

# INTERNAL REVENUE BULLETIN



## HIGHLIGHTS OF THIS ISSUE

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

### INCOME TAX

#### **REG-127203-15, page 918.**

Proposed regulations address transfers of appreciated property by United States persons (U.S. persons) to partnerships with foreign partners related to the transferor. The regulations override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under section 721(a) of the Internal Revenue Code (Code) pursuant to section 721(c) unless the partnership adopts the remedial method and certain other requirements are satisfied. The document also contains regulations under sections 197, 704, and 6038B that apply to certain transfers described in section 721. The regulations affect U.S. partners in domestic or foreign partnerships. The text of the proposed regulations is the same as temporary regulations published in TD 9814.

#### **REG-137604-07, page 920.**

The proposed regulations reflect changes to the Code relating to the dependency exemption. The proposed regulations also make conforming changes relating to the definition of surviving spouse and the definition of head of household, the tax tables for individuals, the child and dependent care credit, the earned income credit, the standard deduction, joint tax returns, and taxpayer identification numbers for children placed for adoption. To make the earned income credit and the dependency exemption easier for taxpayers to claim, the proposed regulations change the IRS's position regarding who may take the childless earned income credit and the source of support for certain payments originating as governmental payments. The proposed regulations also change the IRS's position regarding the adjusted income of a taxpayer filing a joint return to be consistent with other Code sections that require the filing of a joint return.

#### **Action On Decision 2017-01, page 868.**

Nonacquiescence to the holding that a limited partnership was not a farming syndicate because the sole shareholder of a limited partner S Corporation actively participated in the farming business.

**Bulletin No. 2017-7  
February 13, 2017**

#### **Notice 2017-16, page 913.**

This notice provides that, pursuant to the authority granted to the Secretary by § 35(g)(11)(B), a health coverage tax credit (HCTC) election for a month in 2016 may be made at any time before the expiration of the 3-year statute of limitation under § 6511 for such year, including on an amended income tax return. This extension of time is provided because, prior to its expiration, the HCTC did not require an election and the Treasury Department and the IRS are concerned that eligible taxpayers may not be aware of the requirement to affirmatively elect the HCTC for coverage provided in 2016.

#### **Rev. Proc. 2017-19, page 913.**

This revenue procedure provides a safe harbor under which the Service will respect certain Energy Savings Performance Contracts for the sale of electricity by an Energy Service Company to a Federal Agency as a service contract under § 7701(e)(3).

#### **Rev. Proc. 2017-24, page 916.**

This revenue procedure extends the relief provided under Rev. Proc. 2015-57, 2015-51 I.R.B. 863, to taxpayers who took out Federal student loans to finance attendance at a school owned by American Career Institutes, Inc. (ACI) and whose Federal student loans are discharged under the Department of Education's "Defense to Repayment" or "Closed School" discharge process. Further, this revenue procedure provides that the Internal Revenue Service (IRS) will not assert that the creditor must file information returns and furnish payee statements as a result of discharging these loans. This revenue procedure also modifies Rev. Proc. 2015-57 to provide that the IRS will not assert that creditors under that revenue procedure must file information returns and furnish payee statements as a result of discharges under the revenue procedure.

**(Continued on the next page)**

**T.D. 9811, page 869.**

This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code. Specifically, the final regulations modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

**T.D. 9814, page 878.**

Temporary regulations address transfers of appreciated property by United States persons (U.S. persons) to partnerships with foreign partners related to the transferor. The regulations override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under section 721(a) of the Internal Revenue Code (Code) pursuant to section 721(c) unless the partnership adopts the remedial method and certain other requirements are satisfied. The document also contains regulations under sections 197, 704, and 6038B that apply to certain transfers described in section 721. The regulations affect U.S. partners in domestic or foreign partnerships.

## EMPLOYEE PLANS

**T.D. 9811, page 869.**

This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code. Specifically, the final regulations modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

## ESTATE TAX

**T.D. 9811, page 869.**

This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code. Specifically, the final regulations modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

## GIFT TAX

**T.D. 9811, page 869.**

This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code. Specifically, the final regulations modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

## ADMINISTRATIVE

**Rev. Proc. 2017-23, page 915.**

This revenue procedure describes the process for filing Form 8975, Country-by-Country Report, and accompanying Schedules A, Tax Jurisdiction and Constituent Entity Information (collectively, Form 8975), by ultimate parent entities of U.S. multinational enterprise (MNE) groups for reporting periods beginning on or after January 1, 2016, but before the applicability date of § 1.6038-4 (early reporting periods).

# 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.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

## Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar

cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions. Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the **Internal Revenue Bulletin**.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both “acquiescence” and “acquiescence in result only” mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the

same controlling facts. However, “acquiescence” indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, “acquiescence in result only” indicates disagreement or concern with some or all of those reasons. “Nonacquiescence” signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a “nonacquiescence” indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Commissioner does NOT ACQUIESCE in the following decision:

**Burnett Ranches, Ltd v. United States,**<sup>1</sup>

753 F.3d 143 (5th Cir. 2014),  
aff’g 113 A.F.T.R.2d (RIA) 2014–2178 (N.D. Tex. 2012)

<sup>1</sup>Nonacquiescence to the holding that a limited partnership was not a farming syndicate because the sole shareholder of a limited partner S Corporation actively participated in the farming business.

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

26 CFR 1.1041-1: Basis of property acquired from a decedent

## T.D. 9811

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Application of Modified Carryover Basis to General Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code (Code). Specifically, the final regulations modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

DATES: *Effective Date:* The regulations are effective on January 19, 2017.

*Applicability Date:* The regulations are applicable on January 19, 2017.

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels at (202) 317-6859 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to 26 CFR part 1 under various provisions of the Code in response to statutory changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (EGTRRA) and the Tax Relief, Unemployment Insurance

Reauthorization, and Job Creation Act of 2010, Public Law 111-312 (TRUIRJA).

Section 501(a) of EGTRRA enacted section 2210 of the Code, which made chapter 11 (the estate tax) inapplicable to the estate of any decedent who died after 2009. Section 542 of EGTRRA also enacted section 1022. While section 1014 generally provides that the recipient's basis in property passing from a decedent is the fair market value of the property on the decedent's date of death, section 1022 sets forth a modified carryover basis system applicable after 2009 generally providing that the recipient's basis in property acquired from a decedent is the lesser of the decedent's adjusted basis in the property or the fair market value of the property on the decedent's date of death. Section 901(a) of EGTRRA, known as the "sunset clause", provided that all provisions of and amendments made by EGTRRA do not apply to estates of decedents dying, gifts made, or generation-skipping transfers after December 31, 2010. The sunset clause effectively limited the application of sections 501(a) and 542 of EGTRRA to 2010.

Section 301(a) of TRUIRJA, which became law on December 17, 2010, retroactively reinstated the estate tax and repealed section 1022 with respect to the estates of decedents who died in 2010. However, section 301(c) of TRUIRJA allowed the executor of the estate of a decedent who died in 2010 to elect to apply the Code and regulations thereunder as though section 301(a) of TRUIRJA did not apply with respect to chapter 11 and with respect to property acquired or passing from the decedent (within the meaning of section 1014(b) of the Code). Thus, section 301(c) of TRUIRJA allowed the executor of the estate of a decedent who died in 2010 to elect not to have the provisions of chapter 11 apply to the decedent's estate, but rather to have the provisions of section 1022 apply (a Section 1022 Election).

To provide executors with guidance regarding the making of a Section 1022 Election and certain other collateral issues arising from the determination of basis

under section 1022, on August 29, 2011, the Treasury Department and the IRS issued Notice 2011-66 (2011-35 IRB 184) and Revenue Procedure 2011-41 (2011-35 IRB 188). Although section 1022 was applicable only to decedents dying in calendar year 2010, basis determined pursuant to that section will continue to be relevant until all of the property whose basis is determined under that section has been sold or otherwise disposed of in a transaction in which gain or loss is recognized. Accordingly, on May 11, 2015, the Treasury Department and the IRS published in the **Federal Register** (80 FR 26873) a notice of proposed rulemaking (REG-107595-11, 2015-21 IRB 986) proposing amendments to existing regulations under various sections of the Code to take into account the application of the modified carryover basis rules of section 1022. The IRS received written comments responding to the notice of proposed rulemaking. No public hearing was requested or held.

After consideration of the comments received on the proposed regulations, this Treasury decision adopts the proposed regulations without modification as final regulations. However, the final regulations adopt certain nonsubstantive, clarifying changes. The comments received on the proposed regulations are discussed in the remainder of this preamble.

#### Summary of Comments

One commenter noted that the proposed regulations proposed to amend § 1.742-1 to provide that the basis of a partnership interest acquired from a decedent is determined under section 1022 if the decedent died in 2010 and the decedent's executor made a Section 1022 Election with respect to the decedent's estate. The commenter noted that there was no similar amendment proposed to be made to § 1.1367-1(j), relating to the basis of stock of an S corporation where a portion of the value of the stock is attributable to items constituting income in respect of a decedent (IRD). The commenter recommended that the final regulations



amend § 1.1367-1(j) with language referencing section 1022.

After considering this comment, the Treasury Department and the IRS have determined that no change is necessary. Section 1.1367-1(j) states, “[t]he basis determined under section 1014 of any stock in an S corporation is reduced by the portion of the value of the stock that is attributable to items constituting income in respect of a decedent.” This regulation section, with its required basis adjustment for IRD, is limited to situations in which section 1014 applies. Section 1.1367-1(j) does not apply when a Section 1022 Election is made because there is no basis adjustment under section 1022 to the date of death value of S corporation stock. Without an adjustment to date of death value, no further adjustment to the basis of S corporation stock is required to account for IRD. Therefore, the final regulations do not adopt this comment.

A commenter noted that the proposed regulations only propose amendments to finalized regulations, and not to proposed regulations or temporary regulations. That commenter specifically requested guidance with respect to proposed regulation § 1.465-69(a) (which provides that a successor to a decedent’s amount at risk in an activity is increased by the amount by which the successor’s basis in the activity is increased under section 1014) and temporary regulation § 16A.1255-2(b)(2) (which provides that if, as of the date a person acquires section 126 property from a decedent, the basis of the property is determined under section 1014, then on that date the aggregate of excludable portions under section 126 in the hands of such transferee is zero). This Treasury decision cannot modify provisions of the proposed or temporary regulations referenced by the commenter without adopting those provisions as final or temporary regulations. The Treasury Department and the IRS continue to study these areas, and therefore are not prepared to adopt modifications to the proposed or temporary regulations referenced by the commenter at this time. Accordingly, the final regulations do not adopt this comment. However, the Treasury Department and the IRS expect that, if those proposed or temporary regulations are adopted as final or temporary regulations in the future, such

regulations will be updated as appropriate to account for the existence of section 1022.

Another commenter asked why the preamble to the proposed regulations omitted any discussion of the revisions made to regulations under six particular sections of the Code, and requested an explanation as to why changes to those regulatory provisions were considered less significant than the changes for which an explanation was given. Generally, the Treasury Department and the IRS included descriptions of the proposed changes in that preamble that involved more than a mere insertion of a reference to section 1022 in addition to an existing reference to section 1014. In such cases, it was determined that an explanation or clarification of the substance or effect of the proposed revision would be helpful. In the case of the proposed amendments to regulations under the six Code sections mentioned by the commenter, the only change proposed was the mere insertion of references to section 1022 in addition to existing references to section 1014. Accordingly, the Treasury Department and the IRS determined that no further explanation of those changes was necessary.

A commenter also asked why the proposed regulations did not incorporate the treatment of items under the various Code sections addressed in Revenue Procedure 2011-41, 2011-35 IRB 188. That revenue procedure provides a safe harbor that determines the effect on the application of various Code sections of a Section 1022 Election. The provisions relating to that safe harbor are available only if the executor of the estate makes a Section 1022 Election and takes no position contrary to a provision in that revenue procedure. Nothing in these final regulations changes or invalidates the provisions of Revenue Procedure 2011-41, so the safe harbor will remain available to qualifying taxpayers. Consequently, it is unnecessary to incorporate the revenue procedure into these regulations.

### Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment

is not required. The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these final regulations because the final regulations do not impose a collection of information requirement on small entities. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

### Drafting Information

The principal author of these final regulations is Mayer R. Samuels, Office of the Associate Chief Counsel (Pass-throughs and Special Industries). Other personnel from the Treasury Department and the IRS 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 1.48-12 is amended by revising the last sentence of paragraph (b)(2)(vii)(B) and adding paragraph (g) to read as follows:

*§ 1.48-12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(vii) \* \* \*

(B) \* \* \* If a transferee’s basis is determined under section 1014 or section 1022, any expenditures incurred by the decedent within the measuring period that are treated as having been incurred by the transferee under paragraph (c)(3)(ii) of this section shall decrease the transferee’s basis for purposes of the substantial rehabilitation test.

\* \* \* \* \*

(g) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.48-12 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 3. Section 1.83-4 is amended by revising the last sentence of paragraph (b)(1) and adding paragraph (d) to read as follows:

§ 1.83-4 *Special rules.*

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \* Such basis shall also reflect any adjustments to basis provided under sections 1015, 1016, and 1022.

\* \* \* \* \*

(d) *Effective/applicability date.* The provisions in this section are applicable for taxable years beginning on or after July 21, 1978. The provisions of paragraph (b)(1) of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 4. Section 1.179-4 is amended by revising the first sentence of paragraph (c)(1)(iv) to read as follows:

§ 1.179-4 *Definitions.*

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(iv) The property is not acquired by purchase if the basis of the property in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, is determined under section 1014(a), relating to property acquired from a decedent, or is determined under section 1022, relating to property acquired from certain decedents who died in 2010. \* \* \*

\* \* \* \* \*

Par. 5. Section 1.179-6 is amended by:

1. Revising the section heading and the first sentence of paragraph (a).
2. Adding paragraph (d).

The revision and addition read as follows:

§ 1.179-6 *Effective/applicability dates.*

(a) \* \* \* Except as provided in paragraphs (b), (c), and (d) of this section, the provisions of §§ 1.179-1 through 1.179-5 apply for property placed in service by the taxpayer in taxable years ending after January 25, 1993. \* \* \*

\* \* \* \* \*

(d) *Application of § 1.179-4(c)(1)(iv).* The provisions of § 1.179-4(c)(1)(iv) relating to section 1022 are effective on and after January 19, 2017.

Par. 6. Section 1.197-2 is amended by revising paragraphs (h)(5)(i) and (h)(12)(viii) and adding paragraph (l)(5) to read as follows:

§ 1.197-2 *Amortization of goodwill and certain other intangibles.*

\* \* \* \* \*

(h) \* \* \*

(5) \* \* \*

(i) The acquisition of a section 197(f)(9) intangible if the acquiring taxpayer's basis in the intangible is determined under section 1014(a) or 1022; or

\* \* \* \* \*

(12) \* \* \*

(viii) *Operating rule for transfers upon death.* For purposes of this paragraph (h)(12), if the basis of a partner's interest in a partnership is determined under section 1014(a) or 1022, such partner is treated as acquiring such interest from a person who is not related to such partner, and such interest is treated as having previously been held by a person who is not related to such partner.

\* \* \* \* \*

(1) \* \* \*

(5) *Application of section 1022.* The provisions of § 1.197-2(h)(5)(i) and (h)(12)(viii) relating to section 1022 are effective on and after January 19, 2017.

Par. 7. Section 1.267(d)-1 is amended by revising paragraph (a)(3) to read as follows:

§ 1.267(d)-1 *Amount of gain where loss previously disallowed.*

(a) \* \* \*

(3) The benefit of the general rule is available only to the original transferee but does not apply to any original trans-

feree (for example, a donee or a person acquiring property from a decedent where the basis of property is determined under section 1014 or 1022) who acquired the property in any manner other than by purchase or exchange.

\* \* \* \* \*

Par. 8. Section 1.267(d)-2 is amended by revising the section heading and adding a sentence to the end of the paragraph to read as follows:

§ 1.267(d)-2 *Effective/applicability dates.*

\* \* \* The provisions of § 1.267(d)-1(a)(3) relating to section 1022 are effective on and after January 19, 2017.

Par. 9. Section 1.273-1 is revised to read as follows:

§ 1.273-1 *Life or terminable interests.*

(a) *In general.* Amounts paid as income to the holder of a life or a terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called by depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deduction for shrinkage or exhaustion thereof due to the passage of time. For the treatment generally of distributions to beneficiaries of an estate or trust, see Subparts A, B, C, and D (section 641 and following), Subchapter J, Chapter 1 of the Code, and the regulations thereunder. For basis of property acquired from a decedent and by gifts and transfers in trust, see sections 1014, 1015, and 1022, and the regulations thereunder.

(b) *Effective/applicability date.* The provisions in this section are applicable for taxable years beginning on or after September 16, 1958. The provisions of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 10. Section 1.306-3 is amended by removing the last sentence of paragraph (e) and adding two sentences in its place to read as follows:

§ 1.306-3 Section 306 stock defined.

\* \* \* \* \*

(e) \* \* \* Section 306 stock ceases to be so classified if the basis of such stock is determined by reference to its fair market value on the date of the decedent-stockholder's death under section 1014 or the optional valuation date under section 2032. Section 306 stock continues to be so classified if the basis of such stock is determined under section 1022.

\* \* \* \* \*

Par. 11. Section 1.306-4 is added to read as follows:

§ 1.306-4 Effective/applicability date.

The provisions of §§ 1.306-1 through 1.306-3 are applicable on or after June 22, 1954. The provisions of § 1.306-3 relating to section 1022 are effective on and after January 19, 2017.

Par. 12. Section 1.336-1 is amended by revising paragraph (b)(5)(i)(A) to read as follows:

§ 1.336-1 General principles, nomenclature, and definitions for a section 336(e) election.

\* \* \* \* \*

- (b) \* \* \*
- (5) \* \* \*
- (i) \* \* \*

(A) The basis of the stock in the hands of the purchaser is not determined in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom the stock is acquired, is not determined under section 1014(a) (relating to property acquired from a decedent), or is not determined under section 1022 (relating to the basis of property acquired from certain decedents who died in 2010);

\* \* \* \* \*

Par. 13. Section 1.336-5 is amended by revising the section heading and adding a sentence to the end of the paragraph to read as follows:

§ 1.336-5 Effective/applicability dates.

\* \* \* The provisions of § 1.336-1(b)(5)(i)(A) relating to section 1022 are effective on and after January 19, 2017.

Par. 14. Section 1.355-6 is amended by revising paragraphs (d)(1)(i)(A)(2) and (g) to read as follows:

§ 1.355-6 Recognition of gain on certain distributions of stock or securities in controlled corporation.

\* \* \* \* \*

- (d) \* \* \*
- (1) \* \* \*
- (i) \* \* \*
- (A) \* \* \*

(2) Under section 1014(a) or 1022; and

\* \* \* \* \*

(g) *Effective/applicability dates.* This section applies to distributions occurring after December 20, 2000, except that they do not apply to any distributions occurring pursuant to a written agreement that is (subject to customary conditions) binding on December 20, 2000, and at all later times. The provisions of paragraph (d)(1)(i)(A)(2) of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 15. Section 1.382-1 is amended by revising the entry for § 1.382-9(d)(6) to read as follows:

§ 1.382-9 Special rules under section 382 for corporations under the jurisdiction of a court in a title 11 or similar case.

\*\*\*\*\*

- (d) \*\*\*\*
- (6) Effective/applicability date.

\*\*\*\*\*

Par. 16. Section 1.382-9 is amended by revising paragraphs (d)(5)(ii)(D) and (d)(6)(i) to read as follows:

§ 1.382-9 Special rules under section 382 for corporations under the jurisdiction of a court in a title 11 or similar case.

\* \* \* \* \*

- (d) \* \* \*
- (5) \* \* \*
- (ii) \* \* \*

(D) The transferee's basis in the indebtedness is determined under section 1014, 1015, or 1022 or with reference to the transferor's basis in the indebtedness;

\* \* \* \* \*

(6) *Effective/applicability date*—(i) *In general.* This paragraph (d) applies to ownership changes occurring on or after March 17, 1994. The provisions of paragraph (d)(5)(ii)(D) of this section relating to section 1022 are effective on and after January 19, 2017.

\* \* \* \* \*

Par. 17. Section 1.421-2 is amended by:

1. Revising paragraphs (c)(4)(i)(a) and (c)(4)(ii).
2. Revising the heading of paragraph (f) and adding paragraph (f)(3).

The revisions and addition read as follows:

§ 1.421-2 General rules.

\* \* \* \* \*

- (c) \* \* \*

(4)(i)(a) In the case of the death of an optionee, the basis of any share of stock acquired by the exercise of an option under this paragraph (c), determined under section 1011, shall be increased by an amount equal to the portion of the basis of the option attributable to such share. For example, if a statutory option to acquire 10 shares of stock has a basis of \$100, the basis of one share acquired by a partial exercise of the option, determined under section 1011, would be increased by 1/10th of \$100, or \$10. The option acquires a basis, determined under section 1014(a) or under section 1022, if applicable, only if the transfer of the share pursuant to the exercise of such option qualifies for the special tax treatment provided by section 421(a). To the extent the option is so exercised, in whole or in part, it will acquire a basis equal to its fair market value (or the basis as determined under section 1022, if applicable) at the date of the employee's death or, if an election is made under section 2032, its value at its applicable valuation date. In certain cases, the basis of the share is subject to the adjustments provided by paragraphs (c)(4)(i)(b) and (c) of this section, but such adjustments are only applicable in the case of an option that is subject to section 423(c).

\* \* \* \* \*

(ii) If a statutory option is not exercised by the estate of the individual to whom the



option was granted, or by the person who acquired such option by bequest or inheritance or by reason of the death of such individual, the option shall be considered to be property that constitutes a right to receive an item of income in respect of a decedent to which the rules of sections 691 and 1014(c) (or section 1022(f), if applicable) apply.

\*\*\*\*\*

(f) *Effective/applicability date.* \* \* \*

(3) *Application of section 1022.* The provisions of paragraph (c) of this section relating to section 1022 are effective on and after [January 19, 2017.

Par. 18. Section 1.423-2 is amended by:

1. Revising the third sentence of paragraph (k)(2).

2. Adding a sentence to the end of paragraph (l).

The revision and addition read as follows:

*§ 1.423-2 Employee stock purchase plan defined.*

\*\*\*\*\*

(k) \* \* \*

(2) \* \* \* If the special rules provided in this paragraph (k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014 or under section 1022, if applicable, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in the decedent's gross income under this paragraph (k). \* \* \*

\*\*\*\*\*

(l) \* \* \* The provisions of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 19. Section 1.424-1 is amended by revising the last sentence of paragraph (c)(2) and adding paragraph (g)(3) to read as follows:

*§ 1.424-1 Definitions and special rules applicable to statutory options.*

\*\*\*\*\*

(c) \* \* \*

(2) \* \* \* For determination of basis in the hands of the survivor where joint ownership is terminated by the death of one of the owners, see section 1014 or section 1022, if applicable.

\*\*\*\*\*

(g) \* \* \*

(3) *Application of section 1022.* The provisions of paragraph (c)(2) of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 20. Section 1.467-7 is amended by revising paragraph (c)(2) and revising the first sentence of paragraph (c)(4) to read as follows:

*§ 1.467-7 Section 467 recapture and other rules relating to dispositions and modifications.*

\*\*\*\*\*

(c) \* \* \*

(2) *Dispositions at death.* Paragraph (a) of this section does not apply to a disposition if the basis of the property in the hands of the transferee is determined under section 1014(a) or section 1022. However, see paragraph (c)(4) of this section for dispositions of property subject to section 1022 by transferees. This paragraph (c)(2) does not apply to property that constitutes a right to receive an item of income in respect of a decedent. See sections 691, 1014(c), and 1022(f).

\*\*\*\*\*

(4) \* \* \* If the recapture amount with respect to a disposition of property (the first disposition) is limited under paragraph (c)(1) or (c)(3) of this section, or under paragraph (c)(2) of this section because the basis of the property in the hands of the transferee is determined under section 1022, and the transferee subsequently disposes of the property in a transaction to which paragraph (a) of this section applies, the prior understated inclusion determined under paragraph (b)(2) of this section is computed by taking into account the amounts attributable to the period of the transferor's ownership of the property prior to the first disposition. \* \* \*

\*\*\*\*\*

Par. 21. Section 1.467-9 is amended by revising the section heading and adding paragraph (f) to read as follows:

*§ 1.467-9 Effective/applicability dates and automatic method changes for certain agreements.*

\*\*\*\*\*

(f) *Application of section 1022.* The provisions of § 1.467-7(c)(2) and (4) relating to section 1022 are effective on and after January 19, 2017.

Par. 22. Section 1.617-3 is amended by revising paragraph (d)(5)(ii)(b) to read as follows:

*§ 1.617-3 Recapture of exploration expenditures.*

\*\*\*\*\*

(d) \* \* \*

(5) \* \* \*

(ii) \* \* \*

(b) The transactions referred to in paragraph (d)(5)(ii)(a) of this section are:

(1) A disposition that is in part a sale or exchange and in part a gift;

(2) A disposition that is described in section 617(d) through the incorporation by reference of the provisions of section 1245(b)(3) (relating to certain tax free transactions); or

(3) A transfer at death where basis of property in the hands of the transferee is determined under section 1022.

\*\*\*\*\*

Par. 23. Section 1.617-4 is amended by revising the second sentence of paragraph (c)(1)(i) to read as follows:

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

\*\*\*\*\*

(c) \* \* \*

(1)(i) \* \* \* For purposes of this paragraph (c), the term *gift* means, except to the extent that paragraph (c)(1)(ii) of this section applies, a transfer of mining property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010). \* \* \*

\*\*\*\*\*

Par. 24. Section 1.617-5 is added to read as follows:

§ 1.617-5 *Effective/applicability date.*

Sections 1.617-3 and 1.617-4 apply on and after January 19, 2017. For rules before January 19, 2017, see §§ 1.617-3 and 1.617-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 25. Section 1.684-3 is amended by revising paragraph (c) to read as follows:

§ 1.684-3 *Exceptions to general rule of gain recognition.*

\* \* \* \* \*

(c) *Certain transfers at death*—(1) *Section 1014 basis.* The general rule of gain recognition under § 1.684-1 shall not apply to any transfer of property to a foreign trust or foreign estate or, in the case of a transfer of property by a U.S. transferor decedent dying in 2010, to a foreign trust, foreign estate, or a nonresident alien, by reason of death of the U.S. transferor, if the basis of the property in the hands of the transferee is determined under section 1014(a).

(2) *Section 1022 basis election.* For U.S. transferor decedents dying in 2010, the general rule of gain recognition under § 1.684-1 shall apply to any transfer of property by reason of death of the U.S. transferor if the basis of the property in the hands of the foreign trust, foreign estate, or the nonresident alien individual is determined under section 1022. The gain on the transfer shall be calculated as set out under § 1.684-1(a), except that adjusted basis will reflect any increases allocated to such property under section 1022.

\* \* \* \* \*

Par. 26. Section 1.684-5 is revised to read as follows:

§ 1.684-5 *Effective/applicability dates.*

(a) Sections 1.684-1 through 1.684-4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000, except as provided in paragraph (b) of this section.

(b) In the case a U.S. transferor decedent dying in 2010, § 1.684-3(c) applies to transfers of property to foreign trusts, foreign estates, and nonresident aliens af-

ter December 31, 2009, and before January 1, 2011.

Par. 27. Section 1.691(a)-3 is amended by revising the last two sentences of paragraph (a) and adding paragraph (c) to read as follows:

§ 1.691(a)-3 *Character of gross income.*

(a) \* \* \* The provisions of section 1014(a), relating to the basis of property acquired from a decedent, and section 1022, relating to the basis of property acquired from certain decedents who died in 2010, do not apply to these amounts in the hands of the estate and such persons. See sections 1014(c) and 1022(f).

\* \* \* \* \*

(c) *Effective/applicability dates.* The last two sentences of paragraph (a) of this section apply on and after January 19, 2017. For rules before January 19, 2017, see § 1.691(a)-3 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 28. Section 1.742-1 is revised to read as follows:

§ 1.742-1 *Basis of transferee partner's interest.*

(a) *In general.* The basis to a transferee partner of an interest in a partnership shall be determined under the general basis rules for property provided by part II (section 1011 and following), Subchapter O, Chapter 1 of the Internal Revenue Code. Thus, the basis of a purchased interest will be its cost. Generally, the basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death or at the alternate valuation date, increased by his estate's or other successor's share of partnership liabilities, if any, on that date, and reduced to the extent that such value is attributable to items constituting income in respect of a decedent (see section 753 and §§ 1.706-1(c)(3)(v) and 1.753-1(b)) under section 691. See section 1014(c). However, the basis of a partnership interest acquired from a decedent is determined under section 1022 if the decedent died in 2010 and the decedent's executor elected to have section 1022 apply to the decedent's estate. For basis of contributing partner's interest, see section 722. The basis so de-

termined is then subject to the adjustments provided in section 705.

(b) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.742-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 29. Section 1.743-1 is amended by revising paragraphs (k)(2)(ii) and (l) to read as follows:

§ 1.743-1 *Optional adjustment to basis of partnership property.*

\* \* \* \* \*

(k) \* \* \*

(2) \* \* \*

(ii) *Special rule.* A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner. The written notice to the partnership must be signed under penalties of perjury and must include the names and addresses of the deceased partner and the transferee, the taxpayer identification numbers of the deceased partner and the transferee, the relationship (if any) between the transferee and the transferor, the deceased partner's date of death, the date on which the transferee became the owner of the partnership interest, the fair market value of the partnership interest on the applicable date of valuation set forth in section 1014 or section 1022, the manner in which the fair market value of the partnership interest was determined, and the carryover basis as adjusted under section 1022 (if applicable).

\* \* \* \* \*

(l) *Effective/applicability date.* The provisions in this section apply to transfers of partnership interests that occur on or after December 15, 1999. The provisions of this section relating to section 1022 are effective on and after January 19, 2017.

Par. 30. Section 1.755-1 is amended by:

1. Revising paragraphs (a)(4)(i)(C) and the first sentence of (b)(4)(i).
2. Revising the heading of paragraph (e) and paragraph (e)(2).

The revisions read as follows:

§ 1.755-1 Rules for allocation of basis.

- (a) \* \* \*
- (4) \* \* \*
- (i) \* \* \*

(C) *Income in respect of a decedent.* Solely for the purpose of determining partnership gross value under this paragraph (a)(4)(i), where a partnership interest is transferred as a result of the death of a partner, the transferee's basis in its partnership interest is determined without regard to section 1014(c) or section 1022(f), and is deemed to be adjusted for that portion of the interest, if any, that is attributable to items representing income in respect of a decedent under section 691.

- (b) \* \* \*
- (4) \* \* \*

(i) \* \* \* Where a partnership interest is transferred as a result of the death of a partner, under section 1014(c) or section 1022(f), the transferee's basis in its partnership interest is not adjusted for that portion of the interest, if any, that is attributable to items representing income in respect of a decedent under section 691.

(e) *Effective/applicability dates.* \* \* \*

(2) *Special rules.* Paragraphs (a) and (b)(3)(iii) of this section apply to transfers of partnership interests and distributions of property from a partnership that occur on or after June 9, 2003. The provisions of paragraphs (a)(4)(i)(C) and (b)(4)(i) of this section relating to section 1022 are effective on and after the date January 19, 2017.

Par. 31. Section 1.995-4 is amended by revising the first sentence of paragraph (d)(2) and adding paragraph (f) to read as follows:

§ 1.995-4 Gain on disposition of stock in a DISC.

\* \* \* \* \*

- (d) \* \* \*

(2) \* \* \* For purposes of this section, the period during which a shareholder has held stock includes the period he is considered to have held it by reason of the application of section 1223 and, if his basis is determined in whole or in part under the provisions of section 1014(d) (relating to special rule for DISC stock

acquired from decedent) or section 1022 (relating to property acquired from certain decedents who died in 2010), the holding period of the decedent.

(f) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.995-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 32. Section 1.1001-1 is amended by revising the last sentence of paragraph (a), revising paragraph (f)(1), and adding paragraph (i) to read as follows:

§ 1.1001-1 Computation of gain or loss.

(a) \* \* \* Section 1001(e) and paragraph (f) of this section prescribe the method of computing gain or loss upon the sale or other disposition of a term interest in property the adjusted basis (or a portion) of which is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust), or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010).

\* \* \* \* \*

- (f) \* \* \*

(1) *General rule.* Except as otherwise provided in paragraph (f)(3) of this section, for purposes of determining gain or loss from the sale or other disposition after October 9, 1969, of a term interest in property (as defined in paragraph (f)(2) of this section), a taxpayer shall not take into account that portion of the adjusted basis of such interest that is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust), or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010) to the extent that such adjusted basis is a portion of the adjusted uniform basis of the entire property (as defined in § 1.1014-5). Where a term interest in property is transferred to a corporation in connection with a transaction to which section 351 applies and the adjusted basis of the term interest:

- (i) Is determined pursuant to sections 1014, 1015, or 1022; and

(ii) Is also a portion of the adjusted uniform basis of the entire property, a subsequent sale or other disposition of such term interest by the corporation will be subject to the provisions of section 1001(e) and this paragraph (f) to the extent that the basis of the term interest so sold or otherwise disposed of is determined by reference to its basis in the hands of the transferor as provided by section 362(a). See paragraph (f)(2) of this section for rules relating to the characterization of stock received by the transferor of a term interest in property in connection with a transaction to which section 351 applies. That portion of the adjusted uniform basis of the entire property that is assignable to such interest at the time of its sale or other disposition shall be determined under the rules provided in § 1.1014-5. Thus, gain or loss realized from a sale or other disposition of a term interest in property shall be determined by comparing the amount of the proceeds of such sale with that part of the adjusted basis of such interest that is not a portion of the adjusted uniform basis of the entire property.

\* \* \* \* \*

(i) *Effective/applicability date.* Except as provided in paragraphs (g) and (h) of this section, this section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1001-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par.33. Section 1.1014-1 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§ 1.1014-1 Basis of property acquired from a decedent.

(a) *General rule.* The purpose of section 1014 is, in general, to provide a basis for property acquired from a decedent that is equal to the value placed upon such property for purposes of the federal estate tax. Accordingly, the general rule is that the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death, or, if the decedent's executor so elects, at the alternate valuation date prescribed in section 2032, or in section 811(j) of the Internal Revenue Code (Code) of 1939. However, the basis of



property acquired from certain decedents who died in 2010 is determined under section 1022, if the decedent's executor made an election under section 301(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-312 (124 Stat. 3296, 3300 (2010)). See section 1022. Property acquired from a decedent includes, principally, property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1953, property required to be included in determining the value of the decedent's gross estate under any provision of the Code of 1954 or the Code of 1939. The general rule governing basis of property acquired from a decedent, as well as other rules prescribed elsewhere in this section, shall have no application if the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent. For general rules on the applicable valuation date where the executor of a decedent's estate elects under section 2032, or under section 811(j) of the Code of 1939, to value the decedent's gross estate at the alternate valuation date prescribed in such sections, see § 1.1014-3(e).

\* \* \* \* \*

(d) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1014-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 34. Section 1.1014-4 is amended by revising the first sentence of paragraph (a)(1), revising the second sentence of paragraph (a)(2), and adding paragraph (d) to read as follows:

*§ 1.1014-4 Uniformity of basis; adjustment to basis.*

(a) \* \* \*

(1) The basis of property acquired from a decedent, as determined under section 1014(a) or section 1022, is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or other instrument or under the laws of descent and distribution. \* \* \*

(2) \* \* \* Accordingly, there is a common acquisition date for all titles to property acquired from a decedent within the

meaning of section 1014 or section 1022, and, for this reason, a common or uniform basis for all such interests. \* \* \*

\* \* \* \* \*

(d) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1014-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 35. Section 1.1014-5 is amended by revising paragraph (b) to read as follows:

*§ 1.1014-5 Gain or loss.*

\* \* \* \* \*

(b) *Sale or other disposition of certain term interests—(1) In general.* In determining gain or loss from the sale or other disposition after October 9, 1969, of a term interest in property (as defined in § 1.1001-1(f)(2)) the adjusted basis of which is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust), or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010), that part of the adjusted uniform basis assignable under the rules of paragraph (a) of this section to the interest sold or otherwise disposed of shall be disregarded to the extent and in the manner provided by section 1001(e) and § 1.1001-1(f).

(2) *Effective/applicability date.* The provisions of paragraph (b)(1) of this section relating to section 1022 are effective on and after January 19, 2017. For rules before January 19, 2017, see § 1.1014-5 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 36. Section 1.1223-1 is amended by adding a sentence to the end of paragraph (b) and adding paragraph (l) to read as follows:

*§ 1.1223-1 Determination of period for which capital assets are held.*

\* \* \* \* \*

(b) \* \* \* Similarly, the period for which property acquired from a decedent who died in 2010 was held by the decedent must be included in determining the period during which the property was held

by the recipient, if the recipient's basis in the property is determined under section 1022.

\* \* \* \* \*

(l) *Effective/applicability date.* This section applies January 23, 2017. For rules before January 19, 2017, see § 1.1223-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 37. Section 1.1245-2 is amended by revising paragraph (c)(2)(ii) and adding paragraph (d) to read as follows:

*§ 1.1245-2 Definition of recomputed basis.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) The transactions referred to in paragraph (c)(2)(i) of this section are:

(A) A disposition that is in part a sale or exchange and in part a gift (see § 1.1245-4(a)(3));

(B) A disposition (other than a disposition to which section 1245(b)(6)(A) applies) that is described in section 1245(b)(3) (relating to certain tax-free transactions);

(C) An exchange described in § 1.1245-4(e)(2) (relating to transfers described in section 1081(d)(1)(A)); or

(D) A transfer at death where the basis of property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

(d) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1245-2 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 38. Section 1.1245-3 is amended by revising paragraph (a)(3) and adding paragraph (d) to read as follows:

*§ 1.1245-3 Definition of section 1245 property.*

(a) \* \* \*

(3) Even though property may not be of a character subject to the allowance for depreciation in the hands of the taxpayer, such property may nevertheless be section 1245 property if the taxpayer's basis for the property is determined by reference to its basis in the hands of a prior owner of the property and such property was of a



character subject to the allowance for depreciation in the hands of such prior owner, or if the taxpayer's basis for the property is determined by reference to the basis of other property that in the hands of the taxpayer was property of a character subject to the allowance for depreciation, or if the taxpayer's basis for the property is determined under section 1022 and such property was of a character subject to the allowance for depreciation in the hands of the decedent. Thus, for example, if a father uses an automobile in his trade or business during a period after December 31, 1961, and then gives the automobile to his son as a gift for the son's personal use, the automobile is section 1245 property in the hands of the son.

\* \* \* \* \*

(d) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1245-3 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 39. Section 1.1245-4 is amended by revising the second sentence of paragraph (a)(1) and adding paragraph (i) to read as follows:

§ 1.1245-4 *Exceptions and Limitations.*

(a) \* \* \*

(1) \* \* \* For purposes of this paragraph (a), the term *gift* means, except to the extent that paragraph (a)(3) of this section applies, a transfer of property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gifts) or section 1022 (relating to basis of property acquired from certain decedents who died in 2010). \* \* \*

\* \* \* \* \*

(i) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1245-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 40. Section 1.1250-4 is amended by adding paragraphs (c)(5) and (h) to read as follows:

§ 1.1250-4 *Holding period.*

\* \* \* \* \*

(c) \* \* \*

(5) A transfer at death where the basis of the property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

(h) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1250-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 41. Section 1.1254-2 is amended by revising the second sentence of paragraph (a)(1) to read as follows:

§ 1.1254-2 *Exceptions and limitations.*

(a) \* \* \*

(1) \* \* \* For purposes of this paragraph (a), the term *gift* means, except to the extent that paragraph (a)(2) of this section applies, a transfer of natural resource recapture property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010). \* \* \*

\* \* \* \* \*

Par. 42. Section 1.1254-3 is amended by revising paragraphs (b)(2)(ii) and (iii) and adding paragraph (b)(2)(iv) to read as follows:

§ 1.1254-3 *Section 1254 costs immediately after certain acquisitions.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(ii) A transaction described in section 1041(a);

(iii) A disposition described in § 1.1254-2(c)(3) (relating to certain tax-free transactions); or

(iv) A transfer at death where basis of property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

Par. 43. Section 1.1254-4 is amended by revising paragraph (e)(4) introductory text to read as follows:

§ 1.1254-4 *Special rules for S corporations and their shareholders.*

\* \* \* \* \*

(e) \* \* \*

(4) \* \* \* If stock is acquired in a transfer that is a gift, in a transfer that is a part sale or exchange and part gift, in a transfer that is described in section 1041(a), or in a transfer at death where the basis of property in the hands of the transferee is determined under section 1022, the amount of section 1254 costs with respect to the property held by the corporation in the acquiring shareholder's hands immediately after the transfer is an amount equal to—

\* \* \* \* \*

Par. 44. Section 1.1254-5 is amended by revising paragraph (c)(2)(iv) introductory text to read as follows:

§ 1.1254-5 *Special rules for partnerships and their partners.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iv) \* \* \* If an interest in a partnership is transferred in a transfer that is a gift, in a transfer that is a part sale or exchange and part gift, in a transfer that is described in section 1041(a), or in a transfer at death where the basis of property in the hands of the transferee is determined under section 1022, the amount of the transferee partner's section 1254 costs with respect to property held by the partnership immediately after the transfer is an amount equal to—

\* \* \* \* \*

Par. 45. Section 1.1254-6 is revised to read as follows:

§ 1.1254-6 *Effective/applicability date.*

(a) Sections 1.1254-1 through 1.1254-3 and 1.1254-5 are effective with respect to any disposition of natural resource recapture property occurring after March 13, 1995. The rule in § 1.1254-1(b)(2)(iv)(A)(2), relating to a nonoperating mineral interest carved out of an operating mineral interest with respect to which an expenditure has been deducted, is effective with respect to any disposition occurring after March 13, 1995, of property (within the meaning of section 614) that is placed in service by the taxpayer after December 31, 1986. Section 1.1254-4 applies to dispositions of natural resource recapture property by an S

corporation (and a corporation that was formerly an S corporation) and dispositions of S corporation stock occurring on or after October 10, 1996. Sections 1.1254-2(d)(1)(ii) and 1.1254-3(b)(1)(i), (b)(1)(ii), (d)(1)(i), and (d)(1)(ii) are effective for dispositions of property occurring on or after October 10, 1996.

(b) The provisions of §§ 1.1254-2(a)(1), 1.1254-3(b)(2), 1.1254-4(e)(4), and 1.1254-5(c)(2)(iv) that relate to section 1022 are effective on and after January 19, 2017.

Par. 46. Section 1.1296-1 is amended by revising paragraphs (d)(4) and (j) to read as follows:

§ 1.1296-1 *Mark to market election for marketable stock.*

\* \* \* \* \*  
(d) \* \* \*

(4) *Stock acquired from a decedent.* In the case of stock of a PFIC that is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which a section 1296 election was in effect as of the date of the decedent's death, notwithstanding section 1014 or section 1022, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis that would have been determined under section 1014 or section 1022 without regard to this paragraph (d)).

\* \* \* \* \*

(j) *Effective/applicability date.* The provisions in this section are applicable for taxable years beginning on or after May 3, 2004. The provisions of paragraph (d)(4) of this section relating to section 1022 are effective on January 19, 2017.

Par. 47. Section 1.1312-7 is amended by revising paragraph (b) and adding paragraph (d) to read as follows:

§ 1.1312-7 *Basis of property after erroneous treatment of a prior transaction.*

\* \* \* \* \*

(b)(1) For this section to apply, the taxpayer with respect to whom the erroneous treatment occurred must be:

(i) The taxpayer with respect to whom the determination is made; or

(ii) A taxpayer who acquired title to the property in the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title in such a manner that he will have a basis ascertained by reference to the basis in the hands of the taxpayer who acquired title to the property in the erroneously treated transaction; or

(iii) A taxpayer who had title to the property at the time of the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010).

(2) No adjustment is authorized with respect to the transferor of the property in a transaction upon which the basis of the property depends, when the determination is with respect to the original transferee or a subsequent transferee of the original transferee.

\* \* \* \* \*

(d) *Effective/applicability date.* This section applies on and after January 19, 2017. For rules before January 19, 2017, see § 1.1312-7 as contained in 26 CFR part 1 revised as of April 1, 2016.

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

Approved: November 11, 2016.

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

(Filed by the Office of the Federal Register on January 18, 2017, 8:45 a.m., and published in the issue of the Federal Register for January 19, 2017, 82 F.R. 6235.)

**T.D. 9814**

**DEPARTMENT OF THE  
TREASURY  
Internal Revenue Service  
26 CFR Part 1**

**Transfers of Certain Property  
by U.S. Persons to  
Partnerships with Related  
Foreign Partners**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

**SUMMARY:** This document contains temporary regulations that address transfers of appreciated property by United States persons (U.S. persons) to partnerships with foreign partners related to the transferor. The regulations override the rules providing for nonrecognition of gain on a contribution of property to a partnership in exchange for an interest in the partnership under section 721(a) of the Internal Revenue Code (Code) pursuant to section 721(c) unless the partnership adopts the remedial method and certain other requirements are satisfied. The document also contains regulations under sections 197, 704, and 6038B that apply to certain transfers described in section 721. The regulations affect U.S. partners in domestic or foreign partnerships. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Internal Revenue Bulletin**. The final regulations revise and add cross-references to coordinate the application of the temporary regulations.

**DATES:** *Effective Date:* These regulations are effective on **January 18, 2017**.

*Applicability Dates:* For dates of applicability, see §§ 1.197-2T(1)(5)(i), 1.704-1T(f), 1.704-3T(g)(1), 1.721(c)-1T(e), 1.721(c)-2T(e), 1.721(c)-3T(e), 1.721(c)-4T(d), 1.721(c)-5T(g), 1.721(c)-6T(g), and 1.6038B-2T(j)(4)(i).

**FOR FURTHER INFORMATION CONTACT:** Concerning the temporary regula-

tions, Ryan A. Bowen, (202) 317-6937; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### **Paperwork Reduction Act**

The collection of information contained in the regulations is listed with the Office of Management and Budget under control numbers 1545-1668 and 1545-0123 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received *February 21, 2017*.

The collections of information are in §§ 1.721(c)-6T and 1.6038B-2T. The collections of information are mandatory. The likely respondents are domestic corporations. Burdens associated with these requirements will be reflected in the burden for Form 1065, U.S. Return of Partnership Income, and Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. Estimates for completing these forms can be located in the form instructions.

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.

##### **Background**

###### *I. Statutory Background*

Until they were repealed as part of the Taxpayer Relief Act of 1997 (the 1997 Act), Public Law 105-34 (111 Stat. 788), section 1131, sections 1491 through 1494 imposed an excise tax on certain transfers of appreciated property by a U.S. person to a foreign partnership, which generally was 35 percent of the amount of gain inherent in the property. Congress believed that the imposition of enhanced in-

formation reporting obligations (including sections 6038, 6038B, and 6046A) with respect to foreign partnerships would eliminate the need for sections 1491 through 1494. Staff of the Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997, Part Two: Taxpayer Relief Act of 1997 (H.R. 2014) (JCS-23-97) (Dec. 17, 1997), at 314-315.

Notwithstanding these enhanced information reporting requirements, the 1997 Act granted the Secretary regulatory authority in section 721(c) to override the application of the nonrecognition provision of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) if the gain, when recognized, would be includible in the gross income of a person other than a U.S. person. In the 1997 Act, Congress also enacted section 367(d)(3), which provides the Secretary regulatory authority to apply the rules of section 367(d)(2) to transfers of intangible property to partnerships in circumstances consistent with the purposes of section 367(d). Regulations have never been issued pursuant to section 721(c) or section 367(d)(3).

Congress enacted section 367 (and its predecessor) in order to prevent U.S. persons from avoiding U.S. tax by transferring appreciated property to foreign corporations using nonrecognition transactions. Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170, 98th Congress; Public Law 98-369) (JCS-41-84) (Dec. 31, 1984), at 427. The outbound transfer of intangible property raises additional issues that Congress also sought to address. Specifically, section 367(d) was enacted to prevent U.S. persons from transferring intangibles offshore in order to achieve deferral of U.S. tax on the profits generated by the intangibles. H.R. Rep. No. 98-432, 98th Cong., 2d Sess., at 1311-15 (1984). Under section 367(d), a U.S. person that transfers intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or section 361 is treated as having sold such property in exchange for payments that are contingent upon the productivity, use, or disposition of such property, and receiving

amounts that reasonably reflect the amounts that would have been received annually in the form of such payments over the useful life of the property, or, in the case of a disposition following the transfer (whether direct or indirect), at the time of the disposition. Section 367(d)(2)(A). The amounts taken into account must be commensurate with the income attributable to the intangible property. *Id.*

Section 721(a) provides a general rule that no gain or loss is recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership. Because section 367 applies only to the transfer of property to a foreign corporation, absent regulations under section 721(c) or section 367(d)(3), a U.S. person generally does not recognize gain on the contribution of appreciated property to a partnership with foreign partners.

Section 704(c)(1)(A) requires partnerships to allocate income, gain, loss, and deduction with respect to property contributed by a partner to the partnership so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of contribution.

###### *II. Regulatory Background*

Section 1.704-3(a)(1) provides that the purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution gain or loss (forward section 704(c) layer). In addition, partnerships may, but are not required to, revalue partnership property pursuant to § 1.704-1(b)(2)(iv)(f) or (s) upon the occurrence of enumerated events, such as the entry of a new partner by contribution, giving rise to a reverse section 704(c) layer. Section 1.704-3(a)(6)(i) provides that the principles of § 1.704-3 apply to allocations with respect to these reverse section 704(c) layers (reverse section 704(c) allocations).

Section 704(c) allocations must be made using any reasonable method consistent with the purpose of section 704(c). Section 1.704-3(a)(1). Section 1.704-3 describes three methods of making section 704(c) allocations that are generally reasonable, including the remedial allocation



method. *Id.* Under the remedial allocation method, a partnership may eliminate distortions caused by the ceiling rule (as described in § 1.704-3(b)(1)) by making remedial allocations of income, gain, loss, or deduction to the noncontributing partners equal to the full amount of the limitation caused by the ceiling rule, and offsetting those allocations with remedial allocations of income, gain, loss, or deduction to the contributing partner. See § 1.704-3(d)(1); see also T.D. 8585 (59 FR 66724). Under § 1.704-3(a)(10), an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse section 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequences of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability. However, § 1.704-3(d)(5)(ii) provides that, in exercising its authority under § 1.704-3(a)(10), the IRS will not require a partnership to use the remedial allocation method.

### III. Reasons for Exercising Regulatory Authority

The Treasury Department and the IRS are aware that certain taxpayers purport to be able to contribute, consistently with sections 704(b), 704(c), and 482, property to a partnership that allocates the income or gain from the contributed property to related foreign partners that are not subject to U.S. tax. Many of these taxpayers choose a section 704(c) method other than the remedial method or use valuation techniques that are inconsistent with the arm's length standard. In 1997, Congress recognized that taxpayers might use a partnership to shift gain to a foreign person and consequently enacted sections 721(c) and 367(d)(3). Based on the experience of the IRS with the taxpayer positions described above, the Treasury Department and the IRS have determined that it is appropriate to exercise the regulatory authority granted in section 721(c) to override the application of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) in certain circumstances in which

the gain, when recognized, ultimately would be includable in the gross income of a foreign person. Although Congress also provided specific authority in section 367(d)(3) to address transfers of intangible property to partnerships, the Treasury Department and the IRS have concluded that acting pursuant to section 721(c) is more appropriate because the transactions at issue are not limited to transfers of intangible property.

### IV. Notice 2015-54

On August 6, 2015, the Department of the Treasury (Treasury Department) and the IRS issued Notice 2015-54, 2015-34 I.R.B. 210 (the notice), which describes regulations to be issued under section 721(c) that would ensure that, when a U.S. person transfers certain property to a partnership that has foreign partners related to the U.S. person, income or gain attributable to the appreciation in the property at the time of the contribution will be taken into account by the transferor either immediately or over time. Comments were received on the notice and will be included in the administrative record for the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Bulletin** (REG-127203-15). The Treasury Department and the IRS have considered all the submitted comments. The significant comments are discussed in the Explanation of Provisions section of this preamble.

The notice states that future regulations generally will override the application of section 721(a) to gain realized on the transfer of property to a partnership (domestic or foreign) in certain circumstances in which the gain, when recognized, ultimately would be includable in the gross income of a related foreign person. The notice further states that future regulations will allow for the continued application of section 721(a) to transfers to partnerships with related foreign partners when certain requirements intended to protect the U.S. tax base are satisfied. The notice described these requirements, in addition to others, as the "gain deferral method."

The requirements of the gain deferral method described in the notice are that (i) the section 721(c) partnership adopts the

remedial allocation method for built-in gain with respect to all section 721(c) property contributed to the partnership pursuant to the same plan by the U.S. transferor and all U.S. transferors that are related persons; (ii) the section 721(c) partnership makes consistent allocations of all section 704(b) items with respect to an item of section 721(c) property (the consistent allocation method); (iii) certain reporting requirements are satisfied; (iv) the U.S. transferor recognizes any remaining built-in gain with respect to section 721(c) property upon an acceleration event; and (v) the gain deferral method is adopted for all section 721(c) property subsequently contributed to the section 721(c) partnership by the U.S. transferor and all other U.S. transferors that are related persons until the earlier of two dates: the date that no built-in gain remains with respect to any section 721(c) property to which the gain deferral method first applied, or the date that is 60 months after the date of the initial contribution of section 721(c) property to which the gain deferral method first applied (unified application requirement). See Part III of the Explanations of Provisions section of this preamble for the definitions of "section 721(c) partnership," "section 721(c) property," "U.S. transferor" and other commonly used terms.

The notice generally provides that the regulations will define an acceleration event as any transaction that either (i) would reduce the amount of remaining built-in gain that a U.S. transferor would recognize under the gain deferral method if the transaction had not occurred, or (ii) could defer the recognition of the built-in gain. The notice also describes several situations that the regulations will not treat as acceleration events.

The notice states that the regulations will apply to transactions involving tiered partnerships in a manner that is consistent with the purpose of the regulations. As examples, the notice provides that the regulations will treat a contribution of section 721(c) property by a partnership (in which a U.S. transferor is a direct or indirect partner) to a lower-tier partnership, or a contribution by a U.S. transferor of an interest in a partnership that owns section 721(c) property to an upper-tier partnership, as though the U.S. transferor contrib-



uted its share of the section 721(c) property directly.

The notice provides that the regulations described therein will apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 that is filed on or after August 6, 2015, and that is effective on or before August 6, 2015. The notice provides, however, that the reporting requirements will not apply to taxable years that end before the date of publication of regulations described in the notice.

The notice also announced the intent to issue regulations under sections 482 and 6662 to ensure the appropriate valuation of controlled transactions involving partnerships. These regulations are not contained in this Treasury decision and will appear in future regulations. Section 482 continues to apply to controlled transactions (within the meaning of § 1.482-1(i)(8)) that are also subject to these regulations. An adjustment pursuant to section 482 does not prevent the application of these regulations.

## Explanation of Provisions

### *I. Comments Regarding Statutory Authority for Regulations*

Comments questioned whether the regulations described in the notice are within the scope of the grant of authority in section 721(c). Specifically, comments asserted that pre-contribution gain could not be taxed under section 721(c) until it is recognized in a sale or exchange by the partnership. The Treasury Department and the IRS disagree with these comments for several reasons.

First, as explained in the notice, Congress added the broad grant of regulatory authority in section 721(c) in the 1997 Act to address transactions in which property is contributed to partnerships in order to inappropriately shift gain offshore as a replacement for the repealed excise tax on transfers to foreign partnerships in sections 1491 through 1494.

Second, section 721(c) provides authority to tax the gain when the property is contributed if the gain “will be includible” in a foreign person’s income; it is not a rule (like section 704(c)(1)(B)) that re-

quires the “wait-and-see” approach suggested by the comments. The comments fail to acknowledge that neither the traditional method nor the traditional method with curative allocations will necessarily ensure that a contributing partner will bear all the tax consequences of pre-contribution gain. A contributing partner exchanges a share of the property it contributes for a share of the property the other partners contribute. Economically, a contribution is a current value-for-value exchange. The purpose of section 704(c) is to prevent the shifting of tax consequences among partners with respect to pre-contribution built-in gain or loss in contributed property. The regulations under section 704(c) provide three generally reasonable methods under which partnerships may allocate items with respect to contributed property so as to take into account the tax consequences of pre-contribution gain or loss—the traditional method, the traditional method with curative allocations, and the remedial allocation method. None of the methods are mandatory, and taxpayers may choose any of them (or another reasonable method) on a property-by-property and section 704(c) layer-by-layer basis. In the case of a contribution of depreciable or amortizable property with pre-contribution gain, under all three methods, book cost recovery deductions reduce the pre-contribution gain in the property (the gain that must be allocated back to the contributor) over the course of the recovery period for the property. Under the traditional method, tax cost recovery deductions (which are based on tax basis in the property) are, to the extent available, allocated first to the noncontributing partner up to its allocated book cost recovery deductions. If the noncontributing partner’s book cost recovery deductions exceed its tax cost recovery deductions, the noncontributing partner will be overtaxed on its investment in the partnership property. The traditional method does not make up for shortfalls in available tax deductions, and if the partnership uses the traditional method with curative allocations, those shortfalls are cured only if there are other tax items available with which to cure. Because book cost recovery deductions reduce the built-in gain in the property regardless of whether the noncontributing partner has

received all of the tax cost recovery deductions to which it is economically entitled or whether the contributing partner has received taxable income (or fewer tax deductions) commensurate with the pre-contribution gain in its property, neither the traditional method nor the traditional method with curative allocations prevents a shift of the tax consequences of pre-contribution gain to the noncontributing partner when tax basis or other tax items are insufficient to reflect the economics of the noncontributing partner. When this shift occurs, the contributing partner generally will not bear the tax consequences of the pre-contribution gain until, at the earliest, its partnership interest is liquidated or sold. In this way, the contribution of property to a partnership applying either of these two methods can result in a tax-advantaged exchange with respect to the contributing partner. When the noncontributing partner is foreign, this situation is the appropriate target for the temporary regulations.

Finally, the regulations under section 704(c) give wide latitude to taxpayers regarding how and when partners may choose to recognize pre-contribution gain. Subject to anti-abuse rules, taxpayers are allowed to adopt the traditional method and the traditional method with curative allocations despite those methods’ inability to prevent a shift of the tax consequences of pre-contribution gain in all cases. This latitude raises more concern in the case of related partners, one or more of whom are foreign, given their likely overall alignment of tax interests, which would not necessarily exist among unrelated partners. As explained in Part II of the Background section of this preamble, the remedial allocation method is the only method that reliably and consistently ensures that the tax consequences of pre-contribution gain from contributed property are properly borne by the contributing partner. This feature of the remedial method is particularly relevant to the Congressional concerns about the erosion of the U.S. tax base that led to the enactment of section 721(c), and thus the remedial method is the method that is most appropriate for appreciated property that is contributed to a partnership controlled by the U.S. transferor and one or more related foreign partners. For these reasons, the

Treasury Department and the IRS have determined that these regulations are within the scope of the grant of authority in section 721(c).

## II. Overview of the Temporary Regulations

The temporary regulations adopt the rules that were described in the notice, with certain modifications, in part, in response to comments received.

Section 1.721(c)-1T provides definitions and rules of general application for purposes of all sections of the temporary regulations. Section 1.721(c)-2T provides the general operative rules that override section 721(a) nonrecognition upon a contribution of section 721(c) property to a partnership. Section 1.721(c)-3T describes the gain deferral method, which, if adopted, avoids the immediate recognition of gain upon a contribution of section 721(c) property. Section 1.721(c)-4T provides rules regarding events that accelerate the recognition of gain that previously was deferred under the gain deferral method. Section 1.721(c)-5T identifies exceptions to the acceleration events provided in § 1.721(c)-4T, the result of which, generally, is that the gain deferral method either ends (termination events) or continues to apply without immediate gain recognition (successor events) or continues to apply with partial gain recognition (partial acceleration events). Section 1.721(c)-6T provides procedural and reporting requirements. Section 1.721(c)-7T provides examples illustrating the application of the temporary regulations.

## III. General Scope of the Temporary Regulations

The temporary regulations apply on a property-by-property basis. Accordingly, as discussed in Paragraph b of Part VI of the Explanations of Provisions section of this preamble, the temporary regulations do not include the unified application requirement announced in the notice.

The temporary regulations apply to all contributions, actual or deemed, of property to a partnership, including, for example, a contribution of property that occurs as a result of (i) a partnership merger, consolidation, or division in the assets-

over form, (ii) a change in entity classification that occurs pursuant to § 301.7701-3, or (iii) a transaction described in Rev. Rul. 99-5, 1999-1 C.B. 434 (change from a disregarded entity to a partnership). However, in response to a comment, the temporary regulations provide that a contribution in a technical termination of a partnership described in section 708(b)(1)(B) (technical termination) will not, by itself, cause a partnership to become a section 721(c) partnership subject to the temporary regulations. For further discussion, see Part IV of the Explanation of Provisions section of this preamble. However, the temporary regulations do apply to a technical termination of a section 721(c) partnership applying the gain deferral method. In this regard, see Part V and Paragraph c of Part VIII of the Explanation of Provisions section of this preamble, concerning the general rule of gain recognition and successor events, respectively.

The temporary regulations provide that a mere change in identity, form, or place of organization of a partnership or a recapitalization of a partnership will not cause the partnership to become a section 721(c) partnership. See § 1.721(c)-1T(c).

Finally, as announced in the notice, the temporary regulations contain rules for transactions involving tiered partnerships, as well as a general anti-abuse rule (see § 1.721(c)-1T(d)) that applies for purposes of all sections of the temporary regulations.

## IV. Definitions: Section 721(c) Partnership, Section 721(c) Property, U.S. Transferor, and Other Terms

The notice states that future regulations would provide that a partnership is a section 721(c) partnership if a U.S. transferor contributes section 721(c) property to the partnership, and, after the contribution and any transactions related to the contribution, (i) a related foreign person is a direct or indirect partner, and (ii) the U.S. transferor and related persons own (directly or indirectly) more than 50 percent of the interests in partnership capital, profits, deductions, or losses.

A comment requested that the definition of section 721(c) partnership be revised to exclude partnerships when the

interests held by related foreign persons are small and an unrelated third-party with a material adverse tax position to the U.S. transferor holds a meaningful interest in the partnership. According to the comment, these two factors would sufficiently mitigate the potential for the abuse that the notice is intended to address. While these factors may reduce the ability of a U.S. transferor to shift gain or income outside the United States, the Treasury Department and the IRS have concluded that these factors alone are insufficient to prevent the erosion of the U.S. tax base that section 721(c) was enacted to address. In particular, the Treasury Department and the IRS are concerned that even a small ownership interest held by a related foreign person may be used for a meaningful shift of gain or income outside the United States. Furthermore, the Treasury Department and the IRS have determined that such a rule would necessitate additional rules to address small interests that later become large either in absolute or relative terms. In this regard, the Treasury Department and the IRS have determined that both a general anti-abuse rule and a more targeted rule that would require periodic retesting of the size of a related foreign person's interest would be difficult to administer. Accordingly, this comment has not been adopted. The Treasury Department and the IRS, however, acknowledge that the higher the overall level of related ownership in the partnership, the more likely the arrangement among the partners will reflect tax considerations. After considering this comment and other comments that requested a higher level of related-party ownership in the definition of a section 721(c) partnership, the temporary regulations increase the threshold from a "more than 50 percent" test to an "80 percent or more" test (ownership requirement). See § 1.721(c)-1T(b)(14)(i) for the general definition of a section 721(c) partnership. The temporary regulations also provide rules that deem certain controlled partnerships in a tiered-partnership structure to be section 721(c) partnerships in order to apply the gain deferral method. See § 1.721(c)-1T(b)(14)(ii).

The temporary regulations define section 721(c) property as property, other than excluded property, with built-in gain

that is contributed to a partnership by a U.S. transferor. See § 1.721(c)-1T(b)(15) (i) for the general definition of section 721(c) property. The notice incorporated the requirement that a U.S. transferor make the contribution in the definition of a section 721(c) partnership rather than in the definition of section 721(c) property. This adjustment to the definitions is intended to be a non-substantive change. The temporary regulations provide that if a U.S. transferor is treated as contributing its share of an item of property, the entire item of property is section 721(c) property. In addition, the temporary regulations provide rules that deem certain property of a tiered partnership to be section 721(c) property. See § 1.721(c)-1T(b)(15)(ii). When an interest in a partnership is contributed, the partnership interest, if it is not excluded property, is the section 721(c) property.

The temporary regulations define excluded property as (i) a cash equivalent; (ii) a security within the meaning of section 475(c)(2), without regard to section 475(c)(4); (iii) an item of tangible property with built-in gain that does not exceed \$20,000 or with an adjusted tax basis in excess of book value (built-in loss); and (iv) an interest in a partnership that holds (directly, or indirectly through interests in one or more partnerships that are not excluded property under this clause (iv)) property of which 90 percent or more of the value consists of property described in clauses (i) through (iii) (partnership interest exclusion). See § 1.721(c)-1T(b)(6). The notice announced the first three categories of excluded property. However, the temporary regulations include tangible property with a built-in loss in the third exclusion so that such property is excluded property for purposes of the partnership interest exclusion. The Treasury Department and the IRS determined that it was appropriate to add the partnership interest exclusion so that the temporary regulations do not apply to transfers of partnership interests when only a small portion of the partnership's property is section 721(c) property. If a partnership interest fails the 90-percent threshold test for the partnership interest exclusion and does not qualify under the second exclusion for securities, the interest is section 721(c) property.

Comments recommended that property that gives rise to income effectively connected with a U.S. trade or business (ECI property) be excluded from the definition of section 721(c) property, because the income will be subject to U.S. tax even if it is allocated to a related foreign person. The Treasury Department and the IRS agree with the reasoning behind this comment, and have determined that the temporary regulations should also address the situation when the property ceases to be ECI property and still has built-in gain. Accordingly, the temporary regulations continue to include ECI property in the definition of section 721(c) property but modify the application of the gain deferral method to ECI property, as discussed in Paragraph c of Part VI of the Explanation of Provisions section of this preamble.

Another comment similarly suggested that the definition of section 721(c) property exclude property the gain on which would be subject to U.S. tax under subpart F of the Code. The Treasury Department and IRS have declined to adopt such a rule, which would depend on a "wait and see" approach and would import the recognition rules of subpart F, including an earnings and profits requirement, rather than the more direct approach of section 721(c).

The temporary regulations define built-in gain with respect to an item of property contributed to a partnership as the excess of the book value of the property over the partnership's adjusted tax basis in the property upon the contribution, determined without regard to the application of the gain recognition rule of § 1.721(c)-2T(b). See § 1.721(c)-1T(b)(2). The temporary regulations clarify the definition provided in the notice in two respects. First, the notice states that built-in gain would be determined with respect to the contributing partner's adjusted tax basis in the property at the time of the contribution, whereas the temporary regulations provide that built-in gain is determined with respect to the partnership's adjusted tax basis in the property. The revision was made in order to more precisely describe the amount of gain that may be shifted to a related foreign partner. Second, the temporary regulations clarify that built-in gain is determined without

regard to the application of the gain recognition rule under § 1.721(c)-2T(b).

The temporary regulations include a new term, "remaining built-in gain." Section 1.721(c)-1T(b)(13)(i) generally defines remaining built-in gain, with respect to an item of section 721(c) property that is subject to the gain deferral method, as the built-in gain, reduced by decreases in the difference between the property's book value and adjusted tax basis. However, subsequent increases or decreases to the property's book value due to a revaluation other than a revaluation required under these temporary regulations for tiered partnerships are not taken into account in determining remaining built-in gain. The temporary regulations provide rules for determining remaining built-in gain in the case of tiered partnerships. See § 1.721(c)-1T(b)(13)(ii).

Consistent with the notice, § 1.721(c)-1T(b)(18)(i) of the temporary regulations generally defines a U.S. transferor as a U.S. person (within the meaning of section 7701(a)(30)) other than a domestic partnership. The temporary regulations also provide a rule that deems certain tiered partnerships to be a U.S. transferor solely for purposes of applying the consistent allocation method. See § 1.721(c)-1T(b)(18)(ii).

Finally, the temporary regulations, consistent with the notice, define (i) a related person as a person that is related (within the meaning of section 267(b) or section 707(b)(1)) to a U.S. transferor; (ii) a related foreign person as a person that is a related person (other than a partnership) that is not a U.S. person; and (iii) a direct or indirect partner as a person (other than a partnership) that owns an interest in a partnership directly or indirectly through one or more partnerships. See § 1.721(c)-1T(b)(12), (b)(11), and (b)(5), respectively.

#### *V. General Rule of Gain Recognition upon a Contribution of Section 721(c) Property to a Section 721(c) Partnership*

Section 1.721(c)-2T provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a partnership. Section 1.721(c)-2T(b) provides the general rule that nonrecognition



under section 721(a) will not apply to gain realized upon a contribution of section 721(c) property to a section 721(c) partnership. In contrast to the regulations described in the notice, § 1.721(c)-2T(b) provides that this general rule does not apply — and therefore that nonrecognition under section 721(a) continues to apply — to a direct contribution of section 721(c) property by an “unrelated” U.S. transferor (in other words, a U.S. transferor that does not, together with related persons with respect to it, satisfy the ownership requirement). The carve-out is consistent with the intent of the temporary regulations to address the shifting of income among related persons. Because this carve-out for an unrelated U.S. transferor is limited to direct contributions of section 721(c) property, it does not apply to a contribution that occurs pursuant to the partnership look-through rule in § 1.721(c)-2T(d)(1) (as discussed elsewhere in this Part V).

Section 1.721(c)-2T(c) provides a de minimis exception to the general rule. The temporary regulations modify the de minimis exception described in the notice — which focused on contributions made by a U.S. transferor (and all related U.S. transferors) during the U.S. transferor’s taxable year — to focus instead on contributions during the partnership’s taxable year, in order to align the rule with the reporting required under § 1.721(c)-6T. Under the de minimis exception in the temporary regulations, contributions of section 721(c) property will not be subject to immediate gain recognition if the sum of all built-in gain for all section 721(c) property contributed to a section 721(c) partnership during the partnership’s taxable year does not exceed \$1 million.

Section 1.721(c)-2T(d)(1) provides a look-through rule for identifying a section 721(c) partnership when an upper-tier partnership in which a U.S. transferor is a direct or indirect partner contributes property to a lower-tier partnership. For purposes of determining if the lower-tier partnership is a section 721(c) partnership, the U.S. transferor will be treated as contributing to the lower-tier partnership its share of the property actually contributed by the upper-tier partnership to the lower-tier partnership. If the lower-tier partnership is a section 721(c) partnership, absent appli-

cation of the gain deferral method by the lower-tier partnership to the entire property and by the upper-tier partnership to the partnership interest in the lower-tier partnership, the upper-tier partnership will recognize the entire built-in gain in the section 721(c) property under the general gain recognition rule, because the entire property will be section 721(c) property (see the general definition of section 721(c) property in § 1.721(c)-1T(b)(15)(i)).

Section 1.721(c)-2T(d)(2) provides that the partnership look-through rule will not apply to a deemed contribution by an “old” partnership to a “new” partnership that occurs as a result of a technical termination of the old partnership. Thus, a technical termination will not cause a non-section 721(c) partnership, in which a U.S. transferor is a direct or indirect partner, to become a section 721(c) partnership subject to these temporary regulations. If, however, a partnership is a section 721(c) partnership subject to the temporary regulations immediately before its technical termination, the technical termination would be a successor event (rather than an acceleration event) only if the new partnership continues the gain deferral method with respect to the section 721(c) property that was subject to the gain deferral method in the terminated partnership. In this regard, see § 1.721(c)-5T(c)(4) (defining a successor event to include certain technical terminations).

## VI. Gain Deferral Method

### a. In general

Section 1.721(c)-3T describes the gain deferral method, which generally must be applied in order to avoid the immediate recognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Section 1.721(c)-3T(b) provides the five general requirements for applying the gain deferral method to an item of section 721(c) property: (i) the section 721(c) partnership adopts the remedial allocation method and allocates section 704(b) items of income, gain, loss, and deduction with respect to the section 721(c) property in a manner that satisfies the consistent allocation method; (ii) the U.S. transferor recognizes gain equal to

the remaining built-in gain with respect to the section 721(c) property upon an acceleration event, or an amount of gain equal to a portion of the remaining built-in gain upon a partial acceleration event or certain transfers to foreign corporations described in section 367; (iii) procedural and reporting requirements are satisfied; (iv) the U.S. transferor extends the period of limitations on assessment of tax (as discussed in Part X of the Explanation of Provisions section of this preamble); and (v) the rules for tiered partnerships are satisfied if either the section 721(c) property is an interest in a partnership or the section 721(c) property is described in the partnership look-through rule in § 1.721(c)-2T(d)(1).

### b. Application of the gain deferral method on a property-by-property basis

Comments questioned the necessity for the unified application requirement announced in the notice. The unified application requirement was intended to prevent taxpayers from disaggregating the contribution of separate but related business property and choosing to recognize gain upon contribution for some property and to apply the gain deferral method for other property, in an attempt to minimize the reported cumulative value for all contributed property or to minimize the reported value of property for which the gain deferral method was not adopted. This concern arises, in part, because the IRS may not be able to make an adjustment for the correct amount of gain with respect to property that is not subject to the gain deferral method due to the expiration of the period of limitations on the assessment of tax. While the Treasury Department and the IRS continue to be concerned that taxpayers will attempt to disaggregate related business property in order to undervalue their contributions, the temporary regulations adopt a more targeted approach to address these comments. Accordingly, the temporary regulations do not include the unified application requirement and instead apply on a property-by-property basis.

As described in the notice, in order to apply the gain deferral method with respect to a contribution of section 721(c) property to a section 721(c) partnership,



the temporary regulations require the U.S. transferor to extend the period of limitations on assessment of tax on all items related to the property with respect to which the gain deferral method applies through the close of the eighth full taxable year following the contribution. To address the concerns that motivated the uniform application requirement, the temporary regulations require a U.S. transferor to extend the period of limitations on assessment of tax on the gain recognized under the general rule with respect to any section 721(c) property that is contributed to the partnership for which the gain deferral method will not be applied through the close of the fifth full taxable year following the contribution of such property, if the property is contributed within five full taxable years after a gain deferral contribution, defined in § 1.721(c)-1T(b)(7) as a contribution of section 721(c) property to a section 721(c) partnership with respect to which the gain is deferred under the gain deferral method. See §§ 1.721(c)-3T(b)(4) and 1.721(c)-6T(b)(5)(iii), discussed in Part X of the Explanation of Provisions section of this preamble. Additionally, it should be noted that § 1.482-1T(f)(2)(i)(B) provides that separate transactions must be aggregated for purposes of determining the arm's length pricing of such transactions under section 482, including for purposes of an analysis under multiple provisions of the Code or regulations, if the transactions are so interrelated that an aggregate analysis provides the most reliable measure of the arm's length result.

#### *c. Application of the gain deferral method to ECI property*

As discussed in Part IV of the Explanation of Provisions section of this preamble, the temporary regulations do not adopt the comment recommending that ECI property be excluded from the definition of section 721(c) property. Instead, the temporary regulations continue to provide that a contribution of section 721(c) property that is ECI property is subject to immediate gain recognition if the gain deferral method is not applied. However, in response to the comment, the temporary regulations modify the gain deferral method such that ECI property is not sub-

ject to the remedial allocation method or the consistent allocation method. This special exception for ECI property applies for as long as, beginning on the date of the contribution and ending when there is no remaining built-in gain with respect to the property, all distributive shares of income and gain with respect to the property for all direct and indirect partners that are related foreign persons will be subject to taxation as effectively connected with a trade or business within the United States (under section 871 or 882), and neither the section 721(c) partnership nor a direct or indirect partner that is a related foreign person claims benefits under an income tax treaty that would exempt the income or gain from tax or reduce the rate of taxation to which the income or gain is subject. See § 1.721(c)-3T(b)(1)(ii).

All the other requirements of the gain deferral method apply with respect to ECI property. Thus, a U.S. transferor must recognize gain upon an acceleration event with respect to ECI property, including when property ceases to be ECI property, and satisfy the procedural and reporting requirements with respect to ECI property. See § 1.721(c)-6T(b)(2)(iii), (b)(3)(vii), and (c)(1).

A comment also requested an exclusion for property subject to tax under section 897 (relating to U.S. real property interests) from the definition of section 721(c) property. The temporary regulations do not adopt this comment because the special rules for ECI property appropriately address the concerns expressed regarding U.S. real property interests.

#### *d. Application of the gain deferral method to anti-churning property*

Comments requested guidance on how the requirement to use the remedial allocation method interacts with the section 197 anti-churning rules. In general, section 197(f)(9) prohibits the amortization of goodwill and going concern value that was non-amortizable before the enactment of section 197 (section 197(f)(9) intangible property), and that prohibition continues if the property is transferred to a related person. Under § 1.197-2(h)(12)(vii)(B), when section 197(f)(9) intangible property is contributed to a partnership, a noncontributing partner generally may re-

ceive remedial allocations of amortization with respect to the property. A noncontributing partner that is related to the contributing partner, however, may not receive such remedial allocations.

One comment requested that a U.S. transferor not be required to include remedial income with respect to section 197(f)(9) intangible property when the gain deferral method is being applied. The temporary regulations do not adopt this comment. The Treasury Department and the IRS are concerned that providing favorable treatment for section 721(c) property belonging to a particular class would incentivize taxpayers to attribute excessive value to that class of property while simultaneously undervaluing related but separate section 721(c) property that remains subject to all of the requirements of the gain deferral method. This concern is especially pronounced in the case of section 197(f)(9) intangible property, which is often difficult to value separately from other identifiable intangible property. In this regard, see the preamble of the notice of proposed rulemaking (REG-139483-13) containing proposed regulations under section 367, published in the **Federal Register** on September 16, 2015 (80 FR 55568). See also the preamble to T.D. 9803, which finalized those proposed regulations, published in the **Federal Register** on December 16, 2016 (81 FR 91012).

Another comment recommended that regulations implementing the gain deferral method require the partnership to amortize the section 197(f)(9) intangible and allocate remedial items of amortization to a related foreign partner and corresponding remedial items of income to the contributing partner. The Treasury Department and the IRS have determined that changing § 1.197-2(h)(12)(vii)(B) to permit remedial allocations of amortization to related partners, or distinguishing between domestic and related foreign partners, would be contrary to section 197(f)(9) and therefore do not adopt this comment. In lieu of providing that remedial allocations may be made to a related partner, the temporary regulations provide a special non-amortizable tax basis adjustment to the property. This special adjustment is made solely with respect to the related partner. The Treasury Department and the IRS have determined that allowing this tax basis adjustment is consistent with

the policy of the section 197 anti-churning rules.

More specifically, the temporary regulations revise the remedial allocation method in § 1.704–3(d) as to related partners when a section 721(c) partnership is applying the gain deferral method with respect to section 197(f)(9) intangible property. The revised rule requires the partnership to amortize the portion of the partnership’s book value in the section 197(f)(9) intangible property that exceeds its adjusted tax basis in the property. Accordingly, the allocation of book amortization to a noncontributing partner will result in a ceiling rule limitation to the extent of this allocation of book amortization. If a noncontributing partner is a related person with respect to the U.S. transferor, the temporary regulations provide that, solely with respect to the related noncontributing partner, the partnership must increase the adjusted tax basis of the property by the amount of the difference between the book allocation of the item to the related person and the tax allocation of the same item to the related person and allocate remedial income in the same amount to the U.S. transferor. See § 1.704–3T(d)(5)(iii)(C).

The rules governing the tax consequences of the special tax basis adjustment are modeled on § 1.743–1 and proposed regulations under section 704(c)(1)(C) that are contained in a notice of proposed rulemaking (REG–144468–05) published in the **Federal Register** (79 FR 3042) on January 16, 2014. The adjustment to the tax basis of section 197(f)(9) intangible property will be recovered by the related partner only upon a sale or exchange of the property by the partnership. Generally, a transfer by the noncontributing related partner of all or a portion of its interest in the partnership will eliminate the tax basis adjustment attributable to the interest such that the transferee will not succeed to the tax basis adjustment. However, if the interest is transferred in a substituted basis transaction, the transferee will succeed to the transferor’s tax basis adjustment and the adjustment will be taken into account in computing and allocating any adjustment to the basis of the section 197(f)(9) intangible property under sections 743(b) and 755. These rules must be applied together with the

general rules under section 197 and subchapter K of the Code. In resolving any uncertainty that arises in the implementation of these rules, it would be reasonable for taxpayers to apply principles similar to those contained in § 1.743–1, the proposed regulations under section 704(c)(1)(C), and any Code sections or regulations that reference those rules.

The Treasury Department and the IRS request comments on the following issues, and on any other issues relevant to a section 721(c) partnership’s application of the remedial allocation method to section 197(f)(9) intangible property: (i) the application of the method to members of a consolidated group; (ii) the treatment of a tax basis adjustment when the adjusted section 197(f)(9) intangible property is transferred (a) in a like-kind exchange described in section 1031, (b) to a lower-tier partnership, (c) in a transaction described in section 351, (d) in a technical termination, or (e) in an installment sale; (iii) the treatment of a tax basis adjustment when the section 197(f)(9) intangible property is distributed to the related person for whom the adjustment was made or to another partner in a current or liquidating distribution; and (iv) any rules that are necessary to ensure that the tax basis adjustment does not become amortizable in contravention of the anti-churning rules.

#### *e. Consistent allocation method*

##### 1. In General

Section 1.721(c)–3T(c)(1) describes the consistent allocation method, which, like the gain deferral method, applies on a property-by-property basis. The consistent allocation method requires a section 721(c) partnership to allocate the same percentage of each book item of income, gain, deduction, and loss “with respect to the section 721(c) property” to the U.S. transferor. Comments questioned the necessity of the requirement to apply the consistent allocation method. Some comments asserted that the requirement is unnecessary because the built-in gain in section 721(c) property will be preserved in the difference between the book and tax capital accounts of a U.S. transferor. The Treasury Department and the IRS have determined that remedial allocations alone

are insufficient to ensure that built-in gain with respect to section 721(c) property will be subject to U.S. tax. The consistent allocation method is intended to prevent a U.S. transferor from rendering the remedial allocation method ineffective by, for example, having the partnership allocate a higher percentage share of book depreciation to the U.S. transferor (which would reduce the U.S. transferor’s remedial income inclusion) than the U.S. transferor’s percentage share of income or gain with respect to the property, which would result in shifting the gain (and taxable income) to related foreign persons that are direct or indirect partners in the partnership. Therefore the temporary regulations do not adopt this comment. The temporary regulations provide rules (discussed in Paragraph e.2 of this Part VI) to determine the amount of income, gain, deduction, and loss that is considered to be “with respect to section 721(c) property” under the gain deferral method.

According to another comment, the consistent allocation method is both over-inclusive, in that situations in which a U.S. transferor is allocated greater income than its share of deductions would violate the rule, and under-inclusive, because deductions allocated to a U.S. transferor that do not arise from section 721(c) property are beyond the scope of the rule. This comment proposed an alternative anti-abuse rule that would require that a minimum cumulative amount of income be allocated to a U.S. transferor. The Treasury Department and the IRS have concluded that the rule described in the comment would be difficult to administer. However, in response to comments, the temporary regulations provide exceptions (discussed in Paragraph e.3 of this Part VI) to the consistent allocation method for certain regulatory allocations and the allocations of creditable foreign tax expenditures.

##### 2. Determining Book Items with Respect to Section 721(c) Property

The notice did not describe how partnership items are determined to be “with respect to section 721(c) property.” The temporary regulations provide guidance for making this determination based on principles that will be familiar to many taxpayers.

### i. Book items of income and gain

Section 1.721(c)-3T(c)(2) provides the rule for determining the extent to which partnership items of book income and gain are considered to be “with respect to” particular section 721(c) property for purposes of applying the consistent allocation method on a property-by-property basis. This rule provides that a section 721(c) partnership must attribute book income and gain to each property in a consistent manner using any reasonable method that takes into account all the facts and circumstances. The temporary regulations provide that all items of book income and gain attributable to each property will comprise a single class of gross income for purposes of determining the extent to which partnership items of deduction or loss are allocated and apportioned with respect to the section 721(c) property.

### ii. Book items of deduction and loss

Section 1.721(c)-3T(c)(3) provides the rules for determining the extent to which partnership items of book deduction and loss are considered to be “with respect to” particular section 721(c) property for purposes of applying the consistent allocation method. A section 721(c) partnership must use the principles of §§ 1.861-8 and 1.861-8T to allocate and apportion all of its items of deduction, except for interest expense and research and experimental expenditures (R&E), and loss to the class of gross income with respect to each section 721(c) property. The section 721(c) partnership may allocate and apportion its interest expense and R&E using any reasonable method, including, but not limited to, the methods described in §§ 1.861-9 and 1.861-9T (interest expense) and § 1.861-17 (R&E).

## 3. Exceptions to the Consistent Allocation Method

In response to comments, the temporary regulations provide exceptions from the requirement to apply the consistent allocation method with respect to certain book items of a section 721(c) partnership.

### i. Regulatory allocations

The temporary regulations provide that a regulatory allocation (as defined in § 1.721(c)-1T(b)(10)) of book income, gain, deduction, or loss with respect to section 721(c) property that otherwise would fail to satisfy the requirements of the consistent allocation method nevertheless will, in certain cases, be deemed to satisfy the requirements. Specifically, a regulatory allocation is deemed to satisfy the requirements of the consistent allocation method if the allocation is (i) an allocation of income or gain to the U.S. transferor (or a member of its consolidated group); or (ii) an allocation of deduction or loss to a partner other than the U.S. transferor (or a member of its consolidated group). In addition, if the allocation is not described in clause (i) or (ii) but the U.S. transferor receives less income or gain or more deductions or loss with respect to the section 721(c) property because of the regulatory allocation, the allocation is treated as described in § 1.721(c)-5T(d)(2) (generally requiring that a portion of remaining built-in gain be recognized, as discussed in Paragraph d.2 of Part VIII of the Explanation of Provisions section of this preamble). See § 1.721(c)-3T(c)(4)(i)(C). The Treasury Department and the IRS have determined that this special rule for regulatory allocations is appropriate because an allocation described in clause (i) or (ii) will not reduce the U.S. tax base and an allocation described in clause (iii) will result in the U.S. transferor recognizing gain that will offset the reduction in the U.S. tax base resulting from the regulatory allocation.

The temporary regulations provide that a regulatory allocation is (i) an allocation pursuant to a minimum gain chargeback, as defined in § 1.704-2(b)(2), (ii) a partner nonrecourse deduction, as determined in § 1.704-2(i)(2), (iii) an allocation pursuant to a partner minimum gain chargeback, as described in § 1.704-2(i)(4), (iv) an allocation pursuant to a qualified income offset, as defined in § 1.704-1(b)(2)(ii)(d), (v) an allocation with respect to the exercise of a noncompensatory option described in § 1.704-1(b)(2)(iv)(s), and (vi) an allocation of partnership level ordinary income or loss described in § 1.751-1(a)(3). The Treasury Department

and the IRS have determined that relief is appropriate for these regulatory allocations because, in general, partners do not have discretion regarding their application and, when necessary, treating them as a partial acceleration event will result in the appropriate amount of gain being recognized for purposes of the gain deferral method. The Treasury Department and the IRS have determined that relief is not appropriate for a nonrecourse deduction, as defined in § 1.704-2(b)(1), because, unlike the other types of regulatory allocations, partners have significant discretion regarding the allocation of a nonrecourse deduction.

### ii. Creditable foreign tax expenditures

The temporary regulations provide that allocations of creditable foreign tax expenditures (as defined in § 1.704-1(b)(4)(viii)(b)) (CFTEs) are not subject to the consistent allocation method. See § 1.721(c)-3T(c)(4)(ii). The regulations governing the allocation of CFTEs take into account section 704(c) income and gain and are not based strictly on the allocation of book items. As a result, it would be difficult to apply the consistent allocation method with respect to CFTEs.

## VII. Acceleration Events

### a. Overview

Section 1.721(c)-4T provides rules regarding acceleration events, which, like the gain deferral method, apply on a property-by-property basis. When an acceleration event occurs with respect to section 721(c) property, remaining built-in gain in the property must be recognized and the gain deferral method no longer applies. The temporary regulations provide exceptions to acceleration events that are discussed in Part VIII of the Explanation of Provisions section of this preamble.

### b. Definition of an acceleration event

#### 1. General Rules

Subject to the exceptions described in Part VIII of the Explanation of Provisions section of this preamble, § 1.721(c)-



4T(b)(1) defines an acceleration event as any event that would reduce the amount of remaining built-in gain that a U.S. transferor would have recognized under the gain deferral method if the event had not occurred or that could defer the recognition of the remaining built-in gain. The temporary regulations clarify that an acceleration event includes the transfer of section 721(c) property via a contribution of the property itself or through a contribution of a partnership interest.

## 2. Failure to Comply with a Requirement of the Gain Deferral Method

The rules described in the notice would have provided that a failure to comply with one of the requirements of the gain deferral method with respect to any section 721(c) property would cause an acceleration event for all section 721(c) property. Comments requested that the Treasury Department and the IRS eliminate this provision. Because the temporary regulations provide that the gain deferral method is applied on a property-by-property basis (in lieu of containing the unified application requirement), the temporary regulations adopt this comment.

Under the temporary regulations, an acceleration event with respect to section 721(c) property occurs when any party fails to comply with a requirement of the gain deferral method with respect to that property. See § 1.721(c)-4T(b)(2)(i). For example, if section 721(c) property is ECI property, an acceleration event occurs if a distributive share of income or gain from the property that is allocated to a direct or indirect partner that is a related foreign person is no longer subject to taxation as income effectively connected with a trade or business within the United States or if the section 721(c) partnership or a direct or indirect partner that is a related foreign person claims certain benefits under an income tax treaty with respect to the income (see § 1.721(c)-3T(b)(1)(ii)).

An acceleration event will not occur solely as a result of a failure to comply with a procedural or reporting requirement of the gain deferral method if that failure is not willful and relief is sought under the prescribed procedures. See

§§ 1.721(c)-4T(b)(2)(ii) and 1.721(c)-6T(f).

## 3. Special Rule when Section 721(c) Property is an Interest in a Partnership

When section 721(c) property is an interest in a partnership, the temporary regulations provide that an acceleration event will not occur because of a reduction in remaining built-in gain in the partnership interest as a result of allocations of book items of deduction and loss or tax items of income and gain by that partnership. See § 1.721(c)-4T(b)(3).

## 4. Deemed Acceleration Event

Under the temporary regulations, a U.S. transferor may affirmatively treat an acceleration event as having occurred with respect to section 721(c) property by recognizing the remaining built-in gain with respect to that property and satisfying the reporting required by § 1.721(c)-6T(b)(3)(iv). See § 1.721(c)-4T(b)(4).

### *c. Consequences of an acceleration event*

Section 1.721(c)-4T(c) sets forth the consequences of an acceleration event. Specifically, the U.S. transferor must recognize gain in an amount equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold the section 721(c) property immediately before the acceleration event for fair market value. Following the acceleration event, the section 721(c) property will no longer be subject to the gain deferral method.

The U.S. transferor generally must make correlative adjustments to its basis in its partnership interest. See § 1.721(c)-4T(c)(1). In addition, the section 721(c) partnership will increase its basis in the section 721(c) property by the amount of gain recognized by the U.S. transferor. This basis increase is made immediately before the acceleration event. See § 1.721(c)-4T(c)(2). If the section 721(c) property remains in the partnership after the acceleration event, the increase in the basis of the section 721(c) property generally would be treated in the same manner as newly purchased property, including for purposes of determining the

depreciation schedule if the property is depreciable property.

## *VIII. Acceleration Event Exceptions*

### *a. In general*

Section 1.721(c)-5T identifies the following categories of exceptions to acceleration events, which, like acceleration events, apply on a property-by-property basis: (i) termination events, in which case, the gain deferral method ceases to apply to the section 721(c) property; (ii) successor events, in which case, the gain deferral method continues to apply to the section 721(c) property but with respect to a successor U.S. transferor or a successor section 721(c) partnership, as applicable; (iii) partial acceleration events, in which case, a U.S. transferor recognizes an amount of gain that is less than the full amount of remaining built-in gain in the section 721(c) property and the gain deferral method continues to apply; (iv) transfers described in section 367 of section 721(c) property to a foreign corporation, in which case, the gain deferral method ceases to apply and a U.S. transferor recognizes an amount of gain equal to the remaining built-in gain attributable to the portion of the section 721(c) property that is not subject to tax under section 367; and (v) fully taxable dispositions of a portion of an interest in a section 721(c) partnership, in which case, the gain deferral method continues to apply for the retained portion of the interest.

### *b. Termination events*

#### 1. In General

Section 1.721(c)-5T(b) identifies the events that cause the gain deferral method to no longer apply. The Treasury Department and the IRS have determined that it is appropriate to terminate the application of the gain deferral method with respect to the affected section 721(c) property in these cases because the potential to shift gain or income to a related foreign person that is a direct or indirect partner in the section 721(c) partnership has been eliminated.

## 2. Transfers of Section 721(c) Property (Other Than a Partnership Interest) to a Domestic Corporation Described in Section 351

The temporary regulations provide that a termination event occurs if a section 721(c) partnership transfers section 721(c) property other than a partnership interest to a domestic corporation in a transaction to which section 351 applies. See § 1.721(c)-5T(b)(2).

## 3. Certain Incorporations of a Section 721(c) Partnership

A comment questioned whether the rules described in the notice would exempt from the definition of an acceleration event certain transactions after which the partnership ceases to exist, such as those described in Rev. Rul. 84-111, 1984-2 C.B. 88 (describing three methods for incorporating a partnership). See § 601.601(d)(2)(ii)(b). The temporary regulations provide that a termination event occurs upon an incorporation of a section 721(c) partnership into a domestic corporation by any method of incorporation other than a method involving an actual distribution of partnership property to the partners, followed by a contribution of that property to a corporation, provided that the section 721(c) partnership is liquidated as part of the incorporation transaction. See § 1.721(c)-5T(b)(3).

## 4. Certain Distributions of Section 721(c) Property

A comment questioned whether an acceleration event should occur as a result of a distribution of section 721(c) property to a partner other than a U.S. transferor outside of the seven-year period described in sections 704(c)(1)(B) and 737 (rules that address certain distributions of property within seven years of a contribution). While sections 704(c)(1)(B) and 737 also are intended to ensure that gain on contributed property is not inappropriately transferred to a partner other than the contributor, in the context of contributions to partnerships with related foreign partners, the Treasury Department and the IRS have determined that concerns about the erosion of the U.S. tax base remain as long as there is remaining built-in gain in

the section 721(c) property. Accordingly, the Treasury Department and the IRS have determined that it is inappropriate to provide a termination event exception for all distributions of section 721(c) property after seven years.

The temporary regulations, however, provide that a termination event occurs if a section 721(c) partnership distributes section 721(c) property to the U.S. transferor. A termination event will also occur if a section 721(c) partnership distributes section 721(c) property to a member of a U.S. transferor's consolidated group and the distribution occurs more than seven years after the contribution. See § 1.721(c)-5T(b)(4).

## 5. Section 721(c) Partnership Ceases to Have a Related Foreign Person Partner

In response to a comment, the temporary regulations generally provide that a termination event occurs when a section 721(c) partnership ceases to have any direct or indirect partners that are related foreign persons, provided there is no plan for a related foreign person to subsequently become a direct or indirect partner in the partnership (or a successor). See § 1.721(c)-5T(b)(5). The no-plan requirement applies independently of the general anti-abuse rule under § 1.721(c)-1T(d). An acceleration event, however, occurs upon a distribution of section 721(c) property in redemption of a related foreign person's interest in a section 721(c) partnership.

## 6. Fully Taxable Dispositions of Section 721(c) Property or of an Entire Interest in a Section 721(c) Partnership

The notice treated a taxable disposition of section 721(c) property by a section 721(c) partnership, or an indirect disposition of section 721(c) property through a taxable disposition of an interest in a section 721(c) partnership interest, as an acceleration event. The Treasury Department and the IRS have determined that it is appropriate instead to treat a fully taxable disposition of section 721(c) property or of an entire interest in a section 721(c) partnership as a termination event because other sections of the Code require gain to be recognized.

Accordingly, the temporary regulations provide that a termination event occurs if a section 721(c) partnership disposes of section 721(c) property in a transaction in which all gain or loss, if any, is recognized. See § 1.721(c)-5T(b)(6). In addition, a termination event occurs if either a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of an entire interest in a section 721(c) partnership that owns section 721(c) property in a transaction in which all gain or loss, if any, is recognized. This rule does not apply if a U.S. transferor is a member of a consolidated group and the interest in the section 721(c) partnership is transferred to another member in an intercompany transaction (as defined in § 1.1502-13(b)(1)). See § 1.721(c)-5T(b)(7). See, however, Paragraph c.2 of this Part VIII, which describes the rule in § 1.721(c)-5T(c)(3) that provides that such a transaction may be a successor event.

### c. Successor events

#### 1. In General

Section 1.721(c)-5T(c) identifies the successor events that allow for the continued application of the gain deferral method. In each of these cases, it is appropriate to continue application of the gain deferral method (rather than accelerate gain recognition), because its application can be preserved in the hands of a successor U.S. transferor or a successor section 721(c) partnership, as applicable. If, however, the successor does not continue the gain deferral method, the event is an acceleration event. If only a portion of an interest in a partnership is transferred in a successor event, the principles of § 1.704-3(a)(7) apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest that is transferred and the portion that is retained. See § 1.721(c)-5T(c)(1).

#### 2. A Domestic Corporation Becomes a Successor U.S. Transferor

The temporary regulations provide that a successor event occurs if either a U.S. transferor or a partnership in which a U.S.

transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to a domestic corporation in a transaction to which section 351 or 381 applies, and the gain deferral method is continued by treating the transferee domestic corporation as the U.S. transferor. See § 1.721(c)-5T(c)(2).

In addition, a successor event occurs if a U.S. transferor that is a member of a consolidated group transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to another member in an intercompany transaction (as defined in § 1.1502-13(b)(1)), and the gain deferral method is continued by treating the transferee member as the U.S. transferor. See § 1.721(c)-5T(c)(3).

### 3. Technical Termination of a Section 721(c) Partnership

In response to comments, the temporary regulations provide that a successor event occurs if there is a technical termination of a section 721(c) partnership, and the gain deferral method is continued by treating the new partnership as the section 721(c) partnership. See § 1.721(c)-5T(c)(4). Although a technical termination will cause the depreciation schedule to be reset with respect to any depreciable section 721(c) property of the terminated section 721(c) partnership, and thus defer the recognition of remaining built-in gain, the Treasury Department and the IRS have concluded that this should not cause an acceleration event. In this case, however, the general anti-abuse rule under § 1.721(c)-1T(d) may apply, depending on the facts relating to the technical termination.

### 4. A Partnership Becomes a Successor Section 721(c) Partnership

The temporary regulations provide two other categories of successor events that involve successor section 721(c) partnerships. In each case, section 721(c) property is directly or indirectly contributed to a successor section 721(c) partnership and the gain deferral method is applied down the chain of ownership with the

result that the remaining built-in gain will continue to be subject to U.S. tax.

In the first category, a successor event occurs if (i) a section 721(c) partnership contributes section 721(c) property to a lower-tier partnership that is a controlled partnership; (ii) the gain deferral method is applied both with respect to the section 721(c) partnership's interest in the lower-tier partnership and with respect to the section 721(c) property in the hands of the lower-tier partnership; and (iii) the lower-tier partnership either is a section 721(c) partnership, or is a controlled partnership that fails the ownership requirement but is treated as a section 721(c) partnership. See § 1.721(c)-5T(c)(5)(i). In the case in which the lower-tier partnership is a controlled partnership but not a section 721(c) partnership, the Treasury Department and the IRS have determined that it is appropriate to allow the parties to continue to apply the gain deferral method to the section 721(c) property, rather than triggering an acceleration event, provided the parties treat the lower-tier partnership as a section 721(c) partnership for purposes of applying the gain deferral method.

In the second category, a successor event occurs if (i) either a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner contributes (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to an upper-tier partnership that is a controlled partnership; (ii) the gain deferral method is continued with respect to the section 721(c) property in the hands of the section 721(c) partnership; (iii) if the upper-tier partnership directly owns its interest in the section 721(c) partnership, the gain deferral method is applied with respect to the upper-tier partnership's interest in the section 721(c) partnership and the upper-tier partnership is, or is treated as, a section 721(c) partnership; and (iv) if the upper-tier partnership indirectly owns its interest in the section 721(c) partnership through one or more partnerships, the principles described in clause (iii) are applied with respect to the upper-tier partnership and each partnership through which the upper-tier partnership indirectly owns an interest in the section 721(c) partnership. See § 1.721(c)-5T(c)(5)(ii).

Both categories of successor events involve tiered partnerships. Therefore, pursuant to § 1.721(c)-3T(b)(5), the rules for tiered partnerships (described in § 1.721(c)-3T(d)) must be applied in order to satisfy the requirements to apply the gain deferral method as required under the rules described in the two preceding paragraphs.

To illustrate, consider the following simplified example: In year 1, USP, a domestic corporation, and CFC1, a wholly owned foreign subsidiary of USP, form PS1, a partnership, as equal partners. USP contributes section 721(c) property, asset A, a depreciable asset with a \$10 million built-in gain (fair market value of \$10 million and tax basis of zero) (USP contribution). PS1 is a section 721(c) partnership as a result of the USP contribution, and the gain deferral method is applied with respect to asset A. In year 2, PS1 and CFC1 form PS2, a partnership, as equal partners. PS1 contributes asset A to PS2 (PS1 contribution) when asset A has remaining built-in gain of \$8 million and a fair market value of \$12 million (the tax basis is still zero). PS2 is a section 721(c) partnership as a result of the PS1 contribution. The PS1 contribution will be a successor event with respect to asset A if PS2 applies the gain deferral method to asset A and PS1 applies the gain deferral method to its interest in PS2 as described in § 1.721(c)-5T(c)(5)(i). The remaining built-in gain in asset A in the hands of PS2 will be \$12 million (excess of book value of \$12 million over PS2's adjusted tax basis of \$0). If PS2 sells the property, PS2 will allocate \$12 million to PS1, and PS1 will allocate \$10 million of the gain to USP (\$8 million of which would be allocated under § 1.704-3(a)(9)).

On the other hand, the PS1 contribution will be an acceleration event (rather than a successor event) with respect to asset A if either PS1 or PS2 does not apply the gain deferral method. In this case, USP will recognize \$8 million of gain, which is the amount of the remaining built-in gain that would have been allocated to USP if PS1 had sold asset A immediately before the PS1 contribution for fair market value, and PS1 will increase its tax basis in asset A from \$0 to \$8 million. See § 1.721(c)-4T(c). Furthermore, the PS1 contribution will be



subject to the general gain recognition rule under § 1.721(c)–2T(b) because PS2 is a section 721(c) partnership and asset A is section 721(c) property. PS1’s realized gain with respect to asset A that will not qualify for nonrecognition under section 721(a) is \$4 million (fair market value of \$12 million less adjusted tax basis of \$8 million) and PS1 will allocate half of that gain to USP.

#### *d. Partial acceleration events*

##### 1. In General

Section 1.721(c)–5T(d) identifies the partial acceleration events, and, in each case, the amount of gain that a U.S. transferor must recognize. The basis adjustments in § 1.721(c)–4T(c) that must be made by a U.S. transferor and a section 721(c) partnership upon a “full” acceleration event also apply for a partial acceleration event, except in the case of a partial acceleration that occurs as a result of an adjustment under section 734 to section 721(c) property, as described in Paragraph d.3 of this Part VIII. If there is remaining built-in gain in the section 721(c) property immediately after the partial acceleration event, the gain deferral method must continue to apply following the partial acceleration event.

##### 2. Regulatory Allocations

Section 1.721(c)–3T(c)(4)(i)(C) provides that a regulatory allocation that results in an over-allocation of book deduction or loss to a U.S. transferor or an under-allocation of book income or gain to a U.S. transferor will nevertheless be treated as satisfying the consistent allocation method if gain is recognized. See the discussion in Paragraph e.3.i of Part VI of the Explanation of Provisions section of this preamble. In order for such a regulatory allocation to be deemed to satisfy the consistent allocation method, the U.S. transferor must recognize an amount of gain equal to the amount of the allocation that, had the regulatory allocation not occurred, would have been allocated to the U.S. transferor in the case of income or gain, or would not have been allocated to the U.S. transferor in the case of deduction or loss. See § 1.721(c)–5T(d)(2).

However, the amount of gain recognized is limited to the amount of the remaining built-in gain that would have been allocated to the U.S. transferor upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the regulatory allocation is made for fair market value.

##### 3. Distributions of Other Partnership Property to a Partner that Result in an Adjustment under Section 734

The temporary regulations provide that a partial acceleration event occurs if there is a distribution of other property by a section 721(c) partnership that results in a positive basis adjustment to section 721(c) property under section 734. In these cases, the U.S. transferor must recognize an amount of gain equal to the positive basis adjustment to the section 721(c) property under section 734. However, the amount of gain recognized is limited to the amount of the remaining built-in gain that would have been allocated to the U.S. transferor upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the regulatory allocation is made for fair market value. Furthermore, if the property that triggered the section 734 adjustment was distributed to the U.S. transferor or a member of its consolidated group, the amount described in the preceding sentence is reduced (but not below zero) by the amount of gain recognized by the U.S. transferor (or the consolidated group member) under section 731(a). See § 1.721(c)–5T(d)(3). The amount of gain recognized as a result of the acceleration event is not reduced by any step-down to distributed property described by section 734(b)(1)(B). The partnership will not increase its basis under § 1.721(c)–4T(c)(2) for the gain recognized by the U.S. transferor.

##### *e. Section 367 transfers of section 721(c) property to a foreign corporation*

Section 1.721(c)–5T(e) provides rules for certain direct and indirect transfers of section 721(c) property to a foreign corporation. These rules apply if a section 721(c) partnership transfers section 721(c) property, or if a U.S. transferor or a part-

nership in which a U.S. transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership, to a foreign corporation in a transaction described in section 367. In this case, the underlying section 721(c) property will no longer be subject to the gain deferral method. The Treasury Department and the IRS have determined that this result is appropriate because to the extent any U.S. transferor is treated as transferring the section 721(c) property to the foreign corporation for purposes of section 367, the tax consequences will be determined under section 367. In this regard, see §§ 1.367(a)–1T(c)(3)(i) and (ii), 1.367(d)–1T(d)(1), and 1.367(e)–2(b)(1)(iii) (in general, providing an aggregate treatment of partnerships for purposes of applying the outbound transfer provisions under section 367). Furthermore, for the remaining portion of the property (which is the portion attributable to non-U.S. persons and therefore not subject to tax under section 367), the U.S. transferor must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to the U.S. transferor upon a hypothetical sale by the section 721(c) partnership of that portion of the property immediately before the transfer for fair market value. The basis adjustments in § 1.721(c)–4T(c) that must be made by a U.S. transferor and a section 721(c) partnership upon a “full” acceleration event also apply in this case. If stock in the transferee foreign corporation is received by a section 721(c) partnership, the stock will not be subject to the gain deferral method.

##### *f. Fully taxable dispositions of a portion of an interest in a section 721(c) partnership*

Section 1.721(c)–5T(f) provides a special rule when there is a fully taxable disposition of a portion of an interest in a section 721(c) partnership. Specifically, if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of (directly or indirectly through one or more partnerships) a portion of an interest in a section 721(c) partnership in a transaction in which all gain or loss, if any, is recognized, an ac-

celeration event will not occur with respect to the portion of the interest transferred. The gain deferral method will continue to apply with respect to the section 721(c) property of the section 721(c) partnership. The principles of § 1.704-3(a)(7) will apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest in a section 721(c) partnership that is retained. This rule does not apply to an intercompany transaction (as defined in § 1.1502-13(b)(1)). See § 1.721-5T(c)(3). See also the discussion in Paragraph c.2 of this Part VIII.

## IX. Tiered Partnerships Rules

### a. Overview

This Part IX discusses the application of the gain deferral method to tiered partnerships. The temporary regulations employ two general principles in applying the gain deferral method to tiered partnerships. First, if the section 721(c) property is an interest in a partnership, the contribution of that partnership interest, and not the indirect contribution of the underlying property of the lower-tier partnership, to a section 721(c) partnership is subject to section 721(c), and the gain deferral method applies to the contribution of the interest. Second, the gain deferral method must also be adopted at all levels in the ownership chain.

These principles, however, raise various issues in applying the gain deferral method to tiered partnerships: (i) not all partnerships in the ownership chain will necessarily be section 721(c) partnerships; (ii) when the book value of an interest in a partnership reflects appreciation in the property of the lower-tier partnership that has not yet been reflected in the book value of the property, there will be a discrepancy between the built-in gain in the partnership interest and the built-in gain in the underlying property; (iii) an upper-tier partnership's allocation of its distributive share of certain lower-tier partnership items must comply with § 1.704-3(a)(9) (concerning the application of section 704(c) to tiered partnerships) and with the consistent allocation method; and (iv) a partnership whose interest is section 721(c) property that is contributed to a

section 721(c) partnership may have previously adopted a method other than the remedial allocation method with respect to its underlying section 704(c) property.

To address these issues, the temporary regulations specify requirements that must be satisfied, in addition to all the other requirements to apply the gain deferral method, in order for the gain deferral method to be applied to tiered partnerships. See § 1.721(c)-3T(b)(5) (the last requirement to apply the gain deferral method).

### b. Additional requirements for applying the gain deferral method

#### 1. In General

For purposes of applying the gain deferral method, the temporary regulations address the conditions required to be satisfied by upper-tier partnerships and lower-tier partnerships involved in tiered-partnership transactions to ensure that the gain deferral method is applied at all levels in the ownership chain and the allocation of partnership items up the chain correctly traces the built-in gain to the U.S. transferor. See § 1.721(c)-3T(d). In the base case in which a U.S. transferor directly contributes section 721(c) property to a section 721(c) partnership, the U.S. transferor will recognize gain under the general rule in these temporary regulations unless the gain deferral method is applied to the contribution. The same principle applies when section 721(c) property is indirectly (through an upper-tier partnership) contributed by a U.S. transferor to a section 721(c) partnership and the partnership look-through rule in § 1.721(c)-2T(d)(1) applies, in which case, the tiered-partnership rules in § 1.721(c)-3T(d)(2) apply to the transferor upper-tier partnership and all controlled partnerships above it in the ownership chain. In addition, when the section 721(c) property is an interest in a partnership, the tiered-partnership rules in § 1.721(c)-3T(d)(1) apply to the partnership whose interest is transferred and all controlled partnerships below it in the ownership chain. Therefore, when a partnership interest described in the preceding sentence is indirectly contributed by a U.S. transferor and the partnership look-

through rule applies, the rules of both § 1.721(c)-3T(d)(1) and (2) apply.

## 2. Indirect Contribution of Section 721(c) Property

Section 1.721(c)-3T(d)(2) provides the additional requirements for applying the gain deferral method if the section 721(c) property is indirectly contributed by a U.S. transferor to a section 721(c) partnership and the partnership look-through rule applies. In particular, this rule applies if an upper-tier partnership in which a U.S. transferor is a direct or indirect partner contributes section 721(c) property to a lower-tier section 721(c) partnership. The upper-tier partnership need not be a section 721(c) partnership for the partnership look-through rule to apply, but, in order for the upper-tier partnership to avoid immediate gain recognition under the general gain recognition rule, the lower-tier section 721(c) partnership must apply the gain deferral method to the contributed property. This application of the gain deferral method has several additional requirements. First, the lower-tier section 721(c) partnership must treat the upper-tier partnership (which is not necessarily a section 721(c) partnership) as the U.S. transferor solely for purposes of applying the consistent allocation method. Second, the upper-tier partnership, if it is a controlled partnership, must apply the gain deferral method to its interest in the lower-tier section 721(c) partnership. If the upper-tier partnership is not a section 721(c) partnership, it is deemed to be so, and the interest in the lower-tier section 721(c) partnership is deemed to be section 721(c) property. See § 1.721(c)-1T(b)(14)(ii) and (b)(15)(ii).

For the upper-tier partnership to apply the gain deferral method to the interest in the lower-tier partnership, § 1.704-3T(a)(13)(ii) provides that the upper-tier partnership must treat its distributive share of lower-tier partnership items of gain, loss, and amortization, depreciation, or other cost recovery deductions with respect to a lower-tier partnership's section 721(c) property as though they were items of gain, loss, and amortization, depreciation, or other cost recovery with respect to the upper-tier partnership's interest in the lower-tier partnership. Section

1.704-3T(a)(13)(ii) is intended to reach the same result as if an aggregate approach governed the application of § 1.704-3(a)(9) in the context of the gain deferral method. Section 1.704-3(a)(9) provides that if a partnership contributes section 704(c) property to a lower-tier partnership, or if a partner that receives a partnership interest in exchange for contributed property subsequently contributes the partnership interest to an upper-tier partnership, the upper-tier partnership must allocate its distributive share of lower-tier partnership items with respect to that section 704(c) property in a manner that takes into account the contributing partner's remaining built-in gain or loss. The Treasury Department and the IRS considered comments about aggregate treatment that were received on Notice 2009-70, 2009-34 I.R.B. 255, in developing the rule in § 1.704-3T(a)(13)(ii). This rule applies only to a tiered-partnership structure that has at least one section 721(c) partnership and to which the gain deferral method is applied. The Treasury Department and the IRS intend no inference regarding the application of § 1.704-3(a)(9) to partnerships not applying the gain deferral method.

If the U.S. transferor is an indirect partner in the upper-tier partnership through one or more partnerships, these requirements must be satisfied by each controlled partnership in the chain of ownership between the upper-tier partnership and the U.S. transferor.

### 3. Contribution of an Interest in a Partnership

Section 1.721(c)-3T(d)(1) provides the additional requirements for applying the gain deferral method if the section 721(c) property that is contributed to a section 721(c) partnership is an interest in a lower-tier partnership. The lower-tier partnership need not be a section 721(c) partnership. First, the lower-tier partnership, if it is a controlled partnership with respect to a U.S. transferor, must revalue all of its property under § 1.704-1T(b)(2)(iv)(f)(6) if the revaluation would result in a new positive reverse section 704(c) layer in at least one property that is not excluded property (revaluation requirement). If the lower-tier partnership is not a

section 721(c) partnership, it will be deemed to be so upon the revaluation. See § 1.721(c)-1T(b)(14)(ii).

The revaluation requirement ensures, to the greatest extent possible, that all appreciation in the underlying property of a lower-tier partnership that is reflected in the book value of the partnership interest in the lower-tier partnership is subject to the temporary regulations to the same extent that appreciation would be subject to the temporary regulations if the property of the lower-tier partnership (rather than the interest in the lower-tier partnership) were contributed.

Second, the lower-tier partnership must apply the gain deferral method with respect to each property (other than excluded property) for which there is a new positive reverse section 704(c) layer as a result of the revaluation. A property with a new positive reverse section 704(c) layer is deemed to be section 721(c) property, and the remaining built-in gain includes the new positive reverse section 704(c) layer. See § 1.721(c)-1T(b)(15)(ii) and (b)(13)(ii), respectively. Although § 1.721(c)-3T(b)(1)(i)(A) requires the application of the remedial allocation method to the remaining built-in gain, a lower-tier partnership may apply the gain deferral method by adopting the remedial allocation method only for the positive reverse section 704(c) layer if the partnership has previously adopted a section 704(c) method other than the remedial method for the property. Accordingly, the lower-tier partnership may continue to apply a different, historical section 704(c) method to forward section 704(c) layers or to pre-existing reverse section 704(c) layers, as applicable, and still satisfy the requirements of the gain deferral method. For further discussion of the revaluation requirement and the definition of a controlled partnership, see Paragraph c of this Part IX.

Third, the lower-tier partnership must treat a partner that is a partnership in which the U.S. transferor is a direct or indirect partner as the U.S. transferor solely for purposes of applying the consistent allocation requirement. As a result, the lower-tier partnership must allocate its book items to the deemed U.S. transferor under the consistent allocation method. Regardless of the number of tiers of

partnerships in the chain, the tiered-partnership rules are intended to cause the U.S. transferor that contributed (directly or indirectly) the lower-tier partnership interest to the section 721(c) partnership to be the person to recognize gain upon an acceleration event.

If the lower-tier partnership owns (directly or indirectly through one or more partnerships) one or more partnerships that are controlled partnerships with respect to the U.S. transferor, these three requirements must be satisfied by each controlled partnership.

#### c. Revaluation requirement

In recognition of the possibility that a U.S. transferor may not be able to cause a lower-tier partnership to revalue its property when a partnership interest is contributed to an upper-tier partnership, the revaluation requirement is limited to those lower-tier partnerships that are controlled partnerships with respect to the U.S. transferor. Control is a facts-and-circumstances test, except that the U.S. transferor and related persons will be deemed to control a partnership in which those persons, in the aggregate, own (directly or indirectly through one or more partnerships) more than 50 percent of the interests in partnership capital or profits. See § 1.721(c)-1T(b)(4).

The definition of built-in gain in the notice excluded revaluation gain because a reverse section 704(c) layer with respect to property does not arise on the contribution of that property. However, a partnership that does not create and apply the remedial method to a positive reverse section 704(c) layer created on the contribution of a lower-tier partnership interest to an upper-tier partnership may shift the tax consequences of a portion of the built-in gain to a partner that is a related foreign person. The Treasury Department and the IRS believe that the description of the tiered-partnership rules contained in the notice notified taxpayers of an intention to promulgate a rule with the result reached by the temporary regulations.

The revaluation requirement described in the gain deferral method requires an expansion of permissible events for partnership revaluations under section 704(b). Accordingly, § 1.704-1T(b)(2)(iv)(f)(6)



allows a partnership to revalue its property if the revaluation is a condition for applying the gain deferral method. When multiple partnerships revalue their property, the revaluations occur in order from the lowest-tier partnership to the highest-tier partnership.

If a partnership revalues its property, § 1.704-3T(a)(13)(i) provides that the principles of § 1.704-3(a)(9) shall apply to any reverse section 704(c) allocations made as a result of the revaluation.

In developing the revaluation requirement and § 1.704-3T(a)(13)(i), the Treasury Department and the IRS considered comments received on revaluation rules in proposed regulations under section 751(b) that are contained in a notice of proposed rulemaking (REG-151416-06) published on November 3, 2014, in the **Federal Register** (79 FR 65151). See proposed §§ 1.704-1(b)(2)(iv)(f) and 1.704-3(a)(9).

#### *X. Procedural and Reporting Requirements*

To comply with the gain deferral method, the notice described regulations that would be issued requiring reporting of a gain deferral contribution and annual reporting with respect to the section 721(c) property to which the gain deferral method applies. The notice requested comments on whether the regulations should provide rules similar to those in the regulations under sections 367(a) and 6038B regarding failures to file gain recognition agreements or to satisfy other reporting obligations, including the standards for relief therein. See T.D. 9704 (79 FR 68763) (the 2014 GRA regulations). Comments were received expressing support for this approach.

##### *a. Reporting and procedural requirements for the year of the gain deferral contribution*

The temporary regulations implement the rules described in the notice in a manner consistent with the approach in the 2014 GRA regulations. For a U.S. transferor, the reporting requirements include, among other information, the information required to be filed under section 6038B. The temporary regulations also adopt procedural requirements in order to seek re-

lief for a failure to meet the reporting requirements of the gain deferral method, which mirror the approach in the 2014 GRA regulations, including procedures relating to the manner by which a transferor can establish the lack of willfulness and that a failure was due to reasonable cause. See §§ 1.721(c)-6T(f) and 1.6038B-2T(h). The temporary regulations adopt these procedural requirements for all U.S. persons that have a reporting obligation under section 6038B with respect to a transfer of property to a foreign partnership and that are seeking relief under the reasonable cause exception, not only for U.S. transferors described in the section 721(c) regulations. The reasonable cause procedure in the temporary regulations applies to all requests for reasonable cause relief (regardless of the date on which the contribution or the failure to file occurred) filed on or after **January 18, 2017**.

In addition to adopting the current requirements of § 1.6038B-2(c), the temporary regulations require reporting necessary to demonstrate compliance with the gain deferral method. In general, the temporary regulations require a U.S. transferor to report information on a statement included on (or attached to) the Form 8865, Schedule O, Transfer of Property to a Foreign Partnership. The Treasury Department and the IRS intend that the Schedule O will be revised to include the information required by the temporary regulations.

For purposes of the U.S. transferor's reporting requirements under § 1.721(c)-6T with respect to a gain deferral contribution to a domestic section 721(c) partnership, a domestic section 721(c) partnership will generally be treated as foreign under section 7701(a)(4) for reporting purposes. See §§ 1.721(c)-6T(b)(4) and 1.6038B-2T(a)(1)(iii). As a result, a U.S. transferor that contributes section 721(c) property to a domestic section 721(c) partnership in a gain deferral contribution must file a Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships (including Form 8865, Schedule O, Transfer of Property to a Foreign Partnership), with its return for the taxable year that includes the date of the gain deferral contribution.

Also as a requirement of the gain deferral method, the temporary regulations

require that the U.S. transferor agree to extend the period of limitations on the assessment of tax for eight full taxable years with respect to the gain realized but not recognized on a gain deferral contribution, and for six full taxable years with respect to the U.S. transferor's distributive share of all items with respect to the section 721(c) property for the year of contribution and two subsequent years. See § 1.721(c)-6T(b)(5)(i) and (ii). The U.S. transferor also must agree to extend the period of limitations on the assessment of tax for five full taxable years with respect to the gain recognized on the contribution of section 721(c) property for which the gain deferral method is not applied if the contribution is made within five partnership taxable years following a gain deferral contribution. See § 1.721(c)-6T(b)(5)(iii). All agreements to extend the period of limitations on assessment of tax are deemed consented to and signed by the Secretary for purposes of section 6501(c)(4). The Treasury Department and the IRS intend to issue a designated form for use in extending the period of limitations by consent, as described above. Until the time such form is issued, the required consent must be submitted as a statement attached to the U.S. Transferor's Form 8865, Schedule O. Once such form is issued, the U.S. transferor must use the designated form to submit the required consent. These agreements must be filed only in connection with contributions occurring on or after **January 18, 2017**.

If section 721(c) property that is subject to the gain deferral method is ECI property, the temporary regulations require the U.S. transferor to obtain from the section 721(c) partnership and each related foreign person that is a direct or indirect partner in the section 721(c) partnership a statement pursuant to which the partner and the partnership waive any claim under any income tax convention (whether or not currently in force at the time of the contribution) to an exemption from U.S. income tax or a reduced rate of U.S. income taxation on income derived from the use of the ECI property for the period in which there is remaining built-in gain. See § 1.721(c)-6T(c)(1).

The temporary regulations require the U.S. transferor also to provide information with respect to related foreign part-

ners and certain section 721(c) partnerships under section 6038B and the gain deferral method. This requirement also applies in the case of a partnership in a tiered-partnership structure that applies the gain deferral method under § 1.721(c)-3T(d). See § 1.721(c)-6T(b)(2). The U.S. transferor must attach this information to its return.

If the section 721(c) partnership has a reporting obligation under section 6031, it also will be required to report certain information under the temporary regulations. See § 1.721(c)-6T(d). Although the temporary regulations require the partnership to submit certain information to the IRS and comply with other requirements relating to the application of the gain deferral method, a failure to do so will not constitute an acceleration event to the U.S. transferor. The Treasury Department and the IRS intend that the Form 1065, Schedule K-1, or their accompanying instructions will be revised to describe this required information. Failure to include this information may result in imposition of a penalty. See sections 6721 and 6722.

#### *b. Annual reporting requirements*

The temporary regulations require the U.S. transferor to provide certain information on an annual basis with respect to section 721(c) property subject to the gain deferral method. See §§ 1.721(c)-6T(b)(3) and 1.6038B-2T(c)(9). This includes information about income from the section 721(c) property (book and remedial income) allocated to the U.S. transferor in the partnership taxable year that ends with, or within, the U.S. transferor's taxable year, a calculation of remaining built-in gain, and information about acceleration, termination, successor, and partial acceleration events. The U.S. transferor must also attach a Schedule K-1 (Form 8865), Partner's Share of Income, Deductions, Credits, etc., for all related foreign persons that are direct or indirect partners in the section 721(c) partnership (if the partnership does not have a filing obligation under section 6031) for the partnership taxable year that ends with, or within, the U.S. transferor's taxable year.

In the case of ECI property subject to the gain deferral method, the U.S. transferor must annually declare that, after ex-

ercising reasonable diligence, to the best of the U.S. transferor's knowledge and belief all the income from the property was income effectively connected with the conduct of a trade or business within the United States, and no benefits with respect to the ECI property were claimed under any income tax convention by related foreign persons that are direct or indirect partners in the section 721(c) partnership or by the section 721(c) partnership. This requirement eliminates the potential need for related foreign persons that are direct or indirect partners in the section 721(c) partnership and the partnership to submit to the U.S. transferor an annual waiver of treaty benefits.

The U.S. transferor must describe all acceleration, termination, successor, and partial acceleration events that occur with respect to the section 721(c) property during the partnership taxable year that ends with, or within, the U.S. transferor's taxable year. When there is a successor event, the U.S. transferor must identify the new partnership, lower-tier partnership, upper-tier partnership, or U.S. corporation (as applicable). If the section 721(c) partnership is a foreign partnership, the U.S. transferor must include the information described in § 1.6038-3(g) (contents of information returns required of certain United States persons with respect to controlled foreign partnerships), if not already reported elsewhere, without regard to whether the section 721(c) partnership is a controlled foreign partnership or whether the U.S. transferor controlled the section 721(c) partnership. If the U.S. transferor is not a controlling fifty-percent partner (as defined in § 1.6038-3(a)), the U.S. transferor may comply with this requirement by providing only the information described in § 1.6038-3(g)(1). These requirements also apply to a U.S. transferor that is a successor, as described in Paragraph c.2 of Part VIII of the Explanation of Provisions section of this preamble.

If the section 721(c) partnership has a filing obligation under section 6031, the partnership must include the information required under § 1.721(c)-6T(b)(2) and (3) on the Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., of the U.S. transferor and all related foreign persons that are direct or

indirect partners in the section 721(c) partnership. See § 1.721(c)-6T(d)(2).

#### *XI. Effective/Applicability Dates*

The applicability dates of the temporary regulations generally relate back to the issuance of the notice. Accordingly, in general, the temporary regulations apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 that is filed on or after August 6, 2015 (referred to in this preamble as the "general applicability date"). However, new rules, including any substantive changes to the rules described in the notice, apply to contributions occurring on or after **January 18, 2017**, or to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 that is filed on or after **January 18, 2017**. Taxpayers may, however, elect to apply those new rules and substantive changes to the rules described in the notice to a contribution occurring on or after the general applicability date. The election is made by reflecting the application of the relevant rule on a timely filed or amended return.

#### **Special Analyses**

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that the collection of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that the temporary regulations include a \$1,000,000 de minimis exception for certain transfers, and tangible property with built-in gain that does not exceed \$20,000 is excluded from the regulations. In addition, the regulations only apply when a U.S. transferor contributes property to a partnership with a partner that is a related foreign person, and persons related to the U.S. transferor own more than 80 percent of the interests in the partner-

ship. Accordingly, the Treasury Department and the IRS expect that these regulations primarily will affect large domestic corporations. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

The principal author of these regulations is Ryan A. Bowen of the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

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### 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 entries in numerical order to read in part as follows:

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

Section 1.197-2T also issued under 26 U.S.C.197(g).

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Section 1.721(c)-1T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-2T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-3T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-4T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-5T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-6T also issued under 26 U.S.C. 721(c).

Section 1.721(c)-7T also issued under 26 U.S.C. 721(c).

\*\*\*\*\*

Section 1.6038B-2T also issued under 26 U.S.C. 6038B.

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Par. 2. Section 1.197-2 is amended by adding paragraphs (h)(12)(vii)(C) and (l)(5) to read as follows:

*§ 1.197-2 Amortization of goodwill and certain other intangibles.*

\*\*\*\*\*

(h) \* \* \*

(12) \* \* \*

(vii) \* \* \*

(C) [Reserved]. For further guidance, see § 1.197-2T(h)(12)(vii)(C).

\*\*\*\*\*

(l) \* \* \*

(5) [Reserved]. For further guidance, see § 1.197-2T(l)(5).

Par 3. Section 1.197-2T is added to read as follows:

*§ 1.197-2T Amortization of goodwill and certain other intangibles.*

(a) through (h)(12)(vii)(B) [Reserved]. For further guidance, see § 1.197-2(a) through (h)(12)(vii)(B).

(C) *Rules for section 721(c) partnerships.* See § 1.704-3T(d)(5)(iii) if there is a contribution of a section 197(f)(9) intangible to a section 721(c) partnership (as defined in § 1.721(c)-1T(b)(14)).

(viii) through (l)(4)(iii) [Reserved]. For further guidance, see § 1.197-2(h)(12)(viii) through (l)(4)(iii).

(5) *Rules for section 721(c) partnerships—(i) Applicability dates—(A) In general.* Except as provided in paragraph (l)(5)(i)(B) of this section, paragraph (h)(12)(vii)(C) of this section applies with respect to contributions occurring on or after **January 18, 2017**, and with respect to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(B) *Election to apply the provisions described in paragraph (l)(5)(i)(A) of this section retroactively.* Paragraph (h)(12)(vii)(C) of this section may, by election, be applied with respect to a contribution occurring on or after August 6, 2015, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (h)(12)(vii)(C) of this section on a timely filed original return (including extensions)

or an amended return filed no later than six months after **January 18, 2017**.

(ii) *Expiration date.* Paragraph (h)(12)(vii)(C) of this section expires on *January 17, 2020*.

Par. 4. Section 1.704-1 is amended by adding paragraph (b)(2)(iv)(f)(6) following the undesignated paragraph at the end of paragraph (b)(2)(iv)(f)(5) and adding paragraph (f) to read as follows:

*§ 1.704-1 Partner's distributive share.*

\*\*\*\*\*

(b) \* \* \*

(2) \* \* \*

(iv) \* \* \*

(f) \* \* \*

(6) [Reserved]. For further guidance, see § 1.704-1T(b)(2)(iv)(f)(6).

\*\*\*\*\*

(f) [Reserved]. For further guidance, see § 1.704-1T(f).

Par. 5. Section 1.704-1T is amended by:

1. Revising paragraphs (b)(1)(iii) through (b)(2)(iv)(f)(5).
2. Adding paragraph (b)(2)(iv)(f)(6).
3. Revising paragraphs (b)(2)(iv)(g) through (b)(4)(viii)(a) introductory text.
3. Redesignating paragraph (f) as paragraph (g).
4. Adding a new paragraph (f).
5. Revising newly redesignated paragraph (g).

The additions and revisions read as follows:

*§ 1.704-1T Partner's distributive share (temporary).*

\*\*\*\*\*

(b)(1)(iii) through (b)(2)(iv)(f)(5) [Reserved]. For further guidance, see § 1.704-1(b)(1)(iii) through (b)(2)(iv)(f)(5).

(6) Notwithstanding paragraph (b)(2)(iv)(f)(5) of this section, the revaluation is required under § 1.721(c)-3T(d)(1) as a condition of the application of the gain deferral method (as described in § 1.721(c)-3T(b)) and is pursuant to an event described in this paragraph (b)(2)(iv)(f)(6). If an interest in a partnership is contributed to a section 721(c) partnership (as defined in § 1.721(c)-1T(b)(14)), the partnership whose interest is contributed



may revalue its property in accordance with this section. In this case, the revaluation by the partnership whose interest was contributed must occur immediately before the contribution. If a partnership that revalues its property pursuant to this paragraph owns an interest in another partnership, the partnership in which it owns an interest may also revalue its property in accordance with this section. When multiple partnerships revalue under this paragraph (b)(2)(iv)(f)(6), the revaluations occur in order from the lowest-tier partnership to the highest-tier partnership.

(b)(2)(iv)(g) through (b)(4)(viii)(a) introductory text [Reserved]. For further guidance, see § 1.704-1(b)(2)(iv)(g) through (b)(4)(viii)(a) introductory text.  
\* \* \* \* \*

(f) *Dates*—(1) *Applicability dates*—(i) *In general*. Except as provided in paragraph (f)(1)(ii) of this section, paragraph (b)(2)(iv)(f)(6) of this section applies with respect to contributions occurring on or after **January 18, 2017**, and with respect to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(ii) *Election to apply the provisions described in paragraph (f)(1)(i) of this section retroactively*. Paragraph (b)(2)(iv)(f)(6) of this section may, by election, be applied with respect to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and with respect to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (b)(2)(iv)(f)(6) of this section on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**.

(2) *Expiration date*. Paragraph (b)(2)(iv)(f)(6) of this section expires on **January 17, 2020**.

(g) *Expiration date*. The applicability of this section (other than paragraphs (b)(2)(iv)(f)(6) and (f) of this section) expires on February 4, 2019.

Par. 6. Section 1.704-3 is amended by adding paragraphs (a)(13), (d)(5)(iii), and (g) to read as follows:

§ 1.704-3 *Contributed property*.

(a) \* \* \*

(13) [Reserved]. For further guidance, see § 1.704-3T(a)(13).

\* \* \* \* \*

(d) \* \* \*

(5) \* \* \*

(iii) [Reserved]. For further guidance, see § 1.704-3T(d)(5)(iii).

\* \* \* \* \*

(g) [Reserved]. For further guidance, see § 1.704-3T(g).

Par. 7. Section 1.704-3T is added to read as follows:

§ 1.704-3T *Contributed property (temporary)*.

(a)(1) through (12) [Reserved]. For further guidance, see § 1.704-3(a)(1) through (12).

(13) *Rules for tiered section 721(c) partnerships*—(i) *Revaluations*. If a partnership revalues its property pursuant to § 1.704-1T(b)(2)(iv)(f)(6) immediately before an interest in the partnership is contributed to another partnership, or if an upper-tier partnership owns an interest in a lower-tier partnership, and both the upper-tier partnership and the lower-tier partnership revalue partnership property pursuant to § 1.704-1T(b)(2)(iv)(f)(6), the principles of § 1.704-3(a)(9) will apply to any reverse section 704(c) allocations made as a result of the revaluation.

(ii) *Basis-derivative items*. If a lower-tier partnership that is a section 721(c) partnership applies the gain deferral method, then, for purposes of applying this section, the upper-tier partnership must treat its distributive share of lower-tier partnership items of gain, loss, amortization, depreciation, or other cost recovery with respect to the lower-tier partnership's section 721(c) property as though they were items of gain, loss, amortization, depreciation, or other cost recovery with respect to the upper-tier partnership's interest in the lower-tier partnership. For purposes of this paragraph (a)(13)(ii), gain deferral method is defined in § 1.721(c)-1T(b)(8), section 721(c) partnership is defined in § 1.721(c)-1T(b)(14), and section 721(c) property is defined in § 1.721(c)-1T(b)(15).

(b) through (d)(5)(ii) [Reserved]. For further guidance, see § 1.704-3(b) through (d)(5)(ii).

(iii) *Special rules for a section 721(c) partnership and anti-churning property*—(A) *In general*. Solely in the case of a gain deferral contribution of section 721(c) property that is a section 197(f)(9) intangible that was not an amortizable section 197 intangible in the hands of the contributor, the remedial allocation method is modified with respect to allocations to a related person to the U.S. transferor pursuant to paragraphs (d)(5)(iii)(B) through (F) of this section. For purposes of this paragraph (d)(5)(iii), gain deferral contribution is defined in § 1.721(c)-1T(b)(7), related person is defined in § 1.721(c)-1T(b)(12), section 721(c) partnership is defined in § 1.721(c)-1T(b)(14), section 721(c) property is defined in § 1.721(c)-1T(b)(15), and U.S. transferor is defined in § 1.721(c)-1T(b)(18). For an example applying the rules of this paragraph (d)(5)(iii), see § 1.721(c)-7T, *Example 6*.

(B) *Book basis recovery*. The section 721(c) partnership must amortize the portion of the partnership's book value in the section 197(f)(9) intangible that exceeds the adjusted basis in the property upon contribution using any recovery period and amortization method available to the partnership as if the property had been newly purchased by the partnership from an unrelated party.

(C) *Effect of ceiling rule limitations*. If the ceiling rule causes the book allocation of the item of amortization of a section 197(f)(9) intangible under paragraph (d)(5)(iii)(B) of this section by a section 721(c) partnership to a related person with respect to the U.S. transferor to differ from the tax allocation of the same item to the related person (a ceiling rule limited related person), the partnership must not create a remedial item of deduction to allocate to the related person but instead must increase the adjusted basis of the section 197(f)(9) intangible by an amount equal to the difference solely with respect to that related person. The partnership simultaneously must create an offsetting remedial item in an amount identical to the increase in adjusted tax basis of the section 197(f)(9) intangible and allocate it to the contributing partner.

(D) *Effect of basis adjustment*—(1) *In general.* The basis adjustment described in paragraph (d)(5)(iii)(C) of this section constitutes an adjustment to the adjusted basis of a section 197(f)(9) intangible with respect to the ceiling rule limited related person only. No adjustment is made to the common basis of partnership property. Thus, for purposes of calculating gain and loss, the ceiling rule limited related person will have a special basis for that section 197(f)(9) intangible. The adjustment to the basis of partnership property under this section has no effect on the partnership's computation of any item under section 703.

(2) *Computation of a partner's distributive share of partnership items.* The partnership first computes its items of gain or loss at the partnership level under section 703. The partnership then allocates the partnership items among the partners, including the ceiling rule limited related person, in accordance with section 704, and adjusts the partners' capital accounts accordingly. The partnership then adjusts the ceiling rule limited related person's distributive share of the items of partnership gain or loss, in accordance with paragraph (d)(5)(iii)(D)(3) of this section, to reflect the effects of that person's basis adjustment under this section. These adjustments to that person's distributive shares must be reflected on Schedules K and K-1 of the partnership's return (Form 1065) (when otherwise required to be completed) and do not affect that person's capital account.

(3) *Effect of basis adjustment in determining items of income, gain, or loss.* The amount of a ceiling rule limited related person's gain or loss from the sale or exchange of a section 197(f)(9) intangible in which that person has a tax basis adjustment is equal to that person's share of the partnership's gain or loss from the sale of the asset (including any remedial allocations under this paragraph (d) and § 1.704-3(d)), minus the amount of that person's tax basis adjustment for the section 197(f)(9) intangible.

(E) *Subsequent transfers*—(1) *In general.* Except as provided in paragraph (d)(5)(iii)(E)(2) of this section, if a ceiling rule limited related person transfers all or part of its partnership interest, the portion of the basis adjustment for a section

197(f)(9) intangible attributable to the interest transferred is eliminated. The transferor of the partnership interest remains the ceiling rule limited related person with respect to any remaining basis adjustment for the section 197(f)(9) intangible.

(2) *Special rules for substituted basis transactions.* Paragraph (d)(5)(iii)(E)(1) of this section does not apply to the extent a ceiling rule limited related person transfers its partnership interest in a transaction in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the ceiling rule limited related person's basis in that interest. Instead, in such a case, the transferee succeeds to that portion of the transferor's basis adjustment for a section 197(f)(9) intangible attributable to the interest transferred. In such a case, the basis adjustment in a section 197(f)(9) intangible to which the transferee succeeds is taken into account for purposes of determining the transferee's share of the adjusted basis to the partnership of the partnership's property for purposes of §§ 1.743-1(b) and 1.755-1(b)(5). To the extent a transferee would be required to decrease the adjusted basis of a section 197(f)(9) intangible pursuant to §§ 1.743-1(b)(2) and 1.755-1(b)(5), the decrease first reduces the special basis adjustment described in paragraph (d)(5)(iii)(C) of this section, if any, to which the transferee succeeds.

(F) *Non-amortization of basis adjustment.* Neither the increase to the adjusted basis of a section 197(f)(9) intangible with respect to a ceiling rule limited related person nor the portion of the basis of any property that was determined by reference to such increase is subject to amortization, depreciation, or other cost recovery.

(d)(6) through (f) [Reserved]. For further guidance, see § 1.704-3(d)(6) through (f).

(g) *Certain rules for section 721(c) partnerships*—(1) *Applicability dates*—(i) *In general.* Notwithstanding § 1.704-3(f), except as provided in paragraph (g)(1)(ii) of this section, paragraphs (a)(13) and (d)(5)(iii) of this section apply with respect to contributions occurring on or after **January 18, 2017**, and with respect to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this

chapter that is filed on or after **January 18, 2017**.

(ii) *Election to apply the provisions described in paragraph (g)(1)(i) of this section retroactively.* Paragraphs (a)(13) and (d)(5)(iii) of this section may, by election, be applied with respect to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and with respect to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (a)(13) or paragraph (d)(5)(iii) of this section, as applicable, on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**.

(2) *Expiration date.* The applicability of paragraphs (a)(13) and (d)(5)(iii) of this section expires on *January 17, 2020*.

Par. 8. Section 1.721(c)-1T is added to read as follows:

*§ 1.721(c)-1T Overview, definitions, and rules of general application (temporary).*

(a) *Overview*—(1) *In general.* This section and §§ 1.721(c)-2T through 1.721(c)-7T (collectively, the *section 721(c) regulations*) provide rules under section 721(c). This section provides definitions and rules of general application for purposes of the section 721(c) regulations. Section 1.721(c)-2T provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Section 1.721(c)-3T describes the gain deferral method, which may be applied in order to avoid the immediate recognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Section 1.721(c)-4T provides rules regarding acceleration events for purposes of applying the gain deferral method. Section 1.721(c)-5T identifies exceptions to the rules regarding acceleration events provided in § 1.721(c)-4T(b). Section 1.721(c)-6T provides procedural and reporting requirements. Section 1.721(c)-7T provides examples illustrating the application of the section 721(c) regulations.

(2) *Scope.* Paragraph (b) of this section provides definitions. Paragraph (c) of this section describes the treatment of a change in form of a partnership. Paragraph (d) of this section provides an anti-abuse rule. Paragraph (e) of this section provides the dates of applicability, and paragraph (f) of this section provides the date of expiration.

(b) *Definitions.* The following definitions apply for purposes of the section 721(c) regulations. Unless otherwise indicated, the definitions apply on a property-by-property basis, as applicable.

(1) *Acceleration event.* An acceleration event has the meaning provided in § 1.721(c)-4T(b).

(2) *Built-in gain.* Built-in gain is, with respect to property contributed to a partnership, the excess of the book value of the property over the partnership's adjusted tax basis in the property upon the contribution, determined without regard to the application of § 1.721(c)-2T(b).

(3) *Consistent allocation method.* The consistent allocation method is the method described in § 1.721(c)-3T(c).

(4) *Controlled partnership.* A partnership is a controlled partnership with respect to a U.S. transferor if the U.S. transferor and related persons control the partnership. For this purpose, control is determined based on all the facts and circumstances, except that a partnership will be deemed to be controlled by a U.S. transferor and related persons if those persons, in the aggregate, own (directly or indirectly through one or more partnerships) more than 50 percent of the interests in the partnership capital or profits.

(5) *Direct or indirect partner.* A direct or indirect partner is a person (other than a partnership) that owns an interest in a partnership directly or indirectly through one or more partnerships.

(6) *Excluded property.* Excluded property is—

- (i) A cash equivalent;
- (ii) A security within the meaning of section 475(c)(2), without regard to section 475(c)(4);
- (iii) Tangible property with a book value exceeding adjusted tax basis by no more than \$20,000 or with an adjusted tax basis in excess of book value; and

(iv) An interest in a partnership in which 90 percent or more of the property (as measured by value) held by the partnership (directly or indirectly through interests in one or more partnerships that are not excluded property) consists of property described in paragraphs (b)(6)(i) through (iii) of this section.

(7) *Gain deferral contribution.* A gain deferral contribution is a contribution of section 721(c) property to a section 721(c) partnership with respect to which the recognition of gain is deferred under the gain deferral method.

(8) *Gain deferral method.* The gain deferral method is the method described in § 1.721(c)-3T(b).

(9) *Partial acceleration event.* A partial acceleration event is an event described in § 1.721(c)-5T(d)(2) or (3).

(10) *Regulatory allocation.* A regulatory allocation is—

- (i) An allocation pursuant to a minimum gain chargeback, as defined in § 1.704-2(b)(2);
- (ii) A partner nonrecourse deduction, as determined in § 1.704-2(i)(2);
- (iii) An allocation pursuant to a partner minimum gain chargeback, as described in § 1.704-2(i)(4);
- (iv) An allocation pursuant to a qualified income offset, as defined in § 1.704-1(b)(2)(ii)(d);
- (v) An allocation with respect to the exercise of a noncompensatory option described in § 1.704-1(b)(2)(iv)(s); and
- (vi) An allocation of partnership level ordinary income or loss described in § 1.751-1(a)(3).

(11) *Related foreign person.* A related foreign person is, with respect to a U.S. transferor, a related person (other than a partnership) that is not a U.S. person.

(12) *Related person.* A related person is, with respect to a U.S. transferor, a person that is related (within the meaning of section 267(b) or 707(b)(1)) to the U.S. transferor.

(13) *Remaining built-in gain*—(i) *In general.* Remaining built-in gain is, with respect to section 721(c) property subject to the gain deferral method, the built-in gain reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for this purpose,

without taking into account increases or decreases to the property's book value pursuant to § 1.704-1(b)(2)(iv)(f) or (s).

(ii) *Special rule for tiered partnerships.* If section 721(c) property is described in § 1.721(c)-3T(d)(1)(ii), the remaining built-in gain includes the new positive reverse section 704(c) layer described in § 1.721(c)-3T(d)(1)(ii), reduced by decreases in the difference between the property's book value and adjusted tax basis, but, for this purpose, without taking into account increases or decreases to the property's book value pursuant to § 1.704-1(b)(2)(iv)(f) or (s) that are unrelated to the revaluation described in § 1.721(c)-3T(d)(1)(i).

(14) *Section 721(c) partnership*—(i) *In general.* A partnership (domestic or foreign) is a section 721(c) partnership if there is a contribution of section 721(c) property to the partnership and, after the contribution and all transactions related to the contribution—

- (A) A related foreign person with respect to the U.S. transferor is a direct or indirect partner in the partnership; and
- (B) The U.S. transferor and related persons own 80 percent or more of the interests in partnership capital, profits, deductions, or losses.

(ii) *Special rule for tiered partnerships.* A partnership described in § 1.721(c)-3T(d)(1) or (2) is deemed to be a section 721(c) partnership for purposes of the gain deferral method.

(15) *Section 721(c) property*—(i) *In general.* Section 721(c) property is property, other than excluded property, with built-in gain that is contributed to a partnership by a U.S. transferor, including pursuant to a contribution described in § 1.721(c)-2T(d) (partnership look-through rule). If the U.S. transferor is treated as contributing its share of property to a partnership pursuant to § 1.721(c)-2T(d), the entire property will be section 721(c) property.

(ii) *Special rule for tiered partnerships.* Property described in § 1.721(c)-3T(d)(1)(ii) and an interest in a partnership described in § 1.721(c)-3T(d)(2)(ii) is deemed to be section 721(c) property.

(16) *Successor event.* A successor event is an event described in § 1.721(c)-5T(c)(2), (3), (4), or (5).



(17) *Termination event.* A termination event is an event described in § 1.721(c)–5T(b)(2), (3), (4), (5), (6), or (7).

(18) *U.S. transferor*—(i) *In general.* A U.S. transferor is a United States person within the meaning of section 7701(a)(30) (a *U.S. person*), other than a domestic partnership.

(ii) *Special rule for tiered partnerships.* Solely for purposes of applying the consistent allocation method, a U.S. transferor includes a partnership that is treated as a U.S. transferor under § 1.721(c)–3T(d)(1)(iii) or (d)(2)(i).

(c) *Change in form of a partnership.* A mere change in identity, form, or place of organization of a partnership or a recapitalization of a partnership will not cause the partnership to become a section 721(c) partnership.

(d) *Anti-abuse rule.* If a U.S. transferor engages in a transaction (or series of transactions) or an arrangement with a principal purpose of avoiding the application of the section 721(c) regulations, the transaction (or series of transactions) or the arrangement may be recharacterized (including by aggregating or disregarding steps or disregarding an intermediate entity) in accordance with its substance.

(e) *Applicability dates*—(1) *In general.* Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015.

(2) *Certain provisions.* Except as provided in paragraph (e)(3) of this section, paragraphs (b)(6)(iv) and (c) of this section apply to contributions occurring on or after **January 18, 2017**, and to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after **January 18, 2017**. Except as provided in paragraph (e)(3) of this section, paragraph (b)(14)(i)(B) of this section applies by replacing “80 percent or more” with “greater than 50 percent” with respect to contributions occurring on or after August 6, 2015, but before **January 18, 2017**, and with respect to contributions occurring before August 6, 2015, resulting from an entity classification election made

under § 301.7701–3 of this chapter that is filed on or after August 6, 2015, but before **January 18, 2017**.

(3) *Election to apply the provisions described in paragraph (e)(2) of this section retroactively.* Paragraphs (b)(6)(iv), (b)(14)(i)(B), and (c) of this section, without the modification described in paragraph (e)(2) of this section, may, by election, be applied to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701–3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (b)(6)(iv) or (c) as described in paragraph (b)(14)(i)(B) or (e)(2) of this section, without the modification described in paragraph (e)(2) of this section, as applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**.

(f) *Expiration date.* The applicability of this section expires on *January 17, 2020*.

Par. 9. Section 1.721(c)–2T is added to read as follows:

*§ 1.721(c)–2T Recognition of gain on certain contributions of property to partnerships with related foreign partners (temporary).*

(a) *Scope.* This section provides the general operative rules that override section 721(a) nonrecognition of gain upon a contribution of section 721(c) property to a section 721(c) partnership. Paragraph (b) of this section provides the general rule that nonrecognition of gain under section 721(a) does not apply to a contribution of section 721(c) property to a section 721(c) partnership. Paragraph (c) of this section provides a de minimis exception to the application of the general rule in paragraph (b) of this section. Paragraph (d) of this section provides rules for identifying a section 721(c) partnership when a partnership in which a U.S. transferor is a direct or indirect partner contributes property to another partnership. Paragraph (e) of this section provides the dates of applicability, and paragraph (f) of this section provides the date of expiration. For

definitions that apply for purposes of this section, see § 1.721(c)–1T(b).

(b) *General rule for contributions of section 721(c) property.* Except as provided in this paragraph (b), paragraph (c) of this section, and § 1.721(c)–3T (describing the gain deferral method), nonrecognition under section 721(a) will not apply to gain realized by the contributing partner upon a contribution of section 721(c) property to a section 721(c) partnership. This paragraph (b) does not apply to a direct contribution by a U.S. transferor if the U.S. transferor and related persons with respect to the U.S. transferor do not own 80 percent or more of the interests in partnership capital, profits, deductions, or losses.

(c) *De minimis exception.* Paragraph (b) of this section will not apply with respect to contributions to a section 721(c) partnership during a taxable year of the section 721(c) partnership for which the sum of the built-in gain with respect to all section 721(c) property contributed in that taxable year does not exceed \$1 million. If, pursuant to the last sentence of paragraph (b) of this section, a direct contribution of property to the section 721(c) partnership by a U.S. transferor is not subject to paragraph (b) of this section, then such contribution is not taken into account for purposes of this paragraph (c).

(d) *Rules for identifying a section 721(c) partnership when a partnership contributes property to another partnership*—(1) *Partnership look-through rule.* If a U.S. transferor is a direct or indirect partner in a partnership (upper-tier partnership) and the upper-tier partnership contributes all or a portion of its property to another partnership (lower-tier partnership), then, for purposes of determining if the lower-tier partnership is a section 721(c) partnership, the U.S. transferor is treated as contributing to the lower-tier partnership its share of the property actually contributed by the upper-tier partnership to the lower-tier partnership.

(2) *Exception for a technical termination of a partnership.* Paragraph (d)(1) of this section will not apply to a deemed contribution that occurs as a result of a termination of a partnership described in section 708(b)(1)(B) (technical termination). If a partnership is a section 721(c) partnership immediately before a technical

termination, see § 1.721(c)-5T(c)(4) (which treats technical terminations as successor events in certain circumstances).

(e) *Applicability dates*—(1) *In general*. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015.

(2) *Certain provisions*. Except as provided in paragraph (e)(3) of this section, the final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, and paragraph (d)(2) of this section apply to contributions occurring on or after **January 18, 2017**, and to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(3) *Election to apply the provisions described in paragraph (e)(2) of this section retroactively*. The final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, and paragraph (d)(2) of this section may, by election, be applied to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying the final sentence of paragraph (b) of this section, the final sentence of paragraph (c) of this section, or paragraph (d)(2) of this section, as applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**.

(f) *Expiration date*. The applicability of this section expires on **January 17, 2020**.

Par. 10. Section 1.721(c)-3T is added to read as follows:

*§ 1.721(c)-3T Gain deferral method (temporary).*

(a) *Scope*. This section describes the gain deferral method to avoid the immediate recognition of gain upon a contribu-

tion of section 721(c) property to a section 721(c) partnership. Paragraph (b) of this section provides the requirements of the gain deferral method, including the requirement to apply the consistent allocation method. Paragraph (c) of this section describes the consistent allocation method. Paragraph (d) of this section provides rules for tiered partnerships. Paragraph (e) of this section provides the dates of applicability, and paragraph (f) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)-1T(b).

(b) *Requirements of the gain deferral method*. A contribution of section 721(c) property to a section 721(c) partnership that would be subject to § 1.721(c)-2T(b) will not be subject to § 1.721(c)-2T(b) if the conditions in paragraphs (b)(1) through (5) of this section are satisfied with respect to that property.

(1) Either—

(i) Both—

(A) The section 721(c) partnership adopts the remedial allocation method described in § 1.704-3(d) with respect to the section 721(c) property; and

(B) The section 721(c) partnership applies the consistent allocation method provided in paragraph (c) of this section; or

(ii) For the period beginning on the date of the contribution of the section 721(c) property and ending on the date on which there is no remaining built-in gain with respect to that property, all distributive shares of income and gain with respect to the section 721(c) property for all direct and indirect partners that are related foreign persons with respect to the U.S. transferor will be subject to taxation as income effectively connected with a trade or business within the United States (under either section 871 or 882), and neither the section 721(c) partnership nor a related foreign person that is a direct or indirect partner in the section 721(c) partnership claims benefits under an income tax convention that would exempt the income or gain from tax or reduce the rate of taxation to which the income or gain is subject.

(2) Upon an acceleration event, the U.S. transferor recognizes an amount of gain equal to the remaining built-in gain with respect to the section 721(c) property or an amount of gain required to be rec-

ognized under § 1.721(c)-5T(d) or (e), as applicable.

(3) The procedural and reporting requirements provided in § 1.721(c)-6T(b) are satisfied.

(4) The U.S. transferor consents to extend the period of limitations on assessment of tax as required by § 1.721(c)-6T(b)(5).

(5) If the section 721(c) property is a partnership interest or property described in the partnership look-through rule provided in § 1.721(c)-2T(d), the applicable tiered-partnership rules provided in paragraph (d) of this section are applied.

(c) *Consistent allocation method*—(1) *In general*. For each taxable year of a section 721(c) partnership in which there is remaining built-in gain in the section 721(c) property, the section 721(c) partnership must allocate each book item of income, gain, deduction, and loss with respect to the section 721(c) property to the U.S. transferor in the same percentage. For exceptions to this general rule, see paragraph (c)(4) of this section.

(2) *Determining income or gain with respect to section 721(c) property*. For purposes of applying paragraph (c)(1) of this section, a section 721(c) partnership must attribute book income and gain to each item of section 721(c) property in a consistent manner using any reasonable method taking into account all the facts and circumstances. All items of book income and gain attributable to an item of section 721(c) property will comprise a single class of gross income for purposes of applying paragraph (c)(3) of this section.

(3) *Determining deduction or loss with respect to section 721(c) property*. For purposes of applying paragraph (c)(1) of this section, a section 721(c) partnership must use the principles of §§ 1.861-8 and 1.861-8T to allocate and apportion its items of deduction, except for interest expense and research and experimental expenditures, and loss to the class of gross income with respect to each item of section 721(c) property as determined in paragraph (c)(2) of this section. Accordingly, a deduction or loss will be considered to be definitely related and therefore allocable to a class of gross income with respect to particular section 721(c) property whether or not there is any item of gross income in that class that is received

or accrued during the taxable year and whether or not the amount of deduction or loss exceeds the amount of gross income in that class during the taxable year. If a deduction or loss is definitely related and therefore allocable to gross income attributable to more than one class of gross income of the section 721(c) partnership or if a deduction or loss is not definitely related to any class of gross income of the section 721(c) partnership, the section 721(c) partnership must apportion that deduction or loss among its classes of gross income using a reasonable method that reflects to a reasonably close extent the factual relationship between the deduction or loss and the classes of gross income. The section 721(c) partnership may allocate and apportion its interest expense and research and experimental expenditures under any reasonable method, including, but not limited to, the methods prescribed in §§ 1.861-9 and 1.861-9T (interest expense) and § 1.861-17 (research and experimental expenditures). For this purpose, the section 721(c) partnership must allocate and apportion its deductions and losses without regard to the partners' percentage interests in the partnership.

(4) *Exceptions to the consistent allocation method*—(i) *Regulatory allocations*. A regulatory allocation (as defined in § 1.721(c)-1T(b)(10)) of book income, gain, deduction, or loss with respect to section 721(c) property that otherwise would fail to satisfy paragraph (c)(1) of this section is nevertheless deemed to satisfy that paragraph if the allocation is—

(A) An allocation of income or gain to the U.S. transferor (or a member of its consolidated group as defined in § 1.1502-1(h));

(B) An allocation of deduction or loss to a partner other than the U.S. transferor (or a member of its consolidated group); or

(C) Treated as a partial acceleration event pursuant to § 1.721(c)-5T(d)(2).

(ii) *Allocation of creditable foreign tax expenditures*. An allocation of a creditable foreign tax expenditure (as defined in § 1.704-1(b)(4)(viii)(b)) is not subject to the consistent allocation method.

(d) *Tiered partnership rules*. This paragraph (d) provides the tiered partnership rules referred to in paragraph (b)(5) of this section.

(1) *Section 721(c) property is a partnership interest*. If the section 721(c) property that is contributed to a section 721(c) partnership is an interest in a partnership (lower-tier partnership), then the lower-tier partnership, if it is a controlled partnership with respect to the U.S. transferor, and each partnership in which an interest is owned (directly or indirectly through one or more partnerships) by the lower-tier partnership and that is a controlled partnership with respect to the U.S. transferor, must satisfy the requirements of paragraphs (d)(1)(i), (ii), and (iii) of this section.

(i) The partnership must revalue all its property under § 1.704-1(b)(2)(iv)(f)(6) if the revaluation would result in a separate positive difference between book value and adjusted tax basis in at least one property that is not excluded property.

(ii) The partnership must apply the gain deferral method for each property (other than excluded property) for which there is a separate positive difference between book value and adjusted tax basis resulting from the revaluation described in paragraph (d)(1) of this section (*new positive reverse section 704(c) layer*). If the partnership has previously adopted a section 704(c) method other than the remedial allocation method for the property, the partnership satisfies the requirement of paragraph (b)(1)(i)(A) of this section by adopting the remedial allocation method for the new positive reverse section 704(c) layer.

(iii) The partnership must treat a partner that is a partnership in which the U.S. transferor is a direct or indirect partner as if it were the U.S. transferor with respect to the section 721(c) property solely for purposes of applying the consistent allocation method.

(2) *Section 721(c) property is indirectly contributed by a U.S. transferor under the partnership look-through rule*. If the U.S. transferor is a direct or indirect partner in the upper-tier partnership described in § 1.721(c)-2T(d)(1), and under § 1.721(c)-2T(d)(1), the U.S. transferor is treated as contributing the section 721(c) property (including an interest in a partnership described in paragraph (d)(1) of this section) to a section 721(c) partnership, then the requirements of paragraphs (d)(2)(i), (ii), and (iii) of this section must be satisfied.

(i) The section 721(c) partnership must treat the upper-tier partnership as the U.S. transferor of the section 721(c) property solely for purposes of applying the consistent allocation method;

(ii) The upper-tier partnership, if it is a controlled partnership with respect to the U.S. transferor, must apply the gain deferral method to its interest in the section 721(c) partnership; and

(iii) If the U.S. transferor is an indirect partner in the upper-tier partnership through one or more partnerships, the principles of paragraphs (d)(2)(i) and (ii) of this section must be applied with respect to those partnerships that are controlled partnerships with respect to the U.S. transferor.

(e) *Applicability dates*—(1) *In general*. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015.

(2) *Certain provisions*. Except as provided in paragraph (e)(3) of this section, paragraphs (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (d)(1) and (2) of this section apply to contributions occurring on or after **January 18, 2017**, and to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(3) *Election to apply the provisions described in paragraph (e)(2) of this section retroactively*. Paragraphs (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (d)(1) and (2) of this section may, by election, be applied to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying paragraph (b)(1)(ii), (c)(2) and (3), (c)(4)(i) and (ii), and (d)(1) or (2) of this section, as applicable, to the contribution on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**. In order to elect to apply paragraph (c)(2) or (3) of this section to a contribution described in



this paragraph (e)(3), an election must also be made to apply paragraph (c)(3) or (2) of this section, respectively, to the contribution.

(4) *Transitional rules.* If a contribution is described in paragraph (e)(2) of this section and no election described in paragraph (e)(3) of this section is made to apply one or more of paragraphs (c)(2) and (3) and (c)(4)(i) and (ii) of this section, as applicable, to the contribution, then, for purposes of paragraph (c)(1) of this section, the section 721(c) partnership must attribute book income, gain, loss, and deduction to the section 721(c) property in a consistent manner under any reasonable method taking into account all the facts and circumstances. If a contribution is described in paragraph (e)(2) of this section and no election described in paragraph (e)(3) of this section is made to apply paragraph (d)(1) or (2) of this section, as applicable, to the contribution, then, this section must be applied in a manner consistent with the purpose of the section 721(c) regulations. Thus, for example, if a U.S. transferor is a direct or indirect partner in a partnership and that partnership contributes section 721(c) property to a lower-tier partnership, or, if a U.S. transferor contributes an interest in a partnership that owns section 721(c) property to a lower-tier partnership, then paragraph (b) of this section applies as though the U.S. transferor contributed its share of the section 721(c) property directly.

(f) *Expiration date.* The applicability of this section expires on **January 17, 2020**.

Par. 11. Section 1.721(c)-4T is added to read as follows:

*§ 1.721(c)-4T Acceleration events (temporary).*

(a) *Scope.* This section provides rules regarding acceleration events for purposes of applying the gain deferral method. Paragraph (b) of this section defines an acceleration event. Paragraph (c) of this section provides the consequences of an acceleration event. Paragraph (d) of this section provides the dates of applicability, and paragraph (e) of this section provides the date of expiration. For definitions that

apply for purposes of this section, see § 1.721(c)-1T(b).

(b) *Definition of an acceleration event—*

(1) *General rules.* Except as provided in this paragraph (b) and § 1.721(c)-5T (acceleration event exceptions), an acceleration event with respect to section 721(c) property is any event that either would reduce the amount of remaining built-in gain that a U.S. transferor would recognize under the gain deferral method if the event had not occurred or could defer the recognition of the remaining built-in gain. An acceleration event includes a contribution of section 721(c) property to another partnership by a section 721(c) partnership and a contribution of an interest in a section 721(c) partnership to another partnership. This paragraph (b) applies on a property-by-property basis.

(2) *Failure to comply with a requirement of the gain deferral method—*(i) *General rule.* An acceleration event with respect to section 721(c) property occurs when any party fails to comply with a condition of the gain deferral method with respect to the section 721(c) property.

(ii) *Certain failures to comply with procedural and reporting requirements.* Notwithstanding paragraph (b)(2)(i) of this section, an acceleration event will not occur solely as a result of a failure to comply with a requirement of § 1.721(c)-3T(b)(3) that is not willful. See §§ 1.721(c)-6T(f) and 1.6038B-2T(h)(3).

(3) *Lower-tier partnership allocations.* Notwithstanding paragraph (b)(1) of this section, an acceleration event will not occur because of a reduction in remaining built-in gain in an interest in a partnership that is section 721(c) property that occurs as a result of allocations of book items of deduction and loss, or tax items of income and gain.

(4) *Deemed acceleration event.* A U.S. transferor may treat an acceleration event as having occurred with respect to section 721(c) property by both recognizing gain in an amount equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold the section 721(c) property immediately before the deemed acceleration event for fair market value and satisfying the reporting required by § 1.721(c)-6T(b)(3)(iv). In this case,

see paragraph (c) of this section regarding basis adjustments.

(c) *Consequences of an acceleration event.* Paragraphs (c)(1) and (2) of this section provide the consequences of an acceleration event with respect to section 721(c) property, a partial acceleration event with respect to section 721(c) property to the extent provided in § 1.721(c)-5T(d)(1), and a transfer described in section 367 of section 721(c) property to the extent provided in § 1.721(c)-5T(e).

(1) *U.S. transferor.* The U.S. transferor must recognize gain in an amount equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold the section 721(c) property immediately before the acceleration event for fair market value. The U.S. transferor will increase its basis in its partnership interest by the amount of gain recognized. If the U.S. transferor is an indirect partner in the section 721(c) partnership through one or more tiered partnerships, appropriate basis adjustments will be made to the interests in the tiered partnerships.

(2) *Section 721(c) partnership.* The section 721(c) partnership will increase its basis in the section 721(c) property by the amount of built-in gain recognized by the U.S. transferor under paragraph (c)(1) of this section. Any tax consequences of the acceleration event will be determined taking into account the increase in the partnership's adjusted tax basis in the section 721(c) property. If the section 721(c) property remains in the partnership after the acceleration event, the increase in basis of the section 721(c) property may be recovered using any applicable recovery period and depreciation (or other cost recovery) method (including first-year conventions) available to the partnership for newly purchased property of the same type placed in service on the date of the acceleration event. The section 721(c) property will no longer be subject to the gain deferral method.

(d) *Applicability dates.* This section applies to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015.

(e) *Expiration date.* The applicability of this section expires on *January 17, 2020*.

Par. 12. Section 1.721(c)–5T is added to read as follows:

*§ 1.721(c)–5T Acceleration event exceptions (temporary).*

(a) *Scope.* This section identifies exceptions to the acceleration events, which, like the rules regarding acceleration events provided in § 1.721(c)–4T(b), apply on a property-by-property basis. Paragraph (b) of this section identifies the events that terminate the requirement to apply the gain deferral method. Paragraph (c) of this section identifies the successor events that allow for the continued application of the gain deferral method. Paragraph (d) of this section identifies the partial acceleration events. Paragraph (e) of this section provides special rules for transfers of section 721(c) property to a foreign corporation described in section 367. Paragraph (f) of this section allows for the continued application of the gain deferral method if there is a fully taxable disposition of a portion of an interest in a partnership. Paragraph (g) of this section provides the dates of applicability, and paragraph (h) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)–1T(b).

(b) *Termination events—(1) In general.* Notwithstanding § 1.721(c)–4T(b)(1), a termination event with respect to section 721(c) property will not constitute an acceleration event. In these cases, the section 721(c) property will no longer be subject to the gain deferral method.

(2) *Transfers of section 721(c) property (other than a partnership interest) to a domestic corporation described in section 351.* A termination event occurs if a section 721(c) partnership transfers section 721(c) property (other than an interest in a partnership) to a domestic corporation in a transaction to which section 351 applies.

(3) *Certain incorporations of a section 721(c) partnership.* A termination event occurs upon an incorporation of a section 721(c) partnership into a domestic corporation by any method of incorporation (other than a method involving an actual distribution of partnership property to the

partners, followed by a contribution of that property to a corporation), provided that the section 721(c) partnership is liquidated as part of the incorporation transaction.

(4) *Certain distributions of section 721(c) property.* A termination event occurs if a section 721(c) partnership distributes section 721(c) property either to the U.S. transferor or, if the U.S. transferor is a member of a consolidated group (as defined in § 1.1502–1(h)) at the time of the distribution and the distribution occurs outside the seven-year period described in section 704(c)(1)(B), to a member of the consolidated group.

(5) *Partnership ceases to have a partner that is a related foreign person.* A termination event occurs when a section 721(c) partnership ceases to have any direct or indirect partners that are related foreign persons with respect to the U.S. transferor, provided there is no plan for a related foreign person to subsequently become a direct or indirect partner in the partnership (or a successor). This paragraph (b)(5) does not apply to a distribution of section 721(c) property in redemption of a related foreign person’s interest in a section 721(c) partnership.

(6) *Fully taxable dispositions of section 721(c) property.* A termination event occurs if a section 721(c) partnership disposes of section 721(c) property in a transaction in which all gain or loss, if any, is recognized.

(7) *Fully taxable dispositions of an entire interest in a section 721(c) partnership.* A termination event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of its entire interest in a section 721(c) partnership that owns the section 721(c) property in a transaction in which all gain or loss, if any, is recognized. This paragraph (b)(7) does not apply if a U.S. transferor is a member of a consolidated group (as defined in § 1.1502–1(h)) and the interest in the section 721(c) partnership is transferred in an intercompany transaction (as defined in § 1.1502–13(b)(1)).

(c) *Successor events—(1) In general.* Notwithstanding § 1.721(c)–4T(b)(1), a successor event with respect to section 721(c) property will not constitute an acceleration event. If only a portion of an interest in a partnership is transferred in a successor event described in this para-

graph (c), the principles of § 1.704–3(a)(7) apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest that is transferred and the portion of the interest that is retained.

(2) *Transfers of an interest in a section 721(c) partnership by a U.S. transferor or upper-tier partnership to a domestic corporation in certain nonrecognition transactions.* A successor event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to a domestic corporation in a transaction to which section 351 or 381 applies, and the gain deferral method is continued by treating the transferee domestic corporation as the U.S. transferor for purposes of the section 721(c) regulations. If the transfer described in this paragraph (c)(2) also results in a termination under section 708(b)(1)(B) of the section 721(c) partnership, see paragraph (c)(4) of this section.

(3) *Transfers of an interest in a section 721(c) partnership in an intercompany transaction.* A successor event occurs if a U.S. transferor that is a member of a consolidated group (as defined in § 1.1502–1(h)) transfers (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership in an intercompany transaction (as defined in § 1.1502–13(b)(1)), and the gain deferral method is continued by treating the transferee member as the U.S. transferor for purposes of the section 721(c) regulations. If the transfer described in this paragraph (c)(3) also results in a termination under section 708(b)(1)(B) of the section 721(c) partnership, see paragraph (c)(4) of this section.

(4) *Termination under section 708(b)(1)(B) of a section 721(c) partnership.* A successor event occurs if there is a termination under section 708(b)(1)(B) of a section 721(c) partnership, and the gain deferral method is continued by treating the new partnership as the section 721(c) partnership for purposes of the section 721(c) regulations.

(5) *Transactions involving tiered partnerships—(i) Contributions of section 721(c) property to a lower-tier partnership.* A successor event occurs if a section 721(c) partnership contributes the section

721(c) property to a partnership that is a controlled partnership with respect to the U.S. transferor (lower-tier section 721(c) partnership) and the requirements of paragraphs (c)(5)(i)(A), (B), and (C) of this section are satisfied.

(A) The lower-tier section 721(c) partnership is a section 721(c) partnership or is treated as a section 721(c) partnership.

(B) The gain deferral method is applied with respect to the section 721(c) property in the hands of the lower-tier section 721(c) partnership.

(C) The gain deferral method is applied with respect to the section 721(c) partnership's interest in the lower-tier section 721(c) partnership. See §§ 1.721(c)-3T(b)(5) and (d)(2).

(ii) *Contributions of an interest in a section 721(c) partnership to an upper-tier partnership.* A successor event occurs if a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner contributes (directly or indirectly through one or more partnerships) an interest in a section 721(c) partnership to a partnership that is a controlled partnership with respect to the U.S. transferor (upper-tier section 721(c) partnership) and the requirements of paragraphs (c)(5)(ii)(A), (B), (C), and (D) of this section are satisfied.

(A) The gain deferral method is continued with respect to the section 721(c) property in the hands of the section 721(c) partnership.

(B) The upper-tier section 721(c) partnership is, or is treated as, a section 721(c) partnership.

(C) If the upper-tier section 721(c) partnership directly owns its interest in the section 721(c) partnership, the gain deferral method is applied with respect to the upper-tier section 721(c) partnership's interest in the section 721(c) partnership. See § 1.721(c)-3T(b)(5) and (d)(1).

(D) If the upper-tier section 721(c) partnership indirectly owns its interest in the section 721(c) partnership through one or more partnerships, the principles of paragraphs (c)(5)(ii)(B) and (C) of this section are applied with respect to each partnership through which the upper-tier section 721(c) partnership indirectly owns an interest in the section 721(c) partnership.

(d) *Partial acceleration events*—(1) *In general.* Notwithstanding § 1.721(c)-4T, a partial acceleration event with respect to

section 721(c) property does not constitute an acceleration event. In these cases, except as provided in paragraph (d)(3) of this section, the rules in § 1.721(c)-4T(c) (concerning the consequences of an acceleration event) for making basis adjustments apply to the extent that the U.S. transferor is required to recognize gain under paragraph (d)(2) or (3) of this section. Furthermore, if there is remaining built-in gain with respect to the section 721(c) property after the application of this paragraph (d), the application of the gain deferral method with respect to the section 721(c) property must be continued in the same manner.

(2) *Regulatory allocations.* If a regulatory allocation is described in § 1.721(c)-3T(c)(4)(i) but not in § 1.721(c)-3T(c)(4)(i)(A) or (B), a partial acceleration event occurs with respect to section 721(c) property if the U.S. transferor recognizes an amount of gain (but not in excess of remaining built-in gain) equal to the amount of the allocation that, under the consistent allocation method, had the regulatory allocation not occurred, would have been allocated to the U.S. transferor in the case of income or gain, or would not have been allocated to the U.S. transferor in the case of deduction or loss.

(3) *Certain distributions of other partnership property to a partner that result in an adjustment under section 734.* A partial acceleration event occurs with respect to section 721(c) property if there is a distribution of other property by the section 721(c) partnership that results in a positive basis adjustment to the section 721(c) property under section 734. In these cases, the U.S. transferor must recognize an amount of gain (but not in excess of the remaining built-in gain) equal to the positive basis adjustment to the section 721(c) property under section 734, reduced (but not below zero) by the amount of gain recognized by the U.S. transferor (or a member of its consolidated group (as defined in § 1.1502-1(h))) under section 731(a). In these cases, the partnership will not increase its basis under § 1.721(c)-4T(c)(2) by the amount of gain recognized by the U.S. transferor.

(e) *Transfers described in section 367 of section 721(c) property to a foreign corporation.* If a section 721(c) partnership transfers section 721(c) property, or a

U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner transfers (directly or indirectly through one or more partnerships) all or a portion of an interest in a section 721(c) partnership that owns section 721(c) property, to a foreign corporation in a transaction described in section 367, then, the property will no longer be subject to the gain deferral method. To the extent any U.S. transferor is treated as transferring the section 721(c) property to the foreign corporation for purposes of section 367, the tax consequences will be determined under section 367. In this regard, see §§ 1.367(a)-1T(c)(3)(i) and (ii), 1.367(d)-1T(d)(1), and 1.367(e)-2(b)(1)(iii) (providing for the aggregate treatment of partnerships). However, for the remaining portion of the property (if any), the U.S. transferor must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to the U.S. transferor if the section 721(c) partnership had sold that portion of the section 721(c) property immediately before the transfer for fair market value. The stock in the transferee foreign corporation received will not be subject to the gain deferral method. The rules in § 1.721(c)-4T(c) (concerning the consequences of an acceleration event) for making basis adjustments will apply to the extent that the U.S. transferor recognizes gain under this paragraph (e).

(f) *Fully taxable dispositions of a portion of an interest in a partnership.* If a U.S. transferor or a partnership in which a U.S. transferor is a direct or indirect partner disposes of (directly or indirectly through one or more partnerships) a portion of an interest in a section 721(c) partnership in a transaction in which all gain or loss, if any, is recognized, an acceleration event will not occur with respect to the portion of the interest transferred. The gain deferral method will continue to apply with respect to the section 721(c) property of the section 721(c) partnership. The principles of § 1.704-3(a)(7) will apply to determine the remaining built-in gain in section 721(c) property that is attributable to the portion of the interest in a section 721(c) partnership that is retained. This paragraph (f) will not apply to an intercompany transaction (as defined in § 1.1502-13(b)(1)).



(g) *Applicability dates*—(1) *In general.* Except as provided in paragraph (g)(2) of this section, this section applies to contributions occurring on or after **January 18, 2017**, and to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(2) *Election to apply this section retroactively.* This section may, by election, be applied to a contribution occurring on or after August 6, 2015, but before **January 18, 2017**, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. The election is made by applying this section to the contribution on a timely filed original return (including extensions) or an amended return filed no later than six months after **January 18, 2017**.

(h) *Expiration date.* The applicability of this section expires on *January 17, 2020*.

Par. 13. Section 1.721(c)-6T is added to read as follows

*§ 1.721(c)-6T Procedural and reporting requirements (temporary).*

(a) *Scope.* This section provides procedural and reporting requirements that must be satisfied under § 1.721(c)-3T(b)(3) of the gain deferral method. Paragraph (b) of this section describes the procedural and reporting requirements of a U.S. transferor. Paragraph (c) of this section describes information required to be reported with respect to related foreign persons and partnerships. Paragraph (d) of this section describes the procedural and reporting requirements of a section 721(c) partnership with a section 6031 filing obligation. Paragraph (e) of this section provides the proper signatory for the information provided under this section. Paragraph (f) of this section provides relief for certain failures to comply that are not willful. Paragraph (g) of this section provides the dates of applicability, and paragraph (h) of this section provides the date of expiration. For definitions that apply for purposes of this section, see § 1.721(c)-1T(b).

(b) *Procedural and reporting requirements of a U.S. transferor*—(1) *In general.* This paragraph (b) describes the procedural and reporting requirements that a U.S. transferor (as defined § 1.721(c)-1T(b)(18)(i)) must satisfy in applying the gain deferral method. The information required under this paragraph (b) must be included with the U.S. transferor's timely filed return on (or attached to) the appropriate forms (including Form 8865, Schedule O, Transfer of Property to a Foreign Partnership), and must be submitted in the form and manner and to the extent prescribed by the form (and its accompanying instructions).

(2) *Reporting of a gain deferral contribution.* A U.S. transferor must report the following information with respect to a gain deferral contribution:

(i) A statement, titled "Statement of Application of the Gain Deferral Method under Section 721(c)," that contains the following information with respect to the section 721(c) property—

(A) A description of the property and recovery period (or periods) for the property;

(B) Whether the property is an intangible described in section 197(f)(9);

(C) A calculation of the built-in gain, the basis, and fair market value on the date of the contribution, including the amount of gain recognized by the U.S. transferor, if any, on the gain deferral contribution;

(D) The name, U.S. taxpayer identification number (if any), address, and country of organization (if any) of each direct or indirect partner in the section 721(c) partnership that is a related person with respect to the U.S. transferor, and a description of each partner's interest in capital and profits immediately after the gain deferral contribution; and

(E) When the section 721(c) property is a partnership interest, the information described in paragraphs (b)(2)(i)(A) through (D) of this section with respect to each property of a lower-tier partnership to which the gain deferral method is applied under § 1.721(c)-3T(d)(1);

(ii) A statement, titled "Consent to Extend the Time to Assess Tax Pursuant to the Gain Deferral Method under Section 721(c)," completed and executed in the manner prescribed in forms and instructions, extending the period of limitations

on the assessment of tax as described in paragraph (b)(5) of this section;

(iii) A copy of the waiver of treaty benefits described in paragraphs (c)(1) of this section (if any);

(iv) Information relating to the section 721(c) partnership described in paragraph (c)(2) of this section (if any);

(v) With respect to any foreign partnership (or partnership treated as foreign under paragraph (b)(4) of this section) the information required under § 1.6038B-2(c)(1) through (7); and

(vi) The information required under paragraph (b)(3) of this section.

(3) *Annual reporting relating to gain deferral method.* A U.S. transferor must file an annual statement, titled "Annual Statement of Application of the Gain Deferral Method under Section 721(c)," for each gain deferral contribution. The information in the statement must be with respect to the partnership taxable year that ends with, or within, the taxable year of the U.S. transferor, beginning with the partnership's taxable year that includes the date of the gain deferral contribution and ending with the last taxable year in which the gain deferral method is applied to the section 721(c) property. The statement must contain the following information:

(i) The amount of book income, gain, deduction, and loss and tax items allocated to the U.S. transferor with respect to the section 721(c) property, including a description of any regulatory allocations;

(ii) The proportion (expressed as a percentage) in which the book income, gain, deduction, and loss with respect to the section 721(c) property was allocated among the U.S. transferor and related persons that are partners in the section 721(c) partnership under the consistent allocation method;

(iii) The amount of remaining built-in gain at the beginning of the taxable year, the remedial income allocated to the U.S. transferor under the remedial allocation method, the amount of built-in gain taken into account by reason of an acceleration event or partial acceleration event (if any), the partnership's adjustment to its tax basis in the section 721(c) property, and the remaining built-in gain at the end of the taxable year;

(iv) A declaration stating whether an acceleration event or partial acceleration event occurred during the taxable year, the date of the event, and a description of the event (including a citation to the relevant paragraph of § 1.721(c)–5T(d) in the case of a partial acceleration event, and whether the acceleration event is described in § 1.721(c)–4T(b)(4));

(v) A description of a termination event or any successor event that occurred during the taxable year with a citation to the relevant paragraph of § 1.721(c)–5T(b) or (c), the date of the event, and, in the case of a successor event, the name, address, and U.S. taxpayer identification number (if any) of any successor partnership, lower-tier partnership, upper-tier partnership, or U.S. corporation (as applicable);

(vi) A description of all transfers of 721(c) property to a foreign corporation described in § 1.721–5T(e) that occurred during the taxable year, and for each transfer, the date of the transfer, the section 721(c) property transferred, and the name, address, and U.S. taxpayer identification number (if any) of the foreign transferee corporation;

(vii) With respect to section 721(c) property for which a waiver of treaty benefits was filed under paragraph (b)(2)(iii) of this section, a declaration that, after exercising reasonable diligence, to the best of the U.S. transferor’s knowledge and belief, all income from the section 721(c) property allocated to the partners during the taxable year remained subject to taxation as income effectively connected with the conduct of a trade or business within the United States (under either section 871 or 882) for all direct or indirect partners that are related foreign persons with respect to the U.S. transferor (regardless of whether any such partner was a partner at the time of the gain deferral contribution), and, that neither the partnership nor any such partner has made any claim under any income tax convention to an exemption from U.S. income tax or a reduced rate of U.S. income taxation on income derived from the use of the section 721(c) property;

(viii) A statement, titled “Consent to Extend the Time To Assess Tax Pursuant to the Gain Deferral Method under Section 721(c),” completed and executed as prescribed in forms and instructions, ex-

tending the period of limitations on the assessment of tax, in the case of a gain deferral contribution, as described in paragraph (b)(5)(ii) of this section, and, in the case of certain contributions on which gain is recognized, as described in paragraph (b)(5)(iii) of this section;

(ix) If the section 721(c) partnership is a partnership that does not have a filing obligation under section 6031, the information described in § 1.6038–3(g) (contents of information returns required of certain United States persons with respect to controlled foreign partnerships), if not already reported elsewhere, without regard to whether the section 721(c) partnership is a controlled foreign partnership within the meaning of section 6038. If the U.S. transferor is not a controlling fifty-percent partner (as defined in § 1.6038–3(a)), the U.S. transferor complies with the requirement of this paragraph (b)(3)(ix) by providing only the information described in § 1.6038–3(g)(1);

(x) A description of all section 721(c) property contributed by the U.S. transferor to the section 721(c) partnership (including pursuant to a contribution described in § 1.721(c)–2T(d)(1)) during the taxable year to which the gain deferral method is not applied; and

(xi) The information required in paragraphs (c)(2) and (3) of this section for related foreign persons that are direct or indirect partners in the section 721(c) partnership and the section 721(c) partnership itself (if any).

(4) *Domestic partnerships treated as foreign.* Solely for purposes of this section, a U.S. transferor must treat a domestic section 721(c) partnership as a foreign partnership if the partnership was formed on or after **January 18, 2017**. If the section 721(c) partnership has an information return filing obligation under section 6031, that requirement is not affected by the requirement of this paragraph (b)(4) that the U.S. transferor treat the partnership as a foreign partnership.

(5) *Extension of period of limitations on assessment of tax.* In order to comply with the gain deferral method, a U.S. transferor must extend the period of limitations on the assessment of tax:

(i) With respect to the gain realized but not recognized on a gain deferral contribution, through the close of the eighth full

taxable year following the U.S. transferor’s taxable year that includes the date of the gain deferral contribution;

(ii) With respect to all book and tax items with respect to the section 721(c) property allocated to the U.S. transferor in the partnership’s taxable year that includes the date of the gain deferral contribution and the subsequent two years, through the close of the sixth full taxable year following such taxable year with which, or within which, the partnership’s taxable year ends; and

(iii) With respect to the gain recognized on a contribution of section 721(c) property to a section 721(c) partnership for which the gain deferral method is not applied, if the contribution occurs within five partnership taxable years following a partnership taxable year that includes the date of a gain deferral contribution, through the close of the fifth full taxable year following the U.S. transferor’s taxable year that includes the date of the contribution on which gain is recognized.

(c) *Information with respect to section 721(c) partnerships and related foreign persons—(1) Effectively connected income.* If the gain deferral method is applied with respect to a contribution of section 721(c) property that satisfies the condition in § 1.721(c)–3T(b)(1)(ii), the U.S. transferor must obtain a statement from the section 721(c) partnership and from each related foreign person that is a direct or indirect partner in the section 721(c) partnership, titled “Statement of Waiver of Treaty Benefits under § 1.721(c)–6T,” pursuant to which the partner and the partnership waive any claim under any income tax convention (whether or not currently in force at the time of the contribution) to an exemption from U.S. income tax or a reduced rate of U.S. income taxation on income derived from the use of the section 721(c) property for the period during which the section 721(c) property is subject to the gain deferral method.

(2) *Partnerships in tiered-partnership structures applying the gain deferral method.* If the gain deferral method is applied as a result of a transaction described in § 1.721(c)–3T(d), the U.S. transferor must supply all information that a section 721(c) partnership would be required to report under paragraph (b) of

this section if the section 721(c) partnership were a U.S. transferor.

(3) *Schedules K-1 for related foreign partners.* If a section 721(c) partnership does not have a filing obligation under section 6031, the U.S. transferor must obtain a Schedule K-1 (Form 8865), Partner's Share of Income, Deduction, Credits, etc., for all related foreign persons that are direct or indirect partners in the section 721(c) partnership.

(d) *Reporting and procedural requirements of a section 721(c) partnership with a section 6031 filing obligation—(1) Waiver of treaty benefits.* A section 721(c) partnership with a return filing obligation under section 6031 must include its waiver of treaty benefits described in paragraph (c)(1) of this section with its tax return for the taxable year that includes the date of the gain deferral contribution.

(2) *Information on Schedule K-1.* A section 721(c) partnership with a return filing obligation under section 6031 must provide the relevant information necessary for the U.S. transferor to comply with the requirements in paragraphs (b)(2) and (3) of this section with the U.S. transferor's Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc. The partnership must also attach to its Form 1065 a Schedule K-1 (Form 1065) for each partner that is a related foreign person with respect to the U.S. transferor.

(e) *Signatory.* The statements required in this section must be signed under penalties of perjury by an agent of the U.S. transferor, the related foreign person that is a direct or indirect partner in the section 721(c) partnership, or the section 721(c) partnership, as applicable, that is authorized to sign under a general or specific power of attorney, or by an appropriate party. For the U.S. transferor, an appropriate party is a person described in § 1.367(a)-8(e)(1). For a partnership with a section 6031 filing obligation, an appropriate party is any party authorized to sign Form 1065.

(f) *Relief for certain failures to file or failures to comply that are not willful—(1) In general.* This paragraph (f)(1) provides relief from the failure to comply with the procedural and reporting requirements of the gain deferral method prescribed by § 1.721(c)-3T(b)(3) and provided in paragraph (b) of this section if

there is a failure to file or to include information required by this section (failure to comply). A failure to comply will be deemed not to have occurred for purposes of § 1.721(c)-3T(b)(3) if the U.S. transferor demonstrates that the failure was not willful using the procedure provided in this paragraph (f). For this purpose, willful is to be interpreted consistent with the meaning of that term in the context of other civil penalties, which would include a failure due to gross negligence, reckless disregard, or willful neglect. Whether a failure to comply was willful will be determined by the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (or any successor to the roles and responsibilities of such position, as appropriate) (Director) based on all the facts and circumstances. The U.S. transferor must submit a request for relief and an explanation as provided in paragraph (f)(2) of this section. A U.S. transferor whose failure to comply is determined not to be willful under this paragraph will be subject to a penalty under section 6038B if it fails to satisfy the applicable reporting requirements under that section and does not demonstrate that the failure was due to reasonable cause and not willful neglect. See § 1.6038B-2(h). The determination of whether the failure to comply was willful under this section has no effect on any request for relief made under § 1.6038B-2(h).

(2) *Procedures for establishing that a failure to comply was not willful—(i) Time and manner of submission.* A U.S. transferor's statement that a failure to comply was not willful will be considered only if, promptly after the U.S. transferor becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section as well as a written statement explaining the reasons for the failure to comply. The U.S. transferor also must file, with the amended return, a Form 8865, Schedule O, and a statement (as described in paragraph (b)(5) of this section), completed and executed as prescribed in forms and instructions, consenting to extend the period of limitations on

assessment of tax with respect to the gain realized but not recognized on the gain deferral contribution to the later of the close of the eighth full taxable year following the taxable year during which the contribution occurred (*date one*), or the close of the third full taxable year ending after the date on which the required information is provided to the Director (*date two*). However, the U.S. transferor is not required to file a Form 8865, Schedule O, with the amended return if both date one is later than date two and a consent to extend the period of limitations on assessment of tax with respect to the gain realized but not recognized on the gain deferral contribution for the U.S. transferor's taxable year that includes the date of the contribution was previously submitted with a Form 8865, Schedule O. The amended return and either a Form 8865, Schedule O, or a copy of the previously filed Form 8865, Schedule O, as the case may be, must be filed with the Internal Revenue Service at the location where the U.S. transferor filed its original return. The U.S. transferor may submit a request for relief from the penalty under section 6038B as part of the same submission. See § 1.6038B-2T(h)(3).

(ii) *Notice requirement.* In addition to the requirements of paragraph (f)(2)(i) of this section, the U.S. transferor must comply with the notice requirements of this paragraph (f)(2)(ii). If any taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return must be delivered to the Internal Revenue Service personnel conducting the examination. If no taxable year of the U.S. transferor is under examination when the amended return is filed, a copy of the amended return must be delivered to the Director.

(g) *Applicability dates—(1) In general.* Except as provided in paragraphs (g)(2) and (3) of this section, this section applies with respect to contributions occurring on or after **January 18, 2017**, and with respect to contributions occurring before **January 18, 2017**, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after **January 18, 2017**.

(2) *Reporting relating to effectively connected income.* Paragraphs (b)(2)(iii), (b)(3)(vii), and (d)(1) of this section apply



to a contribution occurring on or after August 6, 2015, and to a contribution occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015, and, in either case, provided § 1.721(c)-3T(b)(1)(ii) applies to the contribution. To the extent that a previously filed return did not comply with paragraph (b)(2)(iii), (b)(3)(vii), or (d)(1) of this section, an amended return complying with such paragraphs must be filed no later than six months after **January 18, 2017**.

(3) *Transition rules.* For transfers occurring on or after August 6, 2015, and for transfers occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, a U.S. transferor (or a domestic partnership in which a U.S. transferor is a direct or indirect partner) must fulfill any reporting requirements imposed under sections 6038, 6038B, and 6046A and the regulations thereunder with respect to the contribution of the section 721(c) property to the section 721(c) partnership.

(h) *Expiration date.* The applicability of this section expires on **January 17, 2020**.

Par. 14. Section 1.721(c)-7T is added to read as follows:

#### § 1.721(c)-7T Examples (temporary).

(a) *Presumed facts.* For purposes of the examples in paragraph (b) of this section, assume that there are no other transactions that are related to the transactions described in the examples and that all partnership allocations have substantial economic effect under section 704(b). For definitions that apply for purposes of this section, see § 1.721(c)-1T(b). Except where otherwise indicated, the following facts are presumed—

- (1) USP and USX are domestic corporations that each use a calendar taxable year. USX is not a related person with respect to USP.
- (2) CFC1, CFC2, FX, and FY are foreign corporations.
- (3) USP wholly owns CFC1 and CFC2. Neither FX nor FY is a related person with respect to USP or with respect to each other.

(4) PRS1, PRS2, and PRS3 are foreign entities classified as partnerships for U.S. tax purposes. A partnership interest in PRS1, PRS2, and PRS3 is not described in section 475(c)(2).

(5) A taxable year is referred to, for example, as year 1.

(6) A partner in a partnership has the same percentage interest in income, gain, loss, deduction, and capital of the partnership.

(7) No property is described in section 197(f)(9) in the hands of a contributing partner.

(8) No partnership is a controlled partnership solely under the facts and circumstances test in § 1.721(c)-1T(b)(4).

(b) *Examples.* The application of the rules stated in §§ 1.721(c)-1T through 1.721(c)-6T may be illustrated by the following examples:

*Example 1. Determining if a partnership is a section 721(c) partnership.* (i) *Facts.* In year 1, USP and CFC1 form PRS1 as equal partners. CFC1 contributes cash of \$1.5 million to PRS1, and USP contributes three properties to PRS1: a patent with a book value of \$1.2 million and an adjusted tax basis of zero, a security (within the meaning of section 475(c)(2)) with a book value of \$100,000 and an adjusted tax basis of \$20,000, and a machine with a book value of \$200,000 and an adjusted tax basis of \$600,000.

(ii) *Results.* (A) Under § 1.721(c)-1T(b)(18)(i), USP is a U.S. transferor because USP is a U.S. person and not a domestic partnership. Under § 1.721(c)-1T(b)(2), the patent has built-in gain of \$1.2 million. The patent is not excluded property under § 1.721(c)-1T(b)(6). Therefore, under § 1.721(c)-1T(b)(15)(i), the patent is section 721(c) property because it is property, other than excluded property, with built-in gain that is contributed by a U.S. transferor, USP.

(B) Under § 1.721(c)-1T(b)(2), the security has built-in gain of \$80,000. Under § 1.721(c)-1T(b)(6)(ii), the security is excluded property because it is described in section 475(c)(2). Therefore, the security is not section 721(c) property.

(C) The tax basis of the machine exceeds its book value. Under § 1.721(c)-1T(b)(6)(iii), the machine is excluded property and therefore is not section 721(c) property.

(D) Under § 1.721(c)-1T(b)(12), CFC1 is a related person with respect to USP, and under § 1.721(c)-1T(b)(11), CFC1 is a related foreign person. Because USP and CFC1 collectively own at least 80 percent of the interests in the capital, profits, deductions, or losses of PRS1, under § 1.721(c)-1T(b)(14)(i), PRS1 is a section 721(c) partnership upon the contribution by USP of the patent.

(E) The de minimis exception described in § 1.721(c)-2T(c) does not apply to the contribution because during PRS1's year 1 the sum of the built-in gain with respect to all section 721(c) property con-

tributed in year 1 to PRS1 is \$1.2 million, which exceeds the de minimis threshold of \$1 million. As a result, under § 1.721(c)-2T(b), section 721(a) does not apply to USP's contribution of the patent to PRS1, unless the requirements of the gain deferral method are satisfied.

*Example 2. Determining if partnership interest is section 721(c) property.* (i) *Facts.* In year 1, USP and FX form PRS2. USP contributes a security (within the meaning of section 475(c)(2)) with a book value of \$100,000 and an adjusted tax basis of \$20,000 and a building located in country X with a book value of \$30,000 and an adjusted tax basis of \$8,000 in exchange for a 40-percent interest. FX contributes a machine with a book value of \$195,000 and an adjusted tax basis of \$250,000 in exchange for a 60-percent interest.

(ii) *Results.* PRS2 is not a section 721(c) partnership because FX is not a related person with respect to USP. USP's contributions to PRS2 are not subject to § 1.721(c)-2T(b).

(iii) *Alternative facts and results.* (A) Assume the same facts as in paragraph (i) of this *Example 2*. In addition, USP and CFC1 form PRS1 as equal partners. CFC1 contributes cash of \$130,000 to PRS1, and USP contributes its 40-percent interest in PRS2.

(B) PRS2's property consists of a security and a machine that are excluded property, and a building with built-in gain in excess of \$20,000. Under § 1.721(c)-1T(b)(6)(iv), because more than 90 percent of the value of the property of PRS2 consists of excluded property described in § 1.721(c)-1T(b)(6)(i) through (iii) (the security and the machine), any interest in PRS2 is excluded property. Therefore, the 40-percent interest in PRS2 contributed by USP to PRS1 is not section 721(c) property. Accordingly, USP's contribution of its interest in PRS2 to PRS1 is not subject to § 1.721(c)-2T(b).

*Example 3. Assets-over tiered partnerships.* (i) *Facts.* In year 1, USP and CFC1 form PRS1 as equal partners. USP contributes a patent with a book value of \$300 million and an adjusted tax basis of \$30 million (USP contribution). CFC1 contributes cash of \$300 million. Immediately thereafter, PRS1 contributes the patent to PRS2 in exchange for a two-thirds interest (PRS1 contribution), and CFC2 contributes cash of \$150 million in exchange for a one-third interest. The patent has a remaining recovery period of 5 years out of a total of 15 years. With respect to all contributions described in § 1.721(c)-2T(b), the de minimis exception does not apply, and the gain deferral method is applied. Thus, the partnership agreements of PRS1 and PRS2 provide that the partnership will make allocations under section 704(c) using the remedial allocation method under § 1.704-3(d).

(ii) *Results: USP contribution.* PRS1 is a section 721(c) partnership as a result of the USP contribution.

(iii) *Results: PRS1 contribution.* (A) For purposes of determining whether PRS2 is a section 721(c) partnership as a result of the PRS1 contribution, under § 1.721(c)-2T(d)(1), USP is treated as contributing to PRS2 its share of the patent that PRS1 actually contributes to PRS2. USP and CFC1 are each one-third indirect partners in PRS2. Taking into account the one-third interest in PRS2 directly owned by CFC2, USP, CFC1, and CFC2 collectively own at least 80 percent of the interests in PRS2.

Thus, PRS2 is a section 721(c) partnership as a result of the PRS1 contribution.

(B) Under § 1.721(c)-2T(b), section 721(a) does not apply to PRS1's contribution of the patent to PRS2, unless the requirements of the gain deferral method are satisfied. Under § 1.721(c)-3T(b), the gain deferral method must be applied with respect to the patent. In addition, under § 1.721(c)-3T(d)(2), because PRS1 is a controlled partnership with respect to USP, the gain deferral method must be applied with respect to PRS1's interest in PRS2, and, solely for purposes of applying the consistent allocation method, PRS2 must treat PRS1 as the U.S. transferor. As stated in paragraph (i) of this *Example 3*, the gain deferral method is applied. PRS2 is a controlled partnership with respect to USP. Under § 1.721(c)-5T(c)(5)(i), the PRS1 contribution is a successor event with respect to the USP contribution.

(iv) *Results: application of remedial allocation method.* (A) Under § 1.704-3(d)(2), in year 1, PRS2 has \$24 million of book amortization with respect to the patent (\$6 million (\$30 million of book value equal to adjusted tax basis divided by the 5-year remaining recovery period) plus \$18 million (\$270 million excess of book value over tax basis divided by the new 15-year recovery period)). PRS2 has \$6 million of tax amortization. Under the PRS2 partnership agreement, PRS2 allocates \$8 million of book amortization to CFC2 and \$16 million of book amortization to PRS1. Because of the application of the ceiling rule, PRS2 allocates \$6 million of tax amortization to CFC2 and \$0 of tax amortization to PRS1. Because the ceiling rule would cause a disparity of \$2 million between CFC2's book and tax amortization, PRS2 must make a remedial allocation of \$2 million of tax amortization to CFC2 and an offsetting remedial allocation of \$2 million of taxable income to PRS1.

(B) PRS1's distributive share of each of PRS2's items with respect to the patent is \$16 million of book amortization, \$0 of tax amortization, and \$2 million of taxable income from the remedial allocation from PRS1. Under § 1.704-3(a)(9), PRS1 must allocate its distributive share of each of PRS2's items with respect to the patent in a manner that takes into account USP's remaining built-in gain in the patent. Therefore, PRS1 allocates \$2 million of taxable income to USP. Under § 1.704-3T(a)(13)(ii), PRS1 treats its distributive share of each of PRS2's items of amortization with respect to PRS2's patent as items of amortization with respect to PRS1's interest in PRS2. Under the PRS1 partnership agreement, PRS1 allocates \$8 million of book amortization and \$0 of tax amortization to CFC1, and \$8 million of book amortization and \$0 of tax amortization to USP. Because the ceiling rule would cause a disparity of \$8 million between CFC1's book and tax amortization, PRS1 must make a remedial allocation of \$8 million of tax amortization to CFC1. PRS1 must also make an offsetting remedial allocation of \$8 million of taxable income to USP. USP reports \$10 million of taxable income (\$2 million of remedial income from PRS2 and \$8 million of remedial income from PRS1).

*Example 4. Section 721(c) partnership ceases to have a related foreign person as a partner.* (i) *Facts.* In year 1, USP and CFC1 form PRS1. USP contributes a trademark with a built-in gain of \$5 million in

exchange for a 60-percent interest, and CFC1 contributes other property in exchange for the remaining 40-percent interest. With respect to all contributions described in § 1.721(c)-2T(b), the de minimis exception does not apply, and the gain deferral method is applied. On day 1 of year 4, CFC1 sells its entire interest in PRS1 to FX. There is no plan for a related foreign person with respect to USP to subsequently become a partner in PRS1 (or a successor).

(ii) *Results.* (A) PRS1 is a section 721(c) partnership.

(B) With respect to year 4, under § 1.721(c)-5T(b)(5), the sale is a termination event because, as a result of CFC1's sale of its interest, PRS1 will no longer have a partner that is a related foreign person, and there is no plan for a related foreign person to subsequently become a partner in PRS1 (or a successor). Thus, under § 1.721(c)-5T(b)(1), the trademark is no longer subject to the gain deferral method.

*Example 5. Transfer described in section 367 of section 721(c) property to a foreign corporation.* (i) *Facts.* In year 1, USP, CFC1, and USX form PRS1. USP contributes a patent with a built-in gain of \$5 million in exchange for a 60-percent interest, CFC1 contributes other property in exchange for a 30-percent interest, and USX contributes cash in exchange for a 10-percent interest. With respect to all contributions described in § 1.721(c)-2T(b), the de minimis exception does not apply, and the gain deferral method is applied. In year 3, when the patent has remaining built-in gain, PRS1 transfers the patent to FX in a transaction described in section 351.

(ii) *Results.* (A) PRS1 is a section 721(c) partnership.

(B) With respect to year 3, the transfer of the patent to FX is a transaction described in section 367(d). Therefore, under § 1.721(c)-5T(e), the patent is no longer subject to the gain deferral method. Under §§ 1.367(d)-1T(d)(1) and 1.367(a)-1T(c)(3)(i), for purposes of section 367(d), USP and USX are treated as transferring their proportionate share of the patent actually transferred by PRS1 to FX. Under § 1.721(c)-5T(e), to the extent USP and USX are treated as transferring the patent to FX, the tax consequences are determined under section 367(d) and the regulations thereunder. With respect to the remaining portion of the patent, which is attributable to CFC1, USP must recognize an amount of gain equal to the remaining built-in gain that would have been allocated to USP if PRS1 had sold that portion of the patent immediately before the transfer for fair market value. Under § 1.721(c)-4T(c)(1), USP must increase the basis in its partnership interest in PRS1 by the amount of gain recognized by USP and under § 1.721(c)-4T(c)(2), immediately before the transfer, PRS1 must increase its basis in the patent by the same amount. The stock in FX received by PRS1 is not subject to the gain deferral method.

*Example 6. Limited remedial allocation method for anti-churning property with respect to related partners.* (i) *Facts.* USP, CFC1, and FX form PRS1. On January 1 of year 1, USP contributes intellectual property (IP) with a book value of \$600 million and an adjusted tax basis of \$0 in exchange for a 60-percent interest. The IP is a section 197(f)(9) intangible (within the meaning of § 1.197-2(h)(1)(i)) that

was not an amortizable section 197 intangible in USP's hands. CFC1 contributes cash of \$300 million in exchange for a 30-percent interest, and FX contributes cash of \$100 million in exchange for a 10-percent interest. The IP is section 721(c) property, and PRS1 is a section 721(c) partnership. The gain deferral method is applied. The partnership agreement provides that PRS1 will make allocations under section 704(c) with respect to the IP using the remedial allocation method under § 1.704-3T(d)(5)(iii). All of PRS1's allocations with respect to the IP satisfy the requirements of the gain deferral method. On January 1 of year 16, PRS1 sells the IP for cash of \$900 million to a person that is not a related person. During years 1 through 16, PRS1 earns no income other than gain from the sale of the IP in year 16, has no expenses or deductions other than from amortization of the IP, and makes no distributions.

(ii) *Results: year 1.* Under § 1.704-3T(d)(5)(iii)(B), PRS1 must recover the excess of the book value of the IP over its adjusted tax basis at the time of the contribution (\$600 million) using any recovery period and amortization method that would have been available to PRS1 if the property had been newly purchased property from an unrelated party. Thus, under section 197(a), PRS1 must amortize \$600 million of the IP's book value ratably over 15 years for book purposes, and PRS1 will have \$40 million of book amortization per year without any tax amortization. Under the partnership agreement, in year 1, PRS1 allocates book amortization of \$24 million to USP, \$12 million to CFC1, and \$4 million to FX. Because in year 1 the ceiling rule would cause a disparity between FX's allocations of book and tax amortization, PRS1 makes a remedial allocation of tax amortization of \$4 million to FX and an offsetting remedial allocation of \$4 million of taxable income to USP. In year 1, the ceiling rule would also cause a disparity between CFC1's allocations of book and tax amortization. However, § 1.197-2(h)(12)(vii)(B) precludes PRS1 from making a remedial allocation of tax amortization to CFC1. Instead, pursuant to § 1.704-3T(d)(5)(iii)(C), PRS1 increases the adjusted tax basis in the IP by \$12 million, and pursuant to § 1.704-3T(d)(5)(iii)(D), that basis adjustment is solely with respect to CFC1. Pursuant to § 1.704-3T(d)(5)(iii)(C), PRS1 also makes an offsetting remedial allocation of \$12 million of taxable income to USP.

(iii) *Results: years 2-15.* At the end of year 15, PRS1 has book basis and adjusted tax basis of \$0 in the IP. PRS1 has amortized \$600 million for book purposes by allocating total book amortization deductions of \$360 million to USP, \$180 million to CFC1, and \$60 million to FX. For U.S. tax purposes, by the end of year 15, PRS1 has made remedial allocations of \$60 million of tax amortization to FX and increased the adjusted tax basis in the IP by \$180 million solely with respect to CFC1. PRS1 has also made total remedial allocations of \$240 million of taxable income to USP (attributable to \$60 million of remedial tax amortization to FX and \$180 million of tax basis adjustments with respect to CFC1). With respect to their partnership interests in PRS1, USP has a capital account and an adjusted tax basis of \$240 million, CFC1 has a capital account of \$120 million and an adjusted tax basis of \$300 million,

and FX has a capital account and an adjusted tax basis of \$40 million.

(iv) *Results: sale of property in year 16.* PRS1's sale of the IP for cash of \$900 million on January 1 of year 16 results in \$900 million of book and tax gain (\$900 million – \$0). PRS1 allocates the book and tax gain 60 percent to USP (\$540 million), 10 percent to FX (\$90 million), and 30 percent to CFC1 (\$270 million). However, under § 1.704–3T(d)(5)(iii)(D)(3), CFC1's tax gain is \$90 million, equal to its share of PRS1's gain (\$270 million), minus the amount of the tax basis adjustment (\$180 million). After the sale, PRS1's only property is cash of \$1.3 billion. With respect to their partnership interests in PRS1, USP has a capital account and an adjusted tax basis of \$780 million, CFC1 has a capital account and an adjusted tax basis of \$390 million, and FX has a capital account and an adjusted tax basis of \$130 million.

Par. 15. Section 1.6038B–2 is amended by:

1. Revising paragraphs (a)(1)(i) and (ii), (a)(3), (c)(6) and (c)(7)(v).
2. Adding paragraphs (a)(1)(iii) and (c)(8) and (9).
3. Revising paragraphs (h)(1) introductory text and (h)(3).
4. Adding paragraphs (j)(4) and (5).

The revisions and additions read as follows.

*§ 1.6038B–2 Reporting of certain transfers to foreign partnerships.*

- (a) \* \* \*
- (1) \* \* \*

(i) Immediately after the transfer, the United States person owns, directly, indirectly, or by attribution, at least a 10-percent interest in the partnership, as defined in section 6038(e)(3)(C) and the regulations thereunder;

(ii) The value of the property transferred, when added to the value of any other property transferred in a section 721 contribution by such person (or any related person) to the partnership during the 12-month period ending on the date of the transfer, exceeds \$100,000; or

(iii) [Reserved]. For further guidance, see § 1.6038B–2T(a)(1)(iii).

\* \* \* \* \*

(3) [Reserved]. For further guidance see § 1.6038B–2T(a)(3).

\* \* \* \* \*

- (c) \* \* \*

(6) A separate description of each item of contributed property that is appreciated property subject to the allocation rules of section 704(c) (except to the extent that

the property is permitted to be aggregated in making allocations under section 704(c)), or is intangible property, including its estimated fair market value and adjusted basis;

(7) \* \* \*

(v) Other property;

(8) [Reserved]. For further guidance, see § 1.6038B–2T(c)(8); and

(9) [Reserved]. For further guidance, see § 1.6038B–2T(c)(9).

\* \* \* \* \*

(h) \* \* \*

(1) *Consequences of a failure.* If a United States person is required to file a return under paragraph (a) of this section and fails to comply with the reporting requirements of section 6038B and this section, or § 1.721(c)–6T, then that person is subject to the following penalties:

\* \* \* \* \*

(3) [Reserved]. For further guidance see § 1.6038B–2T(h)(3).

\* \* \* \* \*

(j) \* \* \*

(4) through (5) [Reserved]. For further guidance, see § 1.6038B–2T(j)(4) through (5).

Par. 16. Section 1.6038B–2T is added to read as follows:

*§ 1.6038B–2T Reporting of certain transfers to foreign partnerships (temporary).*

(a) introductory text through (a)(1)(ii) [Reserved]. For further guidance, see § 1.6038B–2(a) introductory text through (a)(1)(ii).

(iii) The United States person is a U.S. transferor (as defined in § 1.721(c)–1T(b)(18)) that makes a gain deferral contribution and is required to report under § 1.721(c)–6T(b)(2). The reporting required under this paragraph (a) includes the annual reporting required by § 1.721(c)–6T(b)(3). For purposes of applying this paragraph (a)(1)(iii) to partnerships formed on or after **January 18, 2017**, a domestic partnership is treated as a foreign partnership pursuant to section 7701(a)(4).

(a)(2) [Reserved]. For further guidance, see § 1.6038B–2(a)(2).

(3) *Indirect transfer through a foreign partnership.* Solely for purposes of this section, if a foreign partnership transfers section 721(c) property (as defined in

§ 1.721(c)–1T(b)(15)) to another foreign partnership in a transfer described in § 1.721(c)–3T(d) (tiered-partnership rules), then the transferor foreign partnership's partners will be considered to have transferred a proportionate share of the property to the foreign partnership.

(a)(4) through (c)(7) [Reserved]. For further guidance, see § 1.6038B–2(a)(4) through (c)(7).

(8) With respect to reporting required under § 1.721(c)–6T(b)(2) and paragraph (a)(1)(iii) of this section with regard to a gain deferral contribution, the information required by § 1.721(c)–6T(b)(2); and

(9) With respect to section 721(c) property for which a statement is required to be filed under § 1.721(c)–6T(b)(3) and paragraph (a)(1)(iii) of this section, the information required by § 1.721(c)–6T(b)(3).

(d) through (h)(2) [Reserved]. For further guidance, see § 1.6038B–2(d) through (h)(2).

(3) *Reasonable cause exception.* Under section 6038B(c)(2) and this section, the provisions of paragraph (h)(1) of this section will not apply if the United States person shows, in a timely manner, that a failure to comply was due to reasonable cause and not willful neglect. A United States person's statement that the failure to comply was due to reasonable cause and not willful neglect will be considered timely only if, promptly after the United States person becomes aware of the failure, an amended return is filed for the taxable year to which the failure relates that includes the information that should have been included with the original return for such taxable year or that otherwise complies with the rules of this section, and that includes a written statement explaining the reasons for the failure to comply. If any taxable year of the United States person is under examination when the amended return is filed, a copy of the amended return must be delivered to the Internal Revenue Service personnel conducting the examination when the amended return is filed. If no taxable year of the United States person is under examination when the amended return is filed, a copy of the amended return must be delivered to the Director of Field Operations, Cross Border Activities Practice Area of Large Business & International (or any successor to the roles and responsibilities of



such position, as appropriate) (Director). Whether a failure to comply was due to reasonable cause and not willful neglect will be determined by the Director under all the facts and circumstances.

(i) through (j)(3) [Reserved]. For further guidance, see § 1.6038B-2(i) through (j)(3).

(4) *Transfers of section 721(c) property*—(i) *Applicability dates*. Paragraph (c)(8) of this section applies to transfers occurring on or after August 6, 2015, and to transfers occurring before August 6, 2015, resulting from an entity classification election made under § 301.7701-3 of this chapter that is filed on or after August 6, 2015. Paragraphs (a)(1)(iii), (a)(3), and (c)(9) of this section apply to transfers

occurring on or after **January 18, 2017**, and to transfers occurring before **January 18, 2017**, resulting from entity classification elections made under § 301.7701-3 of this chapter that are filed on or after **January 18, 2017**.

(ii) *Expiration date*. The applicability of paragraphs (a)(1)(iii), (a)(3), and (c)(8) and (9) of this section expires on **January 17, 2020**.

(5) *Reasonable cause exception*—(i) *Applicability date*. Paragraph (h)(3) of this section applies to all requests for relief for transfers of property to partnerships filed on or after **February 21, 2017**.

(ii) *Expiration date*. The applicability of paragraph (h)(3) of this section expires on **January 17, 2020**.

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

Approved: January 10, 2017.

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

(Filed by the Office of the Federal Register on January 18, 2017, 8:45 a.m., and published in the issue of the Federal Register for January 19, 2017, 82 F.R. 7582.)

## Part III. Administrative, Procedural, and Miscellaneous

### Extension of the Due Date for a Section 35 Health Coverage Tax Credit Election

#### Notice 2017-16

##### SECTION 1. PURPOSE

This notice provides guidance regarding the health coverage tax credit (HCTC) under § 35 of the Internal Revenue Code, as modified by the Trade Preferences Extension Act of 2015, Pub. L. 114-27 (June 29, 2015) (Act). Specifically, this notice extends the due date for the election to claim the HCTC for eligible coverage months in taxable years beginning on or after June 29, 2015, and before January 1, 2017.

##### SECTION 2. BACKGROUND

Section 35 provides for the HCTC, which is a tax credit equal to 72.5 percent of the amount paid by an eligible individual for qualified health coverage of the individual and qualifying family members for eligible coverage months. Section 35 was originally enacted by the Trade Act of 2002, Pub. L. 107-210 (Aug. 6, 2002), but expired at the end of 2013. The Trade Act of 2002 also enacted § 7527, which provides for the establishment of a program for making advance payment of the HCTC. In 2015, § 35 was reinstated retroactively to 2014, modified, and extended through 2019 by the Act, and § 7527 was revised by the Act.<sup>1</sup>

As part of the reinstatement of § 35, the Act added a new § 35(g)(11). Section 35(g)(11)(A) provides that, for eligible coverage months in taxable years beginning after December 31, 2013, a taxpayer must make an election to claim the HCTC. Under § 35(g)(11)(B), “except as the Secretary may provide,” an HCTC election for any eligible coverage month in a taxable year must be made not later than the due date (including extensions) of the individual’s Federal income tax return for the taxable year. However, the Act pro-

vided a transition rule under which, for eligible coverage months in taxable years beginning after December 31, 2013, and before the date of enactment of the Act (June 29, 2015), the HCTC election may be made at any time on or after June 29, 2015, and before the expiration of the 3-year period of limitation prescribed in § 6511(a) for the taxable year, and may be made on an amended return. *See* Act § 407(f)(3). Eligible taxpayers elect to claim the HCTC by completing line 1 of Form 8885, Health Coverage Tax Credit, and filing the form with their Federal income tax return. *See* Notice 2016-2 and Instructions for Form 8885.

Prior to its reinstatement, § 35 did not specifically require that taxpayers claim the HCTC by making an election on their Federal income tax return. Taxpayers claimed the HCTC on their Federal income tax return (using Form 8885) only if they were eligible to claim the HCTC in excess of the advance payments made on the taxpayer’s behalf under § 7527. Most eligible individuals received the benefit of the HCTC through the advance payment process described in § 7527 and, therefore, did not claim the HCTC on their Federal income tax returns.

##### SECTION 3. GUIDANCE

The Treasury Department and the Internal Revenue Service have determined that, pursuant to the authority granted by § 35(g)(11)(B), it is appropriate to extend the transition rule provided in the Act with respect to the deadline for electing to claim the HCTC through 2016. Accordingly, an election to claim the HCTC for an eligible coverage month in a taxable year beginning on or after June 29, 2015, and before January 1, 2017, may be made before the end of the 3-year period of limitation prescribed in § 6511(a), and may be made on an amended return. This period of limitation is generally three years from the due date of the return (including extensions). Thus, for example, a calendar year taxpayer who files his or her 2016 Federal income tax return by April

18, 2017, without electing the HCTC must file a return with a Form 8885 by April 15, 2020, to elect the HCTC for coverage provided in 2016.

##### SECTION 4. DRAFTING INFORMATION

The principal author of this notice is James Beatty of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Beatty at (202) 317-4613 (not a toll-free number). For further information about the HCTC, go to <https://www.irs.gov/hctc>.

## Rev. Proc. 2017-19

##### SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which the Internal Revenue Service (Service) will not challenge the treatment of an Energy Savings Performance Contract (ESPC) Energy Sales Agreement (ESA) between an Energy Service Company (ESCO) and a Federal Agency (FA) as a service contract under § 7701(e)(3) of the Internal Revenue Code (Code). The revenue procedure also provides an example of an ESPC ESA.

##### SECTION 2. BACKGROUND

.01. 42 U.S.C § 8287 authorizes FAs to enter into ESPC ESAs with ESCOs for the purpose of achieving energy savings and benefits ancillary to energy savings. It also sets forth certain requirements for such ESPC ESAs. The ESPC ESA project structure is intended to facilitate onsite renewable energy generation projects.

.02. The Office of Management and Budget (OMB) issued OMB Memorandum M-12-21 to provide further guidance to FAs regarding ESPCs that include third-party owned and operated onsite renewable energy generation assets and how they will be treated for Federal budgeting purposes. Specifically, OMB Memorandum M-12-21 requires title to the renew-

<sup>1</sup>For more information about the reinstated HCTC, see Notice 2016-2, 2016-2 I.R.B. 265. Notice 2016-2 provides guidance on various issues relating to the HCTC, including information about eligibility for the HCTC, the types of coverage eligible for the HCTC, and guidance for those who claim the HCTC for a qualified health plan purchased through a Health Insurance Marketplace (also known as an Exchange) in 2014 and 2015.

able energy generation asset to transfer to the FA at the end of the ESPC term.

.03. The ESPC ESA is a type of ESPC that facilitates third-party owned and operated onsite energy generation projects in compliance with ESPC authority and OMB Memorandum M-12-21. An ESPC ESA may also include the implementation of other energy and water conservation measures as part of a comprehensive project.

.04. The example in Section 5 of this revenue procedure illustrates a typical ESPC ESA that would satisfy the requirements of 42 U.S.C § 8287 and OMB Memorandum M-12-21.

.05. Section 48(a) provides for an investment tax credit for certain energy property, including solar energy property described in § 48(a)(3)(A)(i).

.06. Section 50(b)(4)(A)(i) disallows the investment tax credit if the property is used by the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing. This disallowance applies to property used under a lease unless the term of such lease is less than 6 months.

.07. Section 7701(e) provides rules to determine, for federal income tax purposes, whether a contract that purports to be a service contract should be treated as a lease of property. Section 7701(e)(1) generally provides that a service contract will be treated as a lease of property if it is properly treated as a lease of property, taking into account all relevant factors including whether or not:

the service recipient is in physical possession of the property;

the service recipient controls the property;

the service recipient has a significant economic or possessory interest in the property;

the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract;

the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient; and

the total contract price does not substantially exceed the rental value of the property for the contract period.

.08. Notwithstanding the general rule of § 7701(e)(1), § 7701(e)(3) provides special rules for contracts or arrangements involving solid waste disposal, a cogeneration or alternative energy facility, and clean water facilities. Section 7701(e)(3)(D) provides that an “alternative energy facility” means a facility producing electrical or thermal energy if the primary energy source for the facility is not oil, natural gas, coal or nuclear power. Section 7701(e)(3)(A) provides that a purported service contract with respect to this type of facility will be treated as a service contract.

.09. Section 7701(e)(4) provides that the special rule in § 7701(e)(3) will not apply, and thus the general rule in § 7701(e)(1) will apply, to any contract with respect to the facilities described in § 7701(e)(3) if:

the service recipient (or a related entity) operates the facility;

the service recipient (or a related entity) bears any significant financial burden if there is nonperformance under the contract, unless this burden is due to (i) reasons beyond the control of the service provider, (ii) a temporary shut-down for repairs, maintenance, or capital improvements, or (iii) the bankruptcy or other financial difficulty of the service provider; the service recipient (or a related entity) receives any significant financial benefit if the operating costs of such facility are less than the standards of performance or operation under the contract, unless the benefit arises from reduced payments by the service recipient because of increased production or efficiency or the recovery of energy or other products; and

the service recipient (or a related entity) has an option or obligation to purchase all or part of the facility at a fixed and determinable price, other than for the fair market value of the facility.

### SECTION 3. SCOPE

.01. The safe harbor in section 4 of this revenue procedure applies to any ESPC ESA between an ESCO and a FA for the provision of electricity through an alternative energy facility, as defined in

§ 7701(e)(3)(D), that satisfies the requirements of 42 U.S.C § 8287 and OMB Memorandum M-12-21. It may not be relied upon, in whole or part, for any other kind of transaction.

.02. The safe harbor provided in section 4 of this revenue procedure applies only if all the requirements of section 4 are satisfied.

.03. The safe harbor provided in section 4 of this revenue procedure provides guidance to ESCO taxpayers that are establishing or participating in an ESPC ESA with a FA in lieu of providing a letter ruling to those ESCO taxpayers. Therefore, the Service will not rule on whether an ESPC ESA between an ESCO and FA will be considered a service contract under § 7701(e)(3).

### SECTION 4. SAFE HARBOR

.01 *Safe harbor.* If an ESPC ESA entered into between an ESCO and a FA satisfies all of the requirements of section 4.02 of this revenue procedure, the Service will not challenge the treatment of the ESPC ESA as a service contract under § 7701(e)(3).

.02 *Requirements.* The ESPC ESA must satisfy the following requirements:

(1) *Term.* The total term of the ESPC ESA cannot exceed 20 years in length. The term must be consistent with and appropriate for the scope and scale of the renewable project.

(2) *Other Federal guidance.* The ESPC ESA must satisfy the requirements of 42 U.S.C § 8287 and OMB Memorandum M-12-21.

(3) *Operation of Alternative Energy Facility.* Under no circumstances will the FA attempt to operate the renewable energy generation asset. In the event of a shut-down or mechanical issue, FA will immediately notify the ESCO or its designated contractor.

(4) *Risk.* The ESCO bears all financial risk for non-performance, except to the extent such non-performance is attributable to a temporary shut-down of the facility for repairs, maintenance, or capital improvements.

(5) *Reduced Costs.* The contract price for electricity will not be reduced if operating costs should diminish.

(6) *Equipment Purchase.* The FA may have the option to purchase, or may be



required to purchase, the renewable energy generation asset at the end of the contract term, for its fair market value (FMV) at the time of the purchase.

## SECTION 5. EXAMPLE

ESCO contracts with FA under an ESPC ESA to install, maintain ownership of (until the end of the contract), and provide operation and maintenance of a renewable energy generation asset at a federal site. The FA will purchase all of the electricity generated onsite at a rate that is less than the FA's current and forecasted electricity rate.

- The contract term is 20 years.
- The contract price, including operation and maintenance, is based on a fixed per-kWh basis and must be paid for by the FA from the energy savings provided under the project.
  - The ESCO bears all financial risk for non-performance.
  - The contract price does not vary if the operating costs are lower than expected.
- The FA will purchase the renewable energy generation asset at FMV as appraised at the time of the sale by the end of the contract term, consistent with OMB Memorandum 12-21.
  - The ESCO will transfer a portion of the payments it receives from the FA into a reserve account held by the ESCO for the FA's future purchase of the onsite renewable energy assets. The amount charged for each payment period will include both the price of power and an amount for the reserve account (separate and in addition to the price of power).
  - The ESCO's deposit into the reserve account will be based on the estimated future FMV of the on-site renewable energy generation assets. To ensure that the reserve account has sufficient funds for the FMV purchase by the FA at the end of the contract term, there may be periodic reappraisals of the onsite renewable assets and contract modifications (if and as necessary). Any excess reserve account

funds after the onsite renewable asset purchase may be used to offset the final ESPC ESA payments. Alternatively, in the event of termination, funds in the reserve account at that time may be used to satisfy any termination liability of the FA, and any excess amounts will be returned to the FA.

- The FMV will be determined at the time of sale by a mutually agreed upon independent appraiser with expertise in the relevant onsite renewable energy asset industry. The valuation made by the appraiser shall be binding upon the parties in the absence of fraud or error.

- The ESPC ESA includes a schedule for each year which establishes the maximum termination liability of the FA in the event of termination prior to the end of the contract term.

This ESPC ESA satisfies the requirements of the safe harbor in section 4 of this revenue procedure and the Service will not challenge the treatment of the ESPC ESA as a service contract under § 7701(e)(3).

## SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for transactions entered into on or after the date of publication in the Internal Revenue Bulletin. If an ESPC ESA entered into between an ESCO and a FA prior to this date satisfies all of the requirements of the safe harbor provided in section 4 of this revenue procedure, the Service will not challenge the treatment of the ESPC ESA as a service contract under § 7701(e)(3).

## SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Philip Tiegerman of the Office of Associate Chief Counsel (Pass-throughs & Special Industries). For further information regarding this revenue procedure contact Philip Tiegerman at (202) 317-6853.

# Rev. Proc. 2017-23

## SECTION 1. PURPOSE AND SCOPE

This revenue procedure describes the process for filing Form 8975, *Country-by-Country Report*, and accompanying Schedules A, *Tax Jurisdiction and Constituent Entity Information* (collectively, Form 8975), by ultimate parent entities of U.S. multinational enterprise (MNE) groups for reporting periods beginning on or after January 1, 2016, but before the applicability date of § 1.6038-4 (early reporting periods).

## SECTION 2. BACKGROUND

.01 On June 30, 2016, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published in the Federal Register final regulations (T.D. 9773) (CbC reporting regulations) that require certain U.S. business entities that are the ultimate parent entity of a U.S. MNE group to file Form 8975 annually with the IRS. See § 1.6038-4. Form 8975 requires the ultimate parent entity of a U.S. MNE group to report information, on a country-by-country basis, related to the group's income and taxes paid, together with certain indicators of the location of the group's economic activity. The CbC reporting regulations apply to reporting periods of ultimate parent entities of U.S. MNE groups that begin on or after the first day of the first taxable year of the ultimate parent entity that begins on or after June 30, 2016.

.02 Some jurisdictions have adopted country-by-country (CbC) reporting requirements for annual accounting periods beginning on or after January 1, 2016, that would require a constituent entity resident in the jurisdiction to report CbC information if the constituent entity is part of an MNE group with an ultimate parent entity resident in a jurisdiction that does not have a CbC reporting requirement (including pursuant to parent surrogate filing) for the same annual accounting period (local CbC filing). Consequently, constituent entities of a U.S. MNE group may be subject to local CbC filing for early reporting periods, unless the ultimate parent entity files a Form 8975, or reports CbC information to another jurisdiction that accepts surrogate filing, for

such early reporting period. The preamble to the CbC reporting regulations indicated that the Treasury Department and the IRS would provide a procedure for ultimate parent entities of U.S. MNE groups to file Form 8975 for early reporting periods.

### SECTION 3. FILING PROCEDURE

.01 Beginning on September 1, 2017, Form 8975 may be filed for an early reporting period with the income tax return or other return as provided in the Instructions to Form 8975 for the taxable year of the ultimate parent entity of the U.S. MNE group with or within which the early reporting period ends. In order to file Form 8975 for an early reporting period, an ultimate parent entity that files (or has filed) an income tax return for a taxable year that includes an early reporting period without a Form 8975 attached must follow the procedures for filing an amended income tax return and attach Form 8975 to the amended return within twelve months of the close of the taxable year that includes the early reporting period. Filing an amended income tax return solely to attach Form 8975 in accordance with this revenue procedure will have no effect on the statute of limitations for the income tax return.

.02 In order to ensure timely automatic exchange of the information on a Form 8975 for an early reporting period, ultimate parent entities that are able to file their returns electronically are encouraged to file their returns and the Forms 8975 electronically. An ultimate parent entity that files its return electronically must file the Form 8975 through the IRS Modernized e-File system in Extensible Markup Language (XML) format, not as a binary attachment (such as a PDF file). The IRS intends to provide specific electronic filing information on Form 8975 to the software industry in early 2017 so that developers will be able to make Form 8975 available in their software ahead of the September 1, 2017, implementation date. For filers of Form 8975 that are not eligible to use Modernized e-File to file their income tax return, a paper version of Form 8975 will be made available in advance of the September 1, 2017, implementation date.

### SECTION 4. APPLICABILITY DATE

This revenue procedure applies to reporting periods of ultimate parent entities of U.S. MNE groups beginning on or after January 1, 2016, and before the applicability date of § 1.6038-4.

### SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Melinda E. Harvey of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure contact Melinda E. Harvey at (202) 317-6934 (not a toll free number).

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*26 CFR. 1.61-12; Income from discharge of indebtedness.(Also Part III, §§ 61; 1.6050P-1.)*

## Rev. Proc. 2017-24

### SECTION 1. PURPOSE

This revenue procedure extends the relief provided under Rev. Proc. 2015-57, 2015-51 I.R.B. 863, to taxpayers who took out Federal student loans to finance attendance at a school owned by American Career Institutes, Inc. (ACI) and whose Federal student loans are discharged under the Department of Education's "Defense to Repayment" or "Closed School" discharge process.

This revenue procedure provides that the Internal Revenue Service (IRS) will not assert that these taxpayers must recognize gross income as a result of the Defense to Repayment discharge process or increase gross income by the amount of certain tax credits or deductions related to loans discharged under either process and will not assert that the creditor must file information returns and furnish payee statements as a result of discharging these loans. This revenue procedure also modifies Rev. Proc. 2015-57 to provide that the IRS will not assert that creditors under that revenue procedure must file information returns and furnish payee statements as a result of discharges under that revenue procedure.

### SECTION 2. BACKGROUND

#### .01 *In general.*

Revenue Procedure 2015-57 addresses taxpayers who took out Federal student loans to finance attendance at a school owned by Corinthian Colleges, Inc. and whose Federal student loans are discharged under the Department of Education's "Defense to Repayment" or "Closed School" discharge process. The IRS determined that it will not assert that these taxpayers must recognize gross income as a result of these discharge processes.

The Treasury Department and the IRS are aware that the Department of Education (ED) has begun a process for settling and discharging Federal student loans taken out by taxpayers to finance attendance at a school owned by ACI. ED has estimated that to date about 4,400 ACI borrowers may be eligible for discharges under this program and that number may increase.

In general, under the Higher Education Act of 1965 (HEA), Pub. L. 89-329, the Closed School discharge process allows ED to discharge a Federal student loan obtained by a student, or by a parent on behalf of a student, who was attending a school at the time it closed or who withdrew from the school within a certain period prior to the closing date. *See generally* 20 U.S.C. § 1087(c) (Federal Family Education Loan (FFEL)); 20 U.S.C. § 1087dd(g) (Federal Perkins Loan); and 20 U.S.C. § 1087e(a)(1) (Federal Direct Loan).

Under the HEA, the Defense to Repayment process requires ED to discharge a Federal Direct Loan if a student loan borrower establishes, as a defense against repayment, that a school's actions would give rise to a cause of action against the school under applicable state law. *See generally* 20 U.S.C. § 1087e(h) and 34 C.F.R. § 685.206(c). FFEL loans may also be discharged under this process if certain additional requirements are met. *See* 34 C.F.R. § 682.209(g).

Section 61(a)(12) of the Internal Revenue Code (Code) provides that gross income includes income from the discharge of indebtedness. There are, however, exceptions under which a taxpayer may not be required to include income from the

discharge of indebtedness in gross income.

Section 6050P of the Code requires any applicable entity which discharges the indebtedness (in whole or in part) of any person to make an information return and furnish a payee statement for that discharge of indebtedness. The regulations in 26 C.F.R. § 1.6050P-1 provide that reporting is required only upon the occurrence of one of the identifiable events enumerated in the regulations.

#### *.02 Borrowers participating in Closed School discharge process.*

The HEA provides statutory exclusions from gross income for Federal student loans discharged under the Closed School discharge process. 20 U.S.C. §§ 1087(c), 1087dd(g), 1087e(a)(1). Accordingly, a taxpayer whose Federal student loan is discharged under the Closed School discharge process will not recognize gross income as a result of the discharge, and the taxpayer should not report the amount of the discharged loan in gross income on his or her Federal income tax return.

#### *.03 Borrowers participating in Defense to Repayment discharge process.*

The HEA does not provide a statutory exclusion from gross income for Federal student loans discharged under the Defense to Repayment discharge process. However, a taxpayer may be able to exclude amounts discharged under this process from gross income under a provision of the Code or other tax law authorities.

For example, a borrower that has a liability reduced because of a legal infirmity that relates back to the original sale transaction (for example, fraud) may not have gross income to the extent of the debt reduction. This rule requires a case-by-case analysis of each transaction.

In addition, section 108(a)(1)(B) of the Code provides that a taxpayer may exclude from gross income a discharge of indebtedness that occurs when the taxpayer is insolvent (the insolvency exclusion).

The Treasury Department and the IRS conclude that most borrowers whose Federal student loans taken out by taxpayers

to finance attendance at a school owned by ACI that are discharged under the Defense to Repayment discharge process would be able to exclude from gross income all or substantially all of the discharged amounts based on fraudulent or material misrepresentations made by the schools owned by ACI to the students or based on the insolvency exclusion or another tax law authority. Accordingly, the IRS will not assert that a taxpayer within the scope of this revenue procedure recognizes gross income as a result of the Defense to Repayment discharge process. Further, the IRS will not assert that creditors within the scope of this revenue procedure must report under section 6050P regarding these discharges.

### **SECTION 3. SCOPE**

The treatment provided in section 4 of this revenue procedure applies to any taxpayer who took out Federal student loans to finance attendance at a school owned by ACI that are discharged under the Closed School discharge process or the Defense to Repayment discharge process and any applicable entity, as defined in section 6050P and the regulations under that section, discharging these loans.

### **SECTION 4. APPLICATION**

*.01 Discharge of indebtedness income.* The IRS will not assert that a taxpayer within the scope of this revenue procedure must recognize gross income as a result of the Defense to Repayment discharge process for discharged Federal student loans that were taken out to finance attendance at a school owned by ACI. See section 2.02 of this revenue procedure for a general discussion regarding the exclusion from gross income for borrowers participating in the Closed School discharge process.

*.02 Recapture of tax credits and tax benefit rule.* The IRS will not assert that a taxpayer within the scope of this revenue procedure must increase his or her taxes owed in the year of a discharge, or in a prior year, as a result of either discharge process if in a prior year he or she received an education credit under section 25A of the Code attributable to payments made with proceeds of the discharged

loan. In addition, the IRS also will not assert that a taxpayer within the scope of this revenue procedure must increase his or her income in the year of the discharge if he or she took a deduction under section 221 in a prior year attributable to interest paid on a discharged loan or a deduction under section 222 in a prior taxable year attributable to payments of qualified tuition and related expenses made with proceeds of the discharged loan.

*.03 Information reporting.* The IRS will not assert that any creditor that is an applicable entity, as defined in section 6050P of the Code, must file information returns and furnish payee statements under that section for the discharge of any indebtedness within the scope of this revenue procedure.

Further, this revenue procedure modifies Rev. Proc. 2015-57 to provide that the IRS will not assert that any creditor under that revenue procedure that is an applicable entity, as defined in section 6050P of the Code, must file information returns and furnish payee statements for the discharge of any indebtedness under that revenue procedure.

### **SECTION 5. EFFECT ON OTHER DOCUMENTS**

Revenue Procedure 2015-57 is modified.

### **SECTION 6. EFFECTIVE DATE**

This revenue procedure is effective for taxable years beginning on or after January 1, 2016, for Federal student loans discharged under ED's Defense to Repayment discharge process or the Closed School discharge process.

### **SECTION 7. DRAFTING INFORMATION**

The principal author of this revenue procedure is Craig Wojay of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding discharge of indebtedness income and exclusions, contact Mr. Wojay at (202) 317-4718 (not a toll-free call), and for further information regarding information reporting, contact Elie Mishory at (202) 317-6844.



# Part IV. Items of General Interest

## Notice of proposed rulemaking

### Transfers of Certain Property by U.S. Persons to Partnerships with Related Foreign Partners

**REG-127203-15**

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In the Rules and Regulations section of this issue of the **Internal Revenue Bulletin**, temporary regulations are being issued under sections 197, 704, 721(c), and 6038B of the Internal Revenue Code (Code) that address transfers of appreciated property by U.S. persons to partnerships with foreign partners related to the transferor. The temporary regulations affect U.S. partners in domestic or foreign partnerships. The text of the temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by April 19, 2017.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-127203-15), 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-127203-15), 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-127203-15).

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

## SUPPLEMENTARY INFORMATION:

### Background

The temporary regulations in the Rules and Regulations section of this issue of the **Bulletin** contain regulations under sections 197, 704, 721(c), and 6038B of the Code. The temporary regulations contain rules described in Notice 2015-54, 2015-34 I.R.B. 210, and override nonrecognition of gain under section 721(a) for transfers of property to a partnership with related foreign partners and with substantial related-party ownership unless certain requirements are satisfied. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and the corresponding proposed regulations.

### Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that the collection of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This conclusion is based on the fact that the proposed regulations include a \$1,000,000 de minimis exception for certain transfers, and tangible property with built-in gain that does not exceed \$20,000 is excluded from the application of the regulations. In addition, the regulations only apply when a U.S. transferor contributes property to a partnership with a related foreign partner, and persons related to the U.S. transferor own 80 percent or more of the interests in the partnership. Accordingly, the Treasury Department and the IRS expect that these regulations primarily will affect large domestic corporations. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### Drafting information

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

\* \* \* \* \*

### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

Section 1.721(c)-1 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-2 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-3 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-4 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-5 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-6 also issued under 26 U.S.C. 721(c).

Section 1.721(c)-7 also issued under 26 U.S.C. 721(c).

\* \* \* \* \*

Par. 2. Section 1.197-2 is amended by adding paragraphs (h)(12)(vii)(C) and (l)(5) to read as follows:

*§ 1.197-2 Amortization of goodwill and certain other intangibles.*

\* \* \* \* \*

- (h) \* \* \*
- (12) \* \* \*
- (vii) \* \* \*

(C) [The text of proposed § 1.197-2(h)(12)(vii)(C) is the same as the text of § 1.197-2T(h)(12)(vii)(C) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

- (l) \* \* \*

(5) [The text of proposed § 1.197-2(l)(5) is the same as the text of § 1.197-2T(l)(5) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

Par. 3. Section 1.704-1 is amended by adding paragraph (b)(2)(iv)(f)(6) following the undesignated paragraph at the end of paragraph (b)(2)(iv)(f)(5) and adding paragraph (f) to read as follows:

*§ 1.704-1 Partner's distributive share.*

\* \* \* \* \*

- (b) \* \* \*
- (2) \* \* \*
- (iv) \* \* \*
- (f) \* \* \*

(6) [The text of proposed § 1.704-1(b)(2)(iv)(f)(6) is the same as the text of § 1.704-1T(b)(2)(iv)(f)(6) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(f) [The text of proposed § 1.704-1(f) is the same as the text of § 1.704-1T(f) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

Par. 4. Section 1.704-3 is amended by adding paragraphs (a)(13), (d)(5)(iii), and (g) to read as follows:

*§ 1.704-3 Contributed property.*

- (a) \* \* \*

(13) [The text of proposed § 1.704-3(a)(13) is the same as the text of § 1.704-3T(a)(13) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

- (d) \* \* \*

- (5) \* \* \*

(iii) [The text of proposed § 1.704-3(d)(5)(iii) is the same as the text of § 1.704-3T(d)(5)(iii) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(g) [The text of proposed § 1.704-3(g) is the same as the text of § 1.704-3T(g) published elsewhere in this issue of the **Bulletin**].

Par. 5. Section 1.721(c)-1 is added to read as follows:

*§ 1.721(c)-1 Overview, definitions, and rules of general application.*

[The text of proposed § 1.721(c)-1 is the same as the text of § 1.721(c)-1T published elsewhere in this issue of the **Bulletin**].

Par. 6. Section 1.721(c)-2 is added to read as follows:

*§ 1.721(c)-2 Recognition of gain on certain contributions of property to partnerships with related foreign partners.*

[The text of proposed § 1.721(c)-2 is the same as the text of § 1.721(c)-2T published elsewhere in this issue of the **Bulletin**].

Par. 7. Section 1.721(c)-3 is added to read as follows:

*§ 1.721(c)-3 Gain deferral method.*

[The text of proposed § 1.721(c)-3 is the same as the text of § 1.721(c)-3T published elsewhere in this issue of the **Bulletin**].

Par. 8. Section 1.721(c)-4 is added to read as follows:

*§ 1.721(c)-4 Acceleration events.*

[The text of proposed § 1.721(c)-4 is the same as the text of § 1.721(c)-4T published elsewhere in this issue of the **Bulletin**].

Par. 9. Section 1.721(c)-5 is added to read as follows:

*§ 1.721(c)-5 Acceleration event exceptions.*

[The text of proposed § 1.721(c)-5 is the same as the text of § 1.721(c)-5T published elsewhere in this issue of the **Bulletin**].

Par. 10. Section 1.721(c)-6 is added to read as follows:

*§ 1.721(c)-6 Procedural and reporting requirements.*

[The text of proposed § 1.721(c)-6 is the same as the text of § 1.721(c)-6T published elsewhere in this issue of the **Bulletin**].

Par. 11. Section 1.721(c)-7 is added to read as follows:

*§ 1.721(c)-7 Examples.*

[The text of proposed § 1.721(c)-7 is the same as the text of § 1.721(c)-7T published elsewhere in this issue of the **Bulletin**].

Par. 12. Section 1.6038B-2 is amended by:

1. Revising paragraph (a)(3).
2. Adding paragraphs (a)(1)(iii), (c)(8), and (c)(9).
3. Revising paragraph (h)(3).
4. Adding paragraphs (j)(4) and (j)(5).

*§ 1.6038B-2 Reporting of certain transfers to foreign partnerships.*

- (a) \* \* \*

- (1) \* \* \*

(iii) [The text of proposed § 1.6038B-2(a)(1)(iii) is the same as the text of § 1.6038B-2T(a)(1)(iii) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(3) [The text of proposed § 1.6038B-2(a)(3) is the same as the text of § 1.6038B-2T(a)(3) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

- (c) \* \* \*

(8) [The text of proposed § 1.6038B-2(c)(8) is the same as the text of § 1.6038B-2T(c)(8) published elsewhere in this issue of the **Bulletin**].

(9) [The text of proposed § 1.6038B-2(c)(9) is the same as the text of § 1.6038B-2T(c)(9) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(h) \* \* \*

(3) [The text of proposed § 1.6038B-2(h)(3) is the same as the text of § 1.6038B-2T(h)(3) published elsewhere in this issue of the **Bulletin**].

\* \* \* \* \*

(j) \* \* \*

(4) [The text of proposed § 1.6038B-2(j)(4) is the same as the text of § 1.6038B-2T(j)(4) published elsewhere in this issue of the **Bulletin**].

(5) [The text of proposed § 1.6038B-2(j)(5) is the same as the text of § 1.6038B-2T(j)(5) published elsewhere in this issue of the **Bulletin**].

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

(Filed by the Office of the Federal Register on January 18, 2017, 8:45 a.m., and published in the issue of the Federal Register for January 19, 2017, 82 F.R. 6368.)

## Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking

### Definition of Dependent

#### REG-137604-07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking.

SUMMARY: This document withdraws proposed regulations relating to the definition of an authorized placement agency for purposes of a dependency exemption for a child placed for adoption that were issued prior to the changes made to the law by the Working Families Tax Relief Act of 2004 (WFTRA). This document contains proposed regulations that reflect changes made by WFTRA and by the Fostering Connections to Success and Increasing Adoptions Act of 2008 (FC-SIAA) relating to the dependency exemption. This document also contains proposed regulations that, to reflect current law, amend the regulations relating to the sur-

ving spouse and head of household filing statuses, the tax tables for individuals, the child and dependent care credit, the earned income credit, the standard deduction, joint tax returns, and taxpayer identification numbers for children placed for adoption. These proposed regulations change the IRS's position regarding the category of taxpayers permitted to claim the childless earned income credit. In determining a taxpayer's eligibility to claim a dependency exemption, these proposed regulations change the IRS's position regarding the adjusted gross income of a taxpayer filing a joint return for purposes of the tiebreaker rules and the source of support of certain payments that originated as governmental payments. These regulations provide guidance to individuals who may claim certain child-related tax benefits.

DATES: Written or electronic comments and requests for a public hearing must be received by April 19, 2017.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-137604-07), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-137604-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-137604-07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Victoria J. Driscoll, (202) 317-4718; concerning the submission of comments and requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document withdraws a notice of proposed rulemaking (REG-107279-00) amending § 1.152-2(c)(2) of the Income Tax Regulations that was published in the **Federal Register** (65 FR 71277) on November 30, 2000 (2000 proposed regulations) relating to the definition of an au-

thorized placement agency for purposes of a dependency exemption for a child placed for adoption under prior law. Prior law required that a child be placed with the taxpayer for adoption by an authorized placement agency. Section 152 of the Internal Revenue Code was amended by section 201 of WFTRA (Public Law 108-311, 118 Stat. 1166, 1169) to provide that a qualifying child eligible to be the dependent of a taxpayer may include a child lawfully placed with the taxpayer for adoption. Accordingly, the proposed regulations in § 1.152-2(c)(2) under prior law are withdrawn.

This document also contains proposed amendments to 26 CFR Part 1 under sections 2, 3, 21, 32, 63, 151, 152, 6013, and to Part 301 under section 6109 to reflect the changes made by WFTRA and FC-SIAA (Public Law 110-351, 122 Stat. 3949) relating to the dependency exemption, as well as changes to these sections by other acts. WFTRA amended section 152, in part, to provide a uniform definition of a qualifying child; FCSIAA added to the definition of a qualifying child the requirements that the child must be younger than the taxpayer and that the child must not file a joint return (other than as a claim for refund). FCSIAA also amended the rules that apply if two or more taxpayers are eligible to claim an individual as a qualifying child.

#### 1. Dependency Rules

Under section 151, a taxpayer may deduct an exemption amount for a dependent as defined in section 152. Prior to WFTRA, section 151 contained many of the rules related to the definition of a dependent. WFTRA moved those rules to section 152. As amended, section 152(a) defines a *dependent* as a qualifying child or a qualifying relative. Taxpayers should note that a taxpayer's treatment of the dependency exemption under section 151 for a particular qualifying child or qualifying relative might have tax consequences under other Code provisions, such as the education tax credits under section 25A, the premium tax credit under section 36B, and the penalty for failure to maintain minimum essential coverage under section 5000A.



#### a. *Individual not a dependent*

Section 152(b) provides that an individual who is a qualifying child or a qualifying relative of a taxpayer is not a taxpayer's dependent in certain circumstances. Section 152(b)(2) provides that, to be a dependent of a taxpayer, an individual must not have filed a joint return with his or her spouse. However, the WFTRA conference report provides that the "restriction does not apply if the return was filed solely to obtain a refund and no tax liability would exist for either spouse if they filed separate returns." See H.R. Rep. No. 108-696, at 55 n.38 (2004) (Conf. Rep.).

#### b. *Qualifying child*

WFTRA established under section 152(c) a uniform definition of a qualifying child. The legislative history identifies five child-related benefits to which the uniform definition applies: the filing status of head of household under section 2(b), the child and dependent care credit under section 21, the child tax credit under section 24, the earned income credit under section 32, and the dependency exemption under section 151. See H.R. Rep. No. 108-696, at 55-65.

Section 152(c) defines a qualifying child as an individual who bears a certain relationship to the taxpayer (qualifying child relationship test), has the same principal place of abode as the taxpayer for more than one-half of the taxable year (residency test), is younger than the taxpayer and is under the age of 19 (or age 24 if a full-time student or any age if permanently and totally disabled) (age test), does not provide more than one-half of his or her own support (qualifying child support test), and does not file a joint return with a spouse except to claim a refund of estimated or withheld taxes (joint return test).

#### c. *Temporary absence*

A child is considered to reside in the same principal place of abode as a taxpayer during a temporary absence. Under the existing section 152 regulations, a nonpermanent failure to occupy a common abode by reason of illness, education, business, vacation, military service, or a

custody agreement may be a temporary absence due to special circumstances. The existing regulations under section 2 defining surviving spouse and head of household include a similar rule relating to the effect of a temporary absence on the requirement to maintain a household, but add the requirement that it is reasonable to assume that the absent person will return to the household. Under case law, a factor to consider in determining whether an absence is temporary is whether the individual intends to establish a new principal place of abode. In *Rowe v. Commissioner*, 128 T.C. 13 (2007), the court concluded that it was reasonable to assume that a taxpayer would return to her home after pretrial confinement and that the taxpayer's absence was temporary. See also *Hein v. Commissioner*, 28 T.C. 826 (1957) (*acq.*, 1958-2 CB 6), and Rev. Rul. 66-28 (1966-1 CB 31).

#### d. *Two or more taxpayers eligible to claim individual as qualifying child*

Section 152(c)(4) provides tiebreaker rules that apply if an individual meets the definition of a qualifying child for two or more taxpayers (eligible taxpayers). In general, the eligible taxpayer who is a parent (eligible parent) of the individual may claim the individual as a qualifying child or, if there is no eligible parent, then the individual may be claimed by the eligible taxpayer with the highest adjusted gross income.

If more than one of the eligible taxpayers is a parent of the individual, more than one eligible parent claims the individual as a qualifying child, and the eligible parents claiming the individual do not file a joint return with each other, the individual is treated as the qualifying child of the eligible parent claiming the individual with whom the individual resided for the longest period of time during the taxable year. If the individual resided with each eligible parent claiming the individual for the same amount of time during the taxable year, the individual is treated as the qualifying child of the eligible parent claiming the individual with the highest adjusted gross income.

If at least one, but not all, of two or more eligible taxpayers is a parent of the individual, but no eligible parent claims

the individual as a qualifying child, another eligible taxpayer may claim the individual, but only if the eligible taxpayer's adjusted gross income is higher than the adjusted gross income of each eligible parent. Since 2009, IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information*, has stated that "[i]f the child's parents file a joint return with each other, this rule may be applied by dividing the parents' combined AGI equally between the parents."

Notice 2006-86 (2006-2 CB 680) provides interim guidance on these rules prior to the amendments by FCSIAA. The notice provides that, except to the extent that a noncustodial parent may claim the child as a qualifying child under the special rule for divorced or separated parents in section 152(e), discussed in the next paragraph, if more than one taxpayer claims a child as a qualifying child, the child is treated as the qualifying child of only one taxpayer (as determined under the tiebreaker rules of section 152(c)(4)) for purposes of the five provisions subject to the uniform definition of a qualifying child (the filing status of head of household under section 2(b), the child and dependent care credit under section 21, the child tax credit under section 24, the earned income credit under section 32, and the dependency exemption under section 151, as well as for purposes of the exclusion for dependent care assistance under section 129 (which may apply to the care of a dependent qualifying child under age 13)). Thus, in general, the tiebreaker rules for determining which taxpayer may claim a child as a qualifying child apply to these provisions as a group, rather than on a section-by-section basis.

Notice 2006-86 contains an exception to the rule that only one taxpayer may claim a child as a qualifying child for all purposes. Section 152(e) has a special rule for divorced or separated parents that determines who, as between the custodial and noncustodial parent, may claim a child as a qualifying child or qualifying relative if certain tests (different from the general tests under sections 152(c) and (d)) regarding residency and support are met and the custodial parent releases a claim to exemption for the child. The notice provides that, if this special rule applies, a noncustodial parent may claim a

child as a qualifying child for purposes of the dependency exemption and the child tax credit (the only two of the provisions addressed in the notice to which section 152(e) applies in determining who is a qualifying child), and another taxpayer may claim the child for one or more of the other benefits to which section 152(e) does not apply.

Although FCSIAA affects other aspects of section 152(c)(4) and Notice 2006–86, there is nothing in FCSIAA that would compel a change in the rule described in Notice 2006–86 that an individual is treated as the qualifying child of only one taxpayer for the listed child-related tax benefits, except if the special rule in section 152(e) applies.

#### e. *Qualifying relative*

Under section 152(d), a qualifying relative is an individual who bears a certain relationship to the taxpayer, including an individual who has the same principal place of abode as the taxpayer and is a member of the taxpayer's household for the taxable year (qualifying relative relationship test), has gross income less than the exemption amount for the taxable year (gross income test), receives more than one-half of his or her support from the taxpayer (qualifying relative support test), and is not a qualifying child of any taxpayer (not a qualifying child test).

Notice 2008–5 (2008–1 CB 256) addresses whether a taxpayer meets the test under section 152(d)(1)(D) to claim an individual as a qualifying relative. That provision requires that the individual not be a qualifying child of either the taxpayer or any other taxpayer during a taxable year beginning in the calendar year in which the taxpayer's taxable year begins. The notice provides that, for purposes of section 152(d)(1)(D), an individual is not a qualifying child of "any other taxpayer" if the individual's parent (or other person for whom the individual is defined as a qualifying child) is not required by section 6012 to file an income tax return and (1) does not file an income tax return, or (2) files an income tax return solely to obtain a refund of withheld income taxes.

#### f. *Support tests*

Under section 152(c)(1)(D), to be a taxpayer's qualifying child, an individual must not have provided over one-half of the individual's own support for the calendar year. Under section 152(d)(1)(C), to be a taxpayer's qualifying relative, a taxpayer must have provided over one-half of an individual's support for the calendar year.

Regarding governmental payments to a person with a qualifying need, the WFTRA conference report, H.R. Rep. No. 108–696, at 57, states that "[g]overnmental payments and subsidies (e.g., Temporary Assistance [for] Needy Families, food stamps, and housing) generally are treated as support provided by a third party." The IRS has successfully asserted in litigation that governmental payments provided to a parent to aid a family with dependent children and used by the parent for support of her children was support of the children provided by the government, and not support provided by the parent. See *Lutter v. Commissioner*, 61 T.C. 685 (1974), *affd. per curiam*, 514 F.2d 1095 (7th Cir. 1975).

#### 2. *Surviving Spouse and Head of Household, and Conforming Changes*

Prior to amendment by section 803(b) of the Tax Reform Act of 1969 (Public Law 91–172, 83 Stat. 487), section 2(a) provided that the return of a surviving spouse is treated as a joint return for purposes of the tax rates, the tax tables for individuals, and the standard deduction. Following the 1969 amendments, section 2(a) defines the term *surviving spouse* for purposes of section 1. The return of a taxpayer filing as a surviving spouse is no longer treated as a joint return under sections 2, 3, or 63. Section 3 provides tax tables for certain individuals in lieu of the tax imposed by section 1. Section 63(c) provides the same basic standard deduction for a taxpayer filing as a surviving spouse as a taxpayer filing a joint return. Accordingly, a taxpayer filing as a surviving spouse is no longer treated as filing a joint return for any tax purpose, but rather, a taxpayer filing as a surviving spouse simply uses the same tax rates under section 1, the same amounts in the tax tables

under section 3, and the same standard deduction under section 63 as a taxpayer filing a joint return.

Generally, under section 2(b), to qualify as a head of household, a taxpayer must maintain a household that is the principal place of abode of a qualifying child or other dependent for more than one-half of the taxable year. If the dependent is a parent of the taxpayer and the parent does not share a principal place of abode with the taxpayer, the household maintained by the taxpayer must be the parent's principal place of abode for the entire taxable year.

Prior to WFTRA, section 21 required that a taxpayer maintain a household to claim the credit for dependent care expenses, and regulations on maintaining a household were published under that section. WFTRA removed that requirement from the dependent care credit.

#### 3. *Earned Income Credit*

Section 32 provides a tax credit to eligible taxpayers who work and have earned income below a certain dollar amount. Before the amendment of section 32 by the Omnibus Reconciliation Act of 1993 (Public Law 103–66, 107 Stat. 312), the earned income credit (EIC) was allowable only to a taxpayer with one or more qualifying children. If an individual met the definition of a qualifying child for more than one taxpayer, a tiebreaker rule in section 32 determined which taxpayer was allowed to claim the individual as a qualifying child for the EIC. For taxable years beginning after 1993, section 32(c)(1)(A)(ii) allows a taxpayer without a qualifying child to claim the EIC (childless EIC) if certain requirements are met. Although there is no regulatory guidance on this issue, since 1995, the IRS has taken the position in IRS Publication 596, *Earned Income Credit*, that if an individual meets the definition of a qualifying child for more than one taxpayer and the individual is not treated as the qualifying child of a taxpayer under the tiebreaker rules, then that taxpayer is precluded from claiming the childless EIC. WFTRA moved the tiebreaker rules from section 32 to section 152(c)(4).

Before repeal in 2010, section 3507 allowed advance payment of the EIC. Section 3507 was repealed by the FAA Air

Transportation Modernization and Safety Improvement Act (Public Law 111–226, 124 Stat. 2389).

#### 4. *Additional Standard Deduction for the Aged and Blind*

Before the amendments to sections 63 and 151 made by the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2085), a taxpayer was entitled to an additional personal exemption under section 151 for the taxpayer or the taxpayer’s spouse (or both), if either was age 65 or older or was blind at the close of the taxable year. As amended, section 63 provides an additional standard deduction for age or blindness instead of an additional personal exemption under section 151.

#### **Explanation of Provisions**

The proposed regulations reflect statutory amendments to sections 2, 3, 21, 32, 63, 151, 152, 6013, and 6109. In addition, the regulations address certain significant issues arising under these sections and modify certain IRS positions, as explained below.

##### 1. *Dependency Exemption*

Consistent with the amendments made to sections 151 and 152 by WFTRA, the proposed regulations move rules related to the definition of a dependent from the regulations under section 151 to the regulations under section 152.

##### a. *Relationship test*

##### i. *General Rules*

Section 152(c)(2) provides that a qualifying child must be a child or a descendant of a child of the taxpayer, or a brother, sister, stepbrother, or stepsister of the taxpayer, or a descendant of any of these relatives. Section 152(d)(2) provides that a qualifying relative must bear a certain relationship to the taxpayer, which includes a child or a descendant of a child, a brother, sister, stepbrother, stepsister, parent or ancestor of a parent, or an aunt or uncle of the taxpayer. An individual (other than the taxpayer’s spouse) who is not related to the taxpayer in one of the named relationships nevertheless may sat-

isfy the relationship test for a qualifying relative if the individual has the same principal place of abode as the taxpayer and is a member of the taxpayer’s household for the taxpayer’s taxable year.

The proposed regulations adopt the rule in Notice 2008–5 regarding whether an individual is a qualifying child of a taxpayer for purposes of determining whether that individual may be a qualifying relative. That is, the proposed regulations provide that an individual is not a qualifying child of a person if that person is not required to file an income tax return under section 6012, and either does not file an income tax return or files an income tax return solely to claim a refund of estimated or withheld taxes.

##### ii. *Adopted Child—Adoption by Individual Other than the Taxpayer*

Prior to 2005, for purposes of the relationship test, a person’s legally adopted child was treated as that person’s child by blood. Specifically, section 152(b)(2) provided that “a legally adopted child of an individual (and a child who is a member of an individual’s household, if placed with such individual by an authorized placement agency for legal adoption by such individual), . . . shall be treated as a child of such individual by blood.” Therefore, a taxpayer other than the adopting “individual” could be eligible to claim an exemption for an adopted child. For example, the parent of the adopting parent could claim a dependency exemption for the legally adopted child of the taxpayer’s son or daughter (just as biological grandparents may claim an exemption for a grandchild) if all other requirements were met.

WFTRA amended section 152 to change the reference from a child placed by an authorized placement agency for adoption to a child who is “lawfully placed” for legal adoption. In making that change, however, WFTRA also changed the reference to the adopting person from “an individual” to “the taxpayer,” so that section 152(f)(1)(B) currently provides that a legally adopted individual of the taxpayer is treated as a child by blood of the taxpayer. The use of the word “taxpayer” rather than “individual” arguably limits the recognition of a relationship

through adoption only to those situations in which the taxpayer claiming a dependency exemption for the child is the person who adopts the child. This interpretation of the amended statutory language would diverge from the results of a legal adoption under property, inheritance, and other nontax law, and from the prior tax treatment of adoptions – a significant change in the applicable law. However, there is nothing in the legislative history indicating that Congress intended to limit the treatment of an adopted child as a child by blood in this manner or that otherwise suggests this change in language was intended to effect a change in existing law.

To fill this apparent gap in the statute, the proposed regulations provide that any child legally adopted by a “person,” or any child who is placed with a “person” for legal adoption by that “person,” is treated as a child by blood of that person for purposes of the relationship tests under sections 152(c)(2) and 152(d)(2). Similarly, the proposed regulations provide that an eligible foster child is a child who is placed with a “person” rather than with a taxpayer.

##### iii. *Adopted Child and Foster Child—Child Placement*

Although WFTRA removed the reference to an authorized placement agency from the provisions relating to an adopted child in section 152(f)(1)(B), the reference to an authorized placement agency continues to appear in section 152(f)(1)(C), relating to an eligible foster child. Prior to amendment by WFTRA, section 152 treated a child who was a member of an individual’s household pending adoption as a child by blood of the individual for purposes of the relationship test only if the child was a foster child living with the individual or if the child was placed with the individual by an authorized placement agency for adoption by the individual. Similarly, § 301.6109–3(a) currently provides that a taxpayer may obtain an adoption taxpayer identification number (ATIN) only for a child who was placed for adoption by an authorized placement agency.

As amended by WFTRA, section 152 treats a child placed for adoption as a



child by blood of the taxpayer if the child “is lawfully placed with the taxpayer for legal adoption by the taxpayer.” A child may be lawfully placed for legal adoption by an authorized placement agency, the child’s parents, or other persons authorized by State law to place children for legal adoption. These proposed regulations reflect the changes made by WFTRA and amend the regulations under section 6109 to provide that the IRS will assign an ATIN to a child who has been lawfully placed with a person for legal adoption.

Under section 152(f)(1)(A)(ii) and § 1.152-1(b)(1)(iii) of these proposed regulations, the term *child* also includes an eligible foster child of the taxpayer as defined in 152(f)(1)(C), that is, a child who is placed with the taxpayer by an authorized placement agency or by the judgment, decree, or other order of a court of competent jurisdiction.

#### iv. Definition of Authorized Placement Agency

The 2000 proposed regulations under § 1.152-2(c)(2) defined an authorized placement agency for purposes of the prior law regarding a child placed for legal adoption. These proposed regulations define an authorized placement agency for purposes of the definition of an eligible foster child and withdraw the 2000 proposed regulations, which defined that term without reference to an Indian Tribal Government (ITG).

These proposed regulations provide that an *authorized placement agency* may be a State, the District of Columbia, a possession of the United States, a foreign country, an agency or organization authorized by, or a political subdivision of, any of these entities to place children in foster care or for adoption. Under the Indian Child Welfare Act of 1978 (25 U.S.C. chapter 21), ITGs and states perform similar functions for foster care and adoption programs. Thus, the proposed regulations provide that an authorized placement agency also may be an ITG (as defined in section 7701(a)(40)), or an agency or organization authorized by, or a political subdivision of, an ITG that places children in foster care or for adoption.

#### b. Residency test—principal place of abode

For purposes of determining whether an individual has the same principal place of abode as the taxpayer in applying the residency test for a qualifying child and the relationship test for a qualifying relative who does not have one of the listed relationships to the taxpayer, the proposed regulations provide that the term *principal place of abode* means a person’s main home or dwelling where the person resides. A person’s principal place of abode need not be the same physical location throughout the taxable year and may be temporary lodging such as a homeless shelter or relief housing resulting from displacement caused by a natural disaster.

The proposed regulations further provide that a taxpayer and an individual have the same principal place of abode despite a temporary absence by either person. A person is temporarily absent if, based on the facts and circumstances, the person would have resided with the taxpayer but for the temporary absence and it is reasonable to assume the person will return to reside at the place of abode. Thus, the proposed regulations adopt the “reasonable to assume” language from the existing regulations under section 2. The proposed regulations indicate that a nonpermanent failure to occupy the abode by reason of illness, education, business, vacation, military service, institutionalized care for a child who is permanently and totally disabled (as defined in section 22(e)(3)), or incarceration may be treated as a temporary absence due to special circumstances. This definition of temporary absence applies to the residency test for a qualifying child, to the relationship test for a qualifying relative who does not have a listed relationship to the taxpayer, and to the requirements to maintain a household for surviving spouse and head of household.

For purposes of the residency test for a qualifying child, the proposed regulations provide that an individual is treated as having the same principal place of abode as the taxpayer for more than one-half of the taxable year if the individual resides with the taxpayer for at least 183 nights during the taxpayer’s taxable year or for at least 184 nights during the taxpayer’s tax-

able year that includes a leap day (residing for more than one-half of the taxable year). The proposed regulations further provide that an individual resides with the taxpayer for a night if the individual sleeps (1) at the taxpayer’s residence, or (2) in the company of the taxpayer when the individual does not sleep at the taxpayer’s residence (for example, when the parent and the child are on vacation). The regulations provide additional rules for counting nights if a night extends over two taxable years and for taxpayers who work at night.

The proposed regulations provide special rules for determining whether an individual satisfies a residency test if the individual is born or dies during the taxable year, is adopted or placed for adoption, is an eligible foster child, or is a missing child.

#### c. Age test

The age test for a qualifying child requires that an individual be younger than the taxpayer claiming the individual as a qualifying child, and the individual must not have attained the age of 19 (or age 24 if the individual is a student). The age requirement is treated as satisfied if the individual is permanently and totally disabled.

For purposes of this age test, the proposed regulations substantially adopt the existing definition of a student. Accordingly, the proposed regulations provide that the term *student* means an individual who, during some part of each of 5 calendar months during the calendar year in which the taxable year of the taxpayer begins, is a full-time student at an educational organization described in section 170(b)(1)(A)(ii) or is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational institution or of a State or political subdivision of a State. An *educational organization*, as defined in section 170(b)(1)(A)(ii), is a school normally maintaining a regular faculty and curriculum and having a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on.

#### d. Support tests

In determining whether an individual provided more than one-half of the individual's own support (qualifying child support test), or whether a taxpayer provided more than one-half of an individual's support (qualifying relative support test), the proposed regulations compare the amount of support provided by the individual or the taxpayer to the total amount of the individual's support from all sources. In general, the amount of an individual's support from all sources includes support the individual provides and income that is excludable from gross income. The proposed regulations further provide that the amount of an item of support is the amount of expenses paid or incurred to furnish the item of support. If support is furnished in the form of property or a benefit (such as lodging), the amount of that support is the fair market value of the item furnished (Rev. Rul. 58-302 (1958-1 CB 62)).

The proposed regulations provide that the term *support* includes food, shelter, clothing, medical and dental care, education, and similar items for the benefit of the supported individual. Support does not include Federal, State, and local income taxes, or Social Security and Medicare taxes, of an individual paid from the individual's own income (Rev. Rul. 58-67 (1958-1 CB 62)), funeral expenses (Rev. Rul. 65-307 (1965-2 CB 40)), life insurance premiums, or scholarships received by a taxpayer's child who is a student as defined in section 152(f)(2).

The proposed regulations provide that medical insurance premiums are treated as support. These premiums include Part A Basic Medicare premiums, if any, under Title XVIII of the Social Security Act (42 U.S.C. 1395c to 1395i-5), Part B Supplemental Medicare premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395j to 1395w-6), Part C Medicare + Choice Program premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395w-21 to 1395w-29), and Part D Voluntary Prescription Drug Benefit Medicare premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395w-101 to 1395w-154). However, medical insurance proceeds, including benefits received under Medicare Part A,

Part B, Part C, and Part D, are not treated as support and are disregarded in determining the amount of the individual's support. Thus, only the premiums paid and the unreimbursed portion of the expenses for the individual's medical care are support. See Rev. Rul. 64-223 (1964-2 CB 50); and Rev. Rul. 70-341 (1970-2 CB 31), revoked in part by Rev. Rul. 79-173 (1979-1 CB 86) to the extent that it held that Part A Medicare benefits are included as a recipient's contribution to support. In addition, services provided to individuals under the medical and dental care provisions of the Armed Forces Act (10 U.S.C. chapter 55) are not treated as support and are disregarded in determining the amount of the individual's support. Finally, payments from a third party (including a third party's insurance company) for the medical care of an injured individual in satisfaction of a legal claim for the personal injury of the individual are not items of support and are disregarded in determining the amount of the individual's support. See Rev. Rul. 64-223.

The proposed regulations provide that, in general, governmental payments and subsidies are treated as support provided by a third party. Consistent with previously issued rulings and case law, these payments and subsidies include, for example, Temporary Assistance for Needy Families (TANF) (42 U.S.C. 601-619), low-income housing assistance (42 U.S.C. 1437f), benefits under the Supplemental Nutrition Assistance Program (7 U.S.C. chapter 51), Supplemental Security Income payments (42 U.S.C. 1381-1383f), foster care maintenance payments, and adoption assistance payments. See H.R. Rep. No. 108-696, at 57 (2004) (Conf. Rep.); *Gulvin v. Commissioner*, 644 F.2d 2 (5th Cir. 1981); and Rev. Rul. 74-153 (1974-1 CB 20).

However, unlike the subsidies described in the previous paragraph that generally are based solely on need, old age benefits under section 202(b) of Title II of the Social Security Act (SSA) (42 U.S.C. 402) are based on an individual's earnings and contributions into the Social Security system and thus are treated as support provided by the recipient to the extent the recipient uses the payments for support. See Rev. Rul. 58-419 (1958-2

CB 57), as modified by Rev. Rul. 64-222 (1964-2 CB 47). Similarly, Social Security survivor and disability insurance benefit payments made under section 202(d) of the SSA to the child of a deceased or disabled parent are treated as support provided by the child to the extent those payments are used for the child's support. See Rev. Rul. 57-344 (1957-2 CB 112) and Rev. Rul. 74-543 (1974-2 CB 39).

The proposed regulations provide a special rule for governmental payments used by the recipient or other intended beneficiary to support another individual. The proposed regulations draw a distinction between: (1) governmental payments (such as Social Security old age benefits, or survivor and disability insurance benefits for a child) made to a recipient that are intended to benefit a particular named individual (whether the recipient, or another intended beneficiary for whom the recipient merely acts as the payee on behalf of that other intended beneficiary); and (2) governmental payments made to a recipient that are intended to support the recipient and other individuals (such as TANF). Although the governmental payments of the former variety are intended to benefit a particular named individual, because money is fungible, the intended beneficiary might use the governmental payments to support another individual. In this situation, the proposed regulations provide that, if the intended beneficiary (whether the recipient or another individual) uses the governmental payments to support another individual, that amount would constitute support of that other individual provided by the intended beneficiary. Similarly, the proposed regulations provide that the use of governmental payments of the latter variety by the recipient to support another individual would constitute support of that other individual provided by the recipient, whereas any part of such a payment used for the support of the recipient would constitute support of the recipient by a third party. For example, if a mother receives TANF and uses the TANF payments to support her children, the proposed regulations treat the mother as having provided that support. Thus, the IRS will no longer assert the position that it took in *Lutter*, which concerned payments received by a mother under a program that was the predecessor of TANF.

The Treasury Department and the IRS are proposing this rule for the administrative convenience of both the IRS and taxpayers to avoid the need to trace the use of such governmental payments, as opposed to the use of other funds of the recipient, for the support of another individual.

The Treasury Department and IRS request comments on whether various payments made pursuant to the Patient Protection And Affordable Care Act (Public Law 111–148, 124 Stat. 119) in the form of a cost-sharing reduction, an advanced payment of the premium tax credit, or as a reimbursement of health insurance premiums in the form of a premium tax credit, when used for the benefit of another individual, are support provided by the recipient of those benefits or support provided by a third party.

#### e. *Citizenship*

Under section 152(b)(3)(A), an individual who is not a citizen or national of the United States is not a dependent unless the individual is a resident of the United States, Canada, or Mexico. Nevertheless, consistent with the exception for certain adopted children in section 152(b)(3)(B), the proposed regulations provide that an adopted child of a taxpayer who is a U.S. citizen or national may qualify as a dependent if, for the taxpayer's taxable year, the child has the same principal place of abode as the taxpayer and is a member of the taxpayer's household, and otherwise qualifies as the taxpayer's dependent.

#### f. *Tiebreaker rules*

The proposed regulations change the interpretation in Publication 501 regarding a taxpayer's adjusted gross income on a joint return and provide that, in applying the tiebreaker rules that treat an individual as the qualifying child of the eligible taxpayer with the higher or highest adjusted gross income, the adjusted gross income of a taxpayer who files a joint tax return is the total adjusted gross income shown on the return. The prior interpretation is changed to be consistent with other Code sections that require the filing of a joint return to claim a benefit and therefore calculate income based on the entire amount shown on the joint return. For

example, the earned income credit under section 32 calculates the earned income amount based on the entire amount shown on the joint return. This joint return rule also is relevant for determining whether section 152(c)(4)(C) applies. Under that provision, if an eligible parent does not claim an individual as a qualifying child, another eligible taxpayer may claim the individual as a qualifying child only if that taxpayer's adjusted gross income is higher than the adjusted gross income of any eligible parent.

The proposed regulations also expand the tiebreaker rule in section 152(c)(4)(C) to address the situation in which an eligible parent does not claim an individual as a qualifying child and two or more taxpayers, none of whom is a parent, are eligible to claim the individual as a qualifying child and each has adjusted gross income higher than any eligible parent. In this situation, the proposed regulations provide that the individual is treated as the qualifying child of the eligible taxpayer with the highest adjusted gross income.

#### g. *Child of parents who are divorced, separated, or living apart*

Section 152(e) provides, in general, that a child is treated as the qualifying child or qualifying relative of a noncustodial parent for a calendar year if, among other things, the custodial parent provides to the noncustodial parent a written declaration that the custodial parent will not claim the child as a dependent for any taxable year beginning in that calendar year. Under section 152(e)(2)(B), the noncustodial parent must attach the written declaration to his or her return.

The proposed regulations provide that the noncustodial parent must attach a copy of the written declaration to an original or amended return. A taxpayer may submit a copy of the written declaration to the IRS during an examination of that parent's return. However, to provide certainty for both taxpayers and the IRS, the proposed regulations provide that a copy of a written declaration attached to an amended return or provided during an examination will not meet the requirements of section 152(e) and § 1.152–5(e) if the custodial parent signed the written declaration after the custodial parent filed a return claiming

a dependency exemption for the child for the year at issue, and the custodial parent has not filed an amended return to remove that claim to a dependency exemption. The proposed regulations provide similar rules for a parent revoking a written declaration.

#### h. *Filing a return solely to obtain a refund of taxes*

Individuals who file an income tax return solely to obtain a refund of estimated or withheld taxes are subject to special rules under various provisions of section 152. Section 152(c)(1)(E) provides that, for an individual to be a qualifying child of a taxpayer, the individual cannot have filed a joint return "other than only for a claim of refund." Section 152(b)(2) provides that, for an individual to be a dependent of a taxpayer, the individual cannot have filed a joint return with the individual's spouse. However, the WFTRA conference report states that "[t]his restriction does not apply if the return was filed solely to obtain a refund and no tax liability would exist for either spouse if they filed separate returns." Section 152(d)(1)(D) provides that, to be a qualifying relative, an individual may not be the qualifying child of the taxpayer or of any other taxpayer. Notice 2008–5 concludes that an individual is not the qualifying child of "any other taxpayer," within the meaning of section 152(d)(1)(D), if the person who could have claimed the individual as a qualifying child does not have a filing obligation and either does not file a return or files a return solely to obtain a refund of withheld taxes.

The proposed regulations provide a similar exception to the rule in section 152(b)(1) that a taxpayer cannot have a dependent if the taxpayer himself or herself is a dependent of another taxpayer. Specifically, the proposed regulations provide that an individual is not a dependent of a person if that person is not required to file an income tax return under section 6012 and either does not file an income tax return or files an income tax return solely to claim a refund of estimated or withheld taxes.



## 2. *Surviving Spouse, Head of Household, and Conforming Changes*

The proposed regulations amend the regulations under section 2 regarding the definition of surviving spouse and the definition of head of household to conform to the amendments made by WFTRA. To reflect the amendments made by the Tax Reform Act of 1969, the proposed regulations remove from the regulations under sections 2, 3, and 6013 references to the return of a surviving spouse being treated as a joint return. The proposed regulations also revise and move from the regulations under section 21 to the regulations under section 2 the definition of maintaining a household, in part, to conform to the amendments to section 21 made by WFTRA, which removed the requirement that a taxpayer maintain a household to claim the credit under section 21.

### a. *Surviving spouse*

From the time of the 1969 amendment until the enactment of WFTRA, section 2(a)(1)(B) provided that a taxpayer who is a surviving spouse described in section 2(a)(1)(A) may file as a surviving spouse (and thus may use the tax rates of joint filers) only if the taxpayer “maintains as his home a household which constitutes for the taxable year the principal place of abode (as a member of such household) of a dependent (i) who (within the meaning of section 152) is a son, stepson, daughter, or stepdaughter of the taxpayer, and (ii) with respect to whom the taxpayer is entitled to a deduction for the taxable year under section 151.” Thus, the member of the taxpayer’s household had to be a son or daughter or stepson or stepdaughter for whom the taxpayer was entitled to a dependency deduction.

WFTRA amended section 2(a), as well as certain other sections such as section 42 relating to the low-income housing credit and section 125 relating to cafeteria plans, to provide that the reference to section 152 applies “without regard to subsections (b)(1), (b)(2), and (d)(1)(B).” These three subsections, respectively: (1) deny a dependency exemption to a dependent, (2) deny a dependency exemption for a person filing a joint return with his or her spouse, and (3) require the gross income

of a qualifying relative to be less than the amount of the dependency exemption. Thus, the language inserted by the WFTRA technical amendment to section 2(a) was intended to broaden the class of individuals whose members could qualify a taxpayer as a surviving spouse for purposes of section 2. See also Staff of Joint Comm. on Taxation, 108<sup>th</sup> Cong., *General Explanation of Tax Legislation Enacted in the 108<sup>th</sup> Congress* 130 (Comm. Print 2005) (“technical and conforming amendments ... provide that an individual may qualify as a dependent for certain purposes ... without regard to whether the individual has gross income ... or is married and files a joint return.”)

However, in amending section 2(a) for this purpose, WFTRA inserted the direction to exclude the three referenced provisions after the reference to section 152 in section 2(a)(1)(B)(i). Thus, this section currently provides, “(i) who (within the meaning of section 152, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof) is a son, stepson, daughter, or stepdaughter of the taxpayer.” Because section 2(a)(1)(B)(ii) continues to require that the taxpayer be entitled to a deduction under section 151 for the dependent (a requirement that could not be met if any of these three sections applied), read literally, section 2(a)(1)(B)(ii) would override the intent of the statutory change in section 2(a)(1)(B)(i), thus preventing the WFTRA amendment from effecting any change in the statute. Therefore, to give effect to the statutory amendment, the proposed regulations construe the language added by WFTRA instead to modify the section 152 requirements that apply in determining whether the taxpayer is entitled to the dependency exemption under section 151 for purposes of section 2(a)(1)(B)(ii). Accordingly, the proposed regulations provide that an individual is a dependent for purposes of section 2(a) if the taxpayer may claim a deduction under section 151 for the individual without applying sections 152(b)(1), (b)(2), and (d)(1)(B).

### b. *Head of household*

The proposed regulations under section 2(b) update and simplify the existing regulations defining head of household. Con-

sistent with the statutory amendments to the definition of a dependent, the proposed regulations provide rules on qualifying as a head of household by maintaining a household that is the principal place of abode of a qualifying child or a dependent. The proposed regulations on head of household apply the rules in the proposed regulations under section 152 for determining principal place of abode, including whether an absence is temporary.

### c. *Maintaining a household*

The proposed regulations provide that a taxpayer maintains a household only if the taxpayer pays more than one-half of the cost related to operating the household for the relevant period. Expenses related to operating the household include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance, and food consumed on the premises. A taxpayer may treat a home’s fair market rental value as a cost of maintaining a household (instead of the sum of payments for mortgage interest, property taxes, and insurance). The proposed regulations provide rules that, in certain circumstances, prorate on a monthly basis the annual cost of maintaining a household when a qualifying child or dependent resides in the household for less than the entire taxable year. The proposed regulations also, in certain circumstances, recognize the creation of a new household during a year and treat shared living quarters as separate households.

## 3. *Tax Tables for Individuals*

The proposed regulations remove from the regulations under section 3 references to the return of a surviving spouse being treated as a joint return to conform to the amendments made by the Tax Reform Act of 1969. The proposed regulations also update the regulations under section 3 to reflect current law.

## 4. *Earned Income Credit*

The proposed regulations conform the regulations under section 32 to amendments made to section 32 by WFTRA. Consistent with the 2010 repeal of section 3507 by the FAA Air Transportation

Modernization and Safety Improvement Act, the proposed regulations delete the paragraphs of the regulations under section 32 discussing advance payment of the earned income credit.

In addition, the proposed regulations reflect a change in the IRS's position on the interaction of sections 152(c)(4) and 32. Specifically, the proposed regulations provide that, if an individual meets the definition of a qualifying child under section 152(c)(1) for more than one taxpayer and the individual is not treated as the qualifying child of one such taxpayer under the tiebreaker rules of section 152(c)(4), then the individual also is not treated as a qualifying child of that taxpayer for purposes of section 32(c)(1)(A). Thus, that taxpayer may be an eligible individual under section 32(c)(1)(A)(ii) and may claim the childless EIC if he or she meets the other requirements of that section. The Treasury Department and the IRS have concluded that this change in position is consistent with the language and purpose of section 32 and will be less confusing to taxpayers and easier for the IRS to administer.

The problems with the current rule may be illustrated by the following example. Two sisters (B and C) live together and each of them is a low-income taxpayer. Neither has a child and each may claim the childless EIC under section 32(c)(1)(A)(ii). Later, B has a child, and B's child meets the definition of a qualifying child under section 152(c)(1) for both B and C. The child is treated as the qualifying child of B under the tiebreaker rules of section 152(c)(4), and B may claim the EIC as an eligible individual with a qualifying child under section 32(c)(1)(A)(i). Under the current rule, C would not be allowed to claim the childless EIC under section 32(c)(1)(A)(ii). The Treasury Department and the IRS have determined that allowing C to continue to claim the childless EIC after the child is born is equitable and consistent with the purpose of section 32 to assist working, low-income taxpayers. Accordingly, the proposed regulations provide that, if an individual is not treated as a qualifying child of a taxpayer after applying the tiebreaker rules of section 152(c)(4), then the individual will not pre-

vent that taxpayer from qualifying for the childless EIC.

#### *5. Additional Standard Deduction for the Aged and Blind*

The proposed regulations remove the provisions on additional exemptions for age and blindness from the regulations under section 151 and add regulations under section 63 on the additional standard deduction for the aged and the blind to reflect the changes made by the Tax Reform Act of 1986. The proposed regulations amend the regulations under section 63 to remove a cross reference to now-repealed statutory provisions relating to a charitable deduction for taxpayers who do not itemize. To limit impediments to electronic filing, the proposed regulations also delete the requirement that a taxpayer claiming a tax benefit for blindness must attach a certificate or statement to the taxpayer's tax return. Instead, a taxpayer must maintain the certificate or statement in the taxpayer's records.

#### **Applicability Date**

These regulations are proposed to apply to taxable years beginning after the date the regulations are published as final regulations in the **Federal Register**. Pending the issuance of the final regulations, taxpayers may choose to apply these proposed regulations in any open taxable years.

#### **Effect on Other Documents**

When finalized, the proposed regulations will obsolete Rev. Rul. 57-344, Rev. Rul. 58-67, Rev. Rul. 58-302, Rev. Rul. 64-223, Rev. Rul. 65-307, Rev. Rul. 70-341, Rev. Rul. 74-153, Rev. Rul. 74-543, Rev. Rul. 79-173, Rev. Rul. 84-89, Notice 2006-86, and Notice 2008-5.

#### **Special Analyses**

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. The regulations affect individuals and do not impose a collection of information on small entities, therefore the Regulatory Flexibility

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

#### **Statement of Availability of IRS Documents**

IRS revenue procedures, revenue rulings, notices and other guidance 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>.

#### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS, as prescribed in this preamble under the "Addresses" heading. The IRS and Treasury Department request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://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 hearing will be published in the **Federal Register**.

#### **Drafting Information**

The principal authors of these proposed regulations are Christina M. Glendening and Victoria J. Driscoll of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

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#### **Withdrawal of Notice of Proposed Rulemaking**

Accordingly, under authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG-107279-00) that was pub-

lished in the **Federal Register** on November 30, 2000 (65 FR 71277), is withdrawn.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR Parts 1 and 301 are proposed to be amended as follows:

### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.2-1 is revised to read as follows:

#### § 1.2-1 Returns of surviving spouse and head of household.

(a) *In general.* Tax is determined under section 1(a) for a return of a surviving spouse, as defined in section 2(a) and § 1.2-2(a). Tax is determined under section 1(b) for a return of a head of household, as defined in section 2(b) and § 1.2-2(b).

(b) *Death of a spouse.* If married taxpayers have different taxable years solely because of the death of either spouse, the taxable year of the deceased spouse is deemed to end on the last day of the surviving spouse's taxable year for purposes of determining their eligibility to file a joint return for that year. For rules relating to filing a joint return in the year a spouse dies, see section 6013 and the related regulations.

(c) *Tax tables.* For rules on the use of the tax tables that apply to individuals, see section 3 and the related regulations.

(d) *Change in rates.* For the treatment of taxable years during which a change in the tax rates occurs, see section 15.

(e) *Applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 3. Section 1.2-2 is revised to read as follows:

#### § 1.2-2 Definitions and special rules.

(a) *Surviving spouse*—(1) *In general.* If a taxpayer is eligible to file a joint return under section 6013 (without applying section 6013(a)(3)) for the taxable year in which the taxpayer's spouse dies,

the taxpayer qualifies as a surviving spouse for each of the two taxable years immediately following the year of the spouse's death if the taxpayer—

(i) Has not remarried before the close of the taxable year; and

(ii) Maintains as the taxpayer's home a household that is for the taxable year the principal place of abode of a son or daughter (including by adoption), stepson, or stepdaughter who is a member of the taxpayer's household and who is a dependent of the taxpayer within the meaning of paragraph (a)(2) of this section.

(2) *Dependent.* An individual is a dependent of a taxpayer for purposes of this paragraph (a) if the taxpayer may claim a deduction under section 151 for the individual, without applying sections 152(b)(1), (b)(2), and (d)(1)(B).

(b) *Head of household*—(1) *In general.* A taxpayer qualifies as a head of household if the taxpayer is not married at the end of the taxable year, is not a surviving spouse, as defined in paragraph (a) of this section, and either—

(i) Maintains as the taxpayer's home a household that is for more than one-half of the taxable year the principal place of abode of a qualifying child or dependent of the taxpayer, within the meaning of paragraph (b)(2) of this section, who is a member of the taxpayer's household during that period; or

(ii) Maintains a household, whether or not the taxpayer's home, that is for the taxable year the principal place of abode of a parent of the taxpayer, within the meaning of paragraph (b)(3) of this section.

(2) *Qualifying child or dependent*—(i) *Qualifying child.* An individual is a qualifying child for purposes of this paragraph (b) if the individual is a qualifying child of the taxpayer as defined in section 152(c) and the related regulations, determined without applying section 152(e). However, if the individual is married at the end of the taxpayer's taxable year, the individual is not a qualifying child for purposes of this section if the individual is not the taxpayer's dependent because of the limitations of section 152(b)(2) (relating to an individual filing a joint return with his or her spouse) or 152(b)(3) (relating to individuals who are citizens or nationals of other countries).

(ii) *Dependent.* An individual is a dependent for purposes of this paragraph (b) if the individual is the taxpayer's dependent, within the meaning of section 152 without applying sections 152(d)(2)(H) (relating to an individual qualifying as a member of the household) and 152(d)(3) (relating to the special rule for multiple support agreements) for whom the taxpayer may claim a deduction under section 151.

(3) *Parent.* An individual is a parent of the taxpayer for purposes of this paragraph (b) if the individual is the taxpayer's father or mother, including a father or mother who legally adopted the taxpayer, and is the taxpayer's dependent within the meaning of section 152 without applying section 152(d)(3), relating to the special rule for multiple support agreements, for whom the taxpayer may claim a deduction under section 151.

(4) *Limitation.* An individual may qualify only one taxpayer as a head of household for taxable years beginning in the same calendar year.

(5) *Marital status.* For purposes of this paragraph (b), the marital status of a taxpayer is determined at the end of the taxpayer's taxable year. A taxpayer is considered not married if the taxpayer is legally separated from the taxpayer's spouse under a decree of divorce or separate maintenance, if at any time during the taxable year the taxpayer's spouse is a nonresident alien, or if the provisions of section 7703(b) are satisfied. A taxpayer is considered married if the taxpayer's spouse, other than a spouse who is a nonresident alien, dies during the taxable year.

(6) *Nonresident alien.* A taxpayer does not qualify as a head of household if the taxpayer is a nonresident alien, as defined in section 7701(b)(1)(B), at any time during the taxable year.

(c) *Member of the household.* An individual is a member of a taxpayer's household if the individual and the taxpayer reside in the same living quarters and the taxpayer maintains the household, in part, for the benefit of the individual. An individual is a member of a taxpayer's household despite a temporary absence due to special circumstances. An individual is not treated as a member of the taxpayer's household if, at any time during the tax-



able year of the taxpayer, the relationship between the individual and the taxpayer violates local law. See § 1.152-4(c)(2) for rules relating to temporary absences.

(d) *Maintaining a household*—(1) *In general.* A taxpayer maintains a household only if during the taxable year the taxpayer pays more than one-half of the cost of operating the household for the mutual benefit of the residents. These expenses include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance, and food consumed on the premises. A taxpayer may treat a home's fair market rental value as a cost of maintaining a household, instead of the sum of payments for property taxes, mortgage interest, and property insurance. Expenses of maintaining a household do not include—

(i) The cost of clothing, education, medical treatment, vacations, life insurance, and transportation;

(ii) The value of services performed in the household by the taxpayer or any other person qualifying the taxpayer as a head of household or as a surviving spouse; or

(iii) An expense paid or reimbursed by any other person.

(2) *Proration of costs.* In determining whether a taxpayer pays more than one-half of the cost of maintaining a household that is the principal place of abode of a qualifying child or dependent for less than a taxable year, the cost for the entire taxable year is prorated on the basis of the number of calendar months the qualifying child or dependent resides in the household. A period of less than a calendar month is treated as a full calendar month. Thus, for example, if the cost of maintaining a household for a taxable year is \$30,000, and a taxpayer shares a principal place of abode with a qualifying child or dependent from May 20 to December 31, the taxpayer must furnish more than \$10,000 ( $8/12$  of  $\$30,000 \times 50$  percent) in maintaining the household from May 1 to December 31 to satisfy the requirements of this paragraph (d).

(3) *New household.* If a new household is established during the taxpayer's taxable year (for example, if spouses separate and one moves out of the family home with the child), the cost of maintaining the new household for the year is the cost of maintaining that household beginning

with the date the new household is established. If one spouse and the child remain in the family home and the other parent moves out of the home, the cost of maintaining the household for the year is the cost of maintaining the household beginning with the date the other spouse moves out.

(4) *Birth, death, adoption, or placement.* If an individual is a member of a household for less than a taxable year as a result of the individual's birth, death, adoption, or placement with a taxpayer for adoption or in foster care during that year, the requirement that the individual be a member of the household for more than one-half of the taxable year is satisfied if the individual is a member of the household for more than one-half of the period after the individual's birth, adoption, or placement for adoption or in foster care or before the individual's death.

(5) *Shared residence*—(i) *In general.* If two or more taxpayers not filing a joint return reside in the same living quarters, each taxpayer may be treated as maintaining a separate household if each provides more than one-half of the cost of maintaining the separate household. For this purpose, two households in the same living quarters are not considered separate households if any individual in one household is the spouse of any individual in the other household, or if any individual in one household may claim, or would have priority under the tiebreaker rules in section 152(c)(4) to claim, any individual in the other household as a dependent.

(ii) *Examples.* The following examples illustrate the rules in this paragraph (d)(5). In each example, assume that if a taxpayer may be treated as residing in a separate household, that taxpayer provides more than one-half of the cost of maintaining that household.

*Example 1.* Two sisters and their respective children reside in the same living quarters. Neither sister may claim the other sister as a dependent. Each sister pays more than one-half of the expenses for herself and her children, and each sister claims each of her own children as a dependent. Because neither sister may claim the other sister as a dependent, and because neither sister would have priority to claim any of the other sister's children as a qualifying child under the tiebreaker rules of section 152(c)(4), each sister is treated as maintaining a separate household.

*Example 2.* A and B, an unmarried couple, have two children together (C1 and C2) and all four individuals live in the same living quarters for the

entire tax year. Both A and B contribute to paying the expenses of the couple and the two children. A has higher adjusted gross income than B. Each parent files a tax return. Under the tiebreaker rules in section 152(c)(4), the parent with the higher adjusted gross income (in this case, A) would have priority to claim each child as a qualifying child if both claimed the child. As a result, B may not be treated as maintaining a separate household with either child or both children. Therefore, if B may be claimed as A's dependent, then all four individuals are members of the same household. However, if B may not be claimed as A's dependent, B may be treated as maintaining a separate household consisting solely of B, even if B claims one of the children as a dependent on B's return.

*Example 3.* The facts are the same as in *Example 2* of this paragraph (d)(5)(ii) except that A and B do not have any children together; C1 is the child of A and C2 is the child of B. Neither A nor B may claim the other as a dependent, and each parent pays more than one-half of the expenses for himself or herself and his or her child. Because neither A nor B may claim the other adult or the other adult's child as a dependent, each adult is treated as maintaining a separate household.

*Example 4.* Grandparent, Parent, and Child live together and Child meets the definition of a qualifying child for both Parent and Grandparent. Both Parent and Grandparent pay their respective expenses, and both contribute to paying Child's expenses. Neither Parent nor Grandparent may claim the other as a dependent. Under the tiebreaker rules of section 152(c)(4), Parent would have priority over Grandparent to claim Child as a qualifying child. Therefore, Grandparent may not be treated as maintaining a household for Grandparent and Child separate from the household of Parent. However, Parent may be treated as maintaining a household for Parent and Child separate from the household of Grandparent.

(e) *Special rules for maintaining a household*—(1) *Principal place of abode.* For purposes of this section, the term *principal place of abode* has the same meaning as in section 152 and § 1.152-4(c).

(2) *Part-year residence.* If, during the taxable year, an individual who may qualify a taxpayer as head of household is born or dies, is adopted or lawfully placed for adoption with the taxpayer, is an eligible foster child, or is a missing child, whether the taxpayer maintained a household that is the principal place of abode of the individual for the required period is determined under § 1.152-4(d) and (e).

(3) *Change of location.* A taxpayer may maintain a household even though the physical location of the household changes.

(f) *Certain married individuals living apart.* An individual who is considered not married under section 7703(b) also is considered not married for all purposes of

part I of subchapter A of chapter 1 of the Code.

(g) *Applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.3–1 is revised to read as follows:

### § 1.3–1 Tax tables for individuals.

(a) *In general.* Except as otherwise provided in paragraph (b) of this section, in lieu of the tax imposed by section 1, an individual who does not itemize deductions for the taxable year and whose taxable income for the taxable year does not exceed the ceiling amount as defined in paragraph (c) of this section, must determine his or her tax liability under the prescribed tax tables in tax forms and publications of the Internal Revenue Service. The individual must use the appropriate tax rate category under the tax tables. The tax imposed under section 3 and this section shall be treated as tax imposed by section 1.

(b) *Exceptions.* Section 3 and this section do not apply to (1) an individual making a return for a period of fewer than 12 months as a result of a change in annual accounting period, or (2) an estate or trust.

(c) *Ceiling amount defined.* The ceiling amount means the highest amount of taxable income for which a tax amount is determined in the tax tables for the tax rate category in which the taxpayer falls.

(d) *Special rule for surviving spouse.* A taxpayer filing as a surviving spouse uses the same tax rate category as a taxpayer filing a joint return.

(e) *Applicability date.* This section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 5. Section 1.21–1 is amended by revising paragraph (a)(1), removing paragraph (h), redesignating paragraphs (j), (k), and (l) as paragraphs (h), (j), and (k), and revising newly redesignated paragraph (k) to read as follows:

### § 1.21–1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) Section 21 allows a credit to a taxpayer against the tax imposed by chapter 1 for employment-related expenses for household services and care (as defined in paragraph (d) of this section) of a qualifying individual (as defined in paragraph (b) of this section). The purpose of the expenses must be to enable the taxpayer to be gainfully employed (as defined in paragraph (c) of this section). For taxable years beginning after December 31, 2004, a qualifying individual must have the same principal place of abode (as defined by paragraph (g) of this section) as the taxpayer for more than one-half of the taxable year.

\* \* \* \* \*

(k) *Applicability date—(1) In general.* Except as provide in paragraph (k)(2) of this section, this section and §§ 1.21–2 through 1.21–4 apply to taxable years ending after August 14, 2007.

(2) *Exception.* Paragraph (a)(1) of this section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 6. Section 1.32–2 is amended by revising the section heading, adding paragraph (c)(3), and revising paragraph (e) to read as follows:

### § 1.32–2 Earned income credit.

\* \* \* \* \*

(c) \* \* \*

(3) *Qualifying child—(i) In general.* For purposes of this section, a qualifying child of the taxpayer is a qualifying child as defined in section 152(c), determined without applying sections 152(c)(1)(D) and 152(e).

(ii) *Application of tiebreaker rules.* For purposes of determining whether a taxpayer is an eligible individual under section 32(c)(1)(A), if an individual meets the definition of a qualifying child under paragraph (c)(3)(i) of this section for more than one taxpayer and the individual is treated as the qualifying child of a taxpayer under the tiebreaker rules of section 152(c)(4) and the related regulations, then that taxpayer may be an eligible individual under section 32(c)(1)(A)(i) and may

claim the earned income credit for a taxpayer with a qualifying child if all other requirements of section 32 are satisfied. If an individual meets the definition of a qualifying child under paragraph (c)(3)(i) of this section for more than one taxpayer and the individual is not treated as the qualifying child of a taxpayer under the tiebreaker rules of section 152(c)(4) and the related regulations, then the individual also is not treated as a qualifying child of that taxpayer in the taxable year for purposes of section 32(c)(1)(A). Thus, that taxpayer may be an eligible individual under section 32(c)(1)(A)(ii) and may claim the earned income credit for a taxpayer without a qualifying child if all other requirements are satisfied.

(iii) *Examples.* The following examples illustrate the rules of this paragraph (c). In each example, the taxpayer uses the calendar year as the taxpayer's taxable year and, except to the extent indicated, each taxpayer meets the requirements to claim the benefits(s) described in the example.

*Example 1.* Child, Parent, and Grandparent share the same principal place of abode for the taxable year. Child meets the definition of a qualifying child under paragraph (c)(3)(i) of this section for both Parent and Grandparent (and for no other person) for the taxable year. Parent claims the earned income credit with Child as Parent's qualifying child. Under the tiebreaker rules of section 152(c)(4)(A) and the related regulations, Child is treated as the qualifying child of Parent and is not treated as the qualifying child of Grandparent. Under section 32(c)(1) and paragraph (c)(3)(ii) of this section, Parent is an eligible individual under section 32(c)(1)(A)(i) who may claim the earned income credit for a taxpayer with a qualifying child, and Grandparent is an eligible individual under section 32(c)(1)(A)(ii) who may claim the earned income credit for a taxpayer without a qualifying child.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (c)(3)(iii), except that Grandparent, rather than Parent, claims Child as a qualifying child, and Grandparent's adjusted gross income is higher than Parent's adjusted gross income. Under the tiebreaker rules of section 152(c)(4)(C) and the related regulations, Child is treated as the qualifying child of Grandparent and is not treated as the qualifying child of Parent. Under section 32(c)(1) and paragraph (c)(3)(ii) of this section, Grandparent is an eligible individual under section 32(c)(1)(A)(i) who may claim the earned income credit for a taxpayer with a qualifying child, and Parent is an eligible individual under section 32(c)(1)(A)(ii) who may claim the earned income credit for a taxpayer without a qualifying child.

\* \* \* \* \*

(e) *Applicability date—(1) In general.* Except as provided in paragraph (e)(2) of

this section, this section applies to taxable years beginning after March 5, 2003.

(2) *Exception.* Paragraph (c)(3) of this section applies to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

### § 1.63–1 [Amended]

Par. 7. Section 1.63–1 is amended by:

1. Removing the language “the zero bracket amount and” from the section heading.

2. Removing the language “section 63(g)” and replacing it with the language “section 63(e)” in paragraph (a).

Par. 8. Section 1.63–2 is revised to read as follows:

### § 1.63–2 Standard deduction.

The standard deduction means the sum of the basic standard deduction and the additional standard deduction.

Par. 9. Section 1.63–3 is added to read as follows:

### § 1.63–3 Additional standard deduction for the aged and blind.

(a) *In general.* A taxpayer who, at the end of the taxable year, has attained age 65 or is blind is entitled to an additional standard deduction amount. The additional standard deduction amount is the sum of the amounts to which the taxpayer is entitled under paragraphs (b) and (c) of this section. If an individual meets the requirements for both the additional amount for the aged and the additional amount for the blind, the taxpayer is entitled to both additional amounts.

(b) *Additional amount for the aged—*

(1) *Aged taxpayer or spouse.* A taxpayer is entitled to an additional amount under section 63(f)(1) if the taxpayer has attained age 65 before the end of the taxable year. If spouses file a joint return, each spouse who has attained age 65 before the end of the taxable year for which the spouses file the joint return is entitled to an additional amount. A married taxpayer who files a separate return is entitled to an additional amount for the taxpayer’s spouse if the spouse has attained age 65 before the end of the taxable year and, for the calendar year in which the taxable year of the taxpayer begins, the spouse has

no gross income and is not the dependent of another taxpayer. The taxpayer is not entitled to an additional amount if the spouse dies before attaining age 65, even though the spouse would have attained age 65 before the end of the taxpayer’s taxable year.

(2) *Age determined.* For purposes of section 63(f) and this paragraph (b), a taxpayer’s age is determined as of the last day of the taxpayer’s taxable year. A person attains the age of 65 on the first moment of the day preceding his or her sixty-fifth birthday.

(c) *Additional amount for the blind—*

(1) *Blind taxpayer or spouse.* A taxpayer is entitled to an additional amount under section 63(f)(2) if the taxpayer is blind at the end of the taxable year. If spouses file a joint return, each spouse who is blind at the end of the taxable year for which the spouses file the joint return is entitled to an additional amount. A married taxpayer who files a separate return is entitled to an additional amount for the taxpayer’s spouse if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, the spouse has no gross income and is not the dependent of another taxpayer. If the spouse dies during the taxable year, the date of death is the time for determining the spouse’s blindness.

(2) *Blindness determined.* A taxpayer who claims an additional amount allowed by section 63(f)(2) for the blind must maintain in the taxpayer’s records a statement from a physician skilled in the diseases of the eye or a registered optometrist stating that the physician or optometrist has examined the person for whom the additional amount is claimed and, in the opinion of the physician or optometrist, the person’s central visual acuity did not exceed 20/200 in the better eye with correcting lenses, or the person’s visual acuity was accompanied by a limitation in the field of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees. The statement must provide that the physician or optometrist examined the person in the taxpayer’s taxable year for which the amount is claimed, or that the physician or optometrist examined the person in an earlier year and that the visual impairment is irreversible.

(d) *Applicability date.* This section and §§ 1.63–1(a) and 1.63–2 apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 10. Section 1.151–1 is amended by revising paragraphs (a)(1), (c), and (d) to read as follows:

### § 1.151–1 Deductions for personal exemptions.

(a) \* \* \* (1) In computing taxable income, an individual is allowed a deduction for the exemptions for an individual taxpayer and spouse (the personal exemptions) and the exemption for a dependent of the taxpayer.

\* \* \* \* \*

(c) *Additional exemption for dependent.* Section 151(c) allows a taxpayer an exemption for each individual who is a dependent (as defined in section 152) of the taxpayer for the taxable year. See §§ 1.152–1 through 1.152–5 for rules relating to dependents.

(d) *Applicability date.* Paragraphs (a) (1) and (c) of this section apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

### §§ 1.151–2, 1.151–3, and 1.151–4 [Removed]

Par. 11. Sections 1.151–2, 1.151–3, and 1.151–4 are removed.

Par. 12. Section 1.152–0 is added under the undesignated center heading Deductions for Personal Exemptions to read as follows:

### § 1.152–0 Table of contents.

This section lists the captions contained in § 1.152–1 through § 1.152–5.

§ 1.152–1 *General rules for dependents.*

- (a) In general.
  - (1) Dependent defined.
  - (2) Exceptions.
    - (i) Dependents ineligible.
    - (ii) Married dependents.
    - (iii) Citizens or nationals of other countries.
  - (b) Definitions.
    - (1) Child.



- (i) In general.
- (ii) Adopted child.
- (iii) Eligible foster child.
- (iv) Authorized placement agency.
- (2) Student.
- (3) Brother and sister.
- (4) Parent.
- (c) Applicability date.

§ 1.152-2 *Qualifying child.*

- (a) In general.
- (b) Qualifying child relationship test.
- (c) Residency test.
- (d) Age test.
  - (1) In general.
  - (2) Disabled individual.
- (e) Qualifying child support test.
- (f) Joint return test.
- (g) Child who is eligible to be claimed as a qualifying child by more than one taxpayer.
  - (1) In general.
    - (i) More than one eligible parent.
    - (ii) Eligible parent not claiming.
    - (iii) One eligible parent and other eligible taxpayer(s).
    - (iv) No eligible parent.
  - (2) Determination of adjusted gross income of a person who files a joint return.
  - (3) Coordination with other provisions.
  - (4) Examples.

§ 1.152-3 *Qualifying relative.*

- (a) In general.
- (b) Qualifying relative relationship test.
- (c) Gross income test.
  - (1) In general.
  - (2) Income of disabled or handicapped individuals.
- (d) Qualifying relative support test.
  - (1) In general.
  - (2) Certain income of taxpayer's spouse.
  - (3) Support from stepparent.
  - (4) Multiple support agreements.
- (e) Not a qualifying child test.
  - (1) In general.
  - (2) Examples.

§ 1.152-4 *Rules for a qualifying child and a qualifying relative.*

- (a) Support.
  - (1) In general.
  - (2) Payments made during the year for unpaid or future support.

- (3) Governmental payments.
  - (i) Governmental payments as support.
    - (A) In general.
    - (B) Examples.
  - (ii) Governmental payments based on a taxpayer's contributions.
    - (A) In general.
    - (B) Examples.
  - (iii) Payments used for support of another individual.
- (4) Medical insurance.
- (5) Medical care payments from personal injury claim.
- (6) Scholarships.
  - (b) Relationship test.
    - (1) Joint return.
    - (2) Divorce or death of spouse.
  - (c) Principal place of abode.
    - (1) In general.
    - (2) Temporary absence.
    - (3) Residing with taxpayer for more than one-half of the taxable year.
      - (i) In general.
      - (ii) Nights of residence.
        - (A) Nights counted.
        - (B) Night straddling two taxable years.
        - (C) Exception for a parent who works at night.
        - (D) Absences.
  - (4) Examples.
    - (d) Residence for a portion of a taxable year because of special circumstances.
      - (1) Individual who is born or dies during the year.
      - (2) Adopted child or foster child.
  - (e) Missing child.
    - (1) Qualifying child.
    - (2) Qualifying relative.
    - (3) Age limitation.
    - (4) Application.

§ 1.152-5 *Special rule for a child of divorced or separated parents or parents who live apart.*

- (a) In general.
- (b) Release of claim by custodial parent.
  - (1) In general.
  - (2) Support, custody, and parental status.
    - (i) In general.
    - (ii) Multiple support agreement.
  - (3) Release of claim to child.
- (c) Custody.
  - (d) Custodial parent.
    - (1) In general.
    - (2) Night straddling taxable years.
    - (3) Absences.

- (4) Special rule for equal number of nights.
- (5) Exception for a parent who works at night.
- (e) Written declaration.
  - (1) Form of declaration.
    - (i) In general.
    - (ii) Form designated by IRS.
  - (2) Attachment to return.
    - (i) In general.
    - (ii) Examples.
  - (3) Revocation of written declaration.
    - (i) In general.
    - (ii) Form of revocation.
    - (iii) Attachment to return.
  - (4) Ineffective declaration or revocation.
  - (5) Written declaration executed in a taxable year beginning on or before July 2, 2008.
  - (f) Coordination with other sections.
  - (g) Examples.
  - (h) Applicability date.
    - (1) In general.
    - (2) Exception.

Par. 13. Section 1.152-1 is revised to read as follows:

**§ 1.152-1 General rules for dependents.**

(a) *In general*—(1) *Dependent defined.* Except as provided in section 152(b) and paragraph (a)(2) of this section, the term *dependent* means a qualifying child as described in § 1.152-2 or a qualifying relative as described in § 1.152-3. In general, an individual may be treated as the dependent of only one taxpayer for taxable years beginning in the same calendar year.

(2) *Exceptions*—(i) *Dependents ineligible.* If an individual is a dependent of a taxpayer for a taxable year of the taxpayer, the individual is treated as having no dependents for purposes of section 152 and the related regulations in the individual's taxable year beginning in the calendar year in which that taxable year of the taxpayer begins. For purposes of this paragraph (a)(2)(i), an individual is not a dependent of a person if that person is not required to file an income tax return under section 6012 and either does not file an income tax return or files an income tax return solely to claim a refund of estimated or withheld taxes.

(ii) *Married dependents.* An individual is not treated as a dependent of a taxpayer for a taxable year of the taxpayer if the

individual files a joint return, other than solely to claim a refund of estimated or withheld taxes, with the individual's spouse under section 6013 for the taxable year beginning in the calendar year in which that taxable year of the taxpayer begins.

(iii) *Citizens or nationals of other countries.* An individual who is not a citizen or national of the United States is not treated as a dependent of a taxpayer unless the individual is a resident, as defined in section 7701(b), of the United States or of a country contiguous to the United States (Canada or Mexico). This limitation, however, does not apply to an adopted child, as defined in section 152(f)(1)(B) and paragraph (b)(1)(ii) of this section, if the taxpayer is a citizen or national of the United States and the child has the same principal place of abode as the taxpayer and is a member of the taxpayer's household, within the meaning of §§ 1.152-4(c) and 1.152-2(c), respectively, for the taxpayer's taxable year. See § 1.152-4(d)(2) for rules relating to residence for a portion of a taxable year. A taxpayer and the child have the same principal place of abode for the taxpayer's taxable year if the taxpayer and child have the same principal place of abode for the entire portion of the taxable year following the placement of the child with the taxpayer.

(b) *Definitions.* The following definitions apply for purposes of section 152 and the related regulations.

(1) *Child*—(i) *In general.* The term *child* means a son, daughter, stepson, or stepdaughter, or an eligible foster child, within the meaning of paragraph (b)(1)(iii) of this section, of the taxpayer.

(ii) *Adopted child.* In determining whether an individual bears any of the relationships described in paragraph (b)(1)(i) of this section, § 1.152-2(b), or § 1.152-3(b), a legally adopted child of a person, or a child who is lawfully placed with a person for legal adoption by that person, is treated as a child by blood of that person. A child lawfully placed with a person for legal adoption by that person includes a child placed for legal adoption by a parent, an authorized placement agency, or any other person(s) authorized by law to place a child for legal adoption.

(iii) *Eligible foster child.* The term *eligible foster child* means a child who is

placed with a person by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction.

(iv) *Authorized placement agency.* The term *authorized placement agency* means a State, the District of Columbia, a possession of the United States, a foreign country, an Indian Tribal Government (ITG) (as defined in section 7701(a)(40)), or an agency or organization that is authorized by a State, the District of Columbia, a possession of the United States, a foreign country, an ITG, or a political subdivision of any of the foregoing, to place children for legal adoption or in foster care.

(2) *Student.* The term *student* means an individual who, for some part of each of five calendar months, whether or not consecutive, during the calendar year in which the taxable year of the taxpayer begins, either is a full-time student at an educational organization, as defined in section 170(b)(1)(A)(ii), or is pursuing a full-time course of institutional on-farm training under the supervision of an accredited agent of an educational organization or of a State or political subdivision of a State. A full-time student is one who is enrolled for the number of hours or courses that the educational organization considers full-time attendance.

(3) *Brother and sister.* The terms *brother* and *sister* include a brother or sister by half blood.

(4) *Parent.* The term *parent* refers to a biological or adoptive parent of an individual. It does not include a stepparent who has not adopted the individual.

(c) *Applicability date.* This section, and §§ 1.152-2, 1.152-3, and 1.152-4 apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

Par. 14. Section 1.152-2 is revised to read as follows:

### § 1.152-2 Qualifying child.

(a) *In general.* The term *qualifying child* of a taxpayer for a taxable year means an individual who satisfies the tests described in paragraphs (b), (c), (d), (e), and (f) of this section. If an individual satisfies the definition of a qualifying child for more than one taxpayer, then the tiebreaker rules in paragraph (g) of this

section apply. See, however, section 152(e) and § 1.152-5 for a special rule for a child of divorced or separated parents or parents who live apart.

(b) *Qualifying child relationship test.* The individual must bear one of the following relationships to the taxpayer—

(1) A child of the taxpayer or descendant of such a child; or

(2) A brother, sister, stepbrother, or stepsister of the taxpayer, or a descendant of any of these relatives.

(c) *Residency test.* The individual must have the same principal place of abode as the taxpayer for more than one-half of the taxable year. Generally, an individual has the same principal place of abode as the taxpayer for more than one-half of the taxable year if the individual resides with the taxpayer for more than one-half of the taxable year. See § 1.152-4(c) for rules relating to principal place of abode and temporary absence and for determining whether an individual resides with the taxpayer for more than one-half of the taxable year.

(d) *Age test*—(1) *In general.* The individual must be younger than the taxpayer claiming the individual as a qualifying child and must not have attained the age of 19, or age 24 if the individual is a student within the meaning of § 1.152-1(b)(2), as of the end of the calendar year in which the taxpayer's taxable year begins. For purposes of this section, an individual attains an age on the anniversary of the individual's birth.

(2) *Disabled individual.* This age requirement is treated as satisfied if the individual is permanently and totally disabled, as defined in section 22(e)(3), at any time during the calendar year.

(e) *Qualifying child support test.* The individual must not provide more than one-half of the individual's own support for the calendar year in which the taxpayer's taxable year begins. See § 1.152-4(a) for rules relating to the definition and sources of an individual's support.

(f) *Joint return test.* The individual must not file a joint return, other than solely to claim a refund of estimated or withheld taxes, under section 6013 with the individual's spouse for the taxable year beginning in the calendar year in which the taxpayer's taxable year begins.

(g) *Child who is eligible to be claimed as a qualifying child by more than one taxpayer*—(1) *In general.* Under section 152(c)(4), if an individual satisfies the definition of a qualifying child for two or more taxpayers (eligible taxpayers) for a taxable year beginning in the same calendar year, the following rules apply.

(i) *More than one eligible parent.* If more than one eligible taxpayer is a parent of the individual (eligible parent), any one of the eligible parents may claim the individual as a qualifying child. However, if more than one eligible parent claims the individual as a qualifying child, and those eligible parents do not file a joint return with each other, the individual is treated as the qualifying child of the eligible parent claiming the individual with whom the individual resides for the longest period of time during the taxable year as determined under § 1.152-4(c)(3). If the individual resides for the same amount of time during the taxable year with each eligible parent claiming the child, the individual is treated as the qualifying child of the eligible parent with the highest adjusted gross income who claims the individual.

(ii) *Eligible parent not claiming.* If at least one eligible taxpayer is a parent of the individual, but no eligible parent claims the individual as a qualifying child, the individual may be treated as the qualifying child of another eligible taxpayer only if that taxpayer's adjusted gross income exceeds both the adjusted gross income of each eligible parent of the individual and the adjusted gross income of each other eligible taxpayer, if any.

(iii) *One eligible parent and other eligible taxpayer(s).* Except as provided in paragraph (g)(1)(i) or (ii) of this section, if there are two or more eligible taxpayers, only one of whom is the parent of the individual, the individual is treated as the qualifying child of the eligible parent.

(iv) *No eligible parent.* If no eligible taxpayer is a parent of the individual, the individual is treated as the qualifying child of the eligible taxpayer with the highest adjusted gross income for the taxable year.

(2) *Determination of adjusted gross income of a person who files a joint return.* For purposes of section 152 and the related regulations, the adjusted gross income of each person who files a joint

return is the total adjusted gross income shown on the joint return.

(3) *Coordination with other provisions.* Except to the extent that section 152(e) and § 1.152-5 apply, if more than one taxpayer may claim a child as a qualifying child, the child is treated as the qualifying child of only one taxpayer for purposes of head of household filing status under section 2(b), the child and dependent care credit under section 21, the child tax credit under section 24, the earned income credit under section 32, the exclusion from income for dependent care assistance under section 129, and the dependency exemption under section 151. Thus, the taxpayer claiming the individual as a qualifying child under any one of these sections is the only taxpayer who may claim any credit or exemption under these other sections for that same individual for a taxable year beginning in the same calendar year as the taxpayer's taxable year. If section 152(e) applies, however, the noncustodial parent may claim the child as a qualifying child for purposes of the dependency exemption and the child tax credit, and another person may claim the child for purposes of one or more of these other provisions. See § 1.152-5 for rules under section 152(e).

(4) *Examples.* The following examples illustrate the rules in this paragraph (g). In the examples, each taxpayer uses the calendar year as the taxpayer's taxable year, the child is a qualifying child (as described in section 152(c) and this section) of each taxpayer, and, except to the extent indicated, each taxpayer meets the requirements to claim the benefit(s) described in the example.

*Example 1.* (i) A and B, parents of Child, are married to each other. A, B, and Child share the same principal place of abode for the first 8 months of the year. Thus, both parents satisfy the qualifying child residency test of paragraph (c) of this section. For the last 4 months of the year, the parents live apart from each other, and B and Child share the same principal place of abode. Section 152(e), relating to divorced or separated parents, does not apply. The parents file as married filing separately for the taxable year, and both parents claim Child as a qualifying child.

(ii) Under paragraph (g)(1)(i) of this section, Child is treated as a qualifying child of B for all purposes, because Child resided with B for the longer period of time during the taxable year. Because section 152(e) does not apply, Child may not be treated as a qualifying child of A for any purpose.

*Example 2.* (i) The facts are the same as in *Example 1* of this paragraph (g)(4), except that B does not claim Child as a qualifying child.

(ii) Because A and B are not both claiming the same child as a qualifying child, under paragraph (g)(1)(i) of this section, Child is treated as a qualifying child of A.

*Example 3.* (i) Child, Child's parent (D), and Grandparent share the same principal place of abode. D is not married and is not a qualifying child or dependent of Grandparent, and Grandparent is not D's dependent. Section 152(e), relating to divorced or separated parents, does not apply. Under paragraph (a) of this section, Child meets the definition of a qualifying child of both D and Grandparent. D claims Child as a qualifying child for purposes of the child and dependent care credit under section 21, the earned income credit under section 32, and the dependency exemption under section 151. Grandparent claims Child as a qualifying child for purposes of head of household filing status under section 2(b).

(ii) Under paragraph (g)(1)(iii) of this section, Child is treated as the qualifying child of D for all purposes, because D is eligible to claim and claims Child as D's qualifying child. Because D is eligible to claim and claims Child as D's qualifying child, under paragraph (g)(3) of this section, Child may not be treated as a qualifying child of Grandparent for any purpose. Grandparent erroneously claimed Child as Grandparent's qualifying child for purposes of head of household filing status under section 2(b). If D had not claimed Child as D's qualifying child for any purpose, under paragraph (g)(1)(ii) of this section, Grandparent could have claimed Child as Grandparent's qualifying child if Grandparent's adjusted gross income (AGI) exceeded D's AGI. In that situation, under paragraph (g)(3) of this section, Grandparent could have claimed Child as Grandparent's qualifying child for purposes of any of the child-related tax benefits, provided that Grandparent had met the requirements of those sections.

*Example 4.* (i) The facts are the same as in *Example 3* of this paragraph (g)(4), except that Child's parents, D and E, are married to each other and share the same principal place of abode with Child and Grandparent for the entire taxable year. Under paragraph (a) of this section, Child meets the definition of a qualifying child of both parents and Grandparent. D and E file a joint return for the taxable year and do not claim Child as a qualifying child for any purpose.

(ii) Because D or E may claim Child as a qualifying child but neither claims Child as a qualifying child for any purpose, under paragraph (g)(1)(ii) of this section, Grandparent may claim Child as a qualifying child if Grandparent's AGI exceeds the total AGI reported on the joint return of D and E.

*Example 5.* (i) The facts are the same as in *Example 4* of this paragraph (g)(4), except that D and E are divorced from each other, E moved into a separate residence during that year and is the non-custodial parent, and section 152(e), relating to divorced or separated parents, applies. E attaches to E's return a Form 8332 on which D agrees to release D's claim to a dependency exemption for Child and E claims Child as a qualifying child for purposes of the dependency exemption and the child tax credit.



(ii) Under paragraph (g)(3) of this section, Child is treated as a qualifying child of E for purposes of the dependency exemption and the child tax credit. Child may be treated as a qualifying child of D for purposes of the earned income credit. If D claims Child as a qualifying child for purposes of the earned income credit, under paragraph (g)(1)(iii) of this section, Child may not be treated as a qualifying child of Grandparent for any purpose.

*Example 6.* (i) F and G, parents of two children, are married to each other. F, G, and both children share the same principal place of abode for the entire taxable year. F and G file as married filing separately for the taxable year. F claims the older child as a qualifying child for purposes of the child tax credit, dependency exemption, and the child and dependent care credit. G claims the younger child as a qualifying child for purposes of the same three tax benefits.

(ii) The older child is treated as a qualifying child of F and the younger child is treated as a qualifying child of G. The tiebreaker rule of paragraph (g)(1)(i) of this section does not apply because F and G are not claiming the same child as a qualifying child.

Par. 15. Section 1.152-3 is revised to read as follows:

### § 1.152-3 Qualifying relative.

(a) *In general.* The term *qualifying relative* of a taxpayer for a taxable year means an individual who satisfies the tests described in paragraphs (b), (c), (d), and (e) of this section. See, however, section 152(e) and § 1.152-5 for a special rule for a child of divorced or separated parents or parents who live apart.

(b) *Qualifying relative relationship test.* The individual must bear one of the following relationships to the taxpayer:

- (1) A child or descendant of a child;
- (2) A brother, sister, stepbrother, or stepsister;
- (3) A father or mother, or an ancestor of either;
- (4) A stepfather or stepmother;
- (5) A niece or nephew;
- (6) An aunt or uncle;
- (7) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or

(8) An individual (other than one who at any time during the taxable year was the taxpayer's spouse, determined without regard to section 7703) who for the taxable year of the taxpayer has the same principal place of abode as the taxpayer and is a member of the taxpayer's household. See § 1.2-2(c) for the definition of a member of the household, and § 1.152-4(c) for rules relating to the meaning of

principal place of abode and the meaning of temporary absence.

(c) *Gross income test*—(1) *In general.* The individual's gross income for the calendar year in which the taxable year begins must be less than the exemption amount as defined in section 151(d).

(2) *Income of disabled or handicapped individuals.* For purposes of paragraph (c)(1) of this section, the gross income of an individual who is permanently and totally disabled, as defined in section 22(e)(3), at any time during the taxable year does not include income for services performed by the individual at a sheltered workshop, as defined in section 152(d)(4)(B), if—

(i) The principal reason for the individual's presence at the workshop is the availability of medical care there; and

(ii) The individual's income arises solely from activities at the workshop that are incident to the medical care.

(d) *Qualifying relative support test*—(1) *In general.* The individual must receive over one-half of the individual's support from the taxpayer for the calendar year in which the taxpayer's taxable year begins. See § 1.152-4(a) for rules relating to support.

(2) *Certain income of taxpayer's spouse.* A payment to a spouse that is includible in the payee spouse's gross income under section 71 (relating to alimony and separate maintenance payments) or section 682 (relating to income of an estate or trust in the case of divorce) is not treated as a payment by the payor spouse for the support of any dependent.

(3) *Support from stepparent.* Any support provided to or for the benefit of an individual by a stepparent of the individual is treated as support provided by the individual's parent who is married to the stepparent.

(4) *Multiple support agreements.* If more than one-half of an individual's support is provided by two or more persons together, a taxpayer is treated as having contributed over one-half of the support of that individual for the calendar year if—

(i) No one person contributes more than one-half of the individual's support;

(ii) Each member of the group that collectively contributes more than one-half of the support of the individual would have been entitled to claim the individual

as a dependent for a taxable year beginning in that calendar year but for the fact that the group member alone did not contribute more than one-half of the individual's support;

(iii) The taxpayer claiming the individual as a qualifying relative contributes more than 10 percent of the individual's support; and

(iv) Each other group member who contributes more than 10 percent of the support of the individual furnishes to the taxpayer claiming the individual as a dependent a written declaration that the other person will not claim the individual as a dependent for any taxable year beginning in that calendar year.

(e) *Not a qualifying child test*—(1) *In general.* The individual must not be a qualifying child of the taxpayer or of any other taxpayer for any taxable year beginning in the calendar year in which the taxpayer's taxable year begins. An individual is not a qualifying child of a person, however, if that person is not required to file an income tax return under section 6012, and either does not file an income tax return or files an income tax return solely to claim a refund of estimated or withheld taxes.

(2) *Examples.* The following examples illustrate the rules in this paragraph (e). In each example, each taxpayer uses the calendar year as the taxpayer's taxable year, and except to the extent otherwise indicated, each taxpayer meets the requirements to claim the benefits described in the example.

*Example 1.* For the taxable year, B provides more than one-half of the support of an unrelated friend, C, and C's 3-year-old child, D, who are members of B's household. No taxpayer other than C is eligible to claim D as a qualifying child. C has no gross income, is not required by section 6012 to file a Federal income tax return, and does not file a Federal income tax return for the taxable year. Under paragraph (e)(1) of this section, because C does not have a filing requirement and does not file an income tax return, D is not treated as a qualifying child of C, and B may claim both C and D as B's qualifying relatives.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (e)(2) except that C has earned income of \$1,500 during the taxable year, had income tax withheld from C's wages, and is not required by section 6012 to file an income tax return. C files an income tax return solely to obtain a refund of withheld taxes and does not claim the earned income credit under section 32. Under paragraph (e)(1) of this section, because C does not have a filing requirement and files only to obtain a refund of

withheld taxes, D is not treated as a qualifying child of C, and B may claim both C and D as B's qualifying relatives.

*Example 3.* The facts are the same as in *Example 2* of this paragraph (e)(2) except that C's earned income is more than the amount of the dependency exemption for that year. C files an income tax return for the taxable year to obtain a refund of withheld taxes and claims the earned income credit. Because C filed an income tax return to obtain the earned income credit and not solely to obtain a refund of withheld taxes, D is a qualifying child of a taxpayer (C), and B may not claim D as a qualifying relative. B also may not claim C as a qualifying relative because C fails the gross income test under paragraph (c) of this section.

Par. 16. Redesignate § 1.152-4 as § 1.152-5, and add a new § 1.152-4 to read as follows:

### **§ 1.152-4 Rules for a qualifying child and a qualifying relative.**

(a) *Support*—(1) *In general.* The term *support* includes food, shelter, clothing, medical and dental care, education, and similar items. Support does not include an individual's Federal, State, and local income taxes paid from the individual's own income or assets, Social Security and Medicare taxes under section 3101 paid from the individual's own income, life insurance premiums, or funeral expenses. In determining whether an individual provided more than one-half of the individual's own support for purposes of § 1.152-2(e), or whether a taxpayer provided more than one-half of an individual's support for purposes of § 1.152-3(d), the amount of support provided by the individual, or the taxpayer, is compared to the total amount of the individual's support from all sources. For these purposes, except as otherwise provided in this paragraph (a), the amount of an individual's total support is the amount of support from all sources, and includes support the individual provides and amounts that are excludable from gross income. Generally, the amount of an item of support is the amount of expense paid or incurred to furnish the item of support. If the item of support furnished is property or a benefit, such as lodging, however, the amount of the item of support is the fair market value of the item.

(2) *Payments made during the year for unpaid or future support.* For purposes of determining the amount of support provided in a calendar year, an amount paid

in a calendar year after the calendar year in which the liability is incurred is treated as paid in the year of payment. An amount paid in a calendar year before due, whether or not made in the form of a lump sum payment in settlement of a person's liability for support, is treated as support paid during the calendar year of payment rather than the calendar year when payment is due. A payment of a liability from amounts set aside in trust in a prior year is treated as made in the year in which the liability is paid.

(3) *Governmental payments*—(i) *Governmental payments as support*—(A) *In general.* Except as provided in paragraph (a)(3)(iii) of this section, governmental payments and subsidies for an item of support are support provided by a third party, the government.

(B) *Examples.* Payments of Temporary Assistance for Needy Families (42 U.S.C. 601-619), low-income housing assistance (42 U.S.C. 1437f), Supplemental Nutrition Assistance Program benefits (7 U.S.C. chapter 51), Supplemental Security Income payments (42 U.S.C. 1381-1383f), foster care maintenance payments, and adoption assistance payments are governmental payments and subsidies for an item of support as described in paragraph (a)(3)(i)(A) of this section.

(ii) *Governmental payments based on a taxpayer's contributions*—(A) *In general.* Except as provided in paragraph (a)(3)(iii) of this section, governmental payments based on a taxpayer's earnings and contributions into the Social Security system are support provided by the individual for whose benefit the payments are made to the extent those payments are used for that individual's support.

(B) *Examples.* Social Security old age benefits under section 202(b) of Title II of the Social Security Act (SSA) (42 U.S.C. 402) are governmental payments based on a taxpayer's earnings and contributions into the Social Security system as described in paragraph (a)(3)(ii)(A) of this section. Similarly, Social Security survivor and disability insurance benefits paid under section 202(d) of the SSA to, or for the benefit of, the child of a deceased or disabled parent are treated as support provided by the child to the extent those payments are used for the child's support.

(iii) *Payments used for support of another individual.* Governmental payments and subsidies described in paragraph (a)(3)(i) of this section and governmental payments described in paragraph (a)(3)(ii) of this section that are used by the recipient or other intended beneficiary to support another person are support of that person provided by the recipient or other intended beneficiary, rather than support provided by a third party, the government.

(4) *Medical insurance.* Medical insurance premiums, including Part A Basic Medicare premiums, if any, under Title XVIII of the Social Security Act (42 U.S.C. 1395c to 1395i-5), Part B Supplemental Medicare premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395j to 1395w-6), Part C Medicare + Choice Program premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395w-21 to 1395w-29), and Part D Voluntary Prescription Drug Benefit Medicare premiums under Title XVIII of the Social Security Act (42 U.S.C. 1395w-101 to 1395w-154), are treated as support. Medical insurance proceeds, including benefits received under Medicare Part A, Part B, Part C, and Part D, are not treated as items of support and are disregarded in determining the amount of the individual's support. Services provided to an individual under the medical and dental care provisions of the Armed Forces Act (10 U.S.C. chapter 55) are not treated as support and are disregarded in determining the amount of the individual's support.

(5) *Medical care payments from personal injury claim.* Payments for the medical care of an injured individual from a third party, including a third party's insurance company, in satisfaction of a legal claim for the personal injury of the individual are not treated as items of support and are disregarded in determining the amount of the individual's support.

(6) *Scholarships.* Amounts a student who is the child of the taxpayer receives as a scholarship for study at an educational organization described in section 170(b)(1)(A)(ii) are not treated as an item of support and are disregarded in determining the amount of the student's support.

(b) *Relationship test*—(1) *Joint return.* A taxpayer may satisfy the relationship test described in § 1.152-2(b) (relating to

a qualifying child) or in § 1.152-3(b) (relating to a qualifying relative) if a described relationship exists between an individual and the taxpayer claiming that individual as a qualifying child or qualifying relative, even though the taxpayer files a joint return with his or her spouse who does not have a described relationship with the individual.

(2) *Divorce or death of spouse.* If the relationship between the taxpayer and an individual claimed by that taxpayer as a dependent results from a marriage, the taxpayer's qualifying relationship with the individual continues after the termination of the marriage by divorce or death.

(c) *Principal place of abode*—(1) *In general.* The term *principal place of abode* of a person means the primary or main home or dwelling where the person resides. A person's principal place of abode need not be the same physical location throughout the taxable year and may be temporary lodging such as a homeless shelter or relief housing resulting from displacement caused by a natural disaster.

(2) *Temporary absence.* The taxpayer and an individual have the same principal place of abode despite a temporary absence by either person because of special circumstances. An absence is temporary if the person would have resided at the place of abode but for the absence and, under the facts and circumstances, it is reasonable to assume that the person will return to reside at the place of abode. An individual who does not reside with the taxpayer because of a temporary absence is treated as residing with the taxpayer. For example, a nonpermanent failure to occupy the abode by reason of illness, education, business, vacation, military service, institutionalized care for a child who is totally and permanently disabled (as defined in section 22(e)(3)), or incarceration may be treated as a temporary absence because of special circumstances. If an infant must remain in a hospital for a period of time after birth and would have resided with the taxpayer during that period but for the hospitalization, the infant is treated as having the same principal place of abode as the taxpayer during the period of hospitalization.

(3) *Residing with taxpayer for more than one-half of the taxable year*—(i) *In*

*general.* An individual has the same principal place of abode as the taxpayer for more than one-half of the taxable year if the individual resides with the taxpayer for at least 183 nights during the taxpayer's taxable year, or 184 nights if the taxable year includes a leap day.

(ii) *Nights of residence*—(A) *Nights counted.* For purposes of determining whether an individual resides with the taxpayer for more than one-half of the taxable year, an individual resides with a taxpayer for a night if the individual sleeps—

(1) At the taxpayer's principal place of abode, whether or not the taxpayer is present; or

(2) In the company of the taxpayer when the individual does not sleep at the taxpayer's principal place of abode (for example, when the taxpayer and the individual are on vacation).

(B) *Night straddling two taxable years.* If an individual resides with a taxpayer for a night that extends over two taxable years, that night is allocated to the taxable year in which the night begins.

(C) *Exception for a parent who works at night.* If, in a calendar year, because of a taxpayer's nighttime work schedule, an individual resides for at least 183 days, or 184 days if the taxable year includes a leap day, but not nights with the taxpayer, the individual is treated as residing with the taxpayer for more than one-half of the taxable year.

(D) *Absences.* An individual who does not reside with a taxpayer for a night because of a temporary absence as described in paragraph (c)(2) of this section is treated as residing with the taxpayer for that night if the individual would have resided with the taxpayer for that night but for the absence.

(4) *Examples.* The following examples illustrate the rules of this paragraph (c). In each example, each taxpayer uses the calendar taxable year, and section 152(e) does not apply.

*Example 1.* B and C are the divorced parents of Child. In 2015, Child sleeps at B's principal place of abode for 210 nights and at C's principal place of abode for 155 nights. Under paragraph (c)(3) of this section, Child resides with B for at least 183 nights during 2015 and has the same principal place of abode as B for more than one-half of 2015.

*Example 2.* D and E are the divorced parents of Child, and Grandparent is E's parent. In 2015, Child resides with D for 140 nights, with E for 135 nights,

and with Grandparent for the last 90 nights of the year. None of these periods is a temporary absence. Under paragraph (c)(3) of this section, Child does not have the same principal place of abode as D, E, or Grandparent for more than one-half of 2015.

*Example 3.* The facts are the same as in *Example 2* of this paragraph (c)(4), except that, for the 90-day period that Child lives with Grandparent, E is temporarily absent on military service. Child would have lived with E if E had not been absent during that period. Under paragraphs (c)(2) and (c)(3)(ii)(D) of this section, Child is treated as residing with E for 225 nights in 2015 and, therefore, Child has the same principal place of abode as E for more than one-half of 2015.

*Example 4.* The facts are the same as in *Example 2* of this paragraph (c)(4), except that, for the last 90 days of the year Child, who is 18, moves into Child's own apartment and begins full-time employment. Because Child's absence is not temporary, under paragraph (c)(2) of this section, Child is not treated as residing with D or E for the 90 nights. Under paragraph (c) of this section, Child does not have the same principal place of abode as D or E for more than one-half of 2015.

*Example 5.* F and G are the divorced parents of Child. In 2015, Child sleeps at F's principal place of abode for 170 nights and at G's principal place of abode for 170 nights. Child spends 25 nights of the year away from F and G at a summer camp. Child would have spent those nights with F if Child had not gone to summer camp. Under paragraphs (c)(2) and (c)(3)(ii)(D) of this section, Child is treated as residing with F for 195 nights and, therefore, Child has the same principal place of abode as F for more than one-half of 2015.

*Example 6.* H and J are the divorced parents of Child. In 2015, Child sleeps at H's principal place of abode for 180 nights and at J's principal place of abode for 180 nights. For 5 nights during that year, Child sleeps at Grandparent's abode or at the house of a friend. Child would have spent all 5 nights at H's house if Child had not slept at Grandparent's or a friend's house. Under paragraphs (c)(2) and (c)(3)(ii)(D) of this section, Child is treated as residing with H for 185 nights and, therefore, Child has the same principal place of abode as H for more than one-half of 2015.

(d) *Residence for a portion of a taxable year because of special circumstances*—

(1) *Individual who is born or dies during the year.* If an individual is born or dies during a taxpayer's taxable year, the residency test for a qualifying child is treated as met if the taxpayer and the individual have the same principal place of abode for more than one-half of the portion of the taxable year during which the individual is alive. If an individual is born or dies during a taxpayer's taxable year, the relationship test for a qualifying relative who is a member of the taxpayer's household is treated as met if the taxpayer and the individual have the same principal place of abode for the entire portion of the tax-



able year during which the individual is alive.

(2) *Adopted child or foster child.* If, during a taxpayer's taxable year, the taxpayer adopts a child, a child is lawfully placed with a taxpayer for legal adoption by that taxpayer, or an eligible foster child is placed with a taxpayer, the residency test for a qualifying child and the residency requirement under § 1.152-1(a)(2)(iii) for a child who is not a citizen or national of the United States are treated as met if the taxpayer and the child have the same principal place of abode for more than one-half of the portion of the taxable year as required for a qualifying child, or for the entire taxable year as required for a noncitizen, following the placement of the child with the taxpayer.

(e) *Missing child*—(1) *Qualifying child.* A child of the taxpayer who is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of either the child or the taxpayer, and who had for the taxable year in which the kidnapping occurred the same principal place of abode as the taxpayer for more than one-half of the portion of the taxable year before the date of the kidnapping, is treated as meeting the residency test for a qualifying child, as described in § 1.152-2(c), of the taxpayer for all taxable years ending during the period that the child is missing. Also, the child is treated as meeting the residency test in the year of the child's return if the child has the same principal place of abode as the taxpayer for more than one-half of the portion of the taxable year following the date of the child's return.

(2) *Qualifying relative.* A child of the taxpayer who is presumed by law enforcement authorities to have been kidnapped by someone who is not a member of the family of either the child or the taxpayer, and who was a qualifying relative of the taxpayer for the portion of the taxable year before the date of the kidnapping, is treated as a qualifying relative, as described in section 152(d) and § 1.152-3, of the taxpayer for all taxable years ending during the period that the child is missing. Also, the child is treated as a qualifying relative of the taxpayer in the year of the child's return if the child is a qualifying relative of the taxpayer for the

portion of the taxable year following the date of the child's return.

(3) *Age limitation.* The special rules provided in this paragraph (e) cease to apply as of the first taxable year of the taxpayer beginning after the calendar year in which there is a determination that the child is dead or, if earlier, in which the child would have attained age 18.

(4) *Application.* This paragraph (e) applies solely for purposes of determining surviving spouse or head of household filing status under section 2, the child tax credit under section 24, the earned income credit under section 32, and the dependency exemption under section 151.

Par.17 In newly redesignated § 1.152-5, paragraphs (e)(2), (e)(3)(iii), and (h) are revised to read as follows:

**§ 1.152-5 Special rule for a child of divorced or separated parents or parents who live apart.**

\* \* \* \* \*

(e) \* \* \*

(2) *Attachment to return*—(i) *In general.* A noncustodial parent must attach a copy of the written declaration to the parent's original or amended return for each taxable year for which the noncustodial parent claims an exemption for the child. A noncustodial parent may submit a copy of the written declaration to the IRS during an examination to substantiate a claim to a dependency exemption for a child. A copy of a written declaration attached to an amended return, or provided during an examination, will not meet the requirement of this paragraph (e) if the custodial parent signed the written declaration after the custodial parent filed a return claiming a dependency exemption for the child for the year at issue, and the custodial parent has not filed an amended return to remove that claim to a dependency exemption for the child.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (e).

*Example 1.* Custodial parent (CP) files her 2015 return on March 1, 2016, and claims a dependency exemption for Child. At noncustodial parent's (NCP) request, CP signs a Form 8332 for the 2015 tax year on April 15, 2016. On April 15, NCP files his return claiming a dependency exemption for Child and attaches the signed Form 8332 to his return. Under section 152(e) and paragraph (b) of this section, NCP is allowed a dependency exemption for Child for

2015, and CP is not allowed a dependency exemption for Child for that year.

*Example 2.* The facts are the same as in *Example 1* of this paragraph (e)(2)(ii), except NCP files on April 15, 2016, a request for an extension to file his tax return because he does not have a signed Form 8332. CP signs the Form 8332 for the 2015 tax year in August of 2016, and NCP files his return a week later. NCP claims a dependency exemption for Child and attaches the signed Form 8332 to his return. Under section 152(e) and paragraph (b) of this section, NCP is allowed a dependency exemption for Child for 2015, and CP is not allowed a dependency exemption for Child for that year.

*Example 3.* CP files his 2015 return on March 1, 2016, and claims a dependency exemption for Child. NCP files her return on April 15, 2016, and does not claim a dependency exemption for Child, even though her divorce decree allocates the dependency exemption for Child to her. CP signs a Form 8332 for the 2015 tax year in August of 2016, and NCP files an amended return a week later and attaches the signed Form 8332 to her amended return claiming a dependency exemption for Child. Under paragraph (e)(2) of this section, NCP is not allowed a dependency exemption for Child for 2015 if CP has not amended his return to remove a claim to the dependency exemption for Child for that year.

(3) \* \* \*

(iii) *Attachment to return.* The parent revoking the written declaration must attach a copy of the revocation to the parent's original or amended return for each taxable year for which the parent claims a child as a dependent as a result of the revocation. The parent revoking the written declaration must keep a copy of the revocation and evidence of delivery of the notice to the other parent, or of the reasonable efforts to provide actual notice. A parent may submit a copy of a revocation to the IRS during an examination to substantiate a claim to a dependency exemption for the child.

\* \* \* \* \*

(h) *Applicability date*—(1) *In general.* Except as provided in paragraph (h)(2) of this section, this section applies to taxable years beginning after July 2, 2008.

(2) *Exception.* Paragraphs (e)(2) and (e)(3)(iii) of this section apply to taxable years beginning after the date these regulations are published as final regulations in the **Federal Register**.

**§ 1.6013-1 [Amended]**

Par. 18. Section 1.6013-1 is amended by removing paragraph (e).

**PART 301—PROCEDURE AND ADMINISTRATION**

Par. 19. The authority citation for part 301 continues to read in part as follows:

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

Par. 20. Section 301.6109-3 is amended by:

- 1. Revising the first sentence and adding a sentence to the end of the paragraph in paragraph (a)(1).
- 2. Revising paragraphs (b), (c)(1)(ii), the fourth and fifth sentences of (c)(2) introductory text, and paragraph (d).

The revisions and addition read as follows:

**§ 301.6109-3 IRS adoption taxpayer identification numbers.**

(a) *In general*—(1) *Definition*. An IRS adoption taxpayer identification number (ATIN) is a temporary taxpayer identifying number assigned by the Internal Revenue Service (IRS) to a child (other than an alien individual as defined in § 301.6109-1(d)(3)(i)) who has been placed lawfully with a prospective adop-

tive parent for legal adoption by that person. \* \* \* A child lawfully placed with a prospective adoptive parent for legal adoption includes a child placed for legal adoption by the child’s parent or parents by blood, an authorized placement agency, or any other person authorized by State law to place a child for legal adoption.

\* \* \* \* \*

(b) *Definitions*—(1) Authorized placement agency has the same meaning as in § 1.152-1(b)(1)(iv).

(2) *Child* means a child who has not been adopted but has been placed lawfully with a prospective adoptive parent for legal adoption by that person.

(3) *Prospective adoptive parent* means a person in whose household a child has been placed lawfully for legal adoption by that person.

(c) \* \* \*

(1) \* \* \*

(ii) The child has been placed lawfully with the prospective adoptive parent for legal adoption by that person;

\* \* \* \* \*

(2) \* \* \* In addition, the application must include documentary evidence the

IRS prescribes to establish that a child has been placed lawfully with the prospective adoptive parent for legal adoption by that person. Examples of acceptable documentary evidence establishing lawful placement for a legal adoption may include—

\* \* \* \* \*

(d) *Applicability date*—(1) *In general*. Except as otherwise provided in paragraph (d)(2) of this section, the provisions of this section apply to income tax returns due (without regard to extension) on or after April 15, 1998.

(2) *Exception*. Paragraphs (a)(1), (b), (c)(1)(ii), and (c)(2) of this section apply to income tax returns due (without regard to extension) on or after the date these regulations are published as final regulations in the **Federal Register**.

John Dalrymple  
*Deputy Commissioner for Services and Enforcement.*

(Filed by the Office of the Federal Register on January 18, 2017, 8:45 a.m., and published in the issue of the Federal Register for January 19, 2017, 82 F.R. 6370.)

# 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 sub-

stance 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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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2016–27 through 2016–52 is in Internal Revenue Bulletin 2016–52, dated December 26, 2016.

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2016–27 through 2016–52 is in Internal Revenue Bulletin 2016–52, dated December 26, 2016.

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## **INTERNAL REVENUE BULLETIN**

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

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