The number of eligible voters to whom ballot packages have not been provided (because the individuals could not be located);

(C) The number of eligible voters who voted (specifying the number of affirmative votes and the number of negative votes cast); and

(D) Any other information that the Secretary requires.

(iii) *Distribution of the ballot package to the eligible voters*—(A) *Ballot package*. The ballot package distributed to each eligible voter shall consist of—

(*1*) A ballot, approved under paragraph (h)(3)(iii) of this section, which contains the items described in section 432(e)(9)(H)(iii) and paragraph (h)(3)(i) of this section; and

(*2*) A unique identifier assigned to the eligible voter for use in voting.

(B) *Plan sponsor responsibilities*—(*1*) *In general*. This paragraph (h)(2)(iii)(B) sets forth the responsibilities of the plan sponsor with respect to the distribution of the ballot package to the eligible voters.

(*2*) *Furnish information regarding eligible voters*. No later than 7 days following the date the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section, the plan sponsor must furnish the following- (*i*) A list of all eligible voters;

(*ii*) For each eligible voter, the last known mailing address (or, if the plan sponsor has been unable to locate that individual using the standards that apply for purposes of paragraph (f)(1)(i) of this section, an indication that the individual could not be located through reasonable efforts);

(*iii*) Current electronic mailing addresses for those eligible voters identified in paragraph (h)(2)(iii)(B)(*4*) of this section; and

(*iv*) The individualized estimates provided to eligible voters as part of the earlier notices described in section 432(e)(9)(F) (or, if an individualized estimate is no longer accurate for an eligible voter, a corrected version of that estimate).

(*3*) *Communicate with eligible voters*. In accordance with section 432(e)(9)(H)(iv) and paragraph (h)(1)(ii) of this section, the plan sponsor is responsible for communicating with eligible voters, which includes—

(*i*) Notifying the eligible voters described in paragraph (h)(2)(iii)(B)(*4*) of this section that a ballot package is being distributed by first-class U.S. mail; and

(*ii*) Making reasonable efforts (using the standards that apply for purposes of paragraph (f)(1)(i) of this section) as necessary to locate eligible voters for whom the plan sponsor has received notification that the mailed ballot packages are returned as undeliverable so that ballot packages can be sent to those eligible voters.

(*4*) *Eligible voters to receive electronic notification*. Those eligible voters whom the plan sponsor must notify electronically are—

(*i*) Eligible voters who previously received the notice described in paragraph (f) of this section in electronic form (as permitted under paragraph (f)(3)(ii) of this section), and

(*ii*) Any other eligible voters who regularly receive plan-related communications from the plan sponsor in electronic form.

(*5*) *Method of notifying certain eligible voters*. The notification described in paragraph (h)(2)(iii)(B)(*3*)(*i*) of this section for an eligible voter must be made using the electronic form normally used to send plan-related communications to that voter (or the form used to provide the notice in paragraph (f) of this section, if different). The plan sponsor must send this notification promptly after being informed of the ballot distribution date (within the meaning of paragraph (h)(2)(iii)(D) of this section) and the notification must include the ballot distribution date.

(*6*) *Pay costs associated with distribution*. The plan sponsor is responsible for paying all costs associated with printing, assembling, and distributing the ballot package, including postage.

(C) *Required method of distributing ballot package*. Ballot packages must be distributed to eligible voters by first-class U.S. mail. A supplemental copy of the mailed ballot package may also be sent by an electronic communication to an eligible voter who has consented to receive electronic communications.

(D) *Timing*. Ballot packages will be distributed to eligible voters no later than 30 days after the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section. The date on which the ballot packages are mailed to the eligible voters is referred to as the ballot distribution date.

(iv) *Collection and tabulation of votes cast by eligible voters*—(A) *Voting period*. The voting period begins on the ballot distribution date. The voting period generally remains open until the 30th day following the date the Secretary of the Treasury has approved an application for a suspension of benefits under paragraph (g) of this section. However, the voting period will not close earlier than 21 days after the ballot distribution date. In addition, the Secretary (in consultation with the PBGC and the Secretary of Labor) may specify a later date to end the voting period in appropriate circumstances.

(B) *Required use of automated voting system*. Votes must be cast using an automated voting system that meets the requirements of paragraph (h)(2)(iv)(C) of this section. Votes cast by any other method are invalid.

(C) *Automated voting system*. An automated voting system meets the requirements of this paragraph (h)(2)(iv)(C) only if the system—

(*1*) Collects votes cast by eligible voters both electronically (through a website) and telephonically (through a toll-free number using a touch-tone or interactive voice response); and

(*2*) Accepts only votes cast during the voting period by an eligible voter who provides the eligible voter's unique identifier described in paragraph (h)(2)(iii)(A)(*2*) of this section.

(D) *Policies and procedures*. The Secretary of the Treasury (in consultation with the PBGC and the Secretary of Labor) may establish such policies and procedures as may be necessary to facilitate the administration of the vote under this paragraph (h)(2). These policies and procedures may include, but are not limited to, establishing a process for an eligible voter to challenge the vote.

(v) *Determination of whether a majority of the eligible voters has voted to reject the suspension*. Within 7 calendar days after the end of the voting period, the Secretary of the Treasury (in consultation with the PBGC and the Secretary of Labor) will—

(A) Certify that a majority of all eligible voters has voted to reject the suspension that was approved under paragraph (g) of this section, or

(B) Issue a final authorization to suspend as described in paragraph (h)(6) of this section.

* * * * *

(3) * * *

(iv) *Statement in opposition to the proposed suspension*. The statement in opposition to the proposed suspension that is prepared from comments received on the application, as required under section 432(e)(9)(H)(iii)(II), will be compiled by the Secretary of Labor and will be written in accordance with the rules of paragraph (h)(3)(ii) of this section. If no comments in opposition are received, the statement in opposition to the proposed suspension will include a statement indicating that there were no such comments.

(v) *Model ballot*. A model ballot may be published in the form of a revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin.

* * * * *

(7) *Effective/applicability date*. Paragraph (h)(2) and paragraphs (h)(3)(iv) and (h)(3)(v) of this section apply on and after June 17, 2015.

(8) *Expiration date*. The applicability of paragraph (h)(2) and paragraphs (h)(3)(iv) and (h)(3)(v) of this section expires on June 15, 2018.

* * * * *

John M. Dalrymple
Deputy Commissioner for Services and Enforcement.

Approved: August 25, 2015

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

(Filed by the Office of the Federal Register on August 31, 2015, 11:15 a.m., and published in the issue of the Federal Register for September 2, 2015, 80 F.R. 52972)

Part IV. Items of General Interest

Application of the Cooperative and Small Employer Charity Pension Flexibility Act

Notice 2015–58

I. PURPOSE

This notice provides guidance on certain issues relating to the application of the Cooperative and Small Employer Charity Pension Flexibility Act, Pub. L. No. 113–97 (CSEC Act). The CSEC Act, which was enacted on April 7, 2014, specifies minimum funding requirements and related rules that apply with respect to certain defined benefit pension plans maintained by groups of cooperatives and related entities and groups of charities.

II. BACKGROUND

Section 430 of the Internal Revenue Code (Code), which was added by the Pension Protection Act of 2006, Pub. L. No. 109–280, as amended (PPA '06), specifies the minimum funding requirements that generally apply to single-employer defined benefit pension plans (including multiple-employer plans) pursuant to § 412. Under § 430(a)(1), the minimum required contribution for a plan year under § 430 is generally equal to the sum of the target normal cost and the shortfall amortization charge for the plan year.[1] Under § 430(c), the shortfall amortization charge for a plan year is the sum of the shortfall amortization installments with respect to the plan's shortfall amortization bases for the current plan year and prior plan years. Each year, a shortfall amortization base is determined based on the difference between the funding target and the value of plan assets for the plan year for which it is established. In general, the shortfall amortization installment with respect to a shortfall amortization base is the amount needed to amortize that base in level annual installments over 7 years.

Section 436 imposes certain restrictions on the accrual and payment of benefits under a single-employer defined benefit pension plan that are applied based on the plan's funded status for the plan year.

As originally enacted, section 104 of PPA '06 provided that the effective date for the application of the minimum funding rules under § 430 and the funding-based benefit restrictions under § 436 is delayed for certain plans maintained by more than one employer that are specified types of cooperative organizations and related entities. For those plans, the minimum funding rules under § 430 and the funding-based benefit restrictions under § 436 generally do not apply for plan years beginning before January 1, 2017. For plan years before § 430 applies to such a plan, the minimum funding requirement for the plan is determined under the provisions of § 412 as in effect prior to amendment by PPA '06. These provisions are referred to in this notice as "pre-PPA § 412" provisions.

Section 202(b) of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, Pub. L. No.111–192 (PRA 2010), amended section 104 of PPA '06, as originally enacted, to add a new section 104(d). Section 104(d) of PPA '06 expands the group of plans covered by the delayed effective date of section 104 of PPA '06 to include certain plans (referred to as eligible charity plans) that are maintained by employers that are described in § 501(c)(3). Under section 104(d) of PPA '06, a plan is an eligible charity plan for a plan year if, for all periods from July 26, 2005 through the end of the plan year, the plan has been maintained by more than one employer (determined without regard to § 414(c)), provided that all of the employers maintaining the plan are described in § 501(c)(3).

The CSEC Act provides a number of rules relating to the minimum funding requirements for certain defined benefit plans maintained by groups of cooperatives and related entities and groups of charities. Most of the rules under the CSEC Act apply to CSEC plans, as defined in section 414(y). CSEC plans are generally the same plans that are covered by the delayed effective date provisions for the PPA '06 funding rules under section 104 of PPA '06 (as amended by PRA 2010). However, certain eligible charity plans are not CSEC plans, and certain CSEC plans maintained by employers that are § 501(c)(3) organization employers are not eligible charity plans. In addition, the CSEC Act includes some rules that apply solely to eligible charity plans and some rules that apply to all multiple-employer plans.

Section 433, which was added to the Code by the CSEC Act, specifies minimum funding rules that apply to CSEC plans for plan years beginning on or after January 1, 2014.[2] These minimum funding rules are similar to the rules under pre-PPA § 412. However, § 433 provides that the amortization period for the amortization base established for the change in liability resulting from an amendment to a CSEC plan is 15 years (instead of 30 years as provided in pre-PPA § 412) and § 433 does not include a requirement to make a deficit reduction contribution as required under pre-PPA § 412(l). In addition, § 433 provides special rules that apply to a CSEC plan with a funded percentage (as defined in § 433(j)(5)(B)) of less than 80%. Such a plan is in "funding restoration status." If a CSEC plan is in funding restoration status, the plan sponsor must establish a funding restoration plan that is designed to bring the plan's funded percentage to 100% over a period of 7 years (or the shortest amount of time practicable to bring the plan's funded percentage to 100%, if longer).[3] For the period for which a CSEC plan is in funding restoration status (as certified by the enrolled actuary for the plan), an amount no less than the plan's normal cost must be contributed for each plan year. If the normal cost is not contributed for the plan year

[1]For a plan for which a funding waiver has been obtained, the minimum required contribution also includes a waiver amortization charge.

[2]The benefit restrictions under § 436 do not apply to CSEC plans.

[3]Section 4971(h)(1) imposes an excise tax if the plan sponsor fails to timely satisfy the requirement to establish a written funding restoration plan.

then an accumulated funding deficiency will exist regardless of the size of the plan's credit balance. A CSEC plan that is in funding restoration status generally cannot be amended to increase benefits or accelerate vesting unless a specified additional contribution is made.

Under the CSEC Act, a number of elections are available to eligible charity plans and plans that fit within the definition of a CSEC plan.

- Section 414(y)(3)(A) provides that the plan sponsor of a plan that fits within the definition of a CSEC plan can elect for the plan not to be treated as a CSEC plan, effective beginning with the first plan year that begins on or after January 1, 2014. The effect of this election for a plan is that § 433 and related provisions that apply to CSEC plans will not apply to the plan.
- Section 103(b) of the CSEC Act amends section 104(d) of PPA '06 to provide three new options for an eligible charity plan:
  - Pursuant to section 104(d)(2) of PPA '06, the plan sponsor of an eligible charity plan to which § 433 does not apply can elect for the plan to cease to be treated as an eligible charity plan for plan years beginning after December 31, 2013, so that § 430 applies to the plan beginning with the 2014 plan year.
    - If this election is made, then the plan sponsor can also elect to apply certain extended amortization rules under section 104(d)(3) of PPA '06.
  - Pursuant to section 104(d)(4) of PPA '06, the plan sponsor of an eligible charity plan can make a one-time irrevocable election for the plan not to be treated as an eligible charity plan, effective for plan years beginning after December 31, 2007, so that § 430 applies to the plan beginning with the 2008 plan year.
- Section 103(c) of the CSEC Act provides that a CSEC plan that was established before January 1, 2014 is deemed to have made the election under § 410(d) (under which the plan is not treated as a church plan for purposes of certain rules) under certain circumstances.

Section 210(f) of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93–406, as amended (ERISA), provides a definition of a CSEC plan for purposes of title I of ERISA that is parallel to the definition in § 414(y) but also requires a CSEC plan to be an "employee pension benefit plan" within the meaning of section 3(2) of ERISA. Section 306 of ERISA provides minimum funding rules that are parallel to the rules of § 433 for a plan that is a CSEC plan under title I of ERISA.

Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over the subject matter addressed in § 433 and the other statutory provisions addressed in this notice for purposes of ERISA as well as the Code. Accordingly, the guidance in this notice applies not only for purposes of the Code but also for purposes of the parallel provisions of ERISA. Thus, the guidance in this notice under §§ 414(y) and 433 also applies for purposes of sections 210(f) and 306 of ERISA in the case of a CSEC plan (within the meaning of § 414(y)) that is an employee pension benefit plan within the meaning of section 3(2) of ERISA. The Secretary of the Treasury does not have interpretive jurisdiction under the Reorganization Plan to determine whether a CSEC plan within the meaning of § 414(y) is an employee pension benefit plan within the meaning of section 3(2) of ERISA.

III. QUESTIONS AND ANSWERS

Rules for CSEC plans

Q–1: What is a CSEC plan?

A–1: Under § 414(y)(1) and (2), a plan is a CSEC plan for a plan year if it is a defined benefit plan (other than a multiemployer plan) that meets one of the following conditions:

(1) for the plan year, the effective date of the PPA '06 funding rules has been delayed for the plan under section 104 of PPA '06 prior to the change to section 104 made by PRA 2010 (i.e., the plan is maintained by more than one employer and at least 85% of those employers are rural cooperatives or are cooperative organizations or related entities) and without regard to section 104(a)(2) of PPA '06;

(2) for all periods beginning on June 25, 2010 and ending on the last day of the plan year, the plan has been maintained by more than one employer (determined by treating all employers that are treated as a single employer under § 414(b) or (c) as a single employer) and all of those employers were described in § 501(c)(3); or

(3) for all periods beginning on June 25, 2010 and ending on the last day of the plan year, the plan was maintained by an employer described in § 501(c)(3), chartered under part B of subtitle II of title 36, United States Code, with employees in at least 40 States, and whose primary exempt purpose is to provide services with respect to children.

However, in the case of a plan that fits within the definition of a CSEC plan, the plan is not treated as a CSEC plan if the election described in § 414(y)(3) has been made for the plan. If this election is made, then § 433 does not apply to the plan.

Q–2: For a plan to which pre-PPA § 412 applies for the 2013 plan year and § 433 applies for the 2014 plan year, how are the funding standard account and related items established for the 2014 plan year?

A–2: If pre-PPA § 412 applies to a plan for the 2013 plan year and § 433 applies for the 2014 plan year, then all items that are part of the funding standard account determination under pre-PPA § 412 as of the close of the 2013 plan year must be used to establish the corresponding items established under § 433 as of the beginning of the 2014 plan year. This is because § 433 functions as a continuation of pre-PPA § 412. Thus, the balance of the funding standard account under § 433 as of the first day of the 2014 plan year is the same as the balance of the funding standard account under pre-PPA § 412 as of the close of the 2013 plan year. In addition, charge bases under § 433(b)(2) and credit bases under § 433(b)(3) must be established for the 2014 plan year as continuations of the bases that were being amortized under pre-PPA § 412. Thus, as of the first day of the 2014 plan year, the outstanding balances and amortization periods with respect to those bases are the same as if pre-PPA § 412 had continued to apply to the plan. See § 433(b)(6).

Election to cease to be an eligible charity plan beginning in 2014

Q–3: Can a plan sponsor of an eligible charity plan elect for the plan to cease to be treated as an eligible charity plan?

A–3: Pursuant to section 104(d)(2) of PPA '06, as amended by PRA 2010 and the CSEC Act, a plan sponsor of an eligible charity plan (other than a plan to which § 433 applies) can elect for the plan to cease to be treated as an eligible charity plan beginning with the 2014 plan year.

If the election is made, then—

- As of the first day of the plan year beginning in 2014, the plan is subject to the minimum funding requirements of § 430 and the benefit restrictions of § 436.
- Pursuant to § 1.430(f)–1(b)(2), the plan's funding standard carryover balance as of the beginning of the 2014 plan year is the positive balance in the plan's funding standard account under pre-PPA § 412(b) as of the end of the prior plan year.

A plan sponsor makes the election described in this Q&A–3 by providing written notification of the election to the plan administrator and the enrolled actuary for the plan. As a general rule, this election must be made no later than the plan's § 430(j)(1) contribution deadline for the 2014 plan year (i.e., 8½ months after the end of the 2014 plan year). Alternatively, a plan sponsor may make the election described in this Q&A–3 by reflecting the election on the Schedule SB filed for the 2014 plan year and providing written notification of the election to the plan administrator and the enrolled actuary for the plan by December 31, 2015. This election can be revoked only with the consent of the Commissioner.

Extended amortization election

Q–4: If a plan sponsor of an eligible charity plan makes the election described in Q&A–3 of this notice, can the plan sponsor elect extended amortization?

A–4: Pursuant to section 104(d)(3)(A) of PPA '06, which was added by the CSEC Act, if a plan sponsor of an eligible charity plan makes the election for the plan to cease to be treated as an eligible charity plan beginning with the 2014 plan year (as described in Q&A–3 of this notice), then the plan sponsor can also make an election to use the extended amortization rules set forth in section 104(d)(3)(B) through (G) of PPA '06 (which were also added by the CSEC Act). These amortization rules provide funding relief for the plan that is generally comparable to the funding relief that would have applied if (1) § 430 had applied to the plan for all plan years beginning on or after January 1, 2008, (2) the plan sponsor had made a 15-year amortization election under § 430(c)(2)(D)(iii) for the plan years beginning in 2010 and 2011, and (3) there were no previous installment acceleration amounts described in § 430(c)(7).

A plan sponsor makes the election described in this Q&A–4 by providing written notification of the election to the plan administrator and the enrolled actuary for the plan. As a general rule, this election must be made no later than the plan's § 430(j)(1) contribution deadline for the 2014 plan year (i.e., 8½ months after the end of the 2014 plan year). Alternatively, a plan sponsor may make the election described in this Q&A–4 by reflecting the election on the Schedule SB filed for the 2014 plan year and providing written notification of the election to the plan administrator and the enrolled actuary for the plan by December 31, 2015 The election described in this Q&A–4 can be revoked only with the consent of the Commissioner.

Reporting Requirements

Q–5: How should the rules described in this notice for plans that are subject to § 433 be reflected on the Schedule SB for 2014 and 2015?

A–5: For the 2014 and 2015 plan years, the reporting requirements described in this Q&A–5 apply to plans that are subject to § 433.

Complete only the following on Schedule SB:

- Lines A through F
- Part I (including signature of enrolled actuary), determined as if PPA '06 provisions were effective for all plan years beginning after December 31, 2007.
- Part III, line 14, determined as if PPA '06 provisions were effective for all plan years beginning after December 31, 2007.
- Part IV, line 18.
- Part V, determined as if PPA '06 provisions were effective for all plan years beginning after December 31, 2007.

Also, report other information for the current plan year using a 2007 Schedule B (Form 5500). Label this attachment "[Insert reporting year] Schedule SB, line 27 – Actuarial Information for CSEC Plans." Each attachment must include the plan name, the plan sponsor's name and EIN, and the plan number. Complete all items from the 2007 Schedule B, excluding line 9f and Part II, and attach the 2007 Schedule B and all applicable attachments to the Schedule SB. Note that under PPA '06, the third segment rate determined under § 430(h)(2)(C)(iii) and ERISA section 303(h)(2)(C)(iii) is substituted for the current liability interest rate under § 412(b)(5)(B) and ERISA section 302(b)(5)(B) (as in effect before PPA '06).

If the plan's funded percentage (as defined in § 433(j)(5)(B)) as of the beginning of the plan year is less than 80%, then the plan is in funding restoration status. If the plan's enrolled actuary certifies that the plan is in funding restoration status for a plan year, include the following additional information in the attachment "[Insert reporting year] Schedule SB, line 27 – Actuarial Information for CSEC Plans:" (a) the annual certification by the enrolled actuary for the plan; and (b) the value of plan assets and the funding liability, including any adjustments to these amounts as specified in § 433(j)(4) and ERISA section 306(j)(4).

If a plan in funding restoration status has an accumulated funding deficiency based on the excess of the employer's normal cost[4] determined under line 9b, over the amount actually contributed to the plan for the plan year, as determined under § 433(j)(1) and ERISA section 306(j)(1), then the details of this calcula-

[4]In the case of a plan for which a spread gain funding method is used, the normal cost that is used to apply this rule is the normal cost determined under the entry age normal cost funding method.

tion must be included in the attachment "[Insert reporting year] Schedule SB, line 27 – Actuarial Information for CSEC Plans."

Q–6: How should an election for an eligible charity plan to be made subject to the requirements of § 430 beginning either in 2014 or in 2008 (and the related amortization extension election for a plan that applies the requirements of § 430 beginning in 2014) be reflected on Schedule SB for 2014 and later years?

A–6: If a plan sponsor of an eligible charity plan has made an election for the plan not to be treated as an eligible charity plan, a copy of that election should be included as an attachment to line 27 of the 2014 Schedule SB. In addition, if this election takes effect beginning with the 2008 plan year, then any difference between the amount of the funding standard carryover balance or the prefunding balance reported on line 7 of the Schedule SB filed for the 2014 plan year and the corresponding amounts reported on line 13 of the Schedule SB filed for the 2013 plan year must be explained in the attachment to line 7 of the Schedule SB filed for the 2014 plan year.

If a plan sponsor of an eligible charity plan has made an election for the plan to be made subject to the requirements of § 430 beginning in 2014 and has elected extended amortization as described in Q&A–4 of this notice, then the extended amortization election should be reflected on Schedule SB for 2014 by checking the box on line 41a and including an attachment to line 32 showing the development of the 11-year, 12-year and 7-year amortization bases. The Schedule SB for any later plan year to which this information is applicable should include an attachment to line 32 that provides information consistent with the information required with respect to a § 412(c)(7) amortization extension and related installment acceleration amounts.

Q–7: If the guidance provided in this notice affects the computations on the Schedule SB filed with the Form 5500 or Form 5500–SF for the 2014 plan year, must the plan sponsor file a revised 2014 Schedule SB?

A–7: No. The filing of an amended Form 5500 or Form 5500–SF for the 2014 plan year is not required solely to reflect the effect of the guidance provided in this notice on the computations on the Schedule SB. However, the Schedule SB filed with the Form 5500 or Form 5500–SF for the 2015 plan year must accurately reflect the effect of the guidance provided in this notice. To the extent that the amounts shown on the Schedule SB for the 2015 plan year are different than the amounts shown on the Schedule SB for the 2014 year, this difference should be explained in attachments to the Schedule SB for the 2015 plan year.

IV. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-2095.

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

The collections of information in this notice are in section III of this notice. The collections of information are required to provide for the elections permitted under sections 103 and 203 of the CSEC Act. The collections of information are mandatory for those plan sponsors making these elections.

The likely respondents are sponsors of fewer than 50 single-employer defined benefit plans. Currently, it is estimated that any effect on burden as previously reported to OMB will not be significant. Any potential changes on burden will be reported through the renewal of the current OMB approval numbers.

Estimates of the annualized cost to respondents are not relevant, because each collection of information in this notice is a one-time collection.

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 § 6103.

V. DRAFTING INFORMATION

The principal authors of this notice are Michael P. Brewer and Linda S. F. Marshall of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Michael Brewer or Linda Marshall (202) 317-6700 (not a toll-free number).

Notice of Proposed Rulemaking Reportable Transactions Penalties under Section 6707A

REG–103033–11

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the amount of the penalty under section 6707A of the Internal Revenue Code (Code) for failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction. The proposed regulations are necessary to clarify the amount of the penalty under section 6707A, as amended by the Small Business Jobs Act of 2010. The proposed regulations would affect any taxpayer who fails to properly disclose participation in a reportable transaction.

DATES: Written or electronic comments and requests for a public hearing must be received by November 25, 2015.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–103033–11), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–103033–11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (indicate IRS and REG–103033–11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Melissa Henkel, (202) 317-6844; concerning submissions of comments or requests for a public hearing, Oluwafunmilayo (Funmi) Taylor, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 301 under section 6707A of the Internal Revenue Code. Section 6707A was added to the Code by section 811(a) of the American Jobs Creation Act of 2004 (Public Law No. 108–357, 118 Stat. 1418) and was amended by section 11(a)(41) of the Tax Technical Corrections Act of 2007 (Public Law No. 110–172, 121 Stat. 2473). Section 6707A imposes a penalty on a taxpayer who has a duty to disclose a reportable transaction and fails to do so. It also imposes a requirement that certain taxpayers must disclose in filings with the Securities and Exchange Commission (SEC) any requirement to pay a penalty under (1) section 6707A with respect to a listed transaction, (2) section 6662A with respect to an undisclosed reportable transaction, or (3) section 6662(h) with respect to an undisclosed reportable transaction. Failure to make that required disclosure to the SEC subjects a taxpayer to another penalty under section 6707A. On September 11, 2008, temporary regulations (TD 9425) relating to the penalty under section 6707A were published in the **Federal Register** (73 FR 52784). A notice of proposed rulemaking (REG–160868–04) cross-referencing the temporary regulations was published in the **Federal Register** on the same day (73 FR 52805). Section 6707A was amended again in 2010 by section 2041(a) of the Small Business Jobs Act of 2010 (Public Law No. 111–240, 124 Stat. 2504) (the Jobs Act), which changed the amount of the penalty from a stated dollar amount to a percentage (with maximum and minimum dollar amounts). Before the Jobs Act was enacted, the penalty was $10,000 in the case of a natural person ($50,000 in any other case) and, in the case of a listed transaction, $100,000 in the case of a natural person ($200,000 in any other case). In some cases, this structure resulted in penalties that were potentially disproportionate to the tax benefit derived from the transaction. *See* ''Legislative Recommendations with Legislative Action: Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact,'' National Taxpayer Advocate 2008 Annual Report to Congress vol. 1, at 419. In response, Congress amended section 6707A(b) through the Jobs Act. *See* Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress (JCS–2–11), March 2011 (explaining the reasons for the change to section 6707A). The Jobs Act amended section 6707A(b) to make the penalty 75 percent of the decrease in tax shown on the return as a result of a reportable transaction, with a minimum penalty amount of $10,000 ($5,000 in the case of a natural person). The maximum penalty amount is $200,000 ($100,000 in the case of a natural person) for failure to disclose a listed transaction, or $50,000 ($10,000 in the case of a natural person) for failure to disclose any other reportable transaction. The 2010 amendment specifying the amount of the penalty applies to penalties assessed after December 31, 2006. *See* Jobs Act § 2041(b), 124 Stat. at 2560. On September 7, 2011, final regulations (TD 9550) were published in the **Federal Register** (76 FR 55256). The final regulations in TD 9550 did not provide guidance on the amount of the penalty as amended by the Jobs Act beyond reciting the language of section 6707A because the notice of proposed rulemaking on which those final regulations were based predated the Jobs Act. The proposed regulations in this document provide guidance on the amount of the penalty under section 6707A, as amended by the Jobs Act.

Explanation of Provisions

The following is a summary of the proposed changes to the existing regulations relating to the penalties under section 6707A.

1. *Definition of Return*

Treas. Reg. § 1.6011–4 establishes that a taxpayer whose amended return or application for tentative refund reflects participation in a reportable transaction has the same disclosure obligation as a taxpayer whose original return reflects participation in a reportable transaction. Treas. Reg. § 301.6707A–1, published on September 11, 2011, clarifies that a taxpayer's failure to disclose participation in a reportable transaction will trigger a penalty under section 6707A regardless of whether the participation is reflected on an original return, an amended return, or an application for tentative refund. In its current state, the regulation generally refers to original returns, amended returns, and applications for tentative refund in every case where all three terms are relevant. The proposed regulations streamline these references by defining the term "return" to include all three. This change simplifies sentences throughout the regulation without changing their meaning.

2. *Amount of the Penalty*

A. Decrease in tax

Subject to certain minimum and maximum amounts, "the amount of the penalty under subsection (a) with respect to any reportable transaction shall be 75 percent of the decrease in tax shown on the return as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes)." Section 6707A(b)(1). The proposed regulations define this decrease in tax generally as the difference between the amount of tax reported on the return as filed and the amount of tax that would be reported on a hypothetical return where the taxpayer did not participate in the reportable transaction. The amount of tax shown on the hypothetical return will reflect adjustments that result mechanically from backing out the reportable transaction, such as tax items affected by an increase in adjusted gross income resulting from non-participation in the reportable transaction.

In some situations, a taxpayer's participation in a listed transaction creates a liability for a tax that would not exist absent participation in the transaction. For example, a taxpayer engaging in a listed abusive Roth IRA transaction may be subject to an excise tax on excess IRA contributions. If the taxpayer fails to report the excise tax on his excess IRA contributions, this amount of tax would not appear on the return filed by the taxpayer that reflected his participation in the reportable transaction. The excise tax would also not appear on a return filed by the taxpayer if he had not engaged in the transaction, because there would be no excess contribution on which excise tax would be imposed. Therefore, the difference between these two returns would result in no decrease in tax attributable to the unreported tax. To capture this tax, the proposed regulations include in the definition of the decrease in tax "any other tax that results from participation in the reportable transaction but was not reported on the taxpayer's return." Example 1 in § 301.6707A–1(d)(2) illustrates this rule.

B. Subsequently identified transactions

Listed transactions and transactions of interest are identified in published guidance. *See* § 1.6011–4(b)(2), (6). Once a listed transaction or a transaction of interest is identified by published guidance, a taxpayer has a reporting obligation if the taxpayer participated in the transaction prior to the issuance of the guidance and the statute of limitations for the year of the taxpayer's participation remains open. *See* § 1.6011–4(e)(2). Under § 1.6011–4, the taxpayer may use a single disclosure statement to disclose multiple years of participation in a reportable transaction. Because the taxpayer in these cases is permitted to disclose multiple years of participation on a single statement, the taxpayer's failure to complete and submit the disclosure statement properly will result in no more than one penalty under section 6707A. The proposed regulations provide, however, that the amount of that penalty will be determined by taking into account the aggregate decrease in tax shown on all of the returns for which disclosure was not provided. Accordingly, under the proposed regulations, the decrease in tax will be determined separately for each year of participation for which only a single disclosure statement was required and the amount of the penalty will be 75 percent of the aggregate decrease in tax in all years for which disclosure was required, subject to the minimum and maximum penalty amount limitations.

C. Penalty under section 6707A(e) for failure to report to the Securities and Exchange Commission

Section 6707A(e) generally requires certain taxpayers who must pay penalties under sections 6707A, 6662A (accuracy-related penalty on understatements with respect to reportable transactions), or 6662(h) (accuracy-related penalty on underpayments attributable to gross valuation misstatements) to disclose their liability for these penalties in filings with the SEC. The flush language of section 6707A(e) provides that "[f]ailure to make a disclosure in accordance with the preceding sentence shall be treated as a failure to which the penalty under subsection (b)(2) applies." However, as discussed in the Background section of this preamble, subsection (b)(2) was amended in 2010. Prior to enactment of the Jobs Act, section 6707A(b)(2) provided that the amount of the penalty for failure to disclose participation in a listed transaction was $100,000 for natural persons and $200,000 in any other case. After the 2010 amendments, section 6707A(b)(2) now provides that "[t]he amount of the penalty under subsection (a) with respect to any reportable transaction shall not exceed— (A) in the case of a listed transaction, $200,000 ($100,000 in the case of a natural person), or (B) in the case of any other reportable transaction, $50,000 ($10,000 in the case of a natural person)."

Treasury and the IRS do not believe that Congress intended its reference to subsection (b)(2) to impose the maximum penalty on violations of section 6707A(e). This would be contrary to the purpose of the 2010 amendments to section 6707A, which sought to make the penalty proportionate to the tax benefit derived by the transaction. A reference solely to subsection (b)(2) does not make sense in terms of describing the amount of the penalty, as subsection (b)(2) merely caps the amount of the penalty that can be imposed on a failure to disclose and does not provide a particular amount for the penalty. It seems likely that the intent was to reference the amount of the penalty generally under subsection (b). The proposed regulations clarify this point.

In each case giving rise to an obligation to disclose liability in filings with the SEC, there must be a reportable transaction for the relevant penalty to arise. The amount of the penalty for a violation of section 6707A(e), therefore, will be 75 percent of the decrease in tax, as provided in section 6707A(b). In addition to being consistent with the language of section 6707A(e), the proposed regulations are also consistent with the Congressional intent of the 2010 amendments to section 6707A to render proportionality between the amount of the penalty and the tax benefit derived from the reportable transaction. *See* JCS–2–11.

D. Minimum and maximum amount of the penalty

Pursuant to section 6707A(b)(2), "[t]he amount of the penalty under subsection (a) with respect to any reportable transaction shall not exceed" certain specified dollar values. Likewise, under section 6707A(b)(3), "[t]he amount of the penalty under subsection (a) with respect to any transaction shall not be less than" certain specified dollar values. Under the proposed regulations, these minimum and maximum limits on the amount of the penalty would be applied separately to each individual penalty under section 6707A(a). The limitations in sections 6707A(b)(2) and (3) apply expressly to "[t]he amount of the penalty under subsection (a)." Because, as provided in § 301.6707A–1(c), each separate failure to disclose a reportable transaction gives rise to a new penalty under section 6707A(a), the minimum and maximum limits on the amount of the penalty apply separately to each failure to disclose.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866 of, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to the proposed regulations. Because the proposed regulations would not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Internal Revenue 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 businesses.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal authors of the proposed regulations are Melissa Henkel of the Office of the Associate Chief Counsel (Procedure and Administration) and Spence Hanemann, formerly of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.6707A–1 is amended by:

1. Adding paragraph (b)(3).

2. In paragraph (c)(1), removing the language "(including an amended return or application for tentative refund)" in the fifth sentence.

3. Redesignating paragraphs (d), (e) and (f) as paragraphs (e), (f), and (g).

4. Adding new paragraph (d).

5. In newly designated paragraph (e), removing the language "(d)" wherever it appears and adding "(e)" in its place.

6. In newly designated paragraph (e)(3)(i), removing the language "(including an amended return or application for tentative refund)" wherever it appears.

7. In newly designated paragraph (f), removing the language "(e)" wherever it appears and adding "(f)" in its place.

8. Revising newly designated paragraphs (g)(1) and (g)(2).

The revisions and additions read as follows:

§ 301.6707A–1. Failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction.—

* * * * *

(b) * * *

(3) *Return*. For purposes of this section, the term "return" means an original return, amended return, or application for tentative refund, except where otherwise indicated. As used in examples, the term "return" means an original return, except where otherwise indicated.

* * * * *

(d) *Calculation of the penalty*. (1) *Decrease in tax*—(i) *In general*. As used in this section, the phrase "decrease in tax shown on the return as a result of the transaction or the decrease that would have resulted from the transaction if it were respected for Federal tax purposes" means the sum of (A) the excess of the amount of the tax that would be shown on the return if the return did not reflect the taxpayer's participation in the reportable transaction over the tax actually reported on the return reflecting participation in the reportable transaction and (B) any other tax that results from participation in the reportable transaction but was not reported on the taxpayer's return. The amount of tax that would be shown on the return if it did not reflect the taxpayer's participation in the reportable transaction includes adjustments that result mechanically from backing out the reportable transaction, such as tax items affected by an increase in adjusted gross income resulting from not participating in the transaction. Under this rule, it makes no difference whether a taxpayer's tax liability is ultimately settled with the IRS for a different amount or whether the taxpayer subsequently reports a different amount of tax on an amended return, because these amounts do not enter into the calculation of the decrease in tax shown on the return (or returns) to which the penalty relates.

(ii) *Subsequently identified transactions*. If the taxpayer fails to file a complete and proper disclosure statement required by § 1.6011–4(e)(2)(i) disclosing participation in a listed transaction or transaction of interest with respect to more than one return, the amount of the penalty will be computed by aggregating the decrease in tax shown on each return for which the required disclosure was not provided.

(iii) *Penalty for failure to report to the SEC*. In the case of a penalty imposed under section 6707A(e) for failure to disclose liability for certain penalties in reports to the Securities and Exchange Commission, the amount of the penalty will be determined under section 6707A(b) and this paragraph (d), regardless of whether the penalty that the taxpayer failed to disclose is imposed under section 6707A, 6662A, or 6662(h).

(iv) *Minimum and maximum amount of the penalty*. The limitations on the minimum and maximum penalty amounts described in paragraph (a) of this section apply separately to each failure to disclose that is subject to a penalty.

(2) *No tax required to be shown on return*. For returns with respect to which disclosure is required but on which no tax is required to be shown (for example, returns of passthrough entities), the minimum penalty amount will be imposed for failures to disclose.

(3) *Examples*. The rules in paragraphs (d)(1) and (2) of this section are illustrated by the following examples:

Example 1. Taxpayer X, a natural person, filed a return reflecting participation in an abusive Roth IRA transaction listed in Notice 2004–8, 2004–1 I.R.B. 333 (Jan. 26, 2004). As described in the notice, X's Roth IRA acquired shares of a wholly owned corporation and then X sold assets to the corporation at less than fair market value, effectively transferring value to the corporation comparable to a contribution to the Roth IRA. X failed to disclose his participation in the listed transaction as required by the regulations under section 6011. As a result of the transaction, X was liable under section 4973 for a

$10,000 excise tax for excess contributions to his Roth IRA. On his return, X correctly reported $25,000 of income tax, none of which was attributable to the listed transaction, but failed to report the excise tax. If X had not participated in the listed transaction, the excise tax under section 4973 would not have applied and his income tax would have remained $25,000. There would, therefore, be no difference between the tax on his return as filed and the tax on his return if it did not reflect participation in the transaction. The excise tax, however, is another tax that resulted from participation in the transaction but was not reported on X's return, as described in paragraph (d)(1)(i)(B) of this section. Therefore, the decrease in tax resulting from the listed transaction is $10,000, which amount is the sum of zero (the excess of the amount of tax that would be shown on X's return if the return did not reflect X's participation in the transaction over the tax X actually reported on the return reflecting X's participation in the transaction) and $10,000 (the amount of excise tax that resulted from participation in the transaction but was not reported on the return). The amount of the penalty will be $7,500, which amount is 75 percent of the $10,000 decrease in tax.

Example 2. Taxpayer X participated in a listed transaction that resulted in a $40,000 decrease in the tax shown on its return. X failed to disclose its participation and is, therefore, subject to a penalty under section 6707A. After weighing litigating hazards and other costs of litigation, the IRS Office of Appeals agreed to settle X's deficiency for $20,000. For purposes of calculating the amount of the penalty, the settlement does not affect the decrease in tax shown on X's return as a result of the listed transaction, which remains $40,000. The amount of X's penalty will be $30,000, which amount is 75 percent of the $40,000 decrease in tax.

Example 3. Taxpayer X, a natural person, participated in a nonlisted reportable transaction and, because he failed to disclose his participation, is subject to a penalty under section 6707A. After offsetting gross income with the losses generated in the reportable transaction, X's return reported adjusted gross income of $100,000. The return also reported $12,000 of medical expenses, $2,000 of which were deductible after applying the 10 percent floor in section 213(a). If X's return had not reflected participation in the reportable transaction, his adjusted gross income would have been $140,000. The decrease in tax shown on X's return as a result of the transaction would take into account both the tax on the $40,000 difference in adjusted gross income and the tax on the $2,000 adjustment to X's deductible medical expenses under section 213(a) caused by the increase in adjusted gross income.

Example 4. Taxpayer X, a natural person, timely filed his 2014 return and reported income tax of $40,000. X did not participate in a reportable transaction in 2014. X participated in a listed transaction in 2015, but failed to file a complete and proper disclosure statement with his 2015 return as required by the regulations under section 6011. As filed, the 2015 return reports that X owes no tax and has a loss of $10,000. If the tax consequences of the listed transaction were not reflected on the 2015 return, the return would show income tax of $15,000 and no loss. X files an amended return for his 2014 tax year on which its only amendment is to carry back the $10,000 loss reported on its 2015 tax return to the 2014 tax year, which decreases X's tax liability for 2014 by $3,000. X fails to file a complete and proper disclosure statement with the 2014 amended return as required by the regulations under section 6011. X will be assessed two penalties under section 6707A: one for his failure to disclose participation in a listed transaction reflected on his 2015 tax return and another for his failure to disclose participation in the same listed transaction reflected on his 2014 amended return. The decrease in tax on the 2015 tax return resulting from the listed transaction is $15,000, which amount is the excess of the amount of tax that would be shown on X's return if the return did not reflect X's participation in the transaction over the tax X actually reported on the return reflecting X's participation in the transaction. The amount of the penalty with respect to the 2015 tax return is $11,250, which amount is 75 percent of the decrease in tax. The decrease in tax on the 2014 amended return that results from the listed transaction is $3,000, which is the excess of the amount of tax that would be shown on X's return if the return did not reflect X's participation in the transaction over the tax X actually reported on the return reflecting X's participation in the transaction. *See* § 301.6707A–1(c). Because X is a natural person, the amount of the penalty with respect to the 2014 amended return is $5,000, which is the minimum penalty under § 301.6707A–1(a) and section 6707A(b)(3).

Example 5. Taxpayer X, a corporation, timely files its 2012 and 2013 tax returns, each of which reflects participation in the same transaction. In 2015, the transaction becomes a listed transaction and X fails to file a complete and proper disclosure statement as required by the regulations under section 6011. X was required to file a single disclosure statement reflecting its participation in the listed transaction for all years which had open periods of limitation on assessment at the time the transaction became listed. When the transaction at issue became listed, the periods of assessment on X's 2012 and 2013 tax years were open. Pursuant to paragraph (d)(1)(ii) of this section, the amount of the penalty for X's single failure to disclose its participation in the transaction in 2012 and 2013 is computed by aggregating the decrease in tax shown on the 2012 return and the decrease in tax shown on the 2013 return. The decreases in tax shown on the returns as a result of X's participation in the transaction are $265,000 in tax year 2012 and $7,000 in tax year 2013. The total decrease in tax shown on both returns is $272,000, and 75 percent of that amount is $204,000. Because X is a corporation, the amount of the penalty will be limited to the maximum amount of $200,000 under § 301.6707A–1(a) and section 6707A(b)(2)(A).

Example 6. The 2014 return of Taxpayer X, a natural person, reflects participation in a nonlisted reportable transaction, but X fails to file a complete and proper disclosure statement as required by the regulations under section 6011. The decrease in tax shown on X's 2014 return as a result of participation in the reportable transaction is $20,000. X subsequently files an amended 2014 return to include a net operating loss carried forward from a prior year, which X inadvertently failed to include when he filed his original return. The amended return reflects participation in the same reportable transaction, but X again fails to file a complete and proper disclosure statement. The decrease in tax shown on the amended 2014 return as a result of participation in the transaction is also $20,000. X is subject to two separate penalties: one for each failure to disclose. Seventy-five percent of the $20,000 decrease in tax shown on each of the original 2014 return and the amended 2014 return is $15,000 for each return. Because X is a natural person, the amount of the penalty for failure to disclose with respect to the original return will be limited to the maximum amount of $10,000 under § 301.6707A–1(a) and section 6707A(b)(2)(B). The amount of the penalty for failure to disclose with respect to the amended return will also be limited to the maximum amount of $10,000.

Example 7. Partnership M is required to attach Form 8886, Reportable Transaction Disclosure Statement, to its Form 1065, U.S. Return of Partnership Income, for the 2014 taxable year. It fails to do so and is, therefore, subject to a penalty under section 6707A. The amount of the penalty will be the minimum penalty of $10,000 under § 301.6707A–1(a) and section 6707A(b)(3) because Form 1065 is a return that does not show an amount of tax that would be decreased as a result of participation in the reportable transaction. The partners of Partnership M may have separate disclosure obligations as required by the regulations under section 6011 and would be subject to separate section 6707A penalties if they fail to comply with the disclosure requirements.

Example 8. In tax year 2014, Taxpayer X participated in a listed transaction that resulted in a $150,000 deduction. X's gross income for 2014 before the listed transaction deduction is $100,000. X uses $100,000 of the deduction to offset $100,000 of gross income and reports tax of zero for 2014. X also has a $50,000 net operating loss for 2014. X timely elects to waive the carryback period and carry over the 2014 net operating loss to tax year 2015. X's gross income for tax year 2015 is $200,000 but as a result of the $50,000 net operating loss carryover, X reports $150,000 adjusted gross income. Pursuant to § 1.6011–4, X is required to disclose participation in the listed transaction for both 2014 and 2015, but X fails to make the required disclosures and is therefore subject to the section 6707A penalty for each failure. The decrease in tax on the 2014 return is the amount of tax on $100,000 because that is the difference between the amount of tax that would have been shown on the return if it did not reflect participation in the reportable transaction and the tax actually reported. No other tax resulted from X's participation in the listed transaction. The amount of the penalty with respect to X's failure to disclose with respect to 2014 will be 75 percent of the decrease in tax. The decrease in tax on the 2015 return is the difference between the tax shown on the return as filed and the tax that would be shown if the $50,000 net operating loss was not used, including any changes to the amount of tax that are only indirectly connected with the listed transaction. The amount of the penalty with respect to X's failure to disclose with respect to 2015 will be 75 percent of the decrease in tax.

Example 9. In tax year 2014, Taxpayer X, a natural person, participated in a listed transaction that resulted in a $50,000 deduction. X's gross income for 2014 before the listed transaction deduction is $100,000. X also has a net operating loss carryover of $150,000 from 2013. X uses the deduction of $50,000 and a portion of the net operating loss carryover to offset $100,000 of gross income and reports adjusted gross income of zero for 2014. X carries over the remaining net operating loss to tax year 2015. X's gross income for 2015 is $250,000, but as a result of the net operating loss carryover, X reports reduced adjusted gross income of $150,000. Pursuant to § 1.6011–4, X is required to disclose participation in the listed transaction for both 2014 and 2015, but X fails to make the required disclosures and is subject to the section 6707A penalty for each failure. The decrease in tax on the 2014 return that results from the reportable transaction is zero. Because X has $150,000 of a net operating loss carryover not attributable to the reportable transaction, X's tax without the benefits of the reportable transaction is the same as the tax shown on the 2014 return as filed. Because X is a natural person, the minimum penalty of $5,000 under § 301.6707A–1(a) and section 6707A(b)(3) will apply for the failure to disclose the listed transaction with the 2014 return. The decrease in tax on the 2015 return is the difference between the tax shown on the return as filed and the tax that would be shown if X had only $50,000 of net operating loss to carry over to 2015 (i.e., if X had not offset $50,000 of its 2014 gross income with the deduction resulting from the reportable transaction and thus had used $100,000 of its net operating loss carryover in 2014), including any changes to the amount of tax that are only indirectly connected with the listed transaction. The amount of the penalty with respect to the disclosure relating to 2015 will be 75 percent of this decrease in tax.

Example 10. In tax year 2014, Taxpayer X, a corporation, engaged in a nonlisted reportable transaction and is subject to a penalty under section 6662A because its 2014 return resulted in a reportable transaction understatement. As a result of X's involvement in the transaction, it reported tax of $10,000 for 2014; if X had not engaged in the transaction, it would have reported tax of $200,000. X disclosed its involvement in the transaction as required by the regulations under section 6011, and thus was not subject to a penalty under section 6707A(a). As a person who is required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, however, X was also required, pursuant to section 6707A(e), to disclose the penalty imposed under section 6662A to the Securities and Exchange Commission, which X failed to do. X's failure to disclose the section 6662A penalty is treated as a failure to disclose to which section 6707A(b) applies. Thus, X will be subject to a penalty under section 6707A(e), which will equal 75 percent of the decrease in tax resulting from the transaction. The decrease in tax resulting from the nonlisted reportable transaction was $190,000, 75 percent of which is $142,500. Because X is a corporation, the amount of the penalty will be limited to $50,000 under § 301.6707A–1(a) and section 6707A(b)(2)(B).

* * * * *

(g) * * *

(1) This section applies to penalties assessed after the date that these regulations are published as final regulations in the **Federal Register.**

(2) For penalties assessed before the date that these regulations are published as final regulations in the **Federal Register**, § 301.6707A–1 (as contained in 26 CFR part 1, revised April 2013) shall apply.

John M. Dalrymple
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal register on August 27, 2015, 8:45 a.m., and published in the issue of the Federal Register for August 28, 2015, 80 F.R. 52231)

Notice of Proposed Rulemaking
Residence Rules Involving U.S. Possessions

REG–109813–11

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations for determining whether an individual is a bona fide resident of a U.S. territory. These proposed amendments affect individuals establishing bona fide residency in a U.S. territory by allowing additional days of constructive presence in a U.S. territory.

DATES: Written or electronic comments and requests for a public hearing must be received by November 25, 2015.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–109813–11), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–109813–11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–109813–11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stephen Huggs, (202) 317-6941; concerning submission of comments and/or requests for a hearing, Oluwafunmilayo (Funmi) Taylor, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 937 of the Internal Revenue Code (Code). Section 937 was added to the Code by the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418 (2004)). Section 937(a) provides rules for determining if an individual is a bona fide resident of a U.S. possession (generally referred to in this preamble as a "U.S. territory").

On April 11, 2005, the **Federal Register** published temporary regulations (TD 9194, 70 FR 18920) and proposed regulations (REG–159243–03, 70 FR 18949) under section 937, providing rules to implement section 937 and conforming existing regulations to other legislative changes with respect to the U.S. territories. On January 31, 2006, the **Federal Register** published final regulations (TD 9248, 71 FR 4996) under section 937(a) concerning whether an individual is a bona fide resident of a U.S. territory. Section 1.937–1 was amended on November 14, 2006, and on April 9, 2008, to provide additional guidance concerning bona fide residency in the U.S. territories. See TD 9297 (71 FR 66232) and TD 9391 (73 FR 19350).

Section 937(a) provides that an individual is a bona fide resident of a U.S. territory if the individual meets a presence test, a tax home test, and a closer connection test. In order to satisfy the presence test, an individual must be present in the U.S. territory for at least 183 days during the taxable year (183-day rule), unless otherwise provided in regulations.

Section 1.937–1 provides several alternatives to the 183-day rule. An individual who does not satisfy the 183-day rule nevertheless meets the presence test if the individual satisfies one of four alternative tests: (1) the individual is present in the relevant U.S. territory for at least 549 days during the three-year period consisting of the current taxable year and the two immediately preceding taxable years, provided the individual is present in the U.S. territory for at least 60 days during each taxable year of the period; (2) the individual is present no more than 90 days in the United States during the taxable year; (3) the individual has no more than $3,000 of earned income from U.S. sources and is present for more days in the U.S. territory than in the United States during the taxable year; or (4) the individual has no significant connection to the United States during the taxable year. The term "significant connection" is generally defined as a permanent home, voter registration, spouse, or minor child in the United States. See § 1.937–1(c)(5). Section 1.937–1 also provides that certain days count as days of presence in the relevant U.S. territory for purposes of the presence test, even if the individual is not physically present in the U.S. territory (constructive presence).

Explanation of Provisions

Following the original issuance of § 1.937–1, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) received comments requesting that the presence test be revisited to make it more flexible. These comments included a proposal to allow days of constructive presence for business or personal travel outside of the relevant U.S. territory. The Treasury Department and the IRS have concluded that it would be appropriate to allow additional days of constructive presence subject to certain limitations. Accordingly, these proposed regulations provide an additional rule for calculating days of presence in the relevant U.S. territory for purposes of the presence test in § 1.937–1(c)(1).

Under the proposed amendment, an individual would be considered to be present in the relevant U.S. territory for up to 30 days during which the individual is outside of both the United States and the relevant U.S. territory. The proposed amendment would not apply, however, if the number of days that the individual is considered to be present in the United States during the taxable year equals or exceeds the number of days that the individual is considered to be present in the relevant U.S. territory during the taxable year, determined without taking into account any days for which the individual would be treated as present in the U.S. territory under this proposed amendment. Furthermore, the 30-day constructive presence rule would not apply for purposes of calculating the minimum 60 days of presence in the relevant U.S. territory that is required for the 549-day test under § 1.937–1(c)(1)(ii). Therefore, an individual invoking § 1.937–1(c)(1)(ii) must otherwise be considered to have been present at least 60 days in the relevant U.S. territory in each of the three years in order to benefit from the 30-day constructive presence rule.

Proposed Effective/Applicability Date

These amendments to the regulations are proposed to apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Reliance on Proposed Regulations

Until these regulations are published as final regulations in the **Federal Register**, taxpayers may rely on these proposed regulations with respect to taxable years beginning on or after the date these proposed regulations are published in the **Federal Register**.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact 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, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation 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

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. The Treasury Department and the IRS request comments on all aspects of the proposed rules. 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 that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Cleve Lisecki, formerly of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

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 * * *

Section 1.937–1 also issued under 26 U.S.C. 937(a). * * *

Par. 2. Section 1.937–1 is amended as follows:

1. Revising paragraph (c)(3)(i)(B) and paragraph (c)(3)(i)(C)(*2*).

2. Adding paragraph (c)(3)(i)(D).

3. Revising *Example 1* of paragraph (g).

4. Redesignating *Examples 2* through *10* of paragraph (g) as *Examples 5* through *13* respectively.

5. Adding new *Examples 2*, *3*, and *4* to paragraph (g).

6. Revising newly re-designated *Example 5* of paragraph (g).

7. Adding a new sentence to the end of paragraph (i).

The revisions and additions read as follows:

§ 1.937–1 Bona fide residency in a possession.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(B) Any day that an individual is outside of the relevant possession to receive, or to accompany on a full-time basis a parent, spouse, or child (as defined in section 152(f)(1)) who is receiving, qualifying medical treatment as defined in paragraph (c)(4) of this section;

(C) * * *

(*1*) * * *

(*2*) Period for which a mandatory evacuation order is in effect for the geographic area in the relevant possession in which the individual's place of abode is located; and

(D) Any day not described in paragraph (c)(3)(i)(B) or (C) of this section that an individual is outside of the United States and the relevant possession, except that an individual will not be considered present in the relevant possession under this paragraph (c)(3)(i)(D) for more than 30 days during the taxable year, and this paragraph (c)(3)(i)(D) does not apply for purposes of calculating the required minimum 60 days of presence in the relevant possession under paragraph (c)(1)(ii) of this section. Furthermore, this paragraph (c)(3)(i)(D) applies only if the number of days that the individual is considered to be present in the relevant possession during the taxable year, determined without regard to this paragraph (c)(3)(i)(D), exceeds the number of days that the individual is considered to be present in the United States during the taxable year.

* * * * *

(g) * * *

Example 1. Presence test. H, a U.S. citizen, is engaged in a profession that requires frequent travel. In each of the years 2016 and 2017, H spends 195 days in Possession N and the balance of the year in the United States. In 2018, H spends 160 days in Possession N and the balance of the year in the United States. Thus, H spends a total of 550 days in Possession N for the three-year period consisting of years 2016, 2017, and 2018. Under paragraph (c)(1)(ii) of this section, H satisfies the presence test of paragraph (c) of this section with respect to Possession N for taxable year 2018 because H is present in Possession N for more than the required 549 days during the three-year period of 2016 through 2018 and is present in Possession N for at least 60 days during each of those taxable years. Assuming that in 2018 H does not have a tax home outside of Possession N and does not have a closer connection to the United States or a foreign country under paragraphs (d) and (e) of this section respectively, then regardless of whether H was a bona fide resident of Possession N in 2016 and 2017, H is a bona fide resident of Possession N for taxable year 2018.

Example 2. Presence test. Same facts as *Example 1*, except that in 2018, H spends 130 days in Possession N, 110 days in foreign countries, and 125 days in the United States. Because H satisfies the requirements of paragraph (c)(3)(i)(D) of this section, 30 of the days spent in foreign countries during 2018 are treated as days of presence in Possession N. Thus, H will be treated as being present for 160 days in Possession N for 2018. Under paragraph (c)(1)(ii) of this section, H meets the presence test of paragraph (c) of this section with respect to Possession N for taxable year 2018 because H is present in Possession N for 550 days (more than the required 549 days) during the three-year period of 2016 through 2018 and is present in Possession N for at least 60 days in each of those taxable years. As in *Example 1*, assuming that in 2018 H does not have a tax home outside of Possession N and does not have a closer connection to the United States or a foreign country under paragraphs (d) and (e) of this section respectively, then regardless of whether H was a bona fide resident of Possession N in 2016 and 2017, H is a bona fide resident of Possession N in 2018.

Example 3. Presence test. Same facts as *Example 1*, except that in 2018, H spends 130 days in Possession N, 100 days in foreign countries, and 135 days in the United States. Under these facts, H does not satisfy paragraph (c)(1)(ii) of this section for taxable year 2018 because H is present in Possession N for only 520 days (less than the required 549 days) during the three-year period of 2016 through 2018. The rule of paragraph (c)(3)(i)(D) of this section (treating up to 30 days spent in foreign countries as days of presence in Possession N) is not available because H fails to satisfy the condition that H be present more days in Possession N than in the United States during 2018, determined without regard to the application of paragraph (c)(3)(i)(D) of this section.

Example 4. Presence test. Same facts as *Example 1*, except that in 2016, H spends 360 days in Possession N and six days in the United States; in 2017, H spends 45 days in Possession N, 290 days in foreign countries, and 30 days in the United States; and in 2018, H spends 180 days in Possession N and 185 days in the United States. Under these facts, H does not satisfy paragraph (c)(1)(ii) of this section for taxable year 2018. During the three-year period from 2016 through 2018, H is present in Possession N for 615 days, including 30 of the days spent in foreign countries in 2017, which are treated under paragraph (c)(3)(i)(D) of this section as days of presence in Possession N. Although H is present in Possession N for more than the required 549 days during the three-year period, H is only present for 45 days in Possession N during one of the taxable years (2017) of the period, less than the 60 days of minimum presence required under paragraph (c)(1)(ii) of this section. The rule of paragraph (c)(3)(i)(D) of this section does not apply for purposes of determining whether H is present in Possession N for the 60-day minimum required under paragraph (c)(1)(ii) of this section.

Example 5. Presence test. W, a U.S. citizen, owns a condominium in Possession P where she spends part of the taxable year. W also owns a house in State N near her grown children and grandchildren. W is retired and her income consists solely of pension payments, dividends, interest, and Social Security benefits. For 2016, W spends 145 days in Possession P, 101 days in Europe and Asia on vacation, and 120 days in State N. For taxable year 2016, W is not present in Possession P for at least 183 days, is present in the United States for more than 90 days, and has a significant connection to the United States by reason of her permanent home. However, under paragraph (c)(1)(iv) of this section, W still satisfies the presence test of paragraph (c) of this section with respect to Possession P for taxable year 2016 because she has no earned income in the United States and is present for more days in Possession P than in the United States.

* * * * *

(i) * * * Notwithstanding the foregoing, paragraph (c)(3)(i)(D) and *Examples 1*, *2*, *3*, *4*, and *5* of paragraph (g) of this section apply for taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal register on August 26, 2015, 8:45 a.m., and published in the issue of the Federal Register for August 27, 2015, 80 F.R. 51975)

Notice of Proposed Rulemaking Amendments to Domestic Production Activities Deduction Regulations; Allocation of W–2 Wages in a Short Taxable Year and in an Acquisition or Disposition

REG–136459–09

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, notice of proposed rulemaking by cross reference to temporary regulations and notice of public hearing.

SUMMARY: This document contains proposed regulations involving the domestic production activities deduction under section 199 of the Internal Revenue Code (Code). The proposed regulations provide guidance to taxpayers on the amendments made to section 199 by the Energy Improvement and Extension Act of 2008 and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, involving oil related qualified production activities income and qualified films, and the American Taxpayer Relief Act of 2012, involving activities in Puerto Rico. The proposed regulations also provide guidance on: determining domestic production gross receipts; the terms manufactured, produced, grown, or extracted; contract manufacturing; hedging transactions; construction activities; allocating cost of goods sold; and agricultural and horticultural cooperatives. In the Rules and Regulations of this issue of the **Internal Revenue Bulletin**, the Treasury Department and the IRS also are issuing temporary regulations (TD 9731) clarifying how taxpayers calculate W–2 wages for purposes of the W–2 wage limitation in the case of a short taxable year or an acquisition or disposition of a trade or business (including the major portion of a trade or business, or the major portion of a separate unit of a trade or business) during the taxable year. This document also contains a notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments must be received by. Outlines of topics to be discussed at the public hearing scheduled for December 16, 2015, at 10:00 am, must be received by November 24, 2015.

ADDRESSES: Send submissions to: CC: PA:LPD:PR (REG–136459–09), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–136459–09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–136459–09). The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning §§ 1.199–1(f), 1.199–2(c), 1.199–2(e), 1.199–2(f), 1.199–3(b), 1.199–3(e), 1.199–3(h), 1.199–3(k), 1.199–3(m), 1.199–6(m), and 1.199–8(i) of the proposed regulations, James Holmes, (202) 317–4137; concerning § 1.199–4(b) of the proposed regulations, Natasha Mulleneaux (202) 317-7007; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Regina Johnson, at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to §§ 1.199–0, 1.199–1, 1.199–2, 1.199–3, 1.199–4(b), 1.199–6, and 1.199–8(i) of the Income Tax Regulations (26 CFR part 1). Section 1.199–1 relates to income that is attributable to domestic production activities. Section 1.199–2 relates to W–2 wages as defined in section 199(b). Section 1.199–3 relates to determining domestic production gross receipts (DPGR). Section 1.199–4(b) describes the costs of goods sold allocable to DPGR. Section 1.199–6 applies to agricultural and horticultural cooperatives. Section 1.199–8(i) provides the effective/applicability dates.

Section 199 was added to the Code by section 102 of the American Jobs Creation Act of 2004 (Public Law 108–357, 118 Stat. 1418 (2004)), and amended by section 403(a) of the Gulf Opportunity Zone Act of 2005 (Public Law 109–135, 119 Stat. 25 (2005)), section 514 of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222, 120 Stat. 345 (2005)), section 401 of the Tax Relief and Health Care Act of 2006 (Public Law 109–432, 120 Stat. 2922 (2006)), section 401(a), Division B of the Energy Improvement and Extension Act of 2008 (Public Law 110–343, 122 Stat. 3765 (2008)) (Energy Extension Act of 2008), sections 312(a) and 502(c), Division C of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Public Law 110–343, 122 Stat. 3765 (2008)) (Tax Extenders Act of 2008), section 746(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Public Law 111–312, 124 Stat. 3296 (2010)), section 318 of the American Taxpayer Relief Act of 2012 (Public Law 112–240, 126 Stat. 2313 (2013)), and sections 130 and 219(b) of the Tax Increase Prevention Act of 2014 (Public Law 113–295, 128 Stat. 4010 (2014)).

General Overview

Section 199(a)(1) allows a deduction equal to nine percent (three percent in the case of taxable years beginning in 2005 or 2006, and six percent in the case of taxable years beginning in 2007, 2008, or 2009) of the lesser of: (A) the qualified production activities income (QPAI) of the taxpayer for the taxable year, or (B) taxable income (determined without regard to section 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Section 199(b)(1) provides that the amount of the deduction allowable under section 199(a) for any taxable year shall not exceed 50 percent of the W–2 wages of the taxpayer for the taxable year. Section 199(b)(2)(A) generally defines *W–2 wages*, with respect to any person for any taxable year of such person, as the sum of amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 199(b)(3), after its amendment by section 219(b) of the Tax Increase Prevention Act of 2014, provides that the Secretary shall provide for the application of section 199(b) in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business, or the major portion of a separate unit of a trade or business during the taxable year. Section 199(b)(2)(B) limits the W–2 wages to those properly allocable to DPGR for taxable years beginning after May 17, 2006.

Section 199(c)(1) defines QPAI for any taxable year as an amount equal to the excess (if any) of: (A) the taxpayer's DPGR for such taxable year, over (B) the sum of: (i) the cost of goods sold (CGS) that are allocable to such receipts; and (ii) other expenses, losses, or deductions (other than the deduction under section

199) that are properly allocable to such receipts.

Section 199(c)(4)(A)(i) provides that the term DPGR means the taxpayer's gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of: (I) qualifying production property (QPP) that was manufactured, produced, grown, or extracted (MPGE) by the taxpayer in whole or in significant part within the United States; (II) any qualified film produced by the taxpayer; or (III) electricity, natural gas, or potable water (utilities) produced by the taxpayer in the United States.

Section 199(d)(10), as renumbered by section 401(a), Division B of the Energy Extension Act of 2008, authorizes the Secretary to prescribe such regulations as are necessary to carry out the purposes of section 199, including regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any activity described in section 199(c)(4)(A)(i).

Explanation of Provisions

1. Allocation of W–2 Wages in a Short Taxable Year and in an Acquisition or Disposition of a Trade or Business (or Major Portion)

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** contain amendments to the Income Tax Regulations that provide rules clarifying how taxpayers calculate W–2 wages for purposes of the W–2 wage limitation under section 199(b)(1) in the case of a short taxable year or where a taxpayer acquires, or disposes of, the major portion of a trade or business, or the major portion of a separate unit of a trade or business during the taxable year under section 199(b)(3). The text of those regulations serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

2. Oil Related Qualified Production Activities Income

Section 401(a), Division B of the Energy Extension Act of 2008 added new section 199(d)(9), which applies to taxable years beginning after December 31, 2008. Section 199(d)(9) reduces the otherwise allowable section 199 deduction when a taxpayer has oil related qualified production activities income (oil related QPAI), and defines oil related QPAI. Section 199(d)(9)(A) provides that if a taxpayer has oil related QPAI for any taxable year beginning after 2009, the amount otherwise allowable as a deduction under section 199(a) must be reduced by three percent of the least of: (i) the oil related QPAI of the taxpayer for the taxable year, (ii) the QPAI of the taxpayer for the taxable year, or (iii) taxable income (determined without regard to section 199).

Section 1.199–1(f) of the proposed regulations provides guidance on oil related QPAI. In defining oil related QPAI, the Treasury Department and the IRS considered the relationship between QPAI and oil related QPAI. Section 199(c)(1) defines QPAI as the amount equal to the excess (if any) of the taxpayer's DPGR for the taxable year over the sum of CGS allocable to such receipts and other costs, expenses, losses, and deductions allocable to such receipts. So, for example, if gross receipts are not included within DPGR, those gross receipts are not included when calculating QPAI. Section 199(d)(9)(B) defines oil related QPAI as QPAI attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof. In general, gross receipts from the transportation and distribution of QPP are not includable in DPGR because those activities are not considered part of the MPGE of QPP. See § 1.199–3(e)(1), which defines MPGE. Section 199(c)(4)(B)(ii) specifically excludes gross receipts attributable to the transmission or distribution of natural gas from the definition of DPGR.

Based on these considerations, the proposed regulations define *oil related QPAI* as an amount equal to the excess (if any) of the taxpayer's DPGR from the production, refining, or processing of oil, gas, or any primary product thereof (oil related DPGR) over the sum of the CGS that is allocable to such receipts and other expenses, losses, or deductions that are properly allocable to such receipts. The proposed regulations specifically provide that oil related DPGR does not include gross receipts derived from the transportation or distribution of oil, gas, or any primary product thereof, except if the de minimis rule under § 1.199–1(d)(3)(i) or an exception for embedded services applies under § 1.199–3(i)(4)(i)(B). The proposed regulations further provide that, to the extent a taxpayer treats gross receipts derived from the transportation or distribution of oil, gas, or any primary product thereof as DPGR under § 1.199–1(d)(3)(i) or § 1.199–3(i)(4)(i)(B), the taxpayer must include those gross receipts in oil related DPGR.

The proposed regulations define *oil* as including oil recovered from both conventional and non-conventional recovery methods, including crude oil, shale oil, and oil recovered from tar/oil sands. Section 199(d)(9)(C) defines *primary product* as having the same meaning as when used in section 927(a)(2)(C) (relating to property excluded from the term *export property* under the former foreign sales corporations rules), as in effect before its repeal. The proposed regulations incorporate the rules in § 1.927(a)–1T(g)(2)(i) regarding the definition of a primary product with modifications that are consistent with the definition of oil for purposes of section 199(d)(9).

Section 1.199–1(f)(2) of the proposed regulations provides guidance on how a taxpayer should allocate and apportion costs under the section 861 method, the simplified deduction method, and the small business simplified overall method when determining oil related QPAI. The proposed regulations require taxpayers to use the same cost allocation method to allocate and apportion costs to oil related DPGR as the taxpayer uses to allocate and apportion costs to DPGR.

3. Qualified Films

a. Statutory amendments

Section 502(c), Division C of the Tax Extenders Act of 2008 amended the rules relating to qualified films. Section 502(c)(1) added section 199(b)(2)(D) to broaden the definition of the term *W–2 wages* as applied to a qualified film to include compensation for services performed in the United States by actors, production personnel, directors, and producers.

Section 502(c)(2), Division C of the Tax Extenders Act of 2008 amended the definition of qualified film in section 199(c)(6) to mean any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to production of the property is compensation for services performed in the United States by actors, production personnel, directors, and producers. The term does not include property with respect to which records are required to be maintained under 18 U.S.C. section 2257 (generally, films, videotapes, or other matter that depict actual sexually explicit conduct and are produced in whole or in part with materials that have been mailed or shipped in interstate or foreign commerce, or are shipped or transported or are intended for shipment or transportation in interstate or foreign commerce). Section 502(c)(2), Division C of the Tax Extenders Act of 2008 also amended the definition of a qualified film under section 199(c)(6) to include any copyrights, trademarks, or other intangibles with respect to such film. The method and means of distributing a qualified film does not affect the availability of the deduction.

Section 502(c)(3), Division C of the Tax Extenders Act of 2008 added an attribution rule for a qualified film for taxpayers who are partnerships or S corporations, or partners or shareholders of such entities under section 199(d)(1)(A)(iv). Section 199(d)(1)(A)(iv) provides that in the case of each partner of a partnership, or shareholder of an S corporation, who owns (directly or indirectly) at least 20 percent of the capital interests in such partnership or the stock of such S corporation, such partner or shareholder is treated as having engaged directly in any film produced by such partnership or S corporation, and that such partnership or S Corporation is treated as having engaged directly in any film produced by such partner or shareholder.

The amendments made by section 502(c), Division C of the Tax Extenders Act of 2008 apply to taxable years beginning after December 31, 2007.

b. W–2 wages

Section 1.199–2(e)(1) of the proposed regulations modifies the definition of W–2 wages to include compensation for services (as defined in § 1.199–3(k)(4)) performed in the United States by actors, production personnel, directors, and producers (as defined in § 1.199–3(k)(1)).

c. Definition of qualified films

To address the amendments to the definition of qualified film in section 199(c)(6) for taxable years beginning after 2007, the proposed regulations amend the definition of qualified film in § 1.199–3(k)(1) to include copyrights, trademarks, or other intangibles with respect to such film. The proposed regulations define other intangibles with a non-exclusive list of intangibles that fall within the definition.

Section 1.199–3(k)(10) provides a special rule for disposition of promotional films to address concerns of the Treasury Department and the IRS that the inclusion of intangibles in the definition of qualified film could be interpreted too broadly. This rule clarifies that, when a taxpayer produces a qualified film that is promoting a product or service, the gross receipts a taxpayer later derives from the disposition of the product or service promoted in the qualified film are derived from the disposition of the product or service and not from a disposition of the qualified film (including any intangible with respect to such qualified film). The rule is intended to prevent taxpayers from claiming that gross receipts are derived from the disposition of a qualified film (rather than the product or service itself) when a taxpayer sells a product or service with a logo, trademark, or other intangible that appears in a promotional film produced by the taxpayer. The Treasury Department and the IRS recognize that a taxpayer can, in certain cases, derive gross receipts from a disposition of a promotional film or the intangibles in a promotional film. The proposed regulations add *Example 9* in § 1.199–3(k)(11) relating to a license to reproduce a character used in a promotional film to illustrate a situation where gross receipts can qualify as DPGR because the gross receipts are distinct (separate and apart) from the disposition of the product or service. The Treasury Department and the IRS request comments on how to determine when gross receipts are distinct.

The proposed regulations add four examples in redesignated § 1.199–3(k)(11), formerly § 1.199–3(k)(10), to illustrate application of the amended definition of qualified film that includes copyrights, trademarks, or other intangibles.

The proposed regulations remove the last sentence of § 1.199–3(k)(3)(ii) (which states that gross receipts derived from a license of the right to use or exploit film characters are not gross receipts derived from a qualified film) because gross receipts derived from a license of the right to use or exploit film characters are now considered gross receipts derived from a qualified film.

Section 1.199–3(k)(2)(ii), which allows a taxpayer to treat certain tangible personal property as a qualified film (for example, a DVD), is amended to exclude film intangibles because tangible personal property affixed with a film intangible (such as a trademark) should not be treated as a qualified film. For example, the total revenue from the sale of an imported t-shirt affixed with a film intangible should not be treated as gross receipts derived from the sale of a qualified film. The portion of the gross receipts attributable to the qualified film intangible separate from receipts attributable to the t-shirt may qualify as DPGR, however. The proposed regulations also add *Example 10* and *Example 11* in redesignated § 1.199–3(k)(11) to address situations in which tangible personal property is offered for sale in combination with a qualified film affixed to a DVD.

Section 1.199–3(k)(3)(i) and (k)(3)(ii) of the proposed regulations address the amendment to section 199(c)(6) (effective for taxable years beginning after 2007) that provides the methods and means of distributing a qualified film will not affect the availability of the deduction under section 199. The exception that describes the receipts from showing a qualified film in a movie theater or by broadcast on a television station as not derived from a qualified film is removed from § 1.199–3(k)(3)(ii) because, if a taxpayer produces a qualified film, then the receipts the taxpayer derives from these showings qualify as DPGR in taxable years beginning after 2007. In addition, *Example 4* in § 1.199–3(i)(5)(iii) and *Example 3* in § 1.199–3(k)(11) (formerly § 1.199–3(k)(10)) have been revised to illustrate that, for taxable years beginning after 2007, product placement and advertising income derived from the distribution of a qualified film qualifies as DPGR if the qualified film containing the product placements and advertising is broadcast over the air or watched over the Internet.

The proposed regulations also add a sentence to § 1.199–3(k)(6) to clarify that production activities do not include activities related to the transmission or distribution of films. The Treasury Department and the IRS are aware that some taxpayers have taken the inappropriate position that these activities are part of the production of a film. The Treasury Department and the IRS consider film production as distinct from the transmission and distribution of films. This clarification is also consistent with the amendment to the definition of qualified film, which provides that the methods and means of distribution do not affect the availability of the deduction under section 199.

d. Partnerships and S corporations

Section 1.199–3(i)(9) of the proposed regulations describes the application of section 199(d)(1)(A)(iv) to partners and partnerships and shareholders and S corporations for taxable years beginning after 2007. The Treasury Department and the IRS have determined that for a partnership to apply the provisions of section 199(d)(1)(A)(iv) to treat itself as having engaged directly in a film produced by a partner, the partnership must treat itself as a partnership for all purposes of the Code. Further, a partner of a partnership can apply the provisions of section 199(d)(1)(A)(iv) to treat itself as having engaged directly in a film produced by the partnership only if the partnership treats itself as a partnership for all purposes of the Code. Section 1.199–3(i)(9)(i) describes generally that a partner of a partnership or shareholder of an S corporation who owns (directly or indirectly) at least 20 percent of the capital interests in such partnership or the stock of such S corporation is treated as having engaged directly in any film produced by such partnership or S corporation. Further, such partnership or S corporation is treated as having engaged directly in any film produced by such partner or shareholder.

Section 1.199–3(i)(9)(ii) of the proposed regulations generally prohibits attribution between partners of a partnership or shareholders of an S corporation, partnerships with a partner in common, or S corporations with a shareholder in common. Thus, when a partnership or S corporation is treated as having engaged directly in any film produced by a partner or shareholder, any other partners or shareholders who did not participate directly in the production of the film are treated as not having engaged directly in the production of the film at the partner or shareholder level. Similarly, when a partner or shareholder is treated as having engaged directly in any film produced by a partnership or S corporation, any other partnerships or S corporations in which that partner or shareholder owns an interest (excluding the partnership or S corporation that produced the film) are treated as not having engaged directly in the production of the film at the partnership or S corporation level.

Section 1.199–3(i)(9)(iii) of the proposed regulations describes the attribution period for a partner or partnership or shareholder or S corporation under section 199(d)(1)(A)(iv). A partner or shareholder is treated as having engaged directly in any qualified film produced by the partnership or S corporation, and a partnership or S corporation is treated as having engaged directly in any qualified film produced by the partner or shareholder, regardless of when the qualified film was produced, during the period in which the partner or shareholder owns (directly or indirectly) at least 20 percent of the capital interests in the partnership or the stock of the S corporation. During any period that a partner or shareholder owns less than 20 percent of the capital interests in such partnership or the stock of such S corporation that partner or shareholder is not treated as having engaged directly in the qualified film produced by the partnership or S corporation for purposes of § 1.199–3(i)(9)(iii), and that partnership or S corporation is not treated as having engaged directly in any qualified film produced by the partner or shareholder.

Section 1.199–3(i)(9)(iv) of the proposed regulations provides examples that illustrate section 199(d)(1)(A)(iv).

e. Qualified film safe harbor

Existing § 1.199–3(k)(7)(i) provides a safe harbor that treats a film as a qualified film produced by the taxpayer if not less than 50 percent of the total compensation for services paid by the taxpayer is compensation for services performed in the United States and the taxpayer satisfies the safe harbor in § 1.199–3(g)(3) for treating a taxpayer as MPGE QPP in whole or significant part in the United States. The Treasury Department and the IRS are aware that it may be unclear how the safe harbor in § 1.199–3(k)(7)(i) applies to costs of live or delayed television programs that may be expensed (specifically, whether such expensed costs are part of the CGS or unadjusted depreciable basis of the qualified film for purposes of § 1.199–3(g)(3)). Further, it may be unclear whether license fees paid for third-party produced programs are included in direct labor and overhead when applying the safe harbor in § 1.199–3(g)(3). The proposed regulations clarify how a taxpayer producing live or delayed television programs should apply the safe harbor in § 1.199–3(k)(7)(i); in particular, how a taxpayer should calculate its unadjusted depreciable basis under § 1.199–3(g)(3)(ii). Specifically, proposed § 1.199–3(k)(7)(i) requires a taxpayer to include all costs paid or incurred in the production of a live or delayed television program in the taxpayer's unadjusted depreciable basis of such program under § 1.199–3(g)(3)(ii), including the licensing fees paid to a third party under § 1.199–3(g)(3)(ii). The proposed regulations further clarify that license fees for third-party produced programs are not included in the direct labor and overhead to produce the film for purposes of applying § 1.199–3(g)(3).

4. Treatment of Activities in Puerto Rico

Section 199(d)(8)(A) provides that in the case of any taxpayer with gross receipts for any taxable year from sources within the Commonwealth of Puerto Rico, if all of such receipts are taxable under section 1 or 11 for such taxable year, then for purposes of determining the DPGR of such taxpayer for such taxable year under section 199(c)(4), the term *United States* includes the Commonwealth of Puerto Rico. Section 199(d)(8)(B) provides that in the case of a taxpayer described in section 199(d)(8)(A), for purposes of applying the wage limitation under section 199(b) for any taxable year, the determination of W–2 wages of such taxpayer is made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in Puerto Rico. Section 130 of the Tax Increase Prevention Act of 2014 amended section 199(d)(8)(C) for taxable years beginning after December 31, 2013. As amended, section 199(d)(8)(C) provides that section 199(d)(8) applies only with respect to the first nine taxable years of the taxpayer beginning after December 31, 2005, and before January 1, 2015.

Section 1.199–2(f) of the proposed regulations modifies the W–2 wage limitation under section 199(b) to the extent provided by section 199(d)(8). Section 1.199–3(h)(2) of the proposed regulations modifies the term *United States* to include the Commonwealth of Puerto Rico to the extent provided by section 199(d)(8).

5. Determining DPGR on Item-By-Item Basis

Section 1.199–3(d)(1) provides that a taxpayer determines, using any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances, whether gross receipts qualify as DPGR on an item-by-item basis. Section 1.199–3(d)(1)(i) provides that item means the property offered by the taxpayer in the normal course of the taxpayer's business for lease, rental, license, sale, exchange, or other disposition (for purposes of § 1.199–3(d), collectively referred to as disposition) to customers, if the gross receipts from the disposition of such property qualify as DPGR. Section 1.199–3(d)(2)(iii) provides that, in the case of construction activities and services or engineering and architectural services, a taxpayer may use any reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances to determine what construction activities and services or engineering or architectural services constitute an item.

The Treasury Department and the IRS are aware that the item rule in § 1.199–3(d)(2)(iii) has been interpreted to mean that the gross receipts derived from the sale of a multiple-building project may be treated as DPGR when only one building in the project is substantially renovated. The Treasury Department and the IRS have concluded that treating gross receipts from the sale of a multiple-building project as DPGR, and the multiple-building project as one item, is not a reasonable method satisfactory to the Secretary for purposes of § 1.199–3(d)(2)(iii) if a taxpayer did not substantially renovate each building in the multiple-building project. Section 1.199–3(d)(4) of the proposed regulations includes an example (*Example 14*) illustrating the appropriate application of § 1.199–3(d)(2)(iii) to a multiple building project.

In addition, the Treasury Department and the IRS are aware that taxpayers may be unsure how to apply the item rule in § 1.199–3(d)(2)(i) when the property offered for disposition to customers includes embedded services as described in § 1.199–3(i)(4)(i). The proposed regulations add *Example 6* to § 1.199–3(d)(4) to clarify that the item rule applies after excluding the gross receipts attributable to services.

6. MPGE

Section 1.199–3(e)(1) provides that the term *MPGE* includes manufacturing, producing, growing, extracting, installing, developing, improving, and creating QPP; making QPP out of scrap, salvage, or junk material as well as from new or raw material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles; cultivating soil, raising livestock, fishing, and mining minerals. The Treasury Department and the IRS are aware that *Example 5* in § 1.199–3(e)(5) has been interpreted to mean that testing activities qualify as an MPGE activity even if the taxpayer engages in no other MPGE activity. The Treasury Department and the IRS disagree that testing activities, alone, qualify as an MPGE activity. The proposed regulations add a sentence to *Example 5* in § 1.199–3(e)(5) to further illustrate that certain activities will not be treated as MPGE activities if they are not performed as part of the MPGE of QPP. Taxpayers are not required to allocate gross receipts to certain activities that are not MPGE activities when those activities are performed in connection with the MPGE of QPP. However, if the taxpayer in *Example 5* in § 1.199–3(e)(5) did not MPGE QPP, then the activities described in the example, including testing, are not MPGE activities.

Section 1.199–3(e)(2) provides that if a taxpayer packages, repackages, labels, or performs minor assembly of QPP and the taxpayer engages in no other MPGE activities with respect to that QPP, the taxpayer's packaging, repackaging, labeling, or minor assembly does not qualify as MPGE with respect to that QPP. This rule has been the subject of recent litigation. See *United States v. Dean*, 945 F. Supp. 2d 1110 (C.D. Cal. 2013) (concluding that the taxpayer's activity of preparing gift baskets was a manufacturing activity and not solely packaging or repackaging for purposes of section 199). The Treasury Department and the IRS disagree with the interpretation of § 1.199–3(e)(2) adopted by the court in *United States v. Dean*, and the proposed regulations add an example (*Example 9*) that illustrates the appropriate application of this rule in a situation in which the taxpayer is engaged in no other MPGE activities with respect to the QPP other than those described in § 1.199–3(e)(2).

7. Definition of "by the taxpayer"

Section 1.199–3(f)(1) provides that if one taxpayer performs a qualifying activity under § 1.199–3(e)(1), § 1.199–3(k)(1), or § 1.199–3(l)(1) pursuant to a contract with another party, then only the taxpayer that has the benefits and burdens of ownership of the QPP, qualified film, or utilities under Federal income tax principles during the period in which the qualifying activity occurs is treated as engaging in the qualifying activity.

Taxpayers and the IRS have had difficulty determining which party to a contract manufacturing arrangement has the benefits and burdens of ownership of the property while the qualifying activity occurs. Cases analyzing the benefits and burdens of ownership have considered the following factors relevant: (1) whether legal title passes; (2) how the parties treat the transaction; (3) whether an equity interest was acquired; (4) whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments; (5) whether the right of possession is vested in the purchaser and which party has control of the property or process; (6) which party pays the property taxes; (7) which party bears the risk of loss or damage to the property; (8) which party receives the profits from the operation and sale of the property; and (9) whether a taxpayer actively and extensively participated in the management and operations of the activity. See *ADVO, Inc. & Subsidiaries v. Commissioner*, 141 T.C. 298, 324–25 (2013); see also *Grodt & McKay Realty, Inc. v. Commissioner*, 77 T.C. 1221 (1981). The *ADVO* court noted that the factors it used in its analysis are not exclusive or controlling, but that they were in the particular case sufficient to determine which party had the benefits and burdens of ownership. *ADVO, Inc.*, 141 T.C. at 325 n. 21. Determining which party has the benefits and burdens of ownership under Federal income tax principles for purposes of section 199 requires an analysis and weighing of many factors, which in some contexts could result in more than one taxpayer claiming the benefits of section 199 with respect to a particular activity. Resolving the benefits and burdens of ownership issue often requires significant IRS and taxpayer resources.

Section 199(d)(10) directs the Treasury Department to provide regulations that prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any qualifying activity (as described in section 199(c)(4)(A)(i)). The Treasury Department and the IRS have interpreted the statute to mean that only one taxpayer may claim the section 199 deduction with respect to the same activity performed with respect to the same property. See § 1.199–3(f)(1). *Example 1* and *Example 2* in § 1.199–3(f)(4) currently illustrate this one-taxpayer rule using factors that are relevant to the determination of who has the benefits and burdens of ownership.

The Large Business and International (LB&I) Division issued an Industry Director Directive on February 1, 2012 (LB&I Control No. LB&I–4–0112–01) (Directive) addressing the benefits and burdens factors. The Directive provides a three-step analysis of facts and circumstances relating to contract terms, production activities, and economic risks to determine whether a taxpayer has the benefits and burdens of ownership for purposes of § 1.199–3(f)(1). LB&I issued a superseding second directive on July 24, 2013 (LB&I Control No. LB&I–04–0713–006), and a third directive updating the second directive on October 29, 2013 (LB&I Control No. LB&I–04–1013–008). The third directive allows a taxpayer to provide a statement explaining the taxpayer's determination that it had the benefits and burdens of ownership, along with certification statements signed under penalties of perjury by the taxpayer and the counterparty verifying that only the taxpayer is claiming the section 199 deduction.

To provide administrable rules that are consistent with section 199, reduce the burden on taxpayers and the IRS in evaluating factors related to the benefits and burdens of ownership, and prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any qualifying activity, the proposed regulations remove the rule in § 1.199–3(f)(1) that treats a taxpayer in a contract manufacturing arrangement as engaging in the qualifying activity only if the taxpayer has the benefits and burdens of ownership during the period in which the qualifying activity occurs. In place of the benefits and burdens of ownership rule, these proposed regulations provide that if a qualifying activity is performed under a contract, then the party that performs the activity is the taxpayer for purposes of section 199(c)(4)(A)(i). This rule, which applies solely for purposes of section 199, reflects the conclusion that the party actually producing the property should be treated as engaging in the qualifying activity for purposes of section 199, and is therefore consistent with the statute's goal of incentivizing domestic manufacturers and producers. The proposed rule would also provide a readily administrable approach that would prevent more than one taxpayer from being allowed a deduction under section 199 with respect to any qualifying activity.

Example 1 has been revised, and current *Example 2* has been removed, to reflect the new rule. In addition, the benefits and burdens language has been removed from: (1) the definition of MPGE in § 1.199–3(e)(1) and (3), including *Example 1*, *Example 4*, and *Example 5* in § 1.199–3(e)(5); (2) the definition of in whole or in significant part in § 1.199–3(g)(1); (3) *Example 5* in the qualified film rules in existing § 1.199–3(k)(7); and (4) the production pursuant to a contract in the qualified film rules in § 1.199–3(k)(8).

The Treasury Department and the IRS request comments on whether there are narrow circumstances that could justify an exception to the proposed rule. In particular, the Treasury Department and the IRS request comments on whether there should be a limited exception to the proposed rule for certain fully cost-plus or cost-reimbursable contracts. Under such an exception, the party that is not performing the qualifying activity would be treated as the taxpayer engaged in the qualifying activity if the party performing the qualifying activity is (i) reimbursed for, or provided with, all materials, labor, and overhead costs related to fulfilling the contract, and (ii) provided with an additional payment to allow for a profit. The Treasury Department and the IRS are uncertain regarding the extent to which such fully cost-plus or cost-reimbursable contracts are in fact used in practice. Comments suggesting circumstances that could justify an exception to the proposed rule should address the rationale for the proposed exception, the ability of the IRS to administer the exception, and how the suggested exception will prevent two taxpayers from claiming the deduction for the qualifying activity.

8. Hedging Transactions

The proposed regulations make several revisions to the hedging rules in § 1.199–3(i)(3). Section 1.199–3(i) of the proposed regulations defines a hedging transaction to include transactions in which the risk being hedged relates to property described in section 1221(a)(1) giving rise to DPGR, whereas the existing regulations require the risk being hedged relate to QPP described in section 1221(a)(1). A taxpayer commented in a letter to the Treasury Department and the IRS that there is no reason to limit the hedging rules to QPP giving rise to DPGR, and the proposed regulations accept the comment.

The other changes to the hedging rules are administrative. Section 1.199–3(i)(3)(ii) of the existing regulations on currency fluctuations was eliminated because the regulations under sections 988(d) and 1221 adequately cover the treatment of currency hedges. Similarly, the rules in § 1.199–3(i)(3)(iii) that address the effect of identification and non-identification were duplicative of the rules in the section 1221 regulations. Accordingly, § 1.199–3(i)(3)(ii) has been revised to cross-reference the appropriate rules in § 1.1221–2(g), and to clarify that the consequence of an abusive identification or non-identification is that deduction or loss, but not income or gain, is taken into account in calculating DPGR.

9. Construction Activities

Section 199(c)(4)(A)(ii) includes in DPGR, in the case of a taxpayer engaged in the active conduct of a construction trade or business, gross receipts derived from construction of real property performed in the United States by the taxpayer in the ordinary course of such trade or business. Under § 1.199–3(m)(2)(i), activities constituting construction include activities performed by a general contractor or activities typically performed by a general contractor, for example, activities relating to management and oversight of the construction process such as approvals, periodic inspection of progress of the construction project, and required job modifications. The Treasury Department and the IRS are aware that some taxpayers have interpreted this language to mean that a taxpayer who only approves or authorizes payments is engaged in activities typically performed by a general contractor under § 1.199–3(m)(2)(i). The Treasury Department and the IRS disagree that a taxpayer who only approves or authorizes payments is engaged in construction for purposes of § 1.199–3(m)(2)(i). Accordingly, § 1.199–3(m)(2)(i) of the proposed regulations clarifies that a taxpayer must engage in construction activities that include more than the approval or authorization of payments or invoices for that taxpayer's activities to be considered as activities typically performed by a general contractor.

Section 1.199–3(m)(2)(i) provides that activities constituting construction are activities performed in connection with a project to erect or substantially renovate real property. Section 1.199–3(m)(5) currently defines substantial renovation to mean the renovation of a major component or substantial structural part of real property that materially increases the value of the property, substantially prolongs the useful life of the property, or adapts the property to a new or different use. This standard reflects regulations under § 1.263(a)–3 related to amounts paid to improve tangible property that existed at the time of publication of the final § 1.199–3(m)(5) regulations (TD 9263 [71 FR 31268] June 19, 2006) but which have since been revised. See (TD 9636 [78 FR 57686] September 19, 2013).

The proposed regulations under § 1.199–3(m)(5) revise the definition of substantial renovation to conform to the final regulations under § 1.263(a)–3, which provide rules requiring capitalization of amounts paid for improvements to a unit of property owned by a taxpayer. Improvements under § 1.263(a)–3 are amounts paid for a betterment to a unit of property, amounts paid to restore a unit of property, and amounts paid to adapt a unit of property to a new or different use. See § 1.263(a)–3(j), (k), and (l). Under the proposed regulations, a substantial renovation of real property is a renovation the costs of which are required to be capitalized as an improvement under § 1.263(a)–3, other than an amount described in § 1.263(a)–3(k)(1)(i) through (iii) (relating to amounts for which a loss deduction or basis adjustment requires capitalization as an improvement). The improvement rules under § 1.263(a)–3 provide specific rules of application for buildings (see § 1.263(a)–3(j)(2)(ii), (k)(2), and (l)(2)), which apply for purposes of § 1.199–3(m)(5).

10. Allocating Cost of Goods Sold

Section 1.199–4(b)(1) describes how a taxpayer determines its CGS allocable to DPGR. The Treasury Department and the IRS are aware that in the case of transactions accounted for under a long-term contract method of accounting (either the percentage-of-completion method (PCM) or the completed-contract method (CCM)), a taxpayer incurs allocable contract costs. The Treasury Department and the IRS recognize that allocable contract costs under PCM or CCM are analogous to CGS and should be treated in the same manner. Section 1.199–4(b)(1) of the proposed regulations provides that in the case of a long-term contract accounted for under PCM or CCM, CGS for purposes of § 1.199–4(b)(1) includes allocable contract costs described in § 1.460–5(b) or § 1.460–5(d), as applicable.

Existing § 1.199–4(b)(2)(i) provides that a taxpayer must use a reasonable method that is satisfactory to the Secretary based on all of the facts and circumstances to allocate CGS between DPGR and non-DPGR. This allocation must be determined based on the rules provided in § 1.199–4(b)(2)(i) and (ii). Taxpayers have asserted that under § 1.199–4(b)(2)(ii) the portion of current year CGS associated with activities in earlier tax years (including pre-section 199 tax years) may be allocated to non-DPGR even if the related gross receipts are treated by the taxpayer as DPGR. Section 1.199–4(b)(2)(iii)(A) of the proposed regulations clarifies that the CGS must be allocated between DPGR and non-DPGR, regardless of whether any component of the costs included in CGS can be associated with activities undertaken in an earlier taxable year. Section 1.199–4(b)(2)(iii)(B) of the proposed regulations provides an example illustrating this rule.

11. Agricultural and Horticultural Cooperatives

Section 199(d)(3)(A) provides that any person who receives a qualified payment from a specified agricultural or horticultural cooperative must be allowed for the taxable year in which such payment is received a deduction under section 199(a) equal to the portion of the deduction allowed under section 199(a) to such cooperative that is (i) allowed with respect to the portion of the QPAI to which such payment is attributable, and (ii) identified by such cooperative in a written notice mailed to such person during the payment period described in section 1382(d).

Under § 1.199–6(c), the cooperative's QPAI is computed without taking into account any deduction allowable under section 1382(b) or section 1382(c) (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

Section 1.199–6(e) provides that the term *qualified payment* means any amount of a patronage dividend or per-unit retain allocation, as described in section 1385(a)(1) or section 1385(a)(3), received by a patron from a cooperative that is attributable to the portion of the cooperative's QPAI for which the cooperative is allowed a section 199 deduction. For this purpose, patronage dividends and per-unit retain allocations include any advances on patronage and per-unit retains paid in money during the taxable year.

Section 1388(f) defines the term *per-unit retain allocation* to mean any allocation by an organization to which part I of subchapter T applies to a patron with respect to products marketed for him, the amount of which is fixed without reference to net earnings of the organization pursuant to an agreement between the organization and the patron. Per-unit retain allocations may be made in money, property, or certificates.

The Treasury Department and the IRS are aware that *Example 1* in § 1.199–6(m) has been interpreted as describing that the cooperative's payment for its members' corn is a per-unit retain allocation paid in money as defined in sections 1382(b)(3) and 1388(f). *Example 1* in § 1.199–6(m) does not identify the cooperative's payment for its members' corn as a per-unit retain allocation and is not intended to illustrate how QPAI is computed when a cooperative's payments to its patrons are per-unit retain allocations. The proposed regulations provide an example (*Example 4*) in § 1.199–6(m) illustrating how QPAI is computed when the cooperative's payments to members for corn qualify as per-unit retain allocations paid in money under section 1388(f). The new example has the same facts as *Example 1* in § 1.199–6(m), except that the cooperative's payments for its members' corn qualify as per-unit retain allocations paid in money under section 1388(f) and the cooperative reports per-unit retain allocations paid in money on Form 1099–PATR, "Taxable Distributions Received From Cooperatives."

Request for Comments

Existing § 1.199–3(e)(2) provides that if a taxpayer packages, repackages, labels, or performs minor assembly of QPP and the taxpayer engages in no other MPGE activity with respect to that QPP, the taxpayer's packaging, repackaging, labeling, or minor assembly does not qualify as MPGE with respect to that QPP.

The term *minor assembly* for purposes of section 199 was first introduced in Notice 2005–14 (2005–1 CB 498 (February 14, 2005)) (see § 601.601(d)(2)(ii)(*b*)) (Notice 2005–14), and was used (by exclusion) in determining whether a taxpayer met the in-whole-or-in-significant-part requirement. Specifically, section 3.04(5)(d) of Notice 2005–14 states that in connection with the MPGE of QPP, packaging, repackaging, and minor assembly operations should not be considered in applying the general "substantial in nature" test, and the costs should not be considered in applying the safe harbor. The section further states that this rule is similar to the rule in § 1.954–3(a)(4)(iii). The rule in § 1.954–3(a)(4)(iii) applies when deciding whether a taxpayer selling property will be treated as selling a manufactured product rather than components of that sold property.

Section 1.199–3(g) of the current regulations, which superseded Notice 2005–14, does not provide a specific definition of minor assembly, but it does allow taxpayers to consider minor assembly activities to determine whether the taxpayer has met the in-whole-or-in-significant-part requirement (either by showing their activities were substantial in nature under § 1.199–3(g)(2) or by meeting the safe harbor in § 1.199–3(g)(3)). However, the current regulations also contain § 1.199–3(e)(2), which excludes certain activities from the definition of MPGE. Section 1.199–3(e)(2) provides that if a taxpayer packages, repackages, labels, or performs minor assembly of QPP and the taxpayer engages in no other MPGE activity with respect to that QPP, the taxpayer's packaging, repackaging, labeling, or minor assembly does not qualify as MPGE with respect to that QPP. Therefore, a taxpayer with only minor assembly activities would not meet the definition of MPGE and a determination of whether a taxpayer met the in-whole-or-in-significant-part requirement is not made.

In considering whether to provide a specific definition of minor assembly, the Treasury Department and the IRS have found it difficult to identify an objective test that would be widely applicable.

The definition of minor assembly could focus on whether a taxpayer's activity is only a single process that does not transform an article into a materially different QPP. Such process may include, but would not be limited to, blending or mixing two materials together, painting an article, cutting, chopping, crushing (nonagricultural products), or other similar activities. An example of blending or mixing two materials is using a paint mixing machine to combine paint with a pigment to match a customer's color selection when a taxpayer did not MPGE the paint or the pigment. An example of cutting is a taxpayer using an industrial key cutting machine to custom cut keys for customers using blank keys that taxpayer purchased from unrelated third parties. Examples of other similar activities include adding an additive to extend the shelf life of a product and time ripening produce that was purchased from unrelated third parties.

Another possible definition could be based on whether an end user could reasonably engage in the same assembly activity of the taxpayer. For example, assume QPP made up of component parts purchased by taxpayer is sold by a taxpayer to end users in either assembled or disassembled form. To the extent an end user can reasonably assemble the QPP sold in disassembled form, the taxpayer's assembly activity would be considered minor assembly.

The Treasury Department and the IRS request comments on how the term *minor assembly* in § 1.199–3(e)(2) should be defined and encourage the submission of examples illustrating the term.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866 of, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. All comments will be available for public inspection and copying at *http://www.regulations.gov* or upon request.

A public hearing has been scheduled for December 16, 2015, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. In addition, all visitors must present photo identification to enter the building. For information about having your name placed on the building access list to attend the hearing, see the "**FOR FURTHER INFORMATION CONTACT**" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments by November 24, 2015**,** and an outline of the topics to be discussed and the time to be devoted to each topic by November 24, 2015. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

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 1.199–0 is amended by:

1. Adding entries in the table of contents for § 1.199–1(f).

2. Revising the entry in the table of contents for § 1.199–2(c) and adding entries for § 1.199–2(c)(1), (2), and (3).

3. Adding an entry in the table of contents for § 1.199–2(f).

4. Redesignating the entry in the table of contents for § 1.199–3(h) as the entry for § 1.199–3(h)(1), adding introductory text for § 1.199–3(h), and adding an entry for § 1.199–3(h)(2).

5. Redesignating the entry in the table of contents for § 1.199–3(i)(9) as the entry for § 1.199–3(i)(10) and adding introductory text and entries in the table of contents for § 1.199–3(i)(9).

6. Redesignating the entry in the table of contents for § 1.199–3(k)(10) as the entry for § 1.199–3(k)(11) and adding an entry for § 1.199–3(k)(10).

7. Adding entries in the table of contents for § 1.199–4(b)(2)(iii).

8. Revising the introductory text in the table of contents for § 1.199–8(i) and adding the entries for § 1.199–8(i)(10) and (i)(11).

The additions and revision read as follows:

§ 1.199–0 Table of contents.

* * * * *

§ 1.199–1 Income attributable to domestic production activities.

* * * * *

(f) Oil related qualified production activities income.

(1) In general.

(i) Oil related QPAI.

(ii) Special rule for oil related DPGR.

(iii) Definition of oil.

(iv) Primary product from oil or gas.

(A) Primary product from oil.

(B) Primary product from gas.

(C) Primary products from changing technology.

(D) Non-primary products.

(2) Cost allocation methods for determining oil related QPAI.

(i) Section 861 method.

(ii) Simplified deduction method.

(iii) Small business simplified overall method.

§ 1.199–2 Wage limitation.

* * * * *

(c) Acquisitions, dispositions, and short taxable years.

(1) Allocation of wages between more than one taxpayer.

(2) Short taxable years.

(3) Operating rules.

(i) Acquisition or disposition.

(ii) Trade or business.

* * * * *

(f) Commonwealth of Puerto Rico.

§ 1.199–3 Domestic production gross receipts.

* * * * *

(h) United States.

* * * * *

(2) Commonwealth of Puerto Rico.

(i) * * *

(9) Engaging in production of qualified films.

(i) In general.

(ii) No double attribution.

(iii) Timing of attribution.

(iv) Examples.

* * * * *

(k) * * *

(10) Special rule for disposition of promotional films and products or services promoted in promotional films.

* * * * *

§ 1.199–4 Costs allocable to domestic production gross receipts.

* * * * *

(b) * * *

(2) * * *

(iii) Cost of goods sold associated with activities undertaken in an earlier taxable year.

(A) In general.

(B) Example.

* * * * *

§ 1.199–8 Other rules.

* * * * *

(i) Effective/applicability dates.

* * * * *

(10) Acquisition or disposition of a trade or business (or major portion).

(11) Energy Improvement and Extension Act of the 2008, Tax Extenders and Alternative Minimum Tax Relief Act of 2008, American Taxpayer Relief Act of 2012, and other provisions.

* * * * *

Par. 3. Section 1.199–1 is amended by adding paragraph (f) to read as follows:

§ 1.199–1 Income attributable to domestic production activities.

* * * * *

(f) *Oil related qualified production activity income (Oil related QPAI)*—(1) *In general*—(i) *Oil related QPAI*. Oil related QPAI for any taxable year is an amount equal to the excess (if any) of the taxpayer's DPGR (as defined in § 1.199–3) derived from the production, refining or processing of oil, gas, or any primary product thereof (oil related DPGR) over the sum of:

(A) The CGS that is allocable to such receipts; and

(B) Other expenses, losses, or deductions (other than the deduction allowed under this section) that are properly allocable to such receipts. See §§ 1.199–3 and 1.199–4.

(ii) *Special rule for oil related DPGR*. Oil related DPGR does not include gross receipts derived from the transportation or distribution of oil, gas, or any primary product thereof. However, to the extent that a taxpayer treats gross receipts derived from transportation or distribution of oil, gas, or any primary product thereof as DPGR under paragraph (d)(3)(i) of this section or under § 1.199–3(i)(4)(i)(B), then the taxpayer must treat those gross receipts as oil related DGPR.

(iii) *Definition of oil*. The term *oil* includes oil recovered from both conventional and non-conventional recovery methods, including crude oil, shale oil, and oil recovered from tar/oil sands.

(iv) *Primary product from oil or gas*. A primary product from oil or gas is, for purposes of this paragraph:

(A) *Primary product from oil*. The term *primary product from oil* means all products derived from the destructive distillation of oil, including:

(*1*) Volatile products;

(*2*) Light oils such as motor fuel and kerosene;

(*3*) Distillates such as naphtha;

(*4*) Lubricating oils;

(*5*) Greases and waxes; and

(*6*) Residues such as fuel oil.

(B) *Primary product from gas*. The term *primary product from gas* means all gas and associated hydrocarbon components from gas wells or oil wells, whether recovered at the lease or upon further processing, including:

(*1*) Natural gas;

(*2*) Condensates;

(*3*) Liquefied petroleum gases such as ethane, propane, and butane; and

(*4*) Liquid products such as natural gasoline.

(C) *Primary products and changing technology*. The primary products from oil or gas described in paragraphs (f)(1)(iv)(A) and (B) of this section are not intended to represent either the only primary products from oil or gas, or the only processes from which primary products may be derived under existing and future technologies.

(D) *Non-primary products*. Examples of non-primary products include, but are not limited to, petrochemicals, medicinal products, insecticides, and alcohols.

(2) *Cost allocation methods for determining oil related QPAI*—(i) *Section 861 method*. A taxpayer that uses the section 861 method to determine deductions that are allocated and apportioned to gross income attributable to DPGR must use the section 861 method to determine deductions that are allocated and apportioned to gross income attributable to oil related DPGR. See § 1.199–4(d).

(ii) *Simplified deduction method*. A taxpayer that uses the simplified deduction method to apportion deductions between DPGR and non-DPGR must determine the portion of deductions allocable to oil related DPGR by multiplying the deductions allocable to DPGR by the ratio of oil related DPGR divided by DPGR from all activities. See § 1.199–4(e).

(iii) *Small business simplified overall method*. A taxpayer that uses the small business simplified overall method to apportion total costs (CGS and deductions) between DPGR and non-DPGR must determine the portion of total costs allocable to DPGR that are allocable to oil related DPGR by multiplying the total costs allocable to DPGR by the ratio of oil related DPGR divided by DPGR from all activities. See § 1.199–4(f).

Par. 4. Section 1.199–2 is amended by revising paragraph (c), adding a sentence at the end of paragraph (e)(1), and adding paragraph (f) to read as follows:

§ 1.199–2 Wage limitation.

* * * * *

(c) [The text of the proposed amendments to § 1.199–2(c) is the same as the text of § 1.199–2T(c) published elsewhere in this issue of the **Federal Register**].

* * * * *

(e) * * *

(1) * * * In the case of a qualified film (as defined in § 1.199–3(k)) for taxable years beginning after 2007, the term *W–2 wages* includes compensation for services (as defined in § 1.199–3(k)(4)) performed in the United States by actors, production personnel, directors, and producers (as defined in § 1.199–3(k)(1)).

* * * * *

(f) *Commonwealth of Puerto Rico*. In the case of a taxpayer described in § 1.199–3(h)(2), the determination of W–2 wages of such taxpayer shall be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services performed in the Commonwealth of Puerto Rico. This paragraph (f) only applies as provided in section 199(d)(8).

Par. 5. Section 1.199–3 is amended by:

1. In paragraph (d)(4):

a. Redesignating *Example 6*, *Example 7*, *Example 8*, *Example 9*, *Example 10*, *Example 11*, and *Example 12* as *Example 7*, *Example 8*, *Example 9*, *Example 10*, *Example 11*, *Example 12*, and *Example 13*, respectively;

b. In newly-designated *Example 10,* removing the language "*Example 8*" and adding "*Example 9*" in its place; and

c. Adding *Example 6* and *Example 14*.

2. Revising the last sentence in paragraphs (e)(1) and (3).

3. In paragraph (e)(5):

a. Revising the third sentence in *Example 1*, the second sentence in *Example 4*, and *Example 5*.

b. Adding *Example 9*.

4. Revising the last sentence in paragraph (f)(1).

5. Revising *Example 1*, removing *Example 2*, and redesignating *Example 3* as *Example 2* in paragraph (f)(4).

6. Removing the second and third sentences in paragraph (g)(1).

7. Revising paragraph (g)(4)(i).

8. Redesignating paragraph (h) as paragraph (h)(1), adding paragraph (h) heading and adding paragraph (h)(2).

9. Revising paragraph (i)(3).

10. Removing *Example 3*; redesignating *Example 5* as *Example 3*; and revising *Example 4* in paragraph (i)(5)(iii).

11. In paragraph (i)(6)(iv)(D)(*2*), removing the language "§ 1.199–3T(i)(8)" and adding "§ 1.199–3(i)(8)" in its place.

12. Redesignating paragraph (i)(9) as paragraph (i)(10) and adding paragraph (i)(9).

13. Adding three sentences after the first sentence in paragraph (k)(1), revising paragraph (k)(2)(ii) introductory text, and adding a sentence at the end of paragraph (k)(3)(i).

14. Removing the first, second, and fifth sentences in paragraph (k)(3)(ii).

15. Adding one sentence at the end of paragraph (k)(6).

16. Adding two sentences before the last sentence in paragraph (k)(7)(i).

17. Revising the last sentence in paragraph (k)(8).

18. Redesignating paragraph (k)(10) as paragraph (k)(11) and adding paragraph (k)(10).

19. In newly redesignated paragraph (k)(11):

a. Revising *Example 3*;

b. Removing *Example 4*; redesignating *Example 5* and *Example 6* as *Example 4* and *Example 5*, respectively; and adding *Example 6*, *Example 7*, *Example 8*, *Example 9*, *Example 10*, and *Example 11;* and

c. Revising the third sentence in newly redesignated *Example 4*.

20. Adding one sentence at the end of paragraph (m)(2)(i).

21. Revising paragraph (m)(5).

The revisions and additions read as follows:

§ 1.199–3 Domestic production gross receipts.

* * * * *

(d) * * *

(4) * * *

Example 6. The facts are the same as *Example 3* except that R offers three-car sets together with a coupon for a car wash for sale to customers in the normal course of R's business. The gross receipts attributable to the car wash do not qualify as DPGR because a car wash is a service, assuming the de minimis exception under paragraph (i)(4)(i)(B)(6) of this section does not apply. In determining R's DPGR, under paragraph (d)(2)(i) of this section, the three-car set is an item if the gross receipts derived from the sale of the three-car sets without the car wash qualify as DPGR under this section.

* * * * *

Example 14. Z is engaged in the trade or business of construction under NAICS code 23 on a regular and ongoing basis. Z purchases a piece of property that has two buildings located on it. Z performs construction activities in connection with a project to substantially renovate building 1. Building 2 is not substantially renovated and together building 1 and building 2 are not substantially renovated, as defined under paragraph (m)(5) of this section. Z later sells building 1 and building 2 together in the normal course of Z's business. Z can use any reasonable method to determine what construction activities constitute an item under paragraph (d)(2)(iii) of this section. Z's method is not reasonable if Z treats the gross receipts derived from the sale of building 1 and building 2 as DPGR. This is because Z's construction activities would not have substantially renovated buildings 1 and 2 if they were considered together as one item. Z's method is reasonable if it treats the construction activities with respect to building 1 as the item under paragraph (d)(2)(iii) of this section because the proceeds from the sale of building 1 constitute DPGR.

(e) * * *

(1) * * * Pursuant to paragraph (f)(1) of this section, the taxpayer must be the party engaged in the MPGE of the QPP during the period the MPGE activity occurs in order for gross receipts derived from the MPGE of QPP to qualify as DPGR.

* * * * *

(3) * * * Notwithstanding paragraph (i)(4)(i)(B)(*4*) of this section, if the taxpayer installs QPP MPGE by the taxpayer, then the portion of the installing activity that relates to the QPP is an MPGE activity.

* * * * *

(5) * * *

Example 1. * * * A stores the agricultural products.* * *

* * * * *

Example 4. * * * Y engages in the reconstruction and refurbishment activity and installation of the parts.* * *

Example 5. The following activities are performed by Z as part of the MPGE of the QPP: materials analysis and selection, subcontractor inspections and qualifications, testing of component parts, assisting customers in their review and approval of the QPP, routine production inspections, product documentation, diagnosis and correction of system failure, and packaging for shipment to customers. Because Z MPGE the QPP, these activities performed by Z are part of the MPGE of the QPP. If Z did not MPGE the QPP, then these activities, such as testing of component parts, performed by Z are not the MPGE of QPP.

* * * * *

Example 9. X is in the business of selling gift baskets containing various products that are packaged together. X purchases the baskets and the products included within the baskets from unrelated third parties. X plans where and how the products should be arranged into the baskets. On an assembly line in a gift basket production facility, X arranges the products into the baskets according to that plan, sometimes relabeling the products before placing them into the baskets. X engages in no other activity besides packaging, repackaging, labeling, or minor assembly with respect to the gift baskets. Therefore, X is not considered to have engaged in the MPGE of QPP under paragraph (e)(2) of this section.

* * * * *

(f) * * *

(1) * * * If a qualifying activity under paragraph (e)(1), (k)(1), or (l)(1) of this section is performed under a contract, then the party to the contract that is the taxpayer for purposes of this paragraph (f) during the period in which the qualifying activity occurs is the party performing the qualifying activity.

* * * * *

(4) * * *

Example 1. X designs machines that it sells to customers. X contracts with Y, an unrelated person, for the manufacture of the machines. The contract between X and Y is a fixed-price contract. To manufacture the machines, Y purchases components and raw materials. Y tests the purchased components. Y manufactures the raw materials into additional components and Y physically performs the assembly of the components into machines. Y oversees and directs the activities under which the machines are manufactured by its employees. X also has employees onsite during the manufacturing for quality control. Y packages the finished machines and ships them to X's customers. Pursuant to paragraph (f)(1) of this section, Y is the taxpayer during the period the manufacturing of the machines occurs and, as a result, Y is treated as the manufacturer of the machines.

* * * * *

(g) * * *

(4) * * *

(i) *Contract with an unrelated person*. If a taxpayer enters into a contract with an unrelated person pursuant to which the unrelated person is required to MPGE QPP within the United States for the taxpayer, the taxpayer is not considered to have engaged in the MPGE of that QPP pursuant to paragraph (f)(1) of this section, and therefore, for purposes of making any determination under this paragraph (g), the MPGE or production activities or direct labor and overhead of the unrelated person under the contract are only attributed to the unrelated person.

* * * * *

(h) *United States** * *

(2) *Commonwealth of Puerto Rico*. The term *United States* includes the Commonwealth of Puerto Rico in the case of any taxpayer with gross receipts for any taxable year from sources within the Commonwealth of Puerto Rico, if all of such receipts are taxable under section 1 or 11 for such taxable year. This paragraph (h)(2) only applies as provided in section 199(d)(8).

(i) * * *

(3) *Hedging transactions*—(i) *In general*. For purposes of this section, provided that the risk being hedged relates to property described in section 1221(a)(1) giving rise to DPGR or relates to property described in section 1221(a)(8) consumed in an activity giving rise to DPGR, and provided that the transaction is a hedging transaction within the meaning of section 1221(b)(2)(A) and § 1.1221–2(b) and is properly identified as a hedging transaction in accordance with § 1.1221–2(f), then—

(A) In the case of a hedge of purchases of property described in section 1221(a)(1), income, deduction, gain, or loss on the hedging transaction must be taken into account in determining CGS;

(B) In the case of a hedge of sales of property described in section 1221(a)(1), income, deduction, gain, or loss on the hedging transaction must be taken into account in determining DPGR; and

(C) In the case of a hedge of purchases of property described in section 1221(a)(8), income, deduction, gain, or loss on the hedging transaction must be taken into account in determining DPGR.

(ii) *Effect of identification and nonidentification*. The principles of § 1.1221–2(g) apply to a taxpayer that identifies or fails to identify a transaction as a hedging transaction, except that the consequence of identifying as a hedging transaction a transaction that is not in fact a hedging transaction described in paragraph (i)(3)(i) of this section, or of failing to identify a transaction that the taxpayer has no reasonable grounds for treating as other than a hedging transaction described in paragraph (i)(3)(i) of this section, is that deduction or loss (but not income or gain) from the transaction is taken into account under paragraph (i)(3) of this section.

(iii) *Other rules*. See § 1.1221–2(e) for rules applicable to hedging by members of a consolidated group and § 1.446–4 for rules regarding the timing of income, deductions, gains or losses with respect to hedging transactions.

* * * * *

(5) * * *

(iii) * * *

Example 4. X produces a live television program that is a qualified film. In 2010, X broadcasts the television program on its station and distributes the program through the Internet. The television program contains product placements and advertising for which X received compensation in 2010. Because the methods and means of distributing a qualified film under paragraph (k)(1) of this section do not affect the availability of the deduction under section 199 for taxable years beginning after 2007, pursuant to paragraph (i)(5)(ii) of this section, all of X's product placement and advertising gross receipts for the program are treated as derived from the distribution of the qualified film.

* * * * *

(9) *Partnerships and S corporations engaging in production of qualified films*—(i) *In general*. For taxable years beginning after 2007, in the case of each partner of a partnership or shareholder of an S corporation who owns (directly or indirectly) at least 20 percent of the capital interests in such partnership or the stock of such S corporation, such partner or shareholder shall be treated as having engaged directly in any qualified film produced by such partnership or S corporation, and such partnership or S corporation shall be treated as having engaged directly in any qualified film produced by such partner or shareholder.

(ii) *No double attribution*. When a partnership or S corporation is treated as having engaged directly in any qualified film produced by a partner or shareholder, any other partners of the partnership or shareholders of the S corporation who did not participate directly in the production of the qualified film are treated as not having engaged directly in the production of the qualified film at the partner or shareholder level. When a partner or shareholder is treated as having engaged directly in any qualified film produced by a partnership or S corporation, any other partnerships or S corporations in which that partner or shareholder owns an interest (excluding the partnership or S corporation that produced the film), are treated as not having engaged directly in the production of the qualified film at the partnership or S corporation level.

(iii) *Timing of attribution*. A partner or shareholder is treated as having engaged directly in any qualified film produced by the partnership or S corporation, regardless of when the qualified film was produced by the partnership or S corporation, during any period that the partner or shareholder owns (directly or indirectly) at least 20 percent of the capital interests in the partnership or stock of the S corporation (attribution period). During any period that a partner or shareholder owns less than a 20 percent of the capital interests in such partnership or the stock of such S corporation, that partner or shareholder is not treated as having engaged directly in the qualified film produced by the partnership or S corporation for purposes of this paragraph (i)(9). A partnership or S corporation is treated as having engaged directly in a qualified film produced by a partner or shareholder during any period the partner or shareholder owns (directly or indirectly) at least 20 percent of the capital interests in such partnership or the stock of S corporation (attribution period). During any period that the partner or shareholder owns less than 20 percent of the capital interests in such partnership or stock of such S corporation, the partnership or S corporation is not treated as having engaged directly in the qualified film produced by the partner or shareholder for purposes of this paragraph (i)(9). The attribution period under this paragraph (i)(9) may be shorter or longer than a taxpayer's taxable year, depending on the length of the attribution period.

(iv) *Examples*. The following examples illustrate an application of this paragraph (i)(9). Assume that all taxpayers are calendar year taxpayers.

Example 1. In 2010, Studio A and Studio B form an S corporation in which each is a 50-percent shareholder to produce a qualified film. Studio A owns the rights to distribute the film domestically and Studio B owns the rights to distribute the film outside of the United States. The production activities of the S corporation are attributed to each shareholder, and thus each shareholder's revenue from the distribution of the qualified film is treated as DPGR during the attribution period because Studio A and Studio B are treated as having directly engaged in any film that was produced by the S corporation.

Example 2. The facts are the same as *Example 1* except that, in 2011, after the S corporation's production of the qualified film, Studio C becomes a shareholder that owns at least 20 percent of the stock of the S corporation. Studio C is treated as having directly engaged in any film that was produced by the S corporation during the attribution period, as defined in paragraph (i)(9)(iii) of this section.

Example 3. In 2010, Studio A and Studio B form a partnership in which each is a 50-percent partner to distribute a qualified film. Studio A produced the film and contributes it to the partnership and Studio B contributes cash to the partnership. The production activities of Studio A are attributed to the partnership, and thus the partnership's revenue from the distribution of the qualified film is treated as DPGR during the attribution period, as defined in paragraph (i)(9)(iii) of this section, because the partnership is treated as having directly engaged in any film that was produced by Studio A.

Example 4. The facts are the same as *Example 3* except that Studio B receives a distribution of the rights to license an intangible associated with the qualified film produced by Studio A. Any receipts derived from the licensing of the intangible by Studio B are non-DPGR because Studio A's production activities are attributed to the partnership, and are not further attributed to Studio B.

Example 5. The facts are the same as *Example 3* except that, at some point in 2011, Studio A owns less than a 20-percent capital interest in the partnership. During the period that Studio A owns less than a 20-percent capital interest in the partnership between Studio A and Studio B, the partnership is not treated as directly engaging in the production of a qualified film. Therefore, any future receipts the partnership derives from the film after the end of the attribution period, as defined in paragraph (i)(9)(iii) of this section, are non-DPGR. Studio A, however, is still treated as having engaged directly in the production of the qualified film.

* * * * *

(k) * * *

(1) * * * For taxable years beginning after 2007, the term *qualified film* includes any copyrights, trademarks, or other intangibles with respect to such film (intangibles). For purposes of this paragraph (k), other intangibles include rights associated with the exploitation of a qualified film, such as endorsement rights, video game rights, merchandising rights, and other similar rights. See paragraph (k)(10) of this section for a special rule for disposition of promotional films.* * *

(2) * * *

(ii) *Film produced by a taxpayer*. Except for intangibles under paragraph (k)(1) of this section, if a taxpayer produces a film and the film is affixed to tangible personal property (for example, a DVD), then for purposes of this section—

* * * * *

(3) * * *

(i) * * * For taxable years beginning after 2007, the methods and means of distributing a qualified film shall not affect the availability of the deduction under section 199.

* * * * *

(6) * * * Production activities do not include transmission or distribution activities with respect to a film, including the transmission of a film by electronic signal and the activities facilitating such transmission (such as formatting that enables the film to be transmitted).

(7) * * *

(i) * * * Paragraph (g)(3)(ii) of this section includes all costs paid or incurred by a taxpayer, whether or not capitalized or required to be capitalized under section 263A, to produce a live or delayed television program, and also includes any lease, rental, or license fees paid by a taxpayer for all or any portion of a film, or films produced by a third party that taxpayer uses in its film. License fees for films produced by third parties are not included in the direct labor and overhead to produce the film for purposes of applying paragraph (g)(3) of this section. * * *

* * * * *

(8) * * * If one party performs a production activity pursuant to a contract with another party, then only the party that is considered the taxpayer pursuant to paragraph (f)(1) of this section during the period in which the production activity occurs is treated as engaging in the production activity.

* * * * *

(10) *Special rule for disposition of promotional films and products or services promoted in promotional films*. A promotional film is a film produced to promote a taxpayer's particular product or service and the term includes, but is not limited to, commercials, infomercials, advertising films, and sponsored films. A product or service is promoted in a promotional film if the product or service appears in, is described during, or is in a similar way alluded to by such film. If a promotional film meets the requirements to be treated as a qualified film produced by the taxpayer, then a taxpayer derives gross receipts from the lease, rental, license, sale, exchange, or other disposition of a qualified film, including any copyrights, trademarks, or other intangibles when the promotional film's disposition is distinct (separate and apart) from the disposition of the promoted product or service. Gross receipts are not derived from the disposition of a qualified film, including any copyrights, trademarks, or other intangibles when gross receipts are derived from a disposition of the promoted product or service.

(11) * * *

Example 3. X produces live television programs that are qualified films. X shows the programs on its own television station. X sells advertising time slots to advertisers for the television programs. Because the methods and means of distributing a qualified film under paragraph (k)(1) of this section do not affect the availability of the deduction under section 199 for taxable years beginning after 2007, the advertising income X receives from advertisers is derived from the lease, rental, license, sale, exchange, or other disposition of the qualified films and is DPGR.

Example 4. * * * Y is considered the taxpayer performing the qualifying activities pursuant to paragraph (f)(1) of this section with respect to the DVDs during the MPGE and duplication process. * * *

* * * * *

Example 6. X produced a qualified film and licenses the trademark of Character A, a character in the qualified film, to Y for reproduction of the Character A image onto t-shirts. Y sells the t-shirts with Character A's likeness to customers, and pays X a royalty based on sales of the t-shirts. X's qualified film only includes intangibles with respect to the qualified film in taxable years beginning after 2007, including the trademark of Character A. Accordingly, any gross receipts derived from the license of the trademark of Character A to Y occurring in a taxable year beginning before 2008 are non-DPGR, and any gross receipts derived from the license of the trademark of Character A occurring in a taxable year beginning after 2007 are DPGR (assuming all other requirements of this section are met). The royalties X derives from Y occurring in a taxable year beginning before 2008 are non-DPGR because the royalties are derived from an intangible (which is not within the definition of a qualified film under paragraph (k)(1) of this section for taxable years beginning before 2008).

Example 7. Y, a media company, acquires all of the intangible rights to Book A, which was written and published in 2008, and all of the intangible rights associated with a qualified film that is based on Book A. The qualified film based on Book A is produced in 2009 by Y. Y owns the copyright and trademark to Character B, the lead character in Book A and the qualified film based on Book A. Y licenses Character B's copyright and trademark to Z for $50,000,000. For 2009, without taking into account the payment from Z, Y derives 40 percent of its gross receipts from the qualified film based on Book A, and 60 percent from Book A. Z's payment is attributable to both Book A and the qualified film based on Book A. Therefore, Y must allocate Z's payment, and only the gross receipts derived from licensing the intangible rights associated with the qualified film based on Book A, or 40 percent, are DPGR.

Example 8. Z produces a commercial in the United States that features Z's shirts, shoes, and other athletic equipment that all have Z's trademarked logo affixed (promoted products). Z's commercial is a qualified film produced by Z. Z sells the shirts, shoes, and athletic equipment to customers at retail establishments. Z's gross receipts are derived from the disposition of the promoted products and are not derived from the disposition of Z's qualified film, including any copyrights, trademarks, or other intangibles with respect to Z's qualified film.

Example 9. X produces a commercial in the United States that features X's services (promoted services). X's commercial is a qualified film produced by X. The commercial includes Character A developed to promote X's services. Gross receipts that X derives from providing the promoted services are not derived from the disposition of X's qualified film, including any copyrights, trademarks, or other intangibles with respect to X's qualified film. X also licenses the right to reproduce Character A developed to promote X's services to Y so that Y can produce t-shirts featuring Character A. This license is distinct (separate and apart) from a disposition of the promoted services and the gross receipts are derived from the license of an intangible with respect to X's qualified film produced by X. X's gross receipts derived from the license to reproduce Character A are DPGR.

Example 10. Y produces a qualified film in the United States. Y purchases DVDs and affixes the qualified film to the DVDs. Y purchases gift baskets and sells individual gift baskets that contain a DVD with the affixed qualified film in its retail stores in the normal course of Y's business. Under § 1.199–3(k)(2)(ii)(A), Y may treat the DVD as part of the qualified film produced by taxpayer, but Y cannot treat the gift baskets as part of the qualified film produced by taxpayer. The gross receipts that Y derives from the sale of the DVD are DPGR derived from a qualified film, but the gross receipts that Y derives from the sale of the gift baskets are non-DPGR.

Example 11. The facts are the same as in *Example 10* except that the individual gift baskets that Y sells also contain boxes of popcorn and candy manufactured by Y within the United States. Under § 1.199–3(k)(2)(ii)(A), Y cannot treat the gift baskets including the boxes of popcorn and candy manufactured by Y as part of the qualified film produced by taxpayer. Gross receipts from the sale of the DVD are still treated as DPGR derived from a qualified film. Y must separately determine whether the gross receipts from the tangible personal property it sells qualify as DPGR. Thus, Y must determine whether the gift basket, including the boxes of popcorn and candy but excluding the qualified film, is an item for purposes of § 1.199–3(d)(1)(i).

* * * * *

(m) * * *

(2) * * *

(i) * * * A taxpayer whose engagement in the activity is primarily limited to approving or authorizing invoices or payments is not considered engaged in a construction activity as a general contractor or in any other capacity.

* * * * *

(5) *Definition of substantial renovation*. The term *substantial renovation* means activities the costs of which would be required to be capitalized by the taxpayer as an improvement under § 1.263(a)–3, other than an amount described in § 1.263(a)–3(k)(1)(i) through (iii). If not otherwise defined under § 1.263(a)–3, the unit of property for purposes of § 1.263(a)–3 is the real property, as defined in paragraph (m)(3) of this section, to which the activities relate.

* * * * *

Par. 6. Section 1.199–4 is amended by adding a sentence after the seventh sentence in paragraph (b)(1) and adding paragraph (b)(2)(iii) to read as follows:

§ 1.199–4 Costs allocable to domestic production gross receipts.

* * * * *

(b) * * *

(1) * * * In the case of a long-term contract accounted for under the percentage-of-completion method described in § 1.460–4(b) (PCM), or the completed-contract method described in § 1.460–4(d) (CCM), CGS for purposes of this section includes the allocable contract costs described in § 1.460–5(b) (in the case of a contract accounted for under PCM) or § 1.460–5(d) (in the case of a contract accounted for under CCM). * * *

(2) * * *

(iii) *Cost of goods sold associated with activities undertaken in an earlier taxable year*—(A) *In general*. A taxpayer must allocate CGS between DPGR and non-DPGR under the rules provided in paragraphs (b)(2)(i) and (ii) of this section, regardless of whether certain costs included in CGS can be associated with activities undertaken in an earlier taxable year (including a year prior to the effective date of section 199). A taxpayer may not segregate CGS into component costs and allocate those component costs between DPGR and non-DPGR.

(B) *Example*. The following example illustrates an application of paragraph (b)(2)(iii)(A) of this section:

Example. During the 2009 taxable year, X manufactured and sold Product A. All of the gross receipts from sales recognized by X in 2009 were from the sale of Product A and qualified as DPGR. Employee 1 was involved in X's production process until he retired in 2003. In 2009, X paid $30 directly from its general assets for Employee 1's medical expenses pursuant to an unfunded, self-insured plan for retired X employees. For purposes of computing X's 2009 taxable income, X capitalized those medical costs to inventory under section 263A. In 2009, the CGS for a unit of Product A was $100 (including the applicable portion of the $30 paid for Employee 1's medical costs that was allocated to cost of goods sold under X's allocation method for additional section 263A costs). X has information readily available to specifically identify CGS allocable to DPGR and can identify that amount without undue burden and expense because all of X's gross receipts from sales in 2009 are attributable to the sale of Product A and qualify as DPGR. The inventory cost of each unit of Product A sold in 2009, including the applicable portion of retiree medical costs, is related to X's gross receipts from the sale of Product A in 2009. X may not segregate the 2009 CGS by separately allocating the retiree medical costs, which are components of CGS, to DPGR and non-DPGR. Thus, even though the retiree medical costs can be associated with activities undertaken in prior years, $100 of inventory cost of each unit of Product A sold in 2009, including the applicable portion of the retiree medical expense cost component, is allocable to DPGR in 2009.

* * * * *

Par. 7. Section 1.199–6 is amended by adding *Example 4* to paragraph (m) to read as follows:

§ 1.199–6 Agricultural and horticultural cooperatives.

* * * * *

(m) * * *

Example 4. (i) The facts are the same as *Example 1* except that Cooperative X's payments of $370,000 for its members' corn qualify as per-unit retain allocations paid in money within the meaning of section 1388(f) and Cooperative X reports the per-unit retain allocations paid in money on Form 1099–PATR.

(ii) Cooperative X is a cooperative described in paragraph (f) of this section. Accordingly, this section applies to Cooperative X and its patrons and all of Cooperative X's gross receipts from the sale of its patrons' corn qualify as domestic production gross receipts (as defined in § 1.199–3(a)). Cooperative X's QPAI is $1,370,000. Cooperative X's section 199 deduction for its taxable year 2007 is $82,200 (.06 X $1,370,000). Because this amount is more than 50% of Cooperative X's W–2 wages (.5 X $130,000 = $65,000), the entire amount is not allowed as a section 199 deduction, but is instead subject to the wage limitation section 199(b), and also remains subject to the rules of section 199(d)(3) and this section.

Par. 8. Section 1.199–8 is amended by revising the heading of paragraph (i) and adding paragraphs (i)(10) and (11) to read as follows:

§ 1.199–8 Other rules.

* * * * *

(i) *Effective/applicability dates** * *

* * * * *

(10) [The text of the proposed amendments to § 1.199–8(i)(10) is the same as the text of § 1.199–8T(i)(10) published elsewhere in this issue of the **Federal Register**].

(11) *Energy Improvement and Extension Act of the 2008, Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and other provisions*. Section 1.199–1(f); the last sentence in § 1.199–2(e)(1) and paragraph (f); § 1.199–3(d)(4) *Example 6* and *Example 14*, the last sentence in paragraph (e)(1), the last sentence in paragraph (e)(3), the third sentence in paragraph (e)(5) *Example 1*, the second sentence in paragraph (e)(5) *Example 4*, paragraph (e)(5) *Example 5* and *Example 9*, the last sentence in paragraph (f)(1), paragraph (f)(4) *Example 1*, paragraph (g)(4)(i), paragraphs (h)(2), (i)(3), (i)(5) *Example 4*, and (i)(9), the second, third, and fourth sentences in paragraph (k)(1), paragraph (k)(2)(ii), the second sentence in paragraph (k)(3)(i), the last sentence in paragraph (k)(6), the second sentence from the last sentence in paragraph (k)(7)(i), the last sentence in paragraph (k)(8), paragraph (k)(10), the third sentence in paragraph (k)(11) *Example 4*, paragraph (k)(11) *Example 3*, *Example 6*, *Example 7*, *Example 8*, *Example 9*, *Example 10*, and *Example 11*, the last sentence in paragraph (m)(2)(i), paragraph (m)(5); the eighth sentence in § 1.199–4(b)(1) and paragraph (b)(2)(iii); and § 1.199–6(m) *Example 4* apply to taxable years beginning on or after the date the final regulations are published in the **Federal Register**.

John M. Dalrymple,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 26, 2015, 8:45 a.m., and published in the issue of the Federal Register for August 27, 2015, 80 F.R. 51978)

Supplemental notice of proposed rulemaking.

Minimum Value of Eligible Employer-Sponsored Health Plans

REG–143800–14

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Supplemental notice of proposed rulemaking.

SUMMARY: This document withdraws, in part, a notice of proposed rulemaking published on May 3, 2013, relating to the health insurance premium tax credit enacted by the Affordable Care Act (including guidance on determining whether health coverage under an eligible employer-sponsored plan provides minimum value) and replaces the withdrawn portion with new proposed regulations providing guidance on determining whether health coverage under an eligible employer-sponsored plan provides minimum value. The proposed regulations affect participants in eligible employer-sponsored health plans and employers that sponsor these plans.

DATES: Written (including electronic) comments and requests for a public hearing must be received by November 2, 2015.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–143800–14), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–143800–14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–143800–14).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Andrew S. Braden, (202) 317-4725; concerning the submission of comments and/or requests for a public hearing, Oluwafunmilayo Taylor, (202) 317-5179 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document withdraws, in part, a notice of proposed rulemaking (REG–125398–12), which was published in the **Federal Register** on May 3, 2013 (78 FR 25909) and replaces the portion withdrawn with new proposed regulations. The 2013 proposed regulations added § 1.36B–6 of the Income Tax Regulations, providing rules for determining the minimum value of eligible employer-sponsored plans for purposes of the premium tax credit under section 36B of the Internal Revenue Code (Code). Notice 2014–69 (2014–48 IRB 903) advised taxpayers that the Department of Health and Human Service (HHS) and the Treasury Department and the IRS intended to propose regulations providing that plans that fail to provide substantial coverage for inpatient hospitalization or physician services do not provide minimum value. Accordingly, the proposed regulations under § 1.36B–6(a) and (g) are withdrawn.

Beginning in 2014, under the Patient Protection and Affordable Care Act, Public Law 111–148 (124 Stat. 119 (2010)), and the Health Care and Education Reconciliation Act of 2010, Public Law 111–152 (124 Stat. 1029 (2010)) (collectively, the Affordable Care Act), eligible individuals who enroll in, or whose family member enrolls in, coverage under a qualified health plan through an Affordable Insurance Exchange (Exchange), also known as a Health Insurance Marketplace, may receive a premium tax credit under section 36B of the Code.

Premium Tax Credit

Section 36B allows a refundable premium tax credit, which subsidizes the cost of health insurance coverage enrolled in through an Exchange. A taxpayer may claim the premium tax credit on the taxpayer's tax return only if the taxpayer or a member of the taxpayer's tax family (the persons for whom the taxpayer claims a personal exemption deduction on the taxpayer's tax return, generally the taxpayer, spouse, and dependents) has a coverage month. An individual has a coverage month only if the individual enrolls in a qualified health plan through an Exchange, is not eligible for minimum essential coverage other than coverage in the individual market, and premiums for the qualified health plan are paid. Section 36B(b) and (c)(2)(B). Minimum essential coverage includes coverage under an eligible employer-sponsored plan. See section 5000A(f)(1)(B). However, for purposes of the premium tax credit, an individual is not eligible for coverage under an eligible employer-sponsored plan unless the coverage is affordable and provides minimum value or unless the individual enrolls in the plan. Section 36B(c)(2)(C). Final regulations under section 36B (TD 9590) were published on May 23, 2012 (77 FR 30377).

Employer Shared Responsibility Provision

Section 4980H(b) imposes an assessable payment on applicable large employers (as defined in section 4980H(c)(2)) that offer minimum essential coverage under an eligible employer-sponsored plan that is not affordable or does not provide minimum value for one or more full-time employees who receive a premium tax credit subsidy. Final regulations under section 4980H (TD 9655) were published on February 12, 2014 (79 FR 8544).

Minimum Value

Under section 36B(c)(2)(C)(ii), an eligible employer-sponsored plan provides minimum value only if the plan's share of the total allowed costs of benefits provided under the plan is at least 60 percent. Section 1302(d)(2)(C) of the Affordable Care Act provides that, in determining the percentage of the total allowed costs of benefits provided under a group health plan, the regulations promulgated by HHS under section 1302(d)(2), dealing with actuarial value, apply.

HHS published final regulations under section 1302(d)(2) on February 25, 2013 (78 FR 12834). HHS regulations at 45 CFR 156.20, which apply to the actuarial value of plans required to provide coverage of all essential health benefits, define the percentage of the total allowed costs of benefits provided under a group health plan as (1) the anticipated covered medical spending for essential health benefits coverage (as defined in 45 CFR 156.110(a)) paid by a health plan for a standard population, computed in accordance with the plan's cost-sharing, divided by (2) the total anticipated allowed charges for essential health benefit coverage provided to a standard population.

Under section 1302(b) of the Affordable Care Act, only individual market and insured small group market health plans are required to cover the essential health benefits. Minimum value, however, applies to all eligible employer-sponsored plans, including self-insured plans and insured plans in the large group market. Accordingly, HHS regulations at 45 CFR 156.145(b)(2) and (c) apply the actuarial value definition in the context of minimum value by (1) defining the standard population as the population covered by typical self-insured group health plans, and (2) taking into account the benefits a plan provides that are included in any one benchmark plan a state uses to specify the benefits included in essential health benefits.

Notice 2014–69, advising taxpayers of the intent to propose regulations providing that plans that fail to provide substantial coverage for inpatient hospitalization or physician services do not provide minimum value, was released on November 4, 2014. Notice 2014–69 also advised that it was anticipated that, for purposes of section 4980H liability, the final regulations would not apply to certain plans (as described later in this preamble) before the end of a plan year beginning no later than March 1, 2015. However, an offer of coverage under these plans to an employee does not preclude the employee from obtaining a premium tax credit, if otherwise eligible.

As announced by Notice 2014–69, HHS published proposed regulations on November 26, 2014 (79 FR 70674, 70757), and final regulations on February 27, 2015 (80 FR 10872), amending 45 CFR 156.145(a). The HHS regulations provide that an eligible employer-sponsored plan provides minimum value only if, in addition to covering at least 60 percent of the total allowed costs of benefits provided under the plan, the plan benefits include substantial coverage of inpatient hospitalization and physician services. Consistent with Notice 2014–69, the HHS regulations indicate that the changes to the minimum value regulations do not apply before the end of the plan year beginning no later than March 1, 2015 to a plan that fails to provide substantial coverage for inpatient hospitalization services or for physician services (or both), provided that the employer had entered into a binding written commitment to adopt, or had begun enrolling employees in, the plan before November 4, 2014. For this purpose, the plan year is the plan year in effect under the terms of the plan on November 3, 2014. Also for this purpose, a binding written commitment exists when an employer is contractually required to pay for an arrangement, and a plan begins enrolling employees when it begins accepting employee elections to participate in the plan. See 80 FR 10828.

Explanation of Provisions

The preamble to the HHS regulations acknowledges that self-insured and large group market group health plans are not required to cover the essential health benefits, but notes that a health plan that does not provide substantial coverage for inpatient hospitalization and physician services does not meet a universally accepted minimum standard of value expected from and inherent in any arrangement that can reasonably be called a health plan and that is intended to provide the primary health coverage for employees. The preamble concludes that it is evident in the structure of and policy underlying the Affordable Care Act that the minimum value standard may be interpreted to require that employer-sponsored plans cover critical benefits. See 80 FR 10827–10828.

As the preamble notes, allowing plans that fail to provide substantial coverage of inpatient hospital or physician services to be treated as providing minimum value would adversely affect employees (particularly those with significant health risks) who may find this coverage insufficient, by denying them access to a premium tax credit for individual coverage purchased through an Exchange, while at the same time avoiding the employer shared responsibility payment under section 4980H. Plans that omit critical benefits used disproportionately by individuals in poor health would likely enroll far fewer of these individuals, effectively driving down employer costs at the expense of those who, because of their individual health status, are discouraged from enrolling. See 80 FR 10827–10829.

Accordingly, these proposed regulations incorporate the substance of the rule in the HHS regulations. They provide that an eligible employer-sponsored plan provides minimum value only if the plan's share of the total allowed costs of benefits provided to an employee is at least 60 percent and the plan provides substantial coverage of inpatient hospital and physician services. Comments are requested on rules for determining whether a plan provides "substantial coverage" of inpatient hospital and physician services.

Effective/Applicability Date and Transition Relief

These regulations are proposed to apply for plan years beginning after November 3, 2014. However, for purposes of section 4980H(b), the changes to the minimum value regulations (in § 1.36B–6(a)(2) of these proposed regulations) do not apply before the end of the plan year beginning no later than March 1, 2015 to a plan that fails to provide substantial coverage for in-patient hospitalization services or for physician services (or both), provided that the employer had entered into a binding written commitment to adopt the noncompliant plan terms, or had begun enrolling employees in the plan with noncompliant plan terms, before November 4, 2014. For this purpose, the plan year is the plan year in effect under the terms of the plan on November 3, 2014. Also for this purpose, a binding written commitment exists when an employer is contractually required to pay for an arrangement, and a plan begins enrolling employees when it begins accepting employee elections to participate in the plan. The relief provided in this section does not apply to an applicable large employer that would have been liable for a payment under section 4980H without regard to § 1.36B–6(a)(2) of these proposed regulations.

An offer of coverage under an eligible employer-sponsored plan that does not comply with § 1.36B–6(a)(2) of these proposed regulations does not preclude an employee from obtaining a premium tax credit under section 36B, if otherwise eligible.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, 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

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. The Treasury Department and the IRS request comments on all aspects of the proposed rules. 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 timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Andrew Braden of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments

Accordingly, 26 CFR part 1 as proposed to be amended on May 3, 2013 (78 FR 25909), is proposed to be further amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.36B–6, as proposed to be added May 3, 2013 (78 FR 25909), is amended by revising paragraphs (a) and (g) to read as follows:

§ 1.36B–6 Minimum value.

(a) *In general*. An eligible employer-sponsored plan provides minimum value (MV) only if—

(1) The plan's share of the total allowed costs of benefits provided to an employee (the MV percentage) is at least 60 percent; and

(2) The plan provides substantial coverage of inpatient hospital services and physician services.

* * * * *

(g) *Effective/applicability date*—(1) *In general*. Except as provided in paragraph (g)(2) of this section, this section applies for taxable years ending after December 31, 2013.

(2) *Exception*. Paragraph (a)(2) of this section applies for plan years beginning after November 3, 2014.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 31, 2015, 8:45 a.m., and published in the issue of the Federal Register for September 1, 2015, 80 F.R. 52678)

Notice of proposed rulemaking by cross-reference to temporary regulations

Administration of Multiemployer Plan Participant Vote on an Approved Suspension of Benefits Under MPRA

REG–123640–15

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: Temporary regulations relating to the administration of a multiemployer plan participant vote on an approved suspension of benefits under the Multiemployer Pension Reform Act of 2014 (MPRA) are being issued in the Rules and Regulations section of this issue of the **Internal Revenue Bulletin.** The text of those regulations also serves as the text of these proposed regulations.

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

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–123640–15), room 5205, Internal Revenue Service, PO 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–123640–15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C., or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (IRS REG–123640–15).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, the Department of the Treasury MPRA guidance information line at (202) 622-1559; concerning submission of comments, and the previously-scheduled hearing, Regina Johnson 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)) and approved under OMB control number 1545-2260.

The collection of information in the paragraphs of these proposed regulations that cross-reference the temporary regulations that are being published elsewhere in this issue of the **Federal Register** is required for sponsor of a multiemployer defined benefit plan in critical and declining status to satisfy the criteria with respect to the required vote of plan participants and other eligible voters following approval of the plan sponsor's application for a suspension of benefits.

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:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by November 2, 2015.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 collections 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.

For the paragraphs of the proposed regulations that cross-reference the temporary regulations:

Estimated total average annual reporting or recordkeeping burden: 56 hours.

Estimated average annual burden per recordkeeper: 2 hours.

Estimated number of recordkeepers: 28.

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 26 U.S.C. 6103.

Background and Explanation of Provisions

Section 432(e)(9) of the Internal Revenue Code (Code), as amended by the Multiemployer Pension Reform Act of 2014 (MPRA), permits plan sponsors of certain multiemployer plans to reduce the plan benefits payable to participants and beneficiaries (referred to as a "suspension of benefits") if specified conditions are satisfied. Under section 432(e)(9)(H), no suspension of benefits may take effect prior to a vote of the participants of the plan with respect to the suspension. Section 432(e)(9)(H) requires that the vote be administered by the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, within 30 days after approval of a suspension application.

On June 19, 2015, the Treasury Department and the Internal Revenue Service published temporary regulations (TD 9723) under section 432(e)(9) in the **Federal Register** (80 FR 35207) (June 2015 temporary regulations). The June 2015 temporary regulations provide general guidance regarding section 432(e)(9) and outline the requirements for a plan sponsor of a plan that is in critical and declining status to apply for a suspension of benefits and for the Treasury Department to begin processing such an application. A notice of proposed rulemaking cross-referencing the June 2015 temporary regulations (REG–102648–15) was also published in the same issue of the **Federal Register** (80 FR 35262) (June 2015 proposed regulations). Both the June 2015 temporary and proposed regulations reflect consideration of comments received in response to the Request for Information on Suspensions of Benefits under the Multiemployer Pension Reform Act of 2014 published in the **Federal Register** on February 18, 2015 (80 FR 8578).

A public hearing concerning the June 2015 proposed regulations is scheduled for September 10, 2015, beginning at 9:00 a.m. in the Amphitheater of the Ronald Reagan Building and International Trade Center, 1300 Pennsylvania Ave., NW, Washington, D.C. Persons who wish to present oral comments at that hearing regarding the June 2015 proposed regulations were required to submit written or electronic comments, including an outline of topics to be discussed, by August 18, 2015. Anyone who has submitted a timely request to speak at the September 10, 2015, hearing is also permitted to discuss these proposed regulations at that hearing (without submitting a separate request to discuss these proposed regulations at that hearing).

The June 2015 temporary and proposed regulations set forth many of the rules relating to the participant vote under section 432(e)(9)(H). However, neither the June 2015 temporary regulations nor the June 2015 proposed regulations provide detailed guidance on how the Treasury Department would administer the vote.

The temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** (August 2015 temporary regulations) amend the Income Tax Regulations (26 CFR part 1) relating to the previously reserved paragraph in the June 2015 temporary and proposed regulations regarding the participant vote required under section 432(e)(9)(H).

The August 2015 temporary regulations specify that a participant vote requires the completion of three steps. First, a package of ballot materials is distributed to eligible voters. Second, the eligible voters cast their votes and the votes are collected and tabulated. Third, the Treasury Department (in consultation with the PBGC and Labor Department) determines whether a majority of the eligible voters has voted to reject the proposed suspension. The August 2015 temporary regulations also provide guidance regarding the statement in opposition to the proposed suspension and allow for the publication of a model ballot. The text of the August 2015 temporary regulations also serves as the text of these proposed regulations.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

The Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6) requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small entities. In this case, the IRS and the Treasury Department believe that the regulations likely would not have a “significant economic impact on a substantial number of small entities.” 5 U.S.C. 605. This certification is based on the fact that the number of small entities affected by this rule is unlikely to be substantial because it is unlikely that a substantial number of small multiemployer plans in critical and declining status will suspend benefits under section 432(e)(9). Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel of Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Request for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the Treasury Department and the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available for public inspection and copying at www.regulations.gov or upon request. **Please Note:** All comments will be made available to the public. Do not include any personally identifiable information (such as Social Security number, name, address, or other contact information) or confidential business information that you do not want publicly disclosed. All comments may be posted on the Internet and can be retrieved by most Internet search engines.

If requested in writing by any person who timely submits written comments on these proposed regulations, a public hearing will be scheduled on the contents of this document. Comments and requests for a public hearing must be received by November 2, 2015. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register.** Please see the “Background and Explanation of Provisions” heading for information regarding a public hearing scheduled for September 10, 2015, concerning the June 2015 proposed regulations regarding the Suspension of Benefits under the Multiemployer Pension Reform Act of 2014, during which individuals who have already requested to speak regarding those regulations may also address the substance of these proposed regulations.

Contact Information

For general questions regarding these regulations, please contact the Department of the Treasury MPRA guidance information line at (202) 622-1559 (not a toll-free number). For information regarding a specific application for a suspension of benefits, please contact the Department of the Treasury at (202) 622-1534 (not a toll-free number).

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 1.432(e)(9)–1(h) is amended by:

1. Revising paragraph (h)(2).

2. Adding paragraphs (h)(3)(iv) and (h)(3)(v).

The revisions and additions read as follows:

§ 1.432(e)(9)–1 Benefit suspensions for multiemployer plans in critical and declining status.

* * * * *

(h) * * *

(2) *Participant vote*. [The text of the proposed amendments to § 1.432(e)(9)–1(h)(2) is the same as § 1.432(e)(9)–1T(h)(2) published elsewhere in this issue of the **Internal Revenue Bulletin**.]

* * * * *

(3) * * *

(iv) *Statement in opposition to the proposed suspension*. [The text of the proposed amendments to § 1.432(e)(9)–1(h)(3)(iv) is the same as § 1.432(e)(9)–1T(h)(3)(iv) published elsewhere in this issue of the **Internal Revenue Bulletin**.]

(v) *Model ballot*. [The text of the proposed amendments to § 1.432(e)(9)–1(h)(3)(v) is the same as § 1.432(e)(9)–1T(h)(3)(v) published elsewhere in this issue of the **Internal Revenue Bulletin**.]

* * * * *

John M. Dalrymple
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 31, 2015, 11:15 a.m., and published in the issue of the Federal Register for September 2, 2015, 80 F.R. 53068)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2015–01 through 2015–26 is in Internal Revenue Bulletin 2015–26, dated June 29, 2015.

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

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