INTERNAL REVENUE
BULLETIN

IRS

Bulletin No. 2019–27
July 1, 2019

HIGHLIGHTS OF THIS ISSUE

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

EMPLOYEE PLANS

NOT 2019-40, page 59.

This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for June 2019 used under § 417(e)(3)(D), the 24-month average segment rates applicable for June 2019, and the 30-year Treasury rates, as reflected by the application of § 430(h)(2)(C)(iv).

EXEMPT ORGANIZATIONS

ANN 2019-07, page 62.

Revocation of IRC 501(c)(3) Organizations for failure to meet the code section requirements. Contributions made to the organizations by individual donors are no longer deductible under IRC 170(b)(1)(A).

INCOME TAX

T.D. 9863, page 1.

The final regulations provide discounting rules for unpaid losses and estimated salvage recoverable of insurance companies for Federal income tax purposes. The final regulations update and replace existing regulations under section 846 of the Internal Revenue Code to implement recent legislative changes made by section 13523 of the Tax Cuts and Jobs Act.

T.D. 9864, page 6.

The final regulations provide rules for governing the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit. Final regulations under section 642(c) apply similar rules to payments made by a trust or decedent's estate.

T.D. 9865, page 27.

This document contains temporary regulations relating to the addition of section 245A to the Internal Revenue Code by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. The temporary regulations affect United States persons that have undertaken certain transactions with regards to a controlled foreign corporation or own a controlled foreign corporation that has undertaken certain transactions.

NOT 2019-12, page 57.

Notice 2019-12 announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to publish a proposed regulation providing a safe harbor under section 164 of the Internal Revenue Code for certain individuals who make a payment to or for the use of an entity described in section 170(c) in return for state or local tax credit.

REG-105476-18, page 63.

Nonresident aliens and foreign corporations are taxable in the United States on taxable income which is effectively connected with the conduct of a trade or business within the United States. REG-113604-18 published on December 27, 2018, would provide rules for determining under section 864(c)(8) the amount of gain or loss recognized by a nonresident alien individual or foreign corporation from the sale or exchange of a partnership interest that is treated as effectively connected with the conduct of a trade or business within the United States. These proposed regulations would provide the withholding and reporting requirements related to these sales or exchanges.

Finding Lists begin on page ii.

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.

T.D. 9863

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

Modification of Discounting Rules for Insurance Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on discounting rules for unpaid losses and estimated salvage recoverable of insurance companies for Federal income tax purposes. The final regulations update and replace existing regulations to implement recent legislative changes to the Internal Revenue Code (Code) and make a technical improvement to the derivation of loss payment patterns used for discounting. The final regulations affect entities taxable as insurance companies.

DATES: *Effective Date*: These regulations are effective June 17, 2019.

Applicability Date: For dates of applicability, see §1.846-1(e)(2).

FOR FURTHER INFORMATION CONTACT: Kathryn M. Sneade, (202) 317-6995 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 846 of the Code. Section 846 was added to the Code by section 1023(c) of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085, 2399). Final regulations under section 846 were published in the **Federal Register** (57 FR 40841) on September 8, 1992 (T.D. 8433). See §§1.846-0 through 1.846-4 (1992 Final Regulations). The discounting rules under section 846 were amended for taxable years beginning after December 31, 2017, by section 13523 of the Tax Cuts and Jobs Act, Public Law 115-97 (131 Stat. 2054, 2152) (TCJA). The discounting rules of section 846, both prior to and after amendment by the TCJA, are used to determine discounted unpaid losses and estimated salvage recoverable of property and casualty (P&C) insurance companies and discounted unearned premiums of title insurance companies for Federal income tax purposes under section 832, as well as discounted unpaid losses of life insurance companies for Federal income tax purposes under sections 805(a)(1) and 807(c)(2).

The Department of the Treasury (Treasury Department) and the IRS published proposed regulations under section 846 (REG-103163-18) in the **Federal Register** (83 FR 55646) on November 7, 2018 (Proposed Regulations). The Treasury Department and the IRS received public comments on the Proposed Regulations and held a public hearing on December 20, 2018.

On January 7, 2019, the Treasury Department and the IRS published Rev. Proc. 2019-06, 2019-02 I.R.B. 284, which prescribes unpaid loss discount factors for the 2018 accident year and earlier accident years for use in computing discounted unpaid losses under section 846. The unpaid loss discount factors also serve as salvage discount factors for the 2018 accident year and earlier accident years for use in computing discounted estimated salvage recoverable under section 832. The discount factors prescribed in Rev. Proc. 2019-06 were determined under section 846, as amended by section 13523 of the TCJA, and the Proposed Regulations. In Rev. Proc. 2019-06, the Treasury Department and the IRS announced the intent to publish revised unpaid loss discount factors, if necessary, following the publication of the Proposed Regulations as final regulations. The Treasury Department and the IRS also announced the intent to issue guidance on the use of revised discount factors, including the adjustment to be taken into account by certain taxpayers that used the discount factors prescribed in Rev. Proc. 2019-06 in a taxable year ending before the date of publication of final regulations. The Treasury Department and the IRS requested and received public comments on Rev. Proc. 2019-06.

After consideration of all of the comments on the Proposed Regulations and Rev. Proc. 2019-06, the Proposed Regulations are adopted as amended by this Treasury decision (Final Regulations).

Summary of Comments and Explanation of Revisions

This section discusses the public comments received on the Proposed Regulations and Rev. Proc. 2019-06, explains the revisions adopted by the Final Regulations in response to those comments, and describes guidance the Treasury Department and the IRS intend to issue following publication of the Final Regulations in the **Federal Register**.

1. Determination of Applicable Interest Rate

Under section 846(a)(2) and (c)(1), the "applicable interest rate" used to determine the discount factors associated with any accident year and line of business is the "annual rate" determined under section 846(c)(2).

Before amendment by section 13523(a) of the TCJA, section 846(c)(2) provided that the annual rate for any calendar year was a rate equal to the average of the applicable Federal mid-term rates (as defined in section 1274(d) but based on annual compounding) effective as of the beginning of each of the calendar months in the most recent 60-month period ending before the beginning of the calendar year for which the determination is made. The applicable Federal mid-term rate is determined by the Secretary based on the average market yield on outstanding marketable obligations of the United States with remaining periods of over three years but not over nine years. See section 1274(d)(1).

As amended by section 13523(a) of the TCJA, section 846(c)(2) provides that the annual rate for any calendar year will be determined by the Secretary based on the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting "60-month period" for "24-month period" therein). The corporate bond yield curve, commonly referred to as the high quality market (HQM) corporate bond yield curve, is published on a monthly basis by the Treasury Department and the IRS. It reflects the average of monthly yields on investment grade corporate bonds with varying maturities that are in the top three quality levels available, and it consists of spot interest rates for each stated time to maturity. See, for example, Notice 2019-13, 2019-8 I.R.B. 580. The spot rate for a given time to maturity represents the yield on a bond that gives a single payment at that maturity. For the stated yield curve, times to maturity are specified at half-year intervals from one-half year through 100 years. Section 846(c)(2) does not specify how the Secretary is to determine the annual rate for any calendar year based on the corporate bond yield curve.

Section 1.846-1(c) of the Proposed Regulations provides that the "applicable interest rate" used to determine the discount factors associated with any accident year and line of business is the "annual rate" determined by the Secretary for any calendar year on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting "60-month period" for "24-month period" therein). The annual rate for any calendar year is the average of the corporate bond yield curve's monthly spot rates with times to maturity of not more than seventeen and one-half years (that is, when applied to the HQM corporate bond yield curve, times to maturity from one-half year to seventeen and one-half years), computed using the most recent 60-month period ending before the beginning of the calendar year for which the determination is made.

Consistent with the text of section 846, as amended by the TCJA, and the statutory structure as a whole, the Proposed Regulations provide for the use of a single annual rate applicable to all lines of business, as was the case under section 846 prior to amendment by the TCJA. Commenters agreed with this approach. One commenter asserted that a single rate approach continues to be mandated by the statutory language and Congressional intent. This commenter also noted that the use of a single rate is a continuance of longstanding practice related to the discounting of insurance loss reserves, and the TCJA did not specify a change to this practice.

The preamble to the Proposed Regulations states that the change from a rate based on the applicable Federal mid-term rates to a rate based on the corporate bond yield curve indicates that the annual rate should be determined in a manner that more closely matches the investments in bonds used to fund the undiscounted losses to be paid in the future by insurance companies. Several commenters agreed that the annual rate should be determined in a manner that more closely matches the investments of insurance companies.

The maturity range in the Proposed Regulations (that is, times to maturity from one-half year to seventeen and one-half years) was selected to produce a single discount rate that would provide approximately the same present value of taxable income, in the aggregate, as would be obtained by applying the 60-month average corporate bond yield curve (forecast through 2028) directly to the future loss payments expected for each line of business (determined using the loss payment patterns applicable to the 2018 accident year). That is, the selected maturity range approximates, in terms of the present value of taxable income, the overall result of discounting each projected loss payment using the spot rate from the corporate bond yield curve with a time to maturity that matches the time between the end of the accident year and the middle of the year of the projected loss payment.

Several commenters expressed concern with the selection of the maturity range used to determine the single rate applicable to all unpaid losses for all lines of business under the Proposed Regulations. A commenter addressing the application of the Proposed Regulations to certain non-life insurance reserves held by life insurance companies requested a single section 846 discount rate determined by reference to shorter maturities than those specified in the Proposed Regulations to more clearly reflect the income of life insurance companies related to these reserves. Several commenters addressing the application of the Proposed Regulations to P&C insurance companies requested that the discount rate instead be determined by reference to the maturity range of three and one-half to nine years that was used under section 846 prior to amendment by the TCJA. Some of the commenters asserted a lack of clear congressional intent to use a different maturity range than the maturity range used under section 846 prior to amendment by the TCJA. The commenters also asserted that the shorter range with a lower average maturity would more closely match the maturity of the P&C insurance industry's investments and offered alternative approaches to selecting a maturity range should a different maturity range be selected.

Some of the commenters addressing the application of the Proposed Regulations to P&C insurance companies acknowledged that the annual rate calculated under the Proposed Regulations approximates the P&C industry's current investment yield in the current bond market. However, the commenters generally asserted that an annual rate based on the maturity range in the Proposed Regulations would overstate the industry's investment yield in other interest rate environments because the average maturity and average duration of the bonds reflected in that segment of the HQM corporate bond yield curve are longer than both the average maturity and average duration of the industry's actual bond investments. The commenters asserted that the weighted average maturities of bonds held by P&C insurance companies are notably lower than the nine-year average of the maturity range suggested in the Proposed Regulations. According to one commenter, the weighted average maturities of bonds held by P&C insurance companies have ranged between 6.4 and 7.1 years since 2008. The commenters asserted that P&C companies generally do not seek to match the maturities of their investments with the expected payment dates of their liabilities. One commenter stated that P&C insurers' bond portfolios are more skewed to the short end of the curve to ensure sufficient liquidity to pay claims, especially for catastrophic events.

The commenters also explained that the average duration of bond payments held by P&C insurance companies (five to six years, according to data from one commenter) is shorter than the nine-year average payment duration of the bonds underlying the maturity range in the Proposed Regulations because P&C insurance companies typically invest in coupon bonds. Unlike the zero-coupon bonds reflected in the HQM corporate bond yield curve, coupon bonds have an average payment duration that is less than their maturity because of the periodic interest payments. Commenters asserted that the duration difference between coupon bonds and zero-coupon bonds is more pronounced in an environment with higher interest rates and a steeper yield curve.

One of the commenters requesting the use of a shorter maturity range (three and one-half to nine years) suggested that the annual rate should be determined in a manner that more closely matches the P&C insurance industry's investment yield. The commenter asserted that, in a rising rate environment, especially if there is a larger spread between the short-term and long-term rates, the longer maturity range in the Proposed Regulations would overstate the P&C insurance industry's investment yield. The commenter also asserted that the shorter maturity range would result in a better approximation of the P&C insurance industry's investment yield over a longer period of time and in different interest rate environments. The commenter suggested that if the shorter maturity range is not adopted, another approach would be to periodically adjust the maturity range. Under this approach, every five years (that is, for each determination year under section 846(d)(4)), the Secretary would select the maturity range that best approximates the industry's investment yield based on publicly available P&C insurance industry aggregate investment yield data. However, other commenters expressed a preference for a fixed range.

Two of the commenters requesting the use of a shorter maturity range (three and one-half to nine years) suggested that the maturity range selected should more closely match the average maturity of the P&C insurance industry's bond investments. The commenters asserted that the average maturity of a range consisting of three and one-half to nine years more closely matches the six to seven-year average maturity of the industry's bond investments over the past decade than the nine-year average of the longer range in the Proposed Regulations. One commenter suggested that if the shorter maturity range is not adopted, an alternative could be to use the maturity range from one-half to thirteen years because that range also reflects average maturities that more closely match the investments in bonds used to fund the undiscounted losses of P&C insurance companies. Both commenters suggested that if the range in the Proposed Regulations is retained, a "guardrail" should place an upper limit on the maturities that are used when the bond yield curve is unusually steep. The commenters assert that use of the maturity range in the Proposed Regulations in such conditions would result in an annual rate that overstates the P&C insurance industry's investment yield due to the duration and maturity differences between the industry's bond investments and the bonds reflected in the HQM corporate bond yield curve segment selected in the Proposed Regulations. The commenters expressed particular concern that use of the maturity range in the Proposed Regulations would pose a threat to the industry's financial viability in times of economic stress because steep yield curves historically have occurred during or immediately after a recession and often coincide with a downturn in the underwriting cycle.

One commenter provided recommendations regarding the "guardrail" adjustment to be made to the annual rate and the circumstances in which it would apply. The commenter suggested that a guardrail adjustment should be made when the spread between the HQM corporate bond yields at the lower end (one-half year to maturity) and upper end (seventeen and one-half years to maturity) of the maturity range proposed in the Proposed Regulations, measured on the basis of the 12-month average, is greater than 2.75 percentage points. The commenter explained that this "trigger" was selected because, compared to the other possible triggers considered by the commenter, it has the highest correlation to recession-related stress periods, it is simple to implement, and it does not result in undue volatility. The commenter suggested that the "guardrail" be an annual interest rate based on the 60-month average of a narrower range of bond maturities of one-half year to thirteen years. The commenter asserted that this trigger and guardrail adjustment proposal is reasonably simple, easily administrable, and predictable (for both the IRS and taxpayers) in its application.

After consideration of the comments received on the Proposed Regulations, the Treasury Department and the IRS have determined to use a single annual rate based on a narrower range of maturities. Specifically, the annual rate for any calendar year is the average of the corporate bond yield curve's monthly spot rates with times to maturity from four and one-half years to ten years, computed using the most recent 60-month period ending before the beginning of the calendar year for which the determination is made. In response to comments expressing a preference for a fixed range, the Final Regulations do not provide for periodic redetermination of the maturity range used to determine the annual rate.

The maturity range of four and one-half years to ten years was selected in response to comments requesting the adoption of a narrower maturity range with an average maturity that more closely matches the six- to seven-year average maturity of the P&C insurance industry's bond investments. Commenters expressed concern about the inclusion of the times-to-maturity at the upper end of the range in the Proposed Regulations, particularly when the bond yield curve is unusually steep. Therefore, the Final Regulations provide for a narrower maturity range than in the Proposed Regulations (from one-half year to seventeen and one-half years). Use of the narrower range eliminates yields for times-to-maturity at the lower and upper ends of the range in the Proposed Regulations from the calculation of an average annual rate.

The selected maturity range has an average maturity of seven and one-quarter years, which is closer to the average maturity of the industry's bond investments than the nine-year average maturity of the maturity range in the Proposed Regulations. The Final Regulations do not adopt either of the maturity ranges suggested by commenters (three and one-half to nine years and one-half to thirteen years) because the suggested ranges would typically understate the P&C industry's investment yield as compared to the range adopted in the Final Regulations. P&C industry investment portfolios include assets other than high quality bonds, and the higher returns on those other assets typically result in the industry earning a higher rate of return. Therefore, the Final Regulations adopt a maturity range that has an average maturity that is slightly greater than the average maturity of the industry's bond investments.

The Treasury Department and the IRS intend to publish guidance in the Internal Revenue Bulletin that will provide revised unpaid loss discount factors based on the Final Regulations for each property and casualty line of business for all accident years ending with or before calendar year 2018. The guidance will also provide that taxpayers may use either the revised discount factors or the discount factors published in Rev. Proc. 2019-06 for taxable years beginning after December 31, 2017, and ending before June 17, 2019. The guidance will describe the adjustment to be taken into account by any taxpayer that uses the discount factors prescribed in Rev. Proc. 2019-06 in a taxable year. See Rev. Proc. 2019-06. Taxpayers must use the revised discount factors in taxable years ending on or after June 17, 2019.

2. Discontinuance of Composite Method

The Treasury Department and the IRS proposed, in the preamble to the Proposed Regulations, to discontinue the use of the "composite method" described in section 3.01 of Rev. Proc. 2002-74, 2002–2 C.B. 980, and section V of Notice 88-100, 1988-2 C.B. 439.

Commenters suggested that the current rules permitting use of the composite method should be retained. The commenters explained that if the composite method were discontinued, compiling the data required to compute discounted unpaid losses with respect to accident years not separately reported on the National Association of Insurance Commissioners (NAIC) annual statement would prove to be difficult for some insurers given the limitations of company data for older accident years and legacy information technology systems. One of the commenters added that discontinuance of the composite method would cause burdensome reporting requirements for insurers.

In response to these comments, the Treasury Department and the IRS have determined to continue to permit the use of the composite method and to continue to publish composite discount factors annually.

3. Smoothing Adjustments

Section 1.846-1(d)(1) of the Proposed Regulations provides that the loss payment pattern determined by the Secretary for each line of business generally is determined by reference to the historical loss payment pattern applicable to such line of business. However, under §1.846-1(d)(1) and (2) of the Proposed Regulations, the Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one. As explained in section 2.03(4) of Rev. Proc. 2019-06, for the 2017 determination year, one line of business required adjustments under the Proposed Regulations.

Commenters expressed support for the smoothing adjustments described in the Proposed Regulations and Rev. Proc. 2019-06. Accordingly, the Final Regulations adopt §1.846-1(d) as proposed.

4. Determination of Estimated Discounted Salvage Recoverable

Section 1.832-4(c) provides that, except as otherwise provided in guidance published by the Commissioner of Internal Revenue (Commissioner) in the Internal Revenue Bulletin, estimated salvage recoverable must be discounted either (1) by using the applicable discount factors published by the Commissioner for estimated salvage recoverable; or (2) by using the loss payment pattern for a line of business as the salvage recovery pattern for that line of business and by using the applicable interest rate for calculating unpaid losses under section 846(c). The Treasury Department and the IRS proposed, in the preamble to the Proposed Regulations, that estimated salvage recoverable be discounted by using the published discount factors applicable to unpaid losses. Section 4.02 of Rev. Proc. 2019-06 provides that the unpaid loss discount factors set forth therein also serve as salvage discount factors for the 2018 accident year and all prior accident years for use in computing discounted estimated salvage recoverable under section 832.

Commenters expressed support for the proposed use of the discount factors applicable to unpaid losses as the discount factors for salvage. This method is permitted under section 832(b)(5)(A) and §1.832-4(c), and it should reduce compliance complexity and costs. Accordingly, future guidance published in the Internal Revenue Bulletin will continue to provide that estimated salvage recoverable is to be discounted using the published discount factors applicable to unpaid losses.

In the preamble to the Proposed Regulations, the Treasury Department and the IRS requested comments on whether net payment data (loss payments less salvage recovered) and net losses incurred data (losses incurred less salvage recoverable) should be used to compute loss discount factors. No commenters responded to this request. The Treasury Department and the IRS will continue to use payment data unreduced by salvage recovered and losses incurred data unreduced by salvage recoverable to compute loss discount factors.

5. Reinsurance and International Lines of Business

As described in the preamble to the Proposed Regulations, as a result of the repeal of former section 846(d)(3)(E) and (F) by section 13523 of the TCJA, section 846 no longer explicitly provides for the determination of loss payment patterns for non-proportional reinsurance and international lines of business extending beyond three calendar years following the accident year. The Proposed Regulations would remove §1.846-1(b)(3)(iv) (applicable to non-proportional reinsurance business) and (b)(4) (applicable to international business) of the 1992 Final Regulations due to the repeal of former section 846(d)(3)(E) and (F). The Proposed Regulations would retain §1.846-1(b)(3)

(i) and (b)(3)(ii)(A) (applicable to proportional and non-proportional reinsurance, respectively) of the 1992 Final Regulations, however, because these rules are not affected by the repeal of former section 846(d)(3)(E) and (F).

Commenters agreed that the repeal of former section 846(d)(3)(E) and (F) means that the statute requires non-proportional reinsurance and international lines of business to be treated as short-tail lines of business with three-year loss payment patterns. The treatment of the non-proportional reinsurance and international lines of business as short-tail lines of business in Rev. Proc. 2019-06 is consistent with these comments.

Accordingly, §1.846-1(b)(3)(iv) and (b)(4) of the 1992 Final Regulations are removed as proposed in the Proposed Regulations.

6. Other Changes

The Proposed Regulations would (1) remove §1.846-1(a)(2) of the 1992 Final Regulations because the examples are no longer relevant; (2) remove §1.846-1(b)(3)(ii)(B) and (b)(3)(iii) of the 1992 Final Regulations because these provisions apply only to accident years before 1992; (3) remove §1.846-2 of the 1992 Final Regulations because section 13523 of the TCJA repealed the section 846(e) election; (4) remove §1.846-3 because the "fresh start" and reserve strengthening rules therein are no longer applicable; (5) make conforming changes to §1.846-1(a) and (b) of the 1992 Final Regulations to reflect the removal of various §1.846-1 provisions, as well as the removal of §§1.846-2 and 1.846-3 of the 1992 Final Regulations; (6) remove §1.846-4 of the 1992 Final Regulations, which provides applicability dates for §§1.846-1 through 1.846-3 of the 1992 Final Regulations, and adopt proposed §1.846-1(e), which provides applicability dates for §1.846-1; and (7) remove §1.846-0 of the 1992 Final Regulations, which provides a list of the headings in §§1.846-1 through 1.846-4 of the 1992 Final Regulations.

Additionally, the Proposed Regulations would remove §§1.846-2T and 1.846-4T from the Code of Federal Regulations (CFR) because they are obsolete. On April 10, 2006, the Treasury Department and the IRS published in the **Federal Register** (71 FR 17990) a Treasury decision (T.D. 9257) containing §§1.846-2T and 1.846-4T. On January 23, 2008, the Treasury Department and the IRS published in the **Federal Register** (73 FR 3868) a Treasury decision (T.D. 9377) that finalized the rules contained in §1.846-2T in §1.846-2 and finalized the rules contained in §1.846-4T in §1.846-4. T.D. 9377, however, did not remove §§1.846-2T and 1.846-4T from the CFR.

No comments were received regarding any of these changes in the Proposed Regulations. Accordingly, these changes are adopted as proposed.

7. Change in Method of Accounting

The Treasury Department and the IRS plan to publish guidance in the Internal Revenue Bulletin that provides simplified procedures under section 446 and §1.446-1(e) for an insurance company to obtain automatic consent of the Commissioner to change its method of accounting to comply with section 846, as amended by the TCJA, for the first taxable year beginning after December 31, 2017.

Special Analyses

I. *Regulatory Planning and Review and Regulatory Flexibility Act*

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

Under the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities that are directly affected by the final regulations. These final regulations update the 1992 Final Regulations to reflect statutory changes made by the TCJA, including the applicable interest rate to be used for purposes of section 846(c) based on a statutorily prescribed corporate bond yield curve. In addition, these final regulations do not impose a collection of information on any taxpayers, including small entities. Accordingly, this rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

II. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2018, that threshold is approximately $150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

III. *Executive Order 13132: Federalism*

Executive Order 13132 (titled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Drafting Information

The principal author of these regulations is Kathryn M. Sneade, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

The IRS notices and revenue procedures cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

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Adoption of Amendments 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 removing the entry for §1.846-2(d), removing the entry for §§1.846-1 through 1.846-4, and adding an entry in numerical order for §1.846-1. The addition reads in part as follows:

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

* * * * *

Section 1.846-1 also issued under 26 U.S.C. 846.

* * * * *

§1.846-0 [Removed]

Par. 2. Section 1.846-0 is removed.

Par. 3. Section 1.846-1 is amended by:

1. In the first sentence of paragraph (a)(1), removing "section 846(f)(3)" and adding in its place "section 846(e)(3)".
2. In the third sentence of paragraph (a)(1), removing the phrase "and §1.846-3(b) contains guidance relating to discount factors applicable to accident years prior to the 1987 accident year".
3. In paragraph (a)(1), removing the last sentence.
4. Removing paragraph (a)(2) and redesignating paragraphs (a)(3) and (4) as paragraphs (a)(2) and (3), respectively.
5. In the first sentence of paragraph (b)(1), removing "section 846(f)(6)" and adding "section 846(e)(6)" in its place; and removing ", in §1.846-2 (relating to a taxpayer's election to use its own historical loss payment pattern)".
6. In paragraph (b)(3)(i), removing "for accident years after 1987" from the heading.
7. In paragraph (b)(3)(ii), removing the designation "—(A)" and the paragraph heading "Accident years after 1991".
8. Removing paragraphs (b)(3)(ii)(B), and (b)(3)(iii) and (iv).
9. Removing paragraph (b)(4) and redesignating paragraph (b)(5) as paragraph (b)(4).
10. Adding paragraphs (c), (d), and (e).

The additions read as follows:

§1.846-1 Application of discount factors.

* * * * *

(c) *Determination of annual rate.* The applicable interest rate is the annual rate determined by the Secretary for any calendar year on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting "60-month period" for "24-month period" therein). The annual rate for any calendar year is determined on the basis of a yield curve that reflects the average, for the most recent 60-month period ending before the beginning of the calendar year, of monthly yields on corporate bonds described in section 430(h)(2)(D)(i). The annual rate is the average of that yield curve's monthly spot rates with times to maturity from four and one-half years to ten years.

(d) *Determination of loss payment pattern*—(1) *In general.* Under section 846(d)(1), the loss payment pattern determined by the Secretary for each line of business is determined by reference to the historical loss payment pattern applicable to such line of business determined in accordance with the method of determination set forth in section 846(d)(2) and the computational rules prescribed in section 846(d)(3) on the basis of the annual statement data from annual statements described in section 846(d)(2)(A) and (B). However, the Secretary may adjust the loss payment pattern for any line of business as provided in paragraph (d)(2) of this section.

(2) *Smoothing adjustments.* The Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one.

(e) *Applicability dates*. (1) Except as provided in paragraph (e)(2) of this section, this section applies to taxable years beginning after December 31, 1986.

(2) Paragraphs (c) and (d) of this section apply to taxable years beginning after December 31, 2017.

§1.846-2 [Removed]

Par. 4. Section 1.846-2 is removed.

§1.846-2T [Removed]

Par. 5. Section 1.846-2T is removed.

§1.846-3 [Removed]

Par. 6. Section 1.846-3 is removed.

§1.846-4 [Removed]

Par. 7. Section 1.846-4 is removed.

§1.846-4T [Removed]

Par. 8. Section 1.846-4T is removed.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: May 21, 2019.

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 13, 2019, 4:15 p.m., and published in the issue of the Federal Register for June 17, 2019, 84 F.R. 27947)

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26 CFR 1.170A-1(h)(3)(viii): Payments resulting in state and local tax benefits

T.D. 9864

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

Contributions in Exchange for State or Local Tax Credits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains a final regulation under section 170 of the Internal Revenue Code (Code). The final regulation provides rules governing the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit. This document also provides a final regulation under section 642(c) to apply similar rules to payments made by a trust or decedent's estate.

DATES: *Effective date*: These regulations are effective August 12, 2019.

Applicability dates: For dates of applicability, see §1.170A-1(h)(3)(viii) and §1.642(c)-3(g)(2).

FOR FURTHER INFORMATION CONTACT: Mon L. Lam or Richard C. Gano IV at (202) 317-4059 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 170(a)(1) generally allows an itemized deduction for any "charitable contribution" paid within the taxable year. Section 170(c) defines "charitable contribution" as a "contribution or gift to or for the use of" any entity described in that section. Under section 170(c)(1), such an entity includes a State, a possession of the United States, or any political subdivision of the foregoing, or the District of Columbia. Entities described in section 170(c)(2) include certain corporations, trusts, or community chests, funds, or foundations, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

To be deductible as a charitable contribution under section 170, a transfer to an entity described in section 170(c) must be a contribution or gift. A contribution or gift for this purpose is a voluntary transfer of money or property without the receipt of adequate consideration, made with charitable intent. In Rev. Rul. 67-246, 1967-2 C.B. 104, the Internal Revenue Service (IRS) addressed the taxpayer's burden of proof for establishing charitable intent when the taxpayer receives a privilege or benefit in conjunction with its contribution. In this revenue ruling, the IRS set out a two-part test for determining whether the taxpayer is entitled to a charitable contribution deduction under these circumstances. First, the taxpayer has the burden of proving that its payment to the charity exceeds the market value of the privileges or other benefits received. Second, the taxpayer must show that it paid the excess with the intention of making a gift.

In *United States v. American Bar Endowment*, 477 U.S. 105, 116-18 (1986), the Supreme Court elaborated on the test set out in Rev. Rul. 67-246. The Court interpreted the phrase "charitable contribution" in section 170 as it relates to the donor's receipt of consideration, and stated that the "*sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration." *Id*. at 118. The Court concluded that "[a] payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return," (*id*. at 116), (hereinafter referred to as the "*quid pro quo* principle"). The Court recognized that some payments may have a "dual character" — part charitable contribution and part return benefit. *Id*. at 117. The Court reasoned that in dual character cases "it would not serve the purposes of section 170 to deny a deduction altogether"; therefore, a charitable deduction is allowed, but only to the extent the amount donated or the fair market value of the property transferred by the taxpayer exceeds the fair market value of the benefit received in return, and only if the excess amount was transferred with the intent of making a gift. *Id*. See also *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989) (stating that Congress intended to differentiate between unrequited payments and payments made in return for goods or services). Because this inquiry focuses on the donor's expectation of a benefit, it does not matter whether the donor expects the benefit from the recipient of the payment or transfer, or from a third party. See, for example, *Singer Co. v. United States*, 449 F.2d 413, 422-23 (Ct. Cl. 1971); cited with approval in *American Bar Endowment*, 477 U.S. at 116-17.

In *Hernandez*, 490 U.S. at 690-91, the Supreme Court reaffirmed the *quid pro quo* standard articulated in *American Bar Endowment*. Specifically, the Court held that payments to a charity that entitled the taxpayers to receive an identifiable benefit in return for their money were part of a "quintessential *quid pro quo* exchange," and thus, were not contributions or gifts within the meaning of section 170. *Id*. at 691. In making this determination, the Court noted the importance of examining the "external features of a transaction," thereby "obviating the need for the IRS to conduct imprecise inquiries into the motivations of individual taxpayers." *Id*. at 690-91. Thus, both *American Bar Endowment* and *Hernandez* indicate that objective considerations guide the determination of whether the taxpayer purposely contributed money or property in excess of the value of any benefit received in return. In addition, these cases continue to recognize the requirement that the taxpayer have charitable intent. See *American Bar Endowment*, 477 U.S. at 118; *Hernandez*, 490 U.S. at 691.

Section 164 generally allows an itemized deduction for the payment of certain taxes, including state and local, and foreign, real property taxes; state and local personal property taxes; and state and local, and foreign, income, war profits, and excess profits taxes. Section 164(b)(6), as added by section 11042 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" ("the Act"), Pub. L. 115-97, limits an individual's deduction for the aggregate amount of state and local taxes paid during the calendar year to $10,000 ($5,000 in the case of a married individual filing a separate return). This limitation applies to taxable years beginning after December 31, 2017, and before January 1, 2026. This limitation does not apply to foreign taxes described in section 164(a)(3) or to any taxes described in section 164(a)(1) and (2) that are paid and incurred in carrying on a trade or business or an activity described in section 212.

In response to the new limitation under section 164(b)(6), some taxpayers are seeking to pursue tax planning strategies with the goal of avoiding or mitigating the limitation. These strategies rely on state and local tax credit programs under which states provide tax credits in return for contributions by taxpayers to or for the use of certain entities described in section 170(c). The use of state or local tax credits to incentivize charitable giving has become increasingly common over the past 20 years. Moreover, since the enactment of the limitation under section 164(b)(6), states and local governments have created additional programs intended to work around the new limitation on the deduction of state and local taxes.

The new limitation, and the resulting efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes, has generated increased interest in the question of whether a state or local tax credit should be treated as a return benefit – a *quid pro quo* – when received in return for making a payment or transfer to an entity described in section 170(c). The Treasury Department and the IRS did not publish formal guidance on this question before the enactment of the limitation under section 164(b)(6). In 2010, however, the IRS Chief Counsel advised that, under certain circumstances, a taxpayer may take a deduction under section 170 for the full amount of a contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. See CCA 201105010 (Oct. 27, 2010) ("the 2010 CCA"). IRS Chief Counsel has also taken the position in Tax Court litigation that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth includible in income under section 61 or an amount realized for purposes of section 1001. In these cases, the Tax Court agreed with the Chief Counsel's position. See, for example, *Maines v. Commissioner*, 144 T.C. 123, 134 (2015); *Tempel v. Commissioner*, 136 T.C. 341, 351-54 (2011); *aff'd sub nom*. *Esgar Corp. v. Commissioner*, 744 F.3d 648 (10th Cir. 2014).

Upon reviewing the authorities under section 170, the Treasury Department and the IRS questioned the reasoning of the 2010 CCA. On June 11, 2018, the Treasury Department and the IRS issued Notice 2018-54, 2018-24 I.R.B. 750, announcing the intention to propose regulations addressing the federal income tax treatment of contributions pursuant to state and local tax credit programs. On August 27, 2018, the proposed regulations (REG-112176-18) were published in the **Federal Register** (83 FR 43563).

The proposed regulations generally stated that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or *quid pro quo*, to the taxpayer and reduces the taxpayer's charitable contribution deduction. The proposed regulations included a separate rule for state and local tax deductions, providing that they do not constitute a *quid pro quo* unless they exceed the amount of the donor's payment or transfer. The proposed regulations also included an exception under which a state or local tax credit is not treated as a *quid pro quo* if the credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. Finally, the proposed regulations would amend §1.642(c)-3 to provide similar rules for payments made for a purpose specified in section 170(c) by a trust or decedent's estate.

The Treasury Department and the IRS received over 7,700 comments responding to the proposed regulations and 25 requests to speak at the public hearing, which was held on November 5, 2018. Copies of written comments received and the list of speakers at the public hearing are available for public inspection at www.regulations.gov or upon request. The comments and revisions are discussed generally in this preamble. After considering the comments received and the concerns expressed at the public hearing, the Treasury Department and the IRS adopt the proposed regulations with certain revisions explained subsequently.

Additionally, in response to concerns raised in comments, the Treasury Department and the IRS have issued other guidance providing safe harbors on certain issues. On December 28, 2018, the Treasury Department and the IRS issued Rev. Proc. 2019-12, 2019-04 I.R.B. 401, providing a safe harbor under section 162 for certain payments made by a C corporation or specified passthrough entity to or for the use of an organization described in section 170(c) if the C corporation or specified passthrough entity receives or expects to receive a state or local tax credit in return for such payment. On June 11, 2019, the Treasury Department and the IRS will have issued Notice 2019-12, 2019-27 I.R.B. 57, providing a safe harbor for payments made by certain individuals. Under the safe harbor, an individual who itemizes deductions and makes a payment to a section 170(c) entity in return for a state or local tax credit may treat the portion of such payment that is or will be disallowed as a charitable contribution deduction under section 170 as a payment of state or local tax for purposes of section 164. This disallowed portion of the payment may be treated as a payment of state or local tax under section 164 when and to the extent an individual applies the state or local tax credit to offset the individual's state or local tax liability. Notice 2019-12 requests comments for purposes of incorporating the safe harbor into anticipated proposed regulations under section 164. In general, the Treasury Department and the IRS will continue to consider comments and provide additional guidance in this area as needed.

Explanation of Provisions and Summary of Comments

Explanation of Provisions

The final regulations generally retain the proposed amendments set forth in the proposed regulations, with certain clarifying and technical changes. First, the final regulations retain the general rule that if a taxpayer makes a payment or transfers property to or for the use of an entity described in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit to the taxpayer, or *quid pro quo*, reducing the taxpayer's charitable contribution deduction.

Second, the Treasury Department and the IRS have concluded that state tax credits and state tax deductions should be treated differently in light of policy and tax administration considerations identified in the preamble of the proposed regulations. Accordingly, the final regulations retain the rule that a taxpayer generally is not required to reduce its charitable contribution deduction on account of its receipt of state or local tax deductions. However, the final regulations also retain the exception to this rule for excess state or local tax deductions. Specifically, the taxpayer must reduce its charitable contribution deduction if it receives or expects to receive state or local tax deductions in excess of the taxpayer's payment or the fair market value of property transferred by the taxpayer.

Third, the final regulations retain the 15-percent exception, under which a taxpayer may disregard state and local tax credits as a return benefit where such credits do not exceed 15 percent of the taxpayer's payment. However, the final regulations clarify that this 15-percent exception applies only if the sum of the taxpayer's state and local tax credits received, or expected to be received, does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer.

Fourth, the final regulations reflect the correction of a typographical error in §1.170A-1(h)(3)(i) of the proposed regulations. The introductory clause should refer to the 15-percent exception set forth in paragraph (h)(3)(vi), not paragraph (h)(3)(v). In addition, the final regulations clarify the terms used to describe entities that may receive charitable contributions under section 170(c). Specifically, the final regulations refer to entities "described" in section 170(c), rather than entities "listed" under section 170(c).

Finally, the final regulations include the proposed amendments to §1.642(c)-3 providing that the final rules under §1.170A-1(h)(3) apply to payments made by a trust or decedent's estate in determining its charitable contribution deduction under section 642(c).

Summary of Comments

1. *Comments in Support of the Proposed Regulations*

Approximately 70 percent of commenters recommended that the Treasury Department and the IRS finalize the proposed regulations without change. Some commenters characterized state and local tax credit programs as tax shelters and explained how taxpayers could use the programs to generate profits. A substantial number of commenters expressed concerns regarding the effect of these programs on public functions, including public education. Many commenters stated that the proposed regulations apply section 170 fairly. Many commenters noted that the proposed regulations applied to donations to organizations fulfilling both private and public purposes and applied to tax credit programs created both before and after the enactment of the Act. Some commenters stated that state tax credit programs are unfair to individuals who cannot afford to make the contributions and receive the benefit of the credits. Some commenters generally supported the proposed regulations, but provided more substantive comments regarding additional issues posed by the proposed regulations and requested additional guidance on those issues, either when finalizing the proposed regulations or in other guidance.

2. *Section 170 Regulations in Response to a Section 164 Amendment*

Many commenters wrote that it was improper for the Treasury Department and the IRS to issue regulations under section 170 in response to the enactment of section 164(b)(6). Commenters stated that any regulations must be issued under section 164 because an amendment to section 164 is driving the regulatory change.

The limitation under section 164(b)(6) is the impetus for the Treasury Department's and the IRS's consideration of the tax treatment of contributions made in exchange for state and local tax credits. Prior to the enactment of that limitation, the proper treatment of such contributions was of limited significance from a federal revenue perspective and tax administration perspective and was therefore never addressed in formal guidance. Upon careful review of the issue, the Treasury Department and the IRS have determined that longstanding principles under section 170 should guide the tax treatment of these contributions. Section 170 provides a deduction for taxpayers' gratuitous payments to qualifying entities, not for transfers that result in receipt of valuable economic benefits. In applying section 170 and the *quid pro quo* principle, the Treasury Department and the IRS do not believe it is appropriate to categorically exempt state or local tax benefits from the normal rules that apply to other benefits received or expected to be received by a taxpayer in exchange for a contribution. The final regulations are consistent with longstanding principles under section 170 and sound tax policy. Therefore, the regulations are issued under section 170, and not section 164.

3. *Treatment of State and Local Tax Credits as Return Benefits*

Commenters expressed differing views of the proposed regulation's requirement that a taxpayer reduce the taxpayer's charitable contribution deduction under section 170 by the total amount of state and local tax credits received or expected to be received. Many commenters agreed with the Treasury Department and the IRS that the *quid pro quo* principle should be applied to the receipt or expectation of receipt of state and local tax credits. However, some commenters questioned the application and effect of the *quid pro quo* principle under section 170 and the tax consequences of such application.

The Treasury Department and the IRS have determined that it is appropriate to apply longstanding principles under section 170 that require a taxpayer to reduce the amount treated as a charitable contribution by the value of the return benefit received. As discussed earlier in this preamble and in the preamble of the proposed regulations, the final regulations are consistent with the principle that a "payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." *American Bar Endowment*, 477 U.S. at 116. While the Supreme Court has not addressed the specific issue of contributions in exchange for state or local tax credits, the final regulations are a reasonable interpretation of section 170 that accords with the logic of *American Bar Endowment* and *Hernandez*. The final regulations are also supported by important tax policy considerations, including the need to prevent revenue loss from the erosion of the limitation under section 164(b)(6). Thus, the final regulations adopt the rule that the amount otherwise deductible as a charitable contribution under section 170 must generally be reduced by the total amount of state and local tax credits received or expected to be received.

a. *Prior Chief Counsel Advice Memoranda and case law*

Many commenters noted that the proposed regulations reflect a change in the IRS's treatment of charitable contributions that result in state or local tax credits. The commenters pointed to several CCAs issued by IRS Chief Counsel from 2002 to 2010. See, for example, the 2010 CCA (addressing contributions of money or property to governments or charitable entities under several state tax credit programs); CCA 200435001 (July 28, 2004) (reviewing a program issuing state tax credits in return for contributions to certain child care organizations); CCA 200238041 (July 24, 2002) (considering a program issuing tax credits in return for the transfer of conservation easements). The preamble to the proposed regulations noted that, in each of these CCAs, IRS Chief Counsel recognized the complexity of the federal tax law issues involving the tax treatment of the receipt or expectation of receipt of state tax credits, particularly where the tax credits are granted for transfers to section 170(c) entities. The preamble also noted that two of the CCAs declined to provide specific guidance on the availability of the charitable contribution deduction, and suggested the issuance of formal guidance to address this question. Although CCAs are released to the public under section 6110, they are not official rulings or positions of the IRS, and cannot be cited as precedent. See sections 6110(b)(1)(A) and 6110(k)(3).

The Treasury Department and the IRS acknowledge that the proposed and final regulations depart from the conclusion of the 2010 CCA in important respects. As noted in the Background section of this preamble, the 2010 CCA concluded that a taxpayer may take a deduction under section 170 for the full amount of a contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. The 2010 CCA, however, failed to persuasively explain why state and local tax credits should not count as return benefits for purposes of applying the *quid pro quo* principle. The 2010 CCA cited cases in which courts had found that a donor's subjective motivation to minimize taxes is not a basis for disallowing a charitable deduction, but these cases did not specifically address whether the value of state or local tax credits should be treated as a *quid pro quo* that reduces the amount of the deduction. See *McLennan v. United States*, 24 Cl. Ct. 102,106 n.8 (1991); *Skripak v. Commissioner*, 84 T.C. 285, 319; *Allen v. Commissioner*, 92 T.C. 1, 7 (1989). The 2010 CCA also cited a case in which the value of a tax deduction was not treated as income under section 61, but that case did not address the application of the *quid pro quo* principle under section 170. See *Browning v. Commissioner*, 109 T.C. 303 (1997). Furthermore, the analysis in the 2010 CCA assumed that after the taxpayer applied the state or local tax credit to reduce the taxpayer's state or local tax liability, the taxpayer would receive a smaller deduction for state and local taxes under section 164. With the enactment of section 164(b)(6), that assumption no longer holds true for the vast majority of taxpayers. The changes in the tax laws reduce the number of taxpayers who will itemize deductions, and for taxpayers who itemize and have state and local tax liabilities above the new limitation, the use of the tax credit would not reduce the deduction for state and local taxes.

In light of the section 164(b)(6) limitation, the Treasury Department and the IRS have specifically considered the application of the *quid pro quo* principle to state and local tax credit programs. After careful consideration of comments submitted in response to the proposed regulations, the Treasury Department and the IRS have determined that it is appropriate to treat the receipt or the expectation of receipt of state and local tax credits as return benefits. As discussed previously in this preamble, the final regulations are supported by the Supreme Court's interpretation of the term "charitable contribution" under section 170. In *American Bar Endowment*, 477 U.S. at 118, the Court stated that the "*sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration"—that is, without the expectation of a *quid pro quo*. Thus, the Court held that a "payment of money generally cannot constitute a charitable contribution if the contributor expects a substantial benefit in return." *Id*. at 116. The Supreme Court reaffirmed this principle in *Hernandez*, 490 U.S. at 690-91, and this principle has been consistently applied by the courts in subsequent decisions. See, for example, *Rolfs v. Commissioner*, 135 T.C. 471 (2010), *aff'd*, 668 F.3d 888 (7th Cir. 2012) (holding that taxpayers were not entitled to a charitable contribution deduction for the donation of their lake house because they did not show that the market value of the property they donated exceeded the market value of the benefit (demolition services) they received in return); *Triumph Mixed Use Investments III, LLC v. Commissioner*, T.C. Memo. 2018-65 (holding that value of real property and development credits transferred by taxpayer to city in return for development plan approvals was not deductible under section 170 because taxpayer expected a return benefit); *Pollard v. Commissioner*, T.C. Memo. 2013-38 (holding that petitioner's granting of conservation easements to the county was part of a quid pro quo exchange for the county's approval of the taxpayer's subdivision exemption request, a substantial benefit to the taxpayer).

This treatment is consistent not only with the purpose of section 170, but also with the section 164(b)(6) limitation. If the Treasury Department and the IRS were to allow taxpayers to claim a full charitable contribution deduction for contributions made in exchange for state tax credits, this treatment would result in significant federal tax revenue losses that would undermine the limitation on the deduction for state and local taxes in section 164(b)(6). Such an approach would enable taxpayers to characterize payments as fully deductible charitable contributions for federal income tax purposes, while using the same payments to satisfy their state tax liabilities. As a result, the final regulations reject the 2010 CCA's conclusion that the contribution deduction does not need to be reduced by the value of the state and local tax credit received or expected to be received.

Commenters also cited recent cases, such as *Maines v. Commissioner* and *Tempel v. Commissioner*, to conclude that the receipt of a state or local tax credit is, for federal tax purposes, a reduction or potential reduction in the taxpayer's state or local tax liability and not a payment includible in the taxpayer's gross income. *Maines*, 144 T.C. at 134 (citing *Randall v. Loftsgaarden*, 478 U.S. 647, 657 (1986)); *Tempel*, 136 T.C. at 350; see also Rev. Rul. 79-315, 1979-2 C.B. 27 (Holding (3) (amounts credited against unpaid tax is neither includible in taxpayer's income nor deductible as a state income tax paid)). The analysis for determining whether an item is included in gross income is separate and distinct from the analysis for determining whether a payment or transfer is a deductible contribution under section 170. Section 61(a) provides that gross income "means all income from whatever source derived" unless otherwise provided in Subtitle A, Income Taxes. In contrast, to be deductible as a charitable contribution under section 170, a transfer to an entity described in section 170(c) must be a contribution or gift, without the expectation or receipt of a return benefit. Neither *Maines* nor *Tempel* addressed whether a taxpayer's expectation or receipt of a state or local tax credit may reduce a taxpayer's charitable contribution deduction under section 170, and therefore, these cases are not relevant for purposes of interpreting section 170.

Some commenters cited *Arizona Christian School Tuition Organization v. Winn*, 563 U.S. 125, 142-44 (2011), to support their position that the regulations should permit a full charitable contribution deduction when amounts are contributed to a charitable organization, even if the donor receives tax credits in return. While that case involved the types of contributions affected by the proposed regulations, the Court did not address whether such contributions are deductible under section 170 or whether the contributors received a substantial benefit in exchange for their contributions.

b. *Tax consequences of quid pro quo benefits*

Some commenters pointed out that the proposed regulations failed to fully address the tax consequences of treating tax credits as *quid pro quo* benefits and suggested that additional guidance is needed. For example, commenters noted that the proposed regulations did not address the tax treatment of the sale, use, or lapse of the credits. In particular, commenters suggested that additional guidance may be needed to clarify application of the rules under sections 61, 164, 1001, and 1012 to the receipt, expectation of receipt, or use of tax credits. The Treasury Department and the IRS agree with commenters that additional guidance is necessary to address these complex issues.

Regarding the treatment of return benefits under section 164, the Treasury Department and the IRS issued Notice 2019-12 on June 11, 2019. As discussed previously in this preamble, Notice 2019-12 provides a safe harbor under section 164 for an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit. The Treasury Department and the IRS will continue to consider comments regarding other tax consequences of treating tax credits as *quid pro quo* benefits and will provide additional guidance as needed.

c. *Application of substance over form doctrine*

Some commenters suggested that the proposed regulations should have relied in whole or in part on the substance over form doctrine rather than the *quid pro quo* principle. Under a substance over form approach, commenters explained, the proposed regulations could treat contributions to funds established by state or local government entities in exchange for tax credits as, in substance, a payment of taxes to those government entities. These commenters stated that by relying on the substance over form doctrine, the proposed regulations could have been more easily tailored to address only those contributions paid to funds established to assist taxpayers in avoiding the limitation on state and local tax deductions. The commenters also stated that a focus on contributions to funds established by state and local government entities would more directly target the potential revenue loss.

The Treasury Department and the IRS have considered the substance over form doctrine in analyzing the proper tax treatment of contributions in exchange for tax credits, but have ultimately decided that, as a general matter, the application of the *quid pro quo* principle provides a more sound, comprehensive, and administrable approach. While a payment made to a state (or to an entity designated by the state) in exchange for a tax credit might in some circumstances seem similar to a payment of tax under section 164, the analysis raises additional issues and finds less support under other substance over form authorities. Specifically, this approach would result in the significant expansion in the definition of "tax" under section 164, would raise questions involving the proper timing of deductions for such payments, and would result in different treatments for similarly situated taxpayers. Furthermore, even if the substance over form doctrine were applied to treat payments or transfers to certain organizations as a payment of taxes, the proper treatment of these amounts under section 170, including the application of the *quid pro quo* principle, would continue to be relevant for taxpayers that make payments or transfers to certain charities in return for tax credits. The Treasury Department and the IRS have determined that the tax laws and sound tax policy support the treatment of a state tax credit as a return benefit that reduces the amount of the taxpayer's charitable contribution deduction under section 170, regardless of whether the entity to which the contribution is made is controlled by a state or local government. The *quid pro quo* principle is applicable to contributions made to all types of donee entities. Section 170(c) provides an expansive list of the types of entities to which a taxpayer may contribute and receive a charitable contribution deduction. This list includes organizations controlled by state or local governments. If a contribution is made to or for the use of any such entity, the contribution may qualify as a charitable contribution, provided it meets all other requirements.

Moreover, a substance over form approach would not fully address concerns raised by commenters regarding state and local tax credit programs. Such programs can be used to generate tax benefits in excess of the amount the taxpayer contributes to the charitable organization, regardless of whether the contribution is made to an entity controlled by a state or local government. Finally, the Treasury Department and the IRS have serious concerns about the practicability of delineating clear and administrable criteria for distinguishing between state and local government entities and section 170(c)(2) organizations that are closely connected to state and local governments.

d. *Quid pro quo provided by third party*

Some commenters expressed a belief that under current law a *quid pro quo* received or expected to be received by a taxpayer does not reduce the taxpayer's charitable contribution deduction if the *quid pro quo* comes from a party that is not the donee. Based on that belief, these commenters concluded that a tax credit from a state or local government should not reduce the charitable contribution deduction for a payment to a section 170(c)(2) organization. At least one commenter recommended that where contributions are made to section 170(c)(2) entities in exchange for tax credits provided by the state or local government, the benefit should be treated as income to the donor.

In support of this position, many commenters referred to §1.170A-1(h)(1) (payment in exchange for consideration) and §1.170A-13(f)(6) (defining "in consideration for" as a donee organization providing goods and services in consideration for taxpayer's payment). One commenter expressed the view that the *quid pro quo* analysis cannot be applied to contributions to charitable organizations other than state or government entities because when a taxpayer makes a contribution to a charity, but receives consideration from a third party such as the state, the transaction cannot be characterized as a purchase. Commenters suggested that the language in the proposed regulations at §1.170A-1(h)(3)(iii) creating an exception from the "in consideration for" language of §1.170A-13(f)(6) for state or local tax credits provided by third parties is evidence that the proposed regulations depart from established law. Commenters suggested, as an alternative, that the final regulations set forth a general rule applying *quid pro quo* principles to benefits a taxpayer receives from any source, regardless of whether the benefits are provided by the donee or a third party. That rule would be applicable in determining if there is any *quid pro quo* under section 170 in all contexts, not just when a taxpayer receives state or local tax credits.

Section 1.170A-1(h)(1) provides that no part of a payment that a taxpayer makes to or for the use of an organization described in section 170(c) that is in consideration for (as defined in §1.170A-13(f)(6)) goods or services (as defined in §1.170A-13(f)(5)) is a contribution or gift within the meaning of section 170(c) unless the taxpayer (i) intends to make a payment in an amount that exceeds the fair market value of the goods or services; and (ii) makes a payment in an amount that exceeds the fair market value of the goods or services. Section 1.170A-1(h)(2) states that the charitable contribution deduction under section 170(a) may not exceed the amount of cash paid or the fair market value of property transferred to an organization over the fair market value of goods or services the organization provides in return. Section 1.170A-13(f)(5) defines goods or services as cash, property, services, benefits, and privileges, and §1.170A-13(f)(6) provides that a donee provides goods or services in consideration for a taxpayer's payment if, at the time the taxpayer makes a payment to the donee, the taxpayer receives or expects to receive goods or services in exchange for that payment.

The Treasury Department and the IRS acknowledge that the current regulations do not address situations in which the benefits a donor receives or expects to receive come from a third party. While the proposed regulations modify the existing regulations to address the specific case of payments in exchange for tax credits, the Treasury Department and the IRS intend to propose additional regulations setting forth a general rule for all benefits received or expected to be received from third parties, not just tax credits. In the interim, the final regulations regarding tax credits specify an exception to the existing definition of "in consideration for." However, the application of the *quid pro quo* principle to benefits received or expected to be received from third parties is consistent with existing law.

In *American Bar Endowment* and *Hernandez*, the Supreme Court made clear that a payment is not a charitable contribution if the donor expects to receive a substantial benefit in return. *American Bar Endowment*, 477 U.S. at 116-17; *Hernandez*, 490 U.S. at 691-92. The source of the return benefit is immaterial from the donor's financial perspective. The *quid pro quo* principle is thus equally applicable regardless of whether the donor expects to receive the benefit from the donee or from a third party. In either case, the donor's payment is not a charitable contribution or gift to the extent the donor expects a substantial benefit in return.

The Supreme Court in *American Bar Endowment* and *Hernandez* did not directly address the question of third party benefits because the return benefits at issue in those cases were provided by the donees. The Court derived its *quid pro quo* principle in part from a lower court decision and a revenue ruling that had addressed the question. See *American Bar Endowment*, 477 U.S. at 117 (citing *Singer*, 449 F.2d 413 (Ct. Cl. 1971) and Rev. Rul. 67-246); *Hernandez*, 490 U.S. at 691 (citing *Singer*). In *Singer v. United States*, the appellate division of the Court of Claims (the predecessor to the Federal Circuit) held that a sewing machine company was not eligible for a charitable contribution deduction for selling sewing machines to schools at a discount because the company "expected a return in the nature of future increased sales" to students. *Singer*, 449 F.2d at 423–24. In so holding, the court expressly rejected the company's argument that this expected benefit should be ignored because it came from the students (*i.e.*, third parties), rather than directly from the schools. *Id*. at 422-23. The court stated, "Obviously, we cannot agree with plaintiff's distinction." *Id*. Similarly, in Rev. Rul. 67-246, Example 11, a local department store agreed to award a transistor radio, worth $15, to each person who contributed $50 or more to a specific charity. The ruling concluded that if a taxpayer received a $15 radio as a result of a $100 payment to the charity, only $85 qualified as a charitable contribution deduction. It did not matter that the donor received the $15 radio from the department store, a third party, rather than from the charity. This understanding guides the IRS's audit practices. See IRS Conservation Easement Audit Techniques Guide (Rev. Jan. 24, 2018, p. 16) (stating that a "quid pro quo contribution is a transfer of money or property partly in exchange for goods or services in return from the charity or a third party", and "a quid pro quo may be in the form of an indirect benefit from a third party").

The Treasury Department and the IRS conclude that, under the most logical and consistent application of existing law, a charitable contribution deduction is reduced by any consideration a donor receives or expects to receive, regardless of whether the donee is the party from whom consideration is received or expected to be received. To conclude otherwise would provide incentives for taxpayers, charitable organizations, states, and localities to structure transactions involving third party benefits to bypass the requirements to reduce contribution deductions by the value of benefits received or expected to be received. Accordingly, the Treasury Department and the IRS do not adopt the recommendation of the commenters to limit application of the final regulations to circumstances in which a tax credit is provided by the donee, and as noted previously, the Treasury Department and the IRS intend to propose amendments to the existing regulations to make clear that the *quid pro quo* principle applies regardless of whether the party providing the *quid pro quo* is the donee.

4. *Comments on Section 164(b)(6)*

A number of commenters stated that the section 164(b)(6) limitation favors low-tax states, is a form of double taxation, or infringes on states' rights. These comments regarding the statutory limitation itself are beyond the scope of the proposed regulations.

5. *Conservation Easement Contributions*

A large number of comments from conservation easement donors, land trusts, and government entities involved in conservation easement donations were specific to conservation easements. Conservation easement comments that relate to the applicability date of the regulations are addressed under the "Applicability Dates" heading later in this section.[1]

One group of comments relating to conservation easements expressed the view that donations of conservation easements to land trusts should be excluded from the rules in the final regulations because of the importance of land conservation, because Congress has provided extra incentives for contributions of conservation easements over the years, and because easement donations are not intended as section 164(b)(6) workarounds. The Treasury Department and the IRS recognize that conservation easements provide unique and perpetual benefits that are accorded favorable tax treatment by state governments as well as by Congress. Specifically, Congress treats deductions for conservation easement contributions more favorably than other charitable contribution deductions in some contexts, such as the percentage limitation and carryover rules.

The final regulations do not adopt this suggestion. These regulations are based on longstanding rules of general applicability relating to *quid pro quo* and charitable intent, and there is no authority under section 170 that would void the application of the *quid pro quo* principle and charitable intent doctrine to donors of conservation easements.

A second group of comments state that determining the value of a conservation easement tax credit may be difficult for donors and also for donees who prepare contemporaneous written acknowledgments. In at least one state, easement donors receive a property tax credit for each of the years that they continue to own the underlying property. Commenters stated that it is unknowable at the time of the donation how many years the donor would be eligible for the property tax credit or how to value a right to a tax credit that could continue many years into the future. Also, an expected credit may not necessarily be granted, may be granted in a subsequent tax year, may be subsequently reduced, or might never be used or transferred. The Treasury Department and the IRS understand that in some cases taxpayers may never receive the maximum credit. Nevertheless, it is well settled that an expectation of a return benefit negates the requisite charitable intent, and the regulations apply that rule. The final regulations at §1.170A-1(h)(3)(iv) state that the reduction in the amount treated as a charitable contribution is an amount equal to the maximum credit allowable that corresponds to the amount of the taxpayer's payment or transfer. If there is no clear maximum credit allowable, taxpayers may reduce their charitable contribution deduction using a good faith estimate of the value of the credit.

A third group of comments noted that conservation easement donors who sell their credit should get basis in the credit equal to the amount of the reduction in the charitable contribution deduction. A number of states have conservation easement tax credit programs that allow the donor to sell the credit. Under existing case law, an easement donor has no gain or loss on receipt of a credit but recognizes capital gain upon its sale. See, for example, *Tempel v. Commissioner*, 136 T.C. at 354-55 (concluding that conservation easement donors had no basis in the tax credits that they sold). The Treasury Department and the IRS agree with this comment that this basis issue warrants additional consideration. Although the basis issue is beyond the scope of these regulations, the Treasury Department and the IRS intend to consider this issue for future guidance.

6. *Taxpayers at or Below the Section 164(b)(6) Limit*

A number of commenters recommended that the Treasury Department and the IRS revise how the proposed regulations apply to taxpayers whose state and local tax deduction is at or below the $10,000 limit in section 164(b)(6). Under the proposed regulations, a taxpayer who itemizes and is not subject to the alternative minimum tax (AMT), and whose state or local tax deduction is at or below $10,000, may have adverse federal tax consequences. This taxpayer may have made a nondeductible contribution (in exchange for state or local tax credits) in lieu of a fully or partially deductible payment of state or local tax. Accordingly, some commenters

[1]Although commenters used the term "effective date," it is clear that commenters were referring to the "applicability date" as the term is used herein.

recommended that taxpayers whose state and local tax liabilities fall at or below the $10,000 limit be allowed to deduct contributions made in exchange for state or local tax credits up to $10,000. Some commenters recommended allowing these taxpayers to deduct the contributions only when the taxpayers' contributions are to the state (as opposed to an entity described in section 170(c)(2)). Other commenters recommended allowing the deduction only when the taxpayers' contributions are to a state or local tax credit program that was in existence as of December 22, 2017, the date of the enactment of the Act. Many commenters cited case law, legislative intent, and general principles of fairness. Several commenters suggested further study or exceptions for taxpayers with state and local tax liabilities below the $10,000 limit. These commenters were concerned that the impact to these taxpayers may be greater than the Treasury Department forecasted. After considering these comments, the Treasury Department and the IRS published a notice of intent to propose regulations, Notice 2019-12, providing a safe harbor, as discussed previously in this preamble.

7. *Application of Section 162 for Business Taxpayers*

Some commenters stated that business taxpayers are treated more favorably than others because business taxpayers may be able to claim deductions for payments to section 170(c) entities as ordinary and necessary business expenses under section 162. These commenters are correct that taxpayers engaged in a trade or business may be permitted a section 162 deduction for amounts paid to charitable organizations in some circumstances. See, for example, *Marquis v. Commissioner*, 49 T.C. 695 (1968) (taxpayer's cash payments to clients that were charitable entities furthered her travel agency business and were therefore not subject to the limitations of section 170). However, some commenters raised questions regarding whether a payment for a tax credit would always bear a direct relationship to a taxpayer's business.

A few commenters opined that the proposed regulations further escalate the disparate treatment of charitable contributions by individual wage earners as compared to similar contributions by passthrough entities and their members who are individuals. These commenters noted that the limitation imposed by section 164(b)(6) does not apply to state or local real or personal property taxes paid or accrued in carrying on a trade or business or an activity described in section 212. As a result of this exception to the limitation under section 164 and the availability of business expense deductions under section 162, commenters stated that a taxpayer-owner of a passthrough entity will continue to receive the benefits of an allocable share of tax credits received by the passthrough entity. In addition, commenters pointed out that several states have enacted or considered enacting legislation that shifts state taxes from individuals to passthrough entities and entitles the owners to claim a credit on the owner's state tax return for the amount of the owner's distributive share of taxes paid by the passthrough entity.

The proposed and final regulations apply to charitable contributions by business taxpayers. Specifically, a business taxpayer, like an individual taxpayer, must reduce the charitable contribution deduction by the amount of any return benefit received or expected to be received. Thus, the commenters' concerns do not result from disparate treatment of business taxpayers under section 170, but rather result from the application of sections 162 and 164, including application of the limitation under section 164(b)(6) to passthrough entities and their owners. The Treasury Department and the IRS recognize that the final regulations may raise additional questions regarding the application of sections 162 and 164 to business entities that make payments to section 170(c) entities and that receive or expect to receive state or local tax credits in return for such payments. In response to these questions, the Treasury Department and the IRS published Rev. Proc. 2019-12, as previously discussed in this preamble, which provides safe harbors under section 162 for certain payments made by C corporations or specified passthrough entities. Neither the final regulations nor the safe harbors in the revenue procedure otherwise affect the availability of a business expense deduction under section 162 for payments that are ordinary and necessary expenses incurred in carrying on a trade or business. The Treasury Department and the IRS will continue to study comments involving the effect of the final regulation on various business entities and will provide additional guidance as needed.

8. *Disclaiming the Tax Credit*

If a taxpayer properly declines receipt of a benefit, the taxpayer will not be treated as receiving or expecting to receive the benefit, and the charitable contribution deduction will not be reduced by the amount of the benefit. See Rev. Rul. 67-246, 1967-2 C.B. 104, 108, Example 3 (taxpayer who wants to support charity, but does not intend to use the ticket offered in return for his donation, may refuse to accept the ticket and receive a charitable contribution deduction unreduced by the value of the ticket). A number of commenters asked for guidance on how a taxpayer may decline receipt of state or local tax credits. Although not specifically stated in the regulations, taxpayers who prefer to claim an unreduced charitable contribution deduction have the option of not applying for a state or local income tax credit where such an application is required in order to receive the credit. Alternatively, taxpayers may apply for a lesser amount of the credit. The Treasury Department and the IRS request comments as to how taxpayers may decline state or local tax credits in other situations.

9. *Cliff Effect of the 15-Percent Exception*

The proposed regulations include an exception under which a taxpayer may disregard a state or local tax credit if the credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. A number of commenters stated that the 15-percent exception results in an unfair "cliff effect" because credits above 15 percent do not receive the benefit of this exception. The commenters note that this unfairness is most significant where credits only exceed 15 percent by a small amount. A number of commenters suggested that an amount equal to the first 15 percent of all credits should be disregarded. Commenters also noted that the proposed regulations penalized donors of smaller amounts because 15 percent of a large payment results in a much larger amount covered by the exception than 15 percent of a small payment. Commenters also noted that a 15-percent exception would typically permit a deduction for an amount that is more than the amount treated as *de minimis* under the rules of section 170. See, for example, Rev. Proc. 90-12, 1990-1 C.B. 471 (providing guidelines for determining whether the provision of small items or benefits of token value in return for a contribution have insubstantial value such that the contribution is fully deductible under section 170). On the other hand, some commenters requested that a higher percentage be treated as *de minimis*.

The suggestion to disregard an amount equal to 15 percent of the donor's transfer or otherwise change the 15-percent exception was not adopted. The 15-percent exception was designed to provide consistent treatment for state or local tax deductions and state or local tax credits that provide a benefit that is generally equivalent to a deduction. The 15-percent exception is intended to reflect the combined benefit of state and local tax deductions, that is, the combined top marginal state and local tax rates, which the Treasury Department and the IRS understand currently do not exceed 15 percent. The Treasury Department and the IRS considered tailoring this exception to the combined marginal state and local tax rates applicable for a taxpayer's particular jurisdiction. The Treasury Department and the IRS determined that using a single rate sufficient to cover the highest existing marginal rates would avoid the complexity and burden that would arise if a taxpayer had to compute the sum of the taxpayer's state and local marginal tax rates to determine whether the tax credit received exceeded the benefit that the taxpayer would have received as a deduction. The exception ensures that taxpayers in states offering state tax deductions and taxpayers in states offering economically equivalent credits are treated similarly. This exception is not intended to be an application of the *de minimis* standard for insubstantial or inconsequential benefits under Rev. Proc. 90-12, 1990-1 C.B. 471.

10. *Application to State and Local Tax Deductions*

Some commenters expressed concern that the proposed regulations do not apply the *quid pro quo* analysis to state and local tax deductions. These concerns reflect the view that the *quid pro quo* analysis under section 170 is equally applicable to tax benefits in the form of state or local tax deductions as it is to state or local tax credits. As noted in the preamble to the proposed regulations, the Treasury Department and the IRS believe that considerations of tax policy and sound tax administration do not support the application of *quid pro quo* principles in the case of dollar-for-dollar state or local tax deductions. The economic benefit of a dollar-for-dollar deduction is limited because it is based on a taxpayer's state and local marginal rate. Therefore, the risk of a taxpayer using such deductions to circumvent section 164(b)(6), and the potential revenue loss, is comparatively low. This is true even in high tax states. In addition, if state and local tax deductions for charitable contributions were treated as return benefits, it would make the accurate calculation of federal taxes and state and local taxes difficult for both taxpayers and the IRS. For example, the value of a deduction would vary based on the taxpayer's marginal state and local tax rates, making for more complex computations and adding to administrative and taxpayer burden. Also, many states use federal taxable income as the starting point for computing state taxable income, and the amount reported as a charitable contribution deduction on a taxpayer's federal tax return is typically the amount of the deduction on the taxpayer's state tax return. Allowing an unreduced federal charitable contribution deduction even though a state provides a similar deduction in measuring state taxable income would avoid administrative complications. Accordingly, a dollar-for-dollar state or local tax deduction does not raise the same concerns as a state or local tax credit, and it would produce unique complications if it were to be subject to the *quid pro quo* principle. Thus, the final regulations allow taxpayers to calculate their federal tax deductions without regard to their dollar-for-dollar state and local tax deductions. However, the Treasury Department and the IRS are concerned that the granting of state or local tax deductions in excess of the amounts paid or the fair market value of property transferred to an entity described in section 170(c) could result in more substantial economic benefits to the taxpayer and should be treated as a *quid pro quo*. Accordingly, the final regulations also retain the exception to general rule for excess state or local tax deductions.

Some commenters also contended that the proposed regulations disfavor state and local governments relative to the federal government. These commenters noted that the proposed regulations do not require a taxpayer to reduce the taxpayer's charitable contribution deduction by the value of the federal tax deduction. However, as discussed in the prior paragraph, the final regulations do not treat state charitable contribution deductions any differently than federal charitable contribution deductions. Under the final regulations neither state nor federal charitable contribution deductions are treated as return benefits in determining the taxpayer's charitable contribution deduction under section 170. The economic benefit of a state or federal charitable contribution deduction is limited because both are based on a taxpayer's marginal tax rate. In addition, there is minimal risk that a taxpayer will use either of these deductions to circumvent section 164(b)(6), and the potential revenue loss, in both cases, is comparatively low. Furthermore, unlike state or local governments, Congress would not be motivated to enact a provision enabling an excess charitable contribution to circumvent its other federal tax laws. Thus, the final regulations specifically address the workarounds stemming from taxpayer's use of state and local tax credit programs, but continue to provide parallel treatment of both federal and state charitable contributions deductions.

11. *Contributions to Foreign Charitable Organizations*

A small number of commenters expressed the view that the proposed regulations favor payments to foreign charities. Charitable contributions made to foreign organizations generally are not deductible for federal income tax purposes. See section 170(c)(2). Moreover, in the limited situations where these deductions are allowed, taxpayers are treated as if they are making such contributions to entities that are organized in the United States, and accordingly, such contributions would be subject to the rules and regulations under section 170. As a result, while tax credits provided by foreign governments for contributions to foreign charities are outside the scope of the final regulation, if the taxpayer is seeking to deduct such charitable contributions under section 170, the *quid pro quo* principle set out under section 170 would be equally applicable.

12. *Valuation and Substantiation of the Credits*

Commenters expressed concerns about the challenges for taxpayers and donees in determining the value of a state or local tax credit. Under the proposed regulations, a taxpayer needs to know the "maximum credit allowable" that corresponds to the amount of the taxpayer's transfer to the donee. This amount would typically be the stated amount of the credit, and unless the 15-percent exception applies, the taxpayer's charitable contribution deduction would generally be reduced by this amount. However, if the credit does not have a clear maximum credit allowable, a taxpayer's good faith estimate of the value will satisfy the rules of the final regulations.

Commenters have also expressed concerns about substantiation of a charitable contribution when the donee does not know whether the donor expects to receive a state or local tax credit. If a donee is not the entity providing the credit, the contemporaneous written acknowledgment rules do not require that the amount of the credit be reported in the acknowledgment. See section 170(f)(8) (stating that a contemporaneous written acknowledgment includes a statement of whether the donee provided goods and services and if so, includes a good faith estimate of the value of those goods or services). Further, under §1.170A-13(f)(5), goods and services include benefits.

One commenter asked about compliance with section 6115, which generally requires donee disclosures in connection with *quid pro quo* contributions (as defined in section 6115(b)), and specifically requires section 170(c) organizations (but not section 170(c)(1) entities) to provide donors with a good faith estimate of the value of goods or services they provide. If a section 170(c)(2) organization is not providing the state or local tax credit to the donor, section 6115 does not apply. Accordingly, there is no section 6115 requirement for section 170(c)(2) organizations to disclose information about a tax credit provided by a state or local government.

13. *Regulatory Flexibility Act*

Some commenters stated that the Regulatory Flexibility Act (5 U.S.C. chapter 6) ("RFA") applies to the regulations because small tax-exempt organizations and small governmental jurisdictions would be affected by the proposed regulations due to a potential reduction in contributions. These commenters recommended that the final regulations contain a RFA analysis. Other commenters noted that some donors may be small entities affected by the regulation. The Treasury Department and the IRS do not agree that a RFA analysis is required. The organizations and small governmental jurisdictions that receive deductible contributions as part of a state or local tax credit program are not subject to the proposed regulations, and any potential effect on contributions to these organizations is an indirect effect of the regulation. The RFA does not apply to entities indirectly affected by the regulation. See, for example, *Cement Kiln Recycling Coalition v. EPA*, 255 F.3d 855, 868 (D.C. Cir. 2001); *Mid-Tax Elec. Coop v. FERC*, 773 F.2d 327 (D.C. Cir. 1985). For small entities that are donors, and potentially subject to the regulations, the regulations do not impose more than nominal costs and do not impose a collection of information requirement.

14. *Concerns About Reduced Charitable Giving*

A large number of commenters expressed concern that the proposed regulations would result in an overall decline in charitable giving. Many of the commenters expressed concern about the impact of the regulations on particular charities or types of charities. A large number of comments were received on tax credit programs that encourage contributions to organizations that help fund public and private school programs. A number of commenters were concerned that the proposed regulations would decrease education opportunities for impoverished and special needs children in grades K-12. Some commenters suggested that the final regulations apply only to contributions to governments or government entities and not to private school organizations, while others suggested postponing the applicability date of final regulations to allow time to study the effects on scholarship granting organizations. A few commenters expressed a concern that the proposed regulations may result in a decrease in donations to scholarship granting organizations and increase the burden on public schools, given that private schools may not be able to provide as many scholarships to low-income students. Other commenters expressed concern that some state or local tax credit programs unfairly incentivize contributions to private organizations, thus diverting resources from public functions, such as public schools.

Other commenters recommended that donations of conservation easements should be exempted from the rules in the regulations. Commenters representing land trusts expressed concern that the regulations would reduce the number of donated conservation easements, thereby reducing the ability of the federal government, state and local governments, and land trusts to conserve in perpetuity significant natural lands, water, and habitats. A commenter noted the needs of struggling farmers and other landowners who might not be able to afford to donate a conservation easement without a state tax credit. Some commenters observed that because of the significance of land conservation, Congress has already provided special incentives for conservation easement donations under section 170, and the commenters suggested the Treasury Department and the IRS follow Congress's lead by making an exception in the final regulations for donations of conservation easements.

Commenters from health care organizations, such as rural hospital foundations, expressed concern that the proposed regulations would reduce charitable giving for health care, reducing the ability of health care organizations to offset rising medical costs and declining patient revenue. Other commenters expressed concerns that the proposed regulations would undermine state programs that offer tax credits for contributions supporting a variety of local initiatives, including public arts, education, health, human services, environment, enterprise zones, and community betterment. Other commenters were concerned about the effect of the regulations on child care programs. A few commenters opined that the proposed regulations would further strain state and local finances that are already adversely impacted by the new limitation on deductions of state or local taxes. The commenters stated that the new limitation would potentially force states and localities to confront difficult choices regarding tax rates and public services. In addition, several commenters suggested that the Treasury Department and the IRS adopt a facts-and-circumstances test to differentiate between tax credit programs that are consistent with state and federal policy goals and those that are designed for tax avoidance.

The Treasury Department and the IRS recognize the importance of the federal charitable contribution deduction, as well as state tax credit programs, in encouraging charitable giving. The final regulations continue to allow a charitable contribution deduction for the portion of a taxpayer's charitable contribution that is a gratuitous transfer, and the regulations also leave unchanged the state-level benefit provided by state tax credits. In combination with Notice 2019-12, the regulations will not alter the charitable giving incentives for the overwhelming majority of taxpayers as compared to the incentives under federal tax law prior to enactment of section 164(b)(6). As discussed previously in this preamble, Notice 2019-12 provides a safe harbor for certain individual taxpayers who itemize deductions and who make payments to a section 170(c) entity in return for a state or local tax credit. Under the safe harbor, these individuals may treat the portion of such payment that is or will be disallowed as a charitable contribution deduction under section 170 as a payment of state or local tax for purposes of section 164. Notice 2019-12 will mitigate the impact of the final regulations on state or local tax credit programs that incentivize giving to all section 170(c) entities, including entities supporting educational scholarship programs, child care, public health, and other important goals. Thus, the impact on taxpayers' choices will be small.

The final regulations apply longstanding principles regarding charitable intent and *quid pro quo*, and therefore treat all contributions to entities described in section 170(c) similarly. Those principles apply equally to all charitable contributions, regardless of the charitable purpose or type of donee. Accordingly, the final regulations do not adopt a facts-and-circumstances test or a test based on the type of section 170(c) organization.

15. *Programs in Existence Before the Act*

A large number of commenters suggested that the final regulations exempt tax credit programs that were established before the date of the enactment of section 164(b)(6). The commenters noted that the pre-existing programs could not have been intended as section 164(b)(6) workarounds. Other commenters explained that many taxpayers made payments or transfers to existing programs in anticipation of receiving state or local tax credits as well as deductions, and the regulations would cause financial hardships. Further, some commenters expressed an opinion that the regulations are politically motivated, allegedly targeting states and localities with high tax rates. Commenters also stated that exempting pre-existing programs would not lead to an unanticipated revenue loss because revenue implications were known when the Act was enacted.

The regulations are based on longstanding federal tax law principles that apply equally to all taxpayers. To ensure fair and consistent treatment, the final regulations do not distinguish between taxpayers who make transfers to state and local tax credit programs enacted after the Act and those who make transfers to tax credit programs existing prior to the enactment of the Act. Neither the intent of the section 170(c) organization, nor the date of enactment of a particular state tax credit program, are relevant to the application of the *quid pro quo* principle. Accordingly, the final regulations apply the rules equally to all state and local tax credit programs, and the final regulations do not adopt commenter recommendations to create exceptions to the general rule for various types of state tax credit programs.

Regarding the comment on revenue implications for pre-existing programs, state and local governments have the ability to change the parameters, including the aggregate dollar amount of credits, of these programs. In addition, as noted previously, some states and taxpayers have pursued tax planning strategies through the use of pre-existing state or local tax credit programs that would have the effect of allowing taxpayers to deduct their payments of state and local taxes in excess of the limitation under section 164(b)(6). These strategies would increase the revenue loss to the federal government beyond estimates when the Act was enacted.

16. *Applicability Date*

A number of commenters requested a delayed applicability date, or in the alternative, a phased-in implementation of the proposed regulations. The majority of these commenters requested an applicability date of January 1, 2019. Others suggested dates of up to five years after the enactment of the Act, and still others did not propose a specific date. Some commenters requested a delayed applicability date with respect to all tax credit programs, while others requested a delayed applicability date for only certain tax credit programs.

Many commenters requesting a delayed applicability date expressed concern about the adverse impact on state scholarship tax credit programs. Some commenters noted that a phased-in implementation or delayed applicability date may minimize uncertainty for students. Commenters also described the application process for certain state tax credit programs, requesting a delayed applicability date of October 31, 2018, or December 31, 2018, to ensure that states would have sufficient time to inform applicants as to whether their applications were accepted, and to provide applicants with sufficient time to make contributions prior to the date of applicability of the proposed regulations.

Some commenters requested a delayed applicability date of January 1, 2019 or

2020, for conservation easement donations. These commenters stated that donations of conservation easements are unique in that they are time-consuming and costly for donors to plan for and finalize. For example, a conservation easement donor may have to expend tens of thousands of dollars to hire an appraiser, an attorney, a surveyor, and in some jurisdictions, pay an application fee. Also, it takes many months, sometimes more than a year, for the donor to take all the necessary steps to contribute an easement that is deductible under section 170(h) and also creditable under state law, and many easements are donated at the end of the calendar year. The commenters stated that the mid-year applicability date in the proposed regulations has created complexity for taxpayers.

These suggestions were not adopted. The Treasury Department and the IRS continue to believe that the proposed applicability date of August 27, 2018, provides maximum certainty for taxpayers making contributions in exchange for state and local tax credits and minimizes revenue loss. If the proposed applicability date had not been contemporaneous with the proposed regulations, the Treasury Department and the IRS believe that taxpayers would have engaged in significant tax planning in advance of the regulations being finalized, resulting in a significant loss of revenue. Additionally, Notice 2018-54, released May 23, 2018, gave taxpayers timely notice that formal guidance was forthcoming. It would be inequitable to revise the applicability date at this point, as some taxpayers have made decisions regarding their charitable contributions based on the applicability date in the proposed regulations. Finally, any delay in applying the rules of the final regulation would potentially undermine the purposes of the limitation in section 164(b)(6).

Special Analyses

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This rule has been designated as subject to review under Executive Order 12866 (EO 12866) pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. OMB has determined that the rule is economically significant and therefore subject to review under section 1(c) of the Memorandum of Agreement (MOA). Elsewhere in the Special Analyses, the economic effects of the rule are analyzed in conjunction with Notice 2019-12, which provides a safe harbor that taxpayers may immediately rely upon and that likely diminishes the effects of the rule. OMB has made its determination based only on the economic effects of the rule. This rule is a regulatory action under Executive Order 13771.

The following analysis provides further detail regarding the anticipated impacts of the rule. Part I explains the need for the rule. Part II specifies the baseline for the economic analysis. Part III summarizes the economic effects of the rulemaking, relative to this baseline. Part IV provides illustrative scenarios. Part IV.A describes the tax effects of charitable contributions prior to enactment of the statutory limitation on deductions for state and local taxes under section 164(b)(6) (the "SALT limitation") in the Act. Part IV.B provides examples comparing the tax effects of charitable contributions after enactment of the SALT limitation, but absent the rule (the baseline) to the tax effects under the rule and notice. Finally, Part V provides a qualitative assessment of the potential costs and benefits of the rule and notice compared to the baseline.

I. *Need for Regulation*

This regulation provides guidance on the deductibility of charitable contributions when a taxpayer receives or expects to receive a corresponding state or local tax credit. The regulation is intended to clarify the relationship between the federal charitable contribution deduction under section 170 and the recently enacted SALT limitation. Compelling policy considerations reinforce the interpretation and application of section 170 in this context. Disregarding the value of state and local tax credits received or expected to be received in return for charitable contributions would precipitate revenue losses that would undermine the limitation on the deduction for state and local taxes adopted by Congress under the Act.

In this regard, the Treasury Department and the IRS note that the Joint Committee on Taxation (JCT) estimated that the limitation on state and local tax deductions along with certain other reforms of itemized deductions would raise $668 billion over ten years. See Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act,'" JCX-67-17, December 18, 2017, at https://www.jct.gov/publications.html?func=startdown&id=5053. A substantial amount of this revenue would be lost if state tax benefits received in exchange for charitable contributions were ignored in determining the charitable contribution deduction. This estimate is not a revenue estimate of the rule, in part because it includes other reforms of itemized deductions but does not reflect certain other provisions of the Act. In addition, this does not represent an estimate of the non-revenue economic effects of the rule. Still, the JCT estimate provides a rough upper bound of the potential revenue loss and individual contribution choices at stake in this rulemaking.

II. *Baseline*

Prior to the proposed and final regulation, the Treasury Department and the IRS had not issued formal guidance on the deductibility of contributions to entities described in section 170(c) that give rise to state or local tax credits. There was also no guidance, aside from Notice 2018-54, addressing the interaction between section 170 and the newly enacted SALT limitation. As a result, there was a degree of taxpayer uncertainty as to whether state and local tax credits were a return benefit that reduces a taxpayer's charitable contribution deduction, and absent further guidance, taxpayers would likely have taken different filing positions. For informational and analytical purposes, however, this analysis assumes as a baseline that state and local tax credits are generally not treated as a return benefit or consideration and therefore do not reduce the taxpayer's charitable contribution deduction under section 170(a). The illustrative scenarios presented below make use of alternative baseline scenarios to provide clarity on the incremental impacts arising out of the rule and notices.

III. *Summary of Economic Effects*

Section 2 of the MOA stipulates that tax regulations that are likely to have a non-revenue effect on the economy of $100 million or more (identified in section 1(c) of the MOA) will be subject to the analytical requirements applicable to significant regulations under section 6(a)(3)(B) of EO 12866, as well as the additional requirements applicable to economically significant regulations under section 6(a)(3)(C) of EO 12866. Those requirements entail an assessment of potential costs and benefits of significant regulatory actions. Section 6(a)(3)(C) of EO 12866 also states that to the extent feasible, quantitative assessments including the underlying analyses for a non-inclusive list of factors shall be provided for the costs and benefits of rules that have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy or certain aspects of the economy.

At the proposed rule stage, the Treasury Department and the IRS determined that the proposed rulemaking would not result in costs, benefits, or non-revenue transfers in excess of $100 million per year, and thus would not be economically significant. However, the Treasury Department and the IRS acknowledge that there is limited quantitative data available for purposes of evaluating economic effects. Given the level of public interest and engagement, and possible economic and/or behavioral impact, including to individuals' contribution choices, beyond what can be reasonably anticipated with quantitative methods and available data, the final rule has been designated by OMB as economically significant, and it is therefore subject to the analytical requirements for an economically significant rule.

The Treasury Department and the IRS note, however, that the non-revenue impacts of the final rule could be below the economically significant threshold, especially when the potential effects are considered in conjunction with Notice 2019-12, which is to be issued with the final rule. The requirements in the Notice have not been finalized or incorporated into this final rulemaking, but as noted earlier in this preamble, the Treasury Department and the IRS anticipate issuing a proposed rule formalizing the guidance in the Notice shortly after this final rule is issued.

The Treasury Department and the IRS expect that the main effect of this rulemaking with Notice 2019-12 would be to reduce the incentive for individual taxpayers to reallocate state and local taxes from general public funds to funds designated for specific public purposes, solely to generate a charitable gift for federal tax purposes. These transfers from one public fund to another would not be substantive in nature and therefore are not anticipated to generate real economic effects. The rulemaking with Notice 2019-12 would also increase compliance and administrative costs for some taxpayers and charitable entities but decrease them for others. As discussed in Part V of the Special Analyses, the Treasury Department and the IRS expect these effects are likely small and, on net, expect a reduction in compliance burdens (because fewer transactions performed solely for tax avoidance will be undertaken).

The rulemaking with Notice 2019-12 may also marginally reduce the incentive to make contributions to charitable organizations that result in state and local tax credits, which may have the effect of reducing aggregate contributions. But the Treasury Department and the IRS expect this effect to be small. For example, for an individual taxpayer who claims itemized deductions on a Federal income tax return, has more than $10,000 of state and local tax liability, and has a Federal marginal tax rate of 24%, a $1,000 contribution to an organization described in section 170(c) that gives rise to a dollar-for-dollar state tax credit in exchange for the contribution yields a combined $1,240 of tax benefits under the baseline ($240 from the deduction under section 170(a) and $1,000 from the state tax credit). Under the rulemaking with Notice 2019-12, the same $1,000 contribution yields only $1,000 in tax benefits. A substantial incentive to give to the organization still exists (as the cost of giving is $0), though that incentive is reduced because of the rulemaking.

In addition, the direct incentive to make contributions to organizations that do not give rise to state or local tax credits is unchanged by the rulemaking with Notice 2019-12. The reduction in the relative benefit of contributing to organizations that result in state or local credits might induce some taxpayers to contribute to other organizations instead. However, this effect may be modest because the tax benefit of donating to an organization eligible for a large state tax or local credit is still greater than the benefit of donating to another charitable organization. (See column A versus column B for each example in Table 1.) Moreover, transfers between similar charitable organizations (or between the state and a charitable organization generating a state or local tax credit) might have little or no effect on the ultimate beneficiaries of the charitable organizations or on consumers of public goods.

As noted earlier, EO 12866 calls for quantitative analysis to the extent feasible. One commenter to the proposed regulations also stated that the analyses should have included quantitative estimates of the costs and benefits of the rule, including estimates of the potential size of state and local tax credits, federal revenue losses, and efficiency losses. The commenter further stated that without quantitative estimates it is not known "whether the potential problem is significant enough to justify this change in tax regulations."

The Treasury Department and the IRS provide in this Special Analyses an economic analysis, including to the extent feasible, quantitative estimates that offer context regarding the scope of possible impacts arising out of these final regulations. In particular the Treasury Department and the IRS provide examples of how different types of taxpayers would or would not be affected by this rulemaking as well as estimates of the shares of taxpayers potentially affected by the rulemaking with Notice 2019-12. However, because taxpayers do not report whether a charitable donation has given rise to a state or local tax credit, the extent to which states would create new tax credit programs and taxpayers would make contributions to such programs under the baseline or regulations is uncertain, and the extent to which the welfare of the ultimate beneficiaries of such charitable contributions or state spending is uncertain, the Treasury Department and the IRS have not quantified the non-revenue economic effects of the rule.

IV. *Illustrative Scenarios*[2]

For the following illustrative scenarios, assume the following facts: Charitable organizations A and B are entities described in section 170(c) and are equally efficient in providing similar public goods. Contributions to charity A are eligible for a dollar-for-dollar state tax credit. Contributions to charity B are ineligible for this credit but are deductible from state taxable income. The taxpayer itemizes deductions, and these itemized deductions in aggregate are at least $1,000 more than the standard deduction. The taxpayer has the choice to contribute $1,000 to charity A, and this $1,000 contribution generates a state tax credit of $1,000.[3] That is, the tax credit is dollar-for-dollar but does not otherwise figure into the calculation of the taxpayer's state tax liability. The taxpayer has more than $1,000 of state tax liability, so that the taxpayer's state tax liability is reduced by the entire $1,000 of the state tax credit. Finally, if the taxpayer makes the $1,000 contribution that generates a state tax credit of $1,000, the taxpayer reduces by $1,000 the withholding and payments of state tax during the taxable year in question. The state tax liability is therefore reduced by the full amount of the state tax credit in the same taxable year as the contribution is made.[4] Further assume a taxpayer is in the 24 percent federal tax bracket, itemizes federal tax deductions, and has a state tax rate of 5 percent. If the taxpayer is subject to the AMT, assume an AMT marginal tax rate of 26 percent.

The Act, this rule, and the safe harbor for certain individuals described in Notice 2019-12 alter the incentives some taxpayers face about whether and how much to give to organizations that receive charitable contributions, as well as to which organizations. This is illustrated in the following scenarios, which are also summarized in Table 1.

A. *Prior law: Section 170 Charitable Contributions Prior to the Act*

The tax effects of contributions prior to enactment of the Act are illustrated in the columns labeled "Prior Law" in Table 1.

1. *Taxpayer not subject to the AMT*

Prior to enactment of the Act, if the taxpayer made a $1,000 contribution to charity A that generated a state tax credit of $1,000, the deduction for charitable contributions under section 170(a) increased by $1,000, and the taxpayer's liability for state and local taxes deductible under section 164 decreased by $1,000. The taxpayer's itemized deductions, taxable income, and federal tax liability were unchanged from what they would have been in the absence of the contribution.[5] The taxpayer's state tax liability decreased by $1,000 because of the state tax credit. The combined federal and state tax benefits of the $1,000 contribution were therefore $1,000, and the cost to the taxpayer and to the federal government of making the contribution was $0. This is shown in column A under Prior Law for Example 1 in Table 1 and replicated in the same column for Example 2.

2. *Taxpayer subject to the AMT*

If the taxpayer were subject to the AMT under section 55, however, there was a net benefit to the taxpayer from contributions to charity A, which provided state tax credits. State and local taxes are not deductible in determining taxable income under the AMT, but charitable contributions are deductible in determining taxable income under the AMT. If the taxpayer contributed $1,000, taxable income under the AMT was reduced by $1,000 due to the charitable contribution deduction under section 170, but there was no corresponding reduction in the deduction for state and local taxes. Under an AMT marginal tax rate of 26 percent, the federal tax benefit of this $1,000 contribution would be $260. Because of the dollar-for-dollar state tax credit, the taxpayer received a combined federal and state tax benefit of $1,260 for a $1,000 contribution; that is, the taxpayer received $260 *more* in tax benefits than the amount of the contribution. This is shown in column A under Prior Law for Example 3 in Table 1.

3. *Comparison of contributions to different organizations under prior law*

In combination, state and federal tax laws generally provide a greater incentive to contribute to organizations eligible for state tax credits (charity A) than to other organizations (charity B). The effects of a contribution to charity A are described in Parts IV.A1 and IV.A2 previously.

Prior to enactment of the Act, for a taxpayer not subject to the AMT, a $1,000 contribution to charity B yielded a smaller combined federal and state tax benefit than to charity A. The state tax benefit was $50 ($1,000 multiplied by the 5 percent state tax rate). The taxpayer's itemized deductions at the federal level increased by $950 (the $1,000 charitable contribution deduction less the $50 reduction in state taxes paid). The federal tax benefit of this increase was $228 ($950 multiplied by the 24 percent federal tax rate), resulting in a combined federal and state tax benefit

[2]While the illustrative scenarios and the analysis that follow focus on individual taxpayers, the final regulations also apply to business taxpayers. Businesses making payments to entities described in section 170(c), however, may deduct certain of these payments as ordinary and necessary business expenses under section 162. In addition, Rev. Proc. 2019-12, 2019-04 I.R.B. 401, provides safe harbors under section 162 for certain payments by businesses. Therefore, the Treasury Department and the IRS expect that few business donors would be impacted by the final regulations.

[3]Note that this analysis only addresses state tax credits offering a 100% benefit. The results may differ for credits offering a lower benefit, but the comparative results of the illustrative examples would be similar.

[4]The results of the examples are generally unchanged if the taxpayer instead receives the credit as a refund of state taxes paid that were deducted from federal taxable income, as such refund would be includible in federal taxable income in the following year.

[5]This assumes the taxpayer was not subject to limitations such as the overall limitation on itemized deductions under section 68 or subject to a percentage limitation for the deduction under section 170, an assumption that is maintained throughout the succeeding discussion.

of $278. The net cost to the taxpayer of the $1,000 contribution was $722. This is shown in column B under Prior Law for Example 1 in Table 1 and replicated in the same column for Example 2.

For a taxpayer subject to the AMT, a $1,000 contribution to charity B yielded a combined federal and state benefit of $310—the $1,000 contribution multiplied by the taxpayer's marginal tax rate under the AMT of 26 percent, or $260, plus the value of the deduction from state tax, or $50 ($1,000 multiplied by the 5 percent state tax rate). The net cost to the taxpayer of the $1,000 contribution was $690. This is shown in column B under Prior Law for Example 3 in Table 1.

Contributing to either charity A or charity B reduced the taxpayer's combined federal and state tax liability, but the existence of the state tax credit for contributions to charity A made contributions to that organization more attractive. This is seen by comparing the Total Tax Benefit in column A under Prior Law to the corresponding value in column B for each of the three examples. For taxpayers not subject to the AMT, contributions to charity A yielded a combined federal and state tax benefit of $1,000, compared to a combined federal and state tax benefit of $278 for a contribution to charity B. The AMT increased the disparity for contributions to charity A versus charity B, resulting in a combined federal and state tax benefit of $1,260 for a contribution to charity A versus $310 for a contribution to charity B.

B. *Examples of current law and practices under the Act and final rule with Notice 2019-12*

The enactment of the SALT limitation in the Act has, in limited circumstances, altered the federal tax effects of charitable contributions as described in the following examples. These are illustrated in the columns labeled "Baseline" and "Final Rule with Notice 2019-12" in Table 1.

1. *Example 1: Taxpayer is above the SALT limitation and not subject to the AMT*

a. *Baseline*

If a taxpayer who has a state tax liability of more than $1,000 above the SALT limitation and is not subject to the AMT makes a $1,000 contribution to charity A, the deduction for charitable contributions under section 170(a) increases by $1,000, but the deduction for state and local taxes paid under section 164 is unchanged. Consequently, itemized deductions increase by $1,000, and taxable income decreases by $1,000. If the taxpayer is in the 24 percent bracket, federal liability will decrease by $240, and state tax liability will decrease by the $1,000 state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $1,240, and the taxpayer receives a $240 net benefit while the federal government has a loss of $240. This is shown in column A under Baseline for Example 1 in Table 1.

b. *Final Rule with Notice 2019-12*

If the same taxpayer makes the $1,000 contribution to charity A under the rule with Notice 2019-12, the entire $1,000 contribution is not deductible under section 170(a), and the deduction for state and local taxes paid under section 164 is unchanged due to the SALT limitation. The taxpayer's itemized deductions, taxable income, and federal tax liability are unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by $1,000 because of the state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $1,000, or $240 less than under the baseline. This is shown by comparing the Total Tax Benefit in column A under Final Rule with Notice 2019-12 with the corresponding value in column A under Baseline for Example 1 in Table 1. However, the benefit of the contribution for this taxpayer is the same as the taxpayer faced prior to enactment of the Act. This is shown by comparing the Total Tax Benefit under column A under Final Rule with Notice 2019-12 with the corresponding value in column A under Prior Law for Example 1 in Table 1.

c. *Comparison of contributions to different organizations and final rule with Notice 2019-12*

Under the baseline and this rule with Notice 2019-12, for a taxpayer with state and local taxes paid over the SALT limitation, the value of a contribution to charity B, that is a contribution that results in a one-for-one state income tax deduction and not a state tax credit, is slightly higher than it was pre-Act. This increase is because the state deduction does not reduce the federal deduction for state and local taxes for a taxpayer above the SALT limitation. As shown in the Total Tax Benefit row under the B columns for Example 1, under the baseline and this rule with Notice 2019-12, the value of a $1,000 contribution to charity B is $290—the charitable contribution deduction from federal tax ($1,000 multiplied by the 24 percent federal tax rate, or $240), plus the value of the deduction from state tax ($1,000 multiplied by the 5 percent state tax rate, or $50)—compared to $278 for contributions under prior law (described in Part IV.A3 previously). By comparison, as shown in the Total Tax Benefit row under the A columns for Example 1, a contribution to charity A, eligible for a state tax credit, yields a $1,240 tax benefit under the baseline and a $1,000 benefit under this rule with Notice 2019-12.

2. *Example 2: Taxpayer is below the SALT limitation and not subject to the AMT*

a. *Baseline*

If a taxpayer who has state and local taxes paid below the SALT limitation and is not subject to the AMT makes the $1,000 contribution to charity A, the deduction for charitable contributions under section 170(a) increases by $1,000, and the deduction for state and local taxes paid under section 164 decreases by $1,000. The taxpayer's itemized deductions, taxable income, and federal tax liability are unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by $1,000 because of the state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $1,000, and the cost to the taxpayer and to the federal government of making the contribution is $0. This situation is identical to prior law or what the taxpayer faced prior to enactment of the Act. This is shown is column A under Baseline and Prior Law for Example 2 in Table 1.

b. *Final rule with Notice 2019-12*

If the same taxpayer makes the $1,000 contribution to charity A under the proposed rule, the entire $1,000 contribution is not deductible under section 170(a), but the deduction for state and local taxes paid under section 164 still decreases by $1,000 because of the $1,000 state tax credit. If the taxpayer is in the 24 percent bracket, the federal tax liability will increase by $240. The taxpayer's state tax liability decreases by the $1,000 state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $760, or $240 less than the baseline. This is shown by comparing the Total Tax Benefit in column A under Proposed Rulemaking with the corresponding value in column A under Baseline for Example 2. In this case, the proposed rule has the effect of increasing the taxpayer's federal taxable income compared to the baseline if the taxpayer makes a contribution to charity A.

One commenter to the proposed regulations suggested that Example 2 be revised to indicate that the purported donation is a tax for purposes of section 164 if the state is the donee. As noted earlier in the preamble, that issue is outside of the scope of these regulations, but the Treasury Department and the IRS have issued Notice 2019-12, which provides a safe harbor for certain individuals. As described earlier in the preamble, under the safe harbor, an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit may treat the portion of such payment that is disallowed as a charitable contribution deduction under section 170 as a payment of state or local tax for purposes of section 164. This disallowed portion of the payment may be treated as a payment of state or local tax under section 164 when the individual applies the credit to offset the individual's state or local tax liability.

Under the final rule with Notice 2019-12, if the same taxpayer makes the $1,000 contribution to charity A, the entire $1,000 contribution is not deductible under section 170(a), but the deduction for state and local taxes paid under section 164 is unchanged because of the safe harbor. The taxpayer's federal liability is unchanged. The taxpayer's state tax liability decreases by the $1,000 state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $1,000, the same as under prior law and the baseline. This is shown by comparing the Total Tax Benefit in column A under Final Rule with Notice 2019-12 with the corresponding value in column A under Baseline for Example 2.

c. *Comparison of contributions to different organizations, under prior law, baseline, and final rule with Notice 2019-12*

Under the baseline scenario and this final rule with Notice 2019-12, the tax benefit of charitable contributions to charity B, which are not eligible for a state tax credit but are deductible from both federal and state taxable income, is unchanged from prior law for taxpayers below the SALT limitation. Thus, in this example, the benefit of making a contribution to charity B remains $278, as described previously. This is shown in the Total Tax Benefit row under the B columns for Example 2. By comparison, as shown in the Total Tax Benefit row under the A columns for Example 2, a $1,000 contribution to charity A, eligible for a state tax credit, yields a $1,000 tax benefit under the baseline and under the final rule with Notice 2019-12. Under the final rule with Notice 2019-12 contributions to charity A are less costly than contributions to charity B in the same manner as under prior law for taxpayers with itemized state and local tax deductions of $10,000 or less.

3. *Example 3: Taxpayer is subject to the AMT*[6]

a. *Baseline*

If a taxpayer subject to the AMT makes a $1,000 contribution to charity A, the contribution reduces the taxpayer's taxable income under the AMT by $1,000. Using an AMT marginal tax rate of 26 percent, the federal tax benefit of this $1,000 contribution is $260. Because of the dollar-for-dollar state tax credit, the taxpayer would receive a combined federal and state tax benefit of $1,260 for a $1,000 contribution, or a $260 net benefit. This result is identical to the result under prior law (prior to enactment of the Act). This is shown in the A columns under Baseline and Prior Law for Example 3 in Table 1.

b. *Final Rule with Notice 2019-12*

If the same taxpayer makes the $1,000 contribution to charity A under the final rule with Notice 2019-12, the entire $1,000 is not deductible under section 170(a). Therefore, the taxpayer's taxable income and federal tax liability under the AMT would be unchanged from what they would be in the absence of the contribution. The taxpayer's state tax liability decreases by $1,000 because of the state tax credit. The combined federal and state tax benefits of the $1,000 contribution are therefore $1,000, or $260 less than under the baseline and under the law prior to enactment of the Act. This is shown by comparing the A columns of Example 3 in Table 1. However, under the rule, taxpayers subject to the AMT are in the same position as other taxpayers making a $1,000 contribution to charity A. This is shown by comparing the Total Tax Benefit amount under column A for the Final Rule with Notice 2019-12 for Example 3 to that for Examples 1 and 2.

c. *Comparison of contributions to different organizations, under prior law, baseline and final rule with Notice 2019-12*

Under the baseline and the final rule with Notice 2019-12, the treatment of charitable contributions that are deductible from both federal and state taxable income is unchanged from prior law for taxpayers subject to the AMT. This is shown

[6]The Act increased the amount of income exempt from AMT. The Treasury Department estimates that in 2018 only about 150,000 taxpayers will be subject to the AMT under the Act, compared to more than 5 million under prior law.

in the B columns for Example 3 in Table 1. In this example, the benefit of making a contribution to charity B remains $310, as described previously for contributions under prior law. By comparison, a contribution to a charity A, eligible for a state tax credit, yields a $1,260 tax benefit under the baseline and a $1,000 benefit under the final rule with Notice 2019-12. This is shown in column A under Baseline and Final Rule with Notice 2019-12 for Example 3 in Table 1.

4. *Example 4: State tax credit of 15 percent or less*

Suppose, for this example only, that contributions to charity A generate a state tax credit with a rate of 10 percent, instead of 100 percent as described in Examples 1 through 3. If a taxpayer makes the $1,000 contribution to charity A under the final rule with Notice 2019-12, the deduction for charitable contributions under section 170(a) increases by $1,000. The deduction under section 170(a) is not reduced by the value of the credit because it does not exceed 15 percent. Thus, the taxpayer's federal tax liability is the same under the final regulations as under the baseline. The result is also the same as it would have been if the taxpayer's marginal state tax rate were 10 percent and the taxpayer were allowed a dollar-for-dollar deduction from state taxable income instead of a credit.

If the taxpayer is above the SALT limitation or subject to the AMT, the taxpayer's taxable income under the regular tax and under the AMT decreases by $1,000. If the taxpayer is not subject to the AMT and is in the 24 percent bracket, federal tax liability will decrease by $240, and state tax liability will decrease by $100. The combined federal and state tax benefits of the $1,000 contribution are therefore $340. If the taxpayer is subject to the AMT and has an AMT marginal tax rate of 26 percent, federal tax liability will decrease by $260, and state tax liability will decrease by $100, yielding a combined federal and state benefit of $360 for the $1,000 contribution.

If the taxpayer is below the SALT limitation, the taxpayer's deduction for state and local taxes treated as paid under section 164 decreases by $100, and the taxpayer's taxable income decreases by $900. If the taxpayer is in the 24 percent bracket, federal tax liability will decrease by $216, and state tax liability will decrease by $100. The combined federal and state tax benefits of the $1,000 contribution are therefore $316.

V. *Expected Benefits and Costs*

A. *Benefits*

This regulation likely reduces economically inefficient choices motivated by the potential tax benefits available if this regulation were not promulgated. Under the prior law and baseline scenarios, state and local governments have an incentive to fund governmental activities through entities that are eligible to receive deductible contributions and to establish tax credits. This incentive is particularly strong under a SALT limitation scenario where state and local governments may do so solely to enable some taxpayers to circumvent the SALT limitation. The final rule with Notice 2019-12 substantially diminishes this incentive to engage in economically inefficient tax-avoidance behavior. As a result, it is expected that fewer such credit programs would be established in the future under the rule than under the baseline.

To the extent this result occurs, the Treasury Department and the IRS estimate that this rule would reduce the overall complexity burden for states and for taxpayers who would otherwise make charitable contributions solely for the purpose of reducing their state and local tax liability. In addition, the Treasury Department and the IRS anticipate that the rule will also spare some taxpayers compliance costs associated with complex tax planning designed to avoid the SALT limitation.

In addition, the rule is expected to make the federal tax system more neutral to taxpayers' decisions regarding making donations to state and local tax credit programs versus making donations to other, similar charitable organizations that do not give rise to state or local tax credits. Under the baseline scenarios, the combined federal and state tax benefits favor contributions to organizations that give rise to a state tax credit for taxpayers, particularly for taxpayers above the SALT limitation. Under the final rule and Notice 2019-12, this economic distortion is expected to be reduced.

The proposed regulations requested comments from the public on the potential extent of this expected reduction in economic distortion. One commenter responded that increased neutrality in the treatment of contributions to organizations that qualify for tax credits and those that do not is not a benefit of the rule. The commenter argued that such a conclusion ignores the possibility that tax credit programs provide a social benefit. The conclusion in the proposed regulations does not ignore the social benefits that tax credit programs might provide. The Treasury Department and the IRS have clarified in Part IV previously that their analysis was specific to cases where two organizations, one eligible for tax credits and the other not, are equally efficient in their provision of similar public goods. That is, both provide the same social benefit given the same level of contributions.

Finally, the final rule provides more certainty to taxpayers by clarifying the rules governing the amount that they can claim as a charitable contribution deduction when they receive or expect to receive a state or local tax credit or a state or local tax deduction in exchange for the contribution.

One commenter asserted that increased certainty is not a benefit of this rule because other possible rules could also have provided certainty. While the commenter is correct that rules other than the proposed and final rule could also provide certainty, it remains the case that the proposed and final rule provide the benefit of certainty, relative to the baseline of no regulatory guidance at all.

One commenter suggested that the proposed rule would be beneficial because it would promote more efficient state and local spending decisions by making taxpayers bear more of the true cost of those decisions. The SALT limitation imposed by the Act reduced the federal subsidy of state and local spending, and the rule is consistent with this purpose of the Act provision. The reduction in the subsidy has the potential to make state spending decisions more efficient.

B. *Costs*

The rule may result in some increase in compliance costs for taxpayers who make contributions that generate state or local tax credits. Under the baseline, for purposes of the charitable contribution deduction under section 170(a), taxpayers did not need to address state or local tax credits received or expected to be received for purposes of claiming a charitable contribution; however, they would know the amount of credits received as part of the filing process for state returns. In contrast, under the final rule with Notice 2019-12, taxpayers making a contribution to an organization described in section 170(c) will need to determine the amount of any state or local tax credits they received or expect to receive in order to reduce their charitable contribution deduction under section 170(a). This additional step will generate some additional compliance costs.

The compliance burden for recipient organizations that directly issue tax credits may increase under the rule. Under section 170(f)(8), in order to take a charitable contribution deduction of $250 or more, a taxpayer must have a contemporaneous written acknowledgment (CWA) from the donee entity, usually provided in the form of a letter. The CWA includes the amount received by the entity or a description of property received. The CWA must also disclose whether the donee provided any goods or services in consideration for the contribution and a description and good faith estimate of the value of those goods or services. State and local tax credits are not generally provided by the donee entity, but there may be situations in which the entity would be providing the credit and would need to disclose the credit amount in the CWA provided to the donor. The proposed regulations requested comments on whether additional guidance is needed on substantiation and reporting requirements for donors and donees making or receiving payments or transfers of property in return for state and local tax credits and the extent to which entities do provide tax credits under certain circumstances. As mentioned earlier in this preamble, some commenters expressed concerns about substantiation of a charitable contribution when the donee does not know whether the donor receives or expects to receive a state or local tax credit. If a donee is not the entity providing the credit, the CWA rules do not require that the amount of the credit be reported in the acknowledgment. This mitigates the compliance burden for these entities.

The proposed regulations requested comments as to how the rule might alter incentives regarding contributions to state and local tax credit programs. As mentioned previously in the preamble, many commenters expressed concern that the rule would result in an overall decline in charitable giving and in declines in charitable giving to entities or causes they deem to be particularly meritorious. One commenter expressed concern about the lack of evidence provided in support of the statement that this rule will have at most a highly limited, marginal effect on taxpayer decisions to donate to tax credit programs, and the statement that most taxpayers have never contributed to such programs. Another commenter asserted that the rule would cause states to drop tax credit programs that support conservation easements. The commenter noted that this was particularly likely to occur in low-tax states, where more taxpayers will have SALT deductions under $10,000. Several other commenters asserted that a substantial share of donors to tax credit organizations would be affected by the rule.

Based on an analysis of confidential taxpayer return data and forecasts using that data, the Treasury Department and the IRS estimate that this rule will leave charitable giving incentives entirely unchanged for the vast majority of taxpayers. The Treasury Department and the IRS estimate that, after passage of the Act (which significantly increased the standard deduction), 90 percent of taxpayers will not claim itemized deductions of any kind. Those taxpayers are entirely unaffected by this rule.

Approximately five percent of taxpayers are projected to claim itemized deductions and have state and local income tax deductions in excess of the SALT limitation. Under the rule and Notice 2019-12, taxpayers in this group who are not subject to the AMT will receive the same federal tax treatment for donating to organizations providing tax credits as they received prior to the Act, as shown in Example 1 in Table 1 of this special analysis.

Approximately five percent of taxpayers are projected to claim itemized deductions and have SALT deductions below the limitation. Taxpayers in this group who are not subject to the AMT would have faced smaller incentives to donate to organizations resulting in state or local tax credits in excess of 15 percent under the proposed rule. However, these taxpayers will receive the same federal tax benefits for cash contributions under the final rule and Notice 2019-12 as they received prior to the Act and under the baseline, as described in Example 2 in Table 1 of this special analysis.[7]

It is the case that, for taxpayers subject to the AMT, the cost of giving to state and local credit organizations is higher under the rule with Notice 2019-12 than under the baseline and under prior law. The Treasury Department and the IRS estimate that fewer than 150,000 taxpayers (less than 0.1 percent of taxpayers) will be subject to the AMT and claim itemized deductions after enactment of the Act. These taxpayers could be affected by the final rule, but only if they contribute to programs that entitle them to state and local tax credits of greater than 15 percent. (The tax data do not indicate whether a taxpayer has made a contribution that generated a state or local tax credit.) However, as described in Example 3 in Table 1 of this special analysis, the cost of contributing to an organization resulting in a 100 percent state tax credit will be zero for these taxpayers, as it is for other taxpayers under the final rule with Notice 2019-12.

[7]Taxpayers who contribute property do not satisfy the requirements of the safe harbor provided in Notice 2019-12 and may be impacted by the final regulations.

Table 1: Tax Treatment of $1,000 Contribution to (A) Organization that Gives Rise to $1,000 State Tax Credit and (B) Organization for Which Contribution is Deductible at the State Level

Example 1: Taxpayer Above the SALT Limitation, Not Subject to the AMT; Taxpayer Remains Above SALT Limitation After Contribution

	Prior Law		Baseline		Proposed Rulemaking		Final Rule with Notice 2019-12	
Change in	A	B	A	B	A	B	A	B
State Income Tax Liability	–1,000	–50	–1,000	–50	–1,000	–50	–1,000	–50
Federal Income Tax								
Charitable Contribution Deduction	1,000	1,000	1,000	1,000	0	1,000	0	1,000
Deduction for State and Local Taxes	–1,000	–50	0	0	0	0	0	0
Itemized Deductions	0	950	1,000	1,000	0	1,000	0	1,000
Taxable Income	0	–950	–1,000	–1,000	0	–1,000	0	–1,000
Federal Tax Liability	0	–228	–240	–240	0	–240	0	–240
Total Tax Benefit (Federal + State)	1,000	278	1,240	290	1,000	290	1,000	290
Net Cost to Taxpayer of $1,000 Contribution	0	722	–240	710	0	710	0	710

Example 2: Taxpayer Below the SALT Limitation, Not Subject to the AMT

	Prior Law		Baseline		Proposed Rulemaking		Final Rule with Notice 2019-12	
Change in	A	B	A	B	A	B	A	B
State Income Tax Liability	–1,000	–50	–1,000	–50	–1,000	–50	–1,000	–50
Federal Income Tax								
Charitable Contribution Deduction	1,000	1,000	1,000	1,000	0	1,000	0	1,000
Deduction for State and Local Taxes	–1,000	–50	–1,000	–50	–1,000	–50	0	–50
Itemized Deductions	0	950	0	950	–1,000	950	0	950
Taxable Income	0	–950	0	–950	1,000	–950	0	–950
Federal Tax Liability	0	–228	0	–228	240	–228	0	–228
Total Tax Benefit (Federal + State)	1,000	278	1,000	278	760	278	1,000	278
Net Cost to Taxpayer of $1,000 Contribution	0	722	0	722	240	722	0	722

Example 3: Taxpayer Subject to the AMT

	Prior Law		Baseline		Proposed Rulemaking		Final Rule with Notice 2019-12	
Change in	A	B	A	B	A	B	A	B
State Income Tax Liability	–1,000	–50	–1,000	–50	–1,000	–50	–1,000	–50
Federal Income Tax								
Alternative Minimum Taxable Income	–1,000	–1,000	–1,000	–1,000	0	–1,000	0	–1,000
Federal Tax Liability	–260	–260	–260	–260	0	–260	0	–260
Total Tax Benefit (Federal + State)	1,260	310	1,260	310	1,000	310	1,000	310
Net Cost to Taxpayer of $1,000 Contribution	–260	690	–260	690	0	690	0	690

Assumptions: The taxpayer itemizes deductions and has more than $1,000 of state tax liability. Under prior law, the taxpayer is not subject to the overall limitation on itemized deductions under section 68. The taxpayer faces a 24 percent marginal rate under the Federal income tax. If the taxpayer is subject to the AMT, the taxpayer faces a 26 percent marginal rate. A $1,000 contribution to charitable organization A generates a $1,000 state tax credit. A $1,000 contribution to charitable organization B is ineligible for a state tax credit but is deductible under the state's income tax. The taxpayer faces a 5 percent marginal rate under the state's income tax. The baseline assumes continuation of the IRS administrative position that state and local tax credits are not reflected as a return benefit or consideration and therefore do not reduce the taxpayer's charitable contribution deduction under section 170(a). Total Tax Benefit refers to the absolute value of the reduction of the taxpayer's combined federal and state tax liability.

Regulatory Flexibility Act

As noted previously, pursuant to the RFA (5 U.S.C. chapter 6), it is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations primarily affect individuals. It is possible for a small business donor to be affected by this rule. However, small entities will often be able to claim a business expense deduction instead of a charitable donation, and would therefore be unaffected by the rule. For the very few small entity donors that might nevertheless choose to claim a charitable donation deduction and might be directly affected by the regulation, there is no significant economic impact. The rule would impose only nominal costs of subtracting the amount of the credit from the amount contributed, in order to determine the deduction allowed under section 170. There is no collection of information requirement on small entities. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f), the proposed regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses, and no comments were received.

Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2018, that threshold is approximately $150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Congressional Review Act

The Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget has determined that this is a major rule for purposes of the Congressional Review Act (CRA) (5 U.S.C. 801 et seq.).

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 1.170A-1 is amended by redesignating paragraphs (h)(3) through (5) as paragraphs (h)(4) through (6), and adding a new paragraph (h)(3) to read as follows:

§1.170A-1 Charitable, etc., contributions and gifts; allowance of deduction.

* * * * *

(h) * * *

(3) *Payments resulting in state or local tax benefits*—(i) *State or local tax credits*. Except as provided in paragraph (h)(3)(vi) of this section, if a taxpayer makes a payment or transfers property to or for the use of an entity described in section 170(c), the amount of the taxpayer’s charitable contribution deduction under section 170(a) is reduced by the amount of any state or local tax credit that the taxpayer receives or expects to receive in consideration for the taxpayer’s payment or transfer.

(ii) *State or local tax deductions*—(A) *In general*. If a taxpayer makes a payment or transfers property to or for the use of an entity described in section 170(c), and the taxpayer receives or expects to receive state or local tax deductions that do not exceed the amount of the taxpayer’s payment or the fair market value of the property transferred by the taxpayer to the entity, the taxpayer is not required to reduce its charitable contribution deduction under section 170(a) on account of the state or local tax deductions.

(B) *Excess state or local tax deductions*. If the taxpayer receives or expects to receive a state or local tax deduction that exceeds the amount of the taxpayer’s payment or the fair market value of the property transferred, the taxpayer’s charitable contribution deduction under section 170(a) is reduced.

(iii) *In consideration for*. For purposes of paragraph (h)(3)(i) of this section, the term *in consideration for* shall have the meaning set forth in §1.170A-13(f)(6), except that the state or local tax credit need not be provided by the donee organization.

(iv) *Amount of reduction*. For purposes of paragraph (h)(3)(i) of this section, the amount of any state or local tax credit is the maximum credit allowable that corresponds to the amount of the taxpayer’s payment or transfer to the entity described in section 170(c).

(v) *State or local tax*. For purposes of paragraph (h)(3) of this section, the term *state or local tax* means a tax imposed by a State, a possession of the United States, or by a political subdivision of any of the foregoing, or by the District of Columbia.

(vi) *Exception*. Paragraph (h)(3)(i) of this section shall not apply to any payment or transfer of property if the total amount of the state and local tax credits received or expected to be received by the taxpayer is 15 percent or less of the taxpayer’s payment, or 15 percent or less of the fair market value of the property transferred by the taxpayer.

(vii) *Examples*. The following examples illustrate the provisions of this paragraph (h)(3). The examples in paragraph (h)(6) of this section are not illustrative for purposes of this paragraph (h)(3).

(A) *Example 1*. A, an individual, makes a payment of $1,000 to X, an entity described in section 170(c). In exchange for the payment, A receives or expects to receive a state tax credit of 70 percent of the amount of A's payment to X. Under paragraph (h)(3)(i) of this section, A's charitable contribution deduction is reduced by $700 (0.70 x $1,000). This reduction occurs regardless of whether A is able to claim the state tax credit in that year. Thus, A's charitable contribution deduction for the $1,000 payment to X may not exceed $300.

(B) *Example 2*. B, an individual, transfers a painting to Y, an entity described in section 170(c). At the time of the transfer, the painting has a fair market value of $100,000. In exchange for the painting, B receives or expects to receive a state tax credit equal to 10 percent of the fair market value of the painting. Under paragraph (h)(3)(vi) of this section, B is not required to apply the general rule of paragraph (h)(3)(i) of this section because the amount of the tax credit received or expected to be received by B does not exceed 15 percent of the fair market value of the property transferred to Y. Accordingly, the amount of B's charitable contribution deduction for the transfer of the painting is not reduced under paragraph (h)(3)(i) of this section.

(C) *Example 3*. C, an individual, makes a payment of $1,000 to Z, an entity described in section 170(c). In exchange for the payment, under state M law, C is entitled to receive a state tax deduction equal to the amount paid by C to Z. Under paragraph (h)(3)(ii)(A) of this section, C's charitable contribution deduction under section 170(a) is not required to be reduced on account of C's state tax deduction for C's payment to Z.

(viii) *Effective/applicability date*. This paragraph (h)(3) applies to amounts paid or property transferred by a taxpayer after August 27, 2018.

* * * * *

§1.170A-13 [Amended]

Par. 3. Section 1.170A-13 is amended in paragraph (f)(7) by removing the cross-reference "§1.170A-1(h)(4)" and adding in its place "§1.170A-1(h)(5)".

Par. 4. Section 1.642(c)-3 is amended by adding paragraph (g) to read as follows:

§1.642(c)-3 Adjustments and other special rules for determining unlimited charitable contributions deduction.

* * * * *

(g) *Payments resulting in state or local tax benefits*—(1) *In general*. If the trust or decedent's estate makes a payment of gross income for a purpose specified in section 170(c), and the trust or decedent's estate receives or expects to receive a state or local tax benefit in consideration for such payment, §1.170A-1(h)(3) applies in determining the charitable contribution deduction under section 642(c).

(2) *Effective/applicability date*. Paragraph (g)(1) of this section applies to payments of gross income after August 27, 2018.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: June 3, 2019

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 11, 2019, 4:15 p.m., and published in the issue of the Federal Register for June 13, 2019, 84 F.R. 27513)

T.D. 9865

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

Limitation on Deduction for Dividends Received from Certain Foreign Corporations and Amounts Eligible for Section 954 Look-Through Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final temporary regulations.

SUMMARY: This document contains temporary regulations under section 245A of the Internal Revenue Code (the "Code") that limit the dividends received deduction available for certain dividends received from current or former controlled foreign corporations. This document also contains temporary regulations that limit the applicability of the exception to foreign personal holding company income for certain dividends received by upper-tier controlled foreign corporations from lower-tier controlled foreign corporations and temporary regulations under section 6038 to facilitate administration of certain rules in the temporary regulations. The temporary regulations affect certain U.S. persons that are domestic corporations that receive certain dividends from current or former controlled foreign corporations or are United States shareholders of upper-tier controlled foreign corporations that receive certain dividends from lower-tier controlled foreign corporations. The text of the temporary regulations also serves as the text of the proposed regulations set forth in a notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

DATES: *Effective date*: These regulations are effective on June 18, 2019.

Applicability dates: For dates of applicability, see §§1.245A-5T(k), 1.954(c)(6)-1T(b), and 1.6038-2T(m).

FOR FURTHER INFORMATION CONTACT: Logan M. Kincheloe at (202) 317-6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

I. In General

This document contains amendments to 26 CFR part 1 under sections 245A, 954(c)(6), and 6038 (the "temporary regulations"). Any terms used but not defined in this preamble have the meanings given them in the temporary regulations. Added to the Code by section 14101(a) of the Tax Cuts and Jobs Act (the "Act"), section 245A generally allows a domestic corporation a 100-percent dividends received deduction (the "section 245A deduction") for the foreign-source portion of a dividend received after December 31, 2017, from a specified 10 percent-owned foreign corporation (an "SFC"). Section 954, which predates the Act and remains in effect, generally provides that a dividend received by a controlled foreign corporation (a "CFC"), as defined in section 957, is included in the CFC's foreign personal holding company income ("FPHCI"), as defined in section 954(c). Pursuant to section 954(c)(6), however, a dividend received by a CFC from a related CFC is not included in the CFC's FPHCI if certain requirements are satisfied (the "section 954(c)(6) exception").

The temporary regulations limit the availability of the section 245A deduction and the section 954(c)(6) exception in specific and narrow cases where the deduction or exception, respectively, effectively eliminates subpart F income or income subject to tax under section 951A from the U.S. tax system. Specifically, the temporary regulations address transactions that have the effect of avoiding tax under section 965, 951A, or 951 by inappropriately converting income that should have been subject to U.S. tax into non-taxed income. The temporary regulations also include rules under section 6038 to facilitate administration of certain rules in the temporary regulations. The temporary regulations do not include general rules relating to dividends eligible for the section 245A deduction; those rules will be included in separate guidance.

II. Scope of Participation Exemption

In order to transition to the new participation exemption system provided under section 245A and certain other provisions of the Act, the Act imposed a tax on certain earnings and profits of a U.S.-owned foreign corporation that had not previously been subject to U.S. tax. *See* section 965. Section 965 was designed to ensure that previously untaxed foreign income of the foreign corporation that accrued before the advent of the participation exemption system generally is subject to U.S. tax (although at a reduced rate). This transition tax applied to the last taxable year of the foreign corporation beginning before January 1, 2018, and generally increased the subpart F income of the foreign corporation by the amount of its previously untaxed earnings as of no later than December 31, 2017.

The Act's legislative history indicates congressional concern that the new participation exemption could heighten the incentive to shift profits to low-taxed foreign jurisdictions or tax havens absent base erosion protections. *See* Senate Committee on the Budget, 115th Cong., Reconciliation Recommendations Pursuant to H. Con. Res. 71, at 365 (Comm. Print 2017) ("Senate Explanation"). For example, without appropriate limits, domestic corporations might be incentivized to shift income to low-taxed foreign affiliates, "where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed." *See id.*

This risk of base erosion is acute with respect to certain types of income, such as passive or mobile income and income derived from intangible property, which historically have posed transfer pricing challenges. To prevent base erosion, the Act retained the subpart F regime (section 951 et. seq.) and enacted a new regime under section 951A for global intangible lowed-taxed income (the "GILTI regime"), both of which subject certain foreign income of a CFC to current U.S. taxation in the hands of the CFC's United States shareholders (within the meaning of section 951(b)) (each shareholder, a "U.S. shareholder"). In order to avoid double taxation when a CFC distributes earnings and profits that have been taxed on a current basis to a U.S. shareholder, the earnings and profits are designated as "previously taxed earnings and profits" (also known as "PTEP") under section 959. Section 959 generally provides that PTEP are not subject to U.S. tax when distributed to a U.S. shareholder.

The subpart F regime, which was established under the Revenue Act of 1962, Pub. L. No. 87–834, sec. 12, 76 Stat. at 1006, subjects certain income earned by a CFC to U.S. taxation in the hands of the CFC's U.S. shareholders on a current basis at the full ordinary tax rate, regardless of whether the CFC distributes the earnings attributable to such income. H.R. Rep. No. 1447 at 58 (1962). In general, the subpart F regime applies to certain passive or highly mobile income in order to address base erosion concerns. Thus, for example, section 954(c) provides that subpart F income includes FPHCI. FPHCI includes certain types of passive or mobile income that are relatively easy to situate in tax-advantaged jurisdictions, such as dividends, interest, rents, and royalties.

The GILTI regime generally subjects a CFC's U.S. shareholders to current taxation on intangible income earned by the CFC in a manner similar to the treatment of a CFC's subpart F income. *See* section 951A; *see also* Senate Explanation at 366 (explaining that such income is often associated with profit shifting). Intangible income is determined for this purpose on an aggregate basis at the U.S. shareholder level and is based on a formulaic approach under which a "normal return" equal to 10 percent of the basis of certain tangible assets is calculated and then each dollar of income above the "normal return" is effectively treated as intangible income (regardless of whether such income is actually attributable to intangible property). *See* Senate Explanation at 366. However, for purposes of this determination, certain income of the CFC – such as income taxed under another Code provision (for example, under the rules for subpart F income in sections 951 through 964 or under section 882 in the case of income effectively connected with the conduct of a U.S. trade or business), immobile income (such as foreign oil and gas extraction income), or highly taxed income that is excluded from subpart F income by reason of the high-tax exception of section 954(b)(4) – is not taken into account. *See also id.* ("[C]ertain items of income earned by CFCs should be excluded from the GILTI, either because they should be exempt from U.S. tax – as they are generally not the type of income that is the source of base erosion concerns – or are already taxed currently by the United States"). The CFC's U.S. shareholders are subject to current U.S. tax on the CFC's income in excess of the CFC's normal return, potentially at a reduced rate through a deduction under section 250, at the corporate U.S. shareholder level. The differing treatment under the GILTI regime with respect to excess returns (taxed currently, though potentially at a reduced rate) versus normal returns (exempt from tax) generally has the effect of differentiating between income that poses base erosion concerns and income that does not pose such concerns. The GILTI regime applies in the first taxable year of a CFC beginning on or after January 1, 2018. Section 245A applies to distributions made by

SFCs (which include CFCs) on or after that date.

The rules under section 959 generally treat PTEP (including PTEP that arise by reason of the subpart F regime, the GILTI regime, or the transition tax under section 965) as being distributed before non-previously taxed earnings and profits and also prevent section 245A from applying to PTEP. *See* section 959(c) (providing ordering rules that treat PTEP as being distributed first) and section 959(d) (providing that a distribution of PTEP to a U.S shareholder is not treated as a dividend). Thus, both the interaction of the definitions of subpart F income and tested income with the ordering rules for distributions of PTEP and the overall structure of the international provisions of the Act contemplate that only residual earnings remaining after the potential application of sections 951(a), 951A, and 965 generally are eligible for the section 245A deduction. That is, section 245A(a) applies only to certain "dividends" received from foreign corporations. Therefore, sections 951(a), 951A, and 965 generally have priority over section 245A because, when they apply to a foreign corporation's earnings, distributions of those earnings do not qualify as dividends under section 959(d), and, therefore, section 245A does not apply.

The statutory text of the participation exemption system under section 245A, the GILTI regime, the subpart F regime, and the PTEP rules collectively operate as a comprehensive framework with respect to a CFC's foreign earnings after the application of the transition tax under section 965. A central feature of this regime is that income derived by CFCs is eligible for the section 245A deduction only if the earnings being distributed have not been first subject to the subpart F or GILTI regimes. The scope of the section 245A deduction (and the authority set forth in section 245A(g)) is thus informed not only by the text of section 245A in isolation, but also by the role of section 245A in the overall structure of the international provisions and its interaction with the subpart F and GILTI provisions.

Section 245A(g) provides that the Secretary shall issue such regulations as are necessary or appropriate to carry out the provisions of section 245A.

III. Scope of Section 954(c)(6)

Section 954(c)(6) was enacted by the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222. In general, and subject to certain limitations, the section 954(c)(6) exception is intended to facilitate intragroup foreign-to-foreign funds flows by providing that dividends, interest, rents, and royalties received or accrued by a CFC from another related CFC are not treated as FPHCI to the extent attributable or properly allocable to income of the related person which is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States. *See* H.R. Rep. No. 109-304 at 45 (2005). Section 954(c)(6)(A) also provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provision, including regulations to prevent the abuse of the purposes of the provision. As most recently extended by the Consolidated Appropriations Act of 2016, Pub. L. No. 114-113, section 954(c)(6) applies to taxable years of foreign corporations beginning after December 31, 2005, and before January 1, 2020, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Notice 2007-9, 2007-5 I.R.B. 401, provides guidance under section 954(c)(6). The notice describes additional guidance that the Treasury Department and the IRS intend to issue regarding the application of section 954(c)(6), including certain anti-abuse rules.

Explanation of Provisions

I. Overview

The transition tax, the subpart F and GILTI regimes, and the participation exemption under section 245A together form a comprehensive and closely integrated set of tax rules with respect to the earnings of foreign corporations with requisite levels of U.S. ownership. These related provisions must be read and interpreted together in order to ensure that each provision functions as part of a coherent whole, as intended. Although the section 245A deduction is generally available for untaxed foreign-source earnings, read collectively this integrated set of statutory rules can be reasonably understood to require that the deduction not apply to earnings and profits attributable to income of a type that is properly subject to the subpart F or GILTI regimes, which address base erosion-type income. Otherwise, as explained in Part II of this Explanation of Provisions, the section 245A deduction could undermine the anti-base erosion measures that Congress intended to prevent income shifting. Accordingly, and consistent with the coherent functioning of the interlocking statutory scheme for taxation of CFC earnings, the section 245A deduction generally will not apply to distributions of earnings and profits that are attributable to subpart F income or tested income. The interpretation reflected in these rules ensures that these provisions will operate compatibly with, not contradictorily to, each other.

Section 245A is designed to operate residually, such that the section 245A deduction generally applies to any earnings of a CFC to the extent that they are not first subject to the subpart F regime, the GILTI regime, or the exclusions provided in section 245A(c)(3) (and were not subject to section 965). That is, the text of the subpart F and GILTI rules explicitly defines the types of income to which they apply, and section 245A applies to any remaining untaxed foreign earnings. Under ordinary circumstances, this formulation works appropriately, as earnings are first subject to the subpart F or GILTI regimes before the determination of dividends to which section 245A could potentially apply. However, in certain atypical circumstances, a literal application of section 245A (read in isolation) could result in the section 245A deduction applying to earnings and profits of a CFC attributable to the types of income addressed by the subpart F or GILTI regimes – the specific types of earnings that Congress described as presenting base erosion concerns. These circumstances arise when a CFC's fiscal year results in a mismatch between the effective date for GILTI and the final measurement date under section 965 or involve unanticipated interactions between section 245A and the rules for allocating subpart F income and GILTI when there is a change in ownership of a CFC. Moreover, the Treasury Department and the IRS are aware that some taxpayers are undertaking transactions with a view to eliminating current or future taxation of all foreign earnings of a CFC, including earnings attributable to base erosion-type income, by structuring into these situations. These transactions have the potential to substantially undermine the anti-base erosion framework for post-2017 foreign earnings.

Based on the structure and history of the international provisions of the Code, including changes made by the Act, the Treasury Department and the IRS have concluded that section 245A was not intended to eliminate taxation with respect to the foreign earnings of a CFC that are attributable to income of a type that is subject to taxation under the subpart F or GILTI regimes. In these cases where the literal effect of section 245A would reverse the intended effect of the subpart F and GILTI regimes, this conflict is best resolved, and the structure of the statutory scheme is best preserved, by limiting section 245A's effect. The Treasury Department and the IRS do not believe Congress intended section 245A to defeat the purposes of subpart F and GILTI regimes in these instances. Accordingly, given the authority in section 245A(g) directing the Secretary to issue such regulations as are necessary or appropriate to carry out the provisions of section 245A, and the authority under section 7805(a) to issue rules and regulations made necessary by reason of changes in the tax laws, the temporary regulations under section 245A are designed to ensure that the section 245A deduction operates properly within the context of a closely coordinated set of rules and, as a result, is not available to eliminate the taxation of subpart F income and tested income in these limited circumstances. However, consistent with the broad application of section 245A, the temporary regulations apply only to certain well-defined circumstances in which subpart F or tested income earned by a CFC would otherwise escape taxation to its U.S. shareholders as a result of the unanticipated interaction of section 245A and certain rules applicable to the inclusion of subpart F income and GILTI under sections 951(a) and 951A, respectively.

To prevent the avoidance of U.S. tax in these specific and narrow circumstances, the temporary regulations limit the section 245A deduction only with respect to certain dividends received by a domestic corporation in connection with specific transactions that facilitate the avoidance of taxation of subpart F income or tested income and that, in many cases, may have been entered into with a purpose of avoiding the consequences of the new international tax regime as adopted by Congress in the Act. This limited denial ensures that the section 245A deduction will continue to apply to earnings and profits that are attributable to all other classes of income to which Congress intended them to apply. The Treasury Department and the IRS emphasize, however, that when the requirements of section 245A as properly construed are satisfied, it would not be permissible under the statute for the section 245A deduction to be denied for these other classes of income — even if, for example, taxpayers choose to generate such income to avail themselves of the benefits of the deduction. The Treasury Department and the IRS furthermore do not believe it would be permissible to modify the definition of subpart F income or tested income, or to recharacterize income as subpart F income or tested income, under the authority of section 245A(g).

Similar to section 245A, the exemption from subpart F income under section 954(c)(6) can be used in the context of certain transactions to avoid taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Such transactions are not dependent upon the availability of section 245A at the level of the United States shareholder. This type of concern was first generally described in Notice 2007-9, but has been exacerbated by the enactment of section 951A as part of the Act because (1) dividends qualifying for section 954(c)(6) generally are not treated as tested income pursuant to section 951A(c)(2)(A)(i)(IV); and (2) the same structured transactions used to avoid subpart F inclusions can also be used to avoid GILTI inclusions. Given the authority in section 954(c)(6)(A) for the Treasury Department and the IRS to issue regulations preventing the abuse of section 954(c)(6), the temporary regulations under section 954(c)(6) are designed to ensure that the section 954(c)(6) exception is not used to erode the U.S. tax base through certain transactions preventing the taxation of income that would otherwise be taxed under the subpart F or GILTI regimes. Consistent with the temporary regulations issued under section 245A, these rules are targeted to ensure that the section 954(c)(6) exception is not available for this limited category of earnings.

II. Limitation of Amounts Eligible for Section 245A Deduction

A. *Scope*

In the case of a dividend received by a domestic corporation from an SFC, the temporary regulations limit the amount of the section 245A deduction to the portion of a dividend not constituting an "ineligible amount." *See* §1.245A-5T(b). In general, the ineligible amount is the sum of (i) 50 percent of the portion of a dividend attributable to certain earnings and profits resulting from transactions between related parties during a period after the measurement date under section 965(a)(2) and in which the SFC was a CFC but during which section 951A did not apply to it (referred to as the "extraordinary disposition amount") and (ii) the portion of a dividend attributable to certain earnings and profits generated during any taxable year ending after December 31, 2017, in which the domestic corporation reduces its ownership of the CFC (referred to as the "extraordinary reduction amount").

B. *Extraordinary Disposition Amount*

Under the Act, there may be a gap between when section 951A first applies to the U.S. shareholders of a CFC (as of its first taxable year beginning after December 31, 2017) and the last date on which the earnings and profits of the CFC are measured for purposes of section 965, which, under section 965(a), is December 31, 2017 (such period, the "disqualified period"). For example, a fiscal year CFC with a taxable year ending November 30 would have a disqualified period from January 1, 2018, the day after its final E&P measurement date under section 965, to November 30, 2018, the last date before section 951A applies with respect to its income. The Treasury Department and the IRS are aware that during the disqualified period, CFCs may have engaged in certain transactions with related parties with a goal of creating stepped-up basis for the buyer, while generating earnings and profits for the seller CFC that are not subject to any current tax and may be eligible for the section 245A deduction. Because the transactions generally are structured to avoid creating subpart F income and occur during the disqualified period, the income from these transactions generally is not subject to U.S. tax under the transition tax under section 965, the subpart F regime, or the GILTI regime. Such earnings and profits could, for example, reduce taxable gain that would otherwise be recognized on the subsequent disposition of stock of the CFC, thus potentially allowing the CFC and its future earnings to be removed from the U.S. tax system without the imposition of any U.S. tax.

The Treasury Department and the IRS have determined that it would be inconsistent with the closely interdependent set of international tax rules implemented by the Act, specifically the transition tax, the GILTI regime, and the participation exemption, for the earnings and profits resulting from these transactions to be eligible for a section 245A deduction even if the other requirements of section 245A are otherwise satisfied. Thus, the temporary regulations limit the amount of the section 245A deduction allowed to a section 245A shareholder (as defined in §1.245A-5T(i)(21)) with respect to a dividend received from an SFC. Specifically, the deduction is limited to 50 percent of the extraordinary disposition amount, which is the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the section 245A shareholder's "extraordinary disposition account." *See* §1.245A-5T(b)(2) and (c)(1). In general, this account represents the shareholder's pro rata share of the SFC's "extraordinary disposition E&P," reduced by the section 245A shareholder's prior extraordinary disposition amounts, if any. *See* §1.245A-5T(c)((3)(i)(C)(*1*)). Extraordinary disposition E&P is an amount equal to the earnings of an SFC arising from gain recognized by reason of one or more "extraordinary dispositions." *See* §1.245A-5T(c)(3)(i)(C).

The section 245A deduction is limited to 50 percent of the extraordinary disposition amount to reflect the fact that taxpayers generally would have been eligible for a deduction under either (i) section 250(a)(1)(B) had section 951A applied to the SFC during the disqualified period or (ii) section 965(c) had the net gain been subject to the transition tax under section 965.

For a disposition by an SFC to be an extraordinary disposition, the disposition must (i) be of specified property (defined in §1.245A-5T(c)(3)(iv) as any property other than property that produces gross income described in section 951A(c)(2)(A)(i)(I) through (V)), (ii) occur during the SFC's disqualified period (as defined in §1.245A-5T(c)(3)(iii)) and when the SFC was a CFC, (iii) be outside of the ordinary course of the SFC's activities, and (iv) be to a related party. *See* §1.245A-5T(c)(3)(ii). For these purposes, a disposition by an SFC includes certain indirect dispositions by the SFC through a partnership or other pass-through entities (including through ownership structures involving tiered pass-through entities). *See id.*

In addition, pursuant to an exception intended to limit compliance and administrative burdens, no dispositions by an SFC are considered to be an extraordinary disposition if they do not exceed a threshold of the lesser of $50 million or 5 percent of the gross value of the SFC's property. *See* §1.245A-5T(c)(3)(ii)(E).

The temporary regulations provide a facts-and-circumstances rule for determining whether a disposition occurs outside of the ordinary course of an SFC's activities. The temporary regulations also provide a per se rule that a disposition is treated as outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or if the disposition is of intangible property, within the meaning of section 367(d)(4). *See id.* The temporary regulations include this latter rule because the disposition of intangible property is not an ordinary course transaction (relative to, for example, a routine sale of raw materials from one SFC to another for manufacturing); moreover, during the disqualified period taxpayers may have had a particularly strong incentive to dispose of intangible property (which often has low basis) to generate significant amounts of earnings and profits to the seller (without being subject to current tax) that may be eligible for the section 245A deduction.

As described, the Treasury Department and the IRS have determined that the extraordinary disposition rules should not apply to all earnings and profits generated by a CFC during the disqualified period. Rather, the temporary regulations focus on a narrowly and objectively defined class of earnings and profits in circumstances that are inconsistent with the international tax regime adopted by the Act. The Treasury Department and the IRS request comments on whether there should be any further refining of these rules.

The temporary regulations provide shareholder account rules to ensure that a section 245A shareholder's extraordinary disposition account is properly tracked and reduced in appropriate cases (for example, for prior extraordinary disposition amounts). *See* §1.245A-5T(c)(3)(i). These shareholder account rules also contain successor rules for a section 245A shareholder that acquires stock of an SFC from another section 245A shareholder with respect to which there is an extraordinary disposition account and for certain section 381 transactions and distributions involving section 355 (or so much as section 356 as relates to section 355). *See* §1.245A-5T(c)(4).

To address cases in which the section 245A deduction might be available for an SFC held through a pass-through entity or foreign corporation, the temporary regulations provide that a section 245A shareholder is treated as owning a pro rata share of stock of an SFC that is owned by a partnership, trust, or estate (domestic or foreign), or a foreign corporation in which the section 245A shareholder owns an interest or stock, as applicable. *See* §1.245A-5T(g)(3)(i) (providing rules for stock ownership and transfers).

The Treasury Department and the IRS request comments as to how the extraordinary disposition account rules should apply in circumstances in which an SFC is transferred to a partnership, including the extent to which principles similar to section 704(c)(1)(B) apply to prevent the use of partnerships to circumvent the purposes of the temporary regulations, such as where an SFC is subsequently transferred to a non-contributing partner. As a general matter, the Treasury

Department and the IRS believe that §1.701-2(b), as well as the judicial doctrines of economic substance, substance over form, and step transaction, prevent taxpayers from forming or availing of partnerships with a principal purpose of avoiding the application of these rules. The treatment of partnerships under section 245A will be addressed in separate guidance; and it is anticipated that this guidance will provide rules ensuring that partnerships may not be formed or availed of to avoid the purposes of the temporary regulations.

The Treasury Department and the IRS further request comments on the treatment of consolidated groups under the temporary regulations, including for purposes of maintaining extraordinary disposition accounts. The Treasury Department and the IRS believe that consolidated groups generally should be treated in the same manner as a single taxpayer for the purposes of §1.245A-5T(c). Subject to any comments received, it is expected that future rules will provide that consolidated groups generally should not be advantaged or disadvantaged as a result of owning directly or indirectly stock of an SFC through multiple members relative to a standalone corporation owning the same stock.

The Treasury Department and the IRS also request comments on whether and how the rules applicable to disqualified basis in proposed §1.951A-2(c)(5) should be coordinated with §1.245A-5T(c). In this regard, proposed §1.951A-2(c)(5) provides rules for the allocation and apportionment of deductions and losses attributable to disqualified basis, which is asset basis created in certain disqualified transfers during the disqualified period. These deductions and losses are allocated and apportioned solely to gross income that is not tested income, subpart F income, or effectively connected income (defined as "residual CFC gross income"), thereby ensuring that such "costless" tax basis does not inappropriately reduce future tax liability. Thus, the Treasury Department and the IRS are considering the extent to which it would be appropriate to coordinate the two sets of rules, taking into account the ability of the IRS to administer and taxpayers to comply with such rules, and request comments on this issue.

C. *Extraordinary Reduction Amount*

The Treasury Department and the IRS are aware that certain transactions in which a section 245A shareholder of a CFC transfers stock of the CFC, or certain transactions in which the shareholder's ownership of the CFC is diluted, could give rise to results that would be inconsistent with the integrated structure of the U.S. tax system for the taxation of CFC earnings, including section 245A, the subpart F regime, and the GILTI regime. In these cases, absent proper limitation, the section 245A deduction might be allowed inappropriately with respect to a CFC's current year income that, but for the ownership changes, would have been subject to tax under the subpart F or GILTI regimes. Unlike the transactions described in Part II.B of this Explanation of Provisions, the transactions giving rise to these results can occur in any taxable year ending after the Act (and particularly section 245A) is in effect.

These results could arise, for example, as a consequence of the application of section 951(a)(2)(B). Section 951(a)(2)(B), a longstanding provision in the subpart F regime, prevents double taxation of the same earnings by reducing a U.S. shareholder's pro rata share of subpart F income (or, following the Act, tested income as defined in section 951A(c)(2)(A)) of a CFC by dividends received by another person with respect to the same share of stock. However, if section 245A were to apply without limitation to dividends from a CFC that reduce another U.S. shareholder's pro rata share of subpart F income or tested income of the CFC under section 951(a)(2)(B), earnings that would otherwise be subject to the subpart F or GILTI regimes would escape U.S. taxation to the extent of the reduction. For example, in the case of a transfer of CFC stock from one section 245A shareholder (the transferor) to another section 245A shareholder (the transferee), a dividend (including by reason of section 1248) from the CFC to the transferor during the tax year of the transfer might both (i) be excluded from the transferor's income by reason of the section 245A deduction and (ii) reduce the transferee's pro rata share of subpart F income or tested income of the CFC by reason of section 951(a)(2)(B). The Treasury Department and the IRS have determined that it would be inconsistent with the residual definition of section 245A eligible earnings and the interaction of section 245A and the subpart F and GILTI regimes, which form an integrated set of rules to tax post-2017 foreign earnings, to allow a section 245A deduction for a dividend paid out of earnings and profits attributable to subpart F income or tested income where such dividends, by operation of section 951(a)(2)(B), and could result in double non-taxation of such income. Such a result would also be contrary to the legislative intent underlying the interaction of these provisions. *See* Senate Explanation at 365 (noting, in the absence of rules such as the new GILTI regime, the incentive to shift income to low-taxed foreign affiliates, "where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed.").

Similar results can arise in other cases where the stock of a CFC is transferred during a CFC's tax year by a U.S. shareholder to a foreign person where, after the transfer, the CFC remains a CFC but has no U.S. shareholder that owns (within the meaning of section 958(a)) stock of the CFC. Before the Act, section 958(b)(4) prevented certain attribution of stock under section 318 from a foreign person to a U.S. person. However, the Act repealed section 958(b)(4) such that a foreign corporation may be treated as a CFC despite having no direct or indirect U.S. shareholder that owns (within the meaning of section 958(a)) stock of the CFC and that accordingly can recognize an income inclusion under section 951 or 951A. In general, a U.S. shareholder that owns stock in a CFC on the last day within the foreign corporation's year that it is a CFC is taxable on its pro rata share of the CFC's subpart F income or tested income for purposes of the GILTI regime. However, by reason of the Act's repeal of section 958(b)(4), a U.S. shareholder may transfer a CFC to a person that will not be taxed with respect to an inclusion under the subpart F or GILTI regimes without itself being subject to such an inclusion. Absent any specific limitation in these circumstances, any earnings and profits of the CFC distributed as a dividend (including by reason of section 1248) to the transferor U.S. shareholder during the CFC's taxable year might be eligible for the section 245A deduction. However, had the transfer not occurred (or had the CFC ceased to be a CFC as a result of the transfer), the earnings and profits may have been subject to tax under the subpart F or GILTI regimes and, therefore, would not have been eligible for the section 245A deduction.

In the circumstances described in this section, a broad application of section 245A would present taxpayers with a planning opportunity to completely avoid the application of the subpart F and GILTI regimes on an annual basis. The Treasury Department and the IRS have determined that this result would undermine the integrated provisions constituting the Act's framework for taxing post-2017 CFC earnings and would contravene legislative intent. To address this concern, the temporary regulations limit the amount of the section 245A deduction allowed to a "controlling section 245A shareholder" with respect to a dividend from a CFC to the portion of the dividend that is paid out of earnings other than the "extraordinary reduction amount." *See* §1.245A-5T(b)(1) and (e). A controlling section 245A shareholder of a CFC is a section 245A shareholder of the CFC that, taking into account ownership of the CFC by certain other persons (such as related persons), owns more than 50 percent of the stock of the CFC. *See* §1.245A-5T(i)(2). For purposes of applying these rules, a controlling section 245A shareholder also includes any other shareholder who would not otherwise be a controlling section 245A shareholder but acts in concert with the controlling section 245A shareholder. This includes shareholders that sell their shares of the same CFC to the same buyer or buyers (or a related party with respect to the buyer or buyers) as part of the same plan as the controlling section 245A shareholder's extraordinary reduction.

Under the temporary regulations, for an extraordinary reduction amount to exist with respect to a controlling section 245A shareholder of a CFC, an "extraordinary reduction" must occur during the CFC's taxable year with respect to the shareholder's ownership of the CFC. *See* §1.245A-5T(e). An extraordinary reduction generally occurs when either (i) the controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC (for example, an extraordinary reduction occurs if the shareholder owns 90 percent of the stock of the CFC and it transfers stock representing more than nine percent of the stock of the CFC) or (ii) there is a greater than ten percent change in the controlling section 245A shareholder's overall ownership of the CFC (for example, if the shareholder owns 90 percent of the stock of the CFC and, as a result of an issuance to a foreign person, the shareholder's ownership of the CFC is reduced such that it no longer owns at least 81 percent of the stock of the CFC). *See* §1.245A-5T(e)(2)(i)(A). The temporary regulations include the first prong because if, for example, a section 245A shareholder of a CFC were to transfer shares of stock of the CFC to another section 245A shareholder of the CFC and the other shareholder were to transfer an equal number of similar shares to the first shareholder, neither of the shareholders' overall ownership of the CFC would change, but the amount taken into account by each of the shareholders by reason of section 951(a)(2)(B) might be reduced as a result of dividends paid with respect to shares transferred by the other.

An extraordinary reduction amount is earnings and profits representing the amount of dividends paid by the corporation that are attributable to subpart F income or tested income with respect to a CFC, to the extent such subpart F income or tested income (i) would have been taken into account by the controlling section 245A shareholder under section 951 or 951A had the extraordinary reduction not occurred and (ii) is not taken into account by a domestic corporation or a citizen or resident of the United States (that is, a person described in section 7701(a)(30)(A) or (C)). *See* §1.245A-5T(e)(1) and (2).

The limitation of the section 245A deduction in the case of an extraordinary reduction will generally result in a dividend being included in the income of the controlling section 245A shareholder and not offset by a section 245A deduction. In cases where the CFC has tested income during its taxable year that would have been subject to the GILTI regime but for the extraordinary reduction, a controlling section 245A shareholder might prefer to have an income inclusion under section 951A, potentially benefitting from the deduction available under section 250. Therefore, the temporary regulations provide an election under which a controlling section 245A shareholder is not required to reduce its section 245A deduction if it elects (and, in some cases, certain other United States persons also agree) to close the CFC's taxable year for all purposes of the Code on the date of the extraordinary reduction. *See* §1.245A-5T(e)(3)(i). The closing of the taxable year of the CFC results in all U.S. shareholders that own (within the meaning of section 958(a)) stock of the CFC on such date taking into account their pro rata share of subpart F income or tested income earned by the CFC as of that date.

In addition, pursuant to an exception intended to limit compliance and administrative burdens, for a taxable year in which an extraordinary reduction occurs, no amount is considered an extraordinary reduction amount if the sum of the CFC's subpart F income and tested income for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC's total income for the year. *See* §1.245A-5T(e)(3)(ii).

D. *Coordination Rules*

To address cases in which a dividend could qualify as either a hybrid dividend under the rules of section 245A(e) or an ineligible amount under the temporary regulations, the temporary regulations provide a coordination rule pursuant to which a dividend is first subject to the hybrid dividend rules of section 245A(e) and then, to the extent not a hybrid dividend, is subject to the temporary regulations. *See* §1.245A-5T(g)(3)(iv). In future guidance relating to proposed regulations under section 245A(e) and certain other sections (83 FR 67612), the Treasury Department and the IRS anticipate modifying those regulations to reflect this coordination rule.

In addition, to address cases in which a dividend might be either an extraordinary disposition amount under §1.245A-5T(c) or an extraordinary reduction amount under §1.245A-5T(e), the temporary regulations provide a coordination rule pursuant to which a dividend is first subject to the rules of §1.245A-5T(e) and then, to the extent not an extraordinary reduction amount, is subject to the rules of §1.245A-5T(c). *See* §1.245A-5T(g)(5). Because of this ordering rule, the extraordinary disposition amount with respect to a dividend will not exceed the amount by which the dividend exceeds the extraordinary reduction amount with respect to the dividend.

E. *Transactions Described in Section 964(e)(4)*

The rules in these temporary regulations for determining eligibility for the section 245A deduction also apply to deemed dividends arising by reason of section 964(e)(4), which the Act added to the Code. Section 964(e)(4) provides in certain cases that a sale by a CFC of stock of another foreign corporation is treated as a dividend from the target foreign corporation to the selling CFC that is, in turn, treated as subpart F income of the selling CFC and included in the gross income of the U.S. shareholders of the selling CFC. Pursuant to section 964(e)(4)(A)(iii), the section 245A deduction is allowed to any U.S. shareholder with respect to such subpart F income included in gross income in the same manner as if such subpart F income were a dividend received by the shareholder from the selling CFC. Thus, section 964(e)(4) presents the same concerns as direct dividends; absent a rule to the contrary, taxpayers might use section 964(e)(4) to avoid the results applicable to actual distributions from an upper-tier CFC to a U.S. shareholder or to constructive dividends under section 1248 that are addressed elsewhere by these temporary regulations. Therefore, the rules in these temporary regulations for determining eligibility for the section 245A deduction also apply to deemed dividends arising by reason of section 964(e)(4). Moreover, all U.S. shareholders of the selling CFC are deemed to act in concert for purposes of the temporary regulations with respect to transactions described in section 964(e)(4).

III. Limitation of Amount Eligible for Section 954(c)(6) Exception with Respect to Certain Dividends

A. *In General*

As described in Part I of this Explanation of Provisions, the section 954(c)(6) exception may cause dividends from one CFC to another to result in tax consequences similar to, but not dependent upon, those that can be effectuated using section 245A in conjunction with the disqualified period, section 951(a)(2)(B), or the repeal of section 958(b)(4).

To protect against avoidance of the rules for extraordinary dispositions (described in Part II.B of this Explanations of Provisions), the temporary regulations rely on authority under section 954(c)(6)(A) to prevent the section 954(c)(6) exception from applying in cases where a dividend from a lower-tier CFC to an upper-tier CFC would be an extraordinary disposition amount if distributed directly to the section 245A shareholders of the lower-tier CFC. *See* §1.245A-5T(d). In these cases, the section 954(c)(6) exception applies only to the extent that the amount of the dividend exceeds the sum of each section 245A shareholder's extraordinary disposition account with respect to the lower-tier CFC, divided by the aggregate ownership of all U.S. tax residents of the upper-tier CFC that have section 951(a) inclusions and multiplied by 50 percent. The amount is divided by the aggregate ownership of these U.S. tax residents to take into account the fact that the U.S. tax residents (including individuals) will include in gross income a pro rata share of the portion of the dividend not eligible for the section 954(c)(6) exception. The amount is multiplied by 50 percent in order to provide similar treatment for a dividend received by a section 245A shareholder from a CFC and a dividend received by an upper-tier CFC from a lower-tier CFC. In both cases, the 50 percent reduction of the section 245A deduction approximates the reduced tax rate by reason of the deduction provided under section 250(a)(1)(B) with respect to section 951A inclusions or section 965(c) with respect to the transition tax.

Unlike the disallowance of the section 245A deduction under §1.245A-5T(b) with respect to an extraordinary disposition amount, which applies only to corporate U.S. shareholders, the limitation to the application of the section 954(c)(6) exception with respect to a dividend received by an upper-tier CFC can result in a subpart F inclusion to any U.S. shareholder, including individuals. In addition, the temporary regulations limit the section 954(c)(6) exception in these cases, rather than limiting the application of section 245A only when the lower-tier CFC earnings and profits are distributed through intervening CFCs to a section 245A shareholder. This approach prevents deferral of tax with respect to the applicable subpart F income or tested income and minimizes the administrative and compliance burdens that would be created by continuing to track the relevant earnings at the upper-tier CFC.

Similarly, to prevent these inappropriate uses of the section 954(c)(6) exception to avoid the rules for extraordinary reductions (described in Part II.C of this Explanation of Provisions), the temporary regulations apply to limit the amount of any distribution from that CFC out of earnings and profits attributable to subpart F income or tested income that can qualify for the section 954(c)(6) exception in a taxable year in which an extraordinary reduction occurs with respect to the stock of a CFC. Similar to the rules relating to extraordinary disposition amounts, the limitation to the section 954(c)(6) exception with respect to a dividend received by an upper-tier CFC can result in a subpart F inclusion to any U.S. shareholder, including individuals. To the extent a CFC-to-CFC dividend otherwise satisfies the requirements of section 954(c)(6), it is eligible for the section 954(c)(6) exception only to the extent it exceeds the distributing lower-tier CFC's "tiered extraordinary reduction amount," taking into account certain prior inclusions under section 951(a). *See* §1.245A-5T(f)(1). Such amount is equal to the upper-tier CFC's ownership percentage in the lower-tier CFC multiplied by the lower-tier CFC's subpart F income and tested income for the taxable year, with the resulting product reduced by four amounts. The first amount is the pro rata share of the lower-tier CFC's subpart F income and tested income for the taxable year that is taken into account by U.S. tax residents and attributable to the shares of the lower-tier CFC owned by the upper-tier CFC. The second amount is the amount included in an upper-tier CFC's subpart F income resulting from prior dividends paid by the lower-tier CFC giving rise to tiered extraordinary reduction amounts or the application of section 245A(e). The third amount is for certain prior extraordinary reduction amounts with respect to the lower-tier CFC arising in cases in which the lower-tier CFC was a first-tier CFC at some point in the taxable year and paid a dividend to one or more controlling section 245A shareholders at that time. The fourth amount is for subpart F income and tested income taken into account by a U.S. tax resident as a result of an issuance of stock directly by the lower-tier CFC during the taxable year. *See* §1.245A-5T(f)(2). Comments are requested as to whether a lower-tier CFC's tiered extraordinary reduction amount should be reduced for a pro rata portion of a dividend paid on stock of the lower-tier CFC that was held by non-U.S. shareholders before and after an extraordinary reduction. For purposes of applying §1.245A-5T(f)(1) and (2) in taxable years of a lower-tier CFC beginning on or after January 1, 2018, and ending before June 14, 2019, a transition rule is provided such that the tiered extraordinary reduction amount of a lower-tier CFC is determined by treating the lower-tier CFC's subpart F income for the taxable year as if it were neither subpart F income nor tested income. *See* §1.245A-5T(f)(3).

The rule in §1.245A-5T(f)(1) applies to both actual distributions and deemed distributions that occur by reason of stock dispositions subject to section 964(e)(1) but not section 964(e)(4). Dispositions subject to section 964(e)(1) but not section 964(e)(4) are treated as dividends from the target foreign corporation (or other entity whose earnings and profits gave rise to a dividend under section 964(e)(1)) to the selling CFC and, thus, must be tested for eligibility under section 954(c)(6). Additionally, ordering and coordination rules apply with respect to the rules relating to the availability of the section 954(c)(6) exception and generally mirror the rules for the section 245A deduction by giving priority to §1.245A-5T(f) over §1.245A-5T(d). *See* §1.245A-5T(g)(4)(ii). As in the rules relating to extraordinary reduction amounts, a controlling section 245A shareholder of a lower-tier CFC may elect to close the taxable year of the CFC in cases where an extraordinary reduction occurs and the CFC would have a tiered extraordinary reduction amount. *See* §1.245A-5T(e).

Finally, the Treasury Department and the IRS are studying whether §1.245A-5T(f), or a similar rule, should also apply to dividends received by an upper-tier CFC from a lower-tier CFC where such CFCs are owned by individuals and there may be a reduction in the individuals' ownership of the lower-tier CFC. Individuals are not eligible to claim deductions under section 245A and, therefore, dividends subject to section 954(c)(6) do not present the risk of permanently eliminating items of subpart F income, investments in United States property taxed under section 951(a)(1)(B), or tested income from the U.S. tax base. At the same time, section 954(c)(6) dividends might result in a reduction of a U.S. shareholder's pro rata share of a CFC's subpart F income or tested income, thereby resulting in deferred taxation of items that otherwise would have been taxed currently. Therefore, comments are requested as to whether §1.245A-5T(f), or a similar rule, should be extended to CFCs owned by individuals.

B. *Dividends Received by CFCs Ineligible for Section 245A Deduction*

Section 245A(a), by its terms, applies only to certain dividends received by "a domestic corporation." Section 1.952-2, however, which sets forth rules for determining gross income and taxable income of a foreign corporation, provides that for these purposes a foreign corporation is treated as a domestic corporation. *See* §1.952-2(a)(1) and (b)(1). Accordingly, questions have arisen as to whether §1.952-2 could be interpreted such that a foreign corporation could claim a section 245A deduction despite the statutory restriction in section 245A(a) expressly limiting the deduction to domestic corporations. *See* H.R. Rep. No. 115-466, at 599, fn. 1486 (2017).

The Treasury Department and the IRS intend to address issues related to the application of §1.952-2, taking into account various comments received in connection with the Act, including in connection with the proposed section 951A regulations, in a future guidance project. This guidance will clarify that, in general, any provision that is expressly limited in its application to domestic corporations does not apply to CFCs by reason of §1.952-2. The Treasury Department and the IRS continue to study whether, and to what extent, proposed regulations should be issued that provide that dividends received by a CFC are eligible for a section 245A deduction. The Treasury Department and the IRS have determined, however, that in no case would any person, including a foreign corporation, be allowed a section 245A deduction directly or indirectly for the portion of a dividend paid to a CFC that is not eligible for the section 954(c)(6) exception as a result of these temporary regulations. Permitting the deduction in such a case would undermine the application of the rule that reduces the amount of the dividend eligible for the section 954(c)(6) exception (discussed in Part III.A of this Explanation of Provisions).

IV. Information Reporting Under Section 6038

Under section 6038(a)(1), U.S. persons that control foreign business entities must file certain information returns with respect to those entities, which includes information listed in section 6038(a)(1)(A) through (a)(1)(E), as well as information that "the Secretary determines to be appropriate to carry out the provisions of this title." The temporary regulations provide that ineligible amounts, tiered extraordinary disposition amounts, and tiered extraordinary reduction amounts must be reported on the appropriate information reporting form in accordance with section 6038. *See* §1.6038-2T(f)(16). Because transactions subject to these temporary regulations may have occurred in taxable years for which returns have been filed before the issuance of these regulations, or for which returns will be filed before revision of forms and instructions for reporting the information required by §1.6038-2T(f)(16), the temporary regulations provide a transition rule. The transition rule mandates that taxpayers report the required information on the first return filed following the issuance of revised forms, instructions, or other guidance with respect to reporting such information. The transition rule also requires a corporation to report the information with respect to a predecessor corporation (such as a lower-tier foreign corporation that distributes its assets to the corporation in a liquidation described in section 332) to ensure that all of the amounts are properly reported notwithstanding any intervening transactions.

V. Applicability Dates

Consistent with the applicability date of section 245A, and pursuant to section 7805(b)(2), the rules in the temporary regulations relating to eligibility of distributions for the section 245A deduction apply to distributions occurring after December 31, 2017.

Pursuant to section 7805(b)(1) and (2), the rules in the temporary regulations relating to the eligibility of dividends for the section 954(c)(6) exception also apply to distributions occurring after December 31, 2017, subject to the transition rule in §1.245A-5T(f)(3) for determining tiered extraordinary reduction amounts.

VI. Good Cause

The Treasury Department and the IRS are issuing these temporary regulations without prior notice and the opportunity for public comment pursuant to section 553(b)(3)(B) of the Administrative Procedure Act (the "APA"), which provides that advance notice and the opportunity for public comment are not required with respect to a rulemaking when an "agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Under the "public interest" prong of 5 U.S.C. 553(b)(3)(B), the good cause exception appropriately applies where notice-and-comment would harm, defeat, or frustrate the public interest, rather than serving it. The Treasury Department and the IRS are similarly utilizing the good cause exception in section 553(d)(3) of the APA to issue these temporary regulations with an immediate effective date, rather than an effective date no earlier than 30 days after the date of publication.

Among the circumstances in which the good cause exception may be invoked for impracticability or to serve the public interest are situations where the timing and disclosure requirements of the usual procedures would defeat the purpose of the proposal, including if announcement of a proposed rule would enable or increase the sort of financial manipulation the rule sought to prevent. Good cause may also apply where a delayed effective date would have a significant deleterious effect upon the parties to which the regulation applies. Additionally, the good cause exception may apply when the regulations are by their nature short term and there is an opportunity to comment before final rules are introduced. Finally, good cause is supported where regulations are required to be issued and effective by a certain statutory deadline, and in light of the circumstances affecting the agency and its functions leading up to that statutory deadline, the agency is unable during that timeframe to conduct a timely and fulsome notice-and-comment process. Here, these rationales, separately and in combination, provide good cause for the Treasury Department and the IRS's decision to bypass the notice-and-comment and delayed effective date requirements with respect to these temporary regulations. Each rationale is discussed below in turn.

First, good cause exists with respect to these temporary regulations because any period for notice and comment, as well as a delayed effective date, would provide taxpayers with the opportunity to engage in the transactions to which these rules relate with confidence that they achieve the intended tax avoidance results absent the applicability of the regulations. The Treasury Department and the IRS are aware that taxpayers have considered engaging in the transactions described in these temporary regulations, but some may have been deterred from doing so because of uncertainty about the operation and interaction of the various provisions of the Act. By limiting the deduction under section 245A for these transactions, these temporary regulations remove that uncertainty and – if subjected to notice-and-comment and a delayed effective date – could embolden some taxpayers to engage in aggressive tax planning to take advantage of the unintended interactions among the Act's provisions, with the comfort that their actions were not subject to the rules of the temporary regulations during the period of notice and comment and before the regulations' effective date. This concern applies with respect to both the extraordinary disposition and extraordinary reduction rules for an ongoing period. For the extraordinary reduction rules, both the extraordinary reduction and the associated use of section 245A can occur at any time going forward, and although the gap period for entering into extraordinary dispositions has closed, the ability to utilize the section 245A deduction for earnings generated in the extraordinary disposition would apply indefinitely absent these temporary regulations.

For example, a taxpayer who became aware of the tax effects achievable using the transactions described in these temporary regulations could, with confidence, utilize extraordinary disposition E&P or engage in an extraordinary reduction to exit the U.S. taxing jurisdiction without paying any tax during a period of notice and comment and delayed effectiveness. The proliferation of these types of transactions would cause the regulations to exacerbate the very financial manipulation that they are intended to prevent, and accordingly, this rationale supports a finding of good cause for dispensing with pre-promulgation notice and public comment, as well as foregoing a delayed effective date, for these temporary regulations pursuant to 5 U.S.C. 553(b) and (d).

The second reason for a finding of good cause arises from the fact that these temporary regulations, as applied retroactively, will affect taxable years of certain taxpayers ending in 2018. As a result, these regulations can apply to taxable years for which tax returns have been or may be due during a period of comment and delayed effectiveness. Deferring the effectiveness of the temporary regulations until after such a period could increase taxpayer compliance costs because certain taxpayers would only be able to come into compliance with the regulations by amending and refiling returns and paying additional taxes owed with interest.

Third, good cause is supported where a regulation is temporary, with public comment permitted and meaningfully considered before finalization of the temporary rule. In this regard, the temporary regulations have a fixed expiration date and are cross-referenced in a notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**. Comments are requested on all aspects of these rules, and specific comment requests contained in this preamble are incorporated by reference into the cross-referenced notice of proposed rulemaking. The Treasury Department and the IRS will consider all written comments properly and timely submitted when finalizing these temporary regulations.

Finally, these temporary regulations are part of an effort to implement the provisions of the Act, which effected sweeping and complex statutory changes to the international tax regime. In conjunction with developing and issuing these temporary regulations, the Treasury Department and the IRS have also been tasked with issuing regulations implementing the numerous provisions enacted or modified by the Act, along with attendant changes to forms and other sub-regulatory guidance and attention to the orderly administration of the U.S. tax system.

Good cause exists for the issuance of temporary regulations relating to the transactions affected by these temporary regulations partially because of the statutory deadline in section 7805(b)(2), which provides (among other rules) that a regulation may be applied retroactively if it is issued within 18 months of the date of enactment of the statutory provision to which it relates. The rules in these temporary regulations relate to sections 245A, 951A, and 965, which were enacted as part of the Act on December 22, 2017. Thus, to qualify for retroactivity under section 7805(b)(2), a regulation retroactive to the enactment of these provisions must be effective no later than June 22, 2019. These temporary regulations need to apply retroactively from the date of the underlying statutory provisions to ensure that the international tax regime enacted by Congress in the Act, and its interaction with existing tax rules, functions correctly for all affected periods. Retroactivity is also required to prevent treating taxpayers comparatively advantageously if they have engaged in the types of transactions described in these temporary regulations prior to the issuance date of these temporary regulations.

The discussion of good cause with respect to the temporary regulations in this Part VI is consistent with the Policy Statement on the Tax Regulatory Process issued on March 5, 2019, by the Treasury Department and the IRS (the "Statement"). The Statement emphasized the Treasury Department and the IRS's obligation under the APA to issue interim final regulations without prior notice and comment only in conjunction with "a statement of good cause explaining the basis for that finding." The Statement further explains that good cause for interim final regulations may exist, for example, where "such regulations may be necessary and appropriate to stop abusive practices or to immediately resolve an injurious inconsistency between existing regulations and a new statute or judicial decision." As the discussion in this Part VI illustrates, this is the case with respect to these temporary regulations.

Special Analyses

I. Regulatory Planning and Review — Economic Analysis

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

These temporary regulations have been designated by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. OIRA has determined that the proposed rulemaking is significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by the Office of Management and Budget.

A. *Background*

The Tax Cuts and Jobs Act (the Act) transitioned the United States from a primarily deferral-based international tax system (subject to the immediate taxation of generally mobile or passive income under the subpart F regime) to a participation exemption system coupled with immediate taxation of certain offshore earnings (in some cases, at a reduced rate of tax).[8] This transition was effected through several interlocking provisions of the Code – sections 245A, 951A, and 965. All three provisions have different effective dates and thus the Act created periods in which some but not all of them apply. The new system also operates alongside the pre-Act subpart F regime that taxes certain offshore earnings using a longstanding rule for attributing pro rata shares of a foreign corporation's earnings to its U.S. shareholders.

1. Background: Section 245A— Dividends Received Deduction

The Act included section 245A, which provides a participation exemption system for repatriation of certain offshore earnings. Prior to the Act, dividends paid by foreign corporations to their U.S. shareholders were generally taxable. Section 245A(a) reverses this result in the case of corporate U.S. shareholders by providing, subject to certain exceptions, a 100-percent deduction for any dividend received by a corporate U.S. shareholder from a specified 10-percent owned foreign corporation.[9] A 100-percent deduction for divi-

[8]A deferral-based system is a system in which taxable foreign-source income generally is taxed only when it is repatriated to the United States. A participation exemption system is one in which foreign-source income is generally not taxed by the resident country (in this case, the United States). As explained further below, in the United States the participation exemption system is coupled with immediate taxation of certain types of earnings to avoid erosion of the U.S. tax base. These taxed foreign earnings can then be repatriated to the United States without further tax.

[9]A specified 10-percent owned foreign corporation is any foreign corporation, other than a passive foreign investment corporation with respect to a shareholder that is not also a CFC, with at least one corporate U.S. shareholder. Section 245A(b).

dends essentially means that this income is not taxed in the United States at the corporate level. The existing rules in sections 951(a) and 959 continue to apply, meaning that generally only earnings associated with income that is not taxed under the subpart F regime (or under the GILTI regime, discussed below) can, upon distribution, give rise to a dividend eligible for the section 245A deduction. Because subpart F (and GILTI) taxation is not reduced by distributions made during the year (except in the case of certain transfers of stock of a CFC during a taxable year), any distribution of earnings and profits that is taxed under the subpart F regime (or GILTI regime) is a distribution of PTEP (that is, a distribution of previously taxed earnings and profits) that is not treated as a dividend by reason of section 959(d), and thus cannot qualify for section 245A. Section 245A applies to distributions made after December 31, 2017.

Because the pre-Act international tax regime imposed U.S. tax on most non-mobile, non-passive earnings and profits only when those earnings were repatriated, a significant amount of untaxed earnings and profits had been accumulated offshore when the Act was passed. The enactment of section 245A by the Act thus presented a potential windfall, allowing taxpayers who had held earnings and profits offshore to distribute all of those earnings back to the United States tax-free. Congress did not intend for section 245A to apply to such pre-Act earnings, and thus included a so-called transition tax (section 965) "[t]o avoid a potential windfall for corporations that deferred income, and to ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system." H. Rep. No. 115-409 at 375.

2. Background: Section 965 – Transition Tax

Section 965 imposed a transition tax on the post-1986 earnings and profits of foreign corporations that had gone untaxed under the pre-Act international tax regime and would not be subject to the GILTI regime because the income was earned in a year prior to that regime being in effect. Absent section 965, such earnings and profits would have been eligible for tax-free distribution under section 245A. Specifically, section 965(a) increases certain foreign corporations' subpart F income for their last taxable year beginning before January 1, 2018, by the amount of their non-previously taxed earnings and profits computed as of no later than December 31, 2017. This has the effect of subjecting all offshore post-1986 untaxed earnings of most U.S. shareholders as of no later than December 31, 2017, to U.S. tax (albeit at a reduced rate by reason of section 965(c)), turning all such earnings into PTEP under section 959. As a result, none of those earnings and profits are eligible for the section 245A deduction, and such earnings and profits, once taxed under section 965, are instead treated in the same way as if they had been taxed under the pre-Act subpart F regime.

For a calendar year CFC, the transition tax generally provides a mechanism for ensuring that only earnings and profits subject to the new international tax system can qualify for the dividends received deduction under section 245A. This appears to be the intended purpose of section 965(a), as the legislative history of the Act provides that "[t]he [transition tax applies in] the last taxable year of a deferred foreign income corporation that begins before January 1, 2018, which is that foreign corporation's last taxable year before the transition to the new corporate tax regime elsewhere in the bill goes into effect." H. Rep. 115-466 at 613. This is not the case, however, for fiscal year CFCs (i.e., CFCs with a taxable year other than the calendar year) as there is a gap period with respect to such entities during which certain of their earnings may escape taxation.

3. Background: Section 951A – GILTI Regime

By subjecting post-1986 earnings and profits to a transition tax, section 965 was generally intended to ensure that only earnings first subjected to the anti-base erosion provisions of the Act could qualify for section 245A. While the Act preserved the existing subpart F regime, legislative history shows congressional concern that the participation exemption system could heighten the incentive to shift profits to low-taxed foreign jurisdictions or tax havens after the Act. *See* Senate Explanation at 365. For example, Congress expressed concern that a domestic corporation might allocate income susceptible to base erosion to certain foreign affiliates "where the income could potentially be distributed back to the [domestic] corporation with no U.S. tax imposed." *See id*. As a result of these concerns, the Act added another, complementary regime to address the additional base erosion incentives engendered by the participation exemption. This regime taxes a U.S. shareholder on its global intangible low-taxed income, or GILTI, with respect to its CFCs at a reduced rate (by reason of section 250) under new section 951A.

Section 951A(a) generally subjects a U.S. shareholder to current taxation each year on its GILTI with respect to its CFCs. The GILTI of a U.S. shareholder is generally defined as its pro rata share of its CFCs' taxable income for the year in excess of a normal return – a formulaic amount equal to 10 percent of the tax basis of the CFCs' tangible assets. *See* section 951A(b), (c), (d). For purposes of this determination, specific types of income of a CFC, including income taxed under another Code provision (including the subpart F regime), certain immobile income, or certain highly taxed income, are not taken into account. *See* Senate Explanation at 366 (explaining that such income is either already taxed or does not present base erosion concerns). The GILTI regime applies in the first taxable year of a CFC beginning after December 31, 2017. Thus, in the case of calendar year CFCs, the application of the GILTI regime generally must be taken into account with respect to all new earnings and profits of a CFC earned immediately after section 965 has caused all of the CFC's pre-Act earnings to be taxed. *See* Pub. L. No. 115-97, sec. 14201(d).

As is the case with respect to the subpart F regime, the tax base subject to the GILTI regime is not reduced by distributions made by a CFC during a taxable year (except in the case of certain transfers of stock of a CFC during a taxable year), and section 951A(f)(1)(A) provides that an income inclusion under the GILTI regime is treated in the same manner as an inclusion of subpart F income under the subpart F regime for purposes of section 959. These rules cause a CFC's earnings attributable to GILTI to be taxed under the GILTI regime in section 951A regardless of whether those earnings and profits are distributed before the end of the CFC's year, thus converting such earnings into PTEP and turning distributions (including those made before the end of the year in which the earnings and profits were earned) by the CFC into PTEP distributions that do not constitute dividends eligible for section 245A. Section 959(c), (d). Section 951(a)(2) also applies for purposes of determining a U.S. shareholder's pro rata share of its CFCs' income and other relevant items for purposes of section 951A. Section 951A(e).

B. *Need for the temporary regulations*

Sections 245A, 965, and 951A generally act to tax foreign source income equivalently across taxpayers and sources so long as a U.S. shareholder owns the same amount of stock of a calendar year CFC throughout the CFC's entire taxable year. Deviations from that condition, however, potentially allow taxpayers to avoid tax by claiming a section 245A deduction in situations where otherwise identical income would be subject to U.S. tax. This circumstance is inconsistent with the purposes of the new international tax regime enacted by Congress.[10] These temporary regulations are needed to limit section 245A to its intended scope and, thereby, prevent the provision from converting income that should be subject to U.S. tax into non-taxable dividends.

There are two situations in which deviations from the condition described in this section can give rise to these results. These are where (1) a U.S. corporation is the shareholder of a fiscal year CFC during 2018 and (2) a CFC pays a dividend and experiences a direct or indirect change in ownership during a taxable year.

The differing application of the GILTI regime with respect to fiscal year and calendar year CFCs creates one scenario where the interaction of section 245A with other new international tax provisions might be used to avoid tax. For a calendar year CFC, any earnings and profits accumulated as of no later than December 31, 2017, that had not been taxed under the subpart F regime generally were taxed under section 965 in the CFC's 2017 taxable year, turning such earnings and profits into PTEP. Then, starting in the calendar year CFC's taxable year beginning on January 1, 2018, the CFC's income became subject to the complementary subpart F and new GILTI regimes, and any income taxed under those provisions now also becomes PTEP. Concurrent with the applicability date of the GILTI regime, section 245A applies to dividends distributed after December 31, 2017, out of earnings that have not been taxed under the subpart F and GILTI regimes. These interlocking provisions create a cohesive regime in which the section 245A deduction applies only for distributions of post-2017 earnings and profits that are properly not taxed as the subpart F income or GILTI regimes. Operating in tandem, these provisions address Congress's concerns with section 245A by applying that provision (1) without granting windfalls for taxpayers that had historically kept earnings and profits offshore (by taxing all such earnings and profits under section 965 immediately before section 245A applies) and (2) without allowing a section 245A deduction for income susceptible to a heightened risk of base erosion. As a result of these provisions, only post-2017 earnings and profits that are not subject to the subpart F or GILTI regimes can qualify for a dividends received deduction under section 245A upon distribution from a calendar year CFC. Such earnings and profits are generally the normal return on a CFC's property (i.e., 10 percent of tax basis in tangible property), certain immobile income, or certain highly-taxed income that Congress believed would not raise windfall or base erosion concerns.

By contrast, the provisions that apply harmoniously to a calendar year CFC fail to form a cohesive regime when applied to a fiscal year CFC for its first taxable year that ends in 2018. Consider a CFC with a taxable year ending November 30. This CFC's income is still subject to the subpart F regime for all relevant taxable years. Section 965 also applies to the CFC's historical earnings and profits as of no later than December 31, 2017, and section 245A applies to distributions made by the CFC after December 31, 2017. However, the GILTI regime does not begin to apply to the CFC's income until the first taxable year of the CFC beginning after December 31, 2017, and thus does not first apply until the CFC's taxable year that begins on December 1, 2018. As a result of the gap in these effective dates, (1) the ordinary earnings of the CFC during the gap period avoid tax (which is a direct outgrowth of the effective dates); and (2) assets can be transferred between related parties in non-ordinary course transactions during that time period in such a way that current and future earnings and profits associated with the built-in gain in those assets can permanently avoid taxation by the United States because they are not subject to the GILTI regime and are not subject to the transition tax under section 965. Such earnings and profits might nevertheless be eligible to be distributed tax-free under section 245A. Such income, however, is economically identical to income earned by a calendar year CFC. Absent the temporary regulations, similar income from CFCs that differ only in their taxable year would be subject to different taxation. This difference between calendar year and fiscal year CFCs is significant and presents the potential for substantial tax avoidance when utilized to artificially generate earnings and profits in non-ordinary course transactions between related parties.

These temporary regulations refer to the portion of a dividend attributable to earnings and profits arising from such a transaction during this period as an "extraordinary disposition amount." An extraordinary disposition amount consists of certain earnings and profits resulting from transactions between related parties during the disqualified period. *See* the Explanation of Provisions section of this preamble for definitions of all relevant terms and conditions. Although the period during which extraordinary dispositions may have occurred has passed, the regu-

[10]The discussion herein assumes that the transactions at issue would otherwise withstand scrutiny under section 7701(o) (i.e., the economic substance doctrine) and related judicial doctrines. Taxpayers should draw no inferences from this assumption, however, as the IRS may challenge such transactions on these and other grounds.

lations will potentially apply to any distributions of the associated earnings and profits after 2017.

The second issue occurs because the application of the allocation rules under sections 951(a) and 951A (which determine a U.S. shareholder's pro rata share of a CFC's subpart F income or tested income for GILTI purposes) together with section 245A creates situations in which earnings and profits may not be properly subject to the new international tax regime that Congress enacted to prevent the inappropriate application of the section 245A deduction. For example, this situation may arise because of the "dividend offset" rule in section 951(a)(2)(B), which, subject to certain limitations, reduces a U.S. shareholder's pro rata share of subpart F income or tested income for dividends paid to another owner of the same stock of the CFC during the taxable year (such reduction being a rough approximation of the portion of subpart F income and tested income for the year that is properly attributable to the other owner).

In order to illustrate this concern, consider the following example. A corporate U.S. shareholder generally is taxed with respect to a CFC's subpart F income as of the end of the CFC's taxable year. Suppose, however, that the U.S. shareholder received a dividend from the CFC in an amount equal to its subpart F income and thereafter transferred ownership of the CFC to a new U.S. shareholder shortly before the end of the CFC's taxable year. If a section 245A deduction applied to the dividend, the corporate U.S. shareholder would not be taxed on the distribution. Furthermore, the second U.S. shareholder's subpart F inclusion for the CFC's taxable year may be reduced to approximately zero as a result of the dividend offset rule. As a consequence, absent the application of these temporary regulations, income that should have been subject to U.S. taxation under the subpart F regime could escape taxation altogether.

In contrast to the first issue, this second issue implicates the interlocking provisions of the international tax regime on an ongoing basis. As described in Part II.C of the Explanation of Provisions section of this preamble, section 245A could facilitate the avoidance of the subpart F and GILTI regimes by allowing a U.S. shareholder to transfer, before the end of a CFC's taxable year, stock of the CFC to a new shareholder who will not be taxed on the CFC's subpart F income or tested income. As a consequence of the repeal of section 958(b)(4), this new shareholder might be a foreign person who is not taxable with respect to the CFC's subpart F income or tested income. Alternatively, the new shareholder may not be taxable with respect to these amounts as a result of the dividend offset rule of section 951(a)(2)(B), notwithstanding the fact that if the prior owner of the stock is a corporate U.S. shareholder, the section 245A deduction may apply to dividends received by such prior owner. In these cases, current year subpart F income and GILTI could escape taxation altogether, a result that would undermine the post-Act system for taxing foreign earnings. These temporary regulations refer to earnings and profits representing the portion of a dividend of a CFC attributable to subpart F income or tested income of the CFC that, absent a transfer of stock of the CFC pursuant to an extraordinary reduction, would have been subject to the subpart F or GILTI regimes as an "extraordinary reduction amount." An extraordinary reduction amount consists of certain earnings and profits generated during a CFC's taxable year beginning after 2017 in which a domestic corporate U.S. shareholder reduces its ownership of the CFC by certain threshold amounts (e.g., a decrease in ownership of more than 10 percent). For this purpose, "certain earnings and profits" refers to income generally subject to inclusion under the subpart F or GILTI regimes. See the Explanation of Provisions section of this preamble for definitions of all relevant terms and conditions.

Results similar to the ones described in this section for extraordinary disposition amounts and extraordinary reduction amounts can be achieved using the exemption from subpart F income under section 954(c)(6) and lower-tier CFC dividends to upper-tier CFCs. Accordingly, the temporary regulations limit the application of the section 954(c)(6) exception in order to prevent similar results in circumstances in which a lower-tier CFC pays a dividend to another CFC, instead of directly to a U.S. shareholder.

C. *Overview of the temporary regulations*

The Treasury Department and the IRS have determined that it is appropriate to limit the section 245A deduction to distributions of earnings and profits that are attributable to certain normal return, high-taxed, or immobile income, which will ensure that similar income is taxed similarly. The temporary regulations do not permit section 245A deductions for the portions of dividends made by CFCs that are attributable to ineligible amounts, which comprise extraordinary reduction amounts and 50percent of any extraordinary disposition amounts.

To accomplish this, the temporary regulations disallow a deduction for transactions that have the effect of avoiding tax under section 951, 951A, or 965. The extraordinary disposition rules accomplish this by denying the deduction under section 245A for a narrowly and objectively defined class of earnings and profits generated by transactions undertaken in the disqualified period in circumstances that raise abuse concerns. The extraordinary reduction rules accomplish this by denying the deduction under section 245A for certain earnings distributed in the same year as reductions in ownership of CFC stock by a controlling section 245A shareholder. The temporary regulations contain similar rules with respect to section 954(c)(6).

D. *Economic analysis of the temporary regulations*

1. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the temporary regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these temporary regulations.

2. Summary of Economic Effects

To assess the economic effects of these regulations, the Treasury Department and the IRS considered the economic effects of disallowing the 245A deduction for (i) extraordinary disposition amounts and (ii) extraordinary reduction amounts.

The disallowance of the dividends received deduction for extraordinary disposition amounts applies, in plain language, only to earnings and profits accrued prior to issuance of the temporary regulations. Thus, no substantive economic activities can be affected by this disallowance and the economic decisions affected are only those associated with taxpayers' financing of their tax liability.

The Treasury Department and the IRS's analysis therefore focuses on those provisions of the temporary regulations that disallow the dividends received deduction for extraordinary reduction amounts. Absent the temporary regulations, U.S. taxation of income of a CFC that would otherwise be subject to the subpart F or GILTI regime could be avoided by a transfer of ownership of the CFC to other entities in such a way that the income of the CFC would not be subject to U.S. tax. Thus, the economic effects stem from those transfers that would give rise to an extraordinary reduction amount ("ER transfers") and that would not be undertaken as a result of the temporary regulations. The Treasury Department and the IRS project that a substantial portion of these ER transfers would have been undertaken for tax avoidance purposes only and would have negative effects on economic performance (giving rise to a positive economic effect from the temporary regulations) but that those effects would be minor because the transfers would take place among related parties and over short time frames. Thus, there would be only negligible losses in economic performance due to inefficient changes in management, risk-bearing, or other economic activity. Instead, the primary economic losses due to these transfers (and thus gains from the temporary regulations) are likely to consist of resources that would be expended in carrying out such tax planning activities. The Treasury Department and the IRS project that these saved resource costs would be small.

The Treasury Department and the IRS considered that at least some ER transfers that would not be pursued as a result of the temporary regulations would have provided positive economic benefits, such as through more efficient risk-bearing or other managerial control benefits. The Treasury Department and the IRS project that the aggregate value of these foregone benefits will be minimal because the transfers for which a deduction is disallowed and that are likely not to be undertaken as a result of the temporary regulations are not generally associated with productive economic activities. In this regard, the Treasury Department and the IRS expect that economically-motivated transfers of CFCs should not be inhibited by the temporary regulations because the temporary regulations, taking into account the election to close a CFC's taxable year, often will result in the same or similar tax liability to a seller as if the transfer had not occurred. Thus, the temporary regulations should not discourage economically-motivated transfers of CFCs. If anything, the temporary regulations will discourage transfers of CFCs that would not have occurred absent the tax results the temporary regulations seek to prevent. These transfers, which would be motivated by tax avoidance, likely would not be economically productive.

The temporary regulations will require taxpayers to compute, track, and report information relevant for determination of extraordinary dispositions and extraordinary reductions. The compliance burden component of the Treasury Department and the IRS's estimate of the economic effects of the temporary regulations reflects only those record-keeping and related compliance activities that would not have been undertaken in the absence of the temporary regulations. The Treasury Department and the IRS project that these additional costs, relative to the baseline, will be modest. In general, with respect to the initial year of an extraordinary disposition or any extraordinary reduction, taxpayers are already required to keep track of the required information for other purposes. For example, to the extent that a U.S. taxpayer sells stock in its CFC, earns income in its CFC, or receives a dividend from a CFC, the taxpayer would otherwise record the information needed to determine eligibility for the section 245A deduction under the temporary regulations. Additionally, once calculated the costs to track amounts related to extraordinary dispositions in future years are expected to be minimal. For all of these reasons, the Treasury Department and the IRS expect the non-revenue economic effects of these temporary regulations to be small.[11]

The Treasury Department and the IRS have not undertaken a quantitative estimate of the economic benefits arising from avoided transactions that constitute extraordinary reductions. Any such estimates would be highly uncertain because these tax provisions are new and because the transfers would be between related parties and primarily of short duration, both of which factors make estimation difficult. The tax planning costs of effecting these transfers are also highly uncertain because these specific tax planning efforts are new.

While it is not currently feasible for the Treasury Department and the IRS to quantify these economic effects, part I.D.3 of these Special Analyses explains the rationale behind the provisions of these temporary regulations and provides a qualitative assessment of the alternatives considered.

The Treasury Department and the IRS solicit comments on this assessment of the economic effects of the temporary regulations.

3. Analysis of Specific Provisions

i. Ordering of Distributions of Earnings and Profits With Respect to Extraordinary Disposition Amounts

a. Background and Alternatives Considered

Any transaction that gave rise to an extraordinary disposition has already taken place because the disqualified period has closed for all taxpayers. Thus, the temporary regulations should have no economic effect with respect to these transactions. Nevertheless, the denial of a section 245A deduction with respect to the related extraordinary disposition E&P may in some cases lead CFCs to retain earnings rather than distribute them in order to defer the associated U.S. tax. The undistributed earnings in this case may lead to a so-called "lockout effect" pursuant to which some portion of the offshore capital re-

[11]This claim refers solely to the economic benefit arising from this provision and does not refer to any estimate of the tax revenue effects of the provision.

mains in less productive ventures than would otherwise be the case had the earnings and profits been eligible for a section 245A deduction.

The temporary regulations address this potential concern by providing an ordering rule such that extraordinary distribution E&P generally are the last earnings and profits deemed distributed by a CFC. As a result, CFCs generally may distribute all other earnings and profits that are eligible for a section 245A deduction before extraordinary disposition E&P for which a section 245A deduction is not allowed. This rule will generally minimize the capital allocation inefficiencies stemming from a potential lockout effect by deferring the application of the temporary regulations to the latest extent possible. Moreover, the Treasury Department and the IRS expect that the extraordinary disposition E&P will not often be associated with liquid assets, such as cash. An extraordinary disposition requires a non-ordinary course transaction among related parties. The Treasury Department and the IRS are aware that transactions giving rise to an extraordinary disposition typically involve the issuance of related party debt or stock. These instruments are not the sort of assets that implicate lockout effect concerns because they would rarely be used as consideration for making a payment to a third party.

The Treasury Department and the IRS considered as an alternative not providing an ordering rule. For the reasons mentioned above, this alternative was not adopted. In particular, the lack of an ordering rule would have inhibited taxpayers from accessing future offshore earnings that had been appropriately subject to tax under Act, which would have frustrated the congressional purpose underlying the participation exemption. By essentially reviving the lockout effect that had motivated certain international aspects of the Act, this alternative approach may have trapped capital in suboptimal offshore uses.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are direct or indirect U.S. shareholders of certain foreign corporations that are eligible for the section 245A deduction or the section 954(c)(6) exception with respect to distributions from the foreign corporation, and the foreign corporation uses a fiscal year, as opposed to the calendar year, as its taxable year. The foreign corporation must have engaged in a sale of property to a related party (1) during the period between January 1, 2018, and the end of the foreign corporation's last taxable year beginning before 2018, (2) outside the ordinary course of the foreign corporation's activities, and (3) generally, while the corporation was a CFC. Additionally, the property sold must give rise to tested income and the value of the property sold must exceed the lesser of $50 million or 5 percent of the total value of the property of the foreign corporation.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged in these particular transactions is not readily available. However, based on tabulations of the 2014 Statistics of Income Study file the Treasury Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. The actual number of affected taxpayers is smaller than the number of domestic corporations with at least one fiscal year CFC, because a domestic corporation will not be affected unless its fiscal year CFC engages in a non-routine sale with a related party that is of sufficient magnitude that the temporary regulations to apply.

ii. Definition of Extraordinary Reduction

a. Background and Alternatives Considered

The temporary regulations limit the amount of the 245A deduction whenever there is an "extraordinary reduction." The temporary regulations generally define an extraordinary reduction, subject to certain conditions, as when either the controlling section 245A shareholder transfers more than 10 percent of its stock of the CFC or there is a greater than 10 percent change in the controlling section 245A shareholder's overall ownership of the CFC.

The Treasury Department and the IRS, in defining an extraordinary reduction, considered other percentage thresholds. They expect that the ownership change threshold provides an effective balance of compliance costs for taxpayers, effective administration of section 245A, and revenue considerations. The Treasury Department and the IRS do not have appropriate data or models to precisely compute an optimal percentage threshold. The Treasury Department and the IRS solicit comments on the economic and revenue consequences of the ownership change threshold and alternative thresholds. The Treasury Department and the IRS particularly solicit comments that provide data, models, or analysis suitable for evaluating alternative thresholds.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are U.S. shareholders that own directly or indirectly stock of a CFC that has a controlling U.S. shareholder that owns 50 percent or more of the stock of the CFC. Additionally, during the taxable year, the controlling U.S. shareholder generally must directly or indirectly sell stock in the CFC that exceeds 10 percent of the controlling U.S. shareholder's interest in the CFC and 5 percent of the total value of the stock of the CFC. Furthermore, in the year of the ownership reduction, the subpart F income and tested income of the CFC must exceed the lesser of $50 million or 5 percent of the CFC's total income for the year.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged or would engage in these particular transactions is not readily available. However, based on 2014 Statistics of Income tax data, the Treasury Department and the IRS estimate that there are approximately 15,000 domestic corporations with CFCs. The Treasury Department and the IRS project that the actual number of affected taxpayers is likely much smaller than the number of domestic corporations with CFCs, given that the controlling U.S. shareholder must engage in a sale of stock of a CFC in a year in which the CFC pays a dividend in order for the temporary regulations to apply.

iii. Election to Avoid Taxable Dividend by Closing the CFC's Taxable Year

a. Background and Alternatives Considered

The Treasury Department and the IRS provide taxpayers with an election to avoid having a taxable dividend with respect to an extraordinary reduction amount by closing the taxable year of the CFC for all purposes of the Code on the date of the extraordinary reduction. Such an election would subject the earnings and profits that, absent the election, would give rise to an extraordinary reduction amount instead to taxation under the subpart F or GILTI regimes, and therefore, exemption under section 245A for any remaining earnings is appropriate. By providing this election, the Treasury Department and the IRS allow taxpayers to choose the tax treatment that would have been imposed in the absence of the interactions among provisions.

In addition to ensuring that similar income is taxed similarly, this election increases the choices available to taxpayers, thus increasing flexibility and thereby minimizing the burden imposed by these regulations. To the extent taxpayers choose this election, tax burdens could be reduced relative to tax burdens under the temporary regulations in the absence of the election, because denying the section 245A deduction could result in higher tax (i.e., at ordinary corporate rates) than imposition of a reduced tax under the GILTI regime. The Treasury Department and the IRS chose to allow such election because if the election were not allowed, some taxpayers would be taxed more heavily than the Treasury Department and the IRS have determined is intended under the Act.

b. Affected Taxpayers

The taxpayers potentially affected by this aspect of the temporary regulations are described in Part I.D.3.ii.b of this Special Analyses.

II. Paperwork Reduction Act

The collections of information in the temporary regulations are in §§1.245A-5T(e)(3) and 1.6038-2T(f)(16).

The collection of information in §1.245A-5T(e)(3) is elective for a domestic corporation that is a controlling U.S. shareholder of a CFC receiving a dividend from the CFC and wants to elect to have none of the dividend considered an extraordinary reduction amount by closing the CFC's tax year. The collection of information is satisfied by timely filing of the "Elective Section 245A Year-Closing Statement" with the domestic corporation's original Form 1120, U.S. Corporation Income Tax Return, for the taxable year in which the dividend is received. For purposes of the Paperwork Reduction Act, the reporting burden associated with §1.245A-5T will be reflected in the Paperwork Reduction Act submission associated with Form 1120 (OMB control no. 1545-0123).

The collection of information in §1.6038-2T(f)(16) is mandatory for every U.S. person that controls a foreign corporation that has paid a dividend for which a deduction under section 245A was limited by an ineligible amount under § 1.245A-5T(b) or paid a dividend for which the section 954(c)(6) exception was limited by a tiered extraordinary disposition amount or tiered extraordinary reduction amount under §1.245A-5T(d) and (f), respectively, during an annual accounting period and files Form 5471 for that period (OMB control number 1545-0123 in the case of business taxpayers, formerly, OMB control number 1545-0704). The collection of information in §1.6038-2T(f)(16) is satisfied by providing information about the ineligible amount, tiered extraordinary disposition amount, or tiered extraordinary reduction amount for the corporation's accounting period as Form 5471 and its instructions may prescribe. For purposes of the Paperwork Reduction Act, the reporting burden associated with §1.6038-2T(f)(16) will be reflected in the applicable Paperwork Reduction Act submission, associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with §1.6038-2T(f)(16) is 12,000-18,000, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471		✓	12,000–18,000

The current status of the Paperwork Reduction Act submissions related to the new revised Form 5471 as a result of the information collections in the temporary regulations is provided in the accompanying table. The reporting burdens associated with the information collections in §§1.245A-5T-(e)(3) and 1.6038-2T(f)(16) are included in the aggregated burden estimates for OMB control number 1545-0123, which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of $58.148 billion ($2017). The overall burden estimates provided in 1545-0123 are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden of the tax forms that will be revised as a result of the information collections in the proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the temporary regulations. The Treasury Department and the IRS urge readers to recognize that these numbers are duplicates of estimates provided for informational purposes in other proposed and final regulatory actions and to guard against over-counting the burden that international tax provisions imposed prior to the Act.

In September 2018, the IRS released and invited comment on drafts of new revised Form 5471 in order to give members of the public the opportunity to benefit from certain specific provisions made to the Code. The IRS received no comments on the draft revised Form 5471 on the portions of the form that relate to section 245A during the comment period. Consequently, the IRS made the form available in December 2018 for use by the public. The IRS is contemplating making additional changes to Form 5471 to implement these temporary regulations.

No burden estimates specific to the temporary regulations are currently available. The Treasury Department and the IRS have not identified any burden estimates, including those for new information collections, related to the requirements under the temporary regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the temporary regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the temporary regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. Proposed revisions to these forms that reflect the information collections contained in these temporary regulations will be made available for public comment at www.irs.gov/draftforms and will not be finalized until after approved by OMB under the PRA.

<table>
<tr><th>Information Collection</th><th>Type of Filer</th><th>OMB Number(s)</th><th>Status</th></tr>
<tr><td rowspan="2">Form 5471</td><td>Business
(NEW Model)</td><td>1545-0123</td><td>Approved by OMB on 12/21/2018.</td></tr>
<tr><td colspan="3">Link: https://www.federalregister.gov/documents/2018/12/21/2018-27735/agency-information-collection-activities-submission-for-omb-review-comment-request-multiple-irs</td></tr>
</table>

III. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately $154 million. These temporary regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

IV. Executive Order 13132: Federalism

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These temporary regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Drafting Information

The principal author of the temporary regulations is Logan M. Kincheloe, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recording keeping requirements.

Amendments 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 a sectional authority for §1.245A-5 to read in part as follows:

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

* * * * *

Section 1.245A-5 also issued under 26 U.S.C. 245A(g), 951A(a), 954(c)(6)(A), and 965(o).

* * * * *

Par. 2. Reserved sections 1.245A-1 through 4 and § 1.245A-5T are added to read as follows:

Sec.

1.245A-1 [Reserved].

1.245A-2 [Reserved].

1.245A-3 [Reserved].

1.245A-4 [Reserved].

1.245A-5T Limitation of section 245A deduction and section 954(c)(6) exception (temporary).

§1.245A-5T Limitation of section 245A deduction and section 954(c)(6) exception (temporary).

(a) *Overview.* This section provides rules that limit a deduction under section 245A(a) to the portion of a dividend that exceeds the ineligible amount of such dividend or the applicability of section 954(c)(6) when a portion of a dividend is paid out of an extraordinary disposition account or when an extraordinary reduction occurs. Paragraph (b) of this section provides rules regarding ineligible amounts. Paragraph (c) of this section provides rules for determining ineligible amounts attributable to an extraordinary disposition. Paragraph (d) of this section provides rules that limit the application of section 954(c)(6) when one or more section 245A shareholders of a lower-tier CFC have an extraordinary disposition account. Paragraph (e) of this section provides rules for determining ineligible amounts attributable to an extraordinary reduction. Paragraph (f) of this section provides rules that limit the application of section 954(c)(6) when a lower-tier CFC has an extraordinary reduction amount. Paragraph (g) of this section provides special rules for purposes of applying this section.

Paragraph (h) of this section provides an anti-abuse rule. Paragraph (i) of this section provides definitions. Paragraph (j) of this section provides examples illustrating the application of this section. Paragraph (k) of this section provides the applicability date of this section. Paragraph (l) of this section provides the expiration date of this section.

(b) *Limitation of deduction under section 245A*—(1) *In general*. A section 245A shareholder is allowed a section 245A deduction for any dividend received from an SFC (provided all other applicable requirements are satisfied) only to the extent that the dividend exceeds the ineligible amount of the dividend. See paragraphs (j)(2), (4), and (5) of this section for examples illustrating the application of this paragraph (b)(1).

(2) *Definition of ineligible amount.* The term *ineligible amount* means, with respect to a dividend received by a section 245A shareholder from an SFC, an amount equal to the sum of—

(i) 50 percent of the extraordinary disposition amount (as determined under paragraph (c) of this section), and

(ii) The extraordinary reduction amount (as determined under paragraph (e) of this section).

(c) *Rules for determining extraordinary disposition amount*—(1) *Definition of extraordinary disposition amount*. The term *extraordinary disposition amount* means the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder. See paragraph (j)(2) of this section for an example illustrating the application of this paragraph (c).

(2) *Determination of portion of dividend paid out of extraordinary disposition account*—(i) *In general*. For purposes of determining the portion of a dividend received by a section 245A shareholder from an SFC that is paid out of the extraordinary disposition account with respect to the section 245A shareholder, the following rules apply—

(A) The dividend is first considered paid out of non-extraordinary disposition E&P with respect to the section 245A shareholder; and

(B) The dividend is next considered paid out of the extraordinary disposition account to the extent of the section 245A shareholder's extraordinary disposition account balance.

(ii) *Definition of non-extraordinary disposition E&P*. The term *non-extraordinary disposition E&P* means, with respect to a section 245A shareholder and an SFC, an amount of earnings and profits of the SFC equal to the excess, if any, of—

(A) The product of—

(*1*) The amount of the SFC's earnings and profits described in section 959(c)(3), determined as of the end of the SFC's taxable year (for this purpose, without regard to distributions during the taxable year other than as provided in this paragraph (c)(2)(ii)(A)(*1*)), but, if during the taxable year the SFC pays more than one dividend, reduced (but not below zero) by the amounts of any dividends paid by the SFC earlier in the taxable year; and

(*2*) The percentage of the stock (by value) of the SFC that the section 245A shareholder owns directly or indirectly immediately after the distribution (taking into account all transactions related to the distribution); over

(B) The balance of the section 245A shareholder's extraordinary disposition account with respect to the SFC, determined immediately before the distribution.

(3) *Definitions with respect to extraordinary disposition accounts*—(i) *Extraordinary disposition account*—(A) *In general*. The term *extraordinary disposition account* means, with respect to a section 245A shareholder of an SFC, an account the balance of which is equal to the product of the extraordinary disposition ownership percentage and the extraordinary disposition E&P, reduced (but not below zero) by the prior extraordinary disposition amount, and adjusted under paragraph (c)(4) of this section, as applicable.

(B) *Extraordinary disposition ownership percentage*. The term *extraordinary disposition ownership percentage* means the percentage of stock (by value) of a SFC that a section 245A shareholder owns directly or indirectly at the beginning of the disqualified period or, if later, on the first day during the disqualified period on which the SFC is a CFC, regardless of whether the section 245A shareholder owns directly or indirectly such stock of the SFC on the date of an extraordinary disposition giving rise to extraordinary disposition E&P; if not, see paragraph (c)(4) of this section.

(C) *Extraordinary disposition E&P*. The term *extraordinary disposition E&P* means an amount of earnings and profits of an SFC equal the sum of the net gain recognized by the SFC with respect to specified property in each extraordinary disposition. In the case of an extraordinary disposition with respect to the SFC arising as a result of a disposition of specified property by a specified entity (other than a foreign corporation), an interest of which is owned directly or indirectly (through one or more other specified entities that are not foreign corporations) by the SFC, the net gain taken into account for purposes of the preceding sentence is the SFC's distributive share of the net gain recognized by the specified entity with respect to the specified property.

(D) *Prior extraordinary disposition amount*—(*1*) *General rule*. The term *prior extraordinary disposition amount* means, with respect to an SFC and a section 245A shareholder, the sum of the extraordinary disposition amount of each prior dividend received by the section 245A shareholder from the SFC by reason of paragraph (c) of this section and 200 percent of the sum of the amounts included in the section 245A shareholder's gross income under section 951(a) by reason of paragraph (d) of this section (in the case in which the SFC is, or has been, a lower-tier CFC). A section 245A shareholder's prior extraordinary disposition amount also includes—

(*i*) A prior dividend received by the section 245A shareholder from the SFC to the extent not an extraordinary reduction amount and to the extent the dividend was not eligible for the section 245A deduction by reason of section 245A(e) or the holding period requirement of section 246 not being satisfied but would have been an extraordinary disposition amount had paragraph (c) of this section applied to the dividend;

(*ii*) The portion of a prior dividend (to the extent not a tiered extraordinary disposition amount by reason of paragraph (d) of this section) received by an upper-tier CFC from the SFC that by reason of section 245A(e) was included in the upper-tier CFC's foreign personal holding company income and was included in gross income by the section 245A shareholder under section 951(a) but would have been a tiered extraordinary disposition amount by reason of paragraph (d) of this section had paragraph (d) applied to the dividend;

(*iii*) If a prior dividend received by an upper-tier CFC from a lower-tier CFC gives rise to a tiered extraordinary disposition amount with respect to the section 245A shareholder by reason of paragraph (d) of this section, the qualified portion.

(*2*) *Definition of qualified portion*—(i) *In general*. The term *qualified portion* means, with respect to a tiered extraordinary disposition amount of a section 245A shareholder and a lower-tier CFC, 200 percent of the portion of the disqualified amount with respect to the tiered extraordinary disposition amount equal to the sum of the amounts included in gross income by each U.S. tax resident under section 951(a) in the taxable year in which the tiered extraordinary disposition amount arose with respect to the lower-tier CFC by reason of paragraph (d) of this section. For purposes of the preceding sentence, the reference to a U.S. tax resident does not include any section 245A shareholder with a tiered extraordinary disposition amount with respect to the lower-tier CFC.

(*ii*) *Determining a qualified portion if multiple section 245A shareholders have tiered extraordinary disposition amounts*. For the purposes of applying paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, if more than one section 245A shareholder has a tiered extraordinary disposition amount with respect to a dividend received by an upper-tier CFC from a lower-tier CFC, then the qualified portion with respect to each section 245A shareholder is equal to the amount described in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section, without regard to this paragraph (c)(3)(i)(D)(*2*)(*ii*), multiplied by a fraction, the numerator of which is the section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC and the denominator of which is the sum of the tiered extraordinary disposition amounts with respect to each section 245A shareholder and the lower-tier CFC.

(ii) *Extraordinary disposition*—(A) *In general*. Except as provided in paragraph (c)(3)(ii)(E) of this section, the term *extraordinary disposition* means, with respect to an SFC, any disposition of specified property by the SFC on a date on which it was a CFC and during the SFC's disqualified period to a related party if the disposition occurs outside of the ordinary course of the SFC's activities. An extraordinary disposition also includes a disposition during the disqualified period on a date on which the SFC is not a CFC if there is a plan, agreement, or understanding involving a section 245A shareholder to cause the SFC to recognize gain that would give rise to an extraordinary disposition if the SFC were a CFC.

(B) *Facts and circumstances*. A determination as to whether a disposition is undertaken outside of the ordinary course of an SFC's activities is made on the basis of facts and circumstances, taking into account whether the transaction is consistent with the SFC's past activities, including with respect to quantity and frequency. In addition, a disposition of specified property by an SFC to a related party may be considered outside of the ordinary course of the SFC's activities notwithstanding that the SFC regularly disposes of property of the same type of, or similar to, the specified property to persons that are not related parties.

(C) *Per se rules*. A disposition is treated as occurring outside of the ordinary course of an SFC's activities if the disposition is undertaken with a principal purpose of generating earnings and profits during the disqualified period or if the disposition is of intangible property, as defined in section 367(d)(4).

(D) *Treatment of dispositions by certain specified entities*. For purposes of paragraph (c)(3)(ii)(A) of this section, an extraordinary disposition with respect to an SFC includes a disposition by a specified entity other than a foreign corporation, provided that immediately before or immediately after the disposition the specified entity is a related party with respect to the SFC, the SFC directly or indirectly (through one or more other specified entities other than foreign corporations) owns an interest in the specified entity, and the disposition would have otherwise qualified as an extraordinary disposition had the specified entity been a foreign corporation.

(E) *De minimis exception to extraordinary disposition*. If the sum of the net gain recognized by an SFC with respect to specified property in all dispositions otherwise described in paragraph (c)(3)(ii)(A) of this section does not exceed the lesser of $50 million or 5 percent of the gross value of all of the SFC's property held immediately before the beginning of its disqualified period, then no disposition of specified property by the SFC is an extraordinary disposition.

(iii) *Disqualified period*. The term *disqualified period* means, with respect to an SFC that is a CFC on any day during the taxable year that includes January 1, 2018, the period beginning on January 1, 2018, and ending as of the close of the taxable year of the SFC, if any, that begins before January 1, 2018, and ends after December 31, 2017.

(iv) *Specified property*. The term *specified property* means any property if gain recognized with respect to such property during the disqualified period is not described in section 951A(c)(2)(A)(i)(I) through (V). If only a portion of the gain recognized with respect to property during the disqualified period is gain that is not described in section 951A(c)(2)(A)(i)(I) through (V), then a portion of the property is treated as specified property in an amount that bears the same ratio to the value of the property as the amount of gain not described in section 951A(c)(2)(A)(i)(I) through (V) bears to the total amount of gain recognized with respect to such property during the disqualified period.

(4) *Successor rules for extraordinary disposition accounts*. This paragraph (c)(4) applies with respect to an extraordinary disposition account upon certain direct or indirect transfers of stock of an SFC by a section 245A shareholder.

(i) *Another section 245A shareholder succeeds to all or portion of account*. Except for a transfer described in §1.1248-8(a)(1), paragraphs (c)(4)(i)(A) through (C) of this section apply when a section 245A shareholder of an SFC (the *transferor*) transfers directly or indirectly a share of stock (or a portion of a share of stock) of the SFC that it owns directly or indirectly (the share or portion thereof, a *transferred share*).

(A) If immediately after the transfer (taking into account all transactions related to the transfer) another person is a section 245A shareholder of the SFC, then such other person's extraordinary disposition account with respect to the SFC is increased by the person's proportionate share of the amount allocated to the transferred share.

(B) For purposes of paragraph (c)(4)(i)(A) of this section, the amount allocated to a transferred share is equal to the product of—

(*1*) The balance of the transferor's extraordinary disposition account with respect to the SFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(i)(B); and

(*2*) A fraction, the numerator of which is the value of the transferred share and the denominator of which is the value of all of the stock of the SFC that the transferor owns directly or indirectly immediately before the transfer.

(C) For purposes of paragraph (c)(4)(i)(A) of this section, a person's proportionate share of the amount allocated to a transferred share under paragraph (c)(4)(i)(B) of this section is equal to the product of—

(*1*) The amount allocated to the share; and

(*2*) The percentage (expressed as a decimal) of the share (by value) that the person owns directly or indirectly immediately after the transfer (taking into account all transactions related to the transfer).

(D) The transferor's extraordinary disposition account with respect to the SFC is decreased by the amount by which another person's extraordinary disposition account with respect to the SFC is increased pursuant to paragraph (c)(4)(i)(A) of this section.

(E) If a principal purpose of the transfer is to shift, or to avoid, an amount in the transferor's extraordinary disposition account with respect to the SFC to another person, then for purposes of this section, the transfer may be disregarded or other appropriate adjustments may be made.

(ii) *Certain section 381 transactions*. If assets of an SFC (the *acquired corporation*) are acquired by another SFC (the *acquiring corporation*) pursuant to a transaction described in section 381(a) in which the acquired corporation is the transferor corporation for purposes of section 381, then a section 245A shareholder's extraordinary disposition account with respect to the acquiring corporation is increased by the balance of its extraordinary disposition account with respect to the acquired corporation, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and before the application of this paragraph (c)(4)(ii).

(iii) *Certain distributions involving section 355 or 356*. If, pursuant to a reorganization described in section 368(a)(1)(D) involving a distribution under section 355 (or so much of section 356 as it relates to section 355) by an SFC (the *distributing corporation*) of stock of another SFC (the *controlled corporation*), earnings and profits of the distributing corporation are allocated between the distributing corporation and the controlled corporation, then a section 245A shareholder's extraordinary disposition account with respect to the distributing corporation is allocated on a similar basis between the distributing corporation and the controlled corporation.

(iv) *Certain transfers of stock of lower-tier CFCs by upper-tier CFCs*. If an upper-tier CFC directly or indirectly transfers stock of a lower-tier CFC and if as a result of the transfer a section 245A shareholder ceases to be a section 245A shareholder with respect to the lower-tier CFC, then the section 245A shareholder's extraordinary disposition account with respect to the upper-tier CFC is increased by the balance of the section 245A shareholder's extraordinary disposition account with respect to the lower-tier CFC, determined after any reduction pursuant to paragraph (c)(3) of this section by reason of dividends and after application of paragraph (c)(4)(i) of this section, if applicable. If a section 245A shareholder ceases to be a section 245A shareholder with respect to a lower-tier CFC by reason of a direct or indirect transfer of stock of the lower-tier CFC by multiple upper-tier CFCs that occur pursuant to a plan (or series of related transactions), then the balance of the section 245A shareholder's extraordinary disposition account is allocated among the upper-tier CFCs. The portion of the balance of the account allocated to each upper-tier CFC is equal to the balance of the account multiplied by a fraction, the numerator of which is the value of the stock of the lower-tier CFC transferred directly or indirectly by the upper-tier CFC, and the denominator of which is the sum of the value of the stock of the lower-tier CFC transferred directly or indirectly by all upper-tier CFCs.

(d) *Limitation of amount eligible for section 954(c)(6) when there is an extraordinary disposition account with respect to a lower-tier CFC*—(1) *In general*. If an upper-tier CFC receives a dividend from a lower-tier CFC, the dividend is eligible for the exception to foreign personal holding company income under section 954(c)(6) only to the extent that the amount that would be eligible for the section 954(c)(6) exception (determined without regard to this paragraph (d)) exceeds the *disqualified amount*, which is 50 percent of the quotient of the following—

(i) The sum of each section 245A shareholder's tiered extraordinary disposition amount with respect to the lower-tier CFC; and

(ii) The percentage (expressed as a decimal) of stock of the upper-tier CFC (by value) owned, in the aggregate, by U.S. tax residents that include in gross income their pro rata share of the upper-tier CFC's subpart F income under section 951(a) on the last day of the upper-tier CFC's taxable year. If a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder of the upper-tier CFC, the amount of stock owned by the U.S. tax resident for purposes of the preceding sentence is determined under the principles of paragraph (g)(3) of this section.

(2) *Definition of tiered extraordinary disposition amount*—(i) *In general*. The term *tiered extraordinary disposition amount* means, with respect to a dividend received by an upper-tier CFC from a lower-tier CFC and a section 245A shareholder, the portion of the dividend that would be an extraordinary disposition amount if the section 245A shareholder received as a dividend its pro rata share of the dividend from the lower-tier CFC. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC from a lower-tier CFC by reason of section 964(e)(4) (in such case, see paragraphs (b)(1) and (g)(2) of this section).

(ii) *Section 245A shareholder's pro rata share of a dividend received by an* *upper-tier CFC*. For the purposes of paragraph (d)(2)(i) of this section, a section 245A shareholder's pro rata share of the amount of a dividend received by an upper-tier CFC from a lower-tier CFC equals the amount by which the dividend would increase the section 245A shareholder's pro rata share of the upper-tier CFC's subpart F income under section 951(a)(2) and §1.951-1(b) and (e) if the dividend were included in the upper-tier CFC's foreign personal holding company income under section 951(a)(1), determined without regard to section 952(c) and as if the upper-tier CFC had no deductions properly allocable to the dividend under section 954(b)(5).

(e) *Extraordinary reduction amount*—(1) *In general*. Except as provided in paragraph (e)(3) of this section, the term *extraordinary reduction amount* means, with respect to a dividend received by a controlling section 245A shareholder from a CFC during a taxable year of the CFC ending after December 31, 2017, in which an extraordinary reduction occurs with respect to the controlling section 245A shareholder's ownership of the CFC, the lesser of the amounts described in paragraph (e)(1)(i) or (ii) of this section. See paragraphs (j)(4) through (6) of this section for examples illustrating the application of this paragraph (e).

(i) The amount of the dividend.

(ii) The amount equal to the sum of the controlling section 245A shareholder's pre-reduction pro rata share of the CFC's subpart F income (as defined in section 952(a)) and tested income (as defined in section 951A(c)(2)(A)) for the taxable year, reduced, but not below zero, by the prior extraordinary reduction amount.

(2) *Rules regarding extraordinary reduction amounts*—(i) *Extraordinary reduction*—(A) *In general*. Except as provided in paragraph (e)(2)(i)(C) of this section, *an extraordinary* reduction occurs, with respect to a controlling section 245A shareholder's ownership of a CFC during a taxable year of the CFC, if either of the conditions described in paragraph (e)(2)(i)(A)(1) or (2) of this section is satisfied. See paragraphs (j)(4) and (5) of this section for examples illustrating an extraordinary reduction.

(*1*) The condition of this paragraph (e)(2)(i)(A)(*1*) requires that during the taxable year, the controlling section 245A shareholder transfers directly or indirectly (other than by reason of a transfer occurring pursuant to an exchange described in section 368(a)(1)(E) or (F)), in the aggregate, more than 10 percent (by value) of the stock of the CFC that the section 245A shareholder owns directly or indirectly as of the beginning of the taxable year of the CFC, provided the stock transferred, in the aggregate, represents at least 5 percent (by value) of the outstanding stock of the CFC as of the beginning of the taxable year of the CFC; or

(*2*) The condition of this paragraph (e)(2)(i)(A)(*2*) requires that, as a result of one or more transactions occurring during the taxable year, the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly as of the close of the last day of the taxable year of the CFC is less than 90 percent of the percentage of stock (by value) that the controlling section 245A shareholder owns directly or indirectly on either of the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section (such percentage, the *initial percentage*), provided the difference between the initial percentage and percentage at the end of the year is at least five percentage points.

(B) *Dates for purposes of the initial percentage*. For purposes of paragraph (e)(2)(i)(A)(*2*) of this section, the dates described in paragraphs (e)(2)(i)(B)(*1*) and (*2*) of this section are—

(*1*) The day of the taxable year on which the controlling section 245A shareholder owns directly or indirectly its highest percentage of stock (by value) of the CFC; and

(*2*) The day immediately before the first day on which stock was transferred directly or indirectly in the preceding taxable year in a transaction (or a series of transactions) occurring pursuant to a plan to reduce the percentage of stock (by value) of the CFC that the controlling section 245A shareholder owns directly or indirectly.

(C) *Transactions pursuant to which CFC's taxable year ends*. A controlling section 245A shareholder's direct or indirect transfer of stock of a CFC that but for this paragraph (e)(2)(i)(B) would give rise to an extraordinary reduction under paragraph (e)(2)(i)(A) of this section does not give rise to an extraordinary reduction if the taxable year of the CFC ends immediately after the transfer, provided that the controlling section 245A shareholder directly or indirectly owns the stock on the last day of such year. Thus, for example, if a controlling section 245A shareholder exchanges all the stock of a CFC pursuant to a complete liquidation of the CFC, the exchange does not give rise to an extraordinary reduction.

(ii) *Rules for determining pre-reduction pro rata share*—(A) *In general*. Except as provided in paragraph (e)(2)(ii)(B) of this section, the term *pre-reduction pro rata share* means, with respect to a controlling section 245A shareholder and the subpart F income or tested income of a CFC, the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and §1.951-1(b) and (e) or section 951A(e)(1) and §1.951A-1(d)(1), respectively, determined based on the controlling section 245A shareholder's direct or indirect ownership of stock of the CFC immediately before the extraordinary reduction (or, if the extraordinary reduction occurs by reason of multiple transactions, immediately before the first transaction) and without regard to section 951(a)(2)(B) and §1.951-1(b)(1)(ii), but only to the extent that such subpart F income or tested income is not included in the controlling section 245A shareholder's pro rata share of the CFC's subpart F income or tested income under section 951(a)(2) and §1.951-1(b) and (e) or section 951A(e)(1) and §1.951A-1(d)(1), respectively.

(B) *Decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax resident*. A controlling section 245A shareholder's pre-reduction pro rata share of subpart F income or tested income of a CFC for a taxable year is reduced by an amount equal to the sum of the amounts by which each U.S. tax resident's pro rata share of the subpart F income or tested income is increased as a result of a transfer directly or indirectly of stock of the CFC by the controlling section 245A shareholder or an issuance of stock by the CFC (such an amount with respect to a U.S. tax resident, a *specified amount*), in either case, during the taxable year in which the extraordinary reduction occurs. For purposes of this paragraph (e)(2)(ii)(B), if there are extraordinary reductions with respect to more than one controlling section 245A shareholder during the CFC's taxable year, then a U.S. tax resident's specified amount attributable to an acquisition of stock from the CFC is prorated with respect to each controlling section 245A shareholder based on its relative decrease in ownership of the CFC. See paragraph (j)(5) of this section for an example illustrating a decrease in a section 245A shareholder's pre-reduction pro rata share for amounts taken into account by a U.S. tax resident.

(C) *Prior extraordinary reduction amount*. The term *prior extraordinary reduction amount* means, with respect to a CFC and section 245A shareholder and a taxable year of the CFC in which an extraordinary reduction occurs, the sum of the extraordinary reduction amount of each prior dividend received by the section 245A shareholder from the CFC during the taxable year. A section 245A shareholder's prior extraordinary reduction amount also includes—

(*1*) A prior dividend received by the section 245A shareholder from the CFC during the taxable year to the extent the dividend was not eligible for the section 245A deduction by reason of section 245A(e) or the holding period requirement of section 246 not being satisfied but would have been an extraordinary reduction amount had this paragraph (e) applied to the dividend;

(*2*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper tier-CFC, the portion of a prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year of the lower-tier CFC that, by reason of section 245A(e), was included in the upper-tier CFC's foreign personal holding company income and that by reason of section 951(a) was included in income of the section 245A shareholder, and that would have given rise to a tiered extraordinary reduction amount by reason of paragraph (f) of this section had paragraph (f) applied to the dividend of which the section 245A shareholder would have included a pro rata share of the tiered extraordinary reduction amount in income by reason of section 951(a); and

(*3*) If the CFC is a lower-tier CFC for a portion of the taxable year during which the lower-tier CFC pays any dividend to an upper-tier CFC, the sum of the portion of the tiered extraordinary reduction amount of each prior dividend received by an upper-tier CFC from the lower-tier CFC during the taxable year that is included in income of the section 245A shareholder by reason of section 951(a).

(3) *Exceptions*—(i) *Elective exception to close CFC's taxable year*—(A) *In general*. For a taxable year of a CFC in which an extraordinary reduction occurs with respect to a controlling section 245A shareholder and for which, absent this paragraph (e)(3), there would be an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero, no amount is considered an extraordinary reduction amount or tiered extraordinary reduction amount with respect to the controlling section 245A shareholder if each controlling section 245A shareholder elects, pursuant to this paragraph (e)(3), to close the CFC's taxable year for all purposes of the Internal Revenue Code (and, therefore, as to all shareholders of the CFC) as of the end of the date on which the extraordinary reduction occurs, or, if the extraordinary reduction occurs by reason of multiple transactions, as of the end of each date on which a transaction forming a part of the extraordinary reduction occurs. For purposes of applying this paragraph (e)(3), a controlling section 245A shareholder that has an extraordinary reduction (or a transaction forming a part thereof) with respect to a CFC is treated as owning the same amount of stock it owned in the CFC immediately before the extraordinary reduction (or a transaction forming a part thereof) on the end of the date on which the extraordinary reduction occurs (or such transaction forming a part thereof occurs). To the extent that stock of a CFC is treated as owned by a controlling section 245A shareholder as of the close of the CFC's taxable year pursuant to the preceding sentence, such stock is treated as not being owned by any other person as of the close of the CFC's taxable year. If each controlling section 245A shareholder elects to close the CFC's taxable year, that closing will be treated as a change in accounting period for the purposes of §1.964-1(c).

(B) *Allocation of foreign taxes*. If an election is made pursuant to this paragraph (e)(3) to close a CFC's taxable year and the CFC's taxable year under foreign law (if any) does not close at the end of the date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to such foreign taxable year are allocated between the period of the foreign taxable year that ends with, and the period of the foreign taxable year that begins after, the date on which the CFC's taxable year closes as a result of the election. If there is more than one date on which the CFC's taxable year closes as a result of the election, foreign taxes paid or accrued with respect to the foreign taxable year are allocated to all such periods. The allocation is made based on the respective portions of the taxable income of the CFC (as determined under foreign law) for the foreign taxable year that are attributable under the principles of §1.1502-76(b) to the periods during the foreign taxable year. Foreign taxes allocated to a period under this paragraph (e)(3)(i)(B) are treated as paid or accrued by the CFC as of the close of that period.

(C) *Time and manner of making election*—(*1*) *General rule*. An election pursuant to this paragraph (e)(3) is made and effective if the statement required by paragraph (e)(3)(iv) of this section is timely filed (including extensions) by each controlling section 245A shareholder making the election with its original U.S. tax return for the taxable year in which the extraordinary reduction occurs. Before the filing of the statement described in paragraph (e)(3)(iv) of this section, each controlling section 245A shareholder and each U.S. tax resident that on the end of the date on which the extraordinary reduction occurs (or, if the extraordinary reduction occurs by reason of multiple transactions, each U.S. tax resident that on the end of each date on which a transaction forming a part of the extraordinary reduction occurs) owns directly or indirectly stock of the CFC and is a United States shareholder with respect to the CFC must enter into a written, binding agreement agreeing that each controlling section 245A shareholder will elect to close the taxable year of the CFC. If a controlling section 245A shareholder is a member of a consolidated group (within the meaning of

§1.1502-1(h)) and participates in the extraordinary reduction, the agent for such group (within the meaning of §1.1502-77(c)(1)) must file the election described in this paragraph (e)(3) on behalf of such member.

(*2*) *Transition rule*. In the case of an extraordinary reduction occurring before the date these regulations are filed as final regulations in the **Federal Register**, the statement required by paragraph (e)(3)(iv) of this section is considered timely filed if it is attached by each controlling section 245A shareholder to an original or amended return for the taxable year in which the extraordinary reduction occurs.

(D) *Form and content of statement*. The statement required by paragraph (e)(3)(iii) of this section is to be titled "Elective Section 245A Year-Closing Statement." The statement must—

(*1*) Identify (by name and tax identification number, if any) each controlling section 245A shareholder, each U.S tax resident described in paragraph (e)(3)(iii) of this section, and the CFC;

(*2*) State the date of the extraordinary reduction (or, if the extraordinary reduction includes transactions on more than one date, the dates of all such transactions) to which the election applies;

(*3*) State the filing controlling section 245A shareholder's pro rata share of the subpart F income, tested income, and foreign taxes described in section 960 with respect to the stock of the CFC subject to the extraordinary reduction, and the amount of earnings and profits attributable to such stock within the meaning of section 1248, as of the date of the extraordinary reduction;

(*4*) State that each controlling section 245A shareholder and each U.S tax resident described in paragraph (e)(3)(iii) of this section have entered into a written, binding agreement to elect to close the CFC's taxable year in accordance with paragraph (e)(3)(iii) of this section; and

(*5*) Be filed in the manner prescribed by forms, publications, or other guidance published in the Internal Revenue Bulletin.

(E) *Consistency requirements*. If multiple extraordinary reductions occur with respect to one or more controlling section 245A shareholders' ownership in a single CFC during one or more taxable years of the CFC, then to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) section may be made only if it is made for all such extraordinary reductions with respect to the CFC. Furthermore, if an extraordinary reduction occurs with respect to a controlling section 245A shareholder's ownership in multiple CFCs, then, to the extent those extraordinary reductions occur pursuant to a plan or series of related transactions, the election described in this paragraph (e)(3) may be made only if it is made for all such extraordinary reductions with respect to all of the CFCs that have the same or related (within the meaning of section 267(b) or 707(b)) controlling section 245A shareholders.

(ii) *De minimis subpart F income and tested income*. For a taxable year of a CFC in which an extraordinary reduction occurs, no amount is considered an extraordinary reduction amount with respect to a controlling section 245A shareholder of the CFC if the sum of the CFC's subpart F income and tested income (as defined in section 951A(c)(2)(A)) for the taxable year does not exceed the lesser of $50 million or 5 percent of the CFC's total income for the taxable year.

(f) *Limitation of amount eligible for section 954(c)(6) where extraordinary reduction occurs with respect to lower-tier CFCs*—(1) *In general*. If an extraordinary reduction occurs with respect to a lower-tier CFC and an upper-tier CFC receives a dividend from the lower-tier CFC in the taxable year in which the extraordinary reduction occurs, then the amount of the dividend that would otherwise be eligible for the exception to foreign personal holding company income under section 954(c)(6) (determined without regard to this paragraph (f)) is eligible for such exception only to the extent the dividend exceeds the tiered extraordinary reduction amount. The preceding sentence does not apply to an amount treated as a dividend received by an upper-tier CFC by reason of section 964(e)(4) (in this case, see paragraphs (b) and (g)(2) of this section). See paragraph (j)(7) of this section for an example illustrating the application of this paragraph (f)(1).

(2) *Definition of tiered extraordinary reduction amount*. The term *tiered extraordinary reduction amount* means, with respect to the portion of a dividend received by an upper-tier CFC from a lower-tier CFC during a taxable year of the lower-tier CFC that would be eligible for the exception to foreign personal holding company income under section 954(c)(6) (determined without regard to this paragraph (f)), the amount of such dividend equal to the excess, if any, of—

(i) The product of—

(A) The sum of the amount of the subpart F income and tested income of the lower-tier CFC for the taxable year; and

(B) The percentage (by value) of stock of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately before the extraordinary reduction (or the first transaction forming a part thereof); over

(ii) The following amounts—

(A) The sum of each U.S. tax resident's pro rata share of the lower-tier CFC's subpart F income and tested income under section 951(a) or 951A(a), respectively, that is attributable to shares of the lower-tier CFC owned (within the meaning of section 958(a)(2)) by the upper-tier CFC immediately prior to the extraordinary reduction (or the first transaction forming a part thereof), computed without the application of this paragraph (f);

(B) The sum of each prior tiered extraordinary reduction amount and sum of each amount included in an upper-tier CFC's subpart F income by reason of section 245A(e) with respect to prior dividends from the lower-tier CFC during the taxable year;

(C) The sum of the prior extraordinary reduction amounts (but, for this purpose, computed without regard to amounts described in paragraphs (e)(2)(ii)(C)(*2*) and (*3*) of this section) of each controlling section 245A shareholder with respect to shares of the lower-tier CFC that were owned by such controlling section 245A shareholder (including indirectly through a specified entity other than a foreign corporation) for a portion of the taxable year but are owned by an upper-tier CFC (including indirectly through a specified entity other than a foreign corporation) at the time of the distribution of the dividend; and

(D) The product of the amount described in paragraph (f)(2)(i)(B) of this section and the sum of the amounts of each U.S. tax resident's pro rata share of subpart F income and tested income for the taxable year under section 951(a) or 951A(a), respectively, attributable to shares of the lower-tier CFC directly or indirectly acquired by the U.S. tax resident from the lower-tier CFC during the taxable year.

(3) *Transition rule for computing tiered extraordinary reduction amount*. Solely for purposes of applying this paragraph (f) in taxable years of a lower-tier CFC beginning on or after January 1, 2018, and ending before June 14, 2019, a tiered extraordinary reduction amount is determined by treating the lower-tier CFC's subpart F income for the taxable year as if it were neither subpart F income nor tested income.

(g) *Special rules*. The following rules apply for purposes of this section.

(1) *Source of dividends*. A dividend received by any person is considered received directly by such person from the foreign corporation whose earnings and profits give rise to the dividend. Therefore, for example, if a section 245A shareholder sells or exchanges stock of an upper-tier CFC and the gain recognized on the sale or exchange is included in the gross income of the section 245A shareholder as a dividend under section 1248(a), then, to the extent the dividend is attributable under section 1248(c)(2) to the earnings and profits of a lower-tier CFC owned, within the meaning of section 958(a)(2), by the section 245A shareholder through the upper-tier CFC, the dividend is considered received directly by the section 245A shareholder from the lower-tier CFC.

(2) *Certain section 964(e) inclusions treated as dividends*. An amount included in the gross income of a section 245A shareholder under section 951(a)(1)(A) by reason of section 964(e)(4) is considered a dividend received by the section 245A shareholder directly from the foreign corporation whose earnings and profits give rise to the amount described in section 964(e)(1). Therefore, for example, if an upper-tier CFC sells or exchanges stock of a lower-tier CFC, and, as a result of the sale or exchange, a section 245A shareholder with respect to the upper-tier CFC includes an amount in gross income under section 951(a)(1)(A) by reason of section 964(e)(4), then the inclusion is treated as a dividend received directly by the section 245A shareholder from the lower-tier CFC whose earnings and profits give rise to the dividend, and the section 245A shareholder is not allowed a section 245A deduction for the dividend to the extent of the ineligible amount of such dividend.

(3) *Rules regarding stock ownership and stock transfers*—(i) *Determining indirect ownership of stock of an SFC or a CFC*. For purposes of this section, if a person owns an interest in, or stock of, a specified entity, including through a chain of ownership of one or more other specified entities, then the person is considered to own indirectly a pro rata share of stock of an SFC or a CFC owned by the specified entity. To determine a person's pro rata share of stock owned by a specified entity, the principles of section 958(a) apply without regard to whether the specified entity is foreign or domestic.

(ii) *Determining indirect transfers for stock owned indirectly*. If, under paragraph (g)(3)(i) of this section, a person is considered to own indirectly stock of an SFC or CFC that is owned by a specified entity, then the following rules apply in determining if the person transfers stock of the SFC or CFC—

(A) To the extent the specified entity transfers stock that is considered owned indirectly by the person immediately before the transfer, the person is considered to transfer indirectly such stock;

(B) If the person transfers an interest in, or stock of, the specified entity, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the specified entity that is transferred; and

(C) In the case in which the person owns the specified entity through a chain of ownership of one or more other specified entities, if there is a transfer of an interest in, or stock of, another specified entity in the chain of ownership, then the person is considered to transfer indirectly the stock of the SFC or CFC attributable to the interest in, or the stock of, the other specified entity transferred.

(iii) *Definition of specified entity*. The term *specified entity* means any partnership, trust, or estate (in each case, domestic or foreign), or any foreign corporation.

(4) *Coordination rules*—(i) *General rule*. A dividend is first subject to section 245A(e).. To the extent the dividend is not a hybrid dividend or tiered hybrid dividend under section 245A(e), the dividend is subject to paragraph (e) or (f) of this section, as applicable, and then, to the extent the dividend is not subject to paragraph (e) or (f) of this section, it is subject to paragraph (c) or (d) of this section, as applicable.

(ii) *Coordination rule for paragraphs (c) and (d) and (e) and (f) of this section, respectively*. If an SFC or CFC pays a dividend (or simultaneous dividends), a portion of which may be subject to paragraph (c) or (e) of this section and a portion of which may be subject to paragraph (d) or (f) of this section, the rules of this section apply by treating the portion of the dividend or dividends that may be subject to paragraph (c) or (e) of this section as if it occurred immediately before the portion of the dividend or dividends that may be subject to paragraph (d) or (f) of this section. For example, if a dividend arising under section 964(e)(4) occurs at the same time as a dividend that would be eligible for the exception to foreign personal holding company income under section 954(c)(6) but for the potential application of paragraph (d) this section, then the tiered extraordinary disposition amount with respect to the other dividend is determined as if the dividend arising under section 964(e)(4) occurs immediately prior to the other dividend.

(5) *Ordering rule for multiple dividends made by an SFC or a CFC during a taxable year*. If an SFC or a CFC pays dividends on more than one date during its taxable year or at different times on the same date, this section applies based on the order in which the dividends are paid.

(6) *Partner's distributive share of a domestic partnership's pro rata share of subpart F income*. If a section 245A shareholder or a U.S. tax resident is a direct or indirect partner in a domestic partnership that is a United States shareholder with respect to a CFC and includes in gross income its pro rata share of the CFC's subpart F income under section 951(a), then, solely for purposes of this section, a reference to the section 245A shareholder's or U.S. tax resident's pro rata share of the CFC's subpart F income included

in gross income under section 951(a) includes such person's distributive share of the domestic partnership's pro rata share of the CFC's subpart F income. A person is an indirect partner with respect to a domestic partnership if the person indirectly owns the domestic partnership through one or more specified entities (other than a foreign corporation).

(h) *Anti-abuse rule*. The Commissioner may make appropriate adjustments to any amounts determined under this section if a transaction is engaged in with a principal purpose of avoiding the purposes of this section.

(i) *Definitions*. The following definitions apply for purposes of this section.

(1) *Controlled foreign corporation*. The term controlled foreign corporation (or CFC) has the meaning provided in section 957.

(2) *Controlling section 245A shareholder*. The term *controlling section 245A shareholder* means, with respect to a CFC, any section 245A shareholder that owns directly or indirectly more than 50 percent (by vote or value) of the stock of the CFC. For purposes of determining whether a section 245A shareholder is a controlling section 245A shareholder with respect to a CFC, all stock of the CFC owned by a related party with respect to the section 245A shareholder or by other persons acting in concert with the section 245A shareholder to undertake an extraordinary reduction is considered owned by the section 245A shareholder. If section 964(e)(4) applies to a sale or exchange of a lower-tier CFC with respect to a controlling section 245A shareholder, all United States shareholders of the CFC are considered to act in concert with regard to the sale or exchange. In addition, if all persons selling stock in a CFC, held directly, sell such stock to the same buyer or buyers (or a related party with respect to the buyer or buyers) as part of the same plan, all sellers will be considered to act in concert with regard to the sale or exchange.

(3) *Disqualified amount*. The term *disqualified amount* has the meaning set forth in paragraph (d)(1) of this section.

(4) *Disqualified period*. The term *disqualified period* has the meaning set forth in paragraph (c)(3)(iii) of this section.

(5) *Extraordinary disposition*. The term *extraordinary disposition* has the meaning set forth in paragraph (c)(3)(ii) of this section.

(6) *Extraordinary disposition account*. The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i) of this section.

(7) *Extraordinary disposition amount*. The term *extraordinary disposition amount* has the meaning set forth in paragraph (c)(1) of this section.

(8) *Extraordinary disposition E&P*. The term *extraordinary E&P* has the meaning set forth in paragraph (c)(3)(i)(C) of this section.

(9) *Extraordinary disposition ownership percentage*. The term extraordinary disposition ownership percentage has the meaning set forth in paragraph (c)(3)(i)(B) of this section.

(10) *Extraordinary reduction*. The term *extraordinary reduction* has the meaning set forth in paragraph (e)(2)(i)(A) of this section.

(11) *Extraordinary reduction amount*. The term *extraordinary reduction amount* has the meaning set forth in paragraph (e)(1) of this section.

(12) *Ineligible amount*. The term *ineligible amount* has the meaning set forth in paragraph (b)(2) of this section.

(13) *Lower-tier CFC*. The term *lower-tier CFC* means a CFC whose stock is owned (within the meaning of section 958(a)(2)), in whole or in part, by another CFC.

(14) *Non-extraordinary disposition E&P*. The term *non-extraordinary disposition E&P* has the meaning set forth in paragraph (c)(2)(ii) of this section.

(15) *Pre-reduction pro rata share*. The term *pre-reduction pro rata share* has the meaning set forth in paragraph (e)(2)(ii) of this section.

(16) *Prior extraordinary disposition amount*. The term *prior extraordinary disposition amount* has the meaning set forth in paragraph (c)(3)(i)(D) of this section.

(17) *Prior extraordinary reduction amount*. The term *prior extraordinary reduction amount* has the meaning set forth in paragraph (e)(2)(ii)(C) of this section.

(18) *Qualified portion*. The term *qualified portion* has the meaning set forth in paragraph (c)(3)(i)(D)(*2*)(*i*) of this section.

(19) *Related party*. The term *related party* means, with respect to a person, another person bearing a relationship described in section 267(b) or 707(b) to the person, in which case such persons are *related*.

(20) *Section 245A deduction*. The term *section 245A deduction* means, with respect to a dividend received by a section 245A shareholder from an SFC, the amount of the deduction allowed to the section 245A shareholder by reason of the dividend.

(21) *Section 245A shareholder*. The term *section 245A shareholder* means a domestic corporation that is a United States shareholder with respect to an SFC that owns directly or indirectly stock of the SFC.

(22) *Specified 10-percent owned foreign corporation (SFC)*. The term *specified 10-percent owned foreign corporation* (or *SFC*) has the meaning provided in section 245A(b)(1).

(23) *Specified entity*. The term *specified entity* has the meaning set forth in paragraph (g)(3)(iii) of this section.

(24) *Specified property*. The term *specified property* has the meaning set forth in paragraph (c)(3)(iv) of this section.

(25) *Tiered extraordinary disposition amount*. The term *tiered extraordinary disposition amount* has the meaning set forth in paragraph (d)(2)(i) of this section.

(26) *Tiered extraordinary reduction amount*. The term *tiered extraordinary reduction amount* has the meaning set forth in paragraph (f)(2) of this section.

(27) *United States shareholder*. The term *United States shareholder* has the meaning provided in section 951(b).

(28) *Upper-tier CFC*. The term *upper-tier CFC* means a CFC that owns (within the meaning of section 958(a)(2)) stock in another CFC.

(29) *U.S. tax resident*. The term *U.S. tax resident* means a United States person described in section 7701(a)(30)(A) or (C).

(j) *Examples*. The application of this section is illustrated by the examples in this paragraph (j).

(1) *Facts*. Except as otherwise stated, the following facts are assumed for purposes of the examples:

(i) US1 and US2 are domestic corporations, each with a calendar taxable year, and are not related parties with respect to each other.

(ii) CFC1 and CFC2 are foreign corporations that are SFCs and CFCs.

(iii) Each entity uses the U.S. dollar as its functional currency.

(iv) Year 2 begins on or after January 1, 2018, and has 365 days.

(v) Absent application of this section, the dividends received by US1 and US2 from CFC1 meet the requirements to qualify for the section 245A deduction.

(vi) The de minimis rules in paragraphs (c)(3)(ii)(E) and (e)(3)(ii) of this section do not apply.

(2) *Example 1*. *Extraordinary disposition*—(i) *Facts*. US1 and US2 own 60% and 40%, respectively, of the single class of stock of CFC1. CFC1 owns all of the single class of stock of CFC2. CFC1 and CFC2 use the taxable year ending November 30 as their taxable year. On November 1, 2018, CFC1 sells specified property to CFC2 in exchange for $200x of cash (the "Property Transfer"). The Property Transfer is outside of CFC1's ordinary course of activities. The transferred property has a basis of $100x in the hands of CFC1. CFC1 recognizes $100x of gain as a result of the Property Transfer ($200x - $100x). On December 1, 2018, CFC1 distributes $80x pro rata to US1 ($48x) and US2 ($32x), all of which is a dividend within the meaning of section 316 and treated as a distribution out of earnings described in section 959(c)(3). No other distributions are made by CFC1 to either US1 or US2 in CFC1's taxable year ending November 30, 2019. For its taxable year ending on November 30, 2019, CFC1 has $110x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year.

(ii) *Analysis*—(A) *Identification of extraordinary disposition*. Because CFC1 is a CFC and uses the taxable year ending on November 30, under paragraph (c)(3)(iii) of this section, it has a disqualified period beginning on January 1, 2018, and ending on November 30, 2018. In addition, under paragraph (c)(3)(ii) of this section, the Property Transfer is an extraordinary disposition because it (i) is a disposition of specified property by CFC1 on a date on which it was a CFC and during CFC1's disqualified period, (ii) is to CFC2, a related party with respect to CFC1, (iii) occurs outside of the ordinary course of CFC1's activities, and (iv) is not subject to the de minimis rule in paragraph (c)(3)(ii)(E) of this section.

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts*. Because CFC1 undertook an extraordinary disposition, under paragraph (c)(3)(i) of this section, a portion of CFC1's earnings and profits are extraordinary disposition E&P and, therefore, give rise to an extraordinary disposition account with respect to each of CFC1's section 245A shareholders. Under paragraph (i)(21) of this section, US1 and US2 are both section 245A shareholders with respect to CFC1. The amount of the extraordinary disposition account with respect to US1 is $60x, which is equal to the product of the extraordinary disposition E&P (the amount of the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and the extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US1 on January 1, 2018 (60%)), reduced by the prior extraordinary disposition amount ($0). *See* paragraph (c)(3)(i) of this section. Similarly, the amount of the extraordinary disposition account with respect to US2 is $40x, which is equal to the product of the extraordinary disposition E&P (the net gain recognized by CFC1 as a result of the Property Transfer ($100x)) and extraordinary disposition ownership percentage (the percentage of the stock of CFC1 owned directly or indirectly by US2 on January 1, 2018 (40%)), reduced by the prior extraordinary disposition amount ($0).

(C) *Determination of extraordinary disposition amount with respect to US1*. The dividend of $48x paid to US1 on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of the extraordinary disposition account with respect to US1. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US1, to the extent thereof. With respect to US1, $6x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $66x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 60%) over $60x (the balance of US1's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $6x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US1. Under paragraph (c)(2)(i)(B) of this section, the remaining $42x of the dividend is next considered paid out of US1's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $42x of the dividend is considered paid out of the extraordinary disposition account with respect to CFC1 and gives rise to $42x of an extraordinary disposition amount. As a result, US1's prior extraordinary disposition amount is increased by $42x under paragraph (c)(3)(i)(D) of this section, and US1's extraordinary disposition account is reduced to $18x ($60x - $42x) under paragraph (c)(3)(i)(A) of this section.

(D) *Determination of extraordinary disposition amount with respect to US2*. The dividend of $32x paid to US2, on December 1, 2018, is an extraordinary disposition amount to the extent the dividend is paid out of extraordinary disposition E&P with respect to US2. *See* paragraph (c)(1) of this section. Under paragraph (c)(2)(i) of this section, the dividend is first considered paid out of non-extraordinary disposition E&P with respect to US2, to the extent thereof. With respect to US2, $4x of CFC1's earnings and profits is non-extraordinary disposition E&P, calculated as the excess of $44x (the product of $110x of earnings and profits described in section 959(c)(3), without regard to the $80x distribution, and 40%) over $40x (the balance of US2's extraordinary disposition account with respect to CFC1, immediately before the distribution). *See* paragraph (c)(2)(ii) of this section. Thus, $4x of the dividend is considered paid out of non-extraordinary disposition E&P with respect to US2. Under paragraph (c)(2)(i)(B) of this section, the remaining $28x of the dividend is next considered paid out of US2's extraordinary disposition account with respect to CFC1, to the extent thereof. Accordingly, $28x of the dividend is considered paid out of the extraordinary disposition account with respect to US2 and gives rise to $28x of an extraordinary disposition amount. As a result, US2's prior extraordinary disposition amount is increased by $28x under paragraph (c)(3)(i)(D) of this section, and US2's extraordinary disposition account is reduced to $12x ($40x - $28x) under paragraph (c)(3)(i)(A) of this section.

(E) *Determination of ineligible amount with respect to US1 and US2*. Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $48x, the ineligible amount is $21x, the sum of 50 percent of the extraordinary disposition amount ($42x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US1 of $48x, $27x is eligible for a section 245A deduction. With respect to US2 and the dividend of $32x, the ineligible amount is $14x, the sum of 50% of the extraordinary disposition amount ($28x) and extraordinary reduction amount ($0). Therefore, with respect to the dividend received by US2 of $32x, $18x is eligible for a section 245A deduction.

(3) *Example 2*. *Application of section 954(c)(6) exception with extraordinary disposition account*—(i) *Facts*. The facts are the same as in paragraph (j)(2)(i) of this section (the facts in *Example 1*) except that the Property Transfer is a sale by CFC2 to CFC1 instead of a sale by CFC1 to CFC2, the $80x distribution is by CFC2 to CFC1 in a separate transaction that is unrelated to the Property Transfer, and the description of the earnings and profits of CFC1 is applied to CFC2. Additionally, absent the application of this section, section 954(c)(6) would apply to the distribution by CFC2 to CFC1. Under section 951(a)(2) and §1.951-1(b) and (e), US1's pro rata share of any subpart F income of CFC1 is 60% and US2's pro rata share of any subpart F income of CFC2 is 40%.

(ii) *Analysis*—(A) *Identification of extraordinary disposition*. The Property Transfer is an extraordinary disposition under the same analysis as provided in paragraph (j)(2)(ii)(A) of this section (the analysis in *Example 1*).

(B) *Determination of section 245A shareholders and their extraordinary disposition accounts*. Both US1 and US2 are section 245A shareholders with respect to CFC2, US1 has an extraordinary disposition account of $60x with respect to CFC2, and US2 has an extraordinary disposition account of $40x with respect to CFC2 under the same analysis as provided in paragraph (j)(2)(ii)(B) of this section (the analysis in *Example 1*).

(C) *Determination of tiered extraordinary disposition amount*—(*1*) *In general*. US1 and US2 each have a tiered extraordinary disposition amount with respect to the $80x dividend paid by CFC2 to CFC1 to the extent that US1 and US2 would have an extraordinary disposition amount if each had received as a dividend its pro rata share of the dividend from CFC2. *See* paragraph (d)(2)(i) of this section. Under paragraph (d)(2)(ii) of this section, US1's pro rata share of the dividend is $48x (60% x $80x), that is, the increase to US1's pro rata share of the subpart F income if the dividend were included in CFC1's foreign personal holding company income, without regard to section 952(c) and the allocation of expenses. Similarly, US2's pro rata share of the dividend is $32x (40% x $80x).

(2) Determination of tiered extraordinary disposition amount with respect to US1. The extraordinary

disposition amount with respect to US1 is $42x, under the same analysis provided in paragraph (j)(2)(ii)(C) of this section (the analysis in Example 1). Accordingly, the tiered extraordinary disposition amount with respect to US1 is $42x.

(3) Determination of extraordinary disposition amount with respect to US2. The extraordinary disposition amount with respect to US2 is $28x, under the same analysis provided in paragraph (j)(2)(ii)(D) of this section (the analysis in Example 1). Accordingly, the tiered extraordinary disposition amount with respect to US2 is $28x.

(D) *Limitation of section 954(c)(6) exception*. The sum of US1 and US2's tiered extraordinary disposition amounts is $70x ($42x + $28x). The portion of the stock of CFC1 (by value) owned (within the meaning of section 958(a)) by U.S. tax residents on the last day of CFC1's taxable year is 100%. Under paragraph (d)(1) of this section, the disqualified amount with respect to the dividend is $35x (50% x ($70x/100%)). Accordingly, the portion of the $80x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $45x ($80x - $35x). Under section 951(a)(2) and §1.951-1(b) and (e), US1 includes $21x (60% x $35x) and US2 includes $14x (60% x $35x) in income under section 951(a).

(E) *Changes in extraordinary disposition account of US1*. Under paragraph (c)(3)(i)(D)(*1*) of this section, US1's prior extraordinary disposition amount with respect to CFC2 is increased by $42x, or 200% of $21x, the amount US1 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US1 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US1's extraordinary disposition account is reduced to $18x ($60x - $42x) under paragraph (c)(3)(i)(A) of this section.

(F) *Changes in extraordinary disposition account of US2*. Under paragraph (c)(3)(i)(D)(*1*) of this section, US2's prior extraordinary disposition amount with respect to CFC2 is increased by $28x, or 200% of $14x, the amount US2 included in income under section 951(a) with respect to CFC1. Under paragraph (c)(3)(i)(D)(*1*)(*iii*) of this section, US2 has no qualified portion because all of the owners of CFC2 are section 245A shareholders with a tiered extraordinary disposition amount with respect to CFC2. As a result, US2's extraordinary disposition account is reduced to $12x ($40x - $28x) under paragraph (c)(3)(i)(A) of this section.

(4) *Example 3. Extraordinary reduction*—(i) *Facts*. At the beginning of CFC1's taxable year ending on December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. Also as of the beginning of Year 2, CFC1 has no earnings and profits described in section 959(c)(1) or (2), and US1 does not have an extraordinary disposition account with respect to CFC1. As of the end of Year 2, CFC1 has $160x of tested income and no other income. CFC1 has $160x of earnings and profits for Year 2. On October 19, Year 2, US1 sells all of its CFC1 stock to US2 for $100x in a transaction (the "Stock Sale") in which US1 recognizes $90x of gain. Under section 1248(a), the entire $90x of gain is included in US1's gross income as a dividend and, pursuant to section 1248(j), the $90x is treated as a dividend for purposes of applying section 245A. At the end of Year 2, under section 951A, US2 takes into account $70x of tested income, calculated as $160x (100% of the $160x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $90x, the amount of dividends received by US1 with respect to the transferred stock, and $128x, the amount of tested income attributable to the transferred stock ($160x) multiplied by 292/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership*. Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of extraordinary reduction amount*. Under paragraph (e)(1) of this section, the entire $90x dividend to US1 is an extraordinary reduction amount with respect to US1 because the dividend is at least equal to US1's pre-reduction pro rata share of CFC1's Year 2 tested income described in paragraph (e)(2)(ii)(A) of this section ($160x), reduced by the amount of tested income taken into account by US2, a U.S. tax resident, under paragraphs (e)(2)(ii)(B) and (i)(29) of this section ($70x).

(C) *Determination of ineligible amount*. Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $90x, the ineligible amount is $90x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($90x). Therefore, with respect to the dividend received of $90x, no portion is eligible for the dividends received deduction allowed under section 245A(a).

(iii) *Alternative facts – election to close CFC's taxable year*. The facts are the same as in paragraph (j)(4)(i) of this section (the facts of this *Example 3*), except that, pursuant to paragraph (e)(3)(i) of this section, US1 elects to close CFC1's Year 2 taxable year for all purposes of the Internal Revenue Code as of the end of October 19, Year 2, the date on which the Stock Sale occurs; in addition, US1 and US2 enter into a written, binding agreement that US1 will elect to close CFC1's Year 2 taxable year. Accordingly, under section 951A(a), US1 takes into account 100% of CFC1's tested income for the taxable year beginning January 1, Year 2, and ending October 19, Year 2, and US2 takes into account 100% of CFC1's tested income for the taxable year beginning October 20, Year 2, and ending December 31, Year 2. Under paragraph (e)(3)(i)(A) of this section, no amount is considered an extraordinary reduction amount with respect to US1.

(5) *Example 4. Extraordinary reduction; decrease in section 245A shareholder's pre-reduction pro rata share for amounts taken into account by U.S. tax residents*—(i) *Facts*. At the beginning of CFC1's taxable year ending December 31, Year 2, US1 owns all of the single class of stock of CFC1, and no person transferred any CFC1 stock directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1. CFC1 generates $120x of subpart F income during its taxable year ending on December 31, Year 2. On October 1, Year 2, CFC1 distributes a $120x dividend to US1. On October 19, Year 2, US1 sells 100% of its stock of CFC1 to PRS, a domestic partnership, in a transaction in which no gain or loss is realized (the "Stock Sale"). PRS is owned 50% each by A, an individual who is a citizen of the United States, and B, a foreign individual who is not a U.S. tax resident. On December 1, Year 2, US2 and FP, a foreign corporation, contribute property to CFC1; in exchange, each of US2 and FP receives 25% of the stock of CFC1. PRS owns the remaining 50% of the stock of CFC1. US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction*. Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC1. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC1. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the CFC1 stock it owns on the first day of Year 2, and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of Year 2 the percentage of stock (by value) of CFC1 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the highest percentage of stock (by value) of CFC1 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (100%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and the end of year percentage (100 percentage points) is at least 5 percentage points.

(B) *Determination of pre-reduction pro rata share*. Before the extraordinary reduction, US1 owned 100% of the stock of CFC1. Thus, under paragraph (e)(2)(ii)(A) of this section, the tentative amount of US1's pre-reduction pro rata share of CFC1's subpart F income is $120x. A and US2 are U.S. tax residents pursuant to paragraph (i)(29) of this section because they are United States persons described in section 7701(a)(30)(A) or (C). Thus, US1's pre-reduction pro rata share amount is subject to the reduction described in paragraph (e)(2)(ii)(B) of this section because U.S. tax residents directly or indirectly acquire stock of CFC1 from US1 or CFC1 during the taxable year in which the extraordinary reduction occurs. With respect to US1's pre-reduction pro rata share of CFC1's subpart F income, the reduction equals the amount of subpart F income of CFC1 taken into account under section 951(a) by these U.S. tax residents.

(C) *Determination of decrease in pre-reduction pro rata share for amounts taken into account by U.S. tax resident*. On December 31, Year 2, both PRS and US2 will be United States shareholders with respect to CFC1 and will include in gross income their pro rata share of CFC1's subpart F income under section 951(a). With respect to US2, this amount will be $30x, which is equal to 25% of CFC1's subpart F income for the taxable year. With respect to PRS, its pro rata share of $60x under section 951(a)(2)(A) (50% of $120x) will be reduced under section 951(a)(2)(B) by $48x. The section 951(a)(2)(B) reduction is equal to the lesser of the $120x dividend paid with respect to those shares to US1 or $48x (50% x $120x x 292/365, the period during the taxable year that PRS did not own CFC1 stock). Thus, PRS includes $12x in gross income pursuant to section 951(a). Of this amount, $6x is allocated to A (as a 50% partner of PRS) and, therefore, treated as taken into account by A under paragraphs (e)(2)(ii)(B) and (g)(6) of this section. Thus, A and US2 take into account a total of $36x of CFC1's subpart F income under section 951(a). This amount reduces US1's pre-reduction pro rata share of CFC1's subpart F income to $84x ($120x - $36x) under paragraph (e)(2)(ii)(B) of this section. CFC1 did not generate tested income during the taxable year and, therefore, no amount is taken into account under section 951A with respect to CFC1, and US1 has no pre-reduction pro rata share with respect to tested income of CFC1.

(D) *Determination of extraordinary reduction amount*. Under paragraph (e)(1) of this section, the extraordinary reduction amount equals $84x, which is the lesser of the amount of the dividend received by US1 from CFC1 during Year 2 ($120x) and the sum of US1's pre-reduction pro rata share of CFC1's subpart F income ($84x) and tested income ($0).

(E) *Determination of ineligible amount*. Under paragraph (b)(2) of this section, with respect to US1 and the dividend of $120x, the ineligible amount is $84x, the sum of 50% of the extraordinary disposition amount ($0) and extraordinary reduction amount ($84x). Therefore, with respect to the dividend received by US1 from CFC1, $36x ($120x - $84x) is eligible for a section 245A deduction.

(6) *Example 5. Controlling section 245A shareholder*—(i) *Facts*. US1 and US2 own 30% and 25% of the stock of CFC1, respectively. FP, a foreign corporation that is not a CFC, owns all of the stock of US1 and US2. FP owns the remaining 45% of the stock of CFC1. On September 30, Year 2, US1 sells all of its stock of CFC1 to US3, a domestic corporation that is not a related party with respect to FP, US1, or US2. No person transferred any stock of CFC1 directly or indirectly in Year 1 pursuant to a plan to reduce the percentage of stock (by value) of CFC1 owned by US1.

(ii) *Analysis*. Under paragraph (i)(21) of this section, US1 is a section 245A shareholder with respect to CFC1, an SFC. Because US1 owns, together with US2 and FP (related persons with respect to US1), more than 50% of the stock of CFC1, US1 is a controlling section 245A shareholder of CFC1. The sale of US1's CFC1 stock results in an extraordinary reduction occurring with respect to US1's ownership of CFC1. The extraordinary reduction occurs because during Year 2, US1 transferred 100% of the stock of CFC1 that it owned at the beginning of the year and that amount is more than 5% of the total value of the stock of CFC1 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC1 that US1 directly or indirectly owns (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC1 that US1 directly or indirectly owned on the day of the taxable year when it owned the highest percentage of CFC1 stock by value (30%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC1 stock owned by US1, and the difference between the initial percentage and end of year percentage (30 percentage points) is at least 5 percentage points.

(7) *Example 6. Limitation of section 954(c)(6) exception with respect to an extraordinary reduction*. (i) *Facts*. At the beginning of CFC1 and CFC2's taxable year ending on December 31, Year 2, US1 and A, an individual who is a citizen of the United States, own 80% and 20% of the single class of stock of CFC1, respectively. CFC1 owns 100% of the stock of CFC2. Both US1 and A are United States shareholders with respect to CFC1 and CFC2, and US1 and A are not related parties with respect to each other. No person transferred CFC2 stock directly or indirectly in Year 2 pursuant to a plan to reduce the percentage of stock (by value) of CFC2 owned by US1, and US1 does not have an extraordinary disposition account with respect to CFC2. At the end of Year 2, and without regard to any distributions during Year 2, CFC2 had $150x of tested income and no other income, and CFC1 had no income or expenses. On June 30, Year 2, CFC2 distributed $150x as a dividend to CFC1, which would qualify for the exception from foreign personal holding company income under section 954(c)(6) but for the application of this section. On August 7, Year 2, CFC1 sells all of its CFC2 stock to US2 for $100x in a transaction (the "Stock Sale") in which CFC1 realizes no gain or loss. At the end of Year 2, under section 951A, US2 takes into account $60x of tested income, calculated as $150x (100% of the $150x of tested income) less $90x, the amount described in section 951(a)(2)(B). The amount described in section 951(a)(2)(B) is the lesser of $150x, the amount of dividends received by CFC1 during Year 2 with respect to the transferred stock, and $90x, the amount of tested income attributable to the transferred stock ($150x) multiplied by 219/365 (the ratio of the number of days in Year 2 that US2 did not own the transferred stock to the total number of days in Year 2). US1 does not make an election pursuant to paragraph (e)(3)(i) of this section.

(ii) *Analysis*—(A) *Determination of controlling section 245A shareholder and extraordinary reduction of ownership*. Under paragraph (i)(2) of this section, US1 is a controlling section 245A shareholder with respect to CFC2, but A is not. In addition, the Stock Sale results in an extraordinary reduction with respect to US1's ownership of CFC2. *See* paragraph (e)(2)(i) of this section. The extraordinary reduction occurs because during Year 2, US1 transferred indirectly 100% of the CFC2 stock it owned at the beginning of the year and such amount is more than 5% of the total value of the stock of CFC2 at the beginning of Year 2; it also occurs because on the last day of the year the percentage of stock (by value) of CFC2 that US1 owns directly or indirectly (0%) (the end of year percentage) is less than 90% of the stock (by value) of CFC2 that US1 owns directly or indirectly on the day of the taxable year when it owned the highest percentage of CFC2 stock by value (80%) (the initial percentage), no transactions occurred in the preceding year pursuant to a plan to reduce the percentage of CFC2 stock owned by US1, and the difference between the initial percentage and the end of year percentage (80 percentage points) is at least 5 percentage points. Because there is an extraordinary reduction with respect to CFC2 in Year 2 and CFC1 received a dividend from CFC2 in Year 2, under paragraph (f)(1) of this section, it is necessary to determine the limitation on the amount of the dividend eligible for the exception under section 954(c)(6).

(B) *Determination of tiered extraordinary reduction amount*. The limitation on the amount of the dividend eligible for the exception under section 954(c)(6) is based on the tiered extraordinary reduction amount. The sum of the amount of subpart F income and tested income of CFC2 for Year 2 is $150x, and immediately before the extraordinary reduction, CFC1 held 100% of the stock of CFC2. Additionally, US2 is a U.S. tax resident as defined in paragraph (i)(29) of this section because it is a United States person described in section 7701(a)(30)(A) or (C), and US2 has a pro rata share of $60x of tested income under section 951A with respect to CFC2. Accordingly, under paragraph (f)(2) of this section, the tiered extraordinary reduction amount is $90x (($150x x 100%) - $60x).

(C) *Limitation of section 954(c)(6) exception*. Under paragraph (f)(1) of this section, the portion of the $150x dividend from CFC2 to CFC1 that is eligible for the exception to foreign personal holding company income under section 954(c)(6) is $60x ($150x - $90x). To the extent that the $90x that does not qualify for the exception gives rise to additional subpart F income to CFC1, both US1 and A will take into account their pro rata share of that subpart F income under section 951(a)(2) and §1.951-1(b) and (e).

(k) *Applicability date*. This section applies to distributions occurring after December 31, 2017.

(l) *Expiration date*. The applicability of this section expires June 14, 2022.

Par. 3. Section 1.954(c)(6)-1T is added to read as follows:

§1.954(c)(6)-1T Certain cases in which section 954(c)(6) exception not available (temporary).

(a) *Cross-references to other rules*. For a non-exclusive list of rules that limit the applicability of the exception to foreign personal holding company income under section 954(c)(6), see—

(1) Section 1.245A-5T(d) (rules regarding the application of section 954(c)(6) to extraordinary disposition amounts);

(2) Section 1.245A-5T(f) (rules regarding the application of section 954(c)(6) to tiered extraordinary reduction amounts)

(3) Section 1.245A(e)-1(c) (rules regarding tiered hybrid dividends);

(4) Section 1.367(b)-4(e)(4) (rules regarding income inclusion and gain recognition in certain exchanges following an inversion transaction);

(5) Section 964(e)(4)(A) (rules regarding certain gain from the sale or exchange of stock that is recharacterized as a dividend); and

(6) Section 1.7701(l)-4(e) (rules regarding recharacterization of certain transactions following an inversion transaction).

(b) *Applicability date*. This section applies on or after June 14, 2019.

(c) *Expiration date*. The applicability of this section expires June 14, 2022.

Par. 4. Section 1.6038-2T is added to read as follows:

§1.6038-2T Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962 (temporary).

(a) through (e) [Reserved]

(f)(1) through (15) [Reserved]

(16) *Dividends for which section 245A deduction or section 954(c)(6) exception is limited*—(i) *General rule*. If for the annual accounting period, the corporation distributes or receives a dividend that gives rise to an ineligible amount (as defined in §1.245A-5T((i)(12)), a tiered extraordinary disposition amount (as defined in §1.245A-5T(i)(25)), or a tiered extraordinary reduction amount (as defined in §1.245A-5T(i)(26)), then Form 5471 (or a successor form) must contain such information about the ineligible amount, tiered extraordinary disposition amount, or tiered extraordinary reduction amount, as applicable, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(ii) *Transition rule*. If the corporation (or predecessor corporation) distributed or received a dividend that gave rise to an ineligible amount, a tiered extraordinary disposition amount, or a tiered extraordinary reduction amount in an annual accounting period for which the Form 5471 (or successor form) has been filed before the date of publication of these Temporary regulations, the corporation must provide the information described in paragraph (f)(16)(i) of this section on the first Form 5471 (or successor form) filed by the corporation after the issuance of guidance setting forth the form and manner of reporting such information.

(g) through (l) [Reserved].

(m)(1) [Reserved].

(2)*Special rule for paragraph (f)(16)*. Paragraph (f)(16) applies with respect to information for annual accounting periods in which a dividend subject to §1.245A-5T is paid.

(n) *Expiration date*. The applicability of paragraphs (f)(16) and (m) of this section expires June 14, 2022.

KIRSTEN WIELOBOB
Deputy Commissioner for Services and Enforcement.

Approved: June 4, 2019

DAVID J KAUTTER
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 14, 2019, 4:15 p.m., and published in the issue of the Federal Register for June 18, 2019, 84 F.R. 28398)

Part III.

Guidance Providing a Safe Harbor Under Section 164 for Certain Individuals Who Make a Payment to or for the Use of an Entity Described in Section 170(c) in Return for a State or Local Tax Credit

Notice 2019-12

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to publish a proposed regulation providing a safe harbor under section 164 of the Internal Revenue Code (Code) for certain individuals who make a payment to or for the use of an entity described in section 170(c) in return for a state or local tax credit. Under the safe harbor, an individual may treat as a payment of state or local tax for purposes of section 164 the portion of a payment for which a charitable contribution deduction under section 170 is or will be disallowed under Treas. Reg. § 1.170A-1(h)(3) (T.D. 9864). This treatment as a payment of state or local tax under section 164 is allowed in the taxable year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for such taxable year or the preceding taxable year. In states and localities that permit an individual to carry forward an excess credit amount to a subsequent taxable year, an individual may treat the carryforward amount as a state or local tax payment under section 164 for the taxable year or years to which the credit is applied, consistent with applicable state or local law, to offset a state or local tax liability. Prior to issuance of the proposed regulation, taxpayers may rely on the provisions of this notice with respect to payments described in this notice.

SECTION 2. BACKGROUND

Section 170(a)(1) generally allows an itemized deduction for any "charitable contribution" paid within the taxable year. Section 170(c) defines "charitable contribution" as a contribution or gift to or for the use of any entity described in that section. Under section 170(c)(1), such an entity includes a State, a possession of the United States, or any political subdivision of the foregoing, including the District of Columbia. Section 170(c)(2) includes certain corporations, trusts, or community chests, funds, or foundations, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Section 164(a) allows a deduction for the payment of certain taxes, including: (1) state and local, and foreign, real property taxes; (2) state and local personal property taxes; and (3) state and local, and foreign, income, war profits, and excess profits taxes. Section 164(b)(6), as added by section 11042(a) of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018" ("the Act"), Pub. L. 115-97, provides that deductions for foreign real property taxes are not allowable under section 164(a)(1) and limits an individual's deduction to $10,000 ($5,000 in the case of a married individual filing a separate return) for the aggregate amount of the following state and local taxes paid during the calendar year: (1) real property taxes; (2) personal property taxes; (3) income, war profits, and excess profits taxes; and (4) general sales taxes. This limitation applies to taxable years beginning after December 31, 2017, and before January 1, 2026, and does not apply to foreign taxes described in section 164(a)(3) or to any taxes described in section 164(a)(1) and (2) that are paid and incurred in carrying on a trade or business or an activity described in section 212. Section 164(b)(2) provides that for purposes of section 164, a "state or local tax" includes only a tax imposed by a state, a United States territory, or a political subdivision of any of the foregoing, or by the District of Columbia.

Due to the potential for taxpayers to use state or local tax credit programs to avoid the limitation on the deductibility of state and local taxes, the Treasury Department and the IRS have issued guidance on the federal income tax treatment of transfers to entities described in section 170(c) when the taxpayer receives or expects to receive a state or local tax credit in return. On June 11, 2018, the Treasury Department and the IRS issued Notice 2018-54, 2018-24 I.R.B. 750, announcing the intention to propose regulations addressing the federal income tax treatment of transfers pursuant to state and local tax credit programs. On August 27, 2018, proposed regulations under sections 170 and 642(c) were published in the Federal Register (83 FR 43563). The proposed regulations generally state that if a taxpayer makes a payment or transfers property to or for the use of an entity described in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or *quid pro quo*, to the taxpayer and reduces the taxpayer's charitable contribution deduction under section 170(a). On December 28, 2018, the Treasury Department and the IRS issued Rev. Proc. 2019-12, 2019-04 I.R.B. 401, providing a safe harbor under section 162 for certain payments made by C corporations and specified passthrough entities to or for the use of an organization described in section 170(c) if the C corporation or specified passthrough entity receives or expects to receive a state or local tax credit in return for such payment. On June 11, 2019, the Treasury Department and the IRS published T.D. 9864, Contributions in Exchange for State or Local Tax Credits, 2019-27 I.R.B. 6 (effective August 12, 2019 and applicable to amounts paid or property transferred by a taxpayer after August 27, 2018), providing rules governing the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit, as well as providing similar rules under section 642(c) for payments made by a trust or decedent's estate.

In the Special Analyses section of the proposed regulations, the Treasury Department and the IRS explained that the proposed regulations "will leave charitable giving incentives entirely unchanged for the vast majority of taxpayers." The Treasury Department and the IRS acknowledged, however, that a small fraction of taxpayers could see a reduction in their financial incentives to donate to state and local tax credit programs compared to their pre-Act incentives and requested comments on this important consideration. After the publication of the proposed regulations, stakeholders expressed concern, through comments and through testimony at the public hearing, that the proposed regulations would create unfair consequences for certain individuals who receive state or local tax credits in return for payments to section 170(c) entities. Specifically, donors to such tax credit programs who itemize deductions for federal income tax purposes and have total state and local tax liability for the year under $10,000 would be precluded from taking charitable contribution deductions for payments to section 170(c) entities to the extent the donors receive state or local tax credits even though the donors would have been able to deduct equivalent payments of state and local taxes offset by such credits. As a result of the proposed regulations, if these individuals chose to make a payment to a section 170(c) entity instead of paying tax to the state or local government, they would lose a deduction to which they would otherwise have been entitled.

These state tax credit programs effectively offer taxpayers a choice of paying tax to the state or local government or making a payment to a section 170(c) entity and receiving a tax credit that offsets the taxpayer's state or local tax liability. This situation can be analogized to situations in which a party entitled to receive a payment from a second party directs or permits the second party to satisfy its payment obligation by making a payment to a third party. In such situations, the payment may be treated, for federal income tax purposes, as a payment by the payor to the party entitled to receive payment. Cf. Rev. Rul. 74-75, 1974-1 C.B. 19 (payment made by an employer to a third party to discharge an obligation of an employee treated for federal income tax purposes as made by the employer to the employee); Rev. Rul. 86-14, 1986-1 C.B. 304 (same).

SECTION 3. SAFE HARBOR FOR INDIVIDUALS

The Treasury Department and the IRS take seriously the concern that the proposed regulations could create unfair consequences for individuals who (i) itemize deductions for federal income tax purposes, (ii) make a payment to a section 170(c) entity in return for a state or local tax credit, and (iii) would have been able to deduct a payment of tax to the state or local government in the amount of the credit. A safe harbor is appropriate to mitigate the consequences of the proposed regulations in the situation described above.

Accordingly, the Treasury Department and the IRS intend to publish a proposed regulation amending Treasury Regulation § 1.164-3 to provide a safe harbor for certain individuals who make a payment to or for the use of an entity described in section 170(c) in return for a state or local tax credit. Under this safe harbor, an individual who itemizes deductions and who makes a payment to a section 170(c) entity in return for a state or local tax credit may treat as a payment of state or local tax for purposes of section 164 the portion of such payment for which a charitable contribution deduction under section 170 is or will be disallowed under final regulations. This treatment as a payment of state or local tax under section 164 is allowed in the taxable year in which the payment is made to the extent the resulting credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability for such taxable year or the preceding taxable year.[12] To the extent the resulting credit is not applied to offset the individual's state or local tax liability for the taxable year of the payment or the preceding taxable year, any excess credit permitted to be carried forward may be treated as a payment of state or local tax under section 164 in the taxable year or years for which the carryover credit is applied, consistent with applicable state or local law, to offset the individual's state or local tax liability. This safe harbor shall not apply to a transfer of property.

Nothing in this notice may be construed as permitting a taxpayer who applies this safe harbor to treat the amount of any payment as deductible under more than one provision of the Code or Treasury regulations.

Nothing in this notice may be construed as permitting a taxpayer who applies this safe harbor to avoid the limitations of section 164(b)(6) for any amount paid as a tax or treated under this notice as a payment of tax.

SECTION 4. EXAMPLES

In the examples below, assume that the taxpayer's application of the state or local tax credit is consistent with applicable state or local law and that the taxpayer is an individual who itemizes deductions for federal income tax purposes.

Example 1. In year 1, Taxpayer A makes a payment of $500 to an entity described in section 170(c). In return for the payment, A receives a dollar-for-dollar state income tax credit. Prior to application of the credit, A's state income tax liability for year 1 was $500 or more; A applies the $500 credit to A's year 1 state income tax liability. Under section 3 of this notice, A treats the $500 payment as a payment of state income tax in year 1 for purposes of section 164. To determine A's deduction amount, A must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

Example 2. In year 1, Taxpayer B makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, B receives a dollar-for-dollar state income tax credit, which under state law may be carried forward for three taxable years. Prior to application of the credit, B's state income tax liability for year 1 was $5,000; B applies $5,000 of the $7,000 credit to B's year 1 state income tax liability. Under section 3 of this notice, B treats $5,000 of the $7,000 payment as a payment of state income tax in year 1 for purposes of section 164. Prior to application of the remaining credit, B's state income tax liability for year 2 exceeds $2,000; B applies the excess credit of $2,000 to B's year 2 state income tax liability. For year 2, B treats the $2,000 as a payment of state income tax for purposes of section 164. To determine B's deduction amounts in years 1 and 2, B must apply the provisions of section 164

[12] Some state or local tax credit programs allow an individual to apply the state or local tax credit to offset a prior year's state or local tax liability.

applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

Example 3. In year 1, Taxpayer C makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, C receives a local real property tax credit equal to 25 percent of the amount of this payment ($1,750). Prior to application of the credit, C's local real property tax liability in year 1 was $3,500; C applies the $1,750 credit to C's year 1 local real property tax liability. Under section 3 of this notice, for year 1, C treats $1,750 as a payment of local real property tax for purposes of section 164. To determine C's deduction amount, C must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).

SECTION 5. APPLICABILITY DATE

The proposed regulation setting forth the safe harbor described in this notice will apply to payments made to section 170(c) entities after August 27, 2018. Prior to the issuance of that proposed regulation, taxpayers may rely on the provisions of this notice with respect to such payments.

SECTION 6. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on the safe harbor described in this notice by July 11, 2019. Taxpayers may submit comments electronically via the Federal eRulemaking Portal at *www.regulations.gov* (type IRS-2019-0020 in the search field on the *www.regulations.gov* homepage to find this notice and submit comments). Alternatively, taxpayers may submit comments to: CC:PA:LPD:PR (Notice 2019-12), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Notice 2019-12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. All comments received will be available for public inspection on *www.regulations.gov*.

SECTION 7. DRAFTING INFORMATION

The principal authors of this notice are personnel from the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, contact Mon L. Lam at (202) 317-4059 (not a toll-free number).

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

Notice 2019-40

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

YIELD CURVE AND SEGMENT RATES

Section 430 specifies the minimum funding requirements that apply to single-employer plans (except for CSEC plans under § 414(y)) pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins.[13] However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007-81, 2007-44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Consistent with the methodology specified in Notice 2007-81, the monthly corporate bond yield curve derived from May 2019 data is in Table 2019-5 at the end of this notice. The spot first, second, and third segment rates for the month of May 2019 are, respectively, 2.72, 3.76, 4.33.

The 24-month average segment rates determined under § 430(h)(2)(C)(i) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates. For plan years beginning before 2021, the applicable minimum percentage is 90% and the applicable maximum percentage is 110%. The 25-year average segment rates for plan years beginning in 2018 and 2019 were published in Notice 2017-50, 2017-41 I.R.B. 280, and Notice 2018-73, 2018-40 I.R.B. 526, respectively.

24-MONTH AVERAGE CORPORATE BOND SEGMENT RATES

The three 24-month average corporate bond segment rates applicable for June 2019 without adjustment for the 25-year average segment rate limits are as follows:

24-Month Average Segment Rates Without 25-Year Average Adjustment

Applicable Month	First Segment	Second Segment	Third Segment
June 2019	2.74	3.96	4.44

[13]Pursuant to § 433(h)(3)(A), the 3rd segment rate determined under § 430(h)(2)(C) is used to determine the current liability of a CSEC plan (which is used to calculate the minimum amount of the full funding limitation under § 433(c)(7)(C)).

Based on § 430(h)(2)(C)(iv), the 24-month averages applicable for September 2018 adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-Based on § 430(h)(2)(C)(iv), the 24-month averages applicable for June 2019, adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates, are as follows:

Adjusted 24-Month Average Segment Rates

For Plan Years Beginning In	Applicable Month	First Segment	Second Segment	Third Segment
2018	June 2019	3.92	5.52	6.29
2019	June 2019	3.74	5.35	6.11

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for May 2019 is 2.82 percent. The Service determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in February 2049 determined each day through May 8, 2019 and the yield on the 30-year Treasury bond maturing in May 2049 determined each day for the balance of the month. For plan years beginning in June 2019, the weighted average of the rates of interest on 30-year Treasury securities and the permissible range of rates used to calculate current liability are as follows:

Treasury Weighted Average Rates

For Plan Years Beginning In	30-Year Treasury Weighted Average	Permissible Range 90% to 105%
June 2019	2.94	2.64 to 3.08

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007-81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for May 2019 are as follows:

Minimum Present Value Segment Rates

Month	First Segment	Second Segment	Third Segment
May 2019	2.72	3.76	4.33

DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS participated in the development of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Paul Stern at 202-317-8702 (not toll-free calls).

Table 2019-5

Monthly Yield Curve for May 2019

Derived from May 2019 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	2.60	20.5	4.18	40.5	4.35	60.5	4.41	80.5	4.44
1.0	2.63	21.0	4.18	41.0	4.35	61.0	4.41	81.0	4.45
1.5	2.66	21.5	4.19	41.5	4.35	61.5	4.41	81.5	4.45
2.0	2.68	22.0	4.20	42.0	4.36	62.0	4.42	82.0	4.45
2.5	2.70	22.5	4.20	42.5	4.36	62.5	4.42	82.5	4.45
3.0	2.72	23.0	4.21	43.0	4.36	63.0	4.42	83.0	4.45
3.5	2.74	23.5	4.22	43.5	4.36	63.5	4.42	83.5	4.45
4.0	2.78	24.0	4.22	44.0	4.36	64.0	4.42	84.0	4.45
4.5	2.82	24.5	4.23	44.5	4.37	64.5	4.42	84.5	4.45
5.0	2.87	25.0	4.23	45.0	4.37	65.0	4.42	85.0	4.45
5.5	2.94	25.5	4.24	45.5	4.37	65.5	4.42	85.5	4.45
6.0	3.01	26.0	4.24	46.0	4.37	66.0	4.42	86.0	4.45
6.5	3.08	26.5	4.25	46.5	4.37	66.5	4.42	86.5	4.45
7.0	3.16	27.0	4.26	47.0	4.38	67.0	4.43	87.0	4.45
7.5	3.24	27.5	4.26	47.5	4.38	67.5	4.43	87.5	4.45
8.0	3.32	28.0	4.26	48.0	4.38	68.0	4.43	88.0	4.45
8.5	3.40	28.5	4.27	48.5	4.38	68.5	4.43	88.5	4.45
9.0	3.47	29.0	4.27	49.0	4.38	69.0	4.43	89.0	4.45
9.5	3.54	29.5	4.28	49.5	4.38	69.5	4.43	89.5	4.45
10.0	3.61	30.0	4.28	50.0	4.39	70.0	4.43	90.0	4.45
10.5	3.67	30.5	4.29	50.5	4.39	70.5	4.43	90.5	4.46
11.0	3.73	31.0	4.29	51.0	4.39	71.0	4.43	91.0	4.46
11.5	3.78	31.5	4.30	51.5	4.39	71.5	4.43	91.5	4.46
12.0	3.83	32.0	4.30	52.0	4.39	72.0	4.43	92.0	4.46
12.5	3.87	32.5	4.30	52.5	4.39	72.5	4.43	92.5	4.46
13.0	3.91	33.0	4.31	53.0	4.39	73.0	4.43	93.0	4.46
13.5	3.94	33.5	4.31	53.5	4.40	73.5	4.44	93.5	4.46
14.0	3.97	34.0	4.31	54.0	4.40	74.0	4.44	94.0	4.46
14.5	4.00	34.5	4.32	54.5	4.40	74.5	4.44	94.5	4.46
15.0	4.03	35.0	4.32	55.0	4.40	75.0	4.44	95.0	4.46
15.5	4.05	35.5	4.32	55.5	4.40	75.5	4.44	95.5	4.46
16.0	4.07	36.0	4.33	56.0	4.40	76.0	4.44	96.0	4.46
16.5	4.08	36.5	4.33	56.5	4.40	76.5	4.44	96.5	4.46
17.0	4.10	37.0	4.33	57.0	4.40	77.0	4.44	97.0	4.46
17.5	4.11	37.5	4.33	57.5	4.41	77.5	4.44	97.5	4.46
18.0	4.13	38.0	4.34	58.0	4.41	78.0	4.44	98.0	4.46
18.5	4.14	38.5	4.34	58.5	4.41	78.5	4.44	98.5	4.46
19.0	4.15	39.0	4.34	59.0	4.41	79.0	4.44	99.0	4.46
19.5	4.16	39.5	4.34	59.5	4.41	79.5	4.44	99.5	4.46
20.0	4.17	40.0	4.35	60.0	4.41	80.0	4.44	100.0	4.46

Part IV.

Deletions From Cumulative List of Organizations, Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2019-07

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the IRS will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the IRS is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on July 1, 2019 and would end on the date the court first determines the organization is not described in section 170(c)(2) as more particularly set for in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

NAME OF ORGANIZATION	Effective Date of Revocation	LOCATION
Evansville Otters Booster Club Inc	1/1/2015	Evansville, IN
Firemen's Benevolent Association of the Village of Leroy Inc	4/1/2015	LeRoy, NY
Fit Kids	1/1/2015	Forney, TX
Franklin County Memorial Hospital	1/1/2010	Meadville, MS
Global Multicultural Business	1/1/2015	Boca Raton, FL
Grace Heritage Corporation	1/1/2010	Davie, FL
Greater Ontario Convention and Visitors Bureau	7/1/2014	Ontario, CA
Grooming for Greatness Youth & Family Services	1/1/2016	Peachtree, GA
Homeward Society Foster Family Agency	1/1/2015	Agoura Hills, CA
Indiana Endowment Fund	1/1/2011	Fort Branch, IN
International Medical Interpreters	1/1/2014	Lexington, MA
Kingdom Victories Outreach Ministries	1/1/2016	Inkster, MI
Kokopelli Concepts Housing Association Inc	1/1/2015	Houston, TX
Lebanon Stem Foundation Inc	1/1/2015	Lebanon, IN
Light of the World Inc	1/1/2015	Unionville, CT
Magans Light	1/1/2016	Forth Worth, TX
Magnolia Regional Health Center	10/1/2009	Corinth, MS
Marcs Place Inc	1/1/2015	Lake City, AR
Middle Tennessee Clean Fuels Inc	12/31/2015	Nashville, TN
National Association of College Auxiliary Services	1/1/2013	Charlottesville, VA
New School Baseball Academy	1/1/2014	Mission Viejo, CA
No Child Unloved	1/1/2015	Gifford, IL
Northern Illinois Home Medical Supply NFP	1/1/2014	Sterling, IL
NW Somaliland Society	1/1/2014	Lynnwood, WA
Perkinsville Fundraisers Inc	7/1/2014	Springfield, VT
Professional Fire Fighters of Arizona	1/1/2015	Phoenix, AZ

Project Walk Recovery Foundation Inc	1/1/2014	Carlsbad, CA
Rehobooth McKinley Christian Health Inc	1/1/2014	Gallup, NM
Rescue A Vet	1/1/2015	Cleveland, OH
SDQ Foundation	3/27/2012	Houston, TX
Sigma Theta Tau International Inc	1/1/2014	Mayaguez, PR
Sims Chiropractic Clinic Ministering Health	1/1/2014	Gunnison, CO
Society For Mind Brain Sciences	1/1/2014	Santa Monica, CA
Somerset County Farmers' Market Inc	1/1/2016	Somerset, PA
Sons of the American Legion	9/22/2014	Blessing, TX
Sustainable Travel International	1/1/2013	Boulder, CO
The Breast Cancer Society Inc	1/1/2014	Nashville, TN
The Center for Optimal Adult Development	12/31/2015	Austin, TX
The Redi Foundation Inc	6/1/2014	Boca Raton, FL
The Wright Touch Athletics	1/1/2014	Country Club Hills, IL
Thirty Thousand Feet Booster Club	1/1/2015	Travis AFB, CA
Trust and Faith Community Outreach Inc	1/1/2015	Ocoee, FL
University Urology Foundation Inc	1/1/2015	Louisville, KY
Uplift Individuals in Christ	1/1/2015	Ft. Washington, MD
Usangule Food For Thought Inc	1/1/2015	Palo Alto, CA
VMU-1 Wardroom Fund	1/1/2015	Yuma, AZ
We Adopt Kids	1/1/2016	Carson City, NV
Western Conservatory of the Arts & Sciences	1/1/2014	Nunnelly, TN
Wingate Community Improvement Inc	1/1/2015	Wingate, IN
You Are Loved Inc	1/1/2016	Mandeville, LA
Yuen Foundation Incorporated	1/1/2015	Washington, DC

Notice of Proposed Rulemaking

Withholding of Tax and Information Reporting with Respect to Interests in Partnerships Engaged in the Conduct of a U.S. Trade or Business

REG-105476-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations implementing certain sections of the Internal Revenue Code, including sections added to the Internal Revenue Code by the Tax Cuts and Jobs Act, that relate to the withholding of tax and information reporting with respect to certain dispositions of interests in partnerships engaged in the conduct of a trade or business within the United States. The proposed regulations affect certain foreign persons that recognize gain or loss from the sale or exchange of an interest in a partnership that is engaged in the conduct of a trade or business within the United States, and persons that acquire those interests. The proposed regulations also affect partnerships that, directly or indirectly, have foreign persons as partners.

DATES: Written or electronic comments and requests for a public hearing must be received by July 12, 2019.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-105476-18), Internal Revenue Service, Room 5203, 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-105476-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG-105476-18).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Chadwick Rowland, 202-317-6937; concerning submissions of comments or requests for a public hearing, Regina L. Johnson (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. *Section 1446(f)*

Section 1446(f), which was added to the Internal Revenue Code (the "Code") by section 13501 of the Tax Cuts and Jobs Act, Public Law 115-97 (2017) (the "Act"), provides rules for withholding on the transfer of a partnership interest described in section 864(c)(8). Section 1446(f)(1) provides that, except as otherwise provided in section 1446(f), if a portion of the gain (if any) on any disposition of an interest in a partnership would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States, the transferee is required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

Section 1446(f)(2)(A) provides an exception to the general withholding requirement described in section 1446(f)(1) if the transferor furnishes an affidavit to the transferee stating, under penalties of perjury, the transferor's United States taxpayer identification number and that the transferor is not a foreign person. Section 1446(f)(2)(B)(i) provides that the exception to withholding described in section 1446(f)(2)(A) will not apply if the transferee has actual knowledge that the affidavit furnished is false, or if the transferee receives a notice from a transferor's agent or transferee's agent that the affidavit is false.

Section 1446(f)(3) provides that, at the request of the transferor or transferee, the Secretary may prescribe a reduced amount to be withheld under this section if the Secretary determines that reducing the amount to be withheld will not jeopardize the collection of tax on gain treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States.

Section 1446(f)(4) provides that if a transferee fails to withhold any amount required to be withheld under section 1446(f)(1) then the partnership must deduct and withhold from distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold, plus interest.

Section 1446(f)(6) generally provides that the Secretary shall prescribe such regulations as may be necessary to carry out the purposes of section 1446(f), including regulations providing for exceptions from the provisions of section 1446(f). Section 1446(f) is effective for sales, exchanges, and other dispositions after December 31, 2017.

On December 29, 2017, the Department of the Treasury (the "Treasury Department") and the Internal Revenue Service (the "IRS") released Notice 2018-08, 2018-7 I.R.B. 352, which temporarily suspends the requirement to withhold on amounts realized in connection with the sale, exchange, or disposition of certain interests in a publicly traded partnership not treated as a corporation under section 7704 and the regulations thereunder. On April 2, 2018, the Treasury Department and the IRS released Notice 2018-29, 2018-16 I.R.B. 495, which provides temporary guidance and announces an intent to issue proposed regulations under section 1446(f) with respect to the sale, exchange, or disposition of certain interests in non-publicly traded partnerships. Notice 2018-29, and section 1446(f)(1) generally, rely on the principles contained within the section 1445 withholding regime. Under section 1445, if a foreign person disposes of a United States real property interest ("U.S. real property interest"), as defined in section 897(c), a withholding obligation is imposed on the transferee of the interest.

On December 27, 2018, the Treasury Department and the IRS published in the **Federal Register** a notice of proposed rulemaking at 83 FR 66647 (REG-113604-18) under section 864(c)(8) (the "proposed section 864(c)(8) regulations"). The proposed section 864(c)(8) regulations provide rules for determining the amount of gain or loss treated as effectively connected with the conduct of a trade or business within the United States ("effectively connected gain" or "effectively connected loss") described in section 864(c)(8), including rules coordinating section 864(c)(8) with sections 741 and 751 (relating to the character of gain or loss realized in connection with the sale or exchange of an interest in a partnership). They also provide rules for coordination of section 864(c)(8) with section 897 (relating to amounts treated as effectively connected gain or loss with respect to U.S. real property interests), tiered partnerships, and U.S. income tax treaties.

II. *Rules for Withholding under Section 1446(a) on Distributions by Publicly Traded Partnerships*

Generally, withholding under section 1446(a) is required by a partnership when effectively connected taxable income ("ECTI") is allocable to a foreign person. *See* §§1.1446-2 and 1.1446-3. However, withholding on ECTI earned by a publicly traded partnership is required when the ECTI is distributed to the foreign person. *See* §1.1446-4. Often, an interest in the publicly traded partnership is held by a nominee, such as a domestic financial institution that holds the publicly traded partnership interest as a custodian for a foreign partner. Section 1.1446-4 provides rules for applying the withholding tax under section 1446(a) to distributions by publicly traded partnerships. Under those rules, when a publicly traded partnership provides a qualified notice (within the meaning of §1.1446-4(b)(4)), a nominee, which must be a domestic person, may be treated as a withholding agent with respect to a distribution. *See* §1.1446-4(b)(4) and 1.1446-4(d). The qualified notice must be given in accordance with notice requirements with respect to dividends under regulations under the Securities Exchange Act of 1934. Section 1.1445-8(f) provides similar qualified notice rules that apply to certain distributions subject to withholding when attributable to the disposition of a U.S. real property interest.

Section 1.1446-4(f)(3) provides an ordering rule for situations in which the distribution is attributable to multiple types of income (such as amounts attributable to income described in section 1441 or 1442 or amounts subject to withholding under section 1446). However, no rule is provided for situations in which a qualified notice does not provide information regarding the types of income being distributed.

Explanation of Provisions

The proposed regulations provide rules for withholding, reporting, and paying tax under section 1446(f) upon the sale, exchange, or other disposition of an interest in a partnership described in section 864(c)(8) and proposed §1.864(c)(8)-1.[14] The proposed regulations would, when finalized, adopt many of the rules that were described in Notice 2018-29, with certain modifications provided, in part, in response to comments. In addition, the proposed regulations provide reporting rules relating to section 864(c)(8) and rules implementing withholding under section 1446(f)(4). They also contain rules clarifying the reporting rules applicable to transfers of partnership interests subject to section 6050K. Further, the proposed regulations provide rules implementing withholding by brokers on transfers of certain interests in publicly traded partnerships subject to section 1446(f)(1), and make related changes to the reporting rules and procedures for adjusting withholding under sections 1461, 1463, and 1464. They also make changes to the rules regarding withholding on distributions by publicly traded partnerships under §1.1446-4, including the rules that apply to qualified notices and nominees. Finally, the proposed regulations provide rules coordinating withholding under section 1446(f) with other withholding regimes to prevent overwithholding of tax.

I. *Reporting Requirements for Foreign Transferors and Partnerships with Foreign Transferors*

A partnership that is engaged in the conduct of a trade or business within the United States is required to file an annual information return, Form 1065, *U.S. Return of Partnership Income*, and also provide information to its partners on Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, with respect to each partner's distributive share of partnership items and other information. *See* section 6031 and §§1.6031(a)-1 and 1.6031(b)-1T. Domestic partners generally report the information from the Schedule K-1 (Form 1065) on their income tax return, typically Form 1040, *U.S. Individual Income Tax Return*, for an individual, or Form 1120, *U.S. Corporation Income Tax Return*, for a corporation. A foreign partner with a U.S. income tax return filing obligation generally files Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*.

A partner (foreign or domestic) that transfers an interest in a partnership in an exchange described in section 751(a) (relating to an exchange of an interest in a partnership that holds unrealized receivables or inventory) generally has an obligation both to inform the partnership of the transfer and to include a statement with respect to the exchange on the partner's income tax return under §1.751-1(a)(3). *See* section 6050K(c) and §1.6050K-1(d). A partnership also has an obligation to provide information with respect to the exchange to the transferee and transferor under section 6050K(c) and §1.6050K-1(c). *See also* Form 8308, *Report of a Sale or Exchange of Certain Partnership Interests*.

Because section 864(c)(8) requires a deemed sale at the partnership level to determine a foreign partner's effectively connected gain or loss, a foreign person that transfers its partnership interest generally will not be able to compute its income tax liability under section 864(c)(8) unless the partnership provides certain information to the foreign partner. The proposed regulations therefore provide rules that facilitate the transfer of information between a foreign partner and the partnership for purposes of section 864(c)(8).

The proposed regulations generally provide that a notifying transferor (generally, any foreign person and certain domestic partnerships that have a foreign person as a direct or indirect partner) that transfers (within the meaning of proposed §1.864(c)(8)-1(g)(5)) an interest in a partnership (other than certain interests in a publicly traded partnership) in a transaction described in section 864(c)(8) must notify the partnership within 30 days of the transfer by providing a statement that includes information relevant to the partnership for making calculations under section 864(c)(8), including the date on which the notifying transferor transferred its interest, and other identifying information regarding the transferor and transferee. *See* proposed §1.864(c)(8)-2(a). This rule generally parallels §1.6050K-1, including the content of the information and when it must be provided.

Proposed §1.864(c)(8)-2(b) requires a specified partnership (generally, a partnership that is engaged in the conduct of a trade or business within the United States or a partnership that owns, directly or indirectly, an interest in a partnership so engaged) to furnish to a notifying transferor the information necessary for the transferor to comply with section 864(c)(8) by the due date of the Schedule K-1 (Form 1065) for the tax year of the partnership in which the transfer occurred. Proposed §1.864(c)(8)-2(b) applies if a specified partnership receives the notification described in proposed §1.864(c)(8)-2(a), or otherwise knows that a relevant transfer has occurred, and the notifying transferor would have had a distributive share of deemed sale EC gain or deemed sale EC loss (within the meaning of proposed §1.864(c)(8)-1(c)) at the time of the transfer. For these purposes, a notifying transferor that is a partnership is treated as a nonresident alien. Proposed §1.864(c)(8)-2(b) provides that, for purposes of the reporting requirements described in proposed §1.864(c)(8)-2, a partnership that makes a distribution to a transferor that qualifies as a transfer under section 864(c)(8) and proposed §1.864(c)(8)-1(b) will be treated as having actual knowledge that a transfer occurred, thereby triggering the reporting requirement of proposed §1.864(c)(8)-2(b) to the extent that the transferee would have had a distributive share of deemed sale EC gain or deemed sale EC loss within the meaning of proposed §1.864(c)(8)-1(c).

Relatedly, the proposed regulations clarify that the information a partnership must provide under section 6050K upon being notified of a transfer includes the information necessary for a transferor

[14] § 1.864(c)(8)-1 was proposed to be added on December 27, 2018; 83 FR 66647, 66651.

to make the transferor's required statement under §1.751-1(a)(3). *See* proposed §1.6050K-1(c)(2).

II. *Definitions and General Rules of Applicability*

A. *Definitions*

For purposes of the proposed regulations under section 1446(f), the term "transfer" means a sale, exchange, or other disposition, and includes a distribution from a partnership to a partner. *See* proposed §1.1446(f)-1(b)(9). A "transferee" is any person, foreign or domestic, that acquires a partnership interest through a transfer. *See* proposed §1.1446(f)-1(b)(10). The term "transferor" generally means any person, foreign or domestic, that transfers a partnership interest, and therefore refers to the person that directly owns the interest in the partnership. For a trust, to the extent all or a portion of the trust is treated as owned by the grantor or another person under sections 671 through 679 (such trust, "a grantor trust"), the term "transferor" means the grantor or other person. *See* proposed §1.1446(f)-1(b)(11). *See also* Rev. Rul. 85-13, 1985-1 C.B. 184.

B. *Certifications and Books and Records*

Similar to the approach described in Notice 2018-29, the proposed regulations provide various exceptions to withholding and procedures for determining the amount to withhold. Under these rules, the person required to withhold may generally rely on information provided in certifications that it receives or that is contained in its own books and records. The general rules of applicability provide the requirements for providing a valid certification and for retaining certifications or information in books and records. *See* proposed §1.1446(f)-1(c)(2). A certification includes any documents associated with the certification, such as statements from the partnership, IRS forms, withholding certificates, withholding statements, certifications, or other documentation. *Id.*

C. *Determination Dates*

Notice 2018-29 required determinations to be made as of the date of transfer when applying many of its rules and exceptions. Because it may be difficult to make these determinations on the precise date of transfer, the proposed regulations generally allow the choice of one of several dates solely for purposes of making determinations under section 1446(f)(1) with regard to a transfer. This date is referred to as the determination date. It is chosen on a transfer-by-transfer basis and must be used for a transfer for all purposes of section 1446(f). The determination date must be one of the following: the date of the transfer, any date no more than 60 days before the transfer, or, with respect to a transferor that is not a controlling partner, the later of either the first day of the partnership's taxable year in which the transfer occurs or the date before the transfer of the most recent revaluation described in §1.704-1(b)(2)(iv)(*f*)(*5*) or 1.704-1(b)(2)(iv)(*s*)(*1*). *See* proposed §1.1446(f)-1(c)(4). As the determination date applies only for purposes of determining the withholding obligation under section 1446(f), the calculation of tax resulting from the application of section 864(c)(8) and the reporting requirements under proposed §1.864(c)(8)-2 are determined based on the date of the transfer.

D. *IRS Forms and Instructions*

Proposed §1.1446(f)-1(c)(5) provides that any reference in the proposed regulations to an IRS form includes its successor form and that any form must be filed in the manner provided in the instructions to the forms or in other guidance. The IRS intends to modify publications, instructions and forms (including forms discussed in this Explanation of Provisions) as appropriate to take into account sections 864(c)(8) and 1446(f).

E. *Coordination with Other Withholding Rules*

Proposed §1.1446(f)-1(d) provides a rule coordinating section 1446(f)(1) with section 1445. Specifically, the rule provides that if a transferee is required to withhold under section 1445(e)(5) or §1.1445-11T(d)(1) and section 1446(f)(1), then the transferee will be subject to the payment and reporting requirements of section 1445 only. This rule clarifies that even though proposed §1.864(c)(8)-1(d) provides that section 897(g) does not apply to a transfer that is also subject to section 864(c)(8), the withholding regime provided in section 1445 and the regulations thereunder applies under these circumstances, rather than the rules described in section 1446(f)(1). Thus, if a foreign transferor disposes of an interest in a partnership that is engaged in the conduct of a trade or business within the United States (not taking into account the application of section 897(a)) and in which fifty percent or more of the value of the gross assets consist of U.S. real property interests, and ninety percent or more of the value of the gross assets consist of U.S. real property interests plus any cash or cash equivalents, a transferee must generally withhold under section 1445(a) (at 15 percent of the amount realized) and not section 1446(f). However, this rule applies only if the transferor has not applied for a withholding certificate under §1.1445-11T(d)(1). *See* proposed §1.1446(f)-1(d). If the transferor has applied for a withholding certificate, then the transferee must withhold the greater of the amounts required under section 1445(e)(5) or section 1446(f)(1).

Because gain that an upper-tier partnership recognizes on the transfer of an interest in a lower-tier partnership engaged in the conduct of a trade or business within the United States is included when calculating the upper-tier partnership's ECTI, the proposed regulations also provide a coordination rule that allows a partnership that is withheld upon under section 1446(f)(1) (in its capacity as a transferor) to claim a credit for the amount withheld against its withholding tax liability under section 1446(a) (if any). *See* proposed §1.1446-3(c)(4). *See also* §1.1446-3(d)(2) for rules on how the partnership or its partners may claim a credit or refund for tax paid under section 1446.

III. *Withholding on the Transfer of a Non-Publicly Traded Partnership Interest by a Foreign Person*

A. *In General*

Under section 1446(f)(1), a transferee of a partnership interest must withhold a tax equal to 10 percent of the amount realized on any disposition when the disposition results in gain that is treated as effectively connected with the conduct of a trade or business within the United States under section 864(c)(8). Proposed §1.1446(f)-2(a) implements this rule by requiring any transferee to withhold a tax equal to 10 percent of the amount realized on any transfer of a partnership interest (other than certain publicly traded partnership interests) under section 1446(f)(1), unless an exception to withholding applies under proposed §1.1446(f)-2(b). If an exception does not apply and withholding is required, proposed §1.1446(f)-2(c) provides rules for determining and adjusting the amount required to be withheld under section 1446(f)(1). The exceptions and determination procedures in the proposed regulations apply solely for purposes of section 1446(f)(1) and do not affect a foreign person's filing obligation under the Code or a foreign person's tax liability resulting from the application of section 864(c)(8).

B. *Exceptions to Withholding*

1. In General

The proposed regulations provide six exceptions to withholding by a transferee under section 1446(f)(1). These exceptions generally allow the transferee to rely on certain certifications that it receives from the transferor or partnership unless it has actual knowledge that the certifications are incorrect or unreliable. *See* proposed §1.1446(f)-2(b)(1). When the partnership is a transferee because it makes a distribution, it may instead rely on its books and records unless it knows, or has reason to know, that the information is incorrect or unreliable. *Id.*

2. Certification of Non-Foreign Status by Transferor

Consistent with section 6.01 of Notice 2018-29, proposed §1.1446(f)-2(b)(2) provides the requirements for a certification of non-foreign status (including the requirement that it include the transferor's TIN), and clarifies that a valid Form W-9, *Request for Taxpayer Identification Number and Certification*, may be used for this purpose, including a Form W-9 for the transferor that is already in the transferee's possession. The proposed regulations also clarify that a Form W-9 may be used to establish non-foreign status of a transferor for purposes of section 1445. *See* proposed §§1.1445-2(b)(2)(v) and 1.1445-5(b)(3)(iv).

3. No Realized Gain by Transferor

Section 1446(f)(1) applies only when there is gain described in section 864(c)(8) on the transfer of a partnership interest. Consistent with section 6.02 of Notice 2018-29, the proposed regulations provide that a transferee is not required to withhold if the transferor provides the transferee with a certification stating that the transferor would not realize any gain on the transfer of the partnership interest determined as if the transfer occurred on the determination date. Proposed §1.1446(f)-2(b)(3)(i) provides that this certification of no realized gain must take into account any ordinary income arising from application of section 751(a) and the regulations thereunder. Therefore, a transferor may not provide the certification if section 751(a) and the regulations thereunder require the transferor to realize ordinary income, even if the transferor would realize an overall loss on the transfer.

A similar rule in proposed §1.1446(f)-2(b)(3)(ii) applies to partnership distributions. Section 731 generally provides that if a distribution of money to a partner exceeds the partner's adjusted basis in its interest in the partnership, then gain will be recognized to the extent of the difference between the money distributed and the partner's basis. That gain or loss is considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner. *See* section 731(a). Consistent with section 9 of Notice 2018-29, proposed §1.1446(f)-2(b)(3)(ii) provides that for purposes of determining whether withholding is required on a distribution, a partnership is permitted to rely on its books and records or on a certification provided by the transferor (the distributee partner) to determine if there is realized gain to the distributee partner.

4. Effectively Connected Gain upon a Partnership's Deemed Sale

To make the determination of whether there is a transfer to which withholding applies more administrable for transferors and transferees, proposed §1.1446(f)-2(b)(4) provides that no withholding is required if the transferee receives a certification from the partnership stating that if the partnership sold all of its assets at fair market value, the amount of net effectively connected gain resulting from the deemed sale would be less than 10 percent of the total net gain. Section 6.04 of Notice 2018-29 provided a similar rule, but at a threshold of 25 percent. Proposed §1.1446(f)-2(b)(4) lowers the percentage threshold in accordance with section 2 of Notice 2018-29, which stated that the Treasury Department and the IRS intend to provide future guidance reducing the percentage threshold provided in section 6.04 of Notice 2018-29. The proposed regulations also allow a partnership that is a transferee because it makes a distribution to use this exception when it determines that the 10-percent test is satisfied from its books and records.

To make it easier for the partnership to calculate its effectively connected gain from the deemed sale, the proposed regulations allow this amount to be determined as of the determination date. Further, the proposed regulations allow a partnership to make this determination when no gain on the deemed sale would have been effectively connected with the conduct of a trade or business within the United States (for example, when the deemed sale would result in a loss that would have been effectively connected with the conduct of a trade or business within the United States). *See* proposed §1.1446(f)-2(b)(4)(i)(B).

5. Allocable Share of ECTI

Section 6.03 of Notice 2018-29 provided an exception to withholding under section 1446(f)(1) for situations in which a transferor's distributive share of ECTI during the previous three taxable years was less than 25 percent of the transferor's total distributive share of income in each year (the "three-year ECTI exception"). Section 2 of Notice 2018-29 provided that the Treasury Department and the IRS intended to lower the three-year ECTI exception's 25 percent threshold in proposed regulations, and that other limitations for this rule were under consideration. *See* *also* section III.B.4 of this Explanation of Provisions (describing modifications to the threshold set forth in section 6.04 of Notice 2018-29).

The three-year ECTI exception was intended to relieve potentially significant overwithholding that could arise when a partner transfers an interest in a partnership, recognizes relatively little effectively connected gain under section 864(c)(8), but cannot obtain information from the partnership at the time of the transfer necessary to qualify for the deemed sale exception described in section III.B.4 of this Explanation of Provisions. The three-year ECTI exception uses a transferor's allocable share of ECTI as a proxy for distributive share of effectively connected gain recognized in connection with a deemed sale described in section 864(c)(8)(B). The Treasury Department and the IRS are aware that the amount of a partner's recent allocable share of ECTI may not accurately indicate whether, and to what extent, the partner would recognize gain taxable under section 864(c)(8) and proposed §1.864(c)(8)-1. For example, a partnership may recognize relatively little effectively connected income for several years while nonetheless holding assets with significant built-in gain that would be taxable as effectively connected gain. The three-year ECTI exception may in certain cases increase compliance and collection risks if foreign partners with limited connections to the United States and significant tax liability under section 864(c)(8) are not withheld on under section 1446(f)(1).

In the interest of striking the appropriate balance between the risk of noncompliance and the potential for overwithholding, the proposed regulations adopt the three-year ECTI exception from Notice 2018-29 with the modifications described in this section III.B.5 of this Explanation of Provisions. The Treasury Department and the IRS continue to study whether the three-year ECTI exception is appropriate in light of the risk of noncompliance, and request comments on the utility of the rule and modifications to the rule that would reduce that risk.

Accordingly, proposed §1.1446(f)-2(b)(5)(i) provides that no withholding is required if a transferee receives a certification from a transferor stating that the transferor was at all times a partner in the partnership for the immediately prior taxable year and the two taxable years that precede it and that the transferor's allocable share of ECTI for each of those taxable years was less than 10 percent of the transferor's total distributive share of the partnership's net income for that year. *See* proposed §1.1446(f)-2(b)(5)(i)(A) and (C). In addition, a transferor must certify that, in the immediately prior taxable year and the two that preceded it, the transferor's allocable share of ECTI was less than $1 million (including ECTI allocated to certain persons related to the transferor). *See* proposed §1.1446(f)-2(b)(5)(i)(B). A transferor must also certify that its distributive share of income or gain that is effectively connected with the conduct of a trade or business within the United States or deductions or losses properly allocated and apportioned to that income in each of the taxable years described in proposed §1.1446(f)-2(b)(5)(i)(A) has been reported on a Federal income tax return (filed on or before the due date (including extensions) for filing the return (and all amounts due with respect to the return are timely paid)) for each of the three preceding taxable years, if required to be filed, before the date on which the transferor furnishes the certification. *See* proposed §1.1446(f)-2(b)(5)(i)(D). For this purpose, if the transferor is a nonresident alien individual or foreign corporation, the Federal income tax return is the transferor's Form 1040NR or Form 1120-F; if the transferor is a partnership, the Federal income tax returns are the Forms 1040NR or 1120-F of the direct or indirect partners of the transferor.

For purposes of this rule, the immediately prior taxable year is the transferor's most recent taxable year with or within which a taxable year of the partnership ended and for which a Schedule K-1 (Form 1065) was due or furnished (if earlier) before the date of the transfer. *See* proposed §1.1446(f)-2(b)(5)(ii). Consistent with the three-year ECTI exception described in Notice 2018-29, a transferor does not satisfy this requirement if for any of the relevant years it did not receive Form 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax*, unless the transferor was allocated an item of deduction or loss that is effectively connected with the conduct of a trade or business within the United States, in which case it is treated as having an allocable share of ECTI for that year of zero. *See* proposed §1.1446(f)-2(b)(5)(iii).

When a transferor has had neither ECTI nor a net distributive share of income allocated to it in the previous three taxable years, the composition of the income the partnership allocates to the transferor does not provide any indication of the amount of effectively connected gain realized by the transferor in connection with the transfer. Accordingly, the proposed regulations also provide that a transferor does not qualify for the exception provided in proposed §1.1446(f)-2(b)(5) if the transferor did not have a net distributive share of income allocated to it in any of its previous three taxable years. *See* proposed §1.1446(f)-2(b)(5)(iv).

Section 6.03 of Notice 2018-29 provided that the three-year ECTI exception does not apply when a partnership is a transferee by reason of making a distribution. Comments noted that, particularly in tiered partnership structures, a distributing partnership may not be able to obtain the information necessary to use the deemed sale exception described in section 6.04 of Notice 2018-29, such that the partnership would be required to withhold under section 1446(f)(1) in cases in which there was relatively limited effectively connected income earned by the partnership. In response to the comments, the proposed regulations allow a distributing partnership to use this exception when it determines that the three-year ECTI exception is applicable based on its books and records, provided that it receives a representation from the transferor stating that income tax returns have been filed, and tax has been paid, for each of the relevant years for which the transferor was allocated effectively connected income (or loss). *See* proposed §1.1446(f)-2(b)(5)(v).

Finally, proposed §1.1446(f)-2(b)(5)(vi) provides that a transferor may not make the certification if it has actual knowledge that the information relevant to the certification that is reported by the partnership on any Form 8805 or Schedule K-1 (Form 1065) is incorrect.

6. Nonrecognition by Transferor

Section 864(c)(8) and proposed §1.864(c)(8)-1 provide that gain from the transfer of a partnership interest that is treated as effectively connected with the conduct of a trade or business within the United States is limited to gain otherwise recognized under the Code. If a nonrecognition provision of the Code applies to all of the gain realized on a transfer, withholding under section 1446(f)(1) does not apply. Accordingly, section 6.05 of Notice 2018-29 provided an exception to withholding for certain nonrecognition transactions if the transferee receives a notice from the transferor describing the application of a nonrecognition provision. This exception was based on the rules in §1.1445-2(d)(2).

Consistent with the rule provided in Notice 2018-29, the proposed regulations generally permit a transferee to rely on a certification of nonrecognition from the transferor. *See* proposed §1.1446(f)-2(b)(6). The certification provided by the transferor must include a brief description of the transfer and the relevant law and facts relating to the application of the nonrecognition provision.

If only a portion of the gain realized on the transfer is subject to a nonrecognition provision, an adjustment to the amount required to be withheld may be permitted under proposed §1.1446(f)-2(c)(4), discussed in section III.C.4 of this Explanation of Provisions (describing the rules in proposed §1.1446(f)-2(c)(4)(vi) for the certification of maximum tax liability that may be relied upon in these situations).

7. Claim of Treaty Benefits

Notice 2018-29 did not contain specific rules addressing the application of income tax treaties, instead including them in section 6.05 by adopting a modified version of §1.1445-2(d) (providing an exception from withholding under section 1445 when the transferor certifies that it is not required to recognize gain either under a provision of the Code or under a treaty). The proposed regulations provide an exception to withholding under section 1446(f)(1) when a transferor certifies that it is not subject to tax on any gain from the transfer pursuant to an income tax treaty in effect between the United States and a foreign country. *See* proposed §1.1446(f)-2(b)(7)(i). This exception applies only when a transferor (as opposed to owners of an interest in the transferor, including partners in a partnership that is a transferor) qualifies for the benefits of an income tax treaty in order to reduce the burden on a transferee of reviewing documentation from multiple persons. The certification to the transferee must include a valid Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*, or W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)* (as applicable), that contains the information necessary to support the claim for treaty benefits, and the transferee must mail a copy of the certification to the IRS by the 30th day after the date of the transfer in order to rely upon it. *Id. See also* Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*, and the instructions to the form regarding the requirement for the transferor to disclose a claim for treaty benefits with a return.

To ensure that these procedures are followed for claims involving treaty benefits, this exception is the sole method by which a transferor may claim an exception to withholding by reason of a claim of treaty benefits. *See* proposed §1.1446(f)-2(b)(7)(iii). For claims involving transfers with respect to which treaty benefits apply to only a portion of the gain from the transfer, see section III.C.4 of this Explanation of Provisions (describing the rules in proposed §1.1446(f)-2(c)(4)(vi) for the certification of maximum tax liability that that may be relied upon in these situations).

C. *Determining the Amount to Withhold*

1. In General

The proposed regulations provide certain procedures for determining the amount to withhold under section 1446(f)(1). The rules are intended to provide administrable procedures for transferees to determine the amount to withhold, and in some cases, provide procedures intended to better reflect the amount of the transferor's actual tax liability under section 864(c)(8). When applicable, these procedures generally allow the transferee to rely on certifications that it receives from the transferor (or, in certain cases, from the partnership) to determine the amount to withhold unless it has actual knowledge that the certification is incorrect or unreliable. *See* proposed §1.1446(f)-2(c)(1). In cases in which a partnership is the transferee because it makes a distribution, it may instead rely on its books and records unless it knows, or has reason to know, that the information is incorrect or unreliable. *Id.*

2. Amount Realized

i. In General

The amount required to be withheld under section 1446(f)(1) is determined by reference to the transferor's amount realized on the transfer. *See* section 1446(f)(1). The proposed regulations provide that the amount realized for purposes of proposed §1.1446(f)-2 is determined under section 1001 and the regulations thereunder and section 752 and the regulations thereunder. *See* proposed §1.1446(f)-2(c)(2)(i); *see also* §§1.752-1(h) and 1.1001-2.

The proposed regulations also clarify that in the case of a distribution, the amount realized is the sum of the amount of cash distributed (or to be distributed), the fair market value of property distributed (or to be distributed), and the reduction in the transferor's share of partnership liabilities. *Id.*

ii. Procedures to Determine Share of Partnership Liabilities

Comments stated that the allocation of liabilities to a partner under section 752 is not information that normally would be available to a transferee and may be difficult for a transferor to determine as of the date of transfer. To address these issues, section 7.02 of Notice 2018-29 provided that a transferee may in certain cases rely on a certification from the transferor as to the amount of the transferor's share of partnership liabilities reported on the transferor's most recently received Schedule K-1 (Form 1065), provided that the form was for a partnership taxable year that closed no more than 10 months before the date of transfer and the transferor is not a controlling partner. Section 7.03 of Notice 2018-29 allowed a transferee to rely on a certification from the partnership that provided the transferor's share of partnership liabilities as reflected on the most recently prepared Schedule K-1 (Form 1065).

The proposed regulations provide procedures similar to sections 7.02 and 7.03 of Notice 2018-29 that allow a transferee to rely on a certification from the transferor or the partnership. Proposed §1.1446(f)-2(c)(2)(ii)(B) provides that a transferee may generally rely on a certification from a transferor that provides the amount of the transferor's share of partnership liabilities reported on the most recent Schedule K-1 (Form 1065) issued by the partnership. In response to comments stating that a transferor may not possess a Schedule K-1 (Form 1065) that satisfies the 10 month requirement in Notice 2018-29 because of the timing of the extended due date for Schedule K-1 (Form 1065), the proposed regulations provide that a transferee may generally rely on a certification if the last day of the partnership taxable year for which the Schedule K-1 (Form 1065) was provided was no more than 22 months before the date of the transfer. *See* proposed §1.1446(f)-2(c)(2)(ii)(B). Consistent with Notice 2018-29, a transferor that is a controlling partner may not provide this certification because it will generally be able to require the partnership to provide a partnership-level certification as to the controlling partner's share of partnership liabilities. *Id.*

Proposed §1.1446(f)-2(c)(2)(ii)(C) allows a transferee to rely on a certification from the partnership that provides the amount of the transferor's share of partnership liabilities. However, unlike the rule in Notice 2018-29, the partnership is required to make this determination as of the determination date rather than relying on its most recently prepared Schedule K-1 (Form 1065). *Id.* The proposed regulations also provide a new procedure that allows a partnership that is a transferee because it makes a distribution to rely on its books and records to determine the transferor's share of partnership liabilities as of the determination date. *See* proposed §1.1446(f)-2(c)(2)(iii).

If a transferee does not use one of these determination procedures, the reduction in the transferor's share of partnership liabilities must be determined as of the date of the transfer for purposes of computing the amount realized.

iii. Modified Amount Realized for Foreign Partnerships

As discussed in section III.B of this Explanation of Provisions, section 1446(f)(2) and proposed §1.1446(f)-2(b)(2) provide an exception to withholding when the transferor is not a foreign person. A transferor that is a foreign partnership may not rely on this exception even though it may have U.S. persons (which are not subject to tax under section 864(c)(8)) as its partners. To avoid overwithholding when a foreign partnership transfers its interest in a partnership, proposed §1.1446(f)-2(c)(2)(iv) provides a procedure to limit the amount realized for withholding purposes to the portion of the amount realized that is attributable to foreign persons. For this purpose, the portion of the amount realized attributable to a direct or indirect partner is determined based on the percentage of gain allocable to that partner. Any partner that does not provide a valid certification of non-foreign status (including a Form W-9) is treated as a foreign person for this purpose.

To make the certification for a modified amount realized, the transferor must provide to the transferee a Form W-8IMY, *Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting*, that includes a certification of non-foreign status for each partner that is treated as a U.S. person. It must also include a withholding statement that provides the percentage of gain allocable to each direct or indirect partner and that indicates whether that person is a U.S. person or is treated as a foreign person.

3. Lack of Money or Property or Lack of Knowledge Regarding Liabilities

As described in section 8 of Notice 2018-29, in some cases, a reduction in the transferor's share of partnership liabilities may cause the amount otherwise required to be withheld to exceed the cash or other property that the transferee actually pays to the transferor. In other cases, a transferee may have not received, or cannot rely upon, a certification regarding the transferor's share of partnership liabilities, and may not otherwise know the transferor's share of partnership liabilities. In these situations, the proposed regulations generally provide that the amount required to be withheld is equal to the amount realized determined without regard to the decrease in the transferor's share of partnership liabilities. *See* proposed §1.1446(f)-2(c)(3).

4. Certification of Maximum Tax Liability

To more closely align the amount to withhold with the transferor's tax liability under section 864(c)(8), the proposed regulations provide a procedure to determine the amount to withhold that is intended to estimate the amount of tax the transferor is required to pay under section 864(c)(8). *See* proposed §1.1446(f)-2(c)(4).

For this procedure to apply, a transferee must receive a certification from the transferor containing certain information relating to the transferor and the transfer. *See* proposed §1.1446(f)-2(c)(4)(iii). One of the requirements for this certification is for the transferor to identify the amount of outside capital gain and outside ordinary gain that would be treated as effectively connected gain on the determination date. *See* proposed §1.1446(f)-2(c)(4)(iii)(E). Further, to provide this certification, the transferor must represent that it has obtained a statement from the partnership that includes, among other things, information relating to the transferor's distributive share of effectively connected gain in connection with a deemed sale described in section 864(c)(8)(B) as of the determination date. *See* proposed §1.1446(f)-2(c)(4)(iii)(G).

When a transferor provides a transferee this information, proposed §1.1446(f)-2(c)(4)(i) allows the transferee to withhold based on the transferor's maximum tax liability on the transfer. The transferor's maximum tax liability is the amount of the transferor's effectively connected gain multiplied by the applicable percentage. *See* section 1446(b) and §1.1446-3(a)

(2). The applicable percentage applies the highest rate of tax for each particular type of income or gain allocable to a foreign person. *Id.*

Special rules apply for a transfer in which only a portion of the gain is subject to tax under section 864(c)(8) because a nonrecognition provision of the Code or an income tax treaty in effect between the United States and a foreign country applies (for example, when the partnership carries on one trade or business through a U.S. permanent establishment, and another trade or business that is not carried on through a U.S. permanent establishment). *See* proposed §1.1446(f)-2(c)(4)(v) and (vi). These rules provide that the transferor must, in addition to providing the maximum tax liability certification, comply with the procedural requirements that would otherwise apply when claiming a full exception to withholding based on a nonrecognition provision or treaty benefits.

D. *Reporting and Paying Withheld Amounts*

1. In General

A transferee required to withhold must report and pay any tax withheld by the 20th day after the date of the transfer. *See* proposed §1.1446(f)-2(d)(1). To report and pay the amount withheld, the proposed regulations direct the transferee to use Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*. The IRS will stamp a valid Form 8288-A to show receipt and mail a copy to the transferor.

2. Transferee's Obligation to Certify the Amount Withheld to the Partnership

As discussed in section IV of this Explanation of Provisions, a partnership must withhold on distributions to a transferee under section 1446(f)(4) to the extent the transferee fails to properly withhold under section 1446(f)(1) and proposed §1.1446(f)-2(a). *See* proposed §1.1446(f)-3. In order for the partnership to determine whether it must withhold under these rules, proposed §1.1446(f)-2(d)(2) requires a transferee to timely furnish certain information regarding its compliance with section 1446(f)(1) to the partnership.

Specifically, proposed §1.1446(f)-2(d)(2) requires a transferee (other than a partnership that is a transferee because it makes a distribution) to furnish, no later than 10 days after the transfer, a certification to the partnership that either includes a copy of the Form 8288-A that it files with the IRS, or states the amount realized on the transfer and any amount withheld by the transferee. The certification must also include any underlying certifications that the transferee has relied upon that claim an exception or adjustment to withholding. As discussed in section IV.B of this Explanation of Provisions, the partnership must conduct its own review of the certification provided by the transferee, including any underlying certifications. Therefore, a transferee that has relied on a certification claiming an exception or adjustment to withholding may want to ensure that the partnership has determined the certification to be correct and reliable before the due date for payment of any withheld amounts to the IRS.

E. *Effect of Withholding on Transferor*

Proposed §1.1446(f)-2(e) states that a foreign person must file a U.S. tax return and pay any tax due with respect to a transfer that is subject to section 864(c)(8) regardless of whether there is withholding under section 1446(f)(1) and proposed §1.1446(f)-2. To claim a credit under section 33, a transferor that is an individual or corporation must attach to its return the stamped copy of Form 8288-A, as referenced in section III.D of this Explanation of Provisions. *See* proposed §1.1446(f)-2(e)(2)(i). If a stamped copy of Form 8288-A has not been provided to the transferor by the IRS, proposed §1.1446(f)-2(e)(3) provides that a transferor may establish the amount of tax withheld by furnishing substantial evidence of the amount. For a discussion of the rule regarding a transferor that is a foreign partnership claiming a credit for withholding under section 1446(f)(1), see section II.E of this Explanation of Provisions.

IV. *Partnership's Requirement to Withhold under Section 1446(f)(4) on Distributions to Transferee*

A. *In General*

Proposed §1.1446(f)-3 provides rules under section 1446(f)(4) that would implement the partnership's requirement to withhold on distributions to a transferee on any amount that the transferee failed to properly withhold under section 1446(f)(1), plus any interest on this amount. The rules, when made applicable as final rules, would end the suspension of section 1446(f)(4) withholding provided in section 11 of Notice 2018-29.

B. *Requirement to Withhold*

The proposed regulations provide that, if a transferee fails to withhold any amount required to be withheld under proposed §1.1446(f)-2 in connection with the transfer of a partnership interest, the partnership must withhold from any distributions made to the transferee in accordance with the rules in proposed §1.1446(f)-3. Under the general rule, a partnership determines whether a transferee has withheld the amount required to be withheld under proposed §1.1446(f)-2 by relying on the certification described in proposed §1.1446(f)-2(d)(2) that it receives from the transferee. *See* proposed §1.1446(f)-3(a)(1). The partnership may rely on this certification unless it knows, or has reason to know, that the certification is incorrect or unreliable. *Id.* Therefore, the partnership must review the certification received from the transferee, which includes any underlying certifications that the transferee relied on to reduce or eliminate withholding. Because the partnership may have information that may not be available to the transferee (for example, information in its books and records), a partnership may know, or have reason to know, that an underlying certification is incorrect or unreliable even though the transferee properly relied on the certification. In this case, the partnership would be required to withhold on the transferee under section 1446(f)(4) to the extent required in proposed §1.1446(f)-3.

If the partnership timely receives (within 10 days from the transfer), and may rely on, a certification from the transferee stating that an exception to withholding applies or establishing that the transferee has withheld the amount required to be withheld under proposed §1.1446(f)-2, then the partnership is not required to withhold under the general rule in proposed §1.1446(f)-3(a)(1). *See* proposed §1.1446(f)-3(b)(1). For this purpose, the amount required to be withheld may take into account any adjustment procedures under §1.1446(f)-2(c) (for which any documents, including underlying certifications, are attached to the certification provided by the transferee). The proposed regulations thus reduce the burden imposed by section 1446(f)(4) by allowing transferees and partnerships to rely on the information produced under the regulations implementing section 1446(f)(1).

The proposed regulations provide an additional rule that allows the IRS, in limited circumstances, to require a partnership to withhold under section 1446(f)(4) when the IRS notifies the partnership that it has determined that the transferee has provided incorrect information on the certification described in proposed §1.1446(f)-2(d)(2) regarding the amount realized or the amount withheld, or that the transferee failed to pay the amounts reported as withheld to the IRS. *See* proposed §1.1446(f)-3(a)(2). This rule is meant to induce the transferee to properly determine the amount realized on transfer (in accordance with the rules in proposed §1.1446(f)-2(c)(2)), and to correctly report to the partnership the amount of tax withheld and paid to the IRS.

Under the proposed regulations, withholding under section 1446(f)(4) does not apply when a partnership is a transferee because it makes a distribution. *See* proposed §1.1446(f)-3(b)(3). Section 1446(f)(4) imposes a withholding obligation on a secondary party, the partnership, when the transferee fails to withhold under section 1446(f)(1). When the partnership is the transferee because it made a distribution and failed to withhold under section 1446(f)(1) and proposed §1.1446(f)-2, imposing a section 1446(f)(4) withholding obligation on it does not provide an additional party to ensure the 1446(f) liability is paid. Furthermore, the partnership remains liable for its failure to withhold in its capacity as a transferee. *See* section VI.A of this Explanation of Provisions.

A publicly traded partnership generally is also not required to withhold on distributions made to a transferee under section 1446(f)(4). *See* proposed §1.1446(f)-3(b)(2)(i). As described in section V of this Explanation of Provisions, it would be administratively difficult for a publicly traded partnership to determine when a transfer of its interest has occurred, and whether the correct amount has been withheld under section 1446(f)(1). However, the proposed regulations do require a publicly traded partnership to withhold under section 1446(f)(4) in certain limited instances. Specifically, a publicly traded partnership may publish a qualified notice that states that withholding under section 1446(f)(1) does not apply with respect to a distribution. *See* section V.B.2 and 3 of this Explanation of Provisions. To ensure that publicly traded partnerships exercise due diligence when publishing these qualified notices, proposed §1.1446(f)-3(b)(2)(ii) provides that the exception from section 1446(f)(4) withholding applicable to publicly traded partnerships does not apply if a publicly traded partnership determines (including by reason of having received notification from the IRS) that it has published a qualified notice that falsely states that an exemption applied. When a publicly traded partnership makes this determination, it must withhold on distributions to the transferees an amount equal to the amount that any brokers failed to withhold under proposed §1.1446(f)-4 due to reliance on the qualified notice, plus interest.

C. *Withholding Rules*

A partnership that does not receive, or cannot rely on, a timely certification from a transferee stating that an exception to withholding applies or that the proper amount has been withheld must begin to withhold under the general rule on distributions made to the transferee on the later of the date that is 30 days after the transfer or the date that is 15 days after the partnership acquires actual knowledge of the transfer. *See* proposed §1.1446(f)-3(c)(1)(i).

The partnership must withhold on the entire amount of each distribution made to the transferee until it may rely on a certification from the transferee that states that an exception to withholding applies or that provides the information necessary to determine the amount required to be withheld. *See* proposed §1.1446(f)-3(c)(1)(ii). The partnership may rely on this certification to determine its withholding obligation regardless of whether it is provided within the time prescribed in proposed §1.1446(f)-2(d)(2). If the partnership has not already satisfied the amount required to be withheld, as determined from the certification from the transferee, it must continue to withhold on distributions to the transferee until it has done so. *Id.* However, the partnership may stop withholding if the transferee disposes of all of its interest in the partnership, unless the partnership has actual knowledge that any successor to the transferee is related to the transferee or the transferor from which the transferee acquired the interest. *Id.*

The amount required to be withheld under proposed §1.1446(f)-3(a)(1), as determined from the certification provided by the transferee, is a tax equal to 10 percent of the amount realized on the transfer, reduced by any amount already withheld by the transferee, plus any computed interest. *See* proposed §1.1446(f)-3(c)(2)(i). The proposed regulations provide that a partnership that is required to withhold under proposed §1.1446(f)-3(a)(1) may not take into account any adjustment procedures that would otherwise affect the amount required to be withheld under proposed §1.1446(f)-2(c)(2)(i). *See* proposed §1.1446(f)-3(c)(2)(i)(A). Thus, for example, a partnership may not reduce the amount that it is required to withhold under the procedures described in proposed §1.1446(f)-2(c)(4) (adjusting the amount subject to withholding based on a transferor's maximum tax liability). The Treasury Department and the IRS have determined that it would be inappropriate to permit adjustments that may reduce the amount required to be withheld under section 1446(f)(4). Withholding on distributions to transferees under section 1446(f)(4) applies only after the transferee has either failed to properly withhold under section 1446(f)(1) or has not complied with the applicable procedural requirements in the proposed regulations. Accordingly, permitting adjustments to the amount a partnership is required to withhold under section 1446(f)(4) would reduce transferees' incentive to comply with their obligations under section 1446(f)(1) while potentially increasing the partnership's administrative burden associated with that withholding.

Proposed §1.1446(f)-3(c)(2)(ii) provides rules for the partnership to compute interest on the amount that the transferee failed to withhold. Proposed §1.1446(f)-3(c)(3) provides that any amount required to be withheld on a distribution under any other withholding provision in the Code is not required to be withheld under section 1446(f)(4). For example, if a partnership is required to withhold $30 under section 1441 on a $100 distribution, the maximum amount required to be withheld on that distribution under section 1446(f)(4) is $70.

Proposed §1.1446(f)-3(d) provides that a partnership required to withhold under section 1446(f)(4) must report and pay the tax withheld using Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and 8288-C, *Statement of Withholding Under Section 1446(f)(4) for Withholding on Dispositions by Foreign Persons of Partnership Interests*, as provided in forms, instructions, or other guidance.

D. *Effect of Withholding on the Transferor and Transferee*

The withholding of tax under section 1446(f)(4) does not relieve a nonresident alien individual or foreign corporation subject to tax under section 864(c)(8) from filing a U.S. income tax return with respect to the transfer and paying any tax due with the return. *See* proposed §1.1446(f)-3(e)(1). Because this tax is withheld from the transferee rather than from the transferor, the transferor is not allowed a credit under section 33. *Id.* However, the proposed regulations clarify that tax will not be collected from the transferor to the extent it has already been collected from another person under these rules. *See* section VI.A of this Explanation of Provisions. Therefore, the transferor will not be required to pay tax to the extent the tax (but not any portion treated as interest) has been paid through withholding on the transferee.

A transferee remains liable under section 1446(f)(1) even when the partnership is required to withhold under section 1446(f)(4). However, the transferee is treated as satisfying this withholding tax liability under section 1446(f)(1) to the extent that it is withheld upon under section 1446(f)(4). *See* proposed §1.1446(f)-3(e)(2). Any amount withheld that is treated as interest is not treated as satisfying the transferee's liability under section 1446(f)(1), but that amount will instead be treated as interest paid by the transferee with respect to its section 1446(f)(1) liability. *Id.* Under the proposed regulations, if the amount of tax withheld from the transferee exceeds its liability under section 1446(f)(1), only the partnership may claim a refund on behalf of the transferee for the excess amount. *Id.* This rule is meant to make the refund process more administrable by having the partnership act on behalf of each of its transferees for purposes of claiming any excess amounts withheld under section 1446(f)(4). The Treasury Department and the IRS anticipate that partnerships and transferees will make arrangements by contract so that the transferees may be reimbursed for amounts refunded to the partnership. The Treasury Department and the IRS request comments on this issue.

V. *Withholding on the Transfer of a Publicly Traded Partnership Interest by a Foreign Person*

The proposed regulations provide rules for withholding and reporting on the transfer of an interest in a publicly traded partnership if the interest is publicly traded on an established securities market or is readily tradable on a secondary market or the substantial equivalent thereof (such interests, "PTP interests"). The rules, when made applicable as final rules, would end the suspension of section 1446(f)(1) withholding on the disposition of PTP interests provided in Notice 2018-08.

A. *In General*

A transfer of a PTP interest raises unique issues for withholding under section 1446(f). For example, when a transfer of a PTP interest is effected through one or more brokers, the transferee will generally not know the identity of the transferor. Accordingly, the Conference Report for the Act acknowledged that transfers involving PTP interests could require withholding rules different from those that apply to transfers involving non-PTP interests. *See* Conference Report on H.R. 1, Tax Cuts and Jobs Act, H.Rep. No. 115-466, at 511 ("[T]he Secretary may provide guidance permitting a broker, as agent of the transferee, to deduct and withhold the tax ... such guidance may provide that if an interest in a publicly traded partnership is sold by a foreign partner through a broker, the broker may deduct and withhold the 10-percent tax on behalf of the transferee.").

Consistent with the Conference Report, proposed §1.1446(f)-4(a)(1) provides that if a transfer of a PTP interest is effected through one or more brokers, the transferee is not required to withhold, and the withholding obligation is instead imposed on certain brokers involved with the transfer. Generally, the proposed regulations define a broker to include any person, foreign or domestic, that in the ordinary course of a trade or business during the calendar year stands ready to effect sales made by others, and that, in connection with a transfer of a PTP interest, receives all or a portion of the amount realized on behalf of the transferor. *See* proposed §1.1446(f)-1(b)(1). For example, when a transfer of a PTP interest occurs through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, this definition would include a broker that receives an amount realized from the sale against delivery of the PTP interest and any other broker that receives an amount realized from that broker. Therefore, the withholding obligation under proposed §1.1446(f)-4 is generally limited to brokers that receive proceeds from the sale and act on behalf of the transferor. The definition of broker also includes any clearing organization that effects a transfer of a PTP interest on behalf of the transferor. While comments have stated that clearing organizations may not have the capability to complete the withholding required under section 1446(f), the Treasury Department and the IRS anticipate that clearing organizations will make arrangements to ensure that, when effecting the transfer of a PTP interest on behalf of foreign brokers, they act on behalf of brokers that assume withholding responsibility when clearing sales of PTP interests (such as a qualified intermediary (“QI”)).

If a transfer of a PTP interest is effected through multiple brokers, proposed §1.1446(f)-4(a)(2) provides rules that specify which broker or brokers have a withholding obligation. Under proposed §1.1446(f)-4(a)(2)(i), a broker that pays the amount realized to a foreign broker is required to withhold unless the foreign broker is either a U.S branch treated as a U.S. person or a QI that assumes primary withholding responsibility for the payment. Consistent with this rule, the Treasury Department and the IRS intend to modify the QI agreement provided in Revenue Procedure 2017-15, 2017-3 I.R.B. 437, to allow QIs to assume primary withholding responsibility on the amount realized. Proposed §1.1446(f)-4(a)(2)(ii) provides an additional rule requiring the broker that effects a transfer for the transferor as its customer to satisfy the withholding obligation. This rule ensures that withholding will be completed on payment of the amount realized to the transferor when another broker has not already satisfied the withholding.

To avoid withholding by multiple brokers, proposed §1.1446(f)-4(a)(2)(iii) provides the general rule that a broker is not required to withhold when it knows that the withholding obligation has been satisfied by another broker. Proposed §1.1446(f)-4(a)(2)(iv) provides that a broker must treat another broker as a foreign person unless it obtains documentation (including a certification of non-foreign status) establishing that the other broker is a U.S. person.

If the transfer of a PTP interest is not effected through one or more brokers, then proposed §1.1446(f)-4 does not apply, and the general rules of section 1446(f)(1) and proposed §1.1446(f)-2 apply. A transfer that is effected through a broker includes a distribution with respect to a PTP interest held through an account with a broker.

B. *Exceptions to Withholding*

The proposed regulations provide five exceptions to withholding that apply to the transfer of a PTP interest. The exceptions are intended to both reduce the compliance burden placed on brokers and provide rules that are administrable.

1. Certification of Non-Foreign Status

As mentioned in section III.B.2 of this Explanation of Provisions, withholding under section 1446(f)(1) is limited to transfers by foreign partners. Accordingly, a broker is not required to withhold to the extent that it relies on a certification of non-foreign status that it receives from the transferor that claims an exception to withholding. *See* proposed §1.1446(f)-4(b)(2). For purposes of proposed §1.1446(f)-4, a certification of non-foreign status means a Form W-9, or valid substitute form, that meets the requirements of §1.1441-1(d)(2). A broker may rely on a valid Form W-9 that it already possesses, and in certain cases, may instead rely on a certification that it receives from another broker that states the TIN and status of the transferor when that other broker acts as an agent for the transferor and possesses the Form W-9 (for example, from an introducing broker). A broker will not qualify for the exception provided in proposed §1.1446(f)-4(b)(2) if it has actual knowledge that the certification is incorrect or unreliable.

2. 10-Percent Exception

The proposed regulations include an exception to withholding that may apply if, on a deemed sale of the assets of the publicly traded partnership the interest in which is transferred, the amount of effectively connected gain would be less than 10 percent of the total gain. Specifically, proposed §1.1446(f)-4(b)(3) provides that a broker is not required to withhold under proposed §1.1446(f)-4 if it properly relies on a qualified notice stating that the 10-percent exception applies.

The 10-percent exception applies if a hypothetical sale by the publicly traded partnership of all of its assets at fair market value on a specified date would result in an amount of gain effectively connected with the conduct of a trade or business within the United States that is less than 10 percent of the total gain. The specified date must be a date designated by the publicly traded partnership that is within the 92-day period ending on the date that it posts a qualified notice. Unlike the similar exception described in section III.B.4 of this Explanation of Provisions that applies to transfers of non-PTP interests, this rule requires a publicly traded partnership to designate a date for this purpose that generally occurs within the most recent calendar quarter. *Cf.* proposed §1.1446(f)-2(b)(4) (permitting the deemed sale computation to occur on a determination date, which would allow the deemed sale date to be determined as of the first day of a partnership’s taxable year in which the transfer occurred in certain cases). The Treasury Department and the IRS have determined that it is appropriate to limit the availability of this exception to cases in which a publicly traded partnership has designated a deemed sale date occurring within the most recent calendar quarter because publicly traded partnerships are in a better position to determine the value of their assets, and in some cases determine the basis of their assets, on a quarterly basis. The proposed regulations limit reliance on a qualified notice depending on its date of posting. *See* proposed §1.1446(f)-4(b)(3)(iii).

For a discussion of rules regarding when a publicly traded partnership may be liable under section 1446(f)(4) because it falsely states on a qualified notice that this exception applies, see section IV.B of this Explanation of Provisions. For a discussion of the proposed changes to existing qualified notice rules, see section VII of this Explanation of Provisions.

3. Qualified Current Income Distributions

As discussed in section III.B.3 of this Explanation of Provisions, the proposed regulations allow a transferor of a non-PTP interest to provide a certification stating that the transferor would not realize any gain on the transfer. Because it would be administratively difficult for a broker to timely obtain this type of certification from the transferor of a PTP interest, and difficult for the transferor to determine its basis in the PTP interest, the proposed regulations do not provide a similar exception for transfers of PTP interests.

The Treasury Department and the IRS have determined, however, that it would be appropriate to eliminate withholding under section 1446(f)(1) on distributions (the full amount of which is generally treated as an amount realized under the proposed regulations) by a publicly traded partnership when it is likely that the transferor would realize no gain. In general, under section 705(a)(1), a partner's basis in its interest is increased by its distributive share of income for the taxable year, such that a distribution by the partnership not in excess of that income generally does not result in the recognition of gain under section 731(a)(1). Accordingly, the proposed regulations provide that when a qualified notice posted by a publicly traded partnership indicates that the distribution does not exceed the net income the partnership earned since the record date of the partnership's last distribution, no withholding is required with respect to the distribution. *See* proposed §1.1446(f)-4(b)(4).

4. Proceeds Subject to Withholding under Section 3406

A broker may also be required to withhold on gross proceeds from the transfer of a PTP interest under section 3406 when a payment is treated as being made to a non-exempt U.S. recipient. To prevent withholding twice on the same payment, proposed §1.1446(f)-4(b)(5) provides an exception to withholding under section 1446(f)(1) if the amount realized is subject to withholding under section 3406.

5. Claim of Treaty Benefits

The proposed regulations provide an exception similar to the one described in section III.B.6 of this Explanation of Provisions when a transferor states that it is not subject to tax on any gain from the transfer pursuant to an income tax treaty in effect between the United States and a foreign country. *See* proposed §1.1446(f)-4(b)(6). The exception also requires the transferor to furnish a valid Form W-8 with the information necessary to support the claim. *Id.* Unlike the exception for non-PTP interests, a broker is not required to mail the certification to the IRS because under the proposed regulations brokers are required to file a Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding,* to report a transfer of a PTP interest that includes information about the claim of treaty benefits. *See* section V.D of this Explanation of Provisions for reporting requirements with respect to transfers of PTP interests.

C. *Determining the Amount to Withhold*

1. Amount Realized

i. In General

A broker that is required to withhold under proposed §1.1446(f)-4(a) must withhold 10 percent of the amount realized on the transfer of a PTP interest. As explained in section III.C.2 of this Explanation of Provisions, a reduction in a partner's share of partnership liabilities is treated as an amount realized under proposed §1.1446(f)-2(c). However, because of the difficulties involved with requiring a broker to timely determine a transferor's share of partnership liabilities, proposed §1.1446(f)-4(c)(2)(i) provides a special rule that treats the amount realized on the transfer of a PTP interest as the amount of gross proceeds (as defined in §1.6045-1(d)(5)) paid or credited to the customer or another broker (as applicable). If a publicly traded partnership makes a distribution to a partner, the amount realized is the amount of cash distributed (or to be distributed) and the fair market value of property distributed (or to be distributed).

ii. Modified Amount Realized for Foreign Partnerships

Consistent with the rule described in section III.C.2.iii of this Explanation of Provisions that applies to transfers of non-PTP interests, the proposed regulations include a rule that allows brokers to rely on a certification from a foreign partnership to modify the amount realized based on the extent to which the amount realized is attributable to persons who are (or are presumed to be) foreign persons. *See* proposed §1.1446(f)-4(c)(2)(ii).

D. *Reporting and Paying Withheld Amounts*

A broker required to withhold under §1.1446(f)-4 must pay the withheld tax pursuant to the deposit rules in §1.6302-2, and report the withholding on Forms 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and 1042-S pursuant to the procedures in §1.1461-1(b) and (c). The proposed regulations treat as a recipient for Form 1042-S reporting purposes a partner that receives an amount realized from a transfer of a PTP interest subject to §1.1446(f)-4. *See* proposed §1.1461-1(c)(1)(ii)(A)(8). This rule also clarifies that a foreign partnership is treated as a recipient for this purpose to ensure that the foreign partnership receives a Form 1042-S that it may use to claim credit for any withholding under proposed §1.1446(f)-4 against its tax liability under section 1446(a). *See* section II.E of this Explanation of Provisions for discussion of the general coordination rule.

To implement the reporting requirements, the proposed regulations add to the list of amounts subject to reporting on Form 1042-S an amount realized on the transfer of a PTP interest subject to §1.1446(f)-4 (with limited exceptions). *See* proposed §1.1461-1(c)(2). The proposed regulations also add to this list any distributions of effectively connected income by a publicly traded partnership subject to §1.1446-4 to clarify that these amounts are reportable on Form 1042-S. *Id.*

E. *Effect of Withholding on Transferor*

As mentioned in section III.E of this Explanation of Provisions, the proposed regulations neither relieve a transferor of its substantive tax liability under section 864(c)(8), nor relieve a transferor subject to section 864(c)(8) from its filing obligation. *See* proposed §1.1446(f)-4(e)(1). However, a transferor is allowed a credit under section 33 for the amount withheld under section 1446(f)(1) and proposed §1.1446(f)-4. *Id.* To claim the credit, the transferor must attach to its return a copy of the Form 1042-S that includes the transferor's TIN. *Id.* For a discussion of the rules regarding a transferor that is a foreign partnership claiming a credit for withholding under section 1446(f)(1), see section II.E of this Explanation of Provisions.

F. *Procedures to Adjust Overwithholding*

Section 1.1461-2(a) allows a withholding agent that overwithheld under chapter 3 of the Code, and made a deposit of tax as provided in §1.6302-2(a), to adjust the overwithheld amount using either a reimbursement or a set-off procedure. Because these rules are meant to allow withholding agents to adjust overwithholding for any deposited amounts that are reportable on Forms 1042 and 1042-S, the proposed regulations modify §1.1461-2(a) to allow use of the adjustment procedures for amounts withheld by a broker pursuant to proposed §1.1446(f)-4 (which are reported on Forms 1042 and 1042-S, as noted in section V.D. of this Explanation of Provisions).

G. *Procedures to Adjust Underwithholding*

In general, §1.1461-2(b) allows a withholding agent that underwithheld on a beneficial owner under chapter 3 of the Code to withhold from future payments made to the beneficial owner, or satisfy the tax from property or additional contributions of the beneficial owner, before the earlier of the due date for filing Form 1042 or the date on which the form is actually filed. The proposed regulations amend this provision to allow the use of this procedure by brokers that underwithheld under proposed §1.1446(f)-4 on the transfer of a PTP interest.

H. *Refunds and Credits*

Section 1.1464-1 generally provides that if an overpayment of tax has actually been withheld from the beneficial owner of the income, any refund or credit will be made to that beneficial owner. If, however, the tax was not withheld at source, but was instead paid by the withholding agent, the refund or credit will be made to the withholding agent. The proposed regulations clarify that these rules apply for purposes of section 1446(f). *See* proposed §1.1464-1(a).

VI. *Liability for Failure to Withhold*

A. *In General*

Proposed §1.1446(f)-5(a) provides that every person required to deduct and withhold tax under section 1446(f), including under proposed §§1.1446(f)-2 through 1.1446(f)-4, but that fails to do so is liable under section 1461. If the tax required to be withheld is paid by another person required to withhold, or by the nonresident alien individual or foreign corporation subject to tax under section 864(c)(8), section 1463 and the proposed regulations clarify that the tax will only be collected once. However, the satisfaction of this liability does not relieve a person that failed to withhold under section 1446(f) from any interest, penalties, or additions to tax that would otherwise apply. The proposed regulations also provide that a partnership that fails to withhold under proposed §1.1446(f)-3 is liable under section 1461 only for the amount of tax that it failed to withhold, and not any interest computed under §1.1446(f)-3(c)(2)(ii). This rule ensures that interest will be computed and assessed only once with respect to the same underlying tax liability.

B. *Liability of Agents*

Proposed §1.1446(f)-5(b) provides rules for the liability of agents, which generally require an agent of a transferor or transferee to notify the transferee (or other person required to withhold) if it has knowledge that a certification furnished to that person is false. A person that receives notice from an agent may not rely on the certification to apply an exception to withholding or for determining the amount to withhold. Proposed §1.1446(f)-5(b)(2) provides procedural rules regarding the timing and content of the notice, and requires the agent to furnish a copy of the notice to the IRS. An agent that fails to provide the required notice is liable for the tax that the person that should have received the notice would have been required to withhold under section 1446(f). However, under proposed §1.1446(f)-5(b)(4), this liability is limited to the amount of compensation that the agent derives from the transaction (and any civil or criminal penalties that may apply). The proposed regulations clarify that brokers required to withhold under §1.1446(f)-4 are not treated as agents for purposes of this rule, and are instead liable for any failure to withhold under the rules described in section V of this Explanation of Provisions.

VII. *Amendments to Existing Section 1446 Regulations Relating to Distributions by Publicly Traded Partnerships*

In response to comments received outside the context of section 1446(f), the proposed regulations also contain changes to the existing qualified notice rules that apply to distributions that publicly traded partnerships make to foreign partners. The Treasury Department and the IRS are aware that in certain cases nominees receive notices of distribution from publicly traded partnerships that do not provide detailed information regarding the amounts of income comprising the distribution as specified in §1.1446-4(f)(3) (such as amounts described in section 1441 or section 1442 or subject to withholding under section 1446). The term "qualified notice" under §1.1446-4(b)(4) is currently defined by reference to the reporting requirements of 17 CFR 240.10b-17(b)(1) or (3), which do not include a requirement to report information regarding the types of income comprising the distribution. Unless a notice provides that information, however, a nominee will not have the information necessary to apply the ordering rule of §1.1446-4(f)(3) to the distribution for purposes of determining the amount required to be withheld.

The proposed regulations make two changes to resolve this issue. First, proposed §1.1446-4(b)(4) revises the method for a publicly traded partnership to provide a nominee a qualified notice by requiring that the notice be posted in a readily accessible format in an area of the primary public Web site of the publicly traded partnership that is dedicated to this purpose. Second, proposed §1.1446-4(d) creates a default withholding rule subjecting gross distributions to the higher of the withholding percentage required under sections 1441 and 1442 or the applicable percentage under section 1446(b)(2), unless a qualified notice provides the nominee sufficient detail to determine the types of income distributed and the appropriate withholding rates to apply. Thus, if a publicly traded partnership is unable to determine the makeup of a distribution when it is made, the nominee must withhold at the highest applicable rate.

The proposed regulations also expand the definition of a nominee for withholding under §1.1446-4 to include certain foreign persons that agree to assume primary withholding responsibility. Therefore, a QI or a U.S. branch treated as a U.S. person that assumes primary withholding responsibility for a distribution by a publicly traded partnership under proposed §1.1446-4(b)(3) can act as a nominee with respect to the distribution. The Treasury Department and the IRS intend to modify the QI agreement provided in Revenue Procedure 2017-15 to allow QIs to assume primary withholding responsibility for distributions by publicly traded partnerships under section 1446(a).

The proposed regulations also make changes to the qualified notice rules applicable to publicly traded partnerships, publicly traded trusts, and real estate investment trusts ("REITs") under section 1445 that conform to proposed §1.1446-4(b)(4) so that those rules also provide more readily available information for nominees. *See* proposed §1.1445-8(f).

As discussed in sections V.F and V.G of this Explanation of Provisions, the proposed regulations modify §1.1461-2(a) and (b) to allow use of procedures to adjust overwithholding and underwithholding for amounts withheld by a broker pursuant to proposed §1.1446(f)-4. The proposed regulations also amend §1.1461-2(a) to allow the use of reimbursement and set-off procedures with respect to amounts withheld under section 1446(a) on distributions of ECTI by publicly traded partnerships (which are reported on Forms 1042 and 1042-S, as opposed to Forms 8804, *Annual Return for Partnership Withholding Tax (Section 1446)*, and 8805 used by non-publicly traded partnerships to report withholding on ECTI allocable to foreign partners). They also amend §1.1461-2(b) to clarify that the existing reference to "distributions of effectively connected income under section 1446" is meant to apply only to those distributions that are made by publicly traded partnerships.

Applicability Dates

Proposed §1.864(c)(8)-2(a) and proposed §1.6050K-1(d)(3) apply to transfers that occur on or after the date that these regulations are published as final regulations in the **Federal Register** (the "finalization date"). Proposed §1.864(c)(8)-2(b) and (c) and proposed §1.6050K-1(c)(2) and (c)(3) apply to returns filed on or after the finalization date. Proposed §1.864(c)(8)-2(d) applies beginning on the finalization date.

Proposed §§1.1445-2(b)(2)(v) and 1.1445-5(b)(3)(iv) apply to certifications provided on or after May 7, 2019, except that a taxpayer may apply those provisions with respect to certifications provided before that date. A taxpayer may rely on the proposed amendments to §§1.1445-2 and 1.1445-5 with respect to any period before the finalization date. Proposed §1.1445-8(f)(1) applies to distributions made on or after the date that is 60 days after the finalization date.

Proposed §1.1446-3(c)(4) applies to partnership taxable years that include transfers that occur on or after the date that is 60 days after the finalization date. Proposed §1.1446-4(b)(2), (b)(3), (c), (d), and (f) apply to distributions made on or after the date that is 60 days after the finalization date.

Proposed §§1.1446(f)-1 through 1.1446(f)-5 apply to transfers that occur on or after the date that is 60 days after the finalization date. For transfers that occur before the date that is 60 days after the finalization date, taxpayers may apply the rules described in Notice 2018-08 and Notice 2018-29. Alternatively, instead of applying the rules described in Notice 2018-29, taxpayers and other affected persons may choose to apply §§1.1446(f)-1, 1.1446(f)-2, and 1.1446(f)-5 of the proposed regulations in their entirety to all transfers as if they were final regulations.

The proposed amendments to §1.1461-1(a)(1), (c)(1)(i), (c)(1)(ii), (c)(2)(i) and (c)(4) apply with respect to returns for transfers occurring on or after the date that is 60 days after the finalization date. The proposed amendments to §1.1461-2(a)(1) and (b) apply to transfers occurring on or after the date that is 60 days after the finalization date. The proposed amendments to §1.1461-3 apply to returns for transfers occurring on or after the date that is 60 days after the finalization date.

The proposed amendments to §1.1463-1(a) apply to transfers that occur on or after the date that is 60 days after the finalization date.

The proposed amendments to §1.1464-1(a) apply to transfers that occur on or after the date that is 60 days after the finalization date.

The Treasury Department and the IRS intend to obsolete Notice 2018-08 and Notice 2018-29 effective on the date that is 60 days after the finalization date.

Special Analyses

I. *Regulatory Planning and Review*

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

II. *Paperwork Reduction Act*

The collection of information in these proposed regulations is in proposed §1.864(c)(8)-2 regarding reporting for transactions described in section 864(c)(8) and proposed §1.864(c)(8)-1, and proposed §§1.1446(f)-1, 1.1446(f)-2, 1.1446(f)-3, and 1.1446(f)-4 regarding the withholding, reporting, and paying of tax under section 1446(f) following the transfer of an interest described in section 864(c)(8) and proposed §1.864(c)(8)-1. Section II.1 of this Special Analyses discusses the collections of information that will be conducted using IRS forms. The information collections that will not be conducted through IRS forms are discussed in section II.2 of this Special Analyses.

A. *Collections of Information – Forms 1042, 1042-S, 8288, 8288-A, 8288-C, W-8IMY, W-8BEN, and W-8BEN-E*

Under proposed §§1.1446(f)-2(b)(2) and 1.1446(f)-4(b)(2), a transferor qualifies for an exception from withholding if it provides to the transferee or broker (as applicable) a certification of non-foreign status, which includes a valid Form W-9 (at the transferor's option). The IRS has determined that Form W-9 is not a collection of information under 5 CFR 1320.3(h)(1) and is exempt from the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) ("PRA").

The collection of information in proposed §1.1446(f)-2(b)(7) is provided by the transferor by submitting a certification and Form W-8BEN or W-8BEN-E to the transferee and is optional. The information will be used by the transferor to determine whether an exception to withholding applies based on an income tax treaty.

The information in proposed §1.1446(f)-2(c)(2)(iv)(C) by the transferor to the transferee is provided on Form W-8IMY and is optional. This information will be used by the transferee to determine the modified amount realized.

The collection of information in proposed §1.1446(f)-2(d)(1) will be provided on Forms 8288 and 8288-A by the transferee to the IRS and is mandatory if the transferee withholds tax under section 1446(f)(1). These forms will be used by the transferee to report and pay any tax under section 1446(f)(1) and proposed §1.1446(f)-2.

The information provided in proposed §1.1446(f)-3(d) by the partnership to the IRS will be used by the partnership to report and pay any tax under section 1446(f)(4) and proposed §1.1446(f)-3 and will be provided on new Form 8288-C. The IRS anticipates that the burden associated with this collection of information will be reflected in OMB control number 1545-0902.

The collection of information provided in proposed §1.1446(f)-4(a)(2)(i) from certain U.S. branches of foreign persons and qualified intermediaries to the broker that effected the transfer of an interest described in section 864(c)(8) and proposed §1.1446(f)-4 will be provided on Form W-8IMY. This information will be used by the broker to determine its withholding obligation under section 1446(f)(1) and proposed §1.1446(f)-4.

The collection of information in proposed §1.1446(f)-4(b)(6) is provided by the transferor by submitting a certification and Form W-8BEN or W-8BEN-E to the broker and is optional. The information will be used by the broker to determine whether an exception to withholding applies based on an income tax treaty.

The information in proposed §1.1446(f)-4(c)(2)(ii)(C) by the transferor to the broker is provided on Form W-8IMY and is optional. This information will be used by the broker to determine the modified amount realized.

The information in proposed §1.1446(f)-4(d) will be provided on Forms 1042 and 1042-S submitted by the broker to the IRS and is mandatory if the broker withholds tax under section 1446(f)(1) or if it applies the exception described in proposed §1.1446(f)-4(b)(6). These forms will be used to report and pay any tax under section 1446(f)(1) and proposed §1.1446(f)-4.

The information in proposed §1.1446(f)-4(e)(2) provided by the transferor to the IRS will be used to claim a credit for an amount withheld under section 1446(f)(1) and proposed §1.1446(f)-4, and will be satisfied by submitting Form 1042-S with an income tax return (Form 1040NR or 1120-F) to the IRS.

The Treasury Department and the IRS intend that the information collection requirements described in this section II.1 will be set forth in the forms and instructions identified in the Revision of Existing Forms and New Forms table. As a result, for purposes of the PRA, the reporting burdens associated with the collections of information in those forms will be reflected in the PRA submissions associated with those forms.

Revision of Existing Forms and New Forms

	New	Revision of existing form	Number of additional respondents (estimated, rounded to nearest 1,000)
Form 1042-S		Y	< 6,000
Form 8288		Y	< 70,000
Form 8288-A		Y	< 70,000
Form 8288-C	Y		<70,000
Form W-8BEN		Y	< 70,000
Form W-8BEN-E		Y	< 70,000
Form W-8IMY		Y	< 70,000

Source: RAAS:CDW and SOI

The numbers of respondents in the Revision of Existing Forms and New Forms table were estimated by the Research, Applied Analytics and Statistics Division of the IRS from the Compliance Data Warehouse and Statistics of Income, using tax years 2013 through 2015. Data for each of the Forms 1042, 1042-S, 8288, 8288-A, W-8BEN, W-8BEN-E, and W-8IMY represent preliminary estimates of the total number of additional taxpayers that are expected to file these forms. The tax data for 2016 and 2017 are not yet available. Data for Forms 8288, 8288-A, W-8BEN, W-8BEN-E, and W-8IMY represent preliminary estimates of the total number of interests in partnerships, other than publicly traded partnership interests, engaged in the conduct of a trade or business in the United States that will be transferred by foreign persons. Data for Form 8288-C represent preliminary estimates of the total number of transferees on whom partnerships must withhold tax under section 1446(f)(4) if the transferees do not fully withhold tax under section 1446(f)(1). Data for Form 1042-S represent preliminary estimates of the total number of interests in publicly traded partnership engaged in the conduct of a trade or business in the

United States that will be transferred by foreign persons.

The current status of the PRA submissions related to the tax forms that will be used to conduct the information collections in the proposed regulations is provided in the Current Status of PRA Submissions table. The overall burden estimates provided for the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be created or revised as a result of the information collections in the proposed regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed regulations. No burden estimates specific to the forms affected by the proposed regulations are currently available. The Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden.

Current Status of PRA Submissions

	Type of Filer	OMB Number(s)	Status
Form 1042,	All filers (Legacy Model)	1545-0096	Approved 12/27/2016 until 12/31/2019.
Form 1042-S	Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201606-1545-025		
Form 8288,	All filers (Legacy system)	1545-0902	Approved 1/2/2017 until 1/31/2020.
Form 8288-A	Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201608-1545-015		
Form W-8BEN,	Business (NEW Model)	1545-0123	Approved 12/21/2018 until 12/31/2019.
Form W-8BEN-E,	*Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201805-1545-019*		
Form W-8IMY	All other filers (Legacy system)	1545-1621	Approved 12/19/18 until 12/31/2021.
	Link: https://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201708-1545-002		

B. *Collections of Information – Proposed §§1.864(c)(8)-2(a) and (b), 1.1446(f)-1(c)(3), 1.1446(f)-2(b)(2) through (7), (c)(2), and (c)(4), 1.1446(f)-4(b)(2) and (6), 1.1446(f)-4(b)(3) and (4), and 1.1446(f)-2(d)(2)*

These proposed regulations contain collections of information that are not on existing or new IRS forms. These collections of information include:

(a) Notification by a transferor to a partnership that a transfer has occurred (proposed §1.864(c)(8)-2(a));

(b) Statement provided by a partnership to a transferor necessary for the transferor to calculate its tax liability (proposed §1.864(c)(8)-2(b));

(c) Retention of information by partnership in its books and records (proposed §1.1446(f)-1(c)(3));

(d) Certifications from a transferor (or partnership) to a transferee for an exception from withholding or adjustment to amount realized (proposed §1.1446(f)-2(b)(2) through (7), (c)(2), and (c)(4));

(e) Certification from a transferee to partnership regarding the transferee's withholding (proposed §1.1446(f)-2(d)(2)).

(f) Certifications from a transferor to a broker to apply an exception from withholding (proposed §1.1446(f)-4(b)(2) and (6)); and

(g) Information provided by a publicly traded partnership to a broker (proposed §1.1446(f)-4(b)(3) and (4)).

The collections 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 PRA. 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 July 12, 2019. Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information (including underlying assumptions and methodology);

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.

The collections of information provided in proposed §1.864(c)(8)-2 will be used by both the partnership engaged in the conduct of a trade or business in the

United States and the foreign partner that transfers an interest in the partnership and are mandatory. The notification provided to the partnership by the foreign transferor in proposed §1.864(c)(8)-2(a) will serve as notice to the partnership that a transfer described in section 864(c)(8) and proposed §1.864(c)(8)-1 occurred. The statement provided to the foreign transferor by the partnership in proposed §1.864(c)(8)-2(b) is necessary for the foreign transferor to determine its effectively connected gain or loss as described in proposed §1.864(c)(8)-1(b) and (c).

The collection of information provided in proposed §1.1446(f)-1(c)(3) requires a partnership to retain certain identified information in its books and records regarding its obligation to withhold under section 1446(f). The identified information will be used by a partnership to determine the application, and the extent, of withholding under section 1446(f).

The collections of information provided in proposed §1.1446(f)-2(b)(2) through (7), (c)(2), and (c)(4) from the transferor of an interest described in section 1446(f), or from the partnership whose interest is transferred, to the transferee of the interest will be used by the transferee to determine whether an exception applies or to determine the amount realized. These collections of information are optional. The certification in proposed §1.1446(f)-2(b)(7) includes the submission of Form W-8BEN or W-8BEN-E and is also discussed in section II.1 of this Special Analyses.

The information provided in proposed §1.1446(f)-2(d)(2) by the transferee to the partnership will be used by the partnership to determine whether it has a withholding obligation under section 1446(f)(4) and proposed §1.1446(f)-3.

The collection of information provided in proposed §1.1446(f)-4(b)(6) by the transferor to the broker will be used by the broker to determine if an exception applies that relieves the broker from its withholding obligation under section 1446(f)(1) and proposed §1.1446(f)-4. The certification in proposed §1.1446(f)-4(b)(6) includes the submission of Form W-8BEN or W-8BEN-E and is also discussed in section II.1 of this Special Analyses.

Estimated total annual reporting burden: 50,920 hours.

Estimated average annual burden hours per respondent: Approximately 0.67 hours (40 minutes).

Estimated cost per respondent ($2016): $26.00.

Estimated total annual monetized cost ($2016): $1,827,938.00.

Estimated number of respondents: 76,000.

Estimated annual frequency of responses: 0.4 (as the collections of information do not occur on an annual basis).

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.

III. *Regulatory Flexibility Act*

It is hereby certified that this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6).

The proposed regulations affect (i) foreign persons that recognize gain or loss from the sale or exchange of an interest in a partnership that is engaged in the conduct of a trade or business within the United States, and who are not subject to the Regulatory Flexibility Act, (ii) U.S. persons that are transferors providing Forms W-9 to transferees to certify that they are not foreign persons, (iii) persons who acquire those interests, (iv) partnerships that, directly or indirectly, have foreign persons as partners, and (v) brokers that effect transfers of interests in publicly traded partnerships.

The Treasury Department and the IRS do not have data readily available to assess the number of small entities potentially affected by the proposed regulations. However, entities potentially affected by these proposed regulations are generally not small entities, because of the resources and investment necessary to acquire a partnership interest from a foreign person or to directly, or indirectly, have foreign persons as partners. Therefore, the Treasury Department and the IRS do not believe that a substantial number of domestic small entities will be subject to the proposed regulation's information collections. Consequently, the Treasury Department and the IRS certify that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The IRS invites the public to comment on the impact of these regulations on small entities.

Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Comments and Requests for Public Hearing

Before the 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 authors of the proposed regulations are Subin Seth, Ronald M. Gootzeit, and Chadwick Rowland, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, notices, and other guidance cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

* * * * *

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 is amended by adding sectional authorities for §§1.864(c)(8)-2, 1.1445-5, 1.1445-8, 1.1446-3 through 1.1446-4, 1.1446(f)-1 through 1.1446(f)-5, and 1.6050K-1 in numerical order to read in part as follows:

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

Section 1.864(c)(8)-2 also issued under 26 U.S.C. 864(c)(8)(E), 6001 and 6031(b).

* * * * *

Section 1.1445-5 also issued under 26 U.S.C. 1445(e)(7).

* * * * *

Section 1.1445-8 also issued under 26 U.S.C. 1445(e)(7).

* * * * *

Section 1.1446-3 also issued under 26 U.S.C. 1446(g).

* * * * *

Section 1.1446-4 also issued under 26 U.S.C. 1446(g).

* * * * *

Section 1.1446(f)-1 also issued under 26 U.S.C. 1446(f)(6) and 1446(g).

* * * * *

Section 1.1446(f)-2 also issued under 26 U.S.C. 1446(f)(6) and 1446(g).

* * * * *

Section 1.1446(f)-3 also issued under 26 U.S.C. 1446(f)(6) and 1446(g).

* * * * *

Section 1.1446(f)-4 also issued under 26 U.S.C. 1446(f)(6) and 1446(g).

* * * * *

Section 1.1446(f)-5 also issued under 26 U.S.C. 1446(f)(6) and 1446(g).

* * * * *

Section 1.6050K-1 also issued under 26 U.S.C. 6050K(a).

* * * * *

Par. 2. Section 1.864(c)(8)-2 is added to read as follows:

§1.864(c)(8)-2 Notification and reporting requirements.

(a) *Notification by foreign transferor*—(1) *In general*. Except as provided in paragraph (a)(2) of this section, a notifying transferor that transfers an interest in a specified partnership must notify the partnership of the transfer in writing within 30 days of the transfer. The notification must include—

(i) The names and addresses of the notifying transferor and the transferee or transferees;

(ii) The U.S. taxpayer identification number (TIN) of the notifying transferor and, if known, of the transferee or transferees; and

(iii) The date of the transfer.

(2) *Exceptions*—(i) *Certain interests in publicly traded partnerships*. Paragraph (a)(1) of this section does not apply to a notifying transferor that transfers an interest in a publicly traded partnership if the interest is publicly traded on an established securities market or is readily tradable on a secondary market (or the substantial equivalent thereof).

(ii) *Certain distributions*. Paragraph (a)(1) of this section does not apply to a notifying transferor that is treated as transferring an interest in a specified partnership because it received a distribution from that specified partnership.

(3) *Section 6050K*. The notification described in paragraph (a)(1) of this section may be combined with or provided at the same time as the notification described in §1.6050K-1(d), provided that it satisfies the requirements of both sections.

(4) *Other guidance*. The notification described in paragraph (a)(1) of this section must also include any information required in forms, instructions, or other guidance.

(b) *Reporting by specified partnerships with notifying transferor*—(1) *In general*. (i) A specified partnership must provide to a notifying transferor the statement described in paragraph (b)(2) of this section if—

(A) The partnership receives the notice described in paragraph (a) of this section, or otherwise has actual knowledge that there has been a transfer of an interest in the partnership by a notifying transferor; and

(B) At the time of the transfer, the notifying transferor would have had a distributive share of deemed sale EC gain or deemed sale EC loss within the meaning of §1.864(c)(8)-1(c).

(ii) *Distributions*. For purposes of paragraph (b)(1)(i)(B) of this section, a partnership that is a transferee because it makes a distribution is treated as having actual knowledge of that transfer.

(2) *Contents of statement*. The statement required to be furnished by the specified partnership under paragraph (b)(1) of this section must include—

(i) The items described in §1.864(c)(8)-1(c)(3)(ii) (foreign transferor's aggregate deemed sale EC items, which includes items derived from lower-tier partnerships); and

(ii) Any other information as provided in forms, instructions, or other guidance.

(3) *Time for furnishing statement*. The specified partnership must furnish the required information on or before the due date (with extensions) for issuing Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*, or its successor, to the transferor for the year of the transfer. *See* §1.6031(b)-1T(b).

(4) *Manner of furnishing statement*. No specific format is required for the information except as provided in any forms, instructions, or other guidance.

(5) *Partnership notifying transferor*. For purposes of this paragraph (b), a specified partnership must treat a notifying transferor that is a partnership as a nonresident alien individual.

(c) *Statement may be provided to agent*. A partnership may provide a statement required under paragraph (b)(2) of this section to a person other than the notifying transferor if the person is described in §1.6031(b)-1T(c).

(d) *Definitions*. The following definitions apply for purposes of this section.

(1) *Notifying transferor*. The term *notifying transferor* means any foreign person, any domestic partnership that has a foreign person as a direct partner, and any domestic partnership that has actual knowledge that a foreign person indirectly holds, through one or more partnerships, an interest in the domestic partnership.

(2) *Specified partnership*. The term *specified partnership* means a partnership that is engaged in the conduct of a trade

or business within the United States or that owns (directly or indirectly) an interest in a partnership that is engaged in the conduct of a trade or business within the United States, and may include a publicly traded partnership as defined in section 7704 and §§1.7704-1 through 1.7704-4, but does not include a publicly traded partnership treated as a corporation under that section.

(3) *Transfer*. The term *transfer* has the meaning provided in §1.864(c)(8)-1(g)(5).

(e) *Applicability dates*. Paragraph (a) of this section applies to transfers that occur on or after the date that these regulations are published as final regulations in the **Federal Register**. Paragraphs (b) and (c) of this section apply to returns filed on or after the date that these regulations are published as final regulations in the **Federal Register**. Paragraph (d) of this section applies beginning on the date that these regulations are published as final regulations in the **Federal Register**.

Par. 3. Section 1.1445-2 is amended by adding paragraph (b)(2)(v) and a sentence to the end of paragraph (e) to read as follows:

§1.1445-2 Situations in which withholding is not required under section 1445(a).

* * * * *

(b) * * *

(2) * * *

(v) *Form W-9*. For purposes of paragraph (b)(2)(i) of this section, a certification of non-foreign status includes a valid Form W-9, *Request for Taxpayer Identification Number and Certification*, or its successor, submitted to the transferee by the transferor.

* * * * *

(e) *Applicability dates*. * * * Paragraph (b)(2)(v) of this section applies to certifications provided on or after May 7, 2019, except that a taxpayer may apply it with respect to certifications provided before that date.

Par. 4. Section 1.1445-5 is amended by adding paragraph (b)(3)(iv) and a sentence to the end of paragraph (h) to read as follows:

§1.1445-5 Special rules concerning distributions and other transactions by corporations, partnerships, trusts, and estates.

* * * * *

(b) * * *

(3) * * *

(iv) *Form W-9*. For purposes of paragraph (b)(3)(i) of this section, a certification of non-foreign status includes a valid Form W-9, *Request for Taxpayer Identification Number and Certification*, or its successor, submitted to the transferee by the transferor.

* * * * *

(h) *Applicability dates*. * * * Paragraph (b)(3)(iv) of this section applies to certifications provided on or after May 7, 2019, except that a taxpayer may apply it with respect to certifications provided before that date.

Par. 5. Section 1.1445-8 is amended by revising paragraph (f) to read as follows:

§1.1445-8 Special rules regarding publicly traded partnerships, publicly traded trusts and real estate investment trusts (REITs).

* * * * *

(f) *Qualified notice*—(1) *In general*. A qualified notice for purposes of paragraph (b)(3)(iv) of this section is a notice provided in the manner described in §1.1446-4(b)(4) by a partnership, trust, or REIT regarding a distribution that is attributable to the disposition of a United States real property interest. In the case of a REIT, a qualified notice is only a notice of a distribution, all or any portion of which the REIT actually designates, or characterizes in accordance with paragraph (c)(2)(ii)(C) of this section, as a capital gain dividend in the manner described in §1.1446-4(b)(4), with respect to each share or certificate of beneficial interest. A deemed designation under paragraph (c)(2)(ii)(A) of this section may not be the subject of a qualified notice under this paragraph (f). A person described in paragraph (b)(3) of this section is treated as receiving a qualified notice when the notice is provided in accordance with §1.1446-4(b)(4).

(2) *Applicability dates*. Paragraph (f)(1) of this section applies to distributions made on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 6. Section 1.1446-3 is amended:

1. In the first sentence of paragraph (a)(2)(i), by removing "section 11(b)(1)" and adding in its place "section 11(b)".

2. By adding paragraph (c)(4).

The addition reads as follows:

§1.1446-3 Time and manner of calculating and paying the 1446 tax.

* * * * *

(c) * * *

(4) *Coordination with section 1446(f)*. A partnership that is directly or indirectly subject to withholding under section 1446(f)(1) during its taxable year may credit the amount withheld under section 1446(f)(1) against its section 1446 tax liability for that taxable year only to the extent the amount is allocable to foreign partners.

* * * * *

Par. 7. Section 1.1446-4 is amended by:

1. By revising paragraphs (b)(3) and (4).

2. By removing the second sentence of paragraph (c).

3. By revising paragraphs (d) and (f)(3).

The revisions and additions read as follows:

§1.1446-4 Publicly traded partnerships.

* * * * *

(b) * * *

(3) *Nominee*. For purposes of this section, the term nominee means a person that holds an interest in a publicly traded partnership on behalf of a foreign person and that is either a U.S. person, a qualified intermediary (as defined in §1.1441-1(e)(5)(ii)) that assumes primary withholding responsibility for a payment, or a U.S. branch of a foreign person that agrees to be treated as a U.S. person (as described in §1.1441-1(b)(2)(iv)) with respect to a payment.

(4) *Qualified notice*. For purposes of this section, a qualified notice is a notice posted by a publicly traded partnership that states the amount of a distribution that is attributable to each type of income described in paragraphs (f)(3)(i) through (v) of this section. A qualified notice may also include the information described in §1.1446(f)-4(b)(3), relating to an exception from withholding under section 1446(f)(1) for transfers of certain partnership interests. The notice must be posted in a readily accessible format in an area of the primary public Web site of the publicly traded partnership that is dedicated to this purpose. A qualified notice must be posted by the date required for providing

notice with respect to dividends described in 17 CFR 240.10b-17(b)(1) or (3) (or any successor regulation) issued pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a) and contain the information described therein as it would relate to the distribution. The publicly traded partnership must keep the notice accessible to the public for ten years on its primary public Web site or the primary public Web site of any successor organization. No specific format is required unless provided in forms, instructions, or other guidance. See paragraph (d) of this section regarding when a nominee is considered to have received a qualified notice.

* * * * *

(d) *Rules for designation of nominees to withhold tax under section 1446*. A nominee that receives a distribution from a publicly traded partnership subject to withholding under this section, and which is to be paid to (or for the account of) any foreign person, may be treated as a withholding agent under this section. A nominee is treated as receiving a qualified notice on the date that the notice is posted in accordance with paragraph (b)(4) of this section. When a nominee is treated as a withholding agent with respect to a foreign partner of the partnership, the obligation to withhold on distributions to the foreign partner in accordance with the rules of this section is imposed solely on the nominee. A nominee responsible for withholding under the rules of this section is subject to liability under sections 1461 and 6655, as well as all applicable penalties and interest, as if the nominee were a partnership responsible for withholding under this section. A nominee may rely on a qualified notice that meets the requirements in paragraph (b)(4) of this section to determine the amounts on which it must withhold. If a notice a publicly traded partnership issues relating to its distribution does not meet the requirements in paragraph (b)(4) of this section, the nominee must withhold on the distribution with respect to—

(1) Foreign partners that are corporations, at the greater of the highest rate of tax specified in section 11(b) or section 881; and

(2) Foreign partners that are not corporations, at the greater of the highest rate of tax specified in section 1 or section 871.

* * * * *

(f) * * *

(3) *Ordering rule relating to distributions*. Distributions from publicly traded partnerships are deemed to be paid out of the following types of income in the order indicated—

(i) Amounts attributable to income described in section 1441 or 1442 that are not effectively connected with the conduct of a trade or business in the United States but are subject to withholding, before taking into account any treaty exemptions;

(ii) Amounts attributable to income described in section 1441 or 1442 that are not effectively connected with the conduct of a trade or business in the United States and are not subject to withholding because of an exemption under a provision of the Code;

(iii) Amounts attributable to income effectively connected with the conduct of a trade or business in the United States that are not subject to withholding under §§1.1446-1 through 1.1446-6 (for example, amounts exempt by treaty);

(iv) Amounts subject to withholding under §§1.1446-1 through 1.1446-6; and

(v) Amounts not listed in paragraphs (f)(3)(i) through (iv) of this section.

* * * * *

Par. 8. Section 1.1446-7 is amended by revising the section heading and adding two sentences at the end of the section to read as follows:

§1.1446-7 Applicability dates.

* * * The addition of §1.1446-3(c)(4) applies to partnership taxable years that include transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**. The revisions to §1.1446-4(b)(3) and (4), the removal of the second sentence of §1.1446-4(c), and the revisions to §1.1446-4(d) and (f)(3) apply to distributions made on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 9. Sections 1.1446(f)-1 through 1.1446(f)-5 are added to read as follows:

Sec.

* * * * *

1.1446(f)-1 General rules.

1.1446(f)-2 Withholding on the transfer of a non-publicly traded partnership interest.

1.1446(f)-3 Partnership's requirement to withhold under section 1446(f)(4) on distributions to transferee.

1.1446(f)-4 Withholding on the transfer of a publicly traded partnership interest.

1.1446(f)-5 Liability for failure to withhold.

* * * * *

§1.1446(f)-1 General rules.

(a) *Overview*. These regulations provide rules for withholding, reporting, and paying tax under section 1446(f) upon the sale, exchange, or other disposition of certain interests in partnerships. This section provides definitions and general rules of applicability that apply for purposes of section 1446(f). Section 1.1446(f)-2 provides withholding rules for the transfer of a non-publicly traded partnership interest under section 1446(f)(1). Section 1.1446(f)-3 provides rules that apply when a partnership is required to withhold under section 1446(f)(4) on distributions made to the transferee in an amount equal to the amount that the transferee failed to withhold plus interest. Section 1.1446(f)-4 provides special rules for the sale, exchange, or disposition of publicly traded partnership interests, for which the withholding obligation under section 1446(f)(1) is generally imposed on certain brokers that act on behalf of the transferor. Section 1.1446(f)-5 provides rules that address the liability for failure to withhold under section 1446(f) and rules regarding the liability of a transferor's or transferee's agent.

(b) *Definitions*. This paragraph (b) provides definitions that apply for purposes of §§1.1446(f)-1 through 1.1446(f)-5.

(1) The term *broker* means any person, foreign or domestic, that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales made by others, and that, in connection with a transfer of a PTP interest, receives all or a portion of the amount realized on behalf of the transferor. The term broker also includes any clearing organization (as defined in §1.1471-1(b)(21)) that effects the transfer of a PTP interest on behalf of the transferor. The term broker does not include an escrow agent that effects no sales other than such transactions that are incidental to the purpose of escrow (such as sales to collect on collateral).

(2) The term *controlling partner* means a partner that, together with any person that bears a relationship described in sections 267(b) or 707(b)(1) to the partner, owns directly or indirectly a 50 percent or greater interest in the capital, profits, deductions, or losses of the partnership in the 12 months before the determination date.

(3) The term *effect* has the meaning provided in §1.6045-1(a)(10).

(4) The term *foreign person* means a person that is not a United States person.

(5) The term *PTP interest* means an interest in a publicly traded partnership if the interest is publicly traded on an established securities market or is readily tradable on a secondary market (or the substantial equivalent thereof).

(6) The term *publicly traded partnership* has the same meaning as in section 7704 and §§1.7704-1 through 1.7704-4 but does not include a publicly traded partnership treated as a corporation under that section.

(8) The term *TIN* means the tax identifying number assigned to a person under section 6109.

(9) The term *transfer* means a sale, exchange, or other disposition, and includes a distribution from a partnership to a partner.

(10) The term *transferee* means any person, foreign or domestic, that acquires a partnership interest through a transfer, and includes a partnership that makes a distribution.

(11) Except as otherwise provided in this paragraph, the term *transferor* means any person, foreign or domestic, that transfers a partnership interest. In the case of a trust, to the extent all or a portion of the income of the trust is treated as owned by the grantor or another person under sections 671 through 679 (such trust, a grantor trust), the term transferor means the grantor or other person.

(12) The term *transferor's agent* or *transferee's agent* means any person who represents the transferor or transferee (respectively) in any negotiation with another person relating to the transaction or in settling the transaction. A person will not be treated as a transferor's agent or a transferee's agent solely because it performs one or more of the activities described in §1.1445-4(f)(3) (relating to activities of settlement officers and clerical personnel).

(13) The term *United States person* or *U.S. person* means a person described in section 7701(a)(30).

(c) *General rules of applicability*—(1) *In general*. This paragraph (c) provides general rules that apply for purposes of §§1.1446(f)-1 through 1.1446(f)-5.

(2) *Certifications*—(i) *In general*. This paragraph (c)(2) provides rules that are applicable to certifications described in §§1.1446(f)-1 through 1.1446(f)-5, except as otherwise provided therein, or in forms, instructions, or other guidance. A certification must provide the name and address of the person providing it. A certification must also be signed under penalties of perjury and, if the certification is provided by the transferor, must include a TIN if the transferor has, or is required to have, a TIN. A transferee (or other person required to withhold) may not rely on a certification if it knows that a transferor has, or is required to have, a TIN, and that TIN has not been provided with the certification. A certification includes any documents associated with the certification, such as statements from the partnership, IRS forms, withholding certificates, withholding statements, certifications, or other documentation. Documents associated with the certification form an integral part of the certification, and the penalties of perjury statement provided on the certification also applies to the documents. A certification (other than the certification described in §1.1446(f)-2(d)(2)) may not be relied upon if it is obtained earlier than 30 days before the transfer or any time after the transfer.

(ii) *Penalties of perjury*. A certification signed under penalties of perjury must provide the following: "Under penalties of perjury, I declare that I have examined the information on this document, and to the best of my knowledge and belief, it is true, correct, and complete."

(iii) *Authority to sign certifications on behalf of a business entity*. A certification provided by a business entity must be signed by an individual who is an officer, director, general partner, or managing member of the entity, or, if the general partner or managing member is itself a business entity, an individual who is an officer, director, or managing member of the entity that is the general partner or managing member.

(iv) *Electronic submission*. A certification may be sent electronically, including as text in an email, an image embedded in an email, or a Portable Document Format (.pdf) attached to an email. An electronic certification, however, may not be relied upon if the person receiving the submission knows that the certification was transmitted by a person not authorized to do so by the person required to execute the certification.

(v) *Retention period*. Any person that relies on a certification pursuant to §§1.1446(f)-1 through 1.1446(f)-5 must retain the certification (including any documentation) for the longer of five calendar years following the close of the last calendar year in which it relied on the certification or for as long as it may be relevant to the determination of its withholding obligation under section 1446(f) or its withholding tax liability under section 1461.

(vi) *Submission to IRS*. Except as provided in §1.1446(f)-2(b)(7) and 1.1446(f)-2(c)(4)(vi) (involving certifications relating to an income tax treaty), or in any forms, instructions, or other guidance, the recipient of a certification is not required to mail a copy to the IRS.

(vii) *Grantor trusts*. A certification provided by a transferor that is a grantor or other owner of a grantor trust must identify the portion of the amount realized that is attributable to the grantor or other owner.

(3) *Books and records*. A partnership that relies on its books and records pursuant to §§1.1446(f)-1 through 1.1446(f)-5 (including for purposes of providing a certification or other statement) must identify in its books and records the date on which the transfer occurred, the information on which the partnership relied, and the provisions of §§1.1446(f)-1 through 1.1446(f)-5 supporting an exception from, or adjustment to, the partnership's obligation to withhold. The identification required by this paragraph (c)(3) must be made no later than 30 days after the date of the transfer. The partnership must retain the identified information in its books and records for the longer of five calendar years following the close of the last calendar year in which it relied on the information or for as long as

it may be relevant to the determination of its withholding obligation under section 1446(f) or its withholding tax liability under section 1461.

(4) *Determination date*—(i) *In general*. This paragraph (c)(4) provides rules for the determination date. The same determination date must be used for all purposes with respect to a transfer. Any statement, certification, or books and records with regard to a transfer must state the determination date. The determination date of a transfer must be one of the following—

(A) The date of the transfer;

(B) Any date that is no more than 60 days before the date of the transfer; or

(C) The date that is the later of—

(*1*) The first day of the partnership's taxable year in which the transfer occurs, as determined under section 706; or

(*2*) The date, before the date of the transfer, of the most recent event described in §1.704-1(b)(2)(iv)(*f*)(*5*) or §1.704-1(b)(2)(iv)(*s*)(*1*) (revaluation event), irrespective of whether the capital accounts of the partners are adjusted in accordance with §1.704-1(b)(2)(iv)(*f*).

(ii) *Controlling partner*. The determination date for a transferor that is a controlling partner is determined without regard to paragraph (c)(4)(i)(C) of this section.

(5) *IRS forms and instructions*. Any reference to an IRS form includes its successor form. Any form must be filed in the manner provided in the instructions to the forms or in other guidance.

(d) *Coordination with section 1445*. A transferee that is otherwise required to withhold under section 1445(e)(5) or §1.1445-11T(d)(1) with respect to the amount realized, as well as under section 1446(f)(1), will be subject to the payment and reporting requirements of section 1445 only, and not section 1446(f)(1), with respect to that amount. However, if the transferor has applied for a withholding certificate under the last sentence of §1.1445-11T(d)(1), the transferee must withhold the greater of the amounts required under section 1445(e)(5) or section 1446(f)(1). A transferee that has complied with the withholding requirements under either section 1445(e)(5) or section 1446(f)(1), as applicable under this paragraph (d), will be deemed to satisfy the other withholding requirement.

(e) *Applicability date*. This section applies to transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

§1.1446(f)-2 Withholding on the transfer of a non-publicly traded partnership interest.

(a) *Transferee's obligation to withhold*. Except as otherwise provided in this section, a transferee is required to withhold under section 1446(f)(1) a tax equal to 10 percent of the amount realized on any transfer of a partnership interest. This section does not apply to a transfer of a PTP interest that is effected through one or more brokers, including a distribution made with respect to a PTP interest held in an account with a broker. For rules regarding those transfers, see §1.1446(f)-4.

(b) *Exceptions to withholding*—(1) *In general*. A transferee is not required to withhold under this section if it properly relies on a certification or its books and records as described in this paragraph (b). A transferee may not rely on a certification if it has actual knowledge that the certification is incorrect or unreliable. A partnership that is a transferee because it makes a distribution may not rely on its books and records if it knows, or has reason to know, that the information is incorrect or unreliable.

(2) *Certification of non-foreign status by transferor*. A transferee may rely on a certification of non-foreign status from the transferor that states that the transferor is not a foreign person, states the transferor's name, TIN, and address, and is signed under penalties of perjury. For this purpose, a certification of non-foreign status includes a valid Form W-9, *Request for Taxpayer Identification Number and Certification*. For purposes of this paragraph (b)(2), a transferee may rely on a valid Form W-9 from the transferor that it already possesses if the form meets these requirements.

(3) *No realized gain by transferor*—(i) *In general*. A transferee (other than a partnership that is a transferee because it makes a distribution) may rely on a certification from the transferor that states that the transfer of the partnership interest would not result in any realized gain (including ordinary income arising from application of section 751 and §1.751-1 to the transferor as of the determination date. See paragraph (b)(6) of this section for rules that apply when the transferor realizes gain but is not required to recognize the gain under a provision of the Internal Revenue Code.

(ii) *Partnership distributions*. A partnership that is a transferee because it makes a distribution may rely on its books and records, or on a certification from the transferor, to determine that the distribution would not result in any realized gain to the transferor as of the determination date.

(4) *Less than 10 percent effectively connected gain*—(i) *In general*. A transferee (other than a partnership that is a transferee because it makes a distribution) may rely on a certification from the partnership that states that if the partnership sold all of its assets at fair market value as of the determination date in the manner described in §1.864(c)(8)-1(c), either—

(A) The amount of net gain that would have been effectively connected with the conduct of a trade or business within the United States would be less than 10 percent of the total net gain; or

(B) No gain would have been effectively connected with the conduct of a trade or business within the United States.

(ii) *Partnership distributions*. A partnership that is a transferee because it makes a distribution may rely on its books and records to determine that as of the determination date either paragraph (b)(4)(i)(A) or (B) of this section is satisfied.

(5) *Less than 10 percent effectively connected taxable income*—(i) *In general*. A transferee (other than a partnership making a distribution) may rely on a certification from the transferor that states that—

(A) For the transferor's immediately prior taxable year and the two preceding taxable years, the transferor was at all times a partner in the partnership;

(B) The transferor's allocable share of effectively connected taxable income determined under §1.1446-2 (as provided on Form 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax*) (ECTI), including any ECTI allocable to a partner that bears a relationship to the transferor described in sections 267(b) or 707(b)(1), was less than $1 million in each of the taxable years described in paragraph (b)(5)(i)(A) of this section;

(C) The transferor's allocable share of ECTI in each of the taxable years described in paragraph (b)(5)(i)(A) of this section was less than 10 percent of the transferor's total distributive share of net income from the partnership for that year as determined under subchapter K of the Internal Revenue Code (as provided on Schedule K-1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc.*); and

(D) The transferor's distributive share of income or gain that is effectively connected with the conduct of a trade or business within the United States or deductions or losses properly allocated and apportioned to that income in each of the taxable years described in paragraph (b)(5)(i)(A) of this section has been reported on a Federal income tax return (either filed by the transferor or, in the case of transferor that is a partnership, filed by its direct or indirect nonresident alien individual or foreign corporate partners) on or before the due date (including extensions), and all amounts due with respect to the reported amounts has been timely paid to the IRS, provided that the return was required to be filed when the transferor furnishes the certification (taking into account any extensions of time to file).

(ii) *Immediately prior taxable year*—(A) *In general*. The transferor's immediately prior taxable year is the transferor's most recent taxable year—

(*1*) With or within which a taxable year of the partnership ended; and

(*2*) For which a Schedule K-1 (Form 1065) was due (including extensions) or furnished (if earlier) before the transfer.

(B) *Limitation*. A transferee may not rely on a certification that is provided before the transferor's receipt of the Schedule K-1 (Form 1065) described in paragraph (b)(5)(ii)(A) of this section.

(iii) *No Form 8805*—(A) *In general*. Except as provided in paragraph (b)(5)(iii)(B) of this section, a transferor that does not receive Form 8805 because it had no ECTI for which the partnership paid section 1446 tax (within the meaning in §1.1446-2(a)) in any of the years described in paragraph (b)(5)(i)(A) of this section may not make the certification provided in this paragraph (b)(5).

(B) *Exception*. If, in any of the years described in paragraph (b)(5)(i)(A) of this section, a transferor has an allocable share of loss that is effectively connected with the conduct of a trade or business within the United States, or has deductions properly allocated and apportioned to income that is effectively connected with the conduct of a trade or business within the United States from the partnership, paragraph (b)(5)(iii)(A) of this section does not apply by reason of a lack of Form 8805 with respect to that year, and the transferor is treated as having an allocable share of ECTI of zero in that year for purposes of paragraph (b)(5)(i)(C) of this section.

(iv) *No net distributive share of income*. A transferor that did not have a net distributive share of income in any year described in paragraph (b)(5)(i)(A) of this section cannot provide the certification described in this paragraph (b)(5).

(v) *Partnership distributions*. A partnership that is a transferee by reason of making a distribution may rely on its books and records to determine that the requirements in paragraphs (b)(5)(i)(A) through (C) of this section have been satisfied (subject to the rules in paragraphs (b)(5)(ii) through (iv) of this section). The partnership must also obtain a representation from the transferor stating that the requirement in paragraph (b)(5)(i)(D) of this section has been satisfied.

(vi) *No certification when reporting is incorrect*. A transferor may not make the certification described in this paragraph (b)(5) if it has actual knowledge that the information relevant to the certification that is reported by the partnership on any Form 8805 or Schedule K-1 (Form 1065) is incorrect.

(6) *Certification of nonrecognition by transferor*—(i) *In general*. A transferee may rely on a certification from the transferor that states that by reason of the operation of a nonrecognition provision of the Internal Revenue Code the transferor is not required to recognize any gain or loss with respect to the transfer. The certification must briefly describe the transfer and provide the relevant law and facts relating to the certification.

(ii) *Partial nonrecognition*. Paragraph (b)(6)(i) of this section does not apply if only a portion of the gain realized on the transfer is subject to a nonrecognition provision. However, see paragraph (c)(4)(v) of this section for rules applicable to a transferor's claim for partial nonrecognition.

(7) *Income tax treaties*—(i) *In general*. A transferee may rely on a certification from the transferor that states that the transferor is not subject to tax on any gain from the transfer pursuant to an income tax treaty in effect between the United States and a foreign country if the requirements of this paragraph (b)(7) are met. The transferor must include with the certification a withholding certificate (on a Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*, or Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)*) that meets the requirements for validity under §1.1446-1(c)(2)(iv) (or an applicable substitute form that meets the requirements under §1.1446-1(c)(5)) and that contains the information necessary to support the claim for treaty benefits. A transferee may rely on a certification of treaty benefits only if, within 30 days after the date of the transfer, the transferee mails a copy of the certification to the Internal Revenue Service, at the address provided in §1.1445-1(g)(10), together with a cover letter providing the name, TIN, and address of the transferee and the partnership in which an interest was transferred.

(ii) *Treaty claim for less than all of the gain*. Paragraph (b)(7)(i) of this section does not apply if treaty benefits apply to only a portion of the gain from the transfer. However, see paragraph (c)(4)(vi) of this section for rules applicable to situations in which treaty benefits apply to only a portion of the gain.

(iii) *Exclusive means to claim an exception from withholding based on treaty benefits*. A transferor claiming treaty benefits with respect to all of the gain from the transfer must use the exception in this paragraph (b)(6) and not any other exception or determination procedure in paragraphs (b) and (c) of this section to claim an exception to withholding by reason of a claim of treaty benefits.

(c) *Determining the amount to withhold*—(1) *In general*. A transferee that is required to withhold under this section must withhold 10 percent of the amount realized on the transfer of the partnership interest, except as otherwise provided in this paragraph (c). Any procedures in this paragraph (c) apply solely for purposes of determining the amount to withhold under section 1446(f)(1) and this section. A transferee may not rely on a certification if it has actual knowledge that the certification is incorrect or unreliable. A partnership that is a transferee because it makes a distribution may not rely on its books and records if it knows, or has reason to know, that the information is incorrect or unreliable.

(2) *Amount realized*—(i) *In general*. The amount realized on the transfer of the partnership interest is determined under section 1001 (including §§1.1001-1 through 1.1001-5) and section 752 (including §1.752-1 through 1.752-7). Thus, the amount realized includes the amount of cash paid (or to be paid), the fair market value of other property transferred (or to be transferred), the amount of any liabilities assumed by the transferee or to which the partnership interest is subject, and the reduction in the transferor's share of partnership liabilities. In the case of a distribution, the amount realized is the sum of the amount of cash distributed (or to be distributed), the fair market value of property distributed (or to be distributed), and the reduction in the transferor's share of partnership liabilities.

(ii) *Alternative procedures for transferee to determine share of partnership liabilities*—(A) *In general*. A transferee (other than a partnership that is a transferee because it makes a distribution), as an alternative to determining the share of partnership liabilities under paragraph (c)(2)(i) of this section, may use the procedures of this paragraph (c)(2)(ii) to determine the extent to which a reduction in partnership liabilities is included in the amount realized.

(B) *Certification of liabilities by transferor*. Except as otherwise provided in this section, a transferee may rely on a certification from a transferor, other than a controlling partner, that provides the amount of the transferor's share of partnership liabilities reported on the most recent Schedule K-1 (Form 1065) issued by the partnership. If the transferor's actual share of liabilities at the time of the transfer differs from the amount reported on that Schedule K-1 (Form 1065), the certification will not be treated as incorrect or unreliable if the transferor also certifies that it does not have actual knowledge of any events occurring after receiving the Schedule K-1 (Form 1065) that would cause the amount of the transferor's share of partnership liabilities at the time of the transfer to differ by more than 25 percent from the amount shown on the Schedule K-1 (Form 1065). A transferee may not rely on a certification if the last day of the partnership taxable year for which the Schedule K-1 (Form 1065) was provided was more than 22 months before the date of the transfer.

(C) *Certification of liabilities by partnership*. A transferee may rely on a certification from a partnership that provides the amount of the transferor's share of partnership liabilities on the determination date. If the transferor's actual share of liabilities at the time of the transfer differs from the amount on the certification, the certification will not be treated as incorrect or unreliable if the partnership also certifies that it does not have actual knowledge of any events occurring after the determination date that would cause the amount of the transferor's share of partnership liabilities at the time of the transfer to differ by more than 25 percent from the amount shown on the certification by the partnership for the determination date.

(iii) *Partnership's determination of partnership liabilities for distributions*. A partnership that is a transferee because it makes a distribution may rely on its books and records to determine the extent to which the transferor's share of partnership liabilities on the determination date are included in the amount realized. The information in the books and records will not be treated as incorrect or unreliable unless the partnership has actual knowledge, on or before the date of the distribution, of any events occurring after the determination date that would cause the amount of the transferor's share of partnership liabilities at the time of the transfer to differ by more than 25 percent from the amount determined by the partnership as of the determination date.

(iv) *Certification by a foreign partnership of non-foreign status of its partners*—(A) *In general*. When a transferor is a foreign partnership, a transferee may use the procedures of this paragraph (c)(2)(iv) to determine the amount realized. For this purpose, the transferee may rely on a certification from the transferor providing the modified amount realized, and may treat the modified amount realized as the amount realized.

(B) *Determining modified amount realized*. The modified amount realized is determined by multiplying the amount realized (as determined under this paragraph (c)(2), without regard to this paragraph (c)(2)(iv)) by the aggregate percentage computed as of the determination date. The aggregate percentage is the percentage of the gain (if any) arising from the transfer that would be allocated to presumed foreign persons. For this purpose, a presumed foreign person is any direct or indirect partner of the transferor that has not provided a certification of non-foreign status that meets the requirements of paragraph (b)(2) of this section. For purposes of this paragraph (c)(2)(iv), an indirect partner is a person that owns an interest in the transferor indirectly through one or more foreign partnerships.

(C) *Certification*. The certification is made by providing a withholding certificate (on Form W-8IMY, *Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting*) and a withholding statement that provides the percentage of gain allocable to each direct or indirect partner and that provides whether each such person is a United States person or presumed foreign person. The certification must also include a certification of non-foreign status that meets the requirements of paragraph (b)(2) of this section from each of the United States persons that are direct or indirect partners of the transferor that are identified as a United States person on the withholding statement.

(3) *Lack of money or property or lack of knowledge regarding liabilities*. The amount to withhold equals the amount realized determined without regard to any decrease in the transferor's share of partnership liabilities if—

(i) The amount otherwise required to be withheld under this paragraph (c) would exceed the amount realized determined without regard to the decrease in the transferor's share of partnership liabilities; or

(ii) The transferee is unable to determine the amount realized because it does not have actual knowledge of the transferor's share of partnership liabilities (and has not received or cannot rely on a certification described in paragraph (c)(2)(ii)(B) or (C) of this section).

(4) *Certification of maximum tax liability*—(i) *In general*. A transferee may use the procedures of this paragraph (c)(4) for determining the amount to withhold for purposes of section 1446(f)(1) and paragraph (a) of this section. A transferee (other than a partnership that is a transferee because it makes a distribution) may rely on a certification from a transferor that is a foreign corporation, a nonresident alien individual or a foreign partnership regarding the transferor's maximum tax liability as described in paragraph (c)(4)(ii) of this section. A partnership that is a transferee because it makes a distribution may instead rely on its books and records to determine the transferor's maximum tax liability if the books and records includes the information required by paragraphs (c)(4)(iii) and (c)(4)(iv) of this section. A transferor that is a foreign partnership is treated as a nonresident alien individual for purposes of determining the transferor's maximum tax liability.

(ii) *Maximum tax liability*. For purposes of this paragraph (c)(4), the term *maximum tax liability* means the amount of the transferor's effectively connected gain (as determined under paragraph (c)(4)(iii)(E) of this section) multiplied by the applicable percentage, as defined in §1.1446-3(a)(2).

(iii) *Required information*. The certification must include—

(A) A statement that the transferor is either a nonresident alien individual, a foreign corporation, or a foreign partnership;

(B) The transferor's adjusted basis in the transferred interest on the determination date;

(C) The transferor's amount realized (determined in accordance with paragraph (c)(2) of this section) on the determination date;

(D) Whether the transferor remains a partner immediately after the transfer;

(E) The amount of outside ordinary gain and outside capital gain that would be recognized and treated as effectively connected gain under §1.864(c)(8)-1(b) on the determination date (effectively connected gain);

(F) The transferor's maximum tax liability on the determination date;

(G) A representation from the transferor that the transferor determined the amounts described in paragraph (c)(4)(iii)(E) of this section based on the statement described in paragraph (c)(4)(iv) of this section; and

(H) A representation from the transferor that it has provided the transferee with a copy of the statement described in paragraph (c)(4)(iv) of this section.

(iv) *Partnership statement*. A transferor may make the representation in paragraph (c)(4)(iii)(G) of this section only if the partnership provides to the transferor a statement (that meets the requirements for a certification under the general rules for applicability in §1.1446(f)-1(c)) that includes—

(A) The partnership's name, address, and TIN; and

(B) The transferor's aggregate deemed sale EC ordinary gain, within the meaning of §1.864(c)(8)-1(c)(3)(ii)(A) (if any) and the transferor's aggregate deemed sale EC capital gain, within the meaning of §1.864(c)(8)-1(c)(3)(ii)(B) (if any), in each case, on the determination date.

(v) *Partial nonrecognition*. If a nonrecognition provision applies to only a portion of the gain realized on the transfer, a certification described in this paragraph (c)(4) may be relied upon only if the certification also includes the information required in paragraph (b)(6) of this section.

(vi) *Income tax treaties*. If only a portion of the gain on the transfer is not subject to tax pursuant to an income tax treaty in effect between the United States and a foreign country, a certification described in paragraph (c)(4)(i) of this section may be relied upon only if the certification also complies with the requirements of paragraph (b)(7) of this section, including the requirement that the determination that gain from the transfer is not subject to tax pursuant to an income tax treaty be made with respect to the transferor, and that the transferee mail a copy of the relevant certification described in this paragraph (c)(4) to the IRS.

(d) *Reporting and paying withheld amounts*—(1) *In general*. A transferee required to withhold under this section must report and pay any tax withheld by the 20th day after the date of the transfer using Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*, in accordance with the instructions to those forms. The IRS will stamp Form 8288-A to show receipt and mail a stamped copy to the transferor (at the address reported on the form). *See* paragraph (e)(2) of this section for the procedures for the transferor to claim a credit for amounts withheld. Forms 8288 and 8288-A must include the TINs of both the transferor and the transferee. If any required TIN is not provided, the transferee must still report and pay any tax withheld on Form 8288.

(2) *Certification of withholding to partnership for purposes of section 1446(f)(4)*. A transferee (other than a partnership that is a transferee because it makes a distribution) must certify to the partnership the extent to which it has satisfied its obligation to withhold under this section no later than 10 days after the transfer. The certification must either include a copy of Form 8288-A that the transferee files with respect to the transfer, or state the amount realized and the amount withheld on the transfer of the partnership interest. The certification must also include any certifications that the transferee relied on to apply an exception to withholding under paragraph (b) of this section or to determine the amount to withhold under paragraph (c) of this section. See §1.1446(f)-3 for rules regarding a partnership's obligation to withhold on distributions to a transferee when this certification establishes only partial satisfaction of the required amount, is not provided, or cannot be relied upon.

(e) *Effect of withholding on transferor*—(1) *In general*. The withholding of tax by a transferee under this section does not relieve a foreign person from filing a U.S. tax return with respect to the transfer. See §§1.6012-1(b)(1), 1.6012-2(g)(1), and 1.6031(a)-1. Further, the withholding of tax by a transferee does not relieve a nonresident alien individual or foreign corporation subject to tax under section 864(c)(8) from paying any tax due with the return that has not been fully satisfied through withholding.

(2) *Manner of obtaining credit*—(i) *Individuals and corporations*. Except as pro-

vided in paragraph (e)(3) of this section, an individual or corporation may claim a credit under section 33 for the amount withheld under this section by attaching to its applicable return the stamped copy of Form 8288-A provided to it under paragraph (d)(1) of this section. *See also* §1.1462-1.

(ii) *Partnerships*. For a rule allowing a foreign partnership that is a transferor to claim a credit for the amount withheld under this section against its tax liability under section 1446(a), see §1.1446-3(c)(4).

(3) *Failure to receive Form 8288-A*. If a stamped copy of Form 8288-A has not been provided to the transferor by the IRS, the transferor may establish the amount of tax withheld by the transferee by attaching to its return substantial evidence of the amount. The transferor must attach to its return a statement that includes all of the information otherwise required to be provided on Form 8288-A.

(f) *Applicability date*. This section applies to transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

§1.1446(f)-3 Partnership's requirement to withhold under section 1446(f)(4) on distributions to transferee.

(a) *Partnership's obligation to withhold amounts not withheld by the transferee*—(1) *In general*. If a transferee fails to withhold any amount required to be withheld under §1.1446(f)-2, the partnership in which the interest was transferred must withhold from any distributions made to the transferee pursuant to this section. To determine its withholding obligation under this paragraph (a)(1), a partnership may rely on a certification received from the transferee described in §1.1446(f)-2(d)(2) unless it knows, or has reason to know, that the certification is incorrect or unreliable.

(2) *Notification by IRS*. A partnership that receives notification from the IRS that a transferee has provided incorrect information regarding the amount realized or amount withheld on the certification described in §1.1446(f)-2(d)(2), or has failed to pay the IRS the amount reported as withheld on the certification, must withhold the amount prescribed in the notification on distributions to the transferee made on or after the date that is 15 days after it receives the notification. For this purpose, the amount realized is not treated as incorrect if the transferee properly relied on a certification to compute the amount realized pursuant to §1.1446(f)-2(c)(2).

(b) *Exceptions to withholding*—(1) *Withholding has been satisfied by transferee*. A partnership is not required to withhold under paragraph (a)(1) of this section if it relies on a certification described in §1.1446(f)-2(d)(2) received from the transferee (within the time prescribed in that section) that states that an exception to withholding described in §1.1446(f)-2(b) applies or that the transferee withheld the full amount required to be withheld (taking into account any adjustments under §1.1446(f)-2(c)) under §1.1446(f)-2.

(2) *PTP interests*—(i) *In general*. Except as provided in paragraph (b)(2)(ii) of this section, a partnership is not required to withhold under this section on distributions made with respect to a PTP interest.

(ii) *Exception for a false qualified notice*. If a publicly traded partnership determines (including by reason of notification from the IRS) that it has published a qualified notice that falsely states that either the exception described in §1.1446(f)-4(b)(3) (the 10-percent exception) or the exception described in §1.1446(f)-4(b)(4) (the qualified current income exception) applies, the publicly traded partnership must withhold under this section on distributions to the transferee in an amount equal to the amount that a broker failed to withhold under §1.1446(f)-4 due to reliance on the qualified notice, plus interest.

(3) *Distributing partnerships*. A partnership that is a transferee because it makes a distribution is not required to withhold under this section.

(c) *Withholding rules*—(1) *Timing of withholding*—(i) *In general*. A partnership required to withhold under paragraph (a)(1) of this section must withhold on distributions made to the transferee beginning on the later of—

(A) The date that is 30 days after the date of transfer; or

(B) The date that is 15 days after the date on which the partnership acquires actual knowledge that the transfer has occurred.

(ii) *Satisfaction of withholding obligation*. A partnership is treated as satisfying its withholding obligation under paragraph (a)(1) of this section and may stop withholding on distributions to the transferee on the earlier of—

(A) The date on which the partnership completes withholding and paying the amount required to be withheld under paragraph (c)(2) of this section;

(B) The date on which the partnership receives and may rely on a certification from the transferee described in §1.1446(f)-2(d)(2) (without regard to whether the certification is received by the time prescribed in that section) that claims an exception to withholding under §1.1446(f)-2(b); or

(C) If a partnership interest is not a PTP interest, the date on which the transferee no longer owns an interest in the partnership, unless the partnership has actual knowledge that any successor to the transferee is a person that bears a relationship described in section 267(b) or 707(b)(1) with respect to the transferee or the transferor from which the transferee acquired the interest.

(2) *Amount to withhold*—(i) *In general*. A partnership required to withhold under paragraph (a)(1) of this section must withhold the full amount of each distribution made to the transferee until it has withheld—

(A) A tax of 10 percent of the amount realized (determined solely under §1.1446(f)-2(c)(2)(i) or, in the case of a publicly traded partnership, solely under §1.1446(f)-4(c)(2)(i)) on the transfer, reduced by any amount withheld by the transferee, plus

(B) Any interest computed under paragraph (c)(2)(ii) of this section.

(ii) *Computation of interest*. The amount of interest required to be withheld under paragraph (a)(1) of this section is the amount of interest that would be required to be paid under section 6601 and §301.6601-1 if the amount that should have been withheld by the transferee was considered an underpayment of tax. For this purpose, interest is payable between the date that is 20 days after the date of the transfer and the date on which the tax due under paragraph (a)(1) of this section is paid to the IRS.

(iii) *Certifications required*. For purposes of paragraph (c)(2)(i)(A) of this section, a partnership must determine the amount realized on the transfer and any amount withheld by the transferee based on a certification from the transferee described in §1.1446(f)-2(d)(2), without regard to whether the certification is received by the time prescribed in that section. A partnership that does not receive or cannot rely on a certification from the transferee described in §1.1446(f)-2(d)(2) must withhold tax equal to the full amount of each distribution made to the transferee until it receives a certification that it can rely on.

(3) *Coordination with other withholding provisions*. Any amount required to be withheld on a distribution under any other provision of the Internal Revenue Code is not also required to be withheld under section 1446(f)(4) or this section.

(d) *Reporting and paying withheld amounts*. The partnership must report and pay the tax withheld using Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, and 8288-C, *Statement of Withholding Under Section 1446(f)(4) for Withholding on Dispositions by Foreign Persons of Partnership Interests*, as provided in forms, instructions, or other guidance.

(e) *Effect of withholding on transferor and transferee*—(1) *Transferor*. The withholding of tax by a partnership under this section does not relieve a foreign person from filing a U.S. income tax return with respect to the transfer. See §§1.6012-1(b)(1), 1.6012-2(g)(1), and 1.6031(a)-1. Further, the withholding of tax by a partnership does not relieve a nonresident alien individual or foreign corporation subject to tax under section 864(c)(8) from paying any tax due with the return that has not been fully satisfied through withholding. An individual or corporation is not allowed a credit under section 33 for amounts withheld on distributions to the transferee under this section. See, however, §§1.1446(f)-5(a) and 1.1463-1(a), which generally provide that tax will not be recollected if paid by another person.

(2) *Transferee*. A transferee is treated as satisfying its withholding tax liability under §1.1446(f)-2 to the extent that a partnership withholds tax (which does not include interest) from the transferee under this section. Interest computed under paragraph (c)(2)(ii) of this section that is withheld by the partnership from the transferee is treated as interest paid by the transferee with respect to its withholding tax liability under §1.1446(f)-2. A transferee may not obtain a refund when the amount of tax withheld under this section exceeds the transferee's withholding tax liability under §1.1446(f)-2. Instead, only the partnership may claim a refund on behalf of the transferee for the excess amount under this section.

(f) *Applicability date*. This section applies to transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

§1.1446(f)-4 Withholding on the transfer of a publicly traded partnership interest.

(a) *Broker's obligation to withhold on a transfer of a PTP interest*—(1) *In general*. If a transfer of a PTP interest is effected through one or more brokers, the transferee is not required to withhold under section 1446(f)(1) and §1.1446(f)-2. Rather, any broker required to withhold under paragraph (a)(2) of this section must withhold a tax equal to 10 percent of the amount realized (as defined in paragraph (c)(2) of this section) on the transfer of a PTP interest, except as otherwise provided in this section. For rules regarding the application of section 1446(f)(4) and §1.1446(f)-3 to a publicly traded partnership, see §1.1446(f)-3(b)(2).

(2) *Broker's requirement to withhold*—(i) *Payments to foreign brokers*. A broker that pays the amount realized from the transfer of a PTP interest to another broker that is a foreign person must withhold under this section unless the foreign person is—

(A) A qualified intermediary (as defined in §1.1441-1(e)(5)(ii)) that provides a valid qualified intermediary withholding certificate (as described in §1.1441-1(e)(3)(ii)) that states that it assumes primary withholding responsibility under chapter 3; or

(B) A U.S. branch of a foreign person (as described in §1.1441-1(b)(2)(iv)) that provides a valid U.S. branch withholding certificate (as described in §1.1441-1(e)(3)(v)) that states that it agrees to be treated as a U.S. person with respect to any payment associated with the certificate.

(ii) *Brokers with customer relationship with transferor*. A broker that effects the transfer for the transferor as its customer (as defined in §1.6045-1(a)(2)) is required to withhold under this section.

(iii) *Exception*. A broker is not required to withhold under this section if it knows that the withholding obligation has already been satisfied.

(iv) *Determination of foreign broker's status*. For purposes of paragraph (a)(2)(i) of this section, a broker must treat another broker as a foreign person unless it obtains documentation (including a certification of non-foreign status) establishing that the other broker is a U.S. person.

(b) *Exceptions to withholding*—(1) *In general*. A broker is not required to withhold under this section if it properly relies on a certification described in paragraph (b)(2) or (b)(6) of this section, a qualified notice described in paragraph (b)(3) or (b)(4) of this section, or if the exception described in paragraph (b)(5) of this section applies. A broker may not rely on a certification described in this paragraph (b) if it has actual knowledge that the certification is incorrect or unreliable.

(2) *Certification of non-foreign status*. A broker may rely on a certification of non-foreign status that it obtains from the transferor. A certification of non-foreign status under this section means a Form W-9, *Request for Taxpayer Identification Number and Certification*, or valid substitute form, that meets the requirements of §1.1441-1(d)(2). For this purpose, a broker may rely on a valid form that it already possesses from the transferor. A broker may instead rely on certification from a second broker (as defined in §1.6045-1(a)(1)) that acts as an agent for the transferor when the second broker does not receive the amount realized from the transfer of the PTP interest. This certification must state that the second broker has collected a valid certification of non-foreign status (within the meaning of this paragraph (b)(2)) from the transferor, and it must include the transferor's TIN and status as a foreign or U.S. person.

(3) *Less than 10 percent effectively connected gain by partnership*—(i) *In general*. A broker may rely on a qualified notice described in paragraph (b)(3)(iii) of this section that states that the 10-percent

exception applies, as determined under paragraph (b)(3)(ii) of this section.

(ii) *10-percent exception*—(A) *In general*. The 10-percent exception applies to a transfer if, on the PTP designated date described in paragraph (b)(3)(ii)(B) of this section, had the publicly traded partnership sold all of its assets at fair market value in the manner described in §1.864(c)(8)-1(c), either—

(*1*) The amount of gain that would have been effectively connected with the conduct of a trade or business within the United States would be less than 10 percent of the total gain; or

(*2*) No gain would have been effectively connected with the conduct of a trade or business within the United States.

(B) *PTP designated date*. The PTP designated date for a transfer is any date for a deemed sale determination that is designated by the publicly traded partnership in a qualified notice described in paragraph (b)(3)(iii) of this section, provided that the PTP designated date occurs on or after the date that is 92 days before the date on which the publicly traded partnership posted the qualified notice naming the PTP designated date.

(iii) *Qualified notice*—(A) *In general*. Except as provided in paragraph (b)(3)(iii)(B) and (C) of this section, a qualified notice described in this paragraph (b)(3)(iii) is the most recent qualified notice (within the meaning of §1.1446-4(b)(4)) posted by the publicly traded partnership.

(B) *Qualified notice posting date requirement*. A qualified notice is described in this paragraph (b)(3)(iii) only if the publicly traded partnership has posted it within the 92-day period ending on the date of the transfer.

(C) *Recent posting of qualified notice*. If the most recent qualified notice posted by the publicly traded partnership was posted during the 10-day period ending on the date of the transfer, a broker may instead rely on the immediately preceding qualified notice (within the meaning of §1.1446-4(b)(4)) posted by the publicly traded partnership, provided that it satisfies the condition described in paragraph (b)(3)(iii)(B) of this section.

(4) *Distribution made from current income*—(i) *In general*. A broker is not required to withhold under this section on a distribution by a publicly traded partnership if the entire amount of a distribution is designated, on a qualified notice (within the meaning of §1.1446-4(b)(4)) posted with respect to that distribution, as a qualified current income distribution (within the meaning of paragraph (b)(4)(ii) of this section).

(ii) *Qualified current income distribution*. A qualified current income distribution is a distribution that does not exceed the net income of the publicly traded partnership since the record date (within the meaning of 17 CFR 240.14a-1(h) or its successor provision) of the immediately preceding distribution made by the publicly traded partnership.

(5) *Amount subject to withholding under section 3406*. A broker is not required to withhold under this section if the amount realized from the transfer of the PTP interest is subject to withholding under §31.3406(b)(3)-2 of this chapter.

(6) *Income tax treaties*. A broker may rely on a certification from the transferor that states that the transferor is not subject to tax on any gain from the transfer pursuant to an income tax treaty in effect between the United States and a foreign country if the requirements of this paragraph (b)(6) are met. The transferor must include with the certification a withholding certificate (on a Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*, or Form W-8BEN-E, *Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)*) that meets the requirements for validity under §1.1446-1(c)(2)(iv) (or an applicable substitute form that meets the requirements under §1.1446-1(c)(5)) and that contains the information necessary to support the claim for treaty benefits. For purposes of this paragraph (b)(6), a broker may rely on a withholding certificate that it already possesses from the transferor unless it has actual knowledge that the information is incorrect or unreliable. This exception does not apply if treaty benefits apply to only a portion of the gain from the transfer.

(c) *Determining the amount to withhold*—(1) *In general*. A broker that is required to withhold under this section must withhold 10 percent of the amount realized on the transfer of the PTP interest, except as provided in this paragraph (c). Any procedures in this paragraph (c) apply solely for purposes of determining the amount to withhold under section 1446(f)(1) and this section. A broker may not rely on a certification described in this paragraph (c) if it has actual knowledge that the certification is incorrect or unreliable.

(2) *Amount realized*—(i) *In general*. Solely for purposes of this section, the amount realized is the amount of gross proceeds (as defined in §1.6045-1(d)(5)) paid or credited upon the transfer to the customer or other broker (as applicable), or, in the case of a distribution, the amount of cash distributed (or to be distributed) and the fair market value of property distributed (or to be distributed).

(ii) *Certification by a foreign partnership of non-foreign status of its partners*—(A) *In general*. When a transferor is a foreign partnership, a broker may use the procedures of this paragraph (c)(2)(ii) to determine the amount realized. For this purpose, the broker may rely on a certification from the transferor providing the modified amount realized, and may treat the modified amount realized as the amount realized.

(B) *Determining modified amount realized*. The modified amount realized is determined by multiplying the amount realized (as determined under this paragraph (c)(2), without regard to this paragraph (c)(2)(ii)) by the aggregate percentage computed as of the determination date. The aggregate percentage is the percentage of the gain (if any) arising from the transfer that would be allocated to presumed foreign persons. For this purpose, a presumed foreign person is any direct or indirect partner of the transferor that has not provided a certification of non-foreign status that meets the requirements of paragraph (b)(2) of this section. For purposes of this paragraph (c)(2)(ii), an indirect partner is a person that owns an interest in the transferor indirectly through one or more foreign partnerships.

(C) *Certification*. The certification is made by providing a withholding certificate (on Form W-8IMY, *Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting*) and a withholding statement that provides the percentage of gain allocable to each direct or indirect partner and that provides whether each such person is a United States person or presumed foreign person. The certification must also include a certification of non-foreign status that meets the requirements of paragraph (b)(2) of this section from each of the United States persons that are direct or indirect partners of the transferor that are identified as a United States person on the withholding statement. For purposes of this paragraph (c)(2)(ii), a broker may rely on a withholding certificate and withholding statement that it already possesses from the partnership unless it has actual knowledge that the information is incorrect or unreliable.

(d) *Reporting and paying withheld amounts*. A broker that is required to withhold under this section must pay the withheld tax pursuant to the deposit rules in §1.6302-2. For rules regarding reporting on Forms 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, that apply to a broker that withholds under this section, see §1.1461-1(b) and (c). For rules regarding when an amount realized on the transfer of a PTP interest is an amount subject to reporting, see §1.1461-1(c)(2)(i)(Q). A broker that pays the amount realized to a foreign partnership must issue a Form 1042-S directly to the partnership rather than issuing a form to each of the partners of the partnership. *See* §1.1461-1(c)(1)(ii)(A)(*8*) (treating the foreign partnership as a recipient for reporting purposes). A broker making a payment to a U.S. branch treated as a U.S. person must not treat the branch as a U.S. person for purposes of reporting the payment made to the branch. Therefore, a payment to that U.S. branch must be reported on Form 1042-S. *See* §1.1461-1(c). A Form 1042-S issued directly to the transferor must include the TIN of the transferor unless the broker does not know the TIN at the time of issuance.

(e) *Effect of withholding on transferor*—(1) *In general*. The withholding of tax under this section does not relieve a foreign person from filing a U.S. tax return with respect to the transfer. *See* §§1.6012-1(b)(1), 1.6012-2(g)(1), and 1.6031(a)-1. Further, the withholding of tax by a broker does not relieve a nonresident alien individual or foreign corporation subject to tax under section 864(c)(8) from paying any tax due with the return that has not been fully satisfied through withholding.

(2) *Manner of obtaining credit*—(i) *Individuals and corporations*. An individual or corporation may claim a credit under section 33 for the amount withheld under this section by attaching to its applicable return a copy of a Form 1042-S that includes its TIN.

(ii) *Partnerships*. For a rule allowing a foreign partnership that is a transferor to claim a credit for the amount withheld under this section against its obligation to withhold under section 1446(a), see §1.1446-3(c)(4).

(f) *Applicability date*. This section applies to transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

§1.1446(f)-5 Liability for failure to withhold.

(a) *Liability for failure to withhold*. Every person required to withhold and pay tax under section 1446(f), but that fails to do so, is liable for the tax under section 1461. Under section 1463, if the tax required to be withheld is paid by another person required to withhold under section 1446(f) or by the nonresident alien individual or foreign corporation subject to tax under section 864(c)(8), the tax will not be recollected. However, any person that failed to withhold under section 1446(f) is in no case relieved from liability for any interest, penalties, or additions to tax that would otherwise apply. A partnership that failed to withhold and pay tax under §1.1446(f)-3 is only liable for the amount of tax that it failed to collect (but not any interest computed on that amount under §1.1446(f)-3(c)(2)(ii)), plus any interest, penalties, or additions to tax with regard to the partnership's failure to withhold.

(b) *Liability of agents*—(1) *Duty to provide notice of false certification*. A transferee's or transferor's agent (other than a broker required to withhold under §1.1446(f)-4) must provide notice to a transferee (or other person required to withhold) if that person is furnished with a certification described in §§1.1446(f)-1 through 1.1446(f)-4 and the agent knows that the certification is false. A person required to withhold may not rely on a certification if it receives the notice described in this paragraph (b)(1).

(2) *Procedural requirements*. Any agent who is required to provide notice under paragraph (b)(1) of this section must do so in writing (including by electronic submission) as soon as possible after learning of the false certification. If the agent first learns of the false certification before the date of transfer, notice must be given by the third day following that discovery but no later than the date of transfer (before the transferee's payment of consideration). If an agent first learns of a false certification after the date of transfer, notice must be given by the third day following that discovery. The notice must also explain the possible consequences to the recipient of a failure to withhold. The notice need not disclose the information on which the agent's statement is based. The agent must also furnish a copy of the notice to the IRS by the date on which the notice is required to be given to the recipient. The copy of the notice must be delivered to the address provided in §1.1445-1(g)(10) and must be accompanied by a cover letter stating that the copy is being filed pursuant to the requirements of §1.1446(f)-5(b)(2).

(3) *Failure to provide notice*. Any agent who is required to provide notice under paragraph (b)(1) of this section, but fails to do so in the manner required in paragraph (b)(2) of this section, is liable for the tax that the person who should have been provided notice in accordance with paragraph (b)(2) of this section was required to withhold under section 1446(f) if the notice had been given.

(4) *Limitation on liability*. An agent's liability under paragraph (b)(3) of this section is limited to the amount of compensation that the agent derives from the transaction. In addition, an agent that assists in the preparation of, or fails to disclose knowledge of, a false certification may be liable for civil and criminal penalties.

(c) *Applicability date*. This section applies to transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 10. Section 1.1461-1 is amended:

1. As proposed to be amended December 18, 2018, at 83 FR 64757:
   i. Paragraph (a)(1) is further amended by revising the sixth, seventh, and eighth sentences.
   ii. Paragraph (c)(1)(i)(A) is further amended by revising the second and third sentences.
2. By revising paragraph (c)(1)(ii)(A)(*8*).
3. By adding paragraph (c)(1)(ii)(B)(*5*).
4. In paragraph (c)(2)(i) introductory text, by revising the first and second sentences.
5. In paragraph (c)(2)(i)(N), by removing the word "and" that follows the semi-colon.
6. In paragraph (c)(2)(i)(O), by removing the period at the end of the paragraph and adding "; and" in its place.
7. By adding paragraphs (c)(2)(i)(P) and (Q).
8. By adding a sentence at the end of paragraph (c)(4)(ii)(A).
9. Revising paragraph (i).

The revisions and additions read as follows:

§1.1461-1 Payment and returns of tax withheld.

(a) * * *

(1) *Deposits of tax*. * * * With respect to withholding under section 1446, this section shall apply only to publicly traded partnerships and nominees that withhold under §1.1446-4 and brokers that withhold under §1.1446(f)-4 on transfers of publicly traded partnership interests. See §1.1461-3 for penalties that apply for failure to withhold under section 1446(a) on effectively connected taxable income allocable to foreign partners or under section 1446(f) on transfers of partnership interests by foreign partners. The references in the previous two sentences to §1.1446(f)-4 and section 1446(f) shall apply to transfers of partnership interests that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(c) * * *

(1) * * *

(i) * * *

(A) *In general*. * * * Notwithstanding the preceding sentence, any person that withholds or is required to withhold an amount under sections 1441, 1442, 1443, §1.1446-4(a) (applicable to publicly traded partnerships required to pay tax under section 1446(a) on distributions), or §1.1446(f)-4(a) (applicable to brokers required to withhold on transfers of publicly traded partnership interests) must file a Form 1042-S for the payment withheld upon whether or not that person is engaged in the conduct of a trade or business and whether or not the payment is an amount subject to reporting. The reference in the previous sentence to §1.1446(f)-4(a) shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**. * * *

* * * * *

(ii) * * *

(A) * * *

(*8*) A partner (including a foreign partnership) receiving a distribution from a publicly traded partnership subject to withholding under section 1446(a) and §1.1446-4 on distributions of effectively connected income, and a partner (including a foreign partnership) receiving an amount realized from a transfer of a publicly traded partnership interest subject to withholding under section 1446(f)(1) and §1.1446(f)-4. The references in this paragraph (c)(1)(ii)(A)(*8*) to section 1446(f)(1) and §1.1446(f)-4 shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(B) * * *

(*5*) A foreign broker withheld upon under §1.1446(f)-4(a)(2)(i) by another broker paying an amount realized from the transfer of a PTP interest.

* * * * *

(2) * * *

(i) *In general*. Subject to the exceptions described in paragraph (c)(2)(ii) of this section, amounts subject to reporting on Form 1042-S are amounts paid to a foreign payee or partner (including persons presumed to be foreign) that are amounts subject to withholding as defined in §1.1441-2(a), §1.1446-4(a) (addressing publicly traded partnerships required to pay withholding tax under section 1446(a) on distributions of effectively connected income), or §1.1446(f)-4(a) (addressing brokers required to withhold and pay tax on the amount realized on the transfer of an interest in a publicly traded partnership). The reference in the previous sentence to withholding under §1.1446-4(f) shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**. * * *

* * * * *

(P) The amount of any distribution made by a publicly traded partnership that is an amount subject to withholding under §1.1446-4, or that is paid to a qualified intermediary that assumes primary withholding responsibility for the payment or a U.S. branch of a foreign person that agrees to be treated as a U.S. person described in §1.1446-4(b)(2); and

(Q) An amount realized on the transfer of a publicly traded partnership interest subject to §1.1446(f)-4 (unless an exception to withholding applies under §1.1446(f)-4(b)(2) through (5)).

* * * * *

(4) * * *

(ii) * * *

(A) *Amounts paid to a nonqualified intermediary, a flow-through entity, and certain U.S. branches*. * * * For a payment to a foreign partnership on the transfer of a publicly traded partnership interest subject to § 1.1446(f)-4(a), see paragraph (c)(1)(ii)(A)(*8*) of this section (treating the foreign partnership as a recipient).

* * * * *

(i) *Applicability date*—(1) *In general*. Except as provided in paragraph (i)(2) of this section, this section applies to returns required for payments made on or after January 6, 2017. For payments made after June 30, 2014, and before January 6, 2017, see this section as in effect and contained in 26 CFR part 1, as revised April 1, 2016. For payments made after December 31, 2000, and before July 1, 2014, see this section as in effect and contained in 26 CFR part 1, as revised April 1, 2013.

(2) *Exceptions*. Paragraphs (a)(1), (c)(1)(i)(A), (c)(1)(ii)(A)(*8*), (c)(2)(i), and (c)(2)(iii) of this section apply as provided in those paragraphs. Paragraphs (c)(1)(ii)(A)(*11*), (c)(1)(ii)(B)(*5*), (c)(2)(i)(P) and (Q), and (c)(4)(ii)(A) apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 11. Section 1.1461-2 is amended:

1. By revising paragraph (a)(1).
2. As proposed to be amended April 13, 2016, at 81 FR 21795, by revising the first and last sentences of paragraph (b).

The revisions and addition read as follows:

§1.1461-2 Adjustments for overwithholding or underwithholding of tax.

(a) * * *

(1) *In general*. Except as otherwise provided in this paragraph (a)(1), a withholding agent that has overwithheld under chapter 3 of the Internal Revenue Code, and made a deposit of the tax as provided in §1.6302-2(a), may adjust the overwithheld amount either pursuant to the reimbursement procedure described in paragraph (a)(2) of this section or pursuant to the set-off procedure described in paragraph (a)(3) of this section. These rules do not apply to partnerships or nominees required to withhold under section 1446(a), other than on a distribution by a publicly traded partnership subject to withholding under §1.1446-4(a) and a payment of an amount realized on the transfer of an interest in a publicly traded partnership subject to §1.1446(f)-4. The reference in the previous sentence to withholding under §1.1446-4(f) shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

(b) * * * A withholding agent may withhold from future payments (including distributions of effectively connected income subject to withholding under §1.1446-4 and the amount realized from the transfer of a partnership interest subject to §1.1446(f)-4) made to a beneficial owner the tax that should have been withheld from previous payments to that beneficial owner under chapter 3 of the Code. * * * The reference in this paragraph (b) to withholding under §1.1446-4(f)-4 shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 12. Section 1.1461-3 is amended by revising the first sentence and last sentences to read as follows:

§1.1461-3 Withholding under section 1446.

For rules relating to the withholding tax liability of a partnership, nominee, or transferee under section 1446, see §§1.1446-1 through 1.1446-7 and 1.1446(f)-1 through 1.1446(f)-5. * * * The references in this section to §§1.1446-1 through 1.1446-7 apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446-1 through 1.1446-5 apply by reason of an election under §1.1446-7, and the references in this section to §1.1446(f)-1 through 1.1446(f)-5 shall apply with respect to returns for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 13. Section 1.1463-1 is amended by revising the fourth and fifth sentences of paragraph (a) to read as follows:

§1.1463-1 Tax paid by recipient of income.

(a) * * * See §§1.1446-3(e), 1.1446-3(f) and 1.1446(f)-5(a) for application of the rule of this paragraph (a), and for additional rules, in which the withholding tax was required to be paid under section 1446. The references in the previous sentence to §1.1446-3(e) and 1.1446-3(f) apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under §§1.1446-1 through 1.1446-5 apply by reason of an election under §1.1446-7, and the reference in the previous sentence to §1.1446(f)-5(a) shall apply to the tax required to be withheld under section 1446(f) for transfers that occur on or after 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

* * * * *

Par. 14. Section 1.1464-1 is amended by revising the last sentence of paragraph (a) and by revising paragraph (c) to read as follows:

§1.1464-1 Refunds or credits.

(a) *In general*. * * * With respect to section 1446 (other than section 1446(f)), this section applies only to a publicly traded partnership described in §1.1446-4.

* * * * *

(c) *Applicability date*. The last sentence of paragraph (a) applies to publicly traded partnerships described in §1.1446-4 for partnership taxable years beginning after April 29, 2008, and to brokers required to withhold under §1.1446(f)-4 on transfers that occur on or after the date that is 60 days after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 15. Section 1.6050K-1 is amended by:

1. Redesignating the introductory text of paragraph (c) and paragraphs (c)(1) through (3) as the introductory text of paragraph (c)(1) and paragraphs (c)(1)(i) through (iii), respectively.
2. Adding a subject heading to newly-redesignated paragraph (c)(1).
3. Adding paragraphs (c)(2) and (3), (d)(3), and (h).

The revision and additions read as follows:

§1.6050K-1 Returns relating to sales or exchanges of certain partnership interests.

* * * * *

(c) *Statements to be furnished to transferor and transferee*—(1) *In general*. * * *

(2) *Information to be provided to transferors*. The statement a partnership must provide to a transferor partner pursuant to paragraph (c)(1) of this section must also include the information necessary for the transferor to make the transferor's required statement under §1.751-1(a)(3).

(3) *Transfers of partnership interests by foreign persons*. For additional information required to be provided by the partnership if section 864(c)(8) applies to the transfer of a partnership interest by a foreign person, see §1.864(c)(8)-2(b).

(d) * * *

(3) *Transfers of partnership interests by foreign persons*. For notifications re-

quired by foreign transferors of partnership interests, see §1.864(c)(8)-2(a).

* * * * *

(h) *Applicability date*. Paragraphs (c)(2) and (3) of this section apply to returns filed on or after the date that these regulations are published as final regulations in the **Federal Register**. Paragraph (d)(3) of this section applies to transfers that occur on or after the date that these regulations are published as final regulations in the **Federal Register**.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 7, 2019, 4:15 p.m., and published in the issue of the Federal Register for May 13, 2019, 84 F.R. 21198)

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 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

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