Internal Revenue
bulletin

Bulletin No. 2008-21
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2008–25, page 986.

Section 338. This ruling discusses an integrated transaction where stock of a target corporation is acquired in a taxable reverse subsidiary merger, followed by liquidation of target. The ruling addresses the proper treatment and application of the step transaction doctrine in light of the policies behind section 338 of the Code.

Rev. Rul. 2008–26, page 985.

Medicaid rebates. This ruling holds that Medicaid rebates paid by a pharmaceutical manufacturer are adjustments to the sales price in calculating gross receipts, rather than deductions from gross income under section 162 of the Code. Rev. Rul. 2005–28 clarified and superseded.

T.D. 9394, page 988.

Final regulations under section 1446 of the Code provide rules permitting a partnership under certain circumstances to consider partner-level items when computing its section 1446 withholding tax obligation on income that is effectively connected with its U.S. trade or business, which is allocable under section 704 to foreign partners.

Notice 2008–48, page 1008.

Renewable electricity production, refined coal production, and Indian coal production; calendar year 2008 inflation adjustment factors and reference prices. This notice announces the calendar year 2008 inflation adjustment factors and reference prices for the renewable electricity production credit, refined coal production credit, and Indian coal production credit under section 45 of the Code.

Rev. Proc. 2008–26, page 1014.

This procedure sets forth circumstances under which the IRS will not challenge whether a security is "readily marketable" for purposes of section 956(c)(2)(J).

EMPLOYEE PLANS

Notice 2008–50, page 1010.

Weighted average interest rate update; corporate bond indices; 30-year Treasury securities; segment rates. This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in May 2008; the 24-month average segment rates; the funding transitional segment rates applicable for May 2008; and the minimum present value transitional rates for April 2008.

EXEMPT ORGANIZATIONS

Announcement 2008–49, page 1024.

The IRS has revoked its determination that Heritage Christian Schools for Children of Stone Mountain, GA, and Lima Legionnaires Charitable Foundation, Inc., of Lima, OH, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

(Continued on the next page)

Finding Lists begin on page ii.
Index for January through May begins on page vi.

Department of the Treasury
Internal Revenue Service

ESTATE TAX

REG–112196–07, page 1021.
Proposed regulations under section 2032 of the Code clarify that the election to use the alternate valuation method is available to estates that qualify under section 2032(c) and that experience a reduction in the value of the decedent's gross estate due to market conditions. The regulations also define the term "market conditions," clarify that post-death events may not be taken into account in valuing the gross estate on the alternate valuation date, and provide examples, which are not intended to be exclusive.

ADMINISTRATIVE

REG–208199–91, page 1017.
Proposed regulations under section 6503 of the Code pertain to the use of designated summonses and related summonses, particularly as they suspend the period of limitations on assessment when a case is brought with respect to the designated or related summonses.

Rev. Proc. 2008–27, page 1014.
This procedure provides a simplified method for taxpayers to request relief for certain late filings under sections 897 and 1445 of the Code. The provisions of this procedure apply to certain nonrecognition transactions and transfers of domestic corporations that are not United States real property holding corporations.

Announcement 2008–50, page 1024.
The Office of Professional Responsibility intends to publish announcements of disciplinary sanctions in a redesigned format that will list specific violations of Treasury Department Circular No. 230. A new "Disciplinary Sanction" column of the announcements will include the relevant section number of Circular 230 and a brief description of misconduct.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax 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 and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Section 61.—Gross Income Defined

26 CFR 1.61–3: Gross income derived from business. (Also § 162; 1.162–1.)

Medicaid rebates. This ruling holds that Medicaid rebates paid by a pharmaceutical manufacturer are adjustments to the sales price in calculating gross receipts, rather than deductions from gross income under section 162 of the Code. Rev. Rul. 2005–28 clarified and superseded.

Rev. Rul. 2008–26

ISSUE

Are Medicaid Rebates that a pharmaceutical manufacturer pays to State Medicaid Agencies adjustments to the sales price in calculating gross receipts, or are they ordinary and necessary business expenses that are deductible from gross income under § 162 of the Internal Revenue Code?

FACTS

M, who uses an accrual method of accounting and files returns on a calendar year basis, manufactures and sells prescription drugs. In 1992, *M* entered into a "Rebate Agreement" with the Department of Health and Human Services (HHS) pursuant to the Medicaid Rebate Program established by the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101–508, 104 Stat. 1388 (1990) (the Act).

The Medicaid Rebate Program is designed to reduce the cost of drugs paid for by the Medicaid Program and to increase Medicaid beneficiaries' access to prescription drugs. Under the Act, pharmaceutical manufacturers must sign a "Rebate Agreement" with HHS (who acts on behalf of each State Medicaid Agency) to gain access to the Medicaid-funded segment of the pharmaceutical market.

The Rebate Agreements require pharmaceutical manufacturers to pay Medicaid Rebates directly to each State Medicaid Agency. A Medicaid Rebate is a portion of the price paid by State Medicaid Agencies to retailers for covered outpatient drugs dispensed to Medicaid beneficiaries. The amount of the Medicaid Rebate is designed to ensure that the Medicaid Program is charged no more for covered outpatient drugs than any other purchaser. *See* H.R. Rep. No. 101–881 at 96 (1990).

In 2005, the following events occur: (1) *M* sells *Product D*, a prescription drug, to *W*, a wholesaler; (2) *W* sells *Product D* to *R*, a retail pharmacy; (3) *R* dispenses *Product D* to individual *A*, a Medicaid beneficiary, and then files a reimbursement claim with *S*, a State Medicaid Agency; (4) *S* approves the claim and then reimburses *R* for the cost of *Product D* plus a dispensing fee; and (5) *M* pays a Medicaid Rebate to *S* pursuant to the Rebate Agreement.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided, gross income means all income from whatever source derived. Section 1.61–3(a) of the Income Tax Regulations provides that in a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.

Section 162 allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162–1(a) provides, in part, that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.

In *Pittsburgh Milk Co. v. Commissioner*, 26 T.C. 707 (1956), *nonacq.* 1959–2 C.B. 8–9, *nonacq. withdrawn and acq.* 1962–2 C.B. 5–6, *acq. withdrawn and nonacq.* 1976–2 C.B. 3–4, and *nonacq. withdrawn in part and acq. in part* 1982–2 C.B. 2, the Tax Court addressed whether allowances, discounts, or rebates paid by a milk producer to certain purchasers of its milk, in willful violation of state law, are adjustments to the purchase price of the milk resulting in a reduced sales price, or ordinary and necessary business expenses under § 162 (in which case no deduction would be allowed under the rules of § 162(c)). The court reasoned that for income derived from the sale of property, in determining gain, the amount realized must be based on the actual price or consideration for which the property was sold and not on some greater price for which it possibly should have been, but was not, sold. The court focused on the facts and circumstances of the transaction, what the parties intended, and the purpose or consideration for which the allowance was made. The court found that the allowances were part of the sales transaction and concluded that gross income must be computed on the price for which the milk was actually sold. Thus, under *Pittsburgh Milk*, where a payment is made from a seller to a purchaser, and the purpose and intent of the parties is to reach an agreed upon selling price, the payment is properly viewed as an adjustment to the purchase price that reduces gross sales.

In contrast, in *United Draperies, Inc. v. Commissioner*, 41 T.C. 457 (1964), *aff'd,* 340 F.2d 936 (7th Cir.), *cert. denied*, 382 U.S. 813 (1965), the Tax Court held that a drapery manufacturer could not exclude from income kickbacks paid to employees of the companies that purchased the taxpayer's draperies. The court noted that the kickbacks were made to employees of its customers and were "independent of its agreement with its purchasers fixing the selling price of the products sold," and that "[t]hese amounts were paid for a consideration separate from the selling price of its products, namely these employees sending the business of their employers to petitioner ...." *United Draperies* at 465.

Rev. Rul. 76–96, 1976–1 C.B. 23, addresses the tax treatment of rebates paid by an automobile manufacturer to retail customers. The manufacturer offered rebates of a set amount to retail customers who independently negotiated at arm's length with one of the manufacturer's dealers to arrive at a purchase price for a new car. The ruling holds that the rebates reduce the purchase price of the cars and are not includible in the retail customer's gross income. The ruling further holds that the manufacturer may deduct the rebates as ordinary and necessary business expenses under § 162.

The Medicaid Rebate is paid by *M* to *S* pursuant to the terms of the rebate agreement. Under the purpose and intent test of *Pittsburgh Milk*, the Medicaid Rebate is a factor used in setting the actual selling price, negotiated and agreed to before the sale to *W* takes place.

HOLDING

Medicaid Rebates that a pharmaceutical manufacturer pays to State Medicaid Agencies are adjustments to the sales price in calculating gross receipts. This holding is limited to Medicaid Rebates that a pharmaceutical manufacturer pays pursuant to the Medicaid Rebate Program established by the Act.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2005–28, 2005–1 C.B. 997, is clarified and superseded. Rev. Rul. 2005–28 suspended, in part, Rev. Rul. 76–96. Whether a rebate of the type described in Rev. Rul. 76–96 is an ordinary and necessary business expense or, alternatively, is an adjustment to the sales price in calculating gross receipts, is an issue under reconsideration. Therefore, pending the Service's reconsideration of the issue and publication of subsequent guidance, the Service will not apply, and taxpayers may not rely on, the conclusion of Rev. Rul. 76–96 that rebates made by the manufacturer are ordinary and necessary business expenses deductible under § 162.

DRAFTING INFORMATION

The principal author of this revenue ruling is Susie K. Bird of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Bird at (202) 622–4950 (not a toll-free call).

Section 162.—Trade or Business Expenses

A revenue ruling holds that Medicaid Rebates paid by a pharmaceutical manufacturer are adjustments to the sales price in calculating gross receipts, rather than deductions from gross income under section 162 of the Internal Revenue Code. The ruling clarifies and supersedes Rev. Rul. 2005–28, 2005–1 C.B. 997. See Rev. Rul. 2008-26, page 985.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.
(Also § 338; 1.338–3; 1.368–2.)

Section 338. This ruling discusses an integrated transaction where stock of a target corporation is acquired in a taxable reverse subsidiary merger, followed by liquidation of target. The ruling addresses the proper treatment and application of the step transaction doctrine in light of the policies behind section 338 of the Code.

Rev. Rul. 2008–25

ISSUE

What is the proper Federal income tax treatment of the transaction described below?

FACTS

T is a corporation all of the stock of which is owned by individual A. T has 150x dollars worth of assets and 50x dollars of liabilities. P is a corporation that is unrelated to A and T. The value of P's assets, net of liabilities, is 410x dollars. P forms corporation X, a wholly owned subsidiary, for the sole purpose of acquiring all of the stock of T by causing X to merge into T in a statutory merger (the "Acquisition Merger"). In the Acquisition Merger, P acquires all of the stock of T, and A exchanges the T stock for 10x dollars in cash and P voting stock worth 90x dollars. Following the Acquisition Merger and as part of an integrated plan that included the Acquisition Merger, T completely liquidates into P (the "Liquidation"). In the Liquidation, T transfers all of its assets to P and P assumes all of T's liabilities. The Liquidation is not accomplished through a statutory merger. After the Liquidation, P continues to conduct the business previously conducted by T.

LAW

Section 368(a)(1)(A) of the Internal Revenue Code provides that the term "reorganization" means a statutory merger or consolidation. Section 368(a)(2)(E) provides that a transaction otherwise qualifying under § 368(a)(1)(A) shall not be disqualified by reason of the fact that stock of a corporation in control of the merged corporation is used in the transaction, if (i) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction), and (ii) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of the surviving corporation. Further, §1.368–2(j)(3)(iii) of the Income Tax Regulations provides that "[i]n applying the 'substantially all' test to the merged corporation, assets transferred from the controlling corporation to the merged corporation in pursuance of the plan of reorganization are not taken into account."

Section 368(a)(1)(C) provides in part that a reorganization is the acquisition by one corporation, in exchange solely for all or part of its voting stock, of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock, the assumption by the acquiring corporation of a liability of the other shall be disregarded. Section 368(a)(2)(B) provides that if one corporation acquires substantially all of the properties of another corporation, the acquisition would qualify under § 368(a)(1)(C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and the acquiring corporation acquires, solely for voting stock described in § 368(a)(1)(C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation, then such acquisition shall (subject to § 368(a)(2)(A)) be treated as qualifying under § 368(a)(1)(C). Section 368(a)(2)(B) further provides that solely for purposes of determining whether its requirements are satisfied, the amount of any liabilities assumed by the acquiring corporation shall be treated as money paid for the property.

Section 1.368–1(a) generally provides that in determining whether a transaction qualifies as a reorganization under § 368(a), the transaction must be evaluated under relevant provisions of law, including the step transaction doctrine.

Section 1.368–2(k) provides, in part, that a transaction otherwise qualifying as a reorganization under § 368(a) shall not be disqualified or recharacterized as a result of one or more distributions to shareholders (including distribution(s) that involve the assumption of liabilities) if the requirements of §1.368–1(d) are satisfied, the property distributed consists of assets of the surviving corporation, and the aggregate of such distributions does not consist of an amount of assets of the surviving corporation (disregarding assets of the merged corporation) that would result in a liquidation of such corporation for Federal income tax purposes.

Rev. Rul. 67–274, 1967–2 C.B. 141, holds that an acquiring corporation's acquisition of all of the stock of a target corporation solely in exchange for voting stock of the acquiring corporation, followed by the liquidation of the target corporation as part of the same plan, will be treated as an acquisition by the acquiring corporation of substantially all of the target corporation's assets in a reorganization described in § 368(a)(1)(C). The ruling explains that, under these circumstances, the stock acquisition and the liquidation are part of the overall plan of reorganization and the two steps may not be considered independently of each other for Federal income tax purposes. See also, Rev. Rul. 72–405, 1972–2 C.B. 217.

Rev. Rul. 2001–46, 2001–2 C.B. 321, holds that, where a newly formed wholly owned subsidiary of an acquiring corporation merged into a target corporation, followed by the merger of the target corporation into the acquiring corporation, the step transaction doctrine is applied to integrate the steps and treat the transaction as a single statutory merger of the target corporation into the acquiring corporation. Noting that the rejection of step integration in Rev. Rul. 90–95, 1990–2 C.B. 67, and § 1.338–3(d) is based on Congressional intent that § 338 replace any nonstatutory treatment of a stock purchase as an asset purchase under the Kimbell-Diamond doctrine, the Service found that the policy underlying § 338 is not violated by treating the steps as a single statutory merger of the target into the acquiring corporation because such treatment results in a transaction that qualifies as a reorganization in which the acquiring corporation acquires the assets of the target corporation with a carryover basis under § 362, rather than receiving a cost basis in those assets under § 1012. (In *Kimbell-Diamond Milling Co. v. Commissioner*, 14 T.C. 74, *aff'd per curiam*, 187 F.2d 718 (1951), *cert. denied*, 342 U.S. 827 (1951), the court held that the purchase of the stock of a target corporation for the purpose of obtaining its assets through a prompt liquidation should be treated by the purchaser as a purchase of the target corporation's assets with the purchaser receiving a cost basis in the assets.)

Section 338(a) provides that if a corporation makes a qualified stock purchase and makes an election under that section, then the target corporation (i) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value and (ii) shall be treated as a new corporation which purchased all of its assets as of the beginning of the day after the acquisition date. Section 338(d)(3) defines a qualified stock purchase as any transaction or series of transactions in which stock (meeting the requirements of § 1504(a)(2)) of one corporation is acquired by another corporation by purchase during a 12-month acquisition period. Section 338(h)(3) defines a purchase generally as any acquisition of stock, but excludes acquisitions of stock in exchanges to which § 351, § 354, § 355, or § 356 applies.

Section 338 was enacted in 1982 and was "intended to replace any nonstatutory treatment of a stock purchase as an asset purchase under the Kimbell-Diamond doctrine." H.R. Conf. Rep. No. 760, 97th Cong, 2d Sess. 536 (1982), 1982–2 C.B. 600, 632. Stock purchase or asset purchase treatment generally turns on whether the purchasing corporation makes or is deemed to make a § 338 election. If the election is made or deemed made, asset purchase treatment results and the basis of the target assets is adjusted to reflect the stock purchase price and other relevant items. If an election is not made or deemed made, the stock purchase treatment generally results. In such a case, the basis of the target assets is not adjusted to reflect the stock purchase price and other relevant items.

Rev. Rul. 90–95 (Situation 2), holds that the merger of a newly formed wholly owned domestic subsidiary into a target corporation with the target corporation shareholders receiving solely cash in exchange for their stock, immediately followed by the merger of the target corporation into the domestic parent of the merged subsidiary, will be treated as a qualified stock purchase of the target corporation followed by a § 332 liquidation of the target corporation. As a result, the parent's basis in the target corporation's assets will be the same as the basis of the assets in the target corporation's hands. The ruling explains that even though "the step-transaction doctrine is properly applied to disregard the existence of the [merged subsidiary]," so that the first step is treated as a stock purchase, the acquisition of the target corporation's stock is accorded independent significance from the subsequent liquidation of the target corporation and, therefore, is treated as a qualified stock purchase regardless of whether a § 338 election is made. Thus, in that case, the step transaction doctrine was not applied to treat the transaction as a direct acquisition by the domestic parent of the assets of the target corporation because such an application would have resulted in treating a stock purchase as an asset purchase, which would be inconsistent with the repeal of the Kimbell-Diamond doctrine and § 338.

Section 1.338–3(d) incorporates the approach of Rev. Rul. 90–95 into the regulations by requiring the purchasing corporation (or a member of its affiliated group) to treat certain asset transfers following a qualified stock purchase (where no § 338 election is made) independently of the qualified stock purchase. In the example in § 1.338–3(d)(5), the purchase for cash of 85 percent of the stock of a target corporation, followed by the merger of the target corporation into a wholly owned subsidiary of the purchasing corporation, is treated (other than by certain minority shareholders) as a qualified stock purchase of the stock of the target corporation followed by a § 368 reorganization of the target corporation into the subsidiary. As a result, the subsidiary's basis in the target corporation's assets is the same as the basis of the assets in the target corporation's hands.

ANALYSIS

If the Acquisition Merger and the Liquidation were treated as separate from each other, the Acquisition Merger would be

treated as a stock acquisition that qualifies as a reorganization under § 368(a)(1)(A) by reason of § 368(a)(2)(E), and the Liquidation would qualify under § 332. However, as provided in § 1.368–1(a), in determining whether a transaction qualifies as a reorganization under § 368(a), the transaction must be evaluated under relevant provisions of law, including the step transaction doctrine. In this case, because T was completely liquidated, the § 1.368–2(k) safe harbor exception from the application of the step transaction doctrine does not apply. Accordingly, the Acquisition Merger and the Liquidation may not be considered independently of each other for purposes of determining whether the transaction satisfies the statutory requirements of a reorganization described in § 368(a)(1)(A) by reason of § 368(a)(2)(E). As such, this transaction does not qualify as a reorganization described in § 368(a)(1)(A) by reason of § 368(a)(2)(E) because, after the transaction, T does not hold substantially all of its properties and the properties of the merged corporation.

In determining whether the transaction is a reorganization, the approach reflected in Rev. Rul. 67–274 and Rev. Rul. 2001–46 is applied to ignore P's acquisition of the T stock in the Acquisition Merger and to treat the transaction as a direct acquisition by P of T's assets in exchange for 10x dollars in cash, 90x dollars worth of P voting stock, and the assumption of T's liabilities.

However, unlike the transactions considered in Revenue Rulings 67–274, 72–405 and 2001–46, a direct acquisition by P of T's assets in this case does not qualify as a reorganization under § 368(a). P's acquisition of T's assets is not a reorganization described in § 368(a)(1)(C) because the consideration exchanged is not solely P voting stock and the requirements of § 368(a)(2)(B) are not satisfied. Section 368(a)(2)(B) would treat P as acquiring 40 percent of T's assets for consideration other than P voting stock (liabilities assumed of 50x dollars, plus 10x dollars cash). See Rev. Rul. 73–102, 1973–1 C.B. 186 (analyzing the application of § 368(a)(2)(B)). P's acquisition of T's assets is not a reorganization described in § 368(a)(1)(D) because neither T nor A (nor a combination thereof) was in control of P (within the meaning of § 368(a)(2)(H)(i)) immediately after the transfer. Additionally, the transaction is not a reorganization under § 368(a)(1)(A) because T did not merge into P. Accordingly, the overall transaction is not a reorganization under § 368(a).

Additionally, P's acquisition of the T stock in the Acquisition Merger is not a transaction to which § 351 applies because A does not control P (within the meaning of § 368(c)) immediately after the exchange.

Rev. Rul. 90–95 and § 1.338–3(d) reject the step integration approach reflected in Rev. Rul. 67–274 where the application of that approach would treat the purchase of a target corporation's stock without a § 338 election followed by the liquidation or merger of the target corporation as the purchase of the target corporation's assets resulting in a cost basis in the assets under § 1012. Rev. Rul. 90–95 and § 1.338–3(d) treat the acquisition of the stock of the target corporation as a qualified stock purchase followed by a separate carryover basis transaction in order to preclude any nonstatutory treatment of the steps as an integrated asset purchase.

In this case, further application of the approach reflected in Rev. Rul. 67–274, integrating the acquisition of T stock with the liquidation of T, would result in treating the acquisition of T stock as a taxable purchase of T's assets. Such treatment would violate the policy underlying § 338 that a cost basis in acquired assets should not be obtained through the purchase of stock where no § 338 election is made. Accordingly, consistent with the analysis set forth in Rev. Rul. 90–95, the acquisition of the stock of T is treated as a qualified stock purchase by P followed by the liquidation of T into P under § 332.

HOLDING

The transaction is not a reorganization under § 368(a). The Acquisition Merger is a qualified stock purchase by P of the stock of T under § 338(d)(3). The Liquidation is a complete liquidation of a controlled subsidiary under § 332.

PROSPECTIVE APPLICATION

The Service will consider the application of § 7805(b) on a case-by-case basis.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Lyons at (703) 622–7930 (not a toll-free call).

Section 897.—Disposition of Investment in United States Real Property

A revenue procedure describes simplified relief in the case of certain nonrecognition transactions and dispositions of domestic corporations that are not United States real property holding corporations. See Rev. Proc. 2008-27, page 1014.

Section 1445.—Withholding of Tax on Dispositions of United States Real Property Interests

A revenue procedure describes simplified relief in the case of certain nonrecognition transactions and dispositions of domestic corporations that are not United States real property holding corporations. See Rev. Proc. 2008-27, page 1014.

Section 1446.—Withholding Tax on Foreign Partners' Share of Effectively Connected Income

26 CFR 1.1446–6: Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income.

T.D. 9394

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Special Rules to Reduce Section 1446 Withholding

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding when a partnership may consider certain deductions and losses of a foreign partner to reduce or eliminate

the partnership's obligation to pay withholding tax under section 1446 on effectively connected taxable income allocable under section 704 to such partner. The regulations will affect partnerships engaged in a trade or business in the United States that have one or more foreign partners. The final regulations also include conforming amendments to §§1.1446–3 and 1.1446–5 and to regulations under sections 1464, 6071, 6091, 6151, 6302, 6402, 6414, and 6722.

DATES: *Effective Date:* These regulations are effective on April 29, 2008.

Applicability Dates: The regulations are generally applicable for partnership taxable years beginning after December 31, 2007. See §1.1446–6(f). For a transition rule see §1.1446–6(g).

FOR FURTHER INFORMATION CONTACT: Ronald M. Gootzeit at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1934. The collection of information in these final regulations is in §1.1446–6(c) and (d). This information is required to determine the extent to which a partnership will consider certifications of losses and deductions in calculating the amount of withholding tax it must pay with respect to a foreign partner on the partner's allocable share of effectively connected taxable income earned by such partnership.

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

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

Background

On September 3, 2003, the IRS and the Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG–108524–00, 2003–2 C.B. 869 [68 FR 52466]), corrected at 68 FR 62553 (November 5, 2003), under sections 871, 1443, 1446, 1461, 1462, 1463, 6109, and 6721 of the Internal Revenue Code (Code). The regulations provide guidance for partnerships required to pay withholding tax under section 1446 of the Code (1446 tax). On May 18, 2005, the IRS and the Treasury Department issued final and temporary regulations under section 1446. The 2005 final regulations set forth the provisions of the 2003 proposed regulations in final form and the temporary regulations established a new procedure by which a partnership could consider certain partner-level deductions and losses when computing its 1446 tax. The temporary regulations generally apply to partnership taxable years beginning after the date of their issuance, but an election was provided that permitted a partnership to apply the regulations to partnership taxable years beginning after December 31, 2004, provided the partnership elected to apply the 2005 final regulations to partnership taxable years beginning after December 31, 2004. On May 18, 2005, the IRS and the Treasury Department also published in the **Federal Register** a notice of proposed rulemaking (REG–108524–00, 2005–1 C.B. 1158 [70 FR 28701]) under sections 1464, 6071, 6091, 6151, 6302, 6402, 6414, and 6722 of the Code to implement the section 1446 regime, as well as cross-referencing the temporary regulations under §1.1446–6T (see 26 CFR Part 1, revised as of April 1, 2007). Written comments were received in response to the notice of proposed rulemaking, and a public hearing was held on November 16, 2005. After consideration of all the comments, the proposed regulations are adopted, as revised by this Treasury decision and the temporary regulations are removed.

Explanation of Provisions

Section 1446 requires a partnership to pay section 1446 tax on a foreign partner's allocable share of effectively connected taxable income (ECTI) from the partnership. The temporary regulations allow certain foreign partners to certify certain deductions and losses to a partnership to reduce the 1446 tax required to be paid by the partnership with respect to ECTI allocable to such partners. The temporary regulations also permit a nonresident alien partner to certify to the partnership that the partnership investment is (and will be) its only activity for its taxable year that gives rise to effectively connected income, gain, deduction, or loss. In that case, the partnership is not required to pay 1446 tax (or any installment of such tax) with respect to such partner if the partnership estimates that the annualized (or, in the case of a partnership completing its Form 8804 "*Annual Return for Partnership Withholding Tax (Section 1446)*," the actual) 1446 tax due with respect to such nonresident alien partner is less than $1,000.

I. *Modifications to the Temporary Regulations*

A. *Format of certificate submitted to a partnership*

The temporary regulations state that no particular form is required for the partner's certificate of deduction and losses to the partnership. However, the temporary regulations list 13 items the certificate must contain and the caption that must appear at the top of the certificate. To ensure uniformity of the certificates and to reduce the likelihood of an inadvertently omitted item causing the certificate to be defective, the IRS developed a form (Form 8804–C, *"Certificate of Partner-Level Items to Reduce Section 1446 Withholding"*) to be used by the partner providing a certificate to the partnership. The IRS and the Treasury Department believe that the Form 8804–C will facilitate a partner's ability to provide original and updated certificates.

B. *Partners entitled to certify deductions and losses*

1. *Filing period requirement: number of years*

To be eligible to provide a certificate to a partnership the temporary regulations require a partner to have timely filed (or to represent that it will timely file) a U.S. income tax return for each of its preceding four taxable years and for the taxable

year during which the certificate is provided and will be considered by the partnership. The partner is also required to have timely paid (or to represent that it will timely pay) all tax shown on such returns. The final regulations clarify that only returns that report income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities will satisfy the tax return filing requirement (for the current or relevant prior years). Accordingly, the partner may not fulfill this requirement with a U.S. income tax return that reports no items of income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities.

Several commentators suggested reducing the temporary regulations' prior years U.S. tax return filing requirement. One commentator suggested reducing the requirement to the lesser of the two prior years or the number of years the partner has been a partner in the relevant partnership. Another commentator suggested reducing the requirement from four to two years.

The IRS and the Treasury Department believe it is appropriate to require the foreign partner to have filed a certain number of returns and paid any tax relating to those returns regardless of the number of years the partner has been a member of the relevant partnership. The IRS and the Treasury Department do not believe that a reduction to two years is appropriate. Because the return for the year immediately preceding the year a partner submits a certificate to a partnership may not have been filed by the date when the certificate is submitted, reducing the prior years filing requirement to two years could result in only one return being filed by the date on which the certificate is submitted. In response to these comments, however, the IRS and the Treasury Department have determined that it is appropriate to reduce the prior years filing requirement to three years.

The IRS and the Treasury Department have also decided to modify the filing requirement of a tax return for a preceding taxable year in which the partner did not submit a certificate to any partnership, if the return has a due date (without extensions) before the beginning of the partnership taxable year for which the certificate is provided. The final regulations provide that such returns must be filed and all amounts due with such return (including interest, penalties, and additions to tax, if any) must be paid on or before the earlier of: (1) The date that is one year from the due date (without extensions) of such return; or (2) The date on which the certificate for the current taxable year is submitted to the partnership. Once a partner submits a certificate to a partnership, however, it must timely file all its subsequent years' returns (and timely pay all amounts due with the returns) to submit a certificate to a partnership in a later year. The IRS and the Treasury Department anticipate that this modified rule will permit more foreign partners to provide certificates to partnerships under the final regulations.

2. *Trusts and estates*

One commentator requested that the IRS and the Treasury Department explain why foreign estates and domestic or foreign trusts, other than grantor trusts, are not permitted to certify deductions and losses to partnerships. Another commentator asked that the decedent's compliance record be considered in determining whether the estate can certify deductions and losses to a partnership. The final regulations do not modify the treatment of estates and trusts. The IRS and the Treasury Department continue to believe, as stated in the preamble to the temporary regulations, that because trusts and estates are not always pure conduits for tax purposes it is difficult for a partnership to determine the taxpayer (that is, the trust, estate or beneficiary) that will pay tax on the ECTI allocated to the trust or estate. Further, a decedent's filing history may have limited relevance in predicting the estate's likely compliance.

3. *Tiered partnerships*

In a tiered partnership structure, a lower-tier partnership must withhold 1446 tax on ECTI allocable to an upper-tier foreign partnership that is a partner in the lower-tier partnership. However, if the upper-tier foreign partnership provides sufficient information regarding its partners to the lower-tier partnership, the lower-tier partnership may withhold 1446 tax based on the partners in the upper-tier partnership. These rules may also apply to upper-tier domestic partnerships that have foreign partners. See §1.1446–5. Similarly, an upper-tier partnership that receives certificates of deductions and losses from its foreign partners may provide the certificates to the lower-tier partnerships.

The final regulations add several rules to ensure that deductions and losses certified to an upper-tier partnership are not taken into account by both the upper-tier partnership and a lower-tier partnership or by more than one lower-tier partnership. A new rule is also added requiring that sufficient information regarding a partner in the upper-tier partnership submitting the certificate be provided to the lower-tier partnership and then to the IRS so that the IRS can reliably associate the ECTI and the certificate with the partner in the upper-tier partnership.

C. *Submissions of certificates*

1. *Time Lags for submission of certificates*

The temporary regulations provide that the partnership may rely on the first certificate submitted by the foreign partner for a partnership taxable year only if the partnership receives the certificate at least 30 days before the installment due date or the annual Form 8804 filing due date (without regard to extensions) for the partnership taxable year for which the partner would like the certificate to be considered in computing the 1446 tax due with respect to the partner. Updated certificates may only be considered if received at least ten days before the installment due date or the Form 8804 filing date (without regard to extensions). Several commentators questioned the appropriateness of these timing requirements if the partnership is willing to rely on a certification submitted at the last moment and remits the 1446 tax installment or files the final return on a timely basis. The IRS and the Treasury Department agree with the commentators and have removed these requirements in the final regulations.

2. *Resubmission of certificates*

The temporary regulations require the partnership to attach a copy of any certificate, and the computation of 1446 tax due with respect to a partner, to both the Form

8813, *"Partnership Withholding Tax Payment Voucher (Section 1446),"* and Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax,"* filed with the IRS for any period for which such certificate is considered in computing the partnership's 1446 tax (or any installment of such tax). One commentator suggested that a certificate submitted with Form 8813 should not be required to be submitted with subsequent filings of Form 8813 or with Form 8805. The IRS and the Treasury Department agree with the comment regarding Form 8813. The final regulations provide that a partner's certificate need only be submitted for the first installment period for which it is considered. For subsequent installment periods for which the certificate is considered, the partnership may instead attach a list of the name, taxpayer identification number, and the amount of certified deductions of each foreign partner whose certificate was previously considered during the taxable year and whose certificate was again considered in the subject installment period. The partnership would also indicate if it was relying on the state and local taxes withheld and remitted on behalf of the partner. If the partnership is relying on the *de minimis* rule for the partner, the partnership would indicate that, in lieu of indicating the amount of certified deductions. However, if a partnership receives an updated certificate from a partner, that certificate must be attached with the Form 8813 for the first installment period it is considered. In all events, a partnership must attach to the Form 8813 and Form 8805, a computation of 1446 tax due with respect to such partner for all periods for which a certificate received from the partner is considered by the partnership. In addition, in all events the partnership must attach to the Form 8805 a copy of the partner's original or updated certificate, as appropriate.

3. *Denying partnerships the ability to submit certificates*

Consistent with the temporary regulations, the final regulations provide that upon receipt of written notification from the IRS that a foreign partner's certificate is defective, the partnership may no longer rely on the defective certificate or any other certificate submitted by the partner until the IRS notifies the partnership in writing and revokes or modifies the original notice. The final regulations provide that the IRS may also notify the partnership in writing if either a substantial portion of the certificates submitted by the partnership are defective or a substantial amount of the deductions and losses relied on by the partnership in computing its 1446 tax due are reported on one or more defective certificates. Upon receiving that notification the partnership may not rely on any certificate submitted by any partner for the partnership taxable year in which such notification is received or any subsequent partnership taxable year, until the IRS notifies the partnership again in writing and revokes or modifies the original notice.

D. *Deductions and losses certified to the partnership*

1. *Current year deductions*

The temporary regulations provide that a foreign partner can only certify deductions and losses that are or will be reflected on the partner's U.S. income tax return filed (or to be filed) for a taxable year ending prior to the installment due date or Form 8804 filing date (without regard to extensions) for the partnership taxable year for which the certificate is considered. Therefore, no anticipated deduction or loss with respect to current operations may be considered. One commentator suggested that partners should be permitted to certify current year deductions to the partnership. The IRS and the Treasury Department are concerned about the uncertainty associated with fluctuations in estimates of current-year activities and therefore have not adopted this suggestion.

2. *Charitable deductions*

One commentator requested that partners be permitted to certify charitable contribution deductions. The IRS and the Treasury Department have not adopted this recommendation because of the difficulty a partnership would have in determining the amount of a charitable contribution deduction allowed to the foreign partner. Section 170 provides separate rules for corporations and individuals, the type of charity to which the contribution is made, and the type of property contributed to the charity. In addition, separate rules apply to determine the deduction amount in the case of charitable contribution carryover.

3. *Suspended losses*

One commentator raised a concern that a foreign partner could certify a passive activity loss to a partnership that conducts a different activity in which the partner materially participates. If the partnership took that loss into account it would inappropriately reduce its 1446 tax due with respect to that partner. Because on its income tax return the partner could not offset the loss against its allocable share of partnership ECTI, the partner might inappropriately each year recertify that loss to the partnership. To address that concern the final regulations clarify that a partner must identify any certified deductions and losses that are subject to special limitations at the partner level and provide information to the partnership that will allow the partnership to take into account the special limitations.

4. *Net operating losses*

The temporary regulations provide that a partnership may not consider a partner's net operating loss (NOL) deduction in an amount greater than 90 percent of the partner's allocable share of ECTI. Two commentators discerned that this requirement reflects a concern about the alternative minimum tax (AMT) limitation on NOL deductions and suggested the regulations should be tied to the continuing applicability of the 90 percent AMT limitation on the use of NOL carryovers. The IRS and the Treasury Department have adopted this suggestion. One commentator further suggested that if the 90 percent limitation is retained, or as long as it applies, the regulations should be clarified to explain that the limitation should be applied on a cumulative basis for each installment period. This suggestion has also been adopted. With this clarification, if the partnership's annualized income changes during the year, the NOL deduction that the partnership may take into account can increase or decrease accordingly.

E. *Partnership items allocable to partners that give rise to partner level deductions, losses or credits but are not partnership*

allocations of deductions and losses under section 704

1. *State income taxes*

One commentator suggested allowing the partnership to reduce a foreign partner's ECTI by the amount of any state and local taxes paid by the partnership on behalf of the partner with respect to the partner's allocable share of partnership income. The final regulations adopt this recommendation but provide that the partnership may only consider 90 percent of the state and local taxes withheld and remitted on behalf of the partner but only with respect to the partner's allocable share of ECTI. The partnership may consider these amounts regardless of whether the partner submits a certification of deductions and losses or of its *de minimis* status to the partnership for the relevant partnership taxable year.

2. *Section 199 deductions*

One commentator suggested allowing a partnership to consider a partner's available deduction under section 199 in determining its section 1446 tax with respect to that partner. The section 199 deduction is a percentage of the lesser of the qualified production activities income (QPAI) of the taxpayer for the taxable year or the taxpayer's taxable income or, in the case of an individual, adjusted gross income determined without regard to section 199 for the taxable year. In addition, the deduction is limited to 50 percent of the Form W–2, *"Wage and Tax Statement"*, wages for the taxpayer for the taxable year. Depending on a taxpayer's gross receipts and assets, there are up to three permissible methods for calculating QPAI.

In the case of a pass-through entity (such as a partnership), section 199(d)(1)(A) provides that the section 199 deduction is calculated at the partner level. A partner may be a member of more than one partnership and may engage in its own qualifying activities under section 199. The QPAI and Form W–2 wages, and any other QPAI and Form W–2 wages reported by a partnership to the partner, must be added to the partner's own calculation of QPAI and Form W–2 wages. Therefore, because of the difficulty in a partnership determining the section 199 deduction of a partner, the IRS and the Treasury Department determined it would be inappropriate to allow a partnership to consider the section 199 deduction of a partner in determining the amount of section 1446 tax to be withheld with respect to that partner.

3. *Section 470 deductions*

One commentator suggested that the regulations allow the partnership to consider partner-level deductions previously suspended under section 470 (limitation on deductions allocable to property used by governments or other tax-exempt entities) and relating to the partnership, when the deductions become available. Section 470 currently allows the partnership to consider these suspended partner-level deductions in determining the partner's ECTI. Therefore, there is no need to modify the regulations in response to this suggestion.

4. *Tax credits*

One commentator suggested that a foreign partner should be able to certify credits to the partnership and that the partnership be able to consider current-year credits in determining the amount of its 1446 tax. Section 1446 requires that a partnership pay a withholding tax on its ECTI allocable to foreign partners. It provides no authority for partnerships to consider credits in determining the amount of 1446 tax the partnership is required to withhold and pay. Therefore, this suggestion has not been adopted.

F. *Effect on reasonable reliance on certificate of deductions and losses*

The temporary regulations provide that a partnership is not relieved from liability for 1446 tax under section 1461 or for any applicable addition to the tax, interest, or penalties if a partner's certificate is defective or the partner submits an updated certificate that increases the 1446 tax due with respect to such partner. If a certificate is determined to be defective for a reason other than the amount or character of the deductions and losses set forth on such certificate (for example, the partner failed to timely file a U.S. income tax return), then the partnership is liable for the entire 1446 tax amount under section 1461 (or any installment of such tax).

Further, under the temporary regulations, if it is determined that a certificate is defective because the actual deductions and losses available to the partner are less than the amount certified to the partnership (other than when it is determined that the partner certified the same deduction or loss to more than one partnership), the partnership is liable for 1446 tax under section 1461 (or any installment of such tax) only to the extent the amount of certified deductions and losses taken into account by the partnership is greater than the amount determined to be actually available to the partner and permitted to be used under regulations.

Similarly, if it is determined that a certificate is defective because the character of the certified deductions and losses is erroneous, the partnership is liable for 1446 tax under section 1461 (or any installment of such tax) only to the extent the actual character of the deductions and losses results in an increase in the 1446 tax due with respect to such partner.

However, the temporary regulations provide that the partnership is not liable for the addition to tax under section 6655 (as applied though §1.1446–3) for the period during which the partnership reasonably relied on the certificate. Further, the temporary regulations provide that although a partnership is generally liable for the 1446 tax, any addition to the tax, interest, and penalties, the partnership may be relieved of some penalties in certain circumstances.

One commentator stated that reasonable reliance on a certificate should protect a partnership against liability not only under section 6655, but also for liability for the tax under section 1461, interest on the tax under section 6601, and various other penalty provisions. The IRS and the Treasury Department have not adopted this recommendation. Use of the certification procedures under §1.1446–6 is voluntary. The foreign partner is not required to submit a certificate of deductions and losses to the partnership. Moreover, even if the partnership receives a certificate it may consider all, none or only a portion of the certified deductions and losses when calculating its payment of 1446 tax. Further, as the temporary regulations stated, the partnership may be relieved of some penalties in certain circumstances.

G. *Relief for a partnership's failure to timely comply with the requirements of this section*

Among other requirements, to apply the rules of §1.1446–6 the partnership must receive a valid certificate from the foreign partner and attach the certificate, along with the computation of 1446 tax due with respect to that partner, to certain Forms 8813 and Form 8805 filed with respect to that partner. The IRS and the Treasury Department believe that a reasonable cause standard should be applied to determine whether a partnership that failed to attach the certificate and 1446 tax computation to the relevant filing is eligible for an extension of time to comply with this requirement.

Under the reasonable cause standard, if a partnership that may otherwise rely on a partner's certificate fails to comply timely with the requirements of §1.1446–6, the partnership is considered to have satisfied the timeliness requirement if it demonstrates, to the satisfaction of the Area Director, Field Examination, Small Business/Self-Employed or the Director, Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the partnership's return for the taxable year, that such failure was due to reasonable cause and not willful neglect. Once the partnership becomes aware of the failure, the partnership must demonstrate reasonable cause and must satisfy the filing requirement by attaching the certificate and the partnership's computation of 1446 tax due with respect to that partner to an amended Form 8813 or Forms 8804 and 8805 (that amends the tax return to which the certificate and computation should have been attached). A written statement must be included that explains the reasons for the failure to comply.

In determining whether the partnership has reasonable cause, the Director shall determine whether the partnership acted reasonably and in good faith based on all the facts and circumstances. The Director shall notify the partnership in writing within 120 days of the filing if it is determined that the failure to comply was not due to reasonable cause or if additional time will be needed to make such determination. If the Director fails to notify the partnership within 120 days of the filing, the partnership shall be considered to have demonstrated to the Director that such failure was due to reasonable cause and not willful neglect.

H. *Effective/Applicability dates and transition rule*

The final regulations are effective for partnership taxable years beginning after December 31, 2007. However, any certificate submitted on or before July 28, 2008, that met the requirements of the temporary regulations shall not be considered defective solely because it does not meet the requirements of the final regulations. However, any certificate (including any updated certificates and status reports) submitted, or required to be submitted, after July 28, 2008, must comply with the requirements of these final regulations.

II. *Modifications to the 2005 Final Regulations*

The final regulations make several clarifying and conforming changes to the 2005 final regulations including with respect to the calculation of installment payments of 1446 tax when a partnership considers a certificate received under §1.1446–6 and the information that a lower-tier partnership must receive from an upper-tier partnership when the lower-tier partnerships pays 1446 tax on behalf of the partners in the upper-tier partnership. Also the prior year safe harbor provision in §1.1446–3 was conformed with section 6655 to provide that the partnership must compute its current year 1446 tax installments based on the total 1446 tax (without regard to §1.1446–6) as computed for the prior taxable year. These revisions are effective for partnership taxable years beginning after December 31, 2007.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collections of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that only a few small entities are expected to be impacted by these collections and the burden associated with such collections is estimated to be 0.5 hours. Moreover, the information collection in §1.1446–6 and its use is voluntary. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding the final regulations was 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 Ronald M. Gootzeit of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are 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 1.1446–0 is amended as follows:

1. Adding entries for §1.1446–6.
2. Removing entries for §1.1446–6T.
3. Revising the entry for §1.1446–7.

The addition and revision read as follows:

§1.1446–0 Table of contents.

* * * * *

§1.1446–6 Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income.

(a) In general.

(1) Purpose and scope.

(2) Reasonable reliance on a certificate.

(b) Foreign partners to whom this section applies.

(1) In general.

(2) Definitions.

(i) U.S. income tax return.

(ii) Timely-filed.

(iii) Qualifying U.S. income tax return.

(3) Special rules.

(c) Reduction of 1446 tax with respect to a foreign partner.

(1) General rules.

(i) Certified deductions and losses.

(A) Deductions and losses from the partnership.

(B) Deductions and loss from other sources.

(C) Limit on the consideration of a partner's net operating loss deduction.

(D) Limitation on losses subject to certain partner level limitations.

(E) Certification of deductions and losses to other partnerships.

(F) Partner level use of deductions and losses certified to a partnership.

(ii) *De minimis* certificate for nonresident alien individual partners.

(A) In general.

(B) Requirements for exception.

(iii) Consideration of certain current year state and local taxes.

(2) Form and time of certification.

(i) Form of certification.

(ii) Time of certification provided to partnership.

(A) First certificate submitted for a partnership's taxable year.

(B) Updated certificates and status updates.

(*1*) Preceding year tax returns not yet filed.

(*2*) Other circumstances requiring an updated certificate.

(*3*) Form and content of updated certificate.

(*4*) Partnership consideration of an updated certificate.

(3) Notification to partnership when a partner's certificate cannot be relied upon.

(4) Partner to receive copy of notice.

(5) Notification to partnership when no foreign partner's certificate can be relied upon.

(6) Partnership notification to partner regarding use of deductions and losses.

(7) Partner's certificate valid only for partnership taxable year for which submitted.

(d) Effect of certificate of deductions and losses on partner and partnership.

(1) Effect on partner.

(i) No effect on liability for income tax of foreign partner.

(ii) No effect on partner's estimated tax obligations.

(iii) No effect on partner's obligation to file U.S. income tax return.

(2) Effect on partnership.

(i) Reasonable reliance to relieve partnership from addition to tax under section 6665.

(ii) Continuing liability for withholding tax under section 1461 and for applicable interest and penalties.

(A) In general.

(B) Certificate defective because of amount or character of deductions and losses.

(3) Partnership level rules and requirements.

(i) Filing requirement.

(ii) Reasonable cause for failure to timely file a valid certificate and computation.

(A) Determining reasonable cause.

(B) Notification.

(e) Examples.

(f) Effective/Applicability date.

(g) Transition rule.

§1.1446–7 Effective/Applicability date.

Par. 3. For each entry in the table in the "Section" column remove the phrase in the "Remove" column and add the phrase in the "Add" column in its place.

Section	Remove	Add
1.1446–1(a) (First sentence)	1.1446–6T	1.1446–6
1.1446–1(a)	1.1446–6T	1.1446–6
1.1446–1(b)	§1.1446–6T	§1.1446–6
1.1446–1(c)(5) (Second sentence)	1.1446–6T	1.1446–6
1.1446–2(a) (Third sentence)	§1.1446–6T	§1.1446–6
1.1446–2(b)(1) (Second sentence)	§1.1446–6T	§1.1446–6
1.1446–2(b)(1) (Last sentence)	1.1446–6T	1.1446–6
1.1446–2(b)(3)(iii) (First sentence)	§1.1446–6T	§1.1446–6
1.1446–2(b)(3)(iii) (Second sentence)	§1.1446–6T	§1.1446–6
1.1446–2(b)(3)(vii)	§1.1446–6T	§1.1446–6
1.1446–2(b)(5) *Example 3* (Sixth sentence)	§1.1446–6T	§1.1446–6
1.1446–3(b)(2)(v)(F) (Second sentence)	§1.1446–6T	§1.1446–6(c)(1)(ii)
1.1446–3(d)(1)(i) (Third sentence	§1.1446–6T	§1.1446–6(d)(3)
1.1446–3(d)(1)(iii) (Third sentence)	§1.1446–6T	§1.1446–6

Section	Remove	Add
1.1446–3(e)(3)(i) (Last sentence)	§1.1446–6T	§1.1446–6(d)(2)(i)
1.1446–5(f) *Example 1*(i) (Ninth sentence)	§1.1446–6T	§1.1446–6

Par. 4. Section 1.1446–3 is amended by:

1. Removing the acronym "ECTI" from the first sentence in paragraph (b)(1) and adding the language "effectively connected taxable income (ECTI)" in its place.

2. Revising paragraphs (b)(2)(i) and (b)(3)(i)(A).

The revisions read as follows:

§1.1446–3 Time and manner of calculating and paying over the 1446 tax.

* * * * *

(b) * * *

(2) * * * (i) *Application of the principles of section 6655*—(A) *In general*. Installment payments of 1446 tax required during the partnership's taxable year are based upon partnership ECTI for the portion of the partnership taxable year to which the payments relate, and, except as set forth in this paragraph (b)(2) or paragraph (b)(3) of this section, shall be calculated using the principles of section 6655. The principles of section 6655, except as otherwise provided in §1.6655–2, are applied to annualize the partnership's items of effectively connected income, gain, loss, and deduction to determine each foreign partner's allocable share of partnership ECTI. Each foreign partner's allocable share of partnership ECTI is then multiplied by the relevant applicable percentage for the type of income allocable to the foreign partner under paragraph (a)(2) of this section. The respective 1446 tax amounts are then added for each foreign partner to yield an annualized 1446 tax with respect to such partner. The installment of 1446 tax due with respect to a foreign partner equals the excess of the section 6655(e)(2)(B)(ii) percentage of the annualized 1446 tax for that partner (or, if applicable, the adjusted seasonal amount) for the relevant installment period, over the aggregate amount of 1446 tax installment payments previously paid with respect to that partner during the partnership's taxable year. The partnership's total 1446 tax installment payment equals the sum of the installment payments due for such period on behalf of all the partnership's foreign partners.

(B) *Calculation rules when certificates are submitted under §1.1446–6*—(*1*) To the extent applicable, in computing the 1446 tax due with respect to a foreign partner, a partnership may consider a certificate received from such partner under §1.1446–6(c)(1)(i) or (ii) and the amount of state and local taxes permitted to be considered under §1.1446–6(c)(1)(iii). For this purpose, a partnership shall first annualize the partner's allocable share of the partnership's items of effectively connected income, gain, deduction, and loss before—

(*i*) Considering under §1.1446–6(c)(1)(i) the partner's certified deductions and losses;

(*ii*) Determining under §1.1446–6(c)(1)(ii) whether the 1446 tax otherwise due with respect to that partner is less than $1,000 (determined with regard to any certified deductions or losses); or

(*iii*) Considering under §1.1446–6(c)(1)(iii) the amount of state and local taxes withheld and remitted on behalf of the partner.

(*2*) The amount of the limitation provided in §1.1446–6(c)(1)(i)(C) shall be based on the partner's allocable share of these annualized amounts. For any installment period in which the partnership considers a partner's certificate, the partnership must also consider the following events to the extent they occur prior to the due date for paying the 1446 tax for such installment period—

(*i*) The receipt of an updated certificate or status update from the partner under §1.1446–6(c)(2)(ii)(B) certifying an amount of deductions or losses that is less than the amount reflected on the superseded certificate (see §1.1446–6(e)(2) *Example 4*);

(*ii*) The failure to receive an updated certificate or status update from the partner that should have been provided under §1.1446–6(c)(2)(ii)(B); and

(*iii*) The receipt of a notification from the IRS under §1.1446–6(c)(3) or (c)(5) (see §1.1446–6(e)(2) *Example 5*).

* * * * *

(3) * * * (i) * * *

(A) The average of the amount of the current installment and prior installments during the taxable year is at least 25 percent of the total 1446 tax (without regard to §1.1446–6) for the prior taxable year;

* * * * * *

Par. 5. Section 1.1446–5(c)(2) is amended by adding two new sentences after the first sentence to read as follows:

§1.1446–5 Tiered partnership structures.

* * * * *

(c) * * *

(2) * * * The lower-tier partnership required to pay 1446 tax must be able to provide the information necessary for the IRS to determine the chain of ownership, allocation of effectively connected items at each partnership level, as well as to the ultimate beneficial owner of the effectively connected items, and whether the amount of 1446 tax paid was appropriate. This information should permit each partnership in the tiered structure and the IRS to reliably associate any effectively connected items allocable to such upper-tier partnership, as well as to the ultimate beneficial owner of the effectively connected items. * * *

§1.1446–6T [Removed]

Par. 6. Section 1.1446–6T is removed.

Par. 7. Section 1.1446–6 is added to read as follows:

§1.1446–6 Special rules to reduce a partnership's 1446 tax with respect to a foreign partner's allocable share of effectively connected taxable income.

(a) *In general*—(1) *Purpose and scope*. This section provides rules regarding when a partnership required to pay withholding tax under section 1446 (1446 tax), or an installment of 1446 tax, may consider certain partner-level deductions and losses in computing its 1446 tax obligation under §1.1446–3, or otherwise not pay a *de minimis* amount of 1446 tax due with respect

to a nonresident alien individual partner. A partnership determines the applicability of the rules of this section on a partner-by-partner basis for each installment period and when completing its Form 8804, *"Annual Return for Partnership Withholding Tax (Section 1446),"* and paying 1446 tax for the partnership taxable year. Except with respect to certain state and local taxes paid by the partnership on behalf of the partner, to apply the rules of this section with respect to a foreign partner, the partnership must receive a certificate from such partner for each partnership taxable year. Paragraph (b) of this section identifies the foreign partners to which this section applies. Paragraph (c) of this section identifies the deductions and losses that a foreign partner may certify to the partnership as well as the state and local taxes paid by the partnership on behalf of the foreign partner that can be taken into account without a certification, and establishes an exception that permits a partnership to not pay a *de minimis* amount of 1446 tax with respect to a nonresident alien partner. Paragraph (c) of this section also sets forth the requirements for a valid certificate. Paragraphs (a)(2) and (d) of this section establish when a partnership may rely on and consider a foreign partner's certificate in computing its 1446 tax, and the effects of relying on such a certificate. Paragraph (d) of this section also describes the effects of a partnership relying on a certificate (including an updated certificate) and the reporting requirements of a partnership with respect to a certificate. Paragraph (e) of this section sets forth examples that illustrate the rules of this section. Paragraph (f) of this section provides the Effective/Applicability date. Paragraph (g) of this section provides a transition rule.

(2) *Reasonable reliance on a certificate*. Subject to §1.1446–2 and the rules of this section, a partnership receiving a certificate (including an updated certificate or status update under paragraph (c)(2)(ii)(B) of this section) of deductions and losses from a partner provided in accordance with the provisions of this section may reasonably rely on such certificate (to the extent of the certified deductions and losses or other representations set forth in the certificate) until such time that it has actual knowledge or reason to know that the certificate is defective or that the time for receiving an updated certificate or status update from the partner under paragraph (c)(2)(ii)(B) of this section has expired. For this purpose, a partnership shall be considered to have actual knowledge or reason to know that a certificate is defective upon receipt of written notification from the IRS under paragraph (c)(3) or (c)(5) of this section.

(b) *Foreign partner to whom this section applies*—(1) *In general*. Except as otherwise provided in paragraph (b)(3) of this section, a foreign partner to whom this section applies is a foreign partner that meets the requirements of this paragraph (b)(1).

(i) The partner has provided valid documentation to the partnership to which a certificate is submitted under this section in accordance with §1.1446–1.

(ii) If the partner's current taxable year is the first taxable year in which the partner submits a certificate to any partnership, the partner has filed (or will file) a qualifying U.S. income tax return for each of its three taxable years ending before the end of the partnership's taxable year for which the partner is submitting a certificate (regardless of whether it was a partner in that partnership during each of these years). A qualifying U.S. income tax return for a taxable year that is prior to the first taxable year the partner submits a certificate to any partnership is a U.S. income tax return filed within the time specified in paragraph (b)(2)(iii) of this section.

(iii) If the current taxable year of the partner is not the first taxable year in which the partner submits a certificate to any partnership, the partner met the requirements in paragraph (b)(1)(ii) of this section for the first taxable year in which it submitted a certificate to any partnership and has filed (or will file) a qualifying U.S. income tax return for its first taxable year in which it submitted a certificate to any partnership and each subsequent taxable year ending before the beginning of the current taxable year (regardless of whether it was a partner in any partnership during each of those years). A qualifying U.S. income tax return for a taxable year that is prior to the taxable year the partner submits a certificate to any partnership is a U.S. income tax return filed within the time specified in paragraph (b)(2)(iii) of this section.

(iv) The partner files a qualifying U.S. income tax return (within the meaning of paragraph (b)(2)(iii) of this section) for its taxable year in which a certificate is provided to any partnership.

(2) *Definitions*—(i) *U.S. income tax return*. A U.S. income tax return means a Form 1040NR, *"U.S. Nonresident Alien Income Tax Return,"* in the case of a nonresident alien individual and a Form 1120F, *"U.S. Income Tax Return of a Foreign Corporation,"* in the case of a foreign corporation.

(ii) *Timely-filed*. Only for purposes of this section, a U.S. income tax return shall be considered timely-filed if the return is filed on or before the due date set forth in section 6072(c), plus any extension of time to file such return granted under section 6081.

(iii) *Qualifying U.S. income tax return*. A U.S. income tax return shall constitute a qualifying U.S. income tax return if the return reports income or gain that is effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities and if the return is described in paragraph (b)(2)(iii)(A), (B), or (C) of this section. A protective return described in §1.874–1(b)(6) or §1.882–4(a)(3)(vi) is not a qualifying U.S. income tax return for purposes of this section.

(A) A U.S. income tax return for a partner's preceding taxable year in which it did not submit a certificate to any partnership (but not including a taxable year following the first taxable year in which the partner submitted a certificate to any partnership), with a due date as set forth in section 6072(c), not including any extensions of time to file, which falls before the beginning of the current partnership taxable year for which the certificate is provided is described in this paragraph (b)(2)(iii)(A) if the return is filed and all amounts due with respect to such return (including interest, penalties, and additions to tax, if any) are paid on or before the earlier of—

(1) The date that is one year after the due date set forth in section 6072(c) for such return, not including any extensions of time to file; or

(2) The date on which the certificate for the current partnership taxable year is submitted to the partnership.

(B) A U.S. income tax return for a partner's preceding taxable year in which it did not submit a certificate to any partnership (but not including a taxable year fol-

lowing the first taxable year in which the partner submitted a certificate to any partnership), with a due date as set forth in section 6072(c), not including any extensions of time to file, which falls within the current partnership taxable year for which the certificate is provided is described in this paragraph (b)(2)(iii)(B) if the return is timely-filed and all amounts due with respect to such return are timely paid.

(C) A U.S. income tax return for a taxable year in which the partner submits a certificate to any partnership and for a taxable year following the first taxable year in which the partner submits a certificate to any partnership is described in this paragraph (b)(2)(iii)(C) if the return is timely-filed and all amounts due with such return are timely paid with respect to such return.

(3) *Special rules*—(i) In the case of a partnership (upper-tier partnership) that is a partner in another partnership (lower-tier partnership)—

(A) The rules of this section may apply to reduce or eliminate the 1446 tax (or any installment of such tax) of the lower-tier partnership with respect to a foreign partner of the upper-tier partnership only to the extent the provisions of §1.1446–5 apply to look through the upper-tier partnership to the foreign partner of such upper-tier partnership and the certificate described in paragraph (c) of this section is provided by such foreign partner to the upper-tier partnership and, in turn, provided to the lower-tier partnership with other appropriate documentation (see §1.1446–5(c) and (e));

(B) An upper-tier partnership that submits a certificate of deductions and losses or a *de minimis* certificate to a lower-tier partnership may not submit that certificate to another lower-tier partnership;

(C) An upper-tier partnership that relies on a certificate submitted to it by a foreign partner under this section for computing its 1446 tax due on effectively connected taxable income (ECTI) allocable to that partner (other than ECTI allocable to it from a lower-tier partnership) may not submit that certificate to any lower-tier partnership; and

(D) In addition to any other information required by this section, a lower-tier partnership must submit with a Form 8813, *"Partnership Withholding Tax Payment Voucher (Section 1446),"* and Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax,"* for which it relies on a certificate from an upper-tier partnership to reduce the 1446 tax due with respect to a foreign partner of the upper-tier partnership, sufficient information so that the IRS may reliably associate the ECTI and the certificate of deductions and losses with the partner in the upper-tier partnership submitting the certificate, including the name, taxpayer identification number (TIN) and allocation of effectively connected items at each partnership tier, as well as to the ultimate upper-tier partner submitting the certificate.

(ii) This section shall not apply to a partner that is a foreign estate or its beneficiaries.

(iii) This section shall not apply to a partner that is a trust or to its beneficiaries, except to the extent that such trust is owned by a grantor or other person under subpart E of subchapter J of the Internal Revenue Code, the documentation requirements of §1.1446–1 have been met by the grantor or other owner of such trust, and the certificate described in paragraph (c) of this section is provided by the grantor or other owner of such trust to the partnership.

(iv) This section shall not apply to a partner in a publicly-traded partnership subject to §1.1446–4.

(c) *Reduction of 1446 tax with respect to a foreign partner*—(1) *General rules*. Under paragraph (c)(1)(i) of this section a foreign partner to whom this section applies may certify to a partnership for a partnership taxable year that it has certain deductions (other than charitable deductions) and losses properly allocated and apportioned to gross income that is effectively connected (or treated as effectively connected) with the conduct of the partner's trade or business in the United States, and that the partner reasonably expects those deductions and losses to be available and claimed on the partner's U.S. income tax return to be filed for that taxable year. Under paragraph (c)(1)(ii) of this section, a nonresident alien individual partner to whom this section applies may also certify to a partnership for a partnership taxable year that its only investment or activity giving rise to effectively connected items for the partnership's taxable year that ends with or within the partner's taxable year is (and will be) the partner's investment in the partnership. A certificate submitted by a foreign partner to a partnership under this section must be in accordance with the form and requirements set forth in paragraph (c)(2)(ii) of this section. Under paragraph (c)(1)(iii) of this section, a partnership may take into account certain state and local taxes withheld by the partnership on behalf of the partner.

(i) *Certified deductions and losses*—(A) *Deductions and losses from the partnership*. Under this paragraph (c)(1)(i)(A), a partner may certify to a partnership for a partnership taxable year deductions (other than charitable deductions) and losses properly allocated and apportioned to gross income which is effectively connected (or treated as effectively connected) with the conduct of the partner's trade or business in the United States, that are reported on a Form 1065 (Schedule K–1), *"Partner's Share of Income, Deductions, Credits, etc.,"* issued (or to be issued) to the partner by the partnership for a prior partnership taxable year, that are (or will be) reported on a qualifying U.S. income tax return for a partner's taxable year that ends before the installment due date or the close of the partnership taxable year for which the partner is certifying such deductions and losses, and that the partner reasonably expects to be available and claimed on a qualifying U.S. income tax return for the partner's taxable year ending with or after the close of the partnership taxable year. A partner that has a loss reported on a Form 1065 (Schedule K–1) issued (or to be issued) to the partner by the partnership for a prior partnership taxable year, but that is not (and will not be) reported on a qualifying U.S. income tax return for a prior taxable year of the partner because the loss is suspended under section 704(d) may also certify such suspended loss to the partnership under this paragraph (c)(1)(i)(A).

(B) *Deductions and losses from other sources*. Under this paragraph (c)(1)(i)(B), a foreign partner may certify to a partnership for a partnership taxable year deductions (other than charitable deductions) and losses properly allocated and apportioned to gross income that is effectively connected (or treated as effectively connected) with the conduct of the partner's trade or business in the United States and that are from sources other than the partnership to whom the certificate is submit-

ted if the deductions and losses are (or will be) reported on a qualifying U.S. income tax return of the partner for a taxable year that ends before the installment due date or the close of the partnership taxable year for which the partner is certifying the deductions and losses and the partner reasonably expects the deductions and losses to be available and claimed on the a qualifying U.S. income tax return filed for its taxable year ending with or after the close of the partnership taxable year. Any deductions and losses certified under this paragraph (c)(1)(i)(B) that are allocated to the partner from another partnership must be reported on a Form 1065 (Schedule K–1) issued (or to be issued) to the partner by such other partnership. However, the partner may not certify any deduction or loss allocated to it from another partnership that is suspended under section 704(d).

(C) *Limit on the consideration of a partner's net operating loss deduction*. A partnership may not consider a net operating loss deduction (as determined under section 172) certified by the partner under this paragraph (c)(1)(i) in an amount greater than the percentage limitation, if any, provided in section 56(a)(4) and (d) multiplied by the partner's allocable share of ECTI from the partnership reduced by all other certified deductions and losses whether or not taken into account by the partnership, as well as deductions considered under paragraph (c)(1)(iii) of this section.

(D) *Limitation on losses subject to certain partner level limitations*. Pursuant to paragraph (c)(2)(i) of this section, a partner must identify any certified losses or deductions that are subject to special limitations at the partner level (for example, sections 465 and 469) and provide information to the partnership that will allow the partnership to take the special limitations into account. For example, where a partner certifies a loss to the partnership that is a passive activity loss under section 469, the partner shall identify the activities the partnership conducts that the partner expects will be passive activities. The partnership shall then ensure that these limitations are taken into account when determining the 1446 tax due with respect to the partner.

(E) *Certification of deductions and losses to other partnerships*. Deductions and losses certified to a partnership for a taxable year of the partnership may not be certified for the taxable year of another partnership that begins or ends with or within the taxable year of the partnership to which the deductions and losses were certified.

(F) *Partner level use of deductions and losses certified to a partnership*. Any deductions and losses certified to a partnership for a taxable year of the partner and considered by the partnership in computing its section 1446 tax due may not be considered by that partner for the same taxable year in computing the amount of its required installments under section 6654(d) or 6655(d) on income unrelated to the partnership to which the partner has submitted the certificate.

(ii) *De minimis certificate for nonresident alien individual partners*—(A) *In general*. Under this paragraph (c)(1)(ii), a nonresident alien individual partner to whom this section applies and that satisfies the requirements of paragraph (c)(1)(ii)(B) of this section may certify to a partnership that its only activity giving rise to effectively connected income, gain, deduction, or loss for the partnership's taxable year that ends with or within the partner's taxable year is (and will be) the partner's investment in the partnership. A partnership that receives a certificate from a nonresident alien partner under this paragraph (c)(1)(ii) and that may reasonably rely on such certificate is not required to pay 1446 tax (or any installment of such tax) with respect to such partner if the partnership estimates that the annualized (or, in the case of a partnership completing its Form 8804, the actual) 1446 tax otherwise due with respect to such partner is less than $1,000, without taking into account any deductions or losses certified by the partner to the partnership under paragraph (c)(1)(i) of this section or any amounts under paragraph (c)(1)(iii) of this section.

(B) *Requirements for exception*. The requirements of this paragraph (c)(1)(ii)(B) are met if the nonresident individual alien partner's only activity giving rise to effectively connected income, gain, deduction, or loss for the partnership taxable year that ends with or within the partner's taxable year is (and will be) the partner's investment in the partnership. For this purpose, if the partner has (or has reason to expect to have) income or gain described in section 864(c)(6), such income or gain shall be considered derived from a separate investment activity. A certificate submitted by a nonresident alien individual partner under this paragraph (c)(1)(ii) is valid even if such certificate does not certify deductions and losses to partnership under this section. A nonresident alien individual partner that submits a certificate to a partnership under this paragraph (c)(1)(ii) must notify the partnership in writing and revoke such certificate within 10 days of the date that the partner invests or otherwise engages in another activity that may give rise to effectively connected income, gain, deduction, or loss for the partner's taxable year. For example, while an investment in a U.S. real property interest (as defined in section 897(c)) would not give rise to an activity requiring a notification (unless an election is in effect under section 871(d)), the disposition of the U.S. real property interest would give rise to an activity requiring a notification.

(iii) *Consideration of certain current year state and local taxes*. In addition to any deductions and losses certified by a foreign partner to a partnership under paragraph (c)(1)(i) of this section, the partnership may consider as a deduction of such partner 90-percent of any state and local income taxes withheld and remitted by the partnership on behalf of such partner with respect to the partner's allocable share of partnership ECTI. The partnership may consider the amount of state and local taxes of the foreign partner determined under this paragraph (c)(1)(iii) regardless of whether the foreign partner submits a certificate to the partnership under paragraph (c)(1)(i) or (ii) of this section.

(2) *Form and time of certification*—(i) *Form of certification*. A partner's certification to a partnership under paragraph (c)(1)(i) or (iii) of this section shall be made using Form 8804–C, *"Certificate of Partner-Level Items to Reduce Section 1446 Withholding"* in accordance with the instructions of the form and the rules of this section.

(ii) *Time for certification provided to partnership*—(A) *First certificate submitted for a partnership's taxable year*. Provided the other requirements of this section are met, a partnership may only rely on the first certificate received from a foreign partner for any 1446 tax installment due or Form 8804 filing due (without regard to extensions) on or after the date on which the certificate is received. See §1.1446–3 for 1446 tax installment due dates. See

also paragraph (e) of this section for examples illustrating the rules of this paragraph (c)(2).

(B) *Updated certificates and status updates—(1) Preceding year tax returns not yet filed*. If a foreign partner's U.S. income tax return for a preceding taxable year has not been filed as of the time the partner submits to the partnership its first certificate under this paragraph (c), the certificate shall specify this fact and set forth the filing due date for such return set forth in section 6072(c), plus any extension of time to file such return granted under section 6081 and the regulations under section 6081. The partner shall also submit an updated certificate to the partnership in accordance with this paragraph (c) within 10 days of the date the partner files its U.S. income tax return for any such taxable year. In addition, prior to the partnership's final 1446 tax installment due date the partner shall provide to the partnership, under penalties of perjury, a status update regarding any U.S. income tax return for the prior taxable year that has not (or will not) be filed as of the final installment due date. The status update must identify the due date, set forth in section 6072(c), plus any extension of time to file such return granted under section 6081 and the regulations under section 6081, for any un-filed return identified in the first certificate and state whether the first certificate submitted may continue to be considered by the partnership. If the partnership does not receive an updated certificate or a status update from the partner prior to the partnership's final installment due date, the partnership shall disregard the partner's certificate when computing the 1446 tax due with respect to that partner for the final installment period and when completing its Form 8804 for the taxable year. In addition, the foreign partner shall not be permitted to submit an additional or substitute certificate for the disregarded certificate. See §1.1446–3(b)(2)(i) for computation requirements for installment payments of 1446 tax when a partnership receives, or fails to receive, an updated certificate or status update. See also paragraph (e)(2) *Examples 4 and 8* of this section. Notwithstanding this paragraph (c)(2)(ii)(B)(*1*), a partner that can meet the requirements of this section for a subsequent partnership taxable year may submit a certificate to the partnership under this section for such taxable year.

(*2*) *Other circumstances requiring an updated certificate*. If at any time during the partnership taxable year the partner determines that its most recent certificate furnished to the partnership for such taxable year is incorrect, then the partner shall submit to the partnership an updated certificate in accordance with this paragraph (c) within 10 days of such determination. For example, if the partner determines that the amount or character of the certified deductions or losses is incorrect, the partner shall submit an updated certificate to the partnership. See §1.1446–3(b)(2)(i) for computation requirements for installment payments of 1446 tax when a partnership receives an updated certificate.

(*3*) *Form and content of updated certificate*. The updated certificate required by this paragraph (c)(2)(ii) must be provided using the form and instructions identified in paragraph (c)(2)(i) of this section. The updated certificate must indicate that it is an updated certificate filed in accordance with this paragraph (c)(2)(ii). The partner is not required to attach to the updated certificate a copy of the certificate that is being updated (superseded certificate).

(*4*) *Partnership consideration of an updated certificate*. A partnership may consider an updated certificate, that meets the requirements of this paragraph (c), that is received prior to an installment due date in the same partnership taxable year for which the superseded certificate was provided, or prior to the due date of its Form 8804 (without regard to extensions) to be filed for the year the superseded certificate was provided. A partnership must consider an updated certificate that meets all the requirements of this paragraph (c) if it would increase the amount of 1446 tax the partnership would pay by the next installment due date, if any, or the due date of its Form 8804. An updated certificate considered by the partnership under this paragraph (c)(2)(ii)(B)(*4*) supersedes all prior certificates submitted by the foreign partner for the same partnership taxable year, beginning with the installment period or Form 8804 filing date for which the partnership considers the updated certificate. See paragraph (e)(2) *Example 4* of this section.

(3) *Notification to partnership when a partner's certificate cannot be relied upon*. If the IRS determines, in its discretion based on all the facts and circumstances, that a foreign partner's certificate is defective (or that it lacks information sufficient to make this determination after providing written request for such information to the partnership), the IRS shall notify the partnership of such determination in writing. Upon receipt of such written notification, the partnership shall not rely on any certificate submitted by that foreign partner for the partnership taxable year to which the defective certificate relates (or any subsequent partnership taxable year), until the IRS provides written notification to the partnership revoking or modifying the original written notification. For purposes of this section, a foreign partner's certificate of deductions and losses shall be defective if—

(i) The partner is not described in paragraph (b) of this section;

(ii) Any deductions or losses set forth in such certificate are not described in paragraph (c)(1)(i) of this section;

(iii) The timing requirements under paragraph (c)(2) of this section for submitting an original certificate, an updated certificate or a status update to the partnership are not met;

(iv) The certificate does not include all of the information required by paragraph (c)(2)(i) of this section;

(v) Any representation made on the certificate is incorrect;

(vi) The actual amount of deductions and losses available to the partner is less than the amount of deductions and losses certified to the partnership for the partnership taxable year and considered by the partnership in determining its 1446 tax due; or

(vii) There is a failure to comply with any other provision of this section.

(4) *Partner to receive copy of notice*. If the IRS notifies a partnership under paragraph (c)(3) of this section that a certificate of a foreign partner is defective, the IRS shall send a copy of such notice to the partner's address as shown on the certificate. The partnership shall also promptly furnish a copy of the IRS notice to such partner.

(5) *Notification to partnership when no foreign partner's certificate can be relied upon*. If the IRS determines, in its discretion based on all the facts and circumstances, that there would be a substantial

reduction in section 1446 tax as a result of the submission of one or more defective certificates or that a substantial portion of all certificates being submitted by partners to the partnership and by the partnership to the IRS are defective (or lack information sufficient to make this determination), then the IRS shall notify the partnership of such determination in writing. Upon receipt of such written notification, the partnership shall not rely on any certificate submitted by any partner for the partnership taxable year to which the notice relates or any subsequent partnership taxable year, until the IRS provides written notification to the partnership revoking or modifying the original notice.

(6) *Partnership notification to partner regarding use of deductions and losses*. Unless §1.1446–3(d)(1)(i)(A) or (B) applies (relating to waiver of notice of tax paid during the partnership taxable year), a partnership must notify each foreign partner of the amount of such partner's certified deductions and losses and state and local taxes, if any, taken into account under this paragraph (c) in determining the 1446 tax due with respect to such partner for each installment period or Form 8804 filing date, as applicable.

(7) *Partner's certificate valid only for partnership taxable year for which submitted*. A partnership that receives a certificate from a partnership under this paragraph (c) shall consider such certificate only for the partnership taxable year for which the certificate is submitted, as set forth on the certificate.

(d) *Effect of certificate of deductions and losses on partners and partnership*—(1) *Effect on partner*—(i) *No effect on liability for income tax of foreign partner*. A foreign partner that certifies deductions and losses to a partnership under this section is not relieved of liability for income tax on its allocable share of ECTI from the partnership. Further, the submission of a certificate under this section does not constitute an acceptance by the IRS of the amount or character of the deductions or losses certified therein.

(ii) *No effect on partner's estimated tax obligations*. A foreign partner that certifies deductions and losses to a partnership under this section is not relieved of any estimated tax obligation otherwise applicable to such partner with respect to income or gain allocated to such partner from the partnership.

(iii) *No effect on partner's obligation to file U.S. income tax return*. The submission of a certificate under paragraph (c) of this section does not relieve the foreign partner from its obligation to file a U.S. income tax return even if as a result of the partnership considering the certificate the partner would have no additional tax due with such return. See also §1.1446–3(f).

(2) *Effect on partnership*—(i) *Reasonable reliance to relieve partnership from addition to tax under section 6655*. A partnership that has reasonably relied on a certificate received from a foreign partner and complied with the filing requirements of paragraph (d)(3)(i) of this section, shall not be liable for any addition to tax under section 6655 (as applied through §1.1446–3) for any period during which the partnership reasonably relied on such certificate, even if such certificate is later determined to be defective or the partner submits an updated certificate under paragraph (c)(2) of this section that increases the 1446 tax due with respect to such partner.

(ii) *Continuing liability for withholding tax under section 1461 and for applicable interest and penalties*—(A) *In general*. Except as otherwise provided in this section, a partnership that has reasonably relied on a certificate received from a foreign partner and complied with the filing requirements of paragraph (d)(3)(i) of this section, is not relieved from liability for the 1446 tax (or any installment of such tax) under section 1461, any additions to the tax, interest or penalties. However, the partnership may be relieved of additions to the tax or penalties in certain circumstances. See §§301.6651–1(c) and 301.6724–1 of this chapter. Further, see §1.1446–3(e) which deems a partnership to have paid 1446 tax with respect to ECTI allocable to a partner in certain circumstances. See also paragraph (e)(2) *Example 5* of this section.

(B) *Certificate defective because of amount or character of deductions and losses*. If a certificate is determined to be defective because the actual amount of deductions and losses available to the partner is less than the amount reflected on the certificate (other than when it is determined that the partner certified the same deduction or loss to more than one partnership), or because the character of the certified deductions and losses is erroneous, the partnership shall be liable for 1446 tax under section 1461 (or any installment of such tax) with respect to such partner to the extent the partnership considered an amount of certified deductions and losses greater than the amount actually available to the partner and permitted to be used under §§1.1446–1 through 1.1446–5 and this section, or to the extent that the proper character of the certified deductions and losses results in a greater amount of 1446 tax due with respect to such partner. See paragraph (e)(2) *Example 6* of this section.

(3) *Partnership level rules and requirements*—(i) *Filing requirement*. A partnership that relies in whole or in part on a certificate received from a partner under this section in computing its 1446 tax due with respect to such partner must still file Form 8813 or Form 8804 and 8805, whichever is applicable, for the period for which the certificate is considered, even if as a result of relying on the certificate no 1446 tax (or an installment of such tax) is due with respect to such foreign partner. See generally §1.1446–3(d)(1). Except as otherwise provided in this paragraph (d)(3)(i), the partnership must attach a copy of the foreign partner's certificate, and the computation of the 1446 tax due with respect to such partner, to both the Form 8813 and Form 8805 filed with the IRS for any installment period or year for which such certificate is considered in computing the partnership's 1446 tax. See §1.1446–3(d)(1)(iii) requiring the partnership to furnish Form 8805 to the IRS and such foreign partner even if no 1446 tax is paid on behalf of the partner. The partnership must include in that computation the amount of state and local taxes described in paragraph (c)(1)(iii) of this section taken into account in computing the 1446 tax due with respect to that partner. The partnership must also attach a computation of the 1446 tax due with respect to a partner for whom only state and local taxes described in paragraph (c)(1)(iii) are taken into account. For an installment period other than the first installment period for which the partnership considers a foreign partner's certificate or updated certificate, the partnership may, instead of attaching any partner's certificate, attach to Form 8813 a list containing the name, TIN, the amount of certified deductions and losses, and the amount of state and lo-

cal taxes the partnership may consider under paragraph (c)(1)(iii) of this section for each foreign partner whose certificate was relied upon. For purposes of the preceding sentence, if the partnership is relying on a certificate received under paragraph (c)(1)(ii) of this section, instead of providing the amounts described in the prior sentence, it should attach a statement to Form 8813 which provides that, relying on that certificate, no 1446 tax is due with respect to that partner.

(ii) *Reasonable cause for failure to timely file a valid certificate and computation*. This paragraph (d)(3)(ii) provides the sole source of relief for a partnership that fails to timely file a valid certificate or attach a computation of 1446 tax as required under paragraph (d)(3)(i) of this section. To permit the partnership to reasonably rely on such certificate, the partnership shall be considered to have satisfied the requirements of paragraph (d)(3)(i) of this section if the partnership demonstrates to the Area Director, Field Examination, Small Business/Self-Employed or the Director, Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the partnership's return for the taxable year, that such failure was due to reasonable cause and not willful neglect and if once the partnership becomes aware of the failure, the partnership attaches the certificate and computation, as well as a written statement setting forth the reasons for the failure to comply with the requirements of paragraph (d)(3)(i) of this section, to an amended Form 8813 or amended Forms 8804 and 8805 for the relevant period.

(A) *Determining reasonable cause*. In determining whether the partnership has reasonable cause, the Director shall consider whether the partnership acted reasonably and in good faith considering all the facts and circumstances.

(B) *Notification*. If the IRS has notified, as provided in paragraph (c)(3) of this section, the partnership that the certificate is defective or that no foreign partner's certificate may be relied upon, as provided in paragraph (c)(5) of this section, the partnership will be deemed not to have acted reasonably and in good faith. Otherwise, the Director shall notify the partnership in writing within 120 days of the amended filing if it is determined that the failure to comply was not due to reasonable cause, or if additional time will be needed to make such determination. If the Director fails to notify the partnership within 120 days of the amended filing, the partnership shall be considered to have demonstrated to the Director that such failure was due to reasonable cause and not willful neglect.

(e) *Examples*. (1) The rules of this section are illustrated by the examples in paragraph (e)(2) of this section. Except as otherwise provided, in each example assume:

(i) Section 1.1446–3(b)(2)(v)(F) (relating to the *de minimis* exception to paying 1446 tax) does not apply;

(ii) Paragraph (c)(1)(ii) of this section (relating to a nonresident alien individual partner whose sole investment generating effectively connected income or gain is the partnership) does not apply;

(iii) All income and losses are ordinary;

(iv) For purposes of applying paragraph (c)(1)(i)(C) of this section, the percentage limitation under section 56(a)(4) and (d) is 90 percent;

(v) Any loss is not a passive activity loss within the meaning of section 469;

(vi) The partnership uses an acceptable annualization method under §1.1446–3;

(vii) NRA is a nonresident alien individual who maintains a calendar taxable year for U.S. tax purpose;

(viii) B and C are U.S. individuals who maintain a calendar taxable year; and

(ix) Any partnership maintains a calendar taxable year.

(2) The examples are as follows:

Example 1. Qualifying U.S. income tax return. (i) NRA and B form a partnership (PRS) in year 4 to conduct a trade or business in the United States. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. NRA submits a certificate to PRS (using Form 8804–C) on March 20, year 4, to be considered by PRS in determining its 1446 tax due with respect to NRA for the first installment period in the year 4. The Form 8804–C states that NRA reasonably expects to have an effectively connected net operating loss of $5,000 available to offset its allocable share of ECTI from PRS in year 4. Prior to year 4, NRA had not submitted a certificate to a partnership under this section. NRA filed (or will file) its year 1 U.S. income tax return on March 11, year 3; its year 2 U.S. income tax return on February 12, year 4; its year 3 U.S. income tax return on April 13, year 4; and its year 4 U.S. income tax return on May 14, year 5. NRA paid or (will pay) all amounts due with respect to the returns (including interest, penalties, and additions to tax, if any) by the date they are filed. NRA's years 1 though 3 U.S. income tax returns report income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities.

(ii) To be eligible to submit a certificate of deductions and losses to PRS under this section, NRA must satisfy the requirements of paragraph (b)(1) of this section. In accordance with §1.1446–1, NRA provided valid documentation to PRS to establish its status for purposes of section 1446. NRA's year 1 U.S. income tax return is a qualifying U.S. income tax return because it reported income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities and is described under paragraph (b)(2)(iii)(A) of this section. Although NRA filed its year 1 return after the due date of the return (determined under section 6072(c) without regard to any extension of time to file) the return was filed on March 11, year 3, which was on or before the earlier of June 15, year 3, the date one year after its section 6072(c) due date without regard to any extension of time to file, and March 20, year 4, the date on which NRA submitted the certificate to PRS. NRA's year 2 U.S. income tax return is a qualifying U.S. income tax return because it reported income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities and is described under paragraph (b)(2)(iii)(A) of this section. Although NRA filed its year 2 return after the due date of the return (determined under section 6072(c) without regard to any extension of time to file) the return was filed on February 12, year 4, which was on or before the earlier of June 15, year 4, the date one year after its section 6072(c) due date without regard to any extension of time to file, and March 20, year 4, the date on which NRA submitted the certificate to PRS. NRA's year 3 U.S. income tax return is a qualifying U.S. income tax return because it reported income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities and is described under paragraph (b)(2)(iii)(B) of this section. Because NRA filed its year 3 U.S. income tax return on April 13, year 4, the return will be considered timely-filed under paragraph (b)(2)(ii) of this section, as the due date under section 6072(c) was June 15, year 4. NRA's year 4 U.S. income tax return is a qualifying U.S. income tax return because it reported income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities and is described under paragraph (b)(2)(iii)(C) of this section. Because NRA filed its year 4 U.S. income tax return on May 14, year 5, the return will be considered timely-filed under paragraph (b)(2)(ii) of this section. Accordingly, NRA meets the conditions of paragraph (b)(1) of this section and is eligible to provide a certificate of deductions and losses to PRS for year 4.

Example 2. Subsequent year qualifying U.S. income tax return. (i) Assume the same facts as in *Example 1*. Further, NRA and C form a second partnership (XYZ) in year 7 to conduct a trade or business in the United States. NRA and C provide XYZ appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. NRA did not submit a certificate under this section to any partnership for years 5 and 6. NRA submits a certificate to XYZ (using Form 8804–C) on April 10, year 7, to be considered by XYZ in determining its 1446 tax due with respect to NRA for its first installment period in

year 7. The certificate states that NRA reasonably expects to have an effectively connected net operating loss of $8,000 available to offset its allocable share of ECTI from XYZ in year 7. Further, the certificate contains all of the necessary representations required under this section. NRA will file its U.S. income tax return for year 5 on March 25, year 7, (after its section 6072(c) due date and any extension of time to file that could have been granted under section 6081), its U.S. income tax return for year 6 on April 26, year 7; and its U.S. income tax return for year 7 on May 27, year 8. NRA will pay all amounts due with the returns (including interest, penalties, and additions to tax, if any) by the dates they are filed. NRA's years 5, 6, and 7 U.S. income tax returns will report income or gain that is effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities.

(ii) To be eligible to submit a certificate of deductions and losses to XYZ under this section, NRA must satisfy the requirements of paragraph (b)(1) of this section. NRA provided valid documentation to XYZ in accordance with §1.1446–1. As described in *Example 1*, NRA's year 4 U.S. income tax return is a qualifying U.S. income tax return because it will report income or gain effectively connected with a U.S. trade or business and is described under paragraph (b)(2)(iii)(C) of this section. Although NRA's year 5 U.S. income tax return reports income or gain effectively connected with a U.S. trade or business or deductions or losses properly allocated and apportioned to such activities it is not a qualifying U.S. income tax return under paragraph (b)(2)(iii) of this section. Because NRA submitted a certificate to PRS in year 4, to constitute a qualifying U.S. income tax return the year 5 U.S. income tax return must be timely-filed and all amounts due with such return must be timely paid. See paragraph (b)(2)(iii)(C) of this section. However, NRA will not file its U.S. income tax return for year 5 until March 25, year 7, (after its section 6072(c) due date and any extension of time to file that could have been granted under section 6081). Because the year 5 tax return is not a qualifying U.S. income tax return under paragraph (b)(2)(iii) of this section, NRA does not satisfy the requirements of paragraph (b)(1)(ii) of this section and, therefore, may not submit a certificate of deductions and losses to XYZ under this section in year 7.

Example 3. General application of the rules of this section. NRA and B form a partnership (PRS) to conduct a trade or business in the United States. NRA and B are equal partners under the partnership agreement. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. Prior to the formation of PRS, NRA had not invested in or engaged in the conduct of a U.S. trade or business. PRS incurs a $1,500 effectively connected net operating loss in years 1 and 2. The loss incurred in each is allocated equally between NRA and B. NRA has filed a qualifying U.S. income tax return (within the meaning of paragraph (b)(2)(iii) of this section) for years 1 and 2 that report its allocable share of effective connected net operating loss allocated to it from PRS, as reported on the Form 1065 (Schedule K–1) issued to NRA for each year.

(i) In year 3, NRA may not submit a certificate to PRS under paragraph (c) because it will not have filed qualifying U.S. income tax returns for the preceding three years. In year 3, PRS has ECTI of $1,000 that is allocated equally between NRA and B. PRS satisfies its 1446 tax obligation with respect to NRA for year 3.

(ii) In year 4, PRS estimates that it will have ECTI of $4,000, which will be allocated equally between NRA and B. On or before April 15th of year 4 (the first installment due date), NRA submits a certificate to PRS under this section (using Form 8804–C) certifying that it reasonably expects to have an effectively connected net operating loss of $1,000 ($750 loss in both years 1 and 2, less $500 of income in year 3) available to offset its allocable share of ECTI from PRS in year 4. As of the date the certificate is submitted, NRA has received the Form 1065 (Schedule K–1) from PRS for year 3 but has not yet filed its U.S. income tax return for year 3.

(iii) With respect to year 4, and based upon paragraph (b)(1) of this section, NRA can include year 3 (NRA's preceding taxable year) as one of the preceding three years that it has filed or will file qualifying U.S. income tax returns (within the meaning of paragraph (b)(2)(iii) of this section). Therefore, provided PRS has, in accordance with paragraph (a)(2) of this section, no actual knowledge or reason to know the certificate is defective, PRS may reasonably rely on NRA's certificate. Accordingly, PRS may consider NRA's certificate to reduce the 1446 tax that would otherwise be required to be paid on NRA's behalf. Specifically, subject to paragraph (c)(1)(i)(C) of this section, the $1,000 of net losses that have been reported on Forms 1065 (Schedule K–1) issued to NRA that are available to reduce NRA's U.S. income tax on NRA's allocable share of effectively connected income or gain allocable from PRS may be used to reduce the $2,000 of ECTI estimated to be allocable to NRA. As a result, PRS must pay 1446 tax on only $1,100 of NRA's allocable share of partnership ECTI for the first installment period in year 5 ($2,000 - ($1,000 x .90)). PRS must pay 1446 tax of $96.25 for its first installment period with respect to the ECTI allocable to NRA ($1,100 (net ECTI after considering certified losses) x .35 (withholding tax rate) x .25 (section 6655(e)(2)(B) percentage for the first installment period)). See §1.1446–3(b)(2). Pursuant to paragraph (d)(3) of this section, PRS must attach NRA's certificate and PRS's computation of its 1446 tax obligation with respect to NRA to its Form 8813, "*Partnership Withholding Tax Payment Voucher (Section 1446),*" filed for the first installment period. Under paragraph (c)(2)(ii)(B) of this section, NRA is required to provide an updated certificate on or before the 10th day after NRA files its U.S. income tax return for year 3, even if the updated certificate results in no change to the amount of deductions and losses reported on the superseded certificate.

(iv) The results are the same if NRA had not yet received a Form 1065 (Schedule K–1) from PRS for year 3. See paragraph (c)(1)(i)(A) of this section.

Example 4. Updated certificate submitted for losses. On January 1, year 8, NRA and B form a partnership (PRS) to conduct a trade or business in the United States. NRA and B are equal partners in PRS. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. During years 1 through 7 NRA held an interest in another partnership (XYZ) that conducted a trade or business in the United States. NRA timely-filed (within the meaning of paragraph (b)(2) of this section) U.S. income tax returns for years 1 through 6 reporting its allocable year of ECTI (or loss) from XYZ (and timely paid all tax shown on such returns). NRA files its U.S. income tax return for year 7 on June 9, year 8 (and timely pays all tax due with such return). Therefore, NRA has filed qualifying U.S. income tax returns (within the meaning of paragraph (b)(2)(iii) of this section) for years 1 through 7. During years 1 through 7, NRA's only investment generating effectively connected items was its interest in XYZ. The XYZ partnership liquidated and ceased doing business on December 31, year 7.

(i) On or before April 15, year 8, PRS receives from NRA a valid certificate under this section using Form 8804–C in which NRA certifies that it reasonably expects to have available effectively connected net operating losses in the amount of $5,000. Among other statements made in accordance with paragraph (c) of this section, NRA represents that it has not yet filed its year 7 U.S. income tax return, but will timely file such return (and timely pay all tax due with such return). For its first installment period in year 8, PRS estimates that it will earn taxable income of $10,000 for the year which will be allocated equally to NRA and B (NRA's allocable share of PRS's ECTI is $5,000).

(ii) Provided PRS has, in accordance with paragraph (a)(2) of this section, no actual knowledge or reason to know the certificate is defective, PRS may reasonably rely on NRA's certificate when computing its 1446 tax obligation for the first installment period. PRS is limited under paragraph (c)(1)(i)(C) of this section and PRS may only consider $4,500 ($5,000 x .90) of the certified net operating loss. After consideration of the certified loss, PRS owes 1446 tax in the amount of $43.75 for the first installment period ($5,000 estimated allocable ECTI less $4,500 (certified loss as limited under paragraph (c)(1)(i)(C)) x .35 (1446 tax applicable percentage) x .25 (section 6655(e)(2)(B) percentage for the first installment period)). See §1.1446–3(b)(2). Pursuant to paragraph (d)(3) of this section, PRS must attach a copy of NRA's certificate and the computation of 1446 tax due with respect to NRA to the Form 8813 filed with respect to NRA.

(iii) PRS's estimate of ECTI allocable to NRA for the second installment period remains unchanged from the first installment period. On June 10, year 8, NRA provides PRS an updated certificate reporting that NRA now reasonably expects to have an effectively connected net operating loss of $4,000 available to offset its allocable share of ECTI from PRS in year 4. NRA provided the updated certificate within 10 days of filing its U.S. income tax return for the year 7 taxable year, as required by paragraph (c)(2)(ii)(B) of this section. Provided the updated certificate is otherwise valid, PRS may rely on the updated certificate for the second installment period (due date June 15, year 8). Even if the updated certificate were not valid, PRS could no longer rely on the original certificate.

(iv) Under paragraph (d) of this section, PRS is not relieved from liability for the 1446 tax due with respect to NRA under section 1461 if it relies on a certificate determined to be defective, or if it receives an updated certificate reporting an amount of deductions and losses less than the amount reported on the superseded certificate. Under the principles of section

6655 (as applied through §1.1446–3), PRS is required to have paid 50-percent of the annualized 1446 tax due with respect to NRA on or before the due date of the second installment period (section 6655(e)(2)(B) percentage for the second installment period). Under paragraph (c)(2)(ii)(B) of this section, because NRA's updated certificate is valid for the second installment period, if PRS considers a certificate for that period it must consider the updated certificate. Under paragraph (c)(1)(i)(C) of this section, PRS can only consider $3,600 ($4,000 x .90) of NRA's updated effectively connected net operating loss. Assuming PRS considers NRA's updated certificate for the second installment period, PRS must have paid a total of $245 of 1446 tax with respect to the ECTI estimated to be allocable to NRA as of the second installment due date ($1,400 ($5,000 ECTI less $3,600 net operating loss deduction) x .35 (withholding tax rate) x .50 (section 6655(e)(2)(B) percentage for the second installment period)). After considering PRS's payment of 1446 tax for the first installment period, PRS is required to pay $201.25 for the second installment period ($245 less previous payment of $43.75). See §1.1446–3(b)(2). Further, if PRS considers NRA's updated certificate for the second installment period, when PRS files Form 8813 it must attach the updated certificate along with PRS's computation of 1446 tax due with respect to NRA.

(v) Under paragraph (d) of this section, PRS is not liable for the addition to the tax under section 6655 (as applied through §1.1446–3) for the first installment period because PRS reasonably relied on NRA's certificate of losses for that period.

(vi) Assume that PRS's estimate of its ECTI allocable to NRA for the third and fourth installment periods is the same as for the first and second installment periods. Assume PRS may reasonably rely on NRA's updated certificate in calculating its payment of 1446 tax for the third and fourth installment periods. The third installment of 1446 tax would be $122.50 (($5,000 - $3,600) x .35 x .75 = $367.50 - $245 (total previous payments)). The fourth installment of 1446 tax would be $122.50 (($5,000-$3,600) x .35 x 1.00 = $490 - $367.50 (total previous payments)). See §1.1446–3(b)(2). PRS must attach to each Form 8813 a computation of the 1446 tax due with respect to NRA that takes into account the amount of effectively connected net operating loss reported on NRA's updated certificate.

(vii) Because NRA's certified net operating loss has not changed for the third and fourth installments, in lieu of attaching NRA's certificate, PRS may attach a statement containing NRA's name, TIN, and the certified net operating loss amount. However, PRS must attach NRA's certificate and a computation of the 1446 tax due with respect to NRA that takes into account NRA's certified net operating loss to the Form 8805 filed with respect to NRA. See paragraph (d)(3) of this section.

Example 5. IRS determines in subsequent taxable year that partner's certificate is defective because partner failed to timely file a U.S. income tax return. NRA and B form a partnership (PRS) in year 1 to conduct a trade or business in the United States. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. In year 4, NRA timely submits a certificate under this section (using Form 8804–C) to be considered by PRS for its first installment period. The certificate reports that NRA reasonably expects to have an effectively connected net operating loss of $5,000 available to offset its allocable share of ECTI from PRS in year 4. Further, the certificate contains all of the necessary representations required under this section. PRS estimates for each installment period that NRA's allocable share of ECTI will be $5,000 for the taxable year. PRS's actual operating results for the year result in $5,000 of ECTI allocable to NRA.

(i) PRS reasonably relies on (within the meaning of paragraph (a)(2) of this section) NRA's certificate when computing each installment payment during year 4 and the 1446 tax due on Form 8804 and appropriately considers the limitation in paragraph (c)(1)(i)(C) of this section. As a result, PRS paid $175 of 1446 tax on behalf of NRA for the taxable year ($5,000 of ECTI less $4,500 net operating loss deduction x .35 applicable percentage). As required under paragraph (d) of this section, PRS attached the certificate to the Form 8813 for the first installment period and the Form 8805 for year 4. Because NRA did not submit an updated certificate to PRS in year 4, PRS attached to the Forms 8813 for the second, third and fourth installment periods a statement containing NRA's name, TIN, and the certified net operating loss as well as the computation of 1446 tax due with respect to NRA reflecting the amount of net operating loss considered.

(ii) In year 5, NRA timely submits to PRS a certificate under this section to be considered for the first installment period. The certificate represents that NRA reasonably expects to have an effectively connected net operating loss of $5,000 available to offset its allocable share of ECTI from PRS in year 5. For the first installment period, PRS estimates that NRA's allocable share of partnership ECTI is $5,000. PRS reasonably relies on the certificate for the first installment period and determines that it is required to make a 1446 tax installment payment of $43.75 ($5,000 allocable ECTI less $4,500 (certified net operating loss as limited under paragraph (c)(1)(i)(C) of this section) x .35 (1446 tax applicable percentage) x .25 (section 6655(e)(2)(B) percentage for the first installment period)). See §1.1446–3(b)(2). PRS makes the installment payment with the Form 8813 filed for the first installment period, and complies with paragraph (d)(3) of this section by attaching NRA's certificate and the computation of 1446 tax due with respect to NRA to the Form 8813.

(iii) The IRS provides written notification to PRS on June 1, year 5, (pursuant to paragraph (c)(3) of this section) that the certificate received from NRA in year 4 is defective because NRA failed to file a qualifying U.S. income tax return (within the meaning of paragraph (b)(2)(iii) of this section) for one of the preceding taxable years as required under paragraph (b)(1) of this section. The notice further states that PRS is not to rely on any certificate received from NRA in year 5.

(iv) Under paragraph (d)(2)(ii) of this section, because the certificate submitted by NRA in year was determined to be defective for a reason other than the amount or character of the certified deductions and losses, under section 1461 PRS is fully liable for the 1446 tax due with respect to NRA's allocable share of ECTI year 4 without regard to the certificate. The total 1446 tax due for year 4 without regard to the certificate is $1,750 ($5,000 ECTI x .35) and PRS paid $175 of 1446 tax in year 4. Therefore, PRS owes $1,575 of 1446 tax. However, PRS may be deemed to have paid the outstanding 1446 tax due if NRA paid all of its U.S. tax due in year 4. See §1.1446–3(e).

(v) However, because PRS did not have actual knowledge or reason to know that the certificate NRA submitted in year 4 was defective, PRS reasonably relied on the certificate for purposes of paragraph (d)(2) of this section. Therefore, PRS is not liable for an addition to the tax with respect to its underpayment of 1446 tax under the principles of section 6655 (as applied through §1.1446–3) for any installment period in year 4.

(vi) However, PRS is generally liable for interest under section 6601 and for the failure to pay addition to tax under section 6651(a)(2) on the $1,575 of 1446 tax due for year 4 for the period from April 15, year 5 (last date prescribed for payment of 1446 tax) to the date PRS pays the 1446 tax or is deemed to have paid the 1446 tax under §1.1446–3(e).

(vii) With respect to the year 5, PRS reasonably relied on NRA's certificate when computing its first installment payment (due on April 15, year 5). Therefore, in accordance with paragraph (d)(2)(i) of this section, PRS will not be liable for an addition to the tax under the principles of section 6655 (as applied through §1.1446–3) for the first installment period. However, because the IRS provided written notification to PRS on June 1, year 5, to disregard any certificate received from NRA for year 5, PRS may not rely on any certificate received from NRA certificate (or any new certificate provided by NRA) when it computes its second installment payment in year 5. PRS is not permitted to consider any certificate submitted by NRA until the IRS provides written notification to PRS revoking or modifying the original notice. PRS's second installment payment in year 5 must include the additional amount of 1446 tax it would have paid for the first installment period without regard to the certificate received from NRA.

Example 6. IRS determines in subsequent taxable year that partner's certificate is defective because partner's actual losses are less than amount certified and considered by the partnership. Assume the same facts as in *Example 5*, except that the IRS determines that NRA's certificate submitted in year 4 is defective because the actual effectively connected net operating loss available to NRA for year 4 was $1,000 rather than the $5,000 certified.

(i) Under paragraph (d)(2)(ii) of this section, PRS is not relieved from its liability for 1446 tax under section 1461 when it relies on a certificate of losses from a foreign partner that is later determined to be defective. However, when the IRS determines that a partner's certificate is defective because of the amount of the certified deductions and losses, the partnership is liable for the 1446 tax, interest, additions to tax, and penalties to the extent the amount of certified deductions and losses taken into account when computing 1446 tax (or, unless there was reasonable reliance on the certificate, any installment of such tax) is greater than the actual amount of available deductions and losses. Here, PRS considered the certified deductions and losses in the amount of $4,500. The IRS subsequently determined that NRA only had $1,000 of actual losses, only $900 of which were permitted to be considered under paragraph (c)(1)(i)(C) of this section. Accordingly, PRS is liable for the 1446 tax due with respect to

the portion of the overstated losses that it considered when computing its 1446 tax. The remaining 1446 tax due for year 4 is $1,260 ($3,600 ($4,500 less $900) of excess losses considered x .35). However, PRS may be deemed to have paid the $1,260 of 1446 tax under §1.1446–3(e) if NRA has paid all of NRA's U.S. income tax.

(ii) If PRS had considered only $900 (or a lesser amount) of NRA's certified net operating loss when computing and paying its 1446 tax during year 4 then, under paragraph (d)(2)(iii) of this section, PRS would not be liable for 1446 tax because it did not consider a net operating loss greater than the amount actually available to NRA.

Example 7. Partner with different taxable year than partnership. PRS partnership has two equal partners, FC, a foreign corporation, and DC, a domestic corporation. PRS conducts a trade or business in the United States and generates effectively connected income. FC maintains a June 30 fiscal taxable year end, while DC and PRS maintain a calendar taxable year end. FC and DC provide a valid Form W–8BEN and Form W–9, respectively, to PRS. FC and DC are the only persons that have ever been partners in PRS. For its year 1 through year 3 taxable years, PRS issued Forms 1065 (Schedule K–1) reporting in the aggregate $100 of net loss to each partner. For its year 4 taxable year, PRS issued Forms 1065 (Schedule K–1) to its partners reporting $150 of loss to each partner. All of the losses reported on the Forms 1065 (Schedule K–1) are effectively connected to PRS's and FC's trade or business in the United States.

(i) Assume that FC submits a valid certificate under this section certifying losses to the partnership for the partnership's year 5 taxable year. Further, assume that FC's only source of effectively connected income, gain, deduction, or loss is the activity of PRS.

(ii) For PRS's first installment period in year 5, FC may only certify deductions and losses under this section in the amount of $100 (the losses as reported on the Forms 1065 (Schedule K–1) issued for PRS's year 1 through 3 taxable years). Under section 706, the taxable income of a partner shall include the income, gain, loss, deduction, or credit of the partnership for the partnership taxable year ending within or with the taxable year of the partner. PRS's year 4 calendar taxable year ends during FC's fiscal taxable year ending June 30, year 5. Therefore, under paragraph (c)(1) of this section, as of April 15, year 5 (the last date FC may submit its first certificate under paragraph (c) of this section to have it considered for PRS's first installment due date of April 15, year 5), FC's allocable share of the PRS losses for years 1 through 3 are the only losses that FC can represent have been or will be reported on an FC U.S. income tax return filed for a taxable year ending prior to such installment due date.

(iii) The result in paragraph (ii) of this *Example 7* is the same for the year 5 second installment period, the due date of which is June 15, year 5.

(iv) FC may submit an updated certificate under this section after June 30, year 5, which includes the $150 loss for year 4. PRS may consider such an updated certificate for its third installment period (due date September 15, year 5), provided the updated certificate is received by the due date for such installment in accordance with paragraph (c) of this section.

Example 8. Failure to provide status update with respect to prior year unfiled returns. FC, a foreign corporation, and DC, a domestic corporation, form a partnership (PRS) to conduct a trade or business in the United States. FC and DC provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. FC and DC are equal partners in PRS, and all partnership items are allocated equally between FC and DC.

(i) In the current taxable year FC submits a certificate under this section using Form 8804–C prior to PRS's first installment due date. FC represents that it has filed or will file a qualifying U.S. income tax return (within the meaning of paragraph (b)(2)(iii) of this section) in each of the preceding three taxable years. FC specifies that it has not filed its U.S. income tax return for the immediately preceding taxable year. FC also represents that it will timely file its U.S. income tax return for the partnership taxable year during which the certificate is considered (and will timely pay all tax due with such return). Assume all other requirements under paragraph (c) of this section are met for FC's certificate to be valid.

(ii) Provided that PRS does not possess actual knowledge or reason to know that FC's certificate is defective under paragraph (a)(2) of this section, PRS may reasonably rely on FC's certificate for its first, second, and third installment payments.

(iii) If FC does not submit to PRS either an updated certificate or a status update as required by paragraph (c)(2)(ii)(B)(*1*) of this section by December 15th (PRS's final installment due date), PRS must disregard FC's certificate when computing its fourth installment payment of 1446 tax and when completing its Form 8804 for the taxable year. PRS's payment of 1446 tax for its fourth installment period must include the additional amount of 1446 tax it would have paid in the first, second and third installment periods had it not considered FC's certificate. Further, even if the status update is provided by December 15th, PRS may only rely on the certificate if the status update does not contradict the original certificate and such update indicates that the immediately preceding year's return will be timely filed. Finally, even if the status update is provided by December 15th, FC must also submit an updated certificate to the partnership in accordance with paragraph (c) of this section within 10 days of the date FC timely files its U.S. income tax return for the preceding taxable year.

Example 9. Partnership consideration of certified deductions and losses or de minimis certificate. For purposes of this example assume paragraph (c)(1)(ii) of this section may apply. On January 1, year 4, NRA and B form a partnership (PRS) to conduct a trade or business in the United States. NRA and B are equal partners in PRS and all partnership items are shared equally. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. During years 1 through 3, NRA's only activity generating effectively connected items was an interest in partnership XYZ. XYZ allocated NRA a loss for all three years. NRA filed qualifying U.S. income tax returns (within the meaning of paragraph (b)(2)(iii) of this section) reporting its allocable share of losses from XYZ in years 1 through 3. The XYZ partnership dissolved on December 31, year 3.

(i) In year 4, NRA's only activity giving rise to effectively connected income, gain, deduction, or loss is its interest in PRS. NRA submits to PRS a valid certificate (using Form 8804–C) certifying under paragraph (c)(1)(i) its effectively connected net operating losses from years 1 through 3 and under (c)(1)(ii) of this section that its only activity giving rise to effectively connected income, gain, deduction, or loss for the PRS taxable year that ends with or within its taxable year is (and will be) its investment in PRS.

(ii) During year 4, PRS allocates ECTI to NRA. If the 1446 tax otherwise due on the annualized amount allocated to NRA is less than $1,000, determined without regard to any deductions and losses certified by NRA under paragraph (c)(1)(i) of this section, PRS may consider the certificate received from NRA under paragraph (c)(1)(ii) of this section and not pay 1446 tax (or any installment of such tax) with respect to NRA. Alternatively, PRS may consider the deductions and losses certified by NRA under paragraph (c)(1)(i) of this section.

(iii) Regardless of whether PRS considers NRA's certification under paragraph (c)(1)(i) or (c)(1)(ii) of this section in computing its 1446 tax due with respect to NRA, PRS must file Form 8813 for all installment periods as well as a Form 8805 for NRA with its Form 8804. If PRS considers NRA's certification under paragraph (c)(1)(i) or (c)(1)(ii) of this section, PRS must attach to each Form 8813, as well as to the Form 8805, a computation of the 1446 tax with respect to NRA that takes into account its consideration of NRA's certificate. In addition, PRS must attach NRA's certificate to the Form 8813 for the first installment period it considers the certificate, as well as to the Form 8805. For all subsequent installment periods, PRS may attach a statement containing NRA's name, and TIN. If PRS is relying on NRA's certified losses under paragraph (c)(1)(i) of this section, the statement must indicate the amount of losses and deductions NRA certified. If PRS is relying on NRA's certification under paragraph (c)(ii) of this section, the statement must indicate that it is relying on NRA meeting the requirements under paragraph (c)(1)(ii) of this section and the 1446 tax on the annualized amount allocated to NRA is less than $1,000. See paragraph (d)(3)(i) of this section.

Example 10. Application of transition rule. NRA and B form a partnership (PRS) on January 1, 2004, to conduct a trade or business in the United States. NRA and B are equal partners in PRS and all partnership items are shared equally. NRA and B provide PRS appropriate documentation under §1.1446–1 to establish their status for purposes of section 1446. For its 2004 through 2007 tax years, PRS issued Forms 1065 (Schedule K–1) to NRA and B reporting a $1,000 net loss from its U.S. trade or business to each partner for each year (for an aggregate loss of $4,000 per partner). During the 2004 through 2007 tax years, NRA's only activity generating effectively connected items was its investment in PRS.

(i) On February 10, 2008, NRA submitted a certificate to PRS, reporting its aggregate $4,000 effectively connected loss to PRS, that met the requirements of §1.1446–6T(c) (See 26 CFR Part 1, revised as of April 1, 2007), as in effect before January 1, 2008. The certificate stated that NRA had timely filed its U.S. income tax returns for the 2004, 2005 and 2006 tax years, and that it would timely file a U.S. income tax return for its 2007 tax year. For the first and second installments period in 2008, PRS estimates that it will earn ECTI of $10,000.

(ii) Because the certificate submitted by NRA to PRS on February 10, 2008, met the requirements of

§1.1446–6T (See 26 CFR Part 1, revised as of April 1, 2007), as in effect before January 1, 2008, PRS may consider such certificate when computing its 1446 tax due for the first and second installment period even if the certificate does not meet all the requirements of paragraph (c) of this section.

(iii) NRA timely files its U.S. income tax return for the 2007 tax year on July 24, 2008. In accordance with paragraph (c)(2)(ii)(B)(*1*) of this section, within 10 days of filing such return NRA prepares an updated certificate to be submitted to PRS certifying that it reasonably expects to have only $3,500 of losses available to reduce its allocable share of ECTI from PRS. Because the updated certificate will be submitted after July 28, 2008, to be valid the updated certificate must meet the requirements of paragraph (c) this section.

(f) *Effective/Applicability date*. Except as otherwise provided in this paragraph (f), the rules of this section are applicable for partnership taxable years beginning after December 31, 2007. The rules of paragraphs (b)(3)(i)(B) through (D) shall apply to partnership taxable years beginning after July 28, 2008.

(g) *Transition rule*. A certificate that met the requirements of §1.1446–6T(c) (See 26 CFR Part 1, revised as of April 1, 2007), as in effect before January 1, 2008, submitted on or before July 28, 2008 by a partner that met the requirements of §1.1446–6T(b) (See 26 CFR Part 1, revised as of April 1, 2007), as in effect before January 1, 2008, shall not be considered defective because it does not meet the requirements of this section. However, any certificate (including any updated certificates and status updates) submitted, or required to be submitted, under paragraph (c) of this section after July 28, 2008, must meet the requirements of this section. See paragraph (e)(2) *Example 10* of this section.

Par. 8. In §1.1446–7, the section heading is revised and two new sentences are added at the end of the paragraph to read as follows:

§1.1446–7 Effective/Applicability date.

* * * The revisions to §§1.1446–3(b)(2), 1.1446–3(b)(3)(i)(A) and 1.1446–5(c)(2) contained in the final regulations published in 2008 apply to partnership taxable years beginning after December 31, 2007. See §1.1446–6(f) and (g) for the Effective/Applicability date and Transition rule for §1.1446–6.

Par. 9. In §1.1464–1, paragraph (a) is amended by adding one sentence at the end of the paragraph and new paragraph (c) is added to read as follows:

§1.1464–1 Refunds or credits.

(a) * * * With respect to section 1446, this section shall only apply to a publicly traded partnership described in §1.1446–4.

* * * * *

(c) *Effective/Applicability date*. The last two sentences in paragraph (a) of this section shall apply to partnership taxable years beginning after April 29, 2008.

Par. 10. In §1.6071–1, paragraph (c)(15) is revised and paragraph (d) is added to read as follows:

§1.6071–1 Time for filing returns and other documents.

* * * * *

(c) * * *

(15) For provisions relating to the time for filing an annual information return on Form 1042–S, *"Foreign Person's U.S. Source Income Subject to Withholding,"* or Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax,"* for any tax withheld under chapter 3 of the Internal Revenue Code (relating to withholding of tax on nonresident aliens and foreign corporations and tax-free covenant bonds), see §1.1461–1(c) and §1.1446–3(d).

* * * * *

(d) *Effective/Applicability date*. The references to Form 8805 and §1.1446–3(d) in paragraph (c)(15) of this section shall apply to partnership taxable years beginning after April 29, 2008.

Par. 11. In §1.6091–1, paragraph (b)(17) and paragraph (c) are added to read as follows:

§1.6091–1 Place for filing returns or other documents.

* * * * *

(b) * * *

(17) For the place for filing information returns on Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax,"* with respect to certain amounts paid on behalf of foreign partners, see the instructions to the form.

(c) *Effective/Applicability date*. Paragraph (b)(17) of this section shall apply to partnership taxable years beginning after April 29, 2008.

Par. 12. In §1.6151–1, paragraph (d)(2) is amended by adding one sentence at the end of the paragraph and paragraph (e) is added to read as follows:

§1.6151–1 Time and place for paying tax shown on returns.

* * * * *

(d) * * *

(2) * * * With respect to section 1446, the previous sentence shall apply only to a publicly traded partnership described in §1.1446–4.

(e) *Effective/Applicability date*. Paragraph (d)(2) of this section shall apply to publicly traded partnerships described in §1.1446–4 for partnership taxable years beginning after April 29, 2008.

Par. 13. In §1.6302–2, paragraphs (a)(1)(i), (a)(2) and (g) are revised to read as follows:

§1.6302–2 Use of Government depositaries for payment of tax withheld on nonresident aliens and foreign corporations.

(a) * * * (1) * * *

(i) *Monthly deposits*. Except as provided in paragraphs (a)(1)(ii) and (iv) of this section, every withholding agent who, pursuant to chapter 3 of the Internal Revenue Code, has accumulated at the close of any calendar month beginning on or after January 1, 1973, an aggregate amount of undeposited taxes of $200 or more shall deposit such aggregate amount with an authorized financial institution (see paragraph (b)(1)(ii) of this section) within 15 days after the close of such calendar month. However, the preceding sentence shall not apply if the withholding agent has made a deposit of taxes pursuant to paragraph (a)(1)(ii) of this section with respect to a quarter monthly period which occurred during such month. With respect to section 1446, this section shall only apply to a publicly traded partnership described in §1.1446–4.

* * * * *

(2) *Cross reference*. For rules relating to the adjustment of deposits, see §§1.1461–2(b) and 1.6414–1. For rules requiring payment of any undeposited tax, see §1.1461–1.

* * * * *

(g) *Effective/Applicability date*. Except as otherwise provided, this section shall apply to tax required to be withheld under chapter 3 of the Internal Revenue Code after 1966. The last sentence of paragraph (a)(1)(i) of this section shall apply to partnership taxable years beginning after April 29, 2008.

Par. 14. Section 1.6414–1 is amended by:

1. Adding two sentences at the end of paragraph (a)(2).

2. Revising the third sentence of paragraph (b).

3. Adding paragraph (d).

The additions and revision read as follows:

§1.6414–1 Credit or refund of tax withheld on nonresident aliens and foreign corporations.

(a) * * *

(2) * * * With respect to the payment of withholding tax under section 1446, this section shall only apply to a publicly traded partnership described in §1.1446–4. See §1.1446–3(d)(2)(iv) for rules regarding refunds to a withholding agent under section 1446.

(b) * * * The amount claimed as a credit may be applied, to the extent it has not been applied under §1.1461–2(b), by the withholding agent to reduce the amount of a payment or deposit of tax required by §1.1461–1 or §1.6302–2(a) for any payment period occurring in the calendar year following the calendar year of overwithholding. * * *

* * * * *

(d) *Effective/Applicability date*. The last two sentences of paragraph (a) of this section shall apply to partnership taxable years beginning after April 29, 2008.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 15. The authority for 26 CFR part 301 continues to read in part as follows:

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

Par. 16. In §301.6402–3, the second and third sentences of paragraph (e) are revised and paragraph (f) is added to read as follows:

§301.6402–3 Special rules applicable to income tax.

* * * * *

(e) * * * Also, if the overpayment of tax resulted from the withholding of tax at source under chapter 3 of the Internal Revenue Code, a copy of the Form 1042–S, *"Foreign Person's U.S. Source Income Subject to Withholding,"* Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax,"* or other statement (see §1.1446–3(d)(2) of this chapter) required to be provided to the beneficial owner or partner pursuant to §1.1461–1(c)(1)(i) or §1.1446–3(d) of this chapter must be attached to the return. For purposes of claiming a refund, the Form 1042–S, Form 8805, or other statement must include the taxpayer identification number of the beneficial owner or partner even if not otherwise required. * * *

(f) *Effective/Applicability date*. References in paragraph (e) of this section to Form 8805 or other statements required under §1.1446–3(d)(2) shall apply to partnership taxable years beginning after April 29, 2008.

Par. 17. In §301.6722–1, paragraph (d)(3) is revised and paragraph (e) is added to read as follows:

§301.6722–1 Failure to furnish correct payee statements.

* * * * *

(d) * * *

(3) *Other items*. The term *payee statement* also includes any form, statement, or schedule required to be furnished to the recipient of any amount from which tax is required to be deducted and withheld under chapter 3 of the Internal Revenue Code (or from which tax would be required to be so deducted and withheld but for an exemption under the Internal Revenue Code or any treaty obligation of the United States) (generally the recipient copy of Form 1042–S, *"Foreign Person's U.S. Source Income Subject to Withholding,"* or Form 8805, *"Foreign Partner's Information Statement of Section 1446 Withholding Tax.")*

(e) *Effective/Applicability date*. The reference in paragraph (d)(3) of this section to Form 8805 shall apply to partnership taxable years beginning after April 29, 2008.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 18. The authority citation for part 602 continues to read as follows:

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

Par. 19. In §602.101, paragraph (b) is amended by removing the entry for §1.1446–6T from the table, adding an entry for §1.1446–6, and revising the entries to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1446–1	1545–1934
1.1446–3	1545–1934
1.1446–4	1545–1934
1.1446–5	1545–1934
1.1446–6	1545–1934
* * * * *	

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Eric Solomon,
Assistant Secretary of the Treasury.

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Approved April 23, 2008.

Part III. Administrative, Procedural, and Miscellaneous

Credit for Renewable Electricity Production, Refined Coal Production, and Indian Coal Production, and Publication of Inflation Adjustment Factors and Reference Prices for Calendar Year 2008

Notice 2008–48

This notice publishes the inflation adjustment factors and reference prices for calendar year 2008 for the renewable electricity production credit, the refined coal production credit, and the Indian coal production credit under § 45 of the Internal Revenue Code. The 2008 inflation adjustment factors and reference prices are used in determining the availability of the credits. The 2008 inflation adjustment factors and reference prices apply to calendar year 2008 sales of kilowatt-hours of electricity produced in the United States or a possession thereof from qualified energy resources and to calendar year 2008 sales of refined coal and Indian coal produced in the United States or a possession thereof.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under § 45(a) is reduced by an amount which bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents, bears to (B) 3 cents. Under § 45(b)(2), the 1.5 cent amount in § 45(a), the 8 cent amount in § 45(b)(1), the $4.375 amount in § 45(e)(8)(A), and in § 45(e)(8)(B)(i) the reference price of fuel used as feedstock (within the meaning of § 45(c)(7)(A)) in 2002 are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, the amount is rounded to the nearest multiple of 0.1 cent.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production.

Section 45(d)(1) defines a qualified facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1993, and before January 1, 2009. See § 45(e)(7) for rules relating to the inapplicability of the credit to electricity sold to utilities under certain contracts.

Section 45(d)(2)(A) defines a qualified facility using closed-loop biomass to produce electricity as any facility (i) owned by the taxpayer that is originally placed in service after December 31, 1992, and before January 1, 2009, or (ii) owned by the taxpayer which before January 1, 2009, is originally placed in service and modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation as described in 65 Fed. Reg. 63052. Section 45(d)(2)(B) provides that in the case of a qualified facility described in § 45(d)(2)(A)(ii), (i) the 10-year period referred to in § 45(a) is treated as beginning no earlier than the date of enactment of § 45(d)(2)(B)(i); (ii) the amount of the credit determined under § 45(a) with respect to the facility is an amount equal to the amount determined without regard to § 45(d)(2)(B)(ii) multiplied by the ratio of the thermal content of the closed-loop biomass used in the facility to the thermal content of all fuels used in the facility; and (iii) if the owner of the facility is not the producer of the electricity, the person eligible for the credit allowable under § 45(a) is the lessee or the operator of the facility.

Section 45(d)(3)(A) defines a qualified facility using open-loop biomass to produce electricity as any facility owned by the taxpayer which (i) in the case of a facility using agricultural livestock waste nutrients, (I) is originally placed in service after the date of enactment of § 45(d)(3)(A)(i)(I) and before January 1, 2009, and (II) the nameplate capacity rating of which is not less than 150 kilowatts; and (ii) in the case of any other facility, is originally placed in service before January 1, 2009. In the case of any facility described in § 45(d)(3)(A), if the owner of the facility is not the producer of the electricity, § 45(d)(3)(B) provides that the person eligible for the credit allowable under § 45(a) is the lessee or the operator of the facility.

Section 45(d)(4) defines a qualified facility using geothermal or solar energy to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of § 45(d)(4) and before January 1, 2009 (January 1, 2006, in the case of a facility using solar energy). A qualified facility using geothermal or solar energy does not include any property described in § 48(a)(3) the basis of which is taken into account by the taxpayer for purposes of determining the energy credit under § 48.

Section 45(d)(5) defines a qualified facility using small irrigation power to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of § 45(d)(5) and before January 1, 2009.

Section 45(d)(6) defines a qualified facility using gas derived from the biodegradation of municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of § 45(d)(6) and before January 1, 2009.

Section 45(d)(7) defines a qualified facility that burns municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of enactment of § 45(d)(7) and before January 1, 2009. A qualified facility burning municipal solid waste includes a new unit placed in service in connection with a facility placed in service on or before the date of enactment of § 45(d)(7), but only to the extent of the in-

creased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(8) provides in the case of a facility that produces refined coal, the term "refined coal production facility" means a facility which is placed in service after the date of enactment of § 45(d)(8) and before January 1, 2009.

Section 45(d)(9) defines a qualified facility producing qualified hydroelectric production described in § 45(c)(8) as (A) any facility producing incremental hydropower production, but only to the extent of its incremental hydropower production attributable to efficiency improvements or additions to capacity described in § 45(c)(8)(B) placed in service after the date of enactment of § 45(d)(9) and before January 1, 2009, and (B) any other facility placed in service after the date of enactment of § 45(d)(9) and before January 1, 2009. Section 45(d)(9)(C) provides that in the case of a qualified facility described in § 45(d)(9)(A), the 10-year period referred to in § 45(a) is treated as beginning on the date the efficiency improvements or additions to capacity are placed in service.

Section 45(d)(10) provides in the case of a facility that produces Indian coal, the term "Indian coal production facility" means a facility which is placed in service before January 1, 2009.

Section 45(e)(8)(A) provides that the refined coal production credit is an amount equal to $4.375 per ton of qualified refined coal (i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and (ii) sold by the taxpayer (I) to an unrelated person and (II) during the 10-year period and the tax year. Section 45(e)(8)(B) provides that the amount of credit determined under § 45(e)(8)(A) is reduced by an amount which bears the same ratio to the amount of the increase as (i) the amount by which the reference price of fuel used as feedstock (within the meaning of § 45(c)(7)(A)) for the calendar year in which the sale occurs exceeds an amount equal to 1.7 multiplied by the reference price for such fuel in 2002, bears to (ii) $8.75.

Section 45(e)(10)(A) provides in the case of a producer of Indian coal, the credit determined under section 45 for any taxable year shall be increased by an amount equal to the applicable dollar amount per ton of Indian coal (i) produced by the taxpayer at an Indian coal production facility during the 7-year period beginning on January 1, 2006, and (ii) sold by the taxpayer (I) to an unrelated person, and (II) during such 7-year period and such taxable year.

Section 45(e)(10)(B)(i) defines "applicable dollar amount" for any taxable year as (I) $1.50 in the case of calendar years 2006 through 2009, and (II) $2.00 in the case of calendar years beginning after 2009.

Section 45(e)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factor and the reference price for the calendar year. The inflation adjustment factors and the reference prices for the 2008 calendar year were published in the Federal Register on April 30, 2008 (73 Fed. Reg. 23525).

Section 45(e)(2)(B) defines the inflation adjustment factor for a calendar year as the fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Section 45(e)(2)(C) provides that the reference price is the Secretary's determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United States. Only contracts entered into after December 31, 1989, are taken into account.

Under § 45(e)(8)(C), the determination of the reference price for fuel used as feedstock within the meaning of § 45(c)(7)(A) is made according to rules similar to the rules under § 45(e)(2)(C).

Under section 45(e)(10)(B)(ii), in the case of any calendar year after 2006, each of the dollar amounts under section 45(e)(10)(B)(i) shall be equal to the product of such dollar amount and the inflation adjustment factor determined under section 45(e)(2)(B) for the calendar year, except that section 45(e)(2)(B) shall be applied by substituting 2005 for 1992.

INFLATION ADJUSTMENT FACTORS AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2008 for qualified energy resources and refined coal is 1.3854. The inflation adjustment factor for Indian coal is 1.0591. The reference price for calendar year 2008 for facilities producing electricity from wind (based upon information provided by the Department of Energy) is 3.60 cents per kilowatt hour. The reference prices for fuel used as feedstock within the meaning of § 45(c)(7)(A), relating to refined coal production (based upon information provided by the Department of Energy) are $31.90 per ton for calendar year 2002 and $45.56 per ton for calendar year 2008. The reference prices for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production have not been determined for calendar year 2008. The IRS is exploring methods of determining those reference prices for calendar year 2009.

PHASE-OUT CALCULATION

Because the 2008 reference price for electricity produced from wind does not exceed 8 cents multiplied by the inflation adjustment factor, the phaseout of the credit provided in § 45(b)(1) does not apply to such electricity sold during calendar year 2008. Because the 2008 reference price of fuel used as feedstock for refined coal does not exceed the $31.90 reference price of such fuel in 2002 multiplied by the inflation adjustment factor and 1.7, the phaseout of credit provided in § 45(e)(8)(B) does not apply to refined coal sold during calendar year 2008. Further, for electricity produced from closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower production, the phaseout of credit provided in § 45(b)(1) does not apply to such electricity sold during calendar year 2008.

CREDIT AMOUNT BY QUALIFIED ENERGY RESOURCE AND FACILITY, REFINED COAL, AND INDIAN COAL

As required by § 45(b)(2), the 1.5 cent amount in § 45(a)(1), the 8 cent amount in § 45(b)(1), and the $4.375 amount in § 45(e)(8)(A) are each adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, such amount is rounded to the nearest multiple of 0.1 cent. In the case of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities, and qualified hydropower facilities, § 45(b)(4)(A) requires the amount in effect under § 45(a)(1) (before rounding to the nearest 0.1 cent) to be reduced by one-half. Under the calculation required by § 45(b)(2), the credit for renewable electricity production for calendar year 2008 under § 45(a) is 2.1 cents per kilowatt hour on the sale of electricity produced from the qualified energy resources of wind, closed-loop biomass, geothermal energy, and solar energy, and 1.0 cent per kilowatt hour on the sale of electricity produced in open-loop biomass facilities, small irrigation power facilities, landfill gas facilities, trash combustion facilities, and qualified hydropower facilities. Under the calculation required by § 45(b)(2), the credit for refined coal production for calendar year 2008 under section 45(e)(8)(A) is $6.061 per ton on the sale of qualified refined coal. The credit for Indian coal production for calendar year 2008 under § 45(e)(10)(B) is $1.589 per ton on the sale of Indian coal.

DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Philip Tiegerman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Tiegerman at (202) 622–3110 (not a toll-free call).

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

Notice 2008–50

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code as in effect for plan years beginning before 2008. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), the 24-month average segment rates, and the funding transitional segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining the monthly composite corporate bond rate as set forth in Notice 2004–34 continues to apply in determining that rate. See Notice 2006–75, 2006–2 C.B. 366.

The composite corporate bond rate for April 2008 is 6.45 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted	Permissible Range		
Month	*Year*	Average	90%	to	100%
May	2008	6.00	5.40		6.00

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. For plan years beginning in 2008 and 2009, a transitional rule under § 430(h)(2)(G) provides that the segment rates are blended with the corporate bond weighted average

as specified above. An election may be made under § 430(h)(2)(G)(iv) to use the segment rates without applying the transitional rule.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, the 24-month average corporate bond segment rates, and the funding transitional segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007–81, the monthly corporate bond yield curve derived from April 2008 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of April 2008 are, respectively, 4.60, 6.28, and 6.96. The three 24-month average corporate bond segment rates applicable for May 2008 under the election of § 430(h)(2)(G)(iv) are as follows:

First Segment	Second Segment	Third Segment
5.16	6.00	6.53

The transitional segment rates under § 430(h)(2)(G) applicable for May 2008, taking into account the corporate bond weighted average of 6.00 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	5.72	6.00	6.18

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for April 2008 is 4.44 percent. The Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2038.

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The following rates were determined for plan years beginning in the month shown below.

For Plan Years Beginning in		30-Year Treasury Weighted Average	Permissible Range		
Month	*Year*		90%	to	105%
May	2008	4.76	4.29		5.00

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. For plan years beginning in 2008 through 2011, the applicable interest rate is the monthly spot segment rate blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for April 2008, taking into account the April 2008 30-year Treasury rate of 4.44 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2008	4.47	4.81	4.94

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at *RetirementPlanQuestions@irs.gov*.

Table I

Monthly Yield Curve for April 2008

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	3.42	20.5	6.76	40.5	6.98	60.5	7.06	80.5	7.10
1.0	3.84	21.0	6.77	41.0	6.99	61.0	7.06	81.0	7.10
1.5	4.20	21.5	6.78	41.5	6.99	61.5	7.07	81.5	7.11
2.0	4.49	22.0	6.79	42.0	6.99	62.0	7.07	82.0	7.11
2.5	4.71	22.5	6.80	42.5	7.00	62.5	7.07	82.5	7.11
3.0	4.86	23.0	6.81	43.0	7.00	63.0	7.07	83.0	7.11
3.5	4.97	23.5	6.81	43.5	7.00	63.5	7.07	83.5	7.11
4.0	5.07	24.0	6.82	44.0	7.00	64.0	7.07	84.0	7.11
4.5	5.17	24.5	6.83	44.5	7.01	64.5	7.07	84.5	7.11
5.0	5.26	25.0	6.84	45.0	7.01	65.0	7.07	85.0	7.11
5.5	5.35	25.5	6.84	45.5	7.01	65.5	7.08	85.5	7.11
6.0	5.44	26.0	6.85	46.0	7.01	66.0	7.08	86.0	7.11
6.5	5.53	26.5	6.86	46.5	7.01	66.5	7.08	86.5	7.11
7.0	5.63	27.0	6.86	47.0	7.02	67.0	7.08	87.0	7.11
7.5	5.72	27.5	6.87	47.5	7.02	67.5	7.08	87.5	7.11
8.0	5.81	28.0	6.88	48.0	7.02	68.0	7.08	88.0	7.11
8.5	5.89	28.5	6.88	48.5	7.02	68.5	7.08	88.5	7.11
9.0	5.97	29.0	6.89	49.0	7.03	69.0	7.08	89.0	7.12
9.5	6.05	29.5	6.89	49.5	7.03	69.5	7.08	89.5	7.12
10.0	6.12	30.0	6.90	50.0	7.03	70.0	7.09	90.0	7.12
10.5	6.19	30.5	6.90	50.5	7.03	70.5	7.09	90.5	7.12
11.0	6.25	31.0	6.91	51.0	7.03	71.0	7.09	91.0	7.12
11.5	6.30	31.5	6.92	51.5	7.04	71.5	7.09	91.5	7.12
12.0	6.35	32.0	6.92	52.0	7.04	72.0	7.09	92.0	7.12
12.5	6.40	32.5	6.92	52.5	7.04	72.5	7.09	92.5	7.12
13.0	6.44	33.0	6.93	53.0	7.04	73.0	7.09	93.0	7.12
13.5	6.48	33.5	6.93	53.5	7.04	73.5	7.09	93.5	7.12
14.0	6.52	34.0	6.94	54.0	7.04	74.0	7.09	94.0	7.12
14.5	6.55	34.5	6.94	54.5	7.05	74.5	7.09	94.5	7.12
15.0	6.57	35.0	6.95	55.0	7.05	75.0	7.09	95.0	7.12
15.5	6.60	35.5	6.95	55.5	7.05	75.5	7.10	95.5	7.12
16.0	6.62	36.0	6.95	56.0	7.05	76.0	7.10	96.0	7.12
16.5	6.64	36.5	6.96	56.5	7.05	76.5	7.10	96.5	7.12
17.0	6.66	37.0	6.96	57.0	7.05	77.0	7.10	97.0	7.12
17.5	6.68	37.5	6.96	57.5	7.06	77.5	7.10	97.5	7.12
18.0	6.70	38.0	6.97	58.0	7.06	78.0	7.10	98.0	7.13
18.5	6.71	38.5	6.97	58.5	7.06	78.5	7.10	98.5	7.13
19.0	6.72	39.0	6.97	59.0	7.06	79.0	7.10	99.0	7.13
19.5	6.74	39.5	6.98	59.5	7.06	79.5	7.10	99.5	7.13
20.0	6.75	40.0	6.98	60.0	7.06	80.0	7.10	100.0	7.13

26 CFR 1.956–1: Definition of United States property.
(Also: 956(c)(2)(J).)

Rev. Proc. 2008–26

SECTION 1. PURPOSE

This revenue procedure sets forth circumstances in which the Internal Revenue Service (Service) will not challenge whether a security is a "readily marketable security" for purposes of section 956(c)(2)(J) of the Internal Revenue Code (Code). No inference should be drawn regarding whether a security would be described in section 956(c)(2)(J) if it falls outside the scope of this revenue procedure. Furthermore, there should be no inference regarding whether securities within the scope of this revenue procedure would be readily marketable or would not be readily marketable for purposes of section 956(c)(2)(J) but for this revenue procedure. In addition, this revenue procedure does not address any United States federal income tax issue arising under any other section of the Code.

SECTION 2. BACKGROUND

Section 951(a)(1) requires that a United States shareholder of a controlled foreign corporation include in gross income for his taxable year in which or with which such taxable year of the corporation ends certain amounts including the amount determined under section 956 with respect to such shareholder for such year. Section 951(a)(1)(B).

The amount determined under section 956 is generally the lesser of (i) the excess (if any) of the United States shareholder's *pro rata* share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close of each quarter of the controlled foreign corporation's taxable year over the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder or (ii) the United States shareholder's *pro rata* share of the applicable earnings (as defined in section 956(b)(1)) of such controlled foreign corporation. Section 956(a).

The term United States property includes an obligation of a United States person, excluding, however:

> an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of *readily marketable securities* sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities.

Section 956(c)(2)(J) (emphasis added).

Current market conditions and liquidity constraints are creating some uncertainty regarding whether a security is "readily marketable" for purposes of section 956(c)(2)(J). For example, the market for certain securities that were readily marketable in the past has become severely curtailed. As a result, there is uncertainty whether many securities are readily marketable in the current economic environment even though they are of a type that are readily marketable under ordinary market conditions. In response to taxpayers' concerns, this revenue procedure provides certainty to taxpayers by setting forth circumstances under which the Service will not challenge whether a security is "readily marketable" for purposes of section 956(c)(2)(J) to the extent that it is of a type that would be readily marketable under ordinary market conditions.

SECTION 3. SCOPE

This revenue procedure applies to determine whether securities are "readily marketable" for purposes of section 956(c)(2)(J) for any day during calendar years 2007 or 2008 for which it is relevant whether securities are readily marketable for purposes of that section.

SECTION 4. APPLICATION

With respect to a determination within the scope of this revenue procedure, the Service will not challenge whether a security is readily marketable for purposes of section 956(c)(2)(J) if the security is of a type that was readily marketable at any time within three years prior to the effective date of this revenue procedure. For example, the Service will not challenge whether a mortgage-backed security or corporate debt security (whether secured or unsecured) is "readily marketable" if such a security is described in Section 3 of this revenue procedure and is of a type that was readily marketable at any time within three years prior to the effective date of this revenue procedure.

This revenue procedure does not address any other issue relating to the qualification of a transaction under section 956(c)(2)(J) (*e.g.,* whether the transaction is undertaken in the ordinary course of business by a dealer in securities or commodities).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective May 12, 2008.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is John H. Seibert of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Mr. Seibert at (202) 622–0171 (not a toll-free call).

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26 CFR 1.1445–2: Situations in which withholding is not required under section 1445(a).
(Also: §§ 897; 1445; 1.897–1; 1.897–2; 1.897–5T; 1.897–6T; 1.1445–5.)

Rev. Proc. 2008–27

SECTION 1. PURPOSE

This revenue procedure provides a simplified method for taxpayers to request relief for late filings under sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), and 1.1445–5(b)(4) of the Income Tax Regulations.

SECTION 2. BACKGROUND

.01 Section 897(a)(1) of the Internal Revenue Code treats the gain or loss of a nonresident alien or foreign corporation from the disposition of a U.S. real property interest as if the taxpayer were engaged in a trade or business in the United States, and as if such gain or loss were effectively

connected with such trade or business under sections 871(b) or 882. A U.S. real property interest includes an interest in real property located in the United States or the Virgin Islands and any interest (other than an interest solely as a creditor) in a domestic corporation unless the taxpayer establishes that the corporation was at no time a U.S. real property holding corporation (USRPHC) during the period described in section 897(c)(1)(A)(ii).

.02 Section 1.897–2 provides requirements to establish that a corporation is not a USRPHC. Unless these requirements are satisfied, it is presumed that a domestic corporation is a USRPHC.

.03 Section 1445(a) generally requires the transferee of a U.S. real property interest to withhold 10 percent of the amount realized by the foreign person on the disposition of the U.S. real property interest. Section 1445(b) and the regulations thereunder provide several exceptions to this general requirement. In addition, section 1445(e) provides special rules for certain dispositions and distributions. Section 1445(e)(1) requires withholding on certain dispositions of U.S. real property interests by a domestic partnership, domestic trust, or domestic estate. Section 1445(e)(2) requires withholding on certain distributions by foreign corporations. Section 1445(e)(3) requires withholding on distributions by certain domestic corporations to foreign shareholders. Section 1445(e)(4) addresses taxable distributions by domestic or foreign partnerships, trusts, or estates, and section 1445(e)(5) provides rules relating to dispositions of interests in such entities. Section 1445(e)(6) addresses certain distributions by a regulated investment company or real estate investment trust.

.04 One exception to section 1445 withholding involves nonrecognition transactions. Pursuant to section 1.1445–2(d)(2), a transferee is not required to withhold if the transferee provides notice that, by reason of the operation of a nonrecognition provision of the Internal Revenue Code or the provisions of any United States treaty, the transferor is not required to recognize any gain or loss with respect to the transfer. Under section 1.1445–2(d)(2)(i)(A), the transferor may provide a notice to the transferee that the transferor is not required to recognize gain or loss. The notice must include the information described in section 1.1445–2(d)(2)(iii). The transferee must provide a copy of the notice to the IRS within 20 days of the transfer. § 1.1445–2(d)(2)(i)(B). Similarly, in transfers described in section 1445(e), an entity or fiduciary otherwise required to withhold is not required to withhold if, by reason of the operation of a nonrecognition provision of the Internal Revenue Code or the provisions of any United States treaty, no gain or loss is required to be recognized by the foreign person with respect to which withholding would otherwise be required. § 1.1445–5(b)(2)(i)(A). Withholding is not required if, within 20 days of the transfer, the entity or fiduciary delivers a notice to the IRS that includes the information described in section 1.1445–5(b)(2)(ii). § 1.1445–5(b)(2)(i)(B).

.05 Another exception to withholding involves the transfer of an interest in a domestic corporation which is not a USRPHC. Because section 897(a)(1) does not apply to the gain (or loss) from a foreign person's disposition of stock in a domestic corporation that is not a USRPHC, section 1445 does not require the transferee to withhold upon a foreign person's disposition of stock in a domestic corporation that is not a USRPHC. To establish that an interest in a domestic corporation was not a U.S. real property interest as of the date of the disposition, the foreign person must either obtain a statement from the corporation or a determination from the IRS. To qualify for the rule permitting a statement from the corporation, a foreign transferor must obtain from the transferred domestic corporation a statement that the domestic corporation is not a USRPHC as of the date of the disposition. This statement must be obtained no later than the date, including any extensions, on which a tax return would otherwise be due with respect to the foreign transferor's disposition. § 1.897–2(g)(1)(ii)(A). The domestic corporation must mail a notice of the statement to the IRS within 30 days after it is provided to the foreign transferor, unless it meets the requirements of section 1.897–2(h)(4)(i). §§ 1.897–2(h)(2) and 1.897–2(h)(4)(i). If the IRS has been so notified, and the transferee receives a copy of the statement, then the transferee is not required to withhold. §§1.897–2(g)(1)(ii)(B) and 1.1445–2(c)(3)(i). Similarly, in transactions involving the transfer of an interest in a domestic corporation which is not a USRPHC under section 1445(e), where the transferor or its fiduciary obtains a statement that the domestic corporation is not a USRPHC, and timely notice of such statement is provided to the IRS pursuant to section 1.897–2(h), section 1.1445–5(b)(4)(iii) provides that no withholding is required.

.06 Under section 301.9100–1(c), the Commissioner may grant a reasonable extension of time to make a regulatory election or certain statutory elections under all subtitles of the Code, except subtitles E, G, H, and I, if the taxpayer demonstrates to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting the relief will not prejudice the interests of the government. § 301.9100–3(a). Section 301.9100–1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation, a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin. The statements and notices described in sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), and 1.1445–5(b)(4) all fall within the definition of a regulatory election.

.07 The Commissioner has authority under sections 301.9100–1 and 301.9100–3 to grant an extension of time if a taxpayer fails to file a timely election under sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), or 1.1445–5(b)(4). Section 301.9100–3 provides that the Commissioner will grant an extension of time when the taxpayer provides the evidence to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

SECTION 3. SCOPE

This revenue procedure provides a simplified method to request relief for certain late filings under sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), and 1.1445–5(b)(4). This procedure is in lieu of the letter ruling

procedure that otherwise would be used to obtain relief under section 301.9100–3. Accordingly, user fees do not apply to corrective action under this revenue procedure, and a taxpayer can request relief by applying for a letter ruling under section 301.9100–3 only if the taxpayer is denied relief by the IRS pursuant to this revenue procedure.

SECTION 4. APPLICATION

.01 *Eligibility for Relief.* A taxpayer is eligible for relief under section 4.03 of this revenue procedure for a late filing under sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), or 1.1445–5(b)(4) if a statement or notice described in one or more of those sections was not provided to the relevant person or the IRS by the specified deadline and the taxpayer has reasonable cause for the failure to make a timely filing.

.02 *Procedural Requirements for Requesting Relief.* Once the taxpayer becomes aware of the failure to file the statements or notices required by sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), or 1.1445–5(b)(4), the taxpayer must file the completed statement or notice with the appropriate person or the IRS, as applicable. The completed statement or notice filed with the appropriate person or the IRS must state at the top of the document that it is "FILED PURSUANT TO REV. PROC. 2008–27." With respect to a completed statement or notice required to be filed with the IRS under sections 1.897–2(h), 1.1445–2(d)(2), or 1.1445–5(b)(2), as applicable, the taxpayer must attach an explanation describing why the taxpayer's failure to timely file the statement or notice was due to reasonable cause. Additionally, within the explanation, the taxpayer must provide that it filed with, or obtained from, an appropriate person the statements or notices required under sections 1.897–2(g)(1)(ii)(A), 1.1445–2(c)(3)(i), 1.1445–2(d)(2)(i)(A), or 1.1445–5(b)(4)(iii)(A), as applicable. The completed statement or notice attached to the taxpayer's explanation must be sent to the Ogden Service Center, P.O. Box 409101, Ogden, UT 84409.

.03 *Relief for Late Filing.* Upon receipt of a completed application requesting relief under this revenue procedure, the IRS will determine whether the requirements for granting additional time have been satisfied. The IRS will notify the taxpayer in writing within 120 days of the filing of the completed application if the IRS determines that the failure to comply was not due to reasonable cause, or if additional time will be needed to make a determination. For this purpose, the 120-day period shall begin on the date the taxpayer is notified in writing that the request has been received and assigned for review. If, once such period commences, the taxpayer is not again notified within 120 days, then the taxpayer shall be deemed to have established reasonable cause.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to all requests for relief received after June 26, 2008. Taxpayers that have ruling requests pending as of May 27, 2008, are not required to use the procedures of this revenue procedure. However, if taxpayers have not received a determination of their request as of May 27, 2008, they may withdraw their request consistent with the procedures in Rev. Proc. 2008–1, 2008–1 I.R.B. 1, (or any succeeding document). In that event, the IRS will refund the taxpayer's user fee.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–2098.

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

The collection of information in this revenue procedure is in section 4.02. This information is required to be submitted to the applicable service center in order to obtain relief for late filings under sections 1.897–2(g)(1)(ii)(A), 1.897–2(h), 1.1445–2(c)(3)(i), 1.1445–2(d)(2), 1.1445–5(b)(2), or 1.1445–5(b)(4). This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions.

The estimated annual burden per respondent varies from 3 to 5 hours, depending on individual circumstances, with an estimated average of 4 hours. The estimated number of respondents is 200.

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

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Jeffrey P. Cowan of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Jeffrey P. Cowan at (202) 622–3860 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Withdrawal of Notice of Proposed Rulemaking

Suspension of Running of Period of Limitations During a Proceeding to Enforce or Quash a Designated or Related Summons

REG–208199–91

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and withdrawal of notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the use of designated summonses and related summonses and the effect on the period of limitations on assessment when a case is brought with respect to a designated or related summons. This document also withdraws the previous proposed regulations published in the **Federal Register** on July 31, 2003 (REG–208199–91, 2003–2 C.B. 757 [68 FR 44905]). These proposed regulations reflect changes to section 6503 of the Internal Revenue Code of 1986 made by the Omnibus Budget Reconciliation Act of 1990 and the Small Business Job Protection Act of 1996. These regulations affect corporate taxpayers that are examined under the coordinated issue case (CIC) program and are served with designated or related summonses. These regulations also affect third parties that are served with designated or related summonses for information pertaining to the corporate examination.

DATES: Written or electronic comments and requests for a public hearing must be received by July 28, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–208199–91), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–208199–91), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Comments may also be submitted electronically to the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–208199–91).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Elizabeth Rawlins, (202) 622–3630; concerning submissions of comments, Richard Hurst, (202) 622–7180 or *Richard.A.Hurst@IRSCounsel.Treas.Gov* (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations amending the Procedure and Administration regulations (26 CFR part 301) under section 6503. Section 11311 of the Omnibus Budget Reconciliation Act of 1990 (Public Law 101–508, 104 Stat. 1388) amended section 6503(k) to suspend the period of limitations on assessment when a case is brought with respect to a designated or related summons. Section 6503(k) was redesignated as section 6503(j) by section 1702(h)(17)(A) of the Small Business Job Protection Act of 1996 (Public Law 104–188, 110 Stat. 1874).

Proposed regulations under section 6503(j) were previously published in the **Federal Register** on July 31, 2003 (68 FR 44905) (the 2003 proposed regulations). The 2003 proposed regulations contained a procedure for determining the date of compliance with a designated or related summons issued with respect to a taxpayer whose statute of limitations on assessment was suspended under section 6503(j) because a court proceeding was brought. No comments were received with respect to this procedure or any other aspect of the 2003 proposed regulations, and no hearing was requested or held. The IRS and the Treasury Department have determined that, in the interest of effective tax administration, the procedure in the 2003 proposed regulations is not warranted. Instead, the IRS intends to create procedures by which taxpayers can inquire about the suspension of their periods of limitations under section 6503(j), including the date of compliance with the summons, and to publish these procedures in the Internal Revenue Manual. In addition, the IRS has established administrative procedures in the Internal Revenue Manual that ensure substantial IRS executive involvement and oversight of any designated and related summons issued. Additionally, §301.6503(j)–1(c)(1)(i) of these proposed regulations requires that any designated summons be reviewed by the IRS Division Commissioner and Division Counsel of the Office of Chief Counsel before it is issued. Accordingly, the 2003 proposed regulations are withdrawn.

Explanation of Provisions

These proposed regulations generally provide that the period of limitations on assessment provided for in section 6501 is suspended with respect to any return of tax by a corporation that is the subject of a designated or related summons if a court proceeding to enforce or quash is instituted with respect to that summons.

Designated Summonses and Related Summonses

A designated summons is a summons issued to determine the amount of any internal revenue tax of a corporation for which a return was filed if certain additional requirements are satisfied. A designated summons may only be issued to a corporation (or any other person to whom the corporation has transferred records) if the corporation is being examined under the IRS's coordinated examination program or "any successor program." The existing successor program to the coordinated examination program is the coordinated issue case (CIC) program.

Section 6503(j)(2)(A)(i) requires that the issuance of the summons be preceded by a review by the regional counsel of the Office of Chief Counsel for the region in which the examination of the corporation is being conducted. The office of regional counsel was eliminated by the IRS reorganization implemented pursuant to the IRS Reform and Restructuring Act

of 1998. Because the office of regional counsel no longer exists, these proposed regulations provide that the review must by completed by the Division Commissioner and the Division Counsel of the Office of Chief Counsel (or their successors) for the organizations that have jurisdiction over the corporation whose liability is the subject of the summons. The summons also must be issued at least 60 days before the day on which the statute of limitations on assessment under section 6501 would otherwise expire. Finally, the summons must clearly state that it is a designated summons for purposes of section 6503(j).

A related summons is any other summons that is issued with respect to the same tax return of the corporation as a designated summons and is issued during the 30-day period that begins on the date the designated summons is issued.

Suspension of Period of Limitations on Assessment

Section 6503(j)(1) suspends the period of limitations on assessment under section 6501 for the applicable tax period when a court proceeding is brought with respect to a designated or related summons. For purposes of these proposed regulations, a court proceeding is a proceeding brought in a United States district court either to quash a designated or related summons under section 7609(b)(2) or to enforce a designated or related summons under section 7604. The court proceeding must be brought within the otherwise applicable period of limitations in order to suspend that period under section 6503(j).

The proposed regulations provide that the suspension begins on the day that a court proceeding is brought and continues until there is a final resolution as to the summoned party's response to the summons (discussed in the next section), plus an additional 120 days if a court requires any compliance with the summons at issue. If a court does not require any compliance, then the period of limitations on assessment resumes running on the day following the date of the final resolution and in no event shall expire before the 60th day following the date of final resolution.

Final Resolution of a Summoned Party's Response to a Summons

Under section 6503(j)(3)(B), the length of the suspension under section 6503(j) depends on when "final resolution" of a summoned party's response to the designated or related summons occurs. The term "final resolution" is not defined in the statute. The legislative history states that the term "final resolution" has the same meaning it has under section 7609(e)(2)(B), relating to third-party summonses. H.R. Conf. Rep. No. 101–964 (1990). Specifically, the conference report states that final resolution means that no court proceeding remains pending and that the summoned party has complied with the summons to the extent required by a court.

Accordingly, the proposed regulations provide that final resolution occurs when no court proceeding remains pending and the summoned party complies with the summons to the extent required by the court. If the summoned party has complied with the summons to the extent required by the court but there still remains time to appeal that order, final resolution occurs when all appeals have been either disposed of or the period in which an appeal may be taken or a request for further review may be made has expired. If all appeal periods have expired but the summoned party has not complied with the summons to the extent required by the court, the proposed regulations provide that final resolution does not occur until the summoned party has complied with the summons to the extent required by the court. Whether a party has complied with the terms of the summons as enforced by a court cannot be determined until the completeness of the materials produced and the testimony given has been evaluated. The IRS intends to create administrative procedures by which the taxpayer can inquire about the suspension of its period of limitations under section 6503(j) and to publish these procedures in the Internal Revenue Manual.

In cases in which a court wholly denies enforcement or orders that the summons in its entirety be quashed, the date of compliance with the court's order is treated as occurring on the date when all appeals are disposed of or when all appeal periods expire. In cases in which a court orders the summons enforced, in whole or in part, the determination of whether there has been full compliance will be made within a reasonable time after the later of the giving of all testimony or the production of all records required by the order. What constitutes a reasonable time will depend on the volume and complexity of the records produced.

If, following an enforcement order, collateral proceedings are brought challenging whether the production made by the summoned party fully satisfied the court order and whether sanctions should be imposed against the summoned party for a failing to do so, the suspension of the periods of limitations shall continue until the order enforcing any part of the summons is fully complied with and the decision in the collateral proceeding becomes final. A decision in a collateral proceeding becomes final when all appeals are disposed of or when the period for appeal or further review has expired.

Other Rules

These proposed regulations provide additional rules regarding the number of designated and related summonses that may be issued with respect to a return for any taxable period, the time within which a court proceeding must be brought to enforce or quash a designated or related summons, the computation of the suspension period in cases of multiple court proceedings, and the computation of the 60-day period for assessment when the last day falls on a weekend or holiday.

The proposed regulations also address the relationship of the suspension period provided for in section 6503(j) with other suspension provisions in the Code. The proposed regulations provide that if a designated or related summons also could be subject to the suspension rules governing third-party summonses under section 7609(e), then the suspension rules in section 6503(j) govern. In addition, the proposed regulations provide that the section 6503(j) suspension period is independent of, and may run concurrently with, any other period of suspension, such as the suspension period for third-party summonses under section 7609(e) if a separate third-party summons also was issued in a case. Examples of these rules are contained in the proposed regulations.

Proposed Effective Date

These regulations are proposed to be applicable on the date final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Elizabeth Rawlins of the Office of the Associate Chief Counsel, Procedure and Administration.

* * * * *

Withdrawal of Proposed Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–208199–91) that was published in the **Federal Register** on Thursday, July 31, 2003 (68 FR 44905) is withdrawn.

Proposed Amendments to the Regulations

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

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6503(j)–1 is added to read as follows:

§301.6503(j)–1 Suspension of running of period of limitations; extension in case of designated and related summonses.

(a) *General rule*. The running of the applicable period of limitations on assessment provided for in section 6501 is suspended with respect to any return of tax by a corporation that is the subject of a designated or related summons if a court proceeding is instituted with respect to that summons.

(b) *Period of suspension*. The period of suspension is the time during which the running of the applicable period of limitations on assessment provided for in section 6501 is suspended under section 6503(j). If a court requires any compliance with a designated or related summons by ordering that any record, document, paper, object, or items be produced, or the testimony of any person be given, the period of suspension consists of the judicial enforcement period plus 120 days. If a court does not require any compliance with a designated or related summons, the period of suspension consists of the judicial enforcement period, and the period of limitations on assessment provided in section 6501 shall not expire before the 60th day after the close of the judicial enforcement period.

(c) *Definitions*—(1) A *designated summons* is a summons issued to a corporation (or to any other person to whom the corporation has transferred records) with respect to any return of tax by such corporation for a taxable period for which such corporation is being examined under the coordinated industry case program or any other successor to the coordinated examination program if—

(i) The Division Commissioner and the Division Counsel of the Office of Chief Counsel (or their successors) for the organizations that have jurisdiction over the corporation whose tax liability is the subject of the summons have reviewed the summons before it is issued;

(ii) The IRS issues the summons at least 60 days before the day the period prescribed in section 6501 for the assessment of tax expires (determined with regard to extensions); and

(iii) The summons states that it is a designated summons for purposes of section 6503(j).

(2) A *related summons* is any summons issued that—

(i) Relates to the same return of the corporation under examination as the designated summons; and

(ii) Is issued to any person, including the person to whom the designated summons was issued, during the 30-day period that begins on the day the designated summons is issued.

(3) The *judicial enforcement period* is the period that begins on the day on which a court proceeding is instituted with respect to a designated or related summons and ends on the day on which there is a final resolution as to the summoned person's response to that summons.

(4) *Court proceeding*—(i) *In general*. For purposes of this section, a *court proceeding* is a proceeding filed in a United States district court either to quash a designated or related summons under section 7609(b)(2) or to enforce a designated or related summons under section 7604. A court proceeding includes any collateral proceeding, such as a civil contempt proceeding.

(ii) *Date when proceeding is no longer pending*. A proceeding to quash or to enforce a designated or related summons is no longer pending when all appeals (including review by the Supreme Court) are disposed of or after the expiration of the period in which an appeal may be taken or a request for further review (including review by the Supreme Court) may be made. If, however, following an enforcement order, a collateral proceeding is brought challenging whether the testimony given or production made by the

summoned party fully satisfied the court order and whether sanctions should be imposed against the summoned party for a failure to so testify or produce, the proceeding to quash or to enforce the summons shall include the time from which the proceeding to quash or to enforce the summons was brought until the decision in the collateral proceeding becomes final. The decision becomes final on the date when all appeals (including review by the Supreme Court) are disposed of or when all appeal periods or all periods for further review (including review by the Supreme Court) expire. A decision in a collateral proceeding becomes final when all appeals (including review by the Supreme Court) are disposed of or when all appeal periods or all periods for further review (including review by the Supreme Court) expire.

(5) *Compliance*—(i) *In general*. *Compliance* is the giving of testimony or the performance of an act or acts of production, or both, in response to a court order concerning the designated or related summons and the determination that the terms of the court order have been satisfied.

(ii) *Date compliance occurs*. Compliance with a court order that wholly denies enforcement of a designated or related summons is deemed to occur on the date when all appeals (including review by the Supreme Court) are disposed of or when the period in which an appeal may be taken or a request for further review (including review by the Supreme Court) may be made expires. Compliance with a court order that grants enforcement, in whole or in part, of a designated or related summons, occurs on the date it is determined that the testimony given, or the books, papers, records, or other data produced, or both, by the summoned party fully satisfy the court order concerning the summons. The determination of whether there has been full compliance will be made within a reasonable time, given the volume and complexity of the records produced, after the later of the giving of all testimony or the production of all records requested by the summons or required by any order enforcing any part of the summons. If, following an enforcement order, collateral proceedings are brought challenging whether the production made by the summoned party fully satisfied the court order and whether sanctions should be imposed against the summoned party for a failing to do so, the suspension of the periods of limitations shall continue until the order enforcing any part of the summons is fully complied with and the decision in the collateral proceeding becomes final. A decision in a collateral proceeding becomes final when all appeals are disposed of, the period in which an appeal may be taken has expired or the period in which a request for further review may be made has expired.

(6) *Final resolution* occurs when the designated or related summons or any order enforcing any part of the designated or related summons is fully complied with and all appeals or requests for further review are disposed of, the period in which an appeal may be taken has expired or the period in which a request for further review may be made has expired.

(d) *Special rules*—(1) *Number of summonses that may be issued*—(i) *Designated summons*. Only one designated summons may be issued in connection with the examination of a specific taxable year or other period of a corporation. A designated summons may cover more than one year or other period of a corporation. The designated summons may require production of information that was previously sought in a summons (other than a designated summons) issued in the course of the examination of that particular corporation if that information was not previously produced.

(ii) *Related summonses*. There is no restriction on the number of related summonses that may be issued in connection with the examination of a corporation. As provided in paragraph (c)(2) of this section, however, a related summons must be issued within the 30-day period that begins on the date on which the designated summons to which it relates is issued and must relate to the same return as the designated summons. A related summons may request the same information as the designated summons.

(2) *Time within which court proceedings must be brought*. In order for the period of limitations on assessment to be suspended under section 6503(j), a court proceeding to enforce or to quash a designated or related summons must be instituted within the period of limitations on assessment provided in section 6501 that is otherwise applicable to the tax return.

(3) *Computation of suspension period if multiple court proceedings are instituted*. If multiple court proceedings are instituted to enforce or to quash a designated or one or more related summonses concerning the same tax return, the period of limitations on assessment is suspended beginning on the date the first court proceeding is brought. The suspension shall end on the date that is the latest date on which the judicial enforcement period, plus the 120 day or 60 day period (depending on whether the court requires any compliance) as provided in paragraph (b) of this section, expires with respect to each summons.

(4) *Effect on other suspension periods*—(i) *In general*. Suspensions of the period of limitations under section 6501 provided for under subsections 7609(e)(1) and (e)(2) do not apply to any summons that is issued pursuant to section 6503(j). The suspension under section 6503(j) of the running of the period of limitations on assessment under section 6501 is independent of, and may run concurrent with, any other suspension of the period of limitations on assessment that applies to the tax return to which the designated or related summons relates.

(ii) *Examples*. The rules of paragraph (d)(4)(i) of this section are illustrated by the following examples:

Example 1. The period of limitations on assessment against Corporation P, a calendar year taxpayer, for its 2007 return is scheduled to end on March 17, 2011. (Ordinarily, Corporation P's returns are filed on March 15th of the following year, but March 15, 2008 was a Saturday, and Corporation P timely filed its return on the subsequent Monday, March 17, 2008, making March 17, 2011 the last day of the period of limitations on assessment for Corporation P's 2007 tax year.) On January 4, 2011, a designated summons is issued to Corporation P concerning its 2007 return. On March 3, 2011 (14 days before the period of limitations on assessment would otherwise expire with respect to Corporation P's 2007 return), a court proceeding is brought to enforce the designated summons issued to Corporation P. On June 6, 2011, the court orders Corporation P to comply with the designated summons. Corporation P does not appeal the court's order. On September 6, 2011, agents for Corporation P deliver material that they state are the records requested by the designated summons. On October 13, 2011, a final resolution to Corporation P's response to the designated summons occurs when it is determined that Corporation P has fully complied with the court's order. The suspension period applicable with respect to the designated summons issued to Corporation P consists of the judicial enforcement period (March 3, 2011 through October 13, 2011) and an additional 120-day period under section 6503(j)(1)(B), because the court required Corporation P to comply with the designated summons. Thus, the suspension period applicable with respect

to the designated summons issued to Corporation P begins on March 3, 2011, and ends on February 10, 2012. Under the facts of this *Example 1*, the period of limitations on assessment against Corporation P further extends to February 24, 2012, to account for the additional 14 days that remained on the period of limitations on assessment under section 6501 when the suspension period under section 6503(j) began.

Example 2. Assume the same facts set forth in *Example 1*, except that in addition to the issuance of the designated summons and related enforcement proceedings, on April 5, 2011, a summons concerning Corporation P's 2007 return is issued and served on individual A, a third party. This summons is not a related summons because it was not issued during the 30-day period that began on the date the designated summons was issued. The third-party summons served on individual A is subject to the notice requirements of section 7609(a). Final resolution of individual A's response to this summons does not occur until February 15, 2012. Because there is no final resolution of individual A's response to this summons by October 5, 2011, which is six months from the date of service of the summons, the period of limitations on assessment against Corporation P is suspended under section 7609(e)(2) to the date on which there is a final resolution to that response for the purposes of section 7609(e)(2). Moreover, because final resolution to the summons served on individual A does not occur until after February 10, 2012, the end of the suspension period for the designated summons, the period of limitations on assessment against Corporation P expires 14 days after the date that the final resolution as provided for in section 7609(e)(2) occurs with respect to the summons served on individual A.

(5) *Computation of 60-day period when last day of assessment period falls on a weekend or holiday*. For purposes of paragraph (c)(1)(ii) of this section, in determining whether a designated summons has been issued at least 60 days before the date on which the period of limitations on assessment prescribed in section 6501 expires, the provisions of section 7503 apply when the last day of the assessment period falls on a Saturday, Sunday, or legal holiday.

(e) *Effective/applicability date*. This section is applicable on the date the final regulations are published in the **Federal Register**.

Kevin M. Brown,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on April 25, 2008, 8:45 a.m., and published in the issue of the Federal Register for April 28, 2008, 73 F.R. 22879)

Notice of Proposed Rulemaking

Gross Estate; Election to Value on Alternate Valuation Date

REG–112196–07

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance relating to the availability of the election to use the alternate valuation method under section 2032 of the Internal Revenue Code (Code). The proposed regulations will affect estates that file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, and elect to use the alternate valuation method.

DATES: Written or electronic comments and requests for a public hearing must be received by July 24, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–112196–07), Internal Revenue Service, Room 5203, 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–112196–07), 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–112196–07).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Theresa M. Melchiorre, at (202) 622–3090; concerning submissions of comments or to request a hearing, Kelly Banks, at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Estate Tax Regulations (26 CFR part 20) under section 2032 of the Code. Section 2001 imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States. Section 2031(a) provides that the value of the decedent's gross estate includes the value at the time of decedent's death of all property, real or personal, tangible or intangible, wherever situated. Section 2032(a) provides that the value of the gross estate instead may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows. Property distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death must be valued as of the date of distribution, sale, exchange, or other disposition. I.R.C. section 2032(a)(1). Property not distributed, sold, exchanged, or otherwise disposed of within 6 months after the decedent's death must be valued as of the date that is 6 months after the decedent's death. I.R.C. section 2032(a)(2). Any interest or estate which is affected by the mere lapse of time is included at its value as of the time of death (instead of the later date), with adjustment for any difference in its value as of the later date that is not due to the mere lapse of time. I.R.C. section 2032(a)(3).

The predecessor to section 2032 is section 302(j) of the Revenue Act of 1926, as added by section 202(a) of the Revenue Act of 1935. Revenue Act of 1935, 74 Public Law 407, 49 Stat. 1014 (1935). Section 302(j) allowed executors to elect to use a date that was one year after the date of decedent's death to value estate property. Section 302(j) contained provisions for valuing the property on the date of its sale or disposition during the alternate valuation period and for not taking into account changes in value due to a mere lapse of time. Congress enacted section 302(j) in response to "the hardships which were experienced after 1929 when market values decreased very materially between the period from the date of death and the date of distribution to the beneficiaries." 79 Cong. Rec. 14632 (1935) (statement of Mr. Samuel B. Hill). See, also, H.R. Rep. No. 74–1681, at 9 (1935); S. Rep. No. 74–1240, part 1, at 9–10 (1935); and S. Rep. No. 74–1240, part 2, at 8–9 (1935). Section 302(j) was codified as section 811(j) in the Internal Revenue Code of 1939.

In 1941, the U. S. Supreme Court addressed whether rents, dividends, and interest received and accrued during the al-

ternate valuation period are includible in the decedent's gross estate under section 811(j). *Maass v. Higgins*, 312 U.S. 443 (1941). In that case, the Court stated that the purpose of section 811(j) is "to mitigate the hardship consequent upon shrinkage in the value of estates during the year following death. Congress enacted it in the light of the fact that, due to such shrinkages, many estates were almost obliterated by the necessity of paying a tax on the value of the assets at the date of decedent's death." *Id*. at 446.

In 1954, section 811(j) was recodified as section 2032. Congress considered proposals to amend section 811(j) and, again, Congress stated that, "The option to value property [on the alternate valuation date] initially was provided during the depression of the early 1930's because by the time estate taxes were paid, property values had dropped substantially, sometimes to such an extent that the proceeds of the sale would not pay the estate tax due." H. Rep. No. 83–1337 at 90 (1954). See, also, S. Rep. No. 83–1622, at 122–123 (1954).

In 1958, §20.2032–1 of the Estate Tax Regulations was published. This regulation restates the rule in section 2032(a)(3) and provides an example that illustrates the rule that only changes in the value of the decedent's gross estate due to market conditions, and not changes to the value due to a mere lapse of time, are to be considered in valuing the decedent's gross estate under the alternate valuation method. See example in §20.2032–1(f)(1).

Two judicial decisions have interpreted the language of section 2032 and its legislative history differently in determining whether post-death events other than market conditions may be taken into account under the alternate valuation method. In *Flanders v. United States*, 347 F. Supp. 95 (N.D. Cal. 1972), the district court held that the reduction in value of property included in the decedent's estate as a result of a voluntary act by the trustee, instead of as a result of market conditions, could not be taken into consideration in valuing the property under the alternate valuation method. In that case, a few months after the death of the decedent, the trustee of the trust owning decedent's undivided one-half interest in real property entered into a Land Conservation Agreement pursuant to the California Land Conservation Act of 1965. In exchange for restricting the property to agricultural uses for a period of 10 years, the trustee was allowed to reduce the assessed value of the land for purposes of paying property taxes. The estate elected to use the alternate valuation method for estate tax purposes and reported the value of the decedent's interest in the land as $25,000. This value represented one-half of the value of the ranch after the land use restriction was placed upon it, less a lack of marketability discount.

The district court stated that, "It seems clear that Congress intended that the character of the property be established for valuation purposes at the date of death. The option to select the alternate valuation date is merely to allow an estate to pay a lesser tax if unfavorable market conditions (as distinguished from voluntary acts changing the character of the property) result in a lessening of its fair market value." *Id*. at 98.

In *Kohler v. Commissioner*, T.C. Memo. 2006–152, the U.S. Tax Court held that valuation discounts attributable to restrictions imposed on closely-held corporate stock pursuant to a post-death reorganization of the Kohler Company should be taken into consideration in valuing stock on the alternate valuation date. In that case, approximately two months after the death of the decedent, the Kohler Company underwent a reorganization that qualified as a tax-free reorganization under section 368(a) and, thus, was not a sale or disposition for purposes of section 2032(a)(1). The estate opted to receive new Kohler shares that were subject to transfer restrictions. The estate elected to use the alternate valuation method under section 2032(a)(2) and took into account discounts attributable to the transfer restrictions on the stock in determining the value for Federal estate tax purposes. In the Internal Revenue Bulletin No. 2008–9 on March 3, 2008, the IRS nonacquiesced to the Tax Court opinion in *Kohler (AOD 2008–1)*.

Explanation of Provisions

The proposed regulations will amend §20.2032–1 by restructuring paragraph (f) of this section to clarify that the election to use the alternate valuation method under section 2032 is available to estates that experience a reduction in the value of the gross estate following the date of the decedent's death due to market conditions, but not due to other post-death events. The term *market conditions* is defined in the proposed regulations and examples are provided, which are not intended to be exclusive.

Proposed Effective Date

The fourth sentence of §20.2032–1(f)(2)(i) is applicable to decedents dying after May 1, 1999, subject to transition rules for certain incapacitated individuals. The fifth sentence of §20.2032–1(f)(2)(i) is applicable to decedents dying after November 30, 1983, subject to transition rules for certain incapacitated individuals. The first, second, and third sentences of §20.2032–1(f)(2)(i), §20.2032–1(f)(2)(ii), and all but the last sentence in §20.2032–1(f)(2) are applicable to decedent's dying after August 16, 1954. When adopted as final regulations, the rules contained in §20.2032–1(f)(1), §20.2032–1(f)(3), and the last sentence of §20.2032–1(f)(2), will be made applicable to estates of decedents dying on or after April 25, 2008.

Special Analyses

It has been determined that this proposed regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic com-

ments that are submitted timely to the IRS. The IRS and the Treasury Department also request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may 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 author of these proposed regulations is Theresa M. Melchiorre, Office of Associate Chief Counsel (Passthroughs and Special Industries).

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 20 is proposed to be amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2032–1 is amended as follows:

1. Paragraph (f)(1) is redesignated as paragraph (f)(2)(i).

2. Paragraph (f)(2) is redesignated as paragraph (f)(2)(ii).

3. Paragraph (f) introductory text is redesignated as paragraph (f)(2) introductory text and the last sentence in the paragraph is revised.

4. New paragraphs (f)(1) and (f)(3) are added.

5. The heading for paragraph (h) is revised and four sentences are added at the end of the paragraph.

The additions and revisions read as follows.

§20.2032–1 Alternate valuation.

* * * * *

(f) *Post-death market conditions and other post-death events*—(1) *In general*. The election to use the alternate valuation method under section 2032 permits the property included in the gross estate to be valued as of the alternate valuation date to the extent that the change in value during the alternate valuation period is the result of market conditions. The term *market conditions* is defined as events outside of the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property being valued. Changes in value due to mere lapse of time or to other post-death events other than market conditions will be ignored in determining the value of decedent's gross estate under the alternate valuation method.

(2) *Mere lapse of time*. * * * The application of this paragraph (f)(2) is illustrated in paragraphs (f)(2)(i) and (f)(2)(ii) of this section:

(3) *Post-death events*—(i) *In general*. In order to eliminate changes in value due to post-death events other than market conditions, any interest or estate affected by post-death events other than market conditions is included in a decedent's gross estate under the alternate valuation method at its value as of the date of the decedent's death, with adjustment for any change in value that is due to market conditions. The term *post-death events* includes, but is not limited to, a reorganization of an entity (for example, corporation, partnership, or limited liability company) in which the estate holds an interest, a distribution of cash or other property to the estate from such entity, or one or more distributions by the estate of a fractional interest in such entity.

(ii) *Examples*. The following examples illustrate the application of this paragraph (f)(3). In each example, decedent's (D's) estate elects to value D's gross estate under the alternate valuation method, so that the valuation date of the property included in D's gross estate as of D's date of death is either the date the property is distributed, sold, exchanged, or disposed of under section 2032(a)(1) (the date of distribution (distribution date)) or the date that is 6 months after the date of the decedent's death under section 2032(a)(2) (the six month alternate valuation date (AVD)).

Example 1. At D's death, D owned common stock in Corporation, a closely-held subchapter C corporation. At that time, the common stock was not subject to transfer restrictions. D's stock was valued at $50X at the date of death. Two months after D's death, D's estate participated in a tax-free reorganization of Corporation that qualified under section 368(a) with respect to which no gain or loss was recognized for income tax purposes under section 354 or 355. Pursuant to the reorganization, D's estate opted to exchange its stock for stock subject to transfer restrictions. Although the value of the stock did not change during the alternate valuation period, discounts for lack of marketability and lack of control (totaling $20X) were applied in determining the value of the stock held by D's estate on the AVD, and D's estate reported the value of the stock on the AVD as $30X. Because the claimed reduction in value is not attributable to market conditions, the discounts may not be taken into account in determining the value of the stock on the AVD. Accordingly, the value on the AVD is $50X.

Example 2. The facts are the same as in *Example 1* except that the value of the stock declined from $50X to $40X during the alternate valuation period because of changes in market conditions during that period. D's estate may report the value of the stock as $40X on the AVD. As in *Example 1*, however, no discounts resulting from the reorganization are allowed in computing the value on the AVD.

Example 3. At D's death, D owned property valued at $100X. Two months after D's death, the executor of D's estate and other family members formed four limited partnerships. The estate contributed the estate's property to the partnerships in exchange for a 25% interest in each partnership. Discounts for lack of marketability and lack of control (totaling $25X) were applied in determining the value of the estate's partnership interests, and the estate reported $75X as the total value of the estate's partnership interests on the AVD. Because the reduction in value is not attributable to market conditions, the discounts for lack of marketability and control may not be taken into account in determining the value of the partnership interests on the AVD. The result would be the same if the limited partnerships were formed prior to D's death, and the estate transferred property into the partnerships after D's death but prior to the AVD.

Example 4. At D's death, D owned 100% of the units of a limited liability company (LLC). The executor elected the alternative valuation method. During the 6 months following D's death and in accordance with D's will, the executor made 6 distributions, each to a different residuary legatee on a different date and each of a 10% interest in the LLC. Pursuant to section 2032(a)(1), each distribution is valued on the distribution date. On the AVD, the estate held 40% of the units in the LLC. Pursuant to section 2032(a)(2), the 40% is valued on the AVD. In valuing the 10% interests distributed and the 40% interest held on the AVD, discounts for lack of control and lack of marketability were applied. The reduction in value of the units is not attributable to market conditions. Accordingly, the discounts for lack of marketability and control may not be taken into account in determining the value of the units distributed or held by the estate. The value of each 10% distribution is determined by taking 10% of the value on the distribution date of the units (100%) owned by the estate at D's death. The value of the units held by the estate on the AVD is determined by taking 40% of the value on the AVD of all of the units (100%) owned by the estate at D's death. If because of market conditions, the units had declined in value as of each distribution date or as of the AVD, D's estate would take such reduction in value into account.

Example 5. D died owning 100% of Blackacre. D's will directs that Blackacre be divided between two trusts, 70% to Trust A for the benefit of S, D's surviving spouse, and 30% to Trust B for the benefit of C, D's surviving child. The executor of D's estate distributed a 70% interest in Blackacre to Trust A three months after D's death, and distributed a 30% interest in Blackacre to Trust B four months after D's death. On the estate tax return, the executor elected to value the estate's property under the alternate valuation method under section 2032. There was no change in the value of Blackacre during the four-month period following D's death. The 70% interest in Blackacre is to be valued as of the distribution date to Trust A, and that value is determined by taking 70% of the value of all (100%) of Blackacre as of the distribution date. The 30% interest in Blackacre is to be valued as of the distribution date to Trust B, and that value is determined by taking 30% of the value of all (100%) of Blackacre as of the distribution date. If, however, because of market conditions such as a decline in the real estate market, Blackacre's value had declined by 10% between D's date of death and the distribution date of the 30% interest, the value of the 30% interest would be determined by ascertaining 30% of the value of all (100%) of Blackacre as of the distribution date, which would equal 30% of 90% of the date of death value of Blackacre.

* * * * *

(h) *Effective/applicability date*. * * * The fourth sentence of paragraph (f)(2)(i) of this section is applicable to decedents dying after May 1, 1999, subject to transition rules for certain incapacitated individuals. The fifth sentence of paragraph (f)(2)(i) of this section is applicable to decedents dying after November 30, 1983, subject to transition rules for certain incapacitated individuals. The first, second, and third sentences of paragraph (f)(2)(i), paragraph (f)(2)(ii), and all but the last sentence in paragraph (f)(2) of this section are applicable to decedent's dying after August 16, 1954. When adopted as final regulations, the rules contained in paragraphs (f)(1), (f)(3), and the last sentence of paragraph (f)(2) of this section, will be made applicable to estates of decedents dying on or after April 25, 2008.

* * * * *

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on April 24, 2008, 8:45 a.m., and published in the issue of the Federal Register for April 25, 2008, 73 F.R. 22300)

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

Announcement 2008–49

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

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

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on May 27, 2008, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Heritage Christian Schools for Children
Stone Mountain, GA

Lima Legionnaires Charitable Foundation, Inc.
Lima, OH

Announcements of Disciplinary Sanctions From the Office of Professional Responsibility Will List Specific Violations of Circular 230

Announcement 2008–50

The Office of Professional Responsibility intends to publish announcements of disciplinary sanctions in a redesigned format that will list specific violations of Treasury Department Circular No. 230. A new "Disciplinary Sanction" column of the announcements will include the relevant section number of Circular 230 and a brief description of misconduct. Each announcement will be headed by an introduction that explains the various types of sanctions, for example, disbarment or suspension from practice before the IRS.

The listing of individuals sanctioned will continue to include the professional designation: attorney, certified public accountant, enrolled agent, enrolled actuary, enrolled retirement plan agent, or appraiser. The listing in the new format will be alphabetized first by the names of the individuals' states of residence and second by the last names of the individuals sanctioned.

Previously, OPR endeavored to publish announcements of disciplinary sanctions on a quarterly basis, and each announcement was published in five consecutive issues of the Internal Revenue Bulletin (IRB). Future announcements will be published more frequently, and each announcement will be published in one issue of the IRB and also in the Cumulative Bulletin.

OPR redesigned the format of the announcements in order to expand the public availability of information about disciplinary proceedings and disciplinary sanctions. The first announcement in the new format is expected to be published in June 2008.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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